FICCI

PRE-BUDGET MEMORANDUM 2019-20



Federation of Indian Chambers of Commerce and Industry

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ECONOMIC OVERVIEW

1.1. Current State of the Economy

Indian economy that was amongst the fastest growing economies in the world over the last few years, now faces the risk of slow growth amidst a weakening global economic environment and slowdown in domestic demand. India was able to wade through the global headwinds in earlier years as the growth was supported by growing domestic demand. Low inflation due to subdued food and oil prices had also contributed towards higher consumption growth. However, the recent signs of slowdown in the economy stem not only from slow growth in investments and subdued exports but also from weakening growth in consumption demand. This is a matter of serious concern and if not addressed urgently, the repercussions would be long-term.

On the external side, the outlook for the global economy remains gloomy. IMF projects global growth to slow down from 3.6 percent in 2018 to 3.3 percent in 2019. With continuing trade tensions globally, especially the China-US trade war, global trade is also expected to slow down. As per WTO, merchandise trade volume growth is projected to fall to 2.6 percent in 2019 from 3.0 percent in 2018. This would have implications for India's exports growth as well. Already, India's exports scenario has remained muted for significantly long period. Even though exports witnessed some growth momentum during 2018-19 and increased by 9.1 percent y-o-y, trade deficit also surged to an unprecedented high of USD 176.5 billion owing to significant rise in imports (especially oil imports). Since global oil prices are expected to climb further and global trade tensions likely to continue, India's trade and current account deficit could rise significantly in coming year.

Industrial production too remains weak, with IIP witnessing moderation in growth to 4 percent during Apr-Feb 2018-19 as against 4.4 percent growth in the corresponding period of previous year. Weakness in demand conditions has been a key factor behind low industrial growth.

The signs of slowdown in domestic demand are visible both in urban and rural areas. Automobile sales during the year 2018-19 has slowed down significantly across segments like passenger cars as well as two-wheelers. Annual sales growth in scooters has been below 1 percent in 2018-19 as against 19.3 percent growth registered in previous year. Sales of passenger cars has in-fact seen a contraction. Even consumer durables are witnessing slow growth. This is reflected in growth of consumer durables in IIP, that fell to 4.1 percent during Apr-Feb 2018-19 as against 10.2 percent in corresponding period of previous year. With farm incomes remaining weak for a long time now, rural consumption has taken a hit, which has been a key factor in consumption slowdown in the economy.

The silver lining amidst the otherwise weak economic environment are the recent signs of improvement in some of the financial indicators of the economy. This is reflected in improving bank credit as well as declining NPAs. Bank credit grew by 13.2 per cent in financial year 2018-19 as compared to 10.3 per cent in the previous year, but this has come primarily from loans to services and retail sector. The accommodative stance adopted by

the RBI during last two monetary policy meetings is a positive move, but transmission of lower interest rate has remained weak as liquidity concerns remain high – both in the banking as well as non-banking financial services. Moreover, the real repo rate has remained high for a long time and there is a scope of further reduction in the repo rate.

Although industrial capacities have seen some improvement, recovery in investments remain elusive owing to weaker business sentiments. FICCI's Quarterly Business Confidence Survey has also seen steady decline in Overall Business Confidence for the last four quarters. Businesses have shied from making significant investments owing to weak demand, high financial costs, liquidity concerns and uncertainties on both global and domestic front. The prolonged slowdown in private investments has already affected employment and unless steps are taken to revive investments, unemployment scenario will only worsen.

Amidst the rising uncertainties and economic challenges on both domestic and global front, there is an urgent need to re-energise the engines of growth and pump prime the economy. The upcoming Union Budget 2019-20 is an opportunity for the government to boost consumption and investments through appropriate fiscal stimulus and policies.

1.2. Focus areas for Union Budget 2019-20

1.2.1. Addressing agrarian distress and reviving rural economy

Interim Budget 2019-20 included a Direct Income Support (DIS) of Rs 6000 annually to small and marginal farmers. While this is a welcome move, it is suggested that the quantum of this support as well as the coverage of the scheme be expanded. The existing agriculture subsidies should be reviewed and most/ all of them be included within the DIS.

To enhance agriculture yields and mitigate risk of monsoon vagaries, the government should step up investments in irrigation (including micro irrigation) across the country. There is also a need to strengthen the agriculture supply chain to reduce wastage and enable better prices for farmers. Farmgate and near-farmgate storage (of more than 1000 MT) should be developed on priority under RashtriyaKrishiVikasYojana (RKVY) and rural development schemes to enable small producers to hold produce till market prices are remunerative enough to sell. At the same time, tax holidays can be provided for initial 5-7 years for setting up Agri Infrastructure Business.

1.2.2. Reviving animal spirits of industry to boost investments

The Union Budget should be leveraged to boost business sentiments and encourage greater investments. Corporate tax rate for all companies should be brought down to 25 percent, as had been proposed earlier. This will enable Indian industry to remain globally competitive, especially in wake of significant cut in corporate tax rates by countries like the US and France. We also look forward to announcements regarding creation of special industrial zones for manufacturing and exports with attractive tax concessions and a light regulatory regime. At the same time, there is a need to introduce specific schemes like offset policy (as applicable in defence sector) to other sectors importing large quantities of products and machinery, to enable greater investments for indigenisation and domestic manufacturing of such products. Such offset programmes would encourage technology investments,

upgradations and skill enhancements, thereby creating a stronger domestic eco-system for manufacturing.

The government should also announce some major public projects across sectors like power, infrastructure, oil & gas, etc. This will create demand for capital goods. Adequate incentives should also be given to encourage domestic production of such capital goods. Also take steps to correct duty inversions in the capital good sector. While the import of capital good attracts basic custom duty of 7.5 per cent in general, imports of iron and steel products used for manufacturing capital goods attract much higher duties.

1.2.3. Energising India's exports

Giving a stimulus to exporters has become critical to accelerate exports especially under the present global scenario of high trade tension and vigorous competition. Special tax concessions for export oriented manufacturing need to be considered. Export manufacturing zones may be designated for attracting greater domestic and foreign investments in export oriented manufacturing.

Additionally, there is an urgent need to create an institutional mechanism for Global Market Intelligence to regularly conduct market studies, sector specific studies to understand the dynamics of global trade, barriers to trade, market entry opportunities, etc. Detailed information should be made available to exporters through an Export Information Portal.

Export oriented sectors like handlooms, textiles, gems and jewellery, leather products, tourism should be provided additional fiscal support. Measures are also needed for creating massive campaigns in foreign markets for building brand and promoting Make-in-India products.

1.2.4. Strengthening entrepreneurship and MSME eco-system

The key MSMEs issues related to access to credit and access to market can be addressed in the upcoming Union Budget by introducing specific provisions and reviewing existing schemes in this regard. For instance, the government should review the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) scheme to make it more effective and practical for enabling greater credit flow to units in the MSME sector. The current provisions for lock-in period, rate capping and processing fee, etc. make the scheme unattractive for banks and hence need to be reviewed.

The government could also announce setting up of a Market Intelligence Cell for MSMEs that maps specific foreign markets for specific MSME clusters; and accordingly provide information and training to MSMEs about consumer preferences, product specifications, technological developments and trade agreements. A compendium of all schemes and incentives available for MSMEs should be published online.

One of the critical issues faced by start-ups relates to the levy of Angel Tax. It is proposed that angel tax should be abolished to facilitate growth of start-ups. Government could also consider incentivising start-ups and MSMEs working on emerging technologies like Artificial Intelligence, Machine Learning for healthcare, Blockchain for land records and public records, and Big Data Analytics, etc. by providing various tax and non-tax benefits.

1.2.5. Providing stimuli for household consumption and savings

A major direct tax announcement in the Interim Budget 2019-20 related to exemption of income tax for assesses with annual income of up to Rs 5 lakhs. This was a positive step and should be continued in the Union Budget as well. In-fact, it is also recommended that the direct income tax slabs for individuals be revised upwards. The highest tax rate of 30 per cent should be applicable only for incomes above Rs 20 lakhs. At the same time, the investment limits under Sec 80C, Sec 80D and deduction for interest paid on housing loan under Sec 24, etc. be enhanced. These measures would put more disposable income with households and thus boost overall consumption in economy.

1.2.6. Creating avenues for greater employment

Creating employment should be an intrinsic factor while preparing the Union Budget. Greater public investments across sectors like infrastructure would create significant employment opportunities. We look forward to greater budget allocation in these areas. At the same time, additional fiscal incentives should be provided to sectors with potential of creating large employment opportunities such as textiles, leather, food processing, gems &jewellery, footwear, tourism, real estate, etc.

1.2.7. Prudent fiscal management

In addition to the above, it remains critical that the government prudently manages the fiscal balance. It should endeavour to garner higher revenues and attempt to move towards a more efficient expenditure management system. With respect to the revenues, the Government can consider exploring more avenues for non-tax revenues, especially by expediting the disinvestments process. On the expenditure side, while productive investments should continue, more steps should be taken to rein in consumptive expenditure. Subsidies should be pruned, and direct benefit transfer should be extended to all types of subsidies.

SECTORAL ISSUES

AGRICULTURE (POULTRY)

DIRECT TAX

2.1.1. Suggestions

(a) The Income Tax exemption which was available for poultry industry under section 80 JJ of the Income Tax Act, 1961 ('the Act') shall be restored.

(b) The deduction in respect of employment of new workmen under section 80 JJAA of the Act is allowed only for the regular workmen employed in a factory. As the poultry industry is labour intensive unit, deduction should be allowed for the workers employed in farms also.

CHEMICALS AND PETROCHEMICALS

2.2.1. The Indian Chemical Industry is an integral part of Indian economy. The industry has key linkages with several other downstream industries such as agriculture, infrastructure, textiles, food processing etc.

Indian chemical industry comprises of both small scale as well as large scale units. With initiatives like "Make in India" program gaining steam, investments, innovation and infrastructure are going to be the major thrust areas for chemical industry players. The current per capita consumption of chemical products in India is about 1/10th of the world average, indicating that the demand potential is yet to be realized. Moreover, India has a very strong outlook for the key end user industries. Going ahead, it is estimated that the demand of chemical products is expected to grow at ~9% p.a. over the next five years and is pegged at 1.2X GDP growth.

Globally, chemical industry is estimated at $ 4.7 Tn in 2017. Indian chemical industry is estimated to be valued at $163 Bn in 2017 and contributes 3.4% to the global chemical industry.

The growth of this sector will be primarily driven by domestic consumption because per capita consumption of most of the chemicals is much lower than global averages. The government has been taking initiatives to address challenges in infrastructure, feedstock availability, tax system and duty structure and overcome other system intricacies. One of the initiatives is 'Make in India' campaign, which aims to facilitate investment, foster innovation, enhance skill development and build best-in-class manufacturing infrastructure.

To meet the growing demand either the local production will have to ramp up or the imports will have to go up. As import duties have fallen across South and Southeast Asia, resulting primarily from FTAs impact, large global manufacturers have set up transnational supply chains in countries with better infrastructure, ports and friendly regulatory regimes. This has led to global players shifting from manufacturing to assembly and, subsequently, to outright imports into India. Our view is that sustained growth is more likely to stem from the rise of domestic manufacturing, rather than relying on international companies. Besides

simplifying regulatory processes and compliance related issues, the government will have to look at policies specific to the chemical manufacturing sector to generate sizable impact. Industry feels Free Trade Agreements (FTAs) are having a negative impact on business. FTAs create an 'inverted duty structure' making it cheaper to import a finished product and assemble in Indian rather than manufacturing it in India.

The Chemical and Petrochemical industry continues to face several challenges such as availability of feedstock at competitive cost, 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 to boost domestic value addition.

Recommendations for change in Customs Duty in relation to Chemicals and Petrochemical products are given below:-

Chapter 28 - Inorganic chemicals; organic or inorganic compounds of precious metals, of rare – earth metals, of radioactive elements or of; isotopes

Chapter 29 - Organic chemicals

Chapter 39 - Plastics and articles thereof

2.2.2. Inorganic Chemicals (Under Chapter 28)

(a) **Increase basic customs duty on imports of caustic soda and soda ash from 7.5% to 15%**

India is facing challenges due to cheap imports from low power cost countries in South, South East Asia & Middle East. Power tariff in India is among the highest in the world. In terms of technology, India is second only to Japan in adoption of latest technology by investing substantially. However, the high cost of power renders Indian manufacturing at a comparative disadvantage. Indian industry has adequate capacity to meet domestic demand for both caustic soda and soda ash. However, huge imports are affecting plant capacity utilization in the Indian industry. It is recommended that basic customs duty on imports of Sodium Hydroxide (Caustic Soda) (HSN 2815 11 and 2815 12) and on Disodium Carbonate (Soda Ash) (HSN 283620**)** be increased from 7.5% to 15%.

This will lead to higher plant capacity utilization and a level playing field for domestic manufacturers. Further, higher domestic production will reduce dependency on imports and save precious foreign exchange.

(b) **Increase basic customs duty on imports of hydrogen peroxide from 7.5% to 10%**

Hydrogen Peroxide is essentially used as a bleaching agent in paper & textile manufacture in addition to being used in detergent formulations & water treatment. In the period 2006-07 to 2017-18, while demand has grown at a CAGR of 4%, imports have exploded at over 20%

CAGR. As natural gas is a key input in manufacture of hydrogen peroxide, countries like Bangladesh & Thailand have used their cost advantage to the hilt in improving their export volumes to India. In fact, these countries, apart from Korea, Taiwan, Pakistan & Indonesia were found to dump material at highly injurious prices and anti-dumping duty has been imposed on them. Given the competitive disadvantage that Indian producers face on the price of natural gas, it is requested that customs duty on Hydrogen Peroxide be increased from 7.5% to 10%.

2.2.3. Organic Chemicals (Chapter 29)

(a) Ethylene dichloride (EDC) and Vinyl Chlorine Monomer (VCM) are key raw materials for production of PVC, a key polymer. Styrene is the principal raw material for Polystyrene. There is very little production of EDC and VCM for merchant sale within the country and the existing domestic capacity is essentially for captive use. Hence PVC producers have to meet their requirements through imports. Similarly, there is no domestic production of Styrene and the entire Styrene requirement of the country is imported. Both PVC and Polystyrene margins are under severe pressure and manufacturers are facing significant hardship. To provide relief to both these products through reduction in input cost, import tariff on key petrochemical inputs EDC (HS code: 29031500), VCM (HS code: 29032100) and Styrene (HS code: 29025000) may be brought down from the existing 2% to zero.

(b) **Reduction in customs duty on feedstock Acetic Acid (HS code: 29152100)**

Acetic acid 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. Further no domestic capacity is planned in next 5 years thereby increasing the demand supply gap unfavourably to Indian manufacturer. 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. It is therefore requested that basic import duty on Acetic Acid should be reduced to Nil from the current level of 7.5%.

(c) **Reduction in customs duty on Butadiene (HS code:29012400)**

Butadiene is the key input for synthetic rubber and currently attracts 2.5% duty. The synthetic rubber sector in India is already under tremendous pressure on account of the FTAs in operation and low margins. To provide some support to the synthetic rubber industry, it is proposed that import duty on Butadiene (HS code: 29012400) is reduced from the existing 2.5% to nil. Also, duty on crude Butadiene (HS code: 27111900), feedstock for Butadiene, be reduced from existing 5% to nil.

(d) **Reduction in customs duty on MEG (HS Code: 29053100) and PTA (HS Code: 29173600)**

MEG and PTA are fibre intermediates which are key inputs for polyester production. Indian MEG industry has potential for sustained growth, on the strength of growth in the Indian Polyester Industry, which is the World's 2nd largest after China. To realize this growth potential, Indian manufacturers have made huge investments in augmenting domestic MEG capacity. In fact, in the last fiscal itself a million ton of new MEG capacity has been added in India. Indian MEG industry faces threat from very low-cost producers in the Middle East, and upcoming capacities in the US, who all have access to very cheap Gas feedstock. While there is only a marginal shortfall in domestic capacity for meeting domestic demand, in 2017-18 more than a million ton of MEG was imported taking advantage of the low import duty. A higher degree of duty protection will help the financial viability of the new investments and promote continued domestic investments. India already has a surplus of PTA. However, despite the surplus significant volume of PTA is being imported in to the country. In the interest of the domestic industry and the new investments being commissioned, a higher duty is necessary. It is accordingly recommended that duty on PTA (HS Code: 29173600) and MEG (HS Code: 29053100) may be raised from the existing level of 5% to 10%.

2.2.4. Plastics and articles thereof (Under Chapter 39)

(a) Polyethylene, Polypropylene and Polysterene

Import duty on polymers like Polyethylene, Polypropylene, Poly Vinyl Chloride and Polystyrene in India are way below the same in peer countries as is the duty differential between polymers and feedstock naphtha. India already had substantial surplus of Polypropylene and has added over 2 million tons of new Polyethylene capacities in 2017-18 which has created substantial surplus for Polyethylene as well. 700 kT of new Polypropylene capacity will come on stream in the current fiscal. These new investments need fiscal support for their financial viability. For Poly Vinyl Chloride, no new capacity has been added in the country for over a decade despite demand exceeding existing capacity consistently. In view of the surplus in Polyethylene and Polypropylene and the need for a facilitative fiscal structure for the development of the domestic PVC industry, import duty on polymers like Polyethylene, Polypropylene, Poly Vinyl Chloride and Polystyrene, be increased from the existing level of 7.5% to 12.5%.

(b) Poly Vinyl Chlorine

Poly Vinyl Chloride (PVC) is the most important plastic. It is a basic product that goes into serving the basic needs of Indian people. Today unfortunately more than 1.8 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, unfortunately it 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 year to year basis – in the decade between financial year 2006-07 and financial year 2017-18, while overall demand grew by a CAGR of 9%, imports have grown from 320kt to 1,705kt, a CAGR of 17%. Therefore, some fiscal measures, which, apart from having a positive impact on the exchequer, would give a big fillip for growth and investment in the PVC sector in India. 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. To redress this situation, it is requested that duty on PVC be raised to 12.5% from the present level of 7.5%.

(c) Napatha

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 50% 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 nil to bring it at par with other countries. This in turn would increase the duty spread between the feedstock and end-product (polymers) and incentivize domestic manufacturing. Duty on Kerosene (HS code: 27101910) which is also a key petrochemical input needs to be reduced from the existing 5% to nil.

(d) **Styrene Acrylonitrile (SAN) and Acrylonitrile-Butadiene Styrene (ABS)**

ABS and SAN are engineering plastics - advanced materials with superior properties used in critical applications in automotive, appliances, electrical and electronic sectors. Large investments have been made by the Indian petrochemical manufacturers in creating capacity of these critical materials in the country. It is proposed that import duty on ABS (HS code: 39033000) and SAN (HS code: 39032000) be increased from 7.5% to 12.5% aligning this with other major plastic raw-materials.

(e) PET

Polyethylene Terephthalate (PET) is a petrochemical product derived through polymerization like other plastic raw-materials in chapter 39. PET is a vital raw material used both by textile and the packaging industry. India already has augmented large domestic PET capacity involving substantial investments and the country is a net exporter. It is proposed that import duty on PET Bottle GradeChips (HS code: 39076100) may be raised from the existing level of 5% to match the duty

on other major commodity polymers i.e. 12.5%. PET Bottle Grade Chips, if imported under any other HS codes, also would need to attract 12.5% duty.

(f) Other articles of plastics

Currently, plastic products attract import duty of 10% which is lower than what is prevailing in other comparable countries. Most of the articles of plastic in these countries attract duties in the range of 15-20% (Malaysia, Philippines and Indonesia). Plastic Processors in the Middle – East are aggressively increasing downstream industry which is a long-term threat to Indian Plastic Processing Industry particularly to small units. To overcome the above it is essential that import duty structure on

imports of articles of plastics is re-calibrated as suggested below:-

- Increase import duty on plastic goods from current 10% to 15%
- Fix minimum assessable value for import duty at the new level to arrest undervalued imports.

2.2.5. Other Recommendations

(a) Reduction in customs duty on feedstock Ethyl Alcohol/Ethanol (HS code: 22072000)

Ethanol demand in India out-strips supplies. Presently, India is a huge net importer of ethanol with estimated domestic production of around 300 crore litres against domestic demand of 600 crore litres. Even this does not convey the true extent of demand deficit, as some end users have already stopped their consumption on economic grounds.

On application side, the downstream applications of ethanol are fuel blending, potable liquor, Pyridine, Mono Ethyl Glycol (MEG- further used for Polyester Fiber and Films, Packaging Films and Pet bottles etc.). Ethyl Alcohol is also used for making Acetic Acid, Ethyl Acetate and Acetic Anhydride. Total demand of 600 Crore litres constitutes 300-350 Cr litres for Ethanol Blending Program (EBP), about 150 crores litres for Potable Alcohol and another 100 crore litres for Chemical Sector. Deficit in Ethanol availability is faced by the chemical sector as liquor and fuel blending sectors get maximum share of domestic availability.

Launch of 10% Ethanol Blending Program with the requirement of 325 crore litres of ethanol has raised the demand substantially. This scenario has increased price of ethanol available to chemical industries also due to exorbitant administered price of ethanol fixed by Government of India for blending purposes. Due to the inadequate supplies of ethanol in the domestic market, Indian Chemical industry is forced to import ethanol. In the past five years, ethanol imports have been continuously increasing and it is evident that the chemical industry would continue to be dependent on ethanol imports for its major requirement.

Recently, many policies have already been introduced in support of ethanol supplies going for blending. Taking support of such policies, huge ethanol supplies are already being supplied to OMCs. Because of this, ethanol availability has been very limited for the domestic ethanol based chemical industry. The chemical industry has ended up importing

significant volumes of ethanol with a huge forex outflow. The Indian Chemical sector will benefit from reduction in duties of ethanol by higher production, better capacity utilisation, import substitution of finished product and additional exports of value-added chemicals at competitive export prices.

In view of the above, it is requested that the import duty for Industrial Ethanol be reduced to 0% (2.5% present duty) to make ethanol based chemical industry compete in global market with petro-based finished products.

(b) Provide full Exemption from customs duty on import of power equipment for captive power plants

Caustic soda manufacturing is power intensive. Power constitutes 60% of cost of production. 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 Caustic-chlor industry is power intensive. The industry has invested substantially in setting up captive power plants as grid power is insufficient to meet the exacting requirements of the industry. However, the duties and cess imposed by State government largely offset the advantages of setting up captive power plants. For a growing economy like ours, investment in infrastructure and power is essential to sustain the growth and add momentum to the "Make in India" campaign. Exempting customs duty on import of power plant equipment for captive power generation will improve the cost competitiveness of the Indian alkali industry and will result in benefits of higher employment. It is accordingly recommended that full exemption from customs duty on import of power equipment for captive power plants be provided and be reduced from the current 5% to Nil.

STEEL AND OTHER FERROUS PRODUCTS

2.3.1. Exemption from Import duty on Pet Coke

Pet coke (2% Sulphur) is gaining importance as one of the important carbon bearing inserts used by Steel Industry, part replacing costly and scarce coking coal and adding carbon value to the end product i.e., metallurgical coke by increasing the carbon content and yield of coke in turn reducing imports of costly metallurgical coke. Pet coke (2% Sulphur grade) is a relatively cheaper substitute of Met Coke and should therefore be encouraged in domestic industry to help save precious foreign exchange and make domestic steel mills more competitive by lowering their cost of production.

It is therefore recommended that Customs Duty on Pet coke (CTH 2713) be reduced from 2.5% to NIL.

2.3.2. Reduction in customs import duty on Anthracite Coal

Anthracite Coal, Coking coal, Coke, Pet Coke, Limestone, Dolomite are vital Inputs for the steel Industry. The availability of these items in good quality is declining in the country and the Industry has to depend on their imports on regular basis. The basic Customs Import Duty on Anthracite Coal is 2.5%. Since Ferro Alloy Industry plays a vital role in the manufacturing

of steel, it is necessary to make available these reductants at international competitive price to make Indian steel mills more competitive.

It is therefore recommended that Customs duty on Anthracite Coal (CTH 27011100) be reduced from 2.5% to NIL.

2.3.3. Reduction in basic customs duty on Met Coke

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. The coke prices have surged sharply in recent months. As a result, the cost of this vital input in Steel manufacturing has gone up necessitating the increase in the price of steel which is acting as deterrence to the competitiveness of domestic products in international markets. If the duty is reduced, it will help the domestic steel industry to be cost competitive. Therefore, we suggest a reduction of Basic Customs Duty on metallurgical coke to NIL.

2.3.4. Reduction in Customs Duty on Coking Coal to NIL (HS Code 2701 19 10)

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. This amendment has adversely affected the steel manufacturers in India and 'Make in India' drive. It is therefore recommended that the customs duty on coking coal (HS Code: 2701 19 10) be reduced to Nil from 2.5%, as was the case earlier.

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

While cement grade limestone reserves are adequate, SMS, BF and Chemical grade limestone (required by the steel industry) are not and occur in selective areas only. 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, as the reserves of SMS and BF grade limestone within the country are scattered and there is a capacity limitation of the existing limestone mines in various states. In 2014-15 Budget, exemption was granted to Limestone (CTH 2521) and Dolomite (CTH 2518) "for metallurgical use conforming to IS: 10345-2004 (Limestone) and IS: 10346-2004 (Dolomite)". While there is no apparent issue in this regard but now all samples which were hitherto not being tested are now being sent to Bangalore Laboratories for testing due to which finalization of provisional assessments are getting unduly delayed. This substantially increases transaction costs and litigation defeating the purpose of benefit of concessional duty. So, it is requested to reduce the Customs Duty on all grades of limestone (CTH 2521) and dolomite (CTH 2518) from 2.5% to NIL in line with similar imports from ASEAN countries, without any technical condition.

2.3.6. Exemption of Import duty on Ferrous and Stainless Steel Scrap (HS Code 7204 49, 7204 21)

Ferrous and Stainless Steel Scrap is not available indigenously in sufficient quantities. So, the domestic steel companies have to rely on imports of this key raw material. Imposition of import duty on the scrap, increases the raw material cost adversely affecting the steel manufacturers' competitiveness.

Therefore, we recommend that Import duty on Ferrous and Stainless Steel Scrap (HS Code: 7204 49 & 7204 21) should be reduced from the existing rate of 2.5% to 'NIL'.

2.3.7. Imposing 30% Export Duty on exports of Graphite Electrodes

Graphite electrode is a major consumable in steel making. The Indian Producers are major suppliers in the international market. Almost 60% of domestic production of Graphite Electrode is exported creating shortage in the domestic market. In turn, Indian Steel Producers have to resort to imports of Graphite Electrodes. Such high duty merely increases the cost burden. Hence, it is recommended that, BCD on Graphite Electrodes should be reduced from existing rate of 7.5% to 'NIL'; while it is recommended to impose 30% export duty on Graphite Electrodes to increase its domestic availability.

2.3.8. Increase in basic customs duty for certain steel products

Ensuing trade discord between USA & China, protectionist measures by EU, Canada, Turkey etc. and global steel excess capacity is impacting the steel market. The resultant increase in steel imports into India and consequently an increase in the country's current account deficit is a cause of serious concern for the steel industry. Imposition of import duty will provide that much needed correction. Therefore, it is recommended to increase BCD from 10% and 12.5% to 25% on the following steel imports:

i. Hot Rolled Steel - SAE 1006, SAE 1008, SAE 1010, SS400, SPHT 270, any form of IS 10748 and IS 2062
ii. Cold Rolled Steel – CQ, DQ
iii. Galvanised Steel - Defective/Secondary
iv. Colour Coated Steel - JISG3312 ASTM, RAL 5012
v. Wire Rods - IS 7904 High Carbon wire rods

2.3.9. Increase in Basics Customs Duty on alloy steel bars and wire rods (steel long products) (HS codes: 7213, 7214, 7227 & 7228)

A threat of dumping of steel in Indian markets is looming post imposition of protective tariffs by US and European Union. When major steel consuming regions like US or European Union have restricted the imports in their territories, the countries like South Korea and Japan etc. which are majorly hit due to such protective measures may diverge this surplus steel to other lucrative markets like India. This is evident by the fact that imports of AS Wire Rods have registered an increase of 276.5% in April – June 2018.

Hence, it is recommended that, BCD on alloy steel bars and wire rods (HS codes: 7213, 7214, 7227 & 7228) should be increased from the existing rate of 10% to 15%.

2.3.10. Increase of effective Basic import duty on stainless steel flat products

The consumption of stainless steel has grown from 1.3 million tons to 2.4 million tons over the last 7 years at a CAGR of approx 9%. However, a large part of this increase in demand is met by increasing imports, which rose from 3,24,460 MT in 2013-14 to the highest ever record of 5,32,033 MT in 2015-16 and continues to remain high throughout 2016-17 & 2017-18. These imports have been marked by rampant price undercutting, dumping and subsidization. The market share of imports, despite the imposition of numerous trade remedial measures, is still extremely high at 18%-19%. In order to provide a level playing field for the domestic stainless-steel producers, it is recommended that effective basic import duty on stainless steel flat products (Chapter heading 7219 & 7220) should be increased from 7.5% to 12.5% at par with other steel products.

FINANCIAL SERVICES

I – INSURANCE

Direct Tax

2.4.1. 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.

2.4.2. Provide level playing field for pension plans of life insurance companies vis-à-vis National Pension Scheme

It is recommended that pension plans of Life Insurance Companies should also be given a level playing tax treatment as compared to the pension schemes of Central Government.

2.4.3. Exempt annuity received out of maturity proceeds from pension fund established by insurance companies

Commuted amount received from pension fund established by insurance companies is exempt from tax under section 10(23AAB) of the Act. On vesting of the policy, the policy holder can currently commute up to one third of the policy proceeds which is received tax free. The balance two third of the pension fund is converted to an annuity policy and annuity is taxable. It is recommended that the annuities received should be made tax free. Such socio-economic measures will go a long way in creating a desired pensionable society which is the stated objective of the Government. Alternatively, while computing maturity proceeds from an annuity which are taxable, premium amount paid with respect to keeping annuity in force should be reduced. Further, only the amount of accretion should be taxed as per the tax rate applicable to the policyholder.

2.4.4. Exemption under section 10(10D) of the Act should be linked to the term of the policy

By linking the exemption for the sum received under a life insurance policy to the percentage of premium to the sum assured, certain term policies where the premiums are higher are excluded from the tax relief. Premiums can be higher in view of the age of the individual (the elder the individual the more premium he pays) or the riders that are attached to the life policy e.g. critical illness riders or existing illness suffered by the individual. In such cases, the amount received by the individual should not be taxed merely because the premium paid exceeds 10% of the sum assured. Similarly, in case of single premium insurance policies, the inherent feature are such that those policies involve higher premium (single premium collected only once) and the premium paid is likely to exceed 10% of the actual capital sum assured. It is suggested that the tax exemption should be linked to the term of the policy for instance more than ten years and not to the percentage of premium to the sum assured. Alternatively, the limit of premium of 20% of the sum assured should be reinstated instead of 10%. This will also be in line with IRDA regulations.

2.4.5. Tax treatment of Keyman Insurance Policies

As per the provisions of Section 17(3)(ii) of the Act the surrender value under the Keyman insurance policy including the sum allocated by way of bonus on such policy is taxable as Profits in lieu of Salary in the case of assignment of the policy to the employee. Further, section 10(10D) of the Act specifically excludes amount received under keyman insurance policies from exemption. This amounts to double taxation to the extent of the value already taxed under section 17(3)(ii) of the Act. It is recommended that no tax should be levied on assignment of policy to the employee as anyways the amount is taxable on maturity and further no amount is received by the employee at the time of assignment. Alternatively, maturity proceeds under a keyman insurance policy should be reduced by the amount on which tax has already been paid at the time of assignment of such policy.

It is further recommended that the definition of Keyman should be aligned to bring it at par with definition of keyman under IRDA.

2.4.6. 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.

2.4.7. Revise Limit of reserve for unexpired risks

The reserve for unexpired risks is required to be created in respect of the amount representing that part of the premium which is attributable to and to be allocated to succeeding accounting periods, but shall not be less than the amount required under section 64V(1)(ii)(b) of the Insurance Act, 1938.

Traditionally, General Insurance Industry was issuing policies with the term of one year. Over the period as the market evolved, policies with longer terms were issued by the General Insurance industry. As a result, calculating reserve for unexpired risk as per Rule 6E of the Income Tax Rules ('the Rules'), which was designed considering a policy term of one year leads to under calculation of reserve for unexpired risk and thereby higher income recognition in the initial years for the longer-term policies.

Rule 6E of the Rules prescribes the limits for amounts that can be carried to a reserve for unexpired risks - 50% of net premium in case of fire or miscellaneous insurance business, 100% of net premium in case of marine insurance business and 100% of net premium where insurance business relates to fire insurance or engineering insurance and which provides insurance for terrorism risks.It is observed that there is a need to revisit the limit prescribed for creating a reserve for unexpired risks under Rule 6E of the Rules in accordance with the changing needs of the business. It is accordingly recommended that Rule 6E of the Rules be appropriately amended to provide that reserve for unexpired risk should be calculated as per the amount provided for in the books of accounts.

2.4.8. Section 194A be amended to exclude interest component on compensation awarded by Motor Accidents Claims Tribunal

Compensation awarded by Motor Accidents Claims Tribunal (MACT) to victims of motor vehicle accidents includes compensation and interest thereon. Generally, most of the victims are poor and are unlikely to have taxable income. Section 194A of the Act requires deduction of tax at source on the interest amount if it exceeds Rs. 50000 during a financial year. General Insurance companies deduct TDS on interest component to ensure compliance. However, various judicial precedents have held interest component as a capital receipt in the hands of the recipient. It is accordingly recommended that provisions of section 194A of the Act be amended to specifically exclude interest component on MACT awards.

II – NON-BANKING FINANCIAL COMPANIES (NBFCs)

Direct Tax

2.4.9. Treatment of Recognition of Income

Section 43D of the Act recognizes 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, a co-operative bank (other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank) 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. Various judicial precedents have held that interest income on NPA's under the provisions of the Act should be chargeable to tax only on receipt basis following the principle of real income.

However, in absence of specific coverage of NBFCs (other than housing finance companies which are already covered by the provisions of section 43D) in section 43D of the Act and in light of the ICDS provisions, NBFCs would be required to recognise income on such NPAs for tax purposes on an accrual basis, resulting in levy of tax on income which may not be realised at all. This would severely impact the liquidity of NBFCs in terms of cash flow pay-outs, impacts their profitability and also has a consequent impact on their cost of operations.

In light of the above, an amendment should be made to section 43D of the Act, to extend the benefit of section 43D of the Act to "Non- Banking Financial Company" (other than housing finance companies which are already covered by the provisions of section 43D), whereby interest income on non-performing assets should be taxed only on receipt basis. Accordingly, consequential amendment should also be made in Rule 6EA of the Rules which provides special provision regarding interest on bad and doubtful debts of banks and financial institutions, to include the "Non- Banking Financial Company" as well. Alternatively, the benefit be extended to NBFC's which are classified as systematically important by Reserve Bank of India ('RBI') whose asset size is of Rs. 500 crores or more.

2.4.10. Exclusion of interest/processing charges paid to NBFC from the provisions of Section 194A

As per section 194A TDS @ 10% is required to be deducted on interest payment including processing charges under loan/finance arrangement, however, banking companies, LIC and Public finance institution are exempt from purview of this section. NBFC carry on loan/finance business to mostly retail customers who are in organized sectors which includes large number of individual, Partnership firms and SMEs. This provision puts NBFCs in a disadvantage position and creates severe cash flow constraints since NBFCs operate on a very thin spread /margin interest. Margins are very low compared to TDS on interest and processing charges. Further, 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. 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.

2.4.11. Taxability of Excess Interest Spread (EIS) in Direct Assignment transaction be made on receipt basis

As per Ind-AS regime, the present value of future EIS income receivable in relation to Direct Assignment transaction is required to be recognized in the books of accounts on upfront basis even though the same is not realized but would be received over the life span of the underlying pool of assets. Consequently, due to change in the revenue recognition policy as per the Ind-AS in comparison to erstwhile accounting regime and there being no direction

issued by the RBI on booking of such EIS in case of Direct Assignment transaction under IndAS era, NBFC's may now be asked to offer such EIS income to tax on upfront basis when in true spirit, the EIS income would be realized in future years.

It is suggested that a clarification in respect of taxability of EIS income on receipt basis should be issued by the Government.

2.4.12. Provide clarity for higher depreciation rate on vehicles given on lease by NBFCs

NBFCs that are engaged in the business of vehicle financing through lease arrangements, earn lease rental income from such leases, which are offered to tax as business income in accordance with the provisions of the Act. A higher rate of depreciation of 30% is admissible on motor buses, motor lorries and motor taxis used in the business of running them on hire (as per entry in item III (3) (ii) of Appendix I, read with Rule 5(1) of the Rules) as compared with the rate of 15%, as provided under item III (2) of Appendix I of the Rules i.e. the rate applicable to Motor cars, other than those used in the business of running them on hire. The Hon'ble Supreme Court in the case of **I.C.D.S. Ltd. vs. Commissioner of Income-Tax (29 taxmann.com 129) (SC)** has held that NBFCs are entitled to a higher rate of depreciation on the trucks leased by the assessee on hire. It is accordingly recommended that appropriate clarification be issued by CBDT to provide that the higher rate of depreciation of 30% is admissible to the NBFCs, which are in the business of leasing/financing of all kind of vehicles.

2.4.13. Higher depreciation rate on Plant & Machinery given on lease by NBFCs

Depreciation rate on General Plant & Machinery is at present 15% in all cases including for the NBFC companies which are engaged in the business of leasing of assets. NBFC companies have no control on normal wear and tear of the assets and no control on its use.

In view of the rapid obsolescence and user of the assets are different than the NBFC companies, the assessee has no control over the use of the assets and the lowered depreciation is not adequate to meet the requirement of replacement of the asset or depreciation in value of low value assets. It is suggested that depreciation on such Plant & Machinery given by NBFCs on lease should be allowed at higher rate of 40%.

2.4.14. Exclusion from applicability of provisions of section 269T

The Finance Act 2017 introduced section 269ST in the Act, which prohibits receipt of cash exceeding Rs. 2 lacs with a view to curb the black money and promote digital economy. It provides that no person shall receive an amount of Rs. 2 lakhs or more in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account. Banking companies, post office savings bank, co-operative banks have been excluded from the applicability of this section. As per the current provisions, the section applies to NBFCs as well. Applicability of this section to NBFC companies will adversely impact the overdue collections from customers. Given the nature of business of NBFC, there are huge numbers of defaulters and the companies are required to make tremendous efforts to recover

outstanding dues. By restricting the mode of recovery as above, this may have huge impact on the recoveries and consequentially lead to increase in bad debts.

Considering the business model of NBFCs and huge adverse impact on the recoveries and consequentially leading to increase in bad debts, NBFCs should be excluded from the applicability of this section.

2.4.15. Interest deduction limitation under section 94B

Provisions of limitation in deduction of interest are not applicable for banking and insurance companies, the same needs to be extended to NBFCs as well. NBFCs have interest income as main source of income and huge corresponding interest expenses. So capping deduction of interest on such companies will lead to harsh consequences for NBFC's. Interest limitation rules do not apply to an Indian Company/PE of Foreign company which is engaged in the business of banking or insurance. Like banking or insurance business, an exclusion of NBFC Companies from section 94B of the Act is suggested as there are also in the business of financing and leasing.

2.4.16. No MAT to be levied on statutory reserves and statutory provision created by NBFCs

Statutory reserves like Special Reserve and Debenture Redemption Reserve (DRR) created by NBFCs should not be subjected to MAT. DRR, though termed as Reserve is not a reserve, but a provision for ascertained liability. Further statutory provision towards non-performing assets created by NBFCs are strictly in compliance with the statutory RBI Guidelines on the Prudential Norms and not on any ad-hoc basis and by making a Provision for NPA there is no diminution in the value of assets. It is accordingly recommended that appropriate clarification should be issued by the Government to provide that the provision for NPA does not fall within the ambit of 'Provision for diminution in the value of Assets' as per Clause (i) of Explanation to section 115JB of the Act and the same should not be added back while computing book profits under section 115JB of the Act.

FOOD PROCESSING

2.5.1. Almost all type of fish and fish parts covered by chapter 3 are included in general exemption No. 65 when imported from ASEAN countries. Frozen Fish Fillet is not a processed product. It is a part of raw fish used by common people. It is, therefore, suggested that the same should also covered by General Notification No. 65 when imported from ASEAN countries. Local fisheries will not get affected by imports because Local Sea food availability is much lower than its demand in the country.

Frozen Fish Fillets' have already been allowed at 100% Customs Duty exemption when imported from following countries i) Bangladesh (ii) People's Republic of China (iii) Republic of Korea and (iv) Sri Lanka. (Notification No. 50/2018- Customs dated 30th June, 2018 – Item No. 23 and 24). Good quality sea food items are available at competitive price from Vietnam. It is, therefore, suggested that Vietnam should be added in the list of four countries in Notification No. 50/2018 – Customs dated 30th June, 2018 in Appendix – I. When exporters of Sea food items from India approach Vietnamese Importers for selling



their items (prawns, shrimps etc.), the Vietnamese importer who is also exporter of certain Sea food items, expect Indian exporters to buy their items. Indian importers are not able to oblige because of higher rate of duty on Fish Fillets when imported from Vietnam as against Nil duty when imported from China, Bangladesh, Sri Lanka and Korea. It is, therefore, in the interest of encouraging trade between India and Vietnam that Frozen Fish Fillets are allowed at Nil import Duty from Vietnam also.

On Frozen Fish Fillets GST applicable was 5%. However, considering that Frozen Fish Fillet is a raw sea food item used by common people, it has been exempted from GST vide following notifications:-

(a) 42/2017 - Central Tax (Rate) dtd. 14th November, 2017 (S. No. 22)

(b) 42/2017 - State Tax (Rate) dtd. 14" November, 2017 (S. No. 22) (c) 44/2017 - Integrated Tax (Rate) dtd. 14t November, 2017 (S. No. 22)

HEALTHCARE

DIRECT TAX

2.6.1. Tax Exemption on Preventive Health Check-ups

Every year, roughly 5.8 million Indians succumb to heart and lung diseases, stroke, cancer and diabetes. Non-communicable Diseases (NCDs) like diabetes, heart diseases and respiratory diseases are expected to comprise more than 75 percent of India's disease burden by 2025. Preventive health check-ups can help in early diagnosis and timely treatment of NCDs, hence lowering complications, mortality and burden on secondary and tertiary care facilities. It is recommended that tax exemption on Preventive Health check-up should be raised from the current Rs 5,000 per person to Rs 20,000 under section 80-D of Income Tax Act 1961.

Further, given the rising advent of lifestyle diseases in India and the need to prevent loss of productivity, it is imperative that employers get a separate annual deduction of uptoRs 10,000/- per employee, towards expenses incurred for sponsoring the health check expenses of their employees.

2.6.2. Medical reimbursement exemption limit for salaried employees to be set at Rs 100,000 per annum

The annual Medical reimbursement limit set at a sum of Rs 15,000/ per annum under Section 17(2) of the Income Tax Act which was fixed in April 1999, has been merged along with conveyance allowance into a composite standard deduction limit of Rs 40,000. Given the significant rise in cost inflation index in general (70% over the last 5 years) and medical inflation in particular, the medical reimbursement deduction needs to be re-introduced and the annual limit needs to be enhanced to not less than Rs 100,000 per annum.

2.6.3. 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.

Based on the existing dispensation which allows for the weighted deduction scheme, several hospital groups had begun setting up green field capacities and given the long gestation period in identifying suitable land parcels, getting government approvals etc., there are several projects which have taken off but will get completed/commence only in the next 3-4 years. A sudden withdrawal from April 01, 2017 has led to a significant negative impact on the initiatives that have already commenced on these fronts. This move has removed a critical benefit available to the healthcare sector which is already confronted with various other challenges such as contending with spiralling cost of real estate for setting up hospitals, high rate of medical technology obsolescence, shortage of skilled medical resources and long gestation period.

Given the urgent need to add bed capacity in the sector, the 150% weighted deduction scheme should be allowed to continue for the healthcare sector for an additional 10 years at least.

2.6.4. Extend Tax Benefits to Speciality Centres and Hospitals Investing in Substantial Expansion

(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.

2.6.5. Tax Incentives for promoting Specific Developmental Activities

(i) 250% deduction on investment made for the implementation of Electronic Health Records (EHR) should be extended;

(ii) 100% deduction on expenditure incurred for securing accreditation for healthcare facilities;

(iii) 250% deductions on approved expenditure on advanced healthcare technologies for remote care.

2.6.6. Simplification of the tax regime in respect of Real Estate Investment Trusts (REITs)/Business Trust

Under the revised scheme announced in the last Union Budget, there would be no capital gains tax exposure for the sponsor at the time of the listing of the units or subsequent divestment (if securities transaction tax has been paid). Further the REIT/Business Trust entity would not suffer tax on the rental income distributed, though individual investors in the REIT would be liable to pay tax on the income distribution by the REIT. Simplification of the tax regime would accelerate growth and ensure scale, speed and skill sets for setting up

more hospitals and help attract more FDI inflows. It is recommended that there should be no capital gains tax incidence at the time of setting up REIT/Business Trust as well for individual investors on the income distribution by the REIT/Business Trust.

Others

2.6.7. 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 social infrastructure in the expanded definition of 'infrastructure facility'. In spite of this, long term financing options are still not available for healthcare providers. The Ministry of Health and Family Welfare needs to work out a solution along with the Ministry of Finance to provide long term financing to the healthcare sector. This will channelize funds from the banking sector to create necessary healthcare infrastructure and enable 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 as well as catalyzing research and development. Also, the savings that hospitals accrue could be ploughed back to expand hospital bed capacity and facilities which would assist in improvising healthcare services and bed to patient ratio in the country. There is need for long term financing options for the healthcare sector, as provided to the other sectors accorded with the 'Infrastructure Status'. Also, healthcare sector should be accorded 'National Priority' status.

2.6.8. Interest Subsidy on Loans

Healthcare is a capital-intensive industry wherein very few players are able to generate decent returns. High upfront investment coupled with low price realization from the patients makes the gestation period of the projects extremely longer. It is accordingly recommended that an interest subsidy should be given to make investments attractive.

2.6.9. Provide Capital Subsidy on Investments

Land prices are rising at a tremendous pace and it is exorbitant in the prime location of city. This escalates the project cost and makes it unviable. A subsidy on capital investment would reduce the upfront investment and help generate positive returns faster. Accordingly, capital subsidy for acquisition of land and construction of hospitals should be provided.

2.6.10. Provide Specific Funds within Health Sector

Access to funding by creating a specific fund for healthcare infrastructure and innovation would facilitate access to capital for the industry. These funds would encourage entrepreneurship and newer business models which are the need of the hour for improving access, availability and quality, especially in Tier 2, Tier 3 and rural areas. The Government should provide the seed capital for such a fund. The government should set up a Health Infrastructure Fund and a Medical Innovation Fund.

2.6.11. Provide for Liberalized FDI Regime for Investments in Medical Education

There is a strong need for a liberalised FDI Regime for investments relating to Medical Education and training to bridge the huge demand-supply gap and meet global norms. Healthcare organizations should be allowed to leverage FDI for setting up colleges and training centres for healthcare professionals and for specialist training.

2.6.12. Set up Health Infrastructure Fund and Medical Innovation Fund

Access to funding by creating a specific fund for healthcare infrastructure and innovation would facilitate access to capital for the industry. These funds would encourage entrepreneurship and newer business models which are the need of the hour for improving access, availability and quality, especially in Tier 2, Tier 3 and rural areas. The Government should provide the seed capital for such a fund. It is recommended that the government should set up a Health Infrastructure Fund and a Medical Innovation Fund.

2.6.13. Provide Import duty relief for lifesaving equipment

There are several anomalies involved in the current classification of lifesaving equipment leading to variations in import duties for similar set of products. Hence in such cases, there is a need to revisit the classification in order to make the import duty on lifesaving equipment consistently low or even exempt lifesaving equipment from duty completely to ensure lower cost of healthcare services delivery to the common man. Tax incentives could be provided to domestic manufacturers of medical devices. The Indian market would be more attractive to global manufacturers once tax rates are liberalised along with measures taken to improve ease of doing business.

LIFE SCIENCES

DIRECT TAX

2.7.1. Continue weighted deduction under Section 35(2AA) and Section 35(2AB)

Deduction under section 35(2AB) of the Act is restricted to 100% with effect from previous year 2020-21. It is well recognized that scientific research is the lifeline of business in all countries of the world. Withdrawal of weighted deduction in respect of scientific research expenditure will put a dent to the 'Make in India' initiative of the Government. It is recommended that weighted deduction under 35(2AA) and 35(2AB) of the act be continued.

2.7.2. 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.

2.7.3. Safe Harbour Rules for Contract Manufacturing

The Central Board of Direct Taxes has notified Safe Harbour Rules covering sector like IT/ITES, KPO and Auto Component manufacturer prescribing desirable margins to avoid litigation on transfer pricing matters.



It is requested that similar guidelines for pharma companies that are manufacturing and exporting the product as contract manufacturer and loan licensee be provided.

HOUSING & REAL ESTATE

DIRECT TAXES

2.8.1. 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.

2.8.2. Rationalisation of provisions with regard to transaction in immovable property

Prior to amendment by the Finance Act, 2018, income from capital gains (section 50C), business profits (section 43CA) and other sources (section 56) arising out of transactions in an immovable property, is taxed on the basis of the sale consideration or stamp duty value, whichever is higher. Where the consideration is less than the stamp duty, the differential is taxed as income, both in the hands of the purchaser and the seller. The Finance Act, 2018, has made amendment in the above sections to provide that no adjustment shall be made in a case where the variation between stamp duty value and the sale consideration is not more than 5% of the sale consideration. This amendment is in order to minimise hardship in case of genuine transactions in the real estate sector, where the variation can occur in respect of similar properties in the same area because of a variety of factors.

Issues

- The real estate sector has been facing a slack in the recent past due to which the property prices have reduced.
- Further, there is no corresponding reduction of prices as per the circle rates/ ready reckoner rates for the purposes of calculation stamp duty.
- In the above scenario, a variation of 5% would majorly be due to the market scenario of the industry rather than escape from taxability. Variation of flat 5% may not be appropriate for all locations in India.
- It may be thus considered to increase the variation to at least 10% for all or 10% or higher in case of metro cities and 5% or higher in case or non-metro cities.

Recommendation

It is recommended that a different rate of variation may be provided for metro and non-metro cities (say 10% or higher for metro cities and 5% for non-metro cities).

2.8.3. Remove Restriction on Set-off of Loss from House Property

The Finance Act, 2017 has inserted sub-section (3A) in section 71 of the Act to provide that loss from house property up to Rs. 2 lakhs only will be set-off against the income under

other heads in the same financial year. Loss above Rs. 2 lakhs is eligible to be carried forward for a period of eight years and can be set-off against income from house property only. This provision contradicts with the intention of the government to incentivise housing sector and promote investment in real estate sector. This could act as a dampener for promoting investment in the Housing sector. The limitation provided by the Finance Act, 2017 limiting the set-off of loss of house property to the extent of Rs. 200000 should be removed.

2.8.4. Include Real Estate sector within the purview of section 72A

Section 72A of the Act be amended to include real estate sector within its purview. This will enable the consolidation and consequential efficiency for the sector.

2.8.5. Deduction under section 80-IBA

- To fulfil the government aim of Housing for all by 2022, it is suggested that timeline for approval under section 80IBA of the Act be extended to 31st March 2020.
- Profits from projects eligible for deduction under section 80-IBA of the Act be exempted from the ambit of MAT/AMT.

2.8.6. Benefit of section 45(5A) be extended to companies, firms, LLPs

The Finance Act, 2017 had inserted section 45(5A) in the Act to provide for computation of capital gains in case of joint development agreement. The intent for inserting section 45(5A) in the Act was to reduce genuine hardships faced by land-owners in paying the capital gains tax liability in the year in which the possession of immovable property is handed over to the developer for development of a project. Similar to individuals and HUF's, any other taxpayer (viz. Company, firms, LLPs co-operative societies etc.), who being a land-owner intends to enter into a JDA for development of property, would also be faced with similar hardships. It is accordingly recommended that suitable amendment be made in section 45(5A) of the Act to extend its applicability to other taxpayers also viz. companies, firms, LLP etc. Widening the applicability of such beneficial provisions to other taxpayers will give an impetus to enter into JDAs and thereby boost real estate sector.

Section 45(5A) of the Act provides that in case of an assessee being individual or Hindu undivided family, who enters into a specified agreement for development of a project, the capital gains shall be chargeable to income tax as income of the previous year in which the certificate of completion of the whole or part of the project is issued by the competent authority. In order to remove ambiguity, it needs to be clarified that capital gains for the landowner should trigger only in that year in which certificate of completion is issued for his share in the constructed property and liability should be restricted to that part of the project for which certificate of completion is issued.

2.8.7. TDS on Payment on transfer of immovable property – Section 194-IA

The main purpose of introducing section 194-IA in the Act was to capture all major property transactions by enforcing 1% TDS. It may be noted that the same information is already available to the Government from various other sources like stamp duty authorities, annual information returns (AIR), Property registrar's office. Thus, there seems to be no justification

in continuing with the unwarranted compliance burden posed by this section. Further, the limit of Rs. 50 lakhs is irrespective of location and type of property. It may be observed that the property market of metro cities is completely different from non-metro cities, hence there should be a higher threshold limit for the metro cities. It is recommended that the requirement of TDS by the buyer on transfer of property be removed or the limit for applicability of TDS be increased from Rs. 50 lakhs to Rs. 1 crore.

2.8.8. Provide capital exemption on transfer of assets (other than shares of SPV) to ReIT

As per section 47(xvii) of the Act, any transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust to the transferor is exempt from tax. However, if the Sponsor intends to transfer other capital asset (viz. interest in LLP/properties), then such transfer is not covered under section 47 and thereby, transfer of any of these assets would attract tax for the Sponsor. It is recommended that exemption from capital gains be extended to sponsor upon transfer of interest in SPVs (set up as LLP) or property to Real Estate Investment trust (ReIT) in exchange of units in ReIT.

2.8.9. Period of holding of ReITs to be made in line with listed shares

Units of ReIT held by investors shall convert into long-term capital assets ('LTCA') only if they are held for minimum period of 36 months. The requirement to hold the units for 36 months may act as a non-starter. Thereby, many of the investors may not be eligible to utilize the beneficial tax rate on long-term capital gains of 10%. It is recommended that the suitable amendment should be made in section 2(42A) of the Act to reduce the period of holding to 12 months (as applicable for listed shares) even in case of units of ReIT listed on recognised stock exchange.

2.8.10. Provide a carve-out in section 79 to exclude change in shareholding of SPV due to transfer of stake to ReIT

In case the SPV has substantial business losses then lapse of such business losses due to transfer of stake in SPV to ReIT may prove to be detrimental for sponsor. It is recommended that an exception should be carved out in section 79 of the Act to exclude such SPVs whose more than 51% shareholding undergoes change due to transfer of stake to ReIT. The said amendment would provide impetus to the ReIT scheme.

2.8.11. Increase the period under section 23(5) to determine Notional income for house property held as stock-in-trade

Section 23 of the Act provides for the manner of determination of annual value of house property. Considering the business exigencies in case of real estate developers, Finance act, 2017 has inserted sub-section (5) in section 23 of the Act to provide that where the house property consisting of any building and land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period upto one year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be

nil. Real Estate developer assessee's hold land and building as inventory for development and sale to the consumers like any other manufacturer holds raw material, under process stock and finished goods. It is not possible for the real estate developers to lease out the ready to move inventory, hence taxing the deemed rental on the properties held for sale is highly unjustifiable. Secondly, the sale of ready inventories are dependent on various factors and market conditions hence it may not be always possible to sale the entire inventory within twelve months of obtaining the occupation certificate. It is recommended that the said provision should be withdrawn with retrospective effect from April 1, 2018 or the time limit of one year be extended to two years from the end of the financial year on which the certificate of completion of construction of the property is obtained from the competent authority. It is also recommended that suitable amendment may be considered to tax the deemed income only when the property is developed as rent income generating asset (investment property held as Ind AS 40).

HYDROCARBON

CUSTOMS AND EXCISE

2.9.1. Provide clarification on non-applicability of customs duty on disposal of scrap

The condition no. 48 under Sl. No.404 of customs notification no.50/2017 dtd. June 30, 2017 was amended under pre-GST regime vide notification no.6/2017-Customs dtd. February 2, 2017 to allow the disposal of goods imported after availing exemption as such goods were required for petroleum operations and are no longer required for petroleum operations, on payment of applicable customs duty on depreciated value of the goods. In this regard, it is submitted that E&P sector has constructed various onshore and offshore facilities including platforms, pipelines through lumpsum turnkey contracts. For construction of most of the facilities, equipment/goods were imported/domestically purchased by availing exemption or concession of applicable customs duty/excise duty. Many items like cranes, pumps, engines, valves, separators, tanks and piping etc. were imported along with platforms/processing facilities and consolidated value is declared in Bill of entries. As and when such items become unusable due to continuous use, these items are replaced by new items and such old items are declared to be disposed off as scrap. The requisite condition of exemption notification for utilizing the goods in connection with the petroleum operations is duly satisfied. Accordingly, it is requested that a clarification may be issued that the condition no.48 of Notification no.50/2017-Customs (supra) and similar condition under Notification No.3/2017-Integrated Tax (Rate) dtd. June 28, 2017 is not applicable on disposal of items which have been used for petroleum operations and are no longer required and have become scrap.

2.9.2. 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. Import Duty (Basic Customs Duty) @ 2.5% plus Social Welfare surcharge @10% is applicable on import of Liquefied Natural Gas (LNG), thus the effective Customs duty comes to 2.75%. 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 effective Custom duty @ 2.75%. 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 supply of Natural Gas for priority sectors such as Fertilizer, CNG, LPG, PNG etc.It is suggested that LNG Import may be exempted from payment of customs duty (present rate @ 2.5% plus SWS @10%) to provide relief to gas based industries and domestic consumers.

2.9.3. Exemption of Excise Duty for compression of natural gas into Compressed Natural Gas (CNG)

Presently, Central Excise duty is applicable on CNG. It is recommended that CNG (conversion of Natural Gas into CNG) be exempted from Central Excise Duty. This will promote usage of this environmental friendly fuel in domestic and commercial transportation sectors.

MISCELLANEOUS ISSUES

2.9.4. Reduction of percentage of Oil Cess to 10%

The Budget 2016 has amended provisions to levy Oil Cess on the basis of ad-valorem basis instead of fixed rate per MT. OID cess is levied on production of crude oil as a duty of excise under the Oil Industries (Development) Act, 1974. OID cess is levied only on crude oil produced domestically. Thus, it places domestic crude oil production vis-à-vis imported crude oil at a significant disadvantage as imported crude does not attract such duty. This levy is against the spirit of "Make in India". It is believed that the rate of cess should be reduced to 10% to boost the oil and gas sector.

DIRECT TAX

2.9.5. Intimation of discovery of oil on or before 31.03.2017 may be treated as cut-off criteria for phasing out of tax holiday under section 80-IB(9)

The Finance Act, 2011, has inserted a Proviso after clause (ii) of sub-section (9) of section 80-IB to the effect that tax holiday in respect of the production from blocks which are awarded under contracts licensed after 31-03-2011 would not be allowable. Thus, tax holiday under section 80-IB (9) was made unavailable if hydrocarbon production resulted from blocks which are awarded under contracts licensed after 31-03-2011. Further, in a bid to phase out tax holiday under section 80-IB (9) completely, the Finance Act, 2016, has introduced sun set clause in the provisions of section 80-IB (9) which provide that no tax holiday would be available if commercial production of oil is started after 31-03-2017. This would apply even to production from blocks which are awarded under contracts licensed till 31-03-2011. The commencement of commercial production of oil and gas is the culmination of a long series of exploratory and development activities which span over several years. Such exploratory and development activities entail investment of huge amounts of funds. An entity which has already committed huge funds for the exploration and development of an oil and gas block but is not able to commence commercial production by 31.03.2017 due to geological, regulatory, or operational factors would be hugely disadvantaged vis-à-vis



another entity which is able to commence commercial production by 31.03.2017 owing to different geological, regulatory, or operational factors.

It is recommended that the cut-off criteria for phasing out of tax holiday under section 80-IB (9) of the Act may be kept as the intimation of discovery of oil on or before 31.03.2017 rather than the start of commercial production by that date.

2.9.6. Provide clarity on treatment of purchase consideration paid for acquiring Participating Interest in Oil & Gas Blocks

Farm-in and Farm-out is normal business activity in Exploration and production sector. Presently, Section 42(2) of the Income-tax Act contains the tax treatment only in the hand of transferor. In order to avoid unwarranted litigation, requisite provision may be inserted in Act to provide the tax treatment in the hands of transferee. The acquisition of capital assets like platforms, pipelines and other tangible fixed assets etc. shall be treated as tangible assets. Purchase consideration in excess of tangible assets shall be considered as payment for right to explore/produce mineral oil in the contract area and accordingly shall be treated as intangible assets eligible for depreciation under section 32 of the Act.

INFORMATION TECHNOLOGY (IT) AND TELECOMMUNICATIONS

DIRECT TAX

2.10.1. TDS on prepaid distributor margins/discounts from telecom operators

It is a practice in the telecom industry to enter into an arrangement with the pre-paid distributors on “Principal to Principal” basis such that all material is supplied at a discount to the MRP and the distributor can, in turn, sell at any price up to the MSP (max selling price) of the product. The risk of any losses is not borne by the telecom operator but by the distributor. There has been continuous litigation on whether the relationship between the telecom companies and distributors is on “Principal to Principal” or “Principal to Agent” basis. TDS is applicable only if the relationship is of principal to agent basis else not. It is strongly believed that issuance of a clarification that such discounts does not fall within the ambit of TDS provisions is warranted. Alternatively, it is suggested that the Government should introduce the TDS rate of 1% on such payments, which would be closer to the actual tax liability of distributors as margins earned by the distributors are low and they sustain only on volumes.

2.10.2. Introduction of a scheme for allowing self-declaration by a deductor for lower rate TDS

For obtaining certificate for lower deduction of tax at source, every year a taxpayer has to incur a lot of cost and efforts and the certificates are based on estimations only. Also, where are there are additional transactions entered or the limit specified in the certificate exhausts during the year, a fresh application has to be filed and entire proceedings are undertaken.

To provide convenience to tax payers and to reduce costs and efforts of both taxpayers and tax authorities, Government should introduce a scheme wherein the deductee may furnish a self-declaration to the deductor for lower rate of TDS.

2.10.3. Treatment of interest expenditure incurred on acquisition of spectrum

There is no clarity on the treatment of interest expenditure incurred on acquisition of spectrum. While the government has clarified the treatment of spectrum as amortisable under Section 35ABA of the Act read with Rule 6A of the Rules over the validity of period, treatment of interest expenditure incurred prior to the date of put to use is not clear. Under the block concept, spectrum was treated as an intangible asset and hence interest cost incurred prior to the date of put to use was also capitalised in view of Section 32 read with section 36(1)(iii) of the Act. Spectrum is now covered by the provision of Section 35ABA of the Act which allows amortisation of spectrum on payment basis and there is no clarity on treatment of interest under the current regime. It is therefore recommended that an appropriate clarification should be issued to provide that the interest expenditure incurred towards 'right to use spectrum', is allowable as revenue expenditure under section 36(1)(iii) read with Section 37(1) of the Act.

INFRASTRUCTURE

DIRECT TAX

2.11.1. Allow benefit of claim of depreciation in case of Metro Rail Systems

CBDT Circular No.9/2014 dated 23rd April, 2014, clarifies that the expenditure incurred on development and maintenance of infrastructure projects like roads/highways on Built – operate –transfer basis under a concession arrangement may be amortized over the period of the concession and claimed as allowable business expenditure as per the provisions of the Income Tax Act. The above circular is applicable only to infrastructure projects for development of road/highways on BOT basis where ownership is not vested with the assesse under the concession arrangement.

It is requested that the benefit of claiming the depreciation over the period of the concession under the provisions of the Income Tax Act on cost incurred on construction, operation and maintenance of the Metro Rail Systems developed under a concession arrangement on design, build, finance, operate and transfer (DBFOT) basis be also allowed similar road/highway projects.

CUSTOMS

2.11.2. Customs duty on Rope Propelled Transport Solutions for Urban Transport be made at 5%

In General, Basic Customs Duty Applicable for Rope Propelled Transport Solutions is 10%. Further Basic Customs duty applicable for rope propelled transport solutions for tourism is 5% (under rules of Department of Tourism). Rope propelled urban transport solutions have an application in several Government initiatives such as new Metro Policy 2017, Smart City Projects, Last Mile Connectivity, Mass Rapid Transit Systems (MRTS) for non – metro towns in India etc. It is a solution to reduce congestion & pollution for the urban scenario; reduction of basic customs duty to 5% will benefit all these sectors. It is accordingly recommended that basic customs duty for rope propelled transport solutions for urban transport should also be reduced to 5%.



ELECTRONICS

CUSTOMS

2.12.1. Reduce Import duty on compressors used in ACs

There are very few compressor manufacturers in India and manufacturers of quality compressors in India are fewer. Basic Customs Duty on compressors should be kept at 5% instead of 10% at present. It would help Indian manufacturers produce goods at competitive prices which would not only help Indian consumers but help increase exports from India.

2.12.2. Customs Duty on Smart phone components

Display panel are not being made in India yet. And it will take some more time for the industry to start producing quality display panels. As on date, even for Camera, there is not a single mature factory. Display panels comprise almost 50% of the cost of all components in a mobile phone. So, levying a duty would make panels even costlier as local manufacturing of display panels would require time to come up to internationally accepted standards. Moreover, components such as Camera, PCBA, Speaker, Microphone, Charger, Ear phones, Battery etc. are just 20% of the Bill of materials (BOM). So current duty rate is not a big motivator to promote local sourcing. There is already a duty for components such as Camera, PCBA, Speaker, Microphone, Charger, Ear phones, Battery etc. The duty ranges from 10% to 15%.

As per PMP, BCD would be levied on display panels from FY 19-20 onwards. However, it is suggested that this may be pushed back to FY 20-21 or even later. Instead, it is suggested that duties on components mentioned above may be increased by 5% points.

OTHER SUGGESTIONS

2.12.3. Provide Tax benefits for export from India

China offers substantial tax benefits to their exports which can go up to the tune of 17% of total value of exports. However, with rising labour costs, many Chinese factories are looking to shift to India. India already is a huge market and an export incentive will prompt them to shift here sooner. India aims to become a global hub for Electronics export. In order to achieve this aim, it is suggested that tax benefits on export of electronics devices should be provided.

2.12.4. Provide tax breaks for Manufacturing of Sensors, Display Panels, PCB and Chipsets

India should not limit to just electronics device assembly, but rather aim for chip level fabrication. But Hi-Tech fabrication of Chipsets, Sensors and Display panels require huge investment. Countries like Korea /Taiwan/Japan have many fab units. India needs to offer tax breaks and an encouraging tax structure for attracting investments in fabrication of such products.

2.12.5. Reduce Customs duty on lubrication oils

The duty on the R134A synthetic refrigeration oil attracts duty of 7.5% as per notification number 12/2012-customs resulting in increase in the cost of manufacture of compressors. It

is recommended to reduce basic customs duty from 7.5% to 5% on pro-eco oils (Lubrication oils) of HSN 34039900 as an encouragement for manufacture of compressors with non-ODs technology.

CAPITAL GOODS

CUSTOMS

2.13.1. Reduce Customs Duty on articles of iron & steel falling under Excise chapter 72 and 73

Currently, iron & steel items falling under chapter 72 and 73 attract Basic custom duty of 10%. Further certain items in Chapter 72 such as hot rolled flat sheets and plates of alloy or non-alloy attract Basic custom duty of 12.50%. Whereas import of Capital goods attract Basic custom duty of 7.5%. This has resulted in Inverted duty structure. It has discouraged manufacturing of capital goods in India and has encouraged import of capital goods from overseas. Iron and steel are major input for Capital goods industry and therefore increase in basic customs duty on input material has adversely affected the Capital goods industry which is already reeling under economic slowdown. It is therefore requested that such duty inversions are corrected.

2.13.2. Provide Level playing field to Indian manufacturers who import raw materials paying duty

Free Trade Agreements with countries namely Japan, Korea, etc. enabling duty free imports is resulting in disadvantage to Indian manufacturers who have to pay Customs duty on raw materials. Duty exemption under FTAs should be limited to raw materials and not for finished goods to provide level playing field to domestic manufacturer of the finished goods.

2.13.3. Used machinery imports to be discouraged

Advancement in processing machinery for enhancing the energy efficiency and productivity has happened in recent past. Under the compulsions to reduce the carbon footprint, processors in the developed world are replacing the older machines with new technology machines. Thus, used machinery from developed world is finding a way to developing world with an attractive price tag. Used-aged machinery population if allowed to increase will render the domestic processing industry inefficient to face global competition in long term. It is recommended that appropriate action should be taken to discourage imports of used machinery.

2.13.4. Reduce Customs duty

Domestic machinery is produced according to the contemporary technologies for improving productivity and energy efficiency, in order to enable processors to compete in the global markets. The most technology components are imported from Europe, USA and Japan. These imports attract 7.5% customs duty.

- Following Tariff Head (highlighted yellow in above table) wherein Customs duties were reduced to 2.5% from 7.5% for selected machine Tools (CNC Lathe & Machining center) in 2015-16 budget, later extended to all Machine Tools in 2016-17 budget.



- CNC Systems (HS Code 8537 1000),
- Ball Screws (HS Code 8483 4000)
- Linear Motion Guides (HS Code 8466 9390)

- It is requested to consider this customs duty reduction applicable to all machinery manufacturers using these components.
- Commodity with HS code and existing duty structures are given in the table below. A duty reduction on imports of all these components to make Indian manufacturers competitive is also suggested:-

Commodity	**HS Code**	**Existing Rate of Duty Applicable**		
		Custom Duty	**IGST**	**Social Welfare Tax**
Ball Screw	84834000	7.50%	28.00%	10.00%
Bi-Metallic Barrel	84779000	7.50%	18.00%	10.00%
Contact Less Transducers	90319000	7.50%	18.00%	10.00%
Electronic Control	85371000/85372000	7.50%	28.00%	10.00%
Electronic Variable Volume Pump	84135090	7.50%	28.00%	10.00%
Fixed Volume Pump	84136010/84136090	7.50%	28.00%	10.00%
Graphite Bushings	84833000	7.50%	18.00%	10.00%
High Precision Bearing	84828000	7.50%	18.00%	10.00%
High Torque Hydro Motors	84122990	7.50%	28.00%	10.00%
High Wear Resistance Pad	73259910	7.50%	18.00%	10.00%
Hydraulic Valves	84812000	7.50%	28.00%	10.00%
Linear Motion Guide	84818090	7.50%	18.00%	10.00%
Load Cell	90319000/90269000	7.50%	28.00%	10.00%
Lubrication System	84133090	7.50%	18.00%	10.00%
Power Supplies	85044010	7.50%	28.00%	10.00%
Variable Frequency Drive	85013310/85015290	7.50%	28.00%	10.00%
Automation Components	9031	7.50%	18.00%	10.00%

2.13.5. Correction in unit of measure for HS code 8477 9000

Parts of plastics processing machineries falling under HS code 8477 9000 having unit of measure as Kg, however most of these parts are procured in number of units. Hence, a correction in unit of measure for 8477 9000 from Kg to Number of units is suggested.

NON-FERROUS METALS

I – COPPER

CUSTOMS

2.14.1. Reduce Basic Custom Duty on Copper Concentrate (HS Code 260700)

The Indian Copper Industry is under a compulsion to source a major quantity of Copper Concentrate through imports on account of its limited availability in India. The domestic availability is merely 4% of the total requirement. Thus, import of copper concentrate by the domestic copper industry is inevitable. In the last seven years i.e. since financial year 2011, market share of copper imports has grown from 14% to 37% in financial year 2018, whereas the Indian primary producers' market share has been continuously on reducing trend. In real terms, the imports have increased from 64 KT in FY11 to 242 KT in FY18 @ CAGR- 21%.

Given the non-availability of Copper Concentrate in India, there is no economic rationale to continue with Import Duty on Copper Concentrate and hence it is recommended that this is to be reduced (HS 2603) from 2.5% to Nil. This will enable the domestic industry to have a level playing field and compete with imports of value-added copper products from FTA countries under NIL duty.

2.14.2. Removal of exemption for Copper Rods used in Jelly Filled Telecom Cables

Jelly filled telecom cables (JFTC) is an important application where Copper Rod is used. However, when Copper Rod is imported for this application, it is exempt from payment of Customs Duty. This reduces the opportunity for domestic manufacturers to supply to this segment. Hence, it is recommended to introduce Customs Duty on imports against said application of JFTC @ 5%.

II - ALUMINUM

2.14.3. Reduce customs duty on non-fuel grade Petroleum Coke

The import duty on calcined petroleum coke was increased from 2.5% to 10% on 14.12.2017 to restrict import of CP Coke used for fuel purpose, which resulted in increase in custom duty for Non Fuel Grade Petroleum Coke also, since both fuel and non-fuel grade Petroleum Coke are under the same classification (HS Code 2713), which does not differentiate between Fuel Grade and Non-Fuel Grade Petroleum Coke. It has resulted into inverted duty structure as 10% duty on CP Coke is more than the duty on its finished product, aluminium metal (7.5%). Aluminium industry uses Non-Fuel Grade Calcined Petroleum Coke, which is a crucial raw material used for aluminium production as a feedstock/process raw material and is not used as a fuel. It is therefore, recommended that the import duty on non-fuel Grade Petroleum Coke should be restored back to 2.5%.

2.14.4. Reducing Import Duty on Caustic Soda to 2.5%

Caustic Soda Lye is one of the major raw material for production of Alumina, which is further used for production of Aluminium. India is a net importer of caustic soda due to its domestic non-availability. Aluminium industry is one of the largest importers of caustic soda, and imports almost 100% of its requirement. Hence, it is recommended that the import duty of Caustic Soda Lye should be reduced and rationalized from 7.5% to 2.5%.

2.14.5. Reducing Import Duty on Aluminium Fluoride (HS Code 2826 12 00)

India is a net importer of Aluminium fluoride (AlF3), and Aluminium industry imports approx. 100% of its requirement. There is inverted duty structure as the custom duty on AlF3 is 7.5%, i.e. same as duty on Aluminium metal. It is recommended that the import duty on Aluminium Fluoride should be reduced and rationalized from 7.5% to 2.5%.

2.14.6. Reduce import duty of carbon anodes from 7.5% to 2.5% (HS Code 3801 90 00)

The carbon anodes are used during the electrolysis process of Aluminium production. 460 kg Anode is consumed for production of one ton Aluminium metal. As the anodes are not produced domestically for commercial purpose, Aluminium producers are sourcing these through imports to meet domestic requirement. Hence, it is recommended that the import duty of Carbon Anodes should be reduced and rationalized from 7.5% to 2.5%.

2.14.7. Removal of Import Duty on Calcined Alumina (HS Code 2818 20 10)

Alumina is a primary raw material for Aluminium production constituting approx. 40% of production costs of Aluminium metal. Almost 30% of domestic requirement is met through imported Alumina. In last one year, the alumina prices have increased from as low as $270/ MT to around $450/MT currently, with highest of $690/MT. The increased alumina prices have increased aluminium production costs by more than $400/MT. The high import duties on raw materials has a huge disadvantage for domestic aluminium producers which are dependent on imported raw materials, rendering Indian finished goods costlier and uncompetitive in international markets, and discourages domestic value addition within the country.

Being the primary raw material, it is recommended that the import duty on Alumina should be eliminated and rationalized from 5% to Nil to ensure cheaper raw material availability for domestic industry.

2.14.8. Reducing Import Duty on Coal Tar Pitch to 2.5% (HS 2708 10 90)

Coal Tar Pitch is a crucial raw material used as a binding material for Carbon Anodes which are further used for electrolysis process in Aluminium production. Aluminium industry is a major industrial consumer of CT Pitch in India, consuming a substantial quantity of total imports as well as the domestic production of CT Pitch. Hence, it is recommended that the import duty of Coal Tar Pitch to be reduced and rationalized from 5% to 2.5%.

2.14.9. Rationalization of Import Duty on aluminium and its products

Due to unregulated import of aluminium scrap and cheaper imports from China and FTA partners, domestic industry has witnessed continuous surge in imports over the last few

years. Between financial year 2011 and financial year 2018, imports market share has increased from 40% to 54%. Hence, it is recommended to increase the customs duty on following products:

HS Code	Description	Current Duty	Requested Duty
7601	Primary Aluminium	7.5%	10%
7602	Aluminium Waste and Scrap	2.5%	10%
7603 to 7607	Downstream Aluminium Products	7.5%	10%
7608 to 7616	Downstream Aluminium Products	10.0%	12.5%

This will restrict imports and increase domestic capacity utilization thereby generating employment and boosting government's visionary Make in India initiative.

POWER

DIRECT TAX

2.15.1. 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. The companies engaged in development of power plants were eligible for deduction under section 80-IA of the Act. However, the same is set to expire on 31st March 2017. The Finance Act 2016 has allowed investment linked deduction for the capital expenditure incurred on "infrastructure facility" by inserting provision in section 35AD of the Act. However, the definition of 'infrastructure facility' as per section 35AD of the Act does not include power sector and hence companies in the power sector will be deprived of any such benefit under section 35AD of the Act. The definition of 'infrastructure facility' specifically includes road, railways, housing, water supply project, port, airport, inland waterway etc. hitherto being eligible for deduction under section 80-IA of the Act. Considering the thrust of the government on "power for all" this is certainly not intention for the sector which is already reeling under cost escalation due to GST, resulting in higher price to the consumer.

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. Sub-Section (12) of section 80-IA of the Act 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. However, sub-section (12A) was inserted in Section 80-IA of the Act 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.

Recommendation

To keep parity and growth of infrastructure which is one of the priority areas of the Government, it is suggested that generation or generation and distribution of power covered by provisions of section 80IA of the Act should also be covered by section 35AD of the Act. Alternatively, it is suggested that the benefit of deduction under section 80IA of the Act be continued for power sector undertakings and appropriate amendments be made in section 80-IA of the Act. It is further suggested that section 80-IA(12A) of the Act be deleted to enable restructuring of eligible entities or 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.

PAPER AND PAPER BOARD

CUSTOMS

2.16.1. Increase Customs Duty on Paper and Paperboard

The domestic paper and paperboard industry has already made significant capital investments to ramp-up capacities, the gestation period is long and the economic viability of the investments are impacted significantly by availability and cost of raw materials and other inputs. Even as the industry is grappling with the issue of producing paper and paperboards at competitive costs, the problem has been exacerbated by the Government's policy of extending preferential tariff treatment to paper and paperboards under the FTAs and other bilateral and multi-lateral trade agreements and pacts. 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. Under the India-Korea CEPA, the basic customs duty was also progressively reduced and became 0% with effect from 01.01.2017.

Thus, whilst domestic industry is operating under extremely challenging conditions, substantial quantities of paper and paperboard is imported in to the country at significantly lower costs. This is bound to discourage investments towards capacity enhancement by the domestic industry, notwithstanding the fact that such investments will be necessary to cater to the expected growth in demand for paper and paperboards. The inevitable consequence of drop in investments will be a multiplier adverse impact on the Indian farmer community with whom the industry has strong linkages and a significant outflow of foreign exchange towards increased imports of paper and paperboards.

In order to provide a level playing field to the domestic industry it is recommended that:

a) the Customs duty for import of Paper and Paperboards should be suitably increased from the current level of 10%,

b) this category be kept in the Negative List (i.e., no preferential treatment) in bi-lateral and multi-lateral trade treaties and agreements.

Others

2.16.2. Incentives for Investments in Environment Friendly "Clean" Technologies by Paper Industry

The broad policy framework on environment and climate change in India is laid down by the National Environment Policy (NEP) 2006 which aims to chart the way forward to meet the Government's bold announcements in the energy domain like target of reduction of emissions intensity by 33%-35% by 2030 over 2005, share of non-fossil fuel based capacity in the electricity mix aimed at above 40% by 2030 etc. India has a definite plan of action for clean energy, energy efficiency in various sectors of industries, a major thrust to non-fossil based electricity generation and a building sector based on energy conservation. In this context, NITI Aayog, Government of India has published the 'Draft National Energy Policy' to enable meeting the goals of renewable energy capacity, emission intensity and non-fossil fuel share in the electricity mix of India in the year 2030.

Today technology in the area of Energy conservation stands out as one of the critical factors in achieving sustained competitiveness for the Indian Pulp, paper and paperboard Industry. This calls for substantial investments in green and unconventional energy based technologies such as High Energy Soda Recovery Boiler, Elemental Chlorine Free pulp manufacture, Ozone bleaching etc. to ensure a positive environmental footprint.

The domestic manufacturers are consciously focusing on inducting unconventional energy usage and clean technologies which involve significant capital investment, to ensure:-

- Reduction of carbon foot print and save fossil fuel
- Improve performance in the area of environment

These low yielding investments however impact the profitability/viability of the business. It is submitted that appropriate fiscal incentives should be provided in order to encourage manufacturers within the industry to adopt environment friendly "clean" technologies that ensure, inter-alia, reduced carbon footprints, better emission norms, better effluent treatment norms, usage of renewable sources of raw material and energy, improved waste recycling, etc.

It is recommended that:-

(i) Import of capital goods required by the Paper & Paperboard industry for technological up-gradation in the area of Unconventional energy usage and adoption of clean/green technology (e.g., High Efficiency Soda Recovery Boiler, Elemental Chlorine Free pulp manufacture, Ozone bleaching etc.) specially aimed at environmental protection (e.g. saving fossil fuels, reduction of carbon foot print etc.) - be permitted at 'Nil' rate of Customs Duty.

(ii) Following additional benefits may be provided for paper board industry for investing in such clean technologies:

a. Entitlement for import of all raw materials at a 50% concessional rate of duty.

b. Exemption from Goods and Service Tax for paper and paperboard produced using clean technology or alternate suitable refund mechanism of taxes paid (similar to exports).

c. Accelerated tax depreciation @ 150% of the normal depreciation rates under income tax laws for investments on environment friendly technology.

(iii) Extend the benefit of Section 80-IA of the Income Tax Act, for any new investment in the above areas on or after 1st April'2017 including investment in Renewable Energy sources.

(iv) Exports by manufacturers who have adopted environmentally friendly technology are granted additional incentives in the form of cash incentive of 5% of FOB.

TEXTILES

CUSTOMS

2.17.1. Removal of Import Duty on Dissolving Grade (DG) Pulp (HS Code 4702.0000) (Inverted Duty Structure for ASEAN)

Soft Wood Dissolving Grade Pulp is not available in India due to tropical weather conditions and per se has to be imported from temperate countries in Europe, North America, South Africa, etc. Soft Wood Pulp is highly essential to produce high quality Viscose Rayon. Further, the current domestic capacity of Hard Wood Pulp is approximately 2,11,000 MT as against a requirement of approximately 5,00,000 MT thus resulting in more than 55% shortage of DG Pulp. To overcome this shortfall, the domestic industry is compelled to import from Europe, North America, South Africa and also from ASEAN region like Indonesia. Viscose Fibre imports from ASEAN have NIL duly under ASEAN FTA, while pulp has 2.5% duty making it a case of Inverted duty structure. It is therefore recommended that the Import Duty on RGWP be brought down to NIL.

FAST MOVING CONSUMER GOODS

2.18.1. Inverted Duty Structure – Indigenous Manufacture of Soap Noodles/Soap

Lauric Acid (HSN 2915 9090) is an essential ingredient for manufacture of soap noodles. It is sourced primarily from Malaysia and Indonesia and attracts Customs Duty @ 7.5%.

Toilet and Soap Noodles and Soaps, on the other hand, attract 'Nil' Customs Duty under the aegis of the Indo - ASEAN FTA which covers several countries including Malaysia and Indonesia.

Consequently, indigenous manufacture of soap noodles/soap has a higher tax cost than import of soap noodles/soap from ASEAN countries.

In order to provide a level playing field the Government, vide Notification No. 12/2014 dated 11th July 2014 was pleased to exempt from Customs Duty all goods (under HSN 3823 11,12,13 & 90 and 2915 70) used in the manufacture of soaps and oleo chemicals. Unfortunately, Lauric Acid (HSN 2915 90) – a key ingredient of soap manufacture – was not covered by the said notification.



It is recommended that in order to eliminate the inverted duty structure by virtue of which indigenous manufacture of soap noodle/soap is more expensive than import of these goods from ASEAN, Lauric Acid (HSN 2915 70) is also exempted from Customs Duty.

2.18.2. Allow imports of Polyethylene resin (PE resin) at a concessional rate of duty [Mega Notification No. 50/2017]

Currently the PE resin grade attracts 7.5% Basic Custom Duty. Manufacturing industries in India are importing new PE Resin Technologies into India. The import of new resin is primarily being planned to reduce the plastic packaging thereby reducing the plastic waste and promoting environmental safety. These flexible packaging laminates are used in various manufacturing industries including FMCG for use in packing of finished products. These new PE resin technologies are largely being imported from the Gulf countries. The following three grades of resins are imported from Borouge UAE with HS Code 3901.90.90:

a. FB 2230 (Borstar technology bimodal LLDPE resin)

b. FB 1350 (Borstar technology bimodal LLDPE resin)

c. FK 1820 (Borstar technology bimodal Metallocene LLDPE resin)

These new technologies help on protection of degrading natural resources and it is appropriate to country's context as it is environmentally effective, cost efficient. Overall, this would strive to reduce waste from manufacturing operations. It does not result into any kind of damage to the quality of product for which such packaging material would be used.

Middle East traditionally has lowest cost of Polyethylene resin and Asian countries like India has the best cost of converting the resin into film. It's a perfect match and surely suits the current theme of "Make in India" as the country can then use them domestically and/or export the finished polyethylene film to any part of the world at a very competitive price.

These types of resins are also manufactured in Singapore where Indian Government has given the preferential duty treatment of less than 1% under India- Singapore FTA. As there are no local manufacturers, reduction of custom duty will not impact the domestic manufacturer. Secondly, the concession being asked is limited to specific end use and therefore will not result in revenue loss in general.

The actual user condition can be monitored by the revenue department as to the actual use of these resins into specified packing materials. The manufacturing of end products can be checked by monitoring the IEM's and therefore, the necessary system to check the use of resins for manufacturing of packing material for specified end products is already in place.

Recommendation

It is recommended to include PE resins under Mega Notification No.50/2017 as amended allowing import of these resins at "Zero Basic Custom Duty" subject to condition that these resins would be utilized for manufacturing, of flexible packaging laminates required for manufacture of products listed in the IEM of the respective manufacturing industries.

EDUCATION

2.19.1. School Education

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

B. Set up new autonomous specialized research and training institutes with focus on areas such as standardized assessments, leadership, pedagogy etc.

C. 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.

D. Increase 50 per cent spending on the teacher education scheme as this is critical for strengthening teacher education institutes across states.

E. Rs. 10000 crores per year allocation on making smart device available to each student and teacher free of cost under SarvaSikshaAbhiyan.

F. Build technical capacities of existing central institutions such as NCERT, NUEPA, IGNOU, CIET and NIOS.

2.19.2. Higher Education

A. Rs 10000 crore should be allocated over 3 years to create 5 million scholarships@ Rs 20,000 each for admission in HEIs for all students whose parental income is less than 5 Lakhs/annum, irrespective of gender, religion, caste or any other identity.

B. An outlay of Rs 1000 crores per yearshould be allocated to network all public and private institutions with appropriate bandwidth.

C. Rs. 1500 crores should be spend on creating multilingual, multi- format content in languages for which we do not have software.

D. Rs. 5000 crore public spend over 3 years to set up National Science, Humanities, and Technology Research Foundation to fund research. All donations (and not just restricted only to research funding) to qualified Higher Educational Institutions should be eligible for 200% tax deduction.

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

F. 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.

G. 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.



MEDIA & ENTERTAINMENT

2.20.1. Direct Tax

- The Indian film exhibition industry is largely untapped with less than 1/5th number of screens present in developed markets such as the US and China. This is despite India being the largest producer of movies in the world and the second most populated state at the same time. While there has been de-growth in screen-counts in India over the past few years, China has recorded phenomenal growth which can partly be attributed to a lower tax rate. Tax incentives in the form of tax holiday period, lower rates, weighted deductions, subsidies etc. for the film exhibition industry (for instance similar to the one in section 80HHF of the Income tax Act 1961 which has been discontinued) be provided, in order to increase penetration of the exhibition industry in Tier 2 and 3 cities.
- The Indian sports segment is now under limelight with increasing league-based events taking place in the country. However, the lack of infrastructure facilities not only in rural but also in urban areas continue to be a cause of concern. The fact remains that the sportspersons in India have to look beyond India's shores for accessing world-class training facilities. It is about time that a boost is provided for development of sports infrastructure in India.
- In order to ensure development of this evolving sector, the tax benefits need to be extended to M&E players as well. Illustratively, carry forward and set off of losses in case of amalgamations. With the convergence of M&E sector on the horizon extending the tax benefit to the M&E sector would provide a boost to consolidation among media players and keep their growth engine viable.
- Definition of royalty under the Income tax Act 1961 specifically excludes consideration for the sale, distribution or exhibition of cinematographic films. The law was made when non-theatrical rights were not in existence but now with the advent of digital age, there are various non-theatrical ways to exploit film rights as well. There is ambiguity as to whether grant of non-theatrical rights also form part of the exclusion and clarity around this would be much appreciated. Clarity in the definition of royalty pertaining to sale, distribution or exhibition of cinematographic films be provided.
- Rule 9A and Rule 9B of the Income Tax Rules permit deduction of expenditure incurred on production of films and acquisition of film distribution rights respectively based on when the copyrights/distribution rights in films are exploited or depending on the date of release of the film. However, the provision is an old one which requires changes in light of the recent trends for instance films which are showcased on the digital platform. There are several ambiguities surrounding the applicability of the aforesaid Rules (applicable to satellite, music), scope of its applicability on expenses (only revenue or both capital and revenue), etc. to name a few. It could be clarified that these Rules could be extended to movies produced on digital platform and also remove ambiguity regarding its applicability to satellite, music etc.

DIRECT TAXES

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

Issues

- Businesses today are faced with high tax cost leading to increased cost of production and resultant lower surplus for reinvestment and expansion. The basic corporate tax rate of 30 percent coupled with dividend distribution tax rate of 20% makes the effective tax cost for an Indian company too high. The Government has phased out the tax incentives, the reduction in corporate tax rate has been limited only to companies with certain turnover. With many key global economies going for significant rate cuts, there is a need for India to consider across the board rate cuts for businesses. The historic tax reform legislated by US that cuts the corporate tax rate from a top rate of 35% to 21% is noteworthy. This will make the United States more competitive in attracting foreign investment, technology and other areas. It is very important that India should reassess its tax rate to maintain competitiveness in the global market.
- The Government through the Finance Act, 2018 choose to restrict the reduction in tax rate to companies having turnover uptoRs. 250 crores in the financial year 2016-2017, thus putting huge strain on companies not falling within the prescribed turnover criterion.
- 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. Providing lower tax rate only in case of companies may discourage the small and medium businessmen to do business through partnership firms/ LLPs which are otherwise popular forms of doing business in India.
- The benefit of reduced corporate tax of 25% in case of company having turnover or gross receipts not exceeding Rs.250 crores will not be available to the newly incorporated company in financial year 2017-2018. It would be unfair if the benefit of reduced tax rate is not allowed to these companies merely because they started operations in the financial year 2017-2018.
- The increased rate of surcharge coupled with "Health and Education Cess" makes cost of doing business in India significantly high. The increased tax cost adversely impacts the investors' sentiments and economic growth

Recommendations

- It is recommended that the Government should reduce the corporate tax rate across the board to 25% (irrespective of turnover). It would spur economic growth and increase



overall tax collections.

- 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 suggested that the reduced tax rate of 25% should be extended to companies who have started business either during the financial year 2017-18 and if their total turnover/gross receipts in the first year of operation do not exceed Rs. 250 crores.
- The Government should clarify and extend the benefit of reduced tax rate of 25% to those entities that existed as firms during the financial year 2016-17 and subsequently converted into companies.
- It is further suggested that the MAT on such companies should also be reviewed/reduced to make the relief truly meaningful.
- 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 consider removing the levy of surcharge and cess on corporate and non-corporate taxpayers.

3.2. 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.

Slab (Rs. lakhs)	Tax rate
0-3	Nil
3-5	5%
5-10	10%
10-20	20%
Beyond 20	30%

Further, levy of surcharge on individuals @ 10% and 15% having total income above Rs. 50 lakhs and Rs. 1 crore respectively should be completely abolished. It is believed that the increased surcharge on certain category of individuals distorts equity and tends to discourage entrepreneurship and incentivizes people to relocate to other locations.

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

Issues

- The purpose behind introduction of Minimum Alternate Tax ('MAT') was to bring all zero tax companies and to neutralize the impact of certain benefits/incentives. With



phasing out of exemptions and incentives under the Act, the 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. MAT has also diluted significantly the tax incentives offered under Chapter VI-A of the Income-tax Act,1961 (the Act) to eligible businesses and Industrial Undertakings as the difference between the effective tax rate based corporate tax rate at 30% and MAT at 18.5% is not very large.

- The Government and Reserve Bank of India are vigorously pursuing several measures to reduce Non-Performing Assets ('NPAs') through different debt restructuring schemes. Extreme measure of initiating insolvency proceedings against large borrowers through newly enacted Insolvency and Bankruptcy Code 2016 is also being pursued. The outcome of compromise or debt restructuring measures is likely to result in a situation where major part of debt owed by the borrower company may be waived by the lenders. The borrowing companies may consequently write back such liabilities in their books by credit to Profit & Loss statement as required by applicable Accounting Principles. It has historically been recognised that any gain/benefit which is derived by an assessee from an approved scheme of insolvency is kept outside the purview of MAT.However, under the current provisions of MAT, any waiver of loan or interest by banks/ NBFCs will trigger MAT liability since there will be a credit to the P&L account. Such tax costs in turn, could undermine the very purpose of IBC by making schemes costly and financially unviable. Such waiver of loan and interest should be excluded for the purpose of calculation of book profit as per section 115JB of the Act.
- 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 profit under section 115JB of Act. The said provision would adversely affect company which has huge book losses and less unabsorbed depreciation as they will have to pay MAT despite having ample amount of book losses thereby affecting their cash flows.
- 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 profit under section 115JB of the Act. The issue has created unwarranted litigation and needs to be resolved.
- 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.
- The MAT/AMT credit is allowed to be carried forward for 15 years for set-off but this period is generally not always sufficient. Many companies are not able to utilize MAT credit efficiently and within due time-limits provided.



- While computing book profits as per MAT provisions, non- taxable or exempt items are to be excluded as they do not reflect receipts of income nature. Hence, income exempt under section 10(38) of the Act should also not be added back while computing book profits.
- An eligible assessee can claim deduction under section 32AC of the Act while computing income under the normal provisions of the Act. However, presently, the assessee may have to pay MAT on the same though being eligible for the deduction under normal provisions of the Act diluting the benefit intended to be provided by the Government.
- 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 21.54% on foreign dividend due to applicability of MAT provisions as against the effective rate of 17.47% 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.
- Section 115JB(7) of the Act states that where the assessee is a unit located in an International Financial Service Centre ('IFSC') and derives income solely in convertible foreign exchange, a lower MAT rate of 9% shall apply as compared to the present MAT rate of 18.5%. The Memorandum to Finance Bill 2016 states that the MAT rate applicable to a unit located in an IFSC has been reduced to 9% in order to provide a competitive tax regime to the IFSC. It is believed that the current MAT rate does not make the Indian IFSC globally competitive.
- There is an impact of applicability of Ind AS 115 on real estate sector since there is a switchover from Percentage of Completion Method ('POCM') to Project completion method ('PCM'). Ind AS 115 suggests a control model of revenue recognition over a risk and rewards model. Since in case of real estate the control over property is passed on to the customer only on final delivery of apartment the revenue is recognised in that particular year only. Whereas under the current provisions of the Act and ICDS on revenue recognition, the real estate companies may have to offer income to tax of POCM basis. Given the wide difference in accounting treatment and tax treatment, there is a possibility of double taxation once under the normal provisions and then MAT.
- Impact of IND-AS 115 on construction contracts: IND-AS 115 as on the transition date from 1 April 2018 requires creating provision for Expected Credit Loss (ECL provision)



on the contract asset (i.e.; where the entity has transferred goods or services before the payment is due). At the transition date the ECL provision is to be debited to retained earnings. Subsequently, the provisions may need to be written back or may need an actual write off. When the provision is written back, there is a credit to P&L account, however, there is no real income as it is merely reversing the provision. When the provision requires an actual write off, there will not be a debit to P&L and hence, claiming the same as deduction will become a challenge.

Deductibility of income and expense has to be based on the well settled principles of real income theory. Notional income should not be taxed whereas as real and genuine loss should not be disallowed merely on the basis that there was no debit to Profit & Loss account. The issue is illustrated as under:-

A Co has to make ECL provision of Rs. 100 as on the date of transition given that it has contract asset of Rs. 1,000 (which represents that goods and services have been provided before the payment is due). The accounting entry for the same will be as under:

Retained Earnings..... 100

Provision for ECL... 100

Subsequently, when the payment is due and the debtor has paid off, the provision will needs to be reversed and the accounting will be as under:

Provision for ECL.... 100

Profit & Loss..... 100

In the above case, there will be a credit to P&L, however, it represents notional income as it is merely reversal of provision. The same would suffer taxation under MAT as there is no corresponding adjustment provided under section 115JB. The taxation of the contract amount being Rs. 1,000 will be taxable separately as per the accounting and the Rs. 100 (being the reversal of ECL provision) may also get taxed. This will lead to double taxation.

Subsequently, when the payment is due and the debtor has defaulted to the extent of Rs. 100, there is an actual loss to the extent of Rs. 100. However, the accounting entry would be as under:

Provision for ECL.... 100

Debtor..... 100

In the above case, while the taxpayer has actually incurred losses, in absence of any debit to P&L, the same can be disallowed for MAT purposes. Hence, in order to avoid litigation, it is recommended the provisions of section 115JB of the Act should be amended to provide the effect of the above.

- As per clause (f) of Explanation 1 to Section 115JB of the Act, expenditure relatable to exempt income which is debited to the profit and loss account needs to be added back



for the purpose of computation of book profit under Section 115JB of the Act. However, it has been observed that the deeming provisions of Section 14A of the Act read with Rule 8D of the Income Tax Rules, 1962 ('the Rules') are applied by the tax officers to disallow the expenditure incurred in relation to exempt income for the purpose of computing the book profit under Section 115JB of the Act. The law is settled today that only adjustments as provided in Explanation 1 to section 115JB of the Act are allowed to determine the book profit for the purpose of MAT. The practice adopted by the tax officers in disallowing expenditure as per deeming provisions of section 14A read with Rule 8D of the Rules is against the provisions of Section 115JB of the Act and result into disallowance of expenditure in excess of the expenditure actually incurred and debited to the profit and loss account.

- The tax on perquisite borne by the employer is wrongly being interpreted as 'income tax' by the tax officers in some cases for the purposes of adjustment to book profit as provided under Explanation 1 to section 115JB of the Act. It is emphasized that tax on perquisite is being paid by the employer on behalf of employee and does not fall within the purview of 'income tax' for the purposes of section 115JB of the Act.

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.
- Section 115JB of the Act should be amended to exclude waiver of loan and interest waiver credited to Profit and Loss account where the waiver is granted by banks or public financial institutions or NBFCs pursuant to any scheme framed under RBI guidelines or proceedings under Insolvency and Bankruptcy Code 2016. This will provide an additional fillip to entities to approach the Insolvency & Bankruptcy Board and will go a long way in achieving the objects of IBC and in reviving the distressed sector.
- 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.
- MAT on SEZ developers and units should be abolished.
- The MAT/AMT credit should be allowed to be carried forward and set-off without any time limit.
- It is suggested that profits which are exempt from levy of capital gains tax be also not taken as part of book profit for the purposes of MAT.
- The investment allowance @ 15% eligible for deduction under section 32AC of the Act should be reduced while computing book profit of the company under the provisions of section 115JB of the Act. It is recommended that dividend received from foreign company should be exempt from MAT just like domestic dividend is exempt from MAT.
- MAT should be abolished for a unit located in an IFSC to compete with tax breaks offered by IFSCs globally (e.g. Dubai (0%), Malaysia (3%).



- 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 profit. 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.
- Set off of MAT credit should be allowed in full (including applicable surcharge and cess paid on MAT).
- It is recommended that MAT should be made applicable to real estate companies or alternatively, ICDS on real estate to be notified and be aligned to the provisions of Ind AS 115.
- Section 115JB of the Act should be amended to provide that in case of provisions which are debited to retained earnings, subsequent reversal should not be taxable for MAT purposes and should be reduced for computation of book profit. Further, subsequent actual write off needs to be reduced for computation of book profit.
- A specific clarification should be issued to provide that the provisions of Section 14A of the Act read with Rule 8D of the Rules cannot be applied for the purpose of computation of disallowance of expenditure under clause (f) to Explanation 1 to Section 115JB of the Act. It further needs to be clarified that it is only the actual expenditure incurred to earn exempt income and debited to the profit and loss account which has to be added to compute the book profit under Section 115JB of the Act.
- It should be clarified that tax on perquisite borne by the employer on behalf of the employee is not to be considered as income-tax for the purpose of adjustments required as per Explanation 1 to section 115JB of the Act.
- It is recommended that Ind-AS fair valuation gains/losses recognised in P&L on tax neutral amalgamation/ demerger may be excluded from 'book profit'. The Government has already accepted the policy of not levying MAT on Ind-AS fair valuation adjustments by providing for a separate MAT framework for Ind-AS companies through Finance Act 2017 and hence, such exclusion would be in line with Government's policy.

3.4. Tax Rate for transactions done through mode other cash

Issue

In case of presumptive taxation regime under section 44AD of the Act it has been provided that lower rate of 6% would apply instead of 8% for receipts through account payee cheque drawn on bank or account payee draft or use of electronic clearing system through a bank account. The intent appears to be conceptually a push for digital transactions; however, there are certain digital modes of payment like mobile wallets, credit cards etc., which may still be not covered within the scope of the defined mode of payment (as they only cover transactions done by electronic clearing system through a bank account).

Recommendation

In all the sections introduced to promote digital economy, the mode of payment should be defined in such a manner that all non-cash transactions done through traceable mode should be covered within the ambit.

It is further suggested that benefit of lower rate of tax @ 6%, should also be extended for presumptive tax under section 44ADA (presumptive tax for professionals) and 44AE (presumptive tax for truck owners).

3.5 Issues – Dividend Distribution Tax, Deemed Dividend and Taxation of Dividend

3.5.1. 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 condition that the dividend should be received from a subsidiary is in a sense restrictive, as a company is stipulated to be a subsidiary of another company, if such other company, holds more than half in nominal value of the equity share capital of the company. The said condition is unlikely to be fulfilled by majority of the promoter companies which hold investment in operating companies listed on stock exchanges. Even shareholders of joint venture companies are impacted by the above restrictions. In both the scenarios, since the operating/joint venture company i.e. the company declaring the dividend is not a subsidiary of any company, the first condition i.e. dividend should be received from a subsidiary company is never fulfilled and accordingly when the promoter company/shareholder of joint venture company declares dividend to their shareholders, it cannot deduct the dividend so received from the operating/joint venture company for the purpose of payment of DDT.
- 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.
- The Finance Act, 2011 has also burdened the SEZ developers by including them in the scope of DDT.



- 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 infrastructural facility in India.
- Where dividend from subsidiary is received after dividend declared/ distributed/ paid by the holding company, difficulties may arise as to DDT liability computation. Holding company may either estimate its DDT liability without considering dividend to be received from subsidiary (which shall result in blockage of funds until grant of refund) or may consider estimate amount of dividend to be received from subsidiary company (which shall result in excess or shortfall of DDT on such date.

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. Thus, 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 should be avoided.
- 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 thecess, surcharge and grossing-up of the dividend). Alternatively, tax paid under section 115O of the Act should be allowed as credit against the tax payable by the shareholder.
- Since tax is already paid once at corporate level, lower tax rates should be applied to dividend income to partly alleviate double taxation. To provide relief to the shareholders, a deduction should be provided with a cap of Rs. 25,000 (on lines of section 80L). Further, where total income of an individual/ HUF shareholder is below the taxable limit, no TDS should be deducted on a declaration by the shareholder.
- To avoid the cascading impact of dividend income for companies, deduction should be given for inter-corporate dividends on the lines of erstwhile section 80M of the Act.



- To incentivize the investment in the 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. It is also recommended that further exemption from DDT be granted to the 'infrastructure capital company/fund' with the condition that it invests the dividend received from its subsidiary in the infrastructure projects.
- Since DDT payment is mandated within 14 days by section 115O(3) of the Act, it is recommended to amend section 115-O(3) of the Act in line with the provisions for payment of advance tax and interest thereon under section 234B and section 234C of the Act to safeguard interests of holding company in such genuine cases. Accordingly, the penalty provisions under section 271C of the Act and prosecution under section 276B of the Act should also be liberalised in this respect.

3.5.2. Cascading effect of DDT on dividend received from Foreign Companies-Section115O

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.
- Additionally, 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.

Recommendations

- The condition of more than 50 percent holding in Section 115-O of the Act needs to be aligned with the condition of 26 percent holding in case of Section 115BBD of the Act to enable less than 50 percent shareholding entities also to avoid the multiple taxation of dividends distributed.
- 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.

3.5.3. 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 levy amounting to third level of taxation on profits may be done away with. Alternatively, tax paid by the company under section 115-O of the Act should be allowed as a credit against the tax payable by the shareholder.

3.5.4. Application of Dividend Distribution Tax to Deemed Dividend

As per the amendment made by the Finance Act, 2018, Dividend Distribution Tax ('DDT') is made applicable on loans and advances qualifying as Deemed Dividend under section 2(22)(e) of the Act even in case of temporary deployment of funds within the group companies.

Issues

- Applicability of section 2(22)(e) of the Act in case of temporary deployment of funds to group concerns is an existing controversy. Several tribunal rulings1 have held that temporary deployment of funds to group concerns or where the loans/ advances are in the nature of current accommodation entries, the provisions of section 2(22)(e) of the Act are not applicable. However, there is no settled position.
- In case of group concerns, deployment of temporary funds may at times be required on account of business exigencies. It may be difficult to avail temporary funds at short notices from an external borrower. Additionally, the interest cost will be higher for the group as a whole.
- Where, loans and advances given to a shareholder as defined under section 2(22)(e) of the Act have been taxed under section 115-O of the Act, and subsequently profits have been distributed to such shareholder, the distributed profits would be taxed again under section 115O of the Act. However, there are no provisions for set off of DDT paid as "deemed dividend" and later when actual dividend is paid to provide credit for the DDT paid on the former transaction.

Recommendations

- Given that the intent of section 2(22)(e) of the Act is to tax distribution of profits to shareholders camouflaged as loans/ advances, it is suggested that appropriate clarification be provided by the Government that genuine case of deployment of funds, where the transactions are reversed within short period, the levy of DDT will not be applicable. Alternatively, where eventually the transactions are reversed in say

[1]M/s Bombay Oil Industries Limited vs DCIT [128 SOT 383 (Mum)]; Ravindra R Fotedar vs ACIT [(2017) 85 taxmann.com 314 (Mumbai - Trib.)]



subsequent year/s, a mechanism should be in place for the credit/ refund of the DDT.

- It is recommended appropriate amendment in the law should be made to provide for the set off of DDT paid.

3.5.5. Insertion of Explanation 2A in section 2(22) of the Act- Accumulated profits of amalgamating company included in accumulated profits of amalgamated company

Issue

With a view to prevent abusive arrangements whereby companies with large Accumulated Profits (AP) adopt amalgamation route to circumvent DDT levy on capital reduction, Finance Act, 2018, inserted Explanation 2A to Section 2(22) of the Act to provide that the accumulated profits for the purposes of DDT levy in case of an amalgamated company shall be increased by the accumulated profits of the amalgamating company as on the date of the amalgamation.

The amendment is applicable to each of the deemed dividend clauses specified in section 2(22)(a) to 2(22)(e) of the Act, and is applicable from AY 2018-19.

The determination of accumulated profits has direct impact on DDT liability of the company. DDT liability of the company under Section 2(22) of the Act is based on accumulated profits on the date of distribution or payment in respect of deemed dividend.

The amendments to Section 115-O regarding DDT liability have always been made on a prospective basis. The coverage of section 2(22)(e) within the scope of section 115-O by the Finance Act, 2018 has also been made applicable prospectively in respect of payment made post 1 April 2018.

It needs to be kept in view that amalgamations may have been concluded in a number of years prior to the date of distribution of dividend. Say, for example, a company which was established a century back may have undergone amalgamations decades back. A specific clarification may be provided that Explanation 2A is applicable in respect of amalgamations made on or after 1 April 2018.

Recommendation

Clarification should be provided that that the provisions of Explanation 2A of Section 2(22) of the Act apply to mergers made on or after 1 April 2018.

3.6. Phasing out of Deductions and Exemptions vis-à-vis industry needs

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

- There are various sectors (capital intensive; pharma; long term projects like SEZ's; etc.) where the turnaround time for the companies/products to reach a break even and start earning profits takes longer than some other industries. Some of the sectors would take long for the completion of projects for example deduction under Section 80-IA(4) of the Act dealing with development, operation and maintenance of an infrastructure facility, deduction under Section 80-IAB of the Act dealing with development of special



economic zone, deduction under Section 80-IB(9) of the Act dealing with production of mineral oil and natural gas, etc. Further, the phasing out of incentives/exemptions is also likely to impact the government's agenda of 'Make in India', 'Digital India' etc.

- 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. However, with phasing of incentives and deductions under the Act, the rate of MAT has not been reduced.

Recommendations

- The government and health care sectors as well have long gestation periods. There would be certain entities which would have recently commenced commercial operations, and will have to tackle phasing out much faster than anticipated and planned. This would have an adverse impact on the commercial viability as well as the profitability of the said entities. The doing away of weighted deductions could also impede the innovation process in case of certain sectors for e.g. the pharma, etc. and is likely to impact the government's 'Make in India' campaign. The process of phasing out of exemptions and deductions should not be done across sectors. Further the weighted deduction needs to be reinstated in case where it has been withdrawn. Thus, the phase out of deductions and exemptions should be applicable to select sectors based on long-term plans of the government to nurture the growth potential sectors considering a sensitivity analysis of the said sectors.
- 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.

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

The CBDT through its notification no. 87/2016 dated September 29, 2016 has notified revised ICDS (to be applicable from A.Y.2017-18).

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. ICDS along with IND-AS is creating burden for tax payers to prepare detailed and multiple reconciliations each year. The difference between principles of treatment of revenues and expenses between ICDS and IND-AS will necessitate taxpayer to have separate books maintained for tax purposes. Such unnecessary burden of compliance is unwarranted for taxpayers.



- ICDS was introduced to bring clarity and settle tax positions, however, to the contrary it has created ambiguities and some of the ICDS provisions are contrary to the settled tax principles.

Recommendations

- It is recommended that ICDS should be withdrawn.
- Alternatively, it is recommended that the ICDS which is currently based on the erstwhile Accounting Standards, be aligned to IND-AS to bring parity. This will have minimum variance between tax principles and accounting principles and there may not be any need to maintain separate tax books.

3.8. Place of Effective Management

The provisions of Place of Effective Management has been made effective from AY 2017-2018 (i.e. financial 2016-2017). However, the final notification under section 115JH of the Act for implementation of POEM was issued by the Government on June 22, 2018, applicable from AY 2017-2018. It is believed that very little time was left with the taxpayers to study and analyse the impact of these guidelines. POEM is a new concept introduced in the taxation laws in India and appropriate time needs to be given to the taxpayers to align with the new laws. In view of this, it is recommended that POEM should be made effective from financial year 2018-2019 (i.e. Assessment Year 2010-20). Further certain aspects as per Notification No. S.O. 3039(E) dated 22 June 2018 issued under section 115JH of the Act need to be clarified are mentioned below:-

Issues and Recommendations

- The final notification does not clearly clarify whether a foreign company triggering POEM in India is required to maintain books of accounts in India and also get the accounts audited as per the requirements of the Act.It is recommended that the foreign company not having a Permanent Establishment (PE) in India or which is not required to do any registrations under any law in India for the time being in force relating to companies, should be dispensed with maintaining separate books of accounts and tax audit requirements. The books and financial statements prepared as per the corporate law requirements of the foreign jurisdiction be adopted for tax purposes.
- The Finance Act 2016 provides (with retrospective effect from 1 April 2001) that MAT is not applicable to foreign companies which do not trigger PE as per the respective Double Taxation Avoidance Agreement ('DTAA') provisions or where there is no DTAA with India and the company is not required to do any registrations under any law for the time being in force relating to companies. A foreign company may trigger POEM but may not have a PE in India as per the DTAA. Clarity is required for applicability of MAT to such companies. It is recommended that the provisions of MAT should not be applicable to such companies as the requirement would be onerous and unwarranted.
- The provisions of Dividend Distribution Tax ('DDT') is applicable only in case of a domestic company, which is an Indian company or any other company which has made the prescribed arrangements for the declaration and payment of dividend in India. It



needs to be expressly clarified that the provisions of DDT are not applicable to such foreign companies who are treated as Resident due to POEM. It is recommended that appropriate clarification be issued in this regard.

- Given the language used, CBDT Circular No. 25/ 2017 dt 23 Oct 2017 may be interpreted as being applicable only to cases where the role played by the Indian Regional headquarters (RHQ's) employees are in relation to day-to-day or "routine" functions (and that too only if further the foreign company fulfils the Active Business Outside India test). Hence, where highly talented and senior Indian employees of RHQs perform not just a routine function but also participate in senior management functions like strategic or commercial decision-making activities, there is a risk of POEM being held to be in India, despite the Circular. Thus, it is requested that a suitable legislative amendment or specific clarificatory Circular be issued clarifying that the purpose of the POEM guidelines is not to capture income earned by the overseas entities of Foreign Multinational Group Companies or to tax in India their income from operations outside India , merely on the ground of certain employees of the Indian subsidiary having a regional role and multi-country responsibility or oversight over the operations in other countries of the region
- The clarification will be in line with the very intent for which the POEM guidelines were introduced, i.e. to target Indian groups having shell companies outside of India.

3.9. 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
    - 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.

- 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.

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.

(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.

3.10. 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 income 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[2] 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.

[2]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]



- 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 also no clarity on applicability of the levy on payment made by a branch of an Indian entity based outside India to a non-resident and also as to whether surcharge and education cess would be further applied on equalisation levy of 6%.
- 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.
- 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 charge scenario, applicability of levy on payment by branch of an Indian entity based outside India, applicability of surcharge and cess on the levy etc. 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.

3.11. 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.
- Ind-AS 109 provides that the Companies need to carry investment in equity shares (other than investment in Subsidiary, Associates and JV) at Fair Market Value. Also the Company may opt to revalue its investments in Subsidiary, Associates and Joint Venture at fair market value as per the option provided under Ind-AS 101. This exercise will lead to notional increase/decrease in the value of investment. Since computation of disallowance under section 14A of the Act read with Rule 8D of the Rules includes an

amount equal to 1% of the annual average of the monthly average of the opening and closing balances of the value of investment. It should be clarified that disallowance on account of section 14A of the Act has to be computed based on actual cost of investment to avoid any probable litigation on this account.

- As per clause (f) of Explanation 1 to Section 115JB of the Act, expenditure relatable to exempt income which is debited to the profit and loss account needs to be added back for the purpose of computation of book profit under Section 115JB of the Act. However, it has been observed that the deeming provisions of Section 14A of the Act read with Rule 8D of the Rules are applied by the tax officers to disallow the expenditure incurred in relation to exempt income for the purpose of computing the book profit under section 115JB of the Act. It has been even held by the Supreme Court that only adjustments as provided in Explanation 1 to section 115JB of the Act are allowed to determine the book profit for the purpose of MAT. The practice adopted by the tax officers is against the provisions of Section 115JB of the Act and result into disallowance of expenditure in excess of the expenditure actually incurred and debited to the profit and loss account.
- 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.
- It should be clarified that disallowance on account of section 14A of the Act has to be computed based on actual cost of investment.
- A specific clarification should be issued to provide that the provisions of Section 14A of the Act read with Rule 8D of the Rules cannot be applied for the purpose of computation of disallowance of expenditure under clause (f) to Explanation 1 to Section 115JB of the Act. It further needs to be clarified that it is only the actual expenditure incurred to earn exempt income and debited to the profit and loss account which has to be added to compute the book profit under Section 115JB of the Act.
- 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.

3.12. Tax on income from transfer of carbon credits – Section 115BBG

The controversy surrounding the taxation of income from the transfer of carbon credits has been going on for a while now. Introduction of section 115BBG to the Act providing for a 10% tax on income from transfer of carbon credits is a very welcome move. However, since the amendment is a prospective one, litigation for assessment years prior to AY 2018-19 may continue to fester. This coupled with the fact that the global market for carbon credits has all but collapsed and alternative bilateral offset mechanisms are being explored leads to unnecessary hardship for taxpayers.

It is suggested to extend the benefit of this 10% rate to earlier years also as it will go a long way towards furthering the Government's stated objective of curbing litigation as also supporting projects that have helped the global environment by reducing carbon emissions. To this end, for the periods prior to Assessment Year 2018-19, we submit that an option may be given to taxpayers to voluntarily offer income from transfer of carbon credits to tax at the same 10% rate as present in section 115BBG of the Act. This can help put an end to protracted litigation on the issue. Considering that such receipts have been held as non-taxable capital receipts by some High Courts, such a move will also benefit the exchequer.

An appropriate framework for this option (though a Scheme, Notification, Circular etc.) may be considered. This framework could, inter alia, provide that:

- The 10% tax rate is optional for taxpayers who wish to obtain finality on this issue without pursuing further appellate or judicial remedies.
- Such an option could be exercised by the taxpayer making a declaration with his jurisdictional Commissioner.
- Once such a declaration is scrutinised, no Tribunal or Court should proceed to decide any issue relating to taxation of income arising from transfer of carbon credits. In other words, all proceedings with respect to such issue should abate.
- No interest and penalty should be leviable on such taxes.

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

3.13.1. Depreciation – Section 32

Issues

There is no clarity on allowability of depreciation on finance lease transaction. In various judicial precedents 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. An option be provided to the taxpayer to either claim depreciation as "intangible asset" or claim amortised deduction as per the aforesaid circular.

- Current depreciation on plant and machinery @ 15% is too low. Need for Higher depreciation for plant and machinery.
- The accelerated depreciation ranging mostly between 80-100% was available for certain block of assets such as renewable energy devices, air pollution control equipment, energy saving devices, etc. upto AY 2016-2017. CBDT vide notification no. 103/2016, dated, November 7, 2016, has restricted the highest rate of depreciation 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. was 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%. 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.
- Additional depreciation under section 32(1)(iia) of the Act is currently not available to service industries.
- 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. Further, an option be provided to the taxpayer to either claim depreciation as "intangible asset" or amortised deduction as per the Circular No. 9 /2014 dated 23 April 2014.
- 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. This would also provide an impetus to the manufacturing sector.



- The Government should extend the additional 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'.

3.13.2. Deduction of ESOP Expenditure

Issue

ESOPs are granted to employees to reward/remunerate them for their contribution to the organisation and to retain talent. SEBI guidelines prescribe charging of ESOP discount in the books of accounts. This charge to P&L account has, however, been disallowed in majority of the cases by the assessing officers on the ground that it is capital expenditure, and is contingent in nature. This is contrary to SEBI guidelines and against the basic objective of an ESOP viz to motivate & keep employees committed to organisation.

Recommendation

Specific provision be introduced in the Act for allowing ESOP Expenses. Further, the principles regarding the determination of ESOP discount and its timing for claiming expense while computing taxable income under the Act should be clearly laid down to avoid any ambiguity

3.13.3. 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.

3.13.4. 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.

3.13.5. Disallowance - Section 40(a)

Issues

- The Finance Act, 2015 had brought an amendment in section 40(a)(ia) of the Act where in case TDS is not deducted on expenditure, such expenditure is disallowed to an extent of 30% while computing taxable income for the year. This amendment was a beneficial amendment as it reduced the disallowance from 100% to 30%. The provision is however applicable only to a situation where the payment is made to resident assessee and has not been extended in respect of payment made to a non-resident. In order to bring parity for the default of non-deduction of taxes, disallowance of 30% should also be brought in for payments to non-residents.
- 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 an amendment similar to section 40(a)(ia) of the Act to restrict disallowance to 30%, should also be brought in section 40(a)(i) of the Act for payments to non-residents.
- 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 .

3.13.6. Disallowance under section 40A(3)

Issues

- Section 40A(3) of the Act disallows deduction in respect of any expenditure if payment exceeding ten thousand rupees in a single day is made otherwise than by an account payee cheque drawn on a bank or account payee draft or use of electronic clearing system through a bank account. The intent appears to be conceptually a push for digital transactions; however, there are certain digital modes of payment like mobile wallets, etc., which are still not covered within the scope of the defined mode of payment (as they only cover transactions done by electronic clearing system through a bank account).
- Section 40A(3) of the Act does not restrict itself to transactions in Indian rupee but also covers cash payment in foreign currency. Companies do send their employees on business trips or for short duration assignments outside India or for supervising overseas projects. Incurring expenditure in case in excess of Rs. 20,000 outside India could be on account of the following:
    - High cost of living
    - Non-acceptance of travel cards/ credit cards at many places

The intention is not to evade taxes or carry out transactions in cash, it is only due to unavoidable circumstances that expenditure is required to be incurred in cash outside India. Triggering disallowance under section 40A(3) of the Act in such cases will lead to undue hardships to the taxpayers who have operations outside India.

Recommendation

- The mode of payment should be defined in such a manner that all non-cash transactions done through traceable mode should be covered within the ambit.
- Relaxation may be provided in Rule 6DD of the Rules where cash exceeding Rs. 20,000 is used in foreign country by employees on behalf of the company having regard to various factors such as high cost of living, non-acceptance of card, etc.

3.13.7. 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.

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.

3.13.8. Allowability of 100% Head Office Administrative Expenses

Issue

- Section 44C of the Act provides restriction for deduction of head office expenditure in case of non-residents to the extent of 5% of the adjusted total income.

Recommendation

It is recommended that 5% cap on deductibility of Head Office Administrative Expenses as provided in section 44C of the Act should be removed and deduction may be allowed based on arm length principles and transfer pricing provisions.

3.13.9. 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.

3.14. General Anti Avoidance Rule - Chapter X-A

3.14.1. GAAR provisions should not apply when a tax treaty contains the Principal Purpose Test (PPT)/ Limitation of Benefit (LOB) clause

The FAQ's issued by CBDT on 27 January 2017 while dealing with the question on whether GAAR would be applied to deny treaty eligibility in a case where there is compliance with (Limitation of Benefit) LOB test of the treaty, clarified as follows

Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR……(emphasis supplied).

Whether the case of avoidance has been sufficiently addressed may further involve an element of subjectivity as the term 'sufficiently addressed' has not been explicitly defined and there could be an unintended situation where the case would be subjected to both the rigors of the anti-abuse provisions as well as GAAR.

It should be provided by way of an exception that when an arrangement/transaction is subjected to the anti-abuse provisions [particularly the LOB and PPT provisions] dealt with by the tax treaty between India and the respective country, the same should not be further subjected to GAAR provisions.

3.14.2. Overlapping of the GAAR provisions with the anti-abuse provisions introduced through the Multilateral Instrument

India has signed the 'Multilateral Instrument' (MLI) in accordance with the BEPS Action Plan 15 of the OECD, which, inter alia, deals with the denial of tax treaty benefits in certain cases of anti-abuse arrangements/transactions entered into by the taxpayer. The MLI provides for insertion of anti-abuse provisions (the PPT and the LOB provisions) in the tax treaties so as to deny tax treaty benefits in case of abusive arrangements/transactions being entered into by the taxpayer. The anti-abuse provisions inserted through the MLI would be effective once the same are ratified by both the signatories to the MLI. With India having signed the MLI, there could be a possibility that the same transaction/arrangement could be subjected to multiple anti-abuse provisions, one would be through the anti-abuse provisions inserted in the tax treaty network through the MLI and second by way of the same transaction being subjected to the GAAR provisions which also targets anti-abuse provisions.

It is suggested that GAAR provisions should not be made applicable to abusive transactions (in the case of Multinational enterprises {MNE's}) which are subjected to anti-abuse provisions under the tax treaty pursuant to the adoption of the MLI provisions. Once the anti-abuse provisions are inserted in the respective tax treaties through the MLI, the government could then assess the situation and examine if GAAR provisions should be made applicable in the case of the said non-resident taxpayers' (MNE's). This would also pave the way for a conducive economic environment and persuade the global multinationals to



establish their footprint in India with clarity on the domestic tax laws prevalent in the country.

Further, it should be clarified that the provisions of Multilateral Instrument (for instance, the Principle Purpose Test) should not be resorted to in order to take away the benefit of grandfathering granted under Rule 10U (in respect of income from transfer of investments made before 1 April 2017).

Further, it is recommended that suitable safeguards (similar to those present in GAAR provisions) should be put in place for invocation of PPT. This will alleviate the widespread concern of the taxpayers that PPT will be invoked by the tax authorities without satisfying the checks and balances as provided in the GAAR provisions.

3.14.3. The meaning of the terms 'Substantial' and 'Significant' in Section 97(1) of the Act

Section 97(1) of the Act provides that an arrangement shall be deemed to be lacking commercial substance, if inter alia;-

- it involves the location of an asset or of a transaction or of the place of residence of any party which is without any substantial commercial purpose other than obtaining a tax benefit for a party; or
- it does not have a significant effect upon business risks, or net cash flows apart from the tax benefit.

  The terms 'substantial commercial purpose' and 'significant effect' in the context of GAAR have not been defined in the Act.

Recommendations

- It needs to be clarified what shall constitute as "substantial commercial purpose' and "significant effect' for the purpose of section 97 of the Act.
- Substantial commercial purpose may be explained with reference to the terms used viz. location of an asset/transaction or place of residence of a party (for e.g. specified value of assets located; value of a transaction as comparable to the total assets of the business or any other such related parameter).
- Similarly, what will constitute as 'significant effect' vis-a-vis business risks/net cash flows needs to be clarified.

3.14.4. Clarification on the term 'tax benefit' as defined under section 102(10) of the Act

The term 'tax benefit' as defined under section 102(10) of the Act includes,—

*"(a) a reduction or avoidance or **deferral of tax** or other amount payable under this Act; or*

(b) an increase in a refund of tax or other amount under this Act; or

(c) a reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or



*(*d*) an increase in a refund of tax or other amount under this Act as a result of a tax treaty; or*

*(*e*)* ***a reduction in total income; or***

*(*f*)* ***an increase in loss,***

*in the relevant previous year or any other previous year;"****(Emphasis supplied)***

Clause (e) and (f) in the definition refer to "reduction of total income" and "increase in loss" as tax benefit. An ambiguity arises as to how tax benefit is conditioned at income/loss level. This may also defeat the objective of Rs. 3 crore tax benefit threshold as provided in Rule 10U of the Income-tax Rules, 1962 (the Rules).

Computation of tax benefit on deferral of tax (which is merely a timing difference) needs to be clarified. As observed by the Expert Committee[3], in cases of tax deferral, the only benefit to the taxpayer is not paying taxes in one year but paying it in a later year. Overall there may not be any tax benefit but the benefit is in terms of the present value of money.

Further, as observed by the Expert Committee[4], the term tax benefit has been defined to include tax or other amount payable under this Act or reduction in income or increase in loss. The other amount could cover interest.

Recommendation Clause (e) and (f) should be appropriately worded to correspond with the 'tax' amount. In other words, the reference to income/loss should not be the base for defining the term 'tax benefit'.

In line with the Expert Committee recommendations, it is suggested that the tax benefit should be computed in the year of deferral and the present value of money should be ascertained based on the rate of interest charged under the Act for shortfall of tax payment under section 234B of the Act.

3.15. Tax Incentives and Benefits

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

Issues

- 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

[3]Page 48 and 49 of the Final Report by the Expert Committee on GAAR chaired by Dr. ParthasarathiShome.
[4]Page 47 of the Final Report by the Expert Committee on GAAR chaired by Dr. ParthasarathiShome.



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. Like made in India, ease of doing business and encouragement to start up initiatives of the government, innovation and scientific research initiative should be given equal weightage. Withdrawal of weighted deduction in respect of scientific research expenditure will put a dent to the 'Make in India' initiative of the Government.

Innovation and digitisation is not limited to industrial sectors and has gained momentum in service sectors as well.

3.15.2. Issues related to deduction under section 35(2AB)

- 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.
- There is ambiguity with regard to claim of weighted deduction in respect of expenditure on outsourced research and development activities, foreign patent filing expenditure, clinical trial activities carried outside the approved facilities, expenditure on any payments made to members of the board of directors or any other part time employees engaged in research and development etc. The Hon'ble High Court of Gujarat in the case of Cadila Healthcare Limited [2013] 31 taxmann.com 300 (Gujarat) has also confirmed that clinical trials conducted outside the approved in-house research and development laboratory is eligible for deduction under section 35(2AB) of the Act. The High Court has held that Explanation to section 35(2AB)(1) of the Act does not require that expenses included in said Explanation are essentially to be incurred inside an approved in-house research facility.

  It may be noted that the Indian innovators filing patent applications in foreign countries are required to do so under The Patents Act, 1970. Furthermore, Indian companies incur substantial costs in defending their patent rights and applications in and outside India. It should be suitably clarified that the expenditure on patent filing in and outside India is eligible for deduction under section 35(2AB) of the Act.

  Currently, as per DSIR guidelines amount spent by a recognized in-house R&D towards foreign consultancy, building maintenance, foreign patent filing, interest on loan for the

R&D facility 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. It is suggested that DSIR guidelines should not deal with the allowability or disallowability of any expenditure incurred on in-house R&D facility. It is further suggested that the specific clarity be provided regarding allowability of deduction under section 35(2AB) of the Act in respect of the aforesaid expenditure and DSIR guidelines be suitable aligned with the provisions of the Act to avoid any litigation on this matter.

- 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.
- Accordingly, 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) which are directly related to the R&D, etc. be specifically clarified to be falling under the ambit of section 35(2AB) of the Act.
- The weighted deduction under section 35(2AB) of the Act is not available while computing book profit 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.
- 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.
- 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 under section 35(2AB) of the Act.
- Approval under section 35(2AB) of the Act is available only after completion of the research and development facility and therefore, the expenditure incurred prior to approval which normally involve substantial expenditure, does not get the benefit of weighted deduction.



- Eleventh Schedule contains articles/things like cosmetics, toilet preparations, toothpaste, dental cream, tooth powder, soap, photographic apparatus, office machines, steel furniture, safes, etc. There is no logical reason why research expenditure on the abovementioned articles should not be allowed.

Recommendations

- It is recommended that weighted deductions allowed under the Act 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).
- 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 further suggested that it may be specifically clarified that scientific research shall also include research activities in service sector.
- 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).
- It is further suggested that the existing provisions of the Act 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 should 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 profit under Section 115JB of the Act.
- 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 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.



- It should be clarified that deduction under section 35(2AB) of the Act on capital expenditure should be allowed in the year in which the expenditure is incurred.
- It is recommended that suitable amendment be made in section 35(2AB) of the Act to provide that once the approval is granted under section 35(2AB) of the Act the same should be made effective from the date of initiation of the said research and development facility and accordingly, the entire expenditure incurred on establishment of such facility would be eligible for deduction under section 35(2AB) of the Act.
- The list of the Eleventh Schedule should be reviewed and articles/things like cosmetics, toilet preparations, toothpaste, dental cream, tooth powder, soap, photographic apparatus, office machines, steel furniture, safes, etc. should be removed from the eleventh schedule so that research expenditure on these categories is also eligible for weighted deduction under Section 35(2AB) of the Act.

3.15.3. Allow weighted deduction of capital expenditure under section 35AD of the Act

Section 35AD(1A) provided weighted deduction in respect of the capital expenditure (other than land/ goodwill/ financial instrument) to a taxpayer engaged in following business:

- Setting up and operation of cold chain facility;
- Setting up and operation of warehousing facility for storage of agricultural produce;
- Building and operating a hospital with more than 100 beds;
- Building housing project under a scheme for affordable housing framed by the central government or state government and notified by Central Board of Direct Taxes;
- Production of fertilisers.

However, with effect from AY 2018-19, 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 specified business be restored for another 5 years. It is further believed that there is a need to promote the infrastructure sector in India. Accordingly, the benefit of weighted deduction must also be provided to new infrastructure facility covered under section 35AD(8)(c)(xiv) of the Act.

Deduction under Section 35AD of the Act is an alternate form of accelerated deduction for the capital expenditure in the specified business. However, the cash flows of these capital intensive industries suffer on account of levy of MAT. This is because book profit continues to be higher than taxable profits (given that deduction for capital expenditure is not taken to the profit and loss account other than in the form of depreciation) and hence, MAT is paid by the industry during the incentive period. Further, given the restriction on the years for carry forward of MAT, it is possible that MAT paid in initial years may not be recovered, especially for those taxpayers who have a longer period before reaching break-even.

With the governments 'Make in India' campaign, there would be a need to bring under the ambit of deduction of Section 35AD of the Act more sectors to further strengthen the industrial base of the country, for e.g. the steel industry being a high capital intensive



industry, capital expenditure should be allowed as a deduction on the amount of expenditure incurred.

It is suggested that the Government should consider reducing the rate of MAT more so for the infrastructure sector as levy of the same defeats the very purpose of extending tax incentives to the industry, especially given the high rate of MAT now.

3.15.4. 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.

3.15.5. 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.

3.15.6. Prescribe separate audit report form or modify Form 10CCB to include details of investment linked deduction under section 35AD

- It is recommended that specific Form should be prescribed for filing audit report as required by section 35AD(7) of the Act since Form 10CCB (presently applicable only for profit linked deduction under section 80I(7), 80IA(7),80IB, 80IC) does not specifically capture investment linked deduction under section 35AD of the Act. Alternatively, Form 10CCB may be modified to include details relating to investment linked deduction under section 35AD of the Act. Further, such form may also require the taxpayer to specify whether or not it wants to avail deduction under section 35AD of the Act for the relevant previous year

3.16. Taxability of subsidy/grant/incentive/drawback, etc.

Issue

The Finance Act, 2018 introduced Section 145B(3) in the Act, which provides that income referred to Section 2(24)(xviii)5 of the Act shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

The income referred to in Section 2(24)(xviii) of the Act dealing with government grants, subsidy, duty drawback, etc. is to be taxed in the year in which it is received.

When a government gives a grant, the right to receive the grant is bestowed upon the taxpayer upon satisfying certain conditions linked with the grant which generally are to be satisfied in the subsequent years. The income in such a situation would accrue not only when it becomes due but it must also be accompanied by a corresponding liability of the other party to pay the amount.

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[5] [2(24)(*xviii*) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee [*other than*,—

(a) *the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of* Explanation 10 *to clause* (1) *of section 43; or*

(b) *the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be*];]



The result of the amendment is that the year in which the government grant is taxed in the hands of the taxpayer may be different from the year in which the said entitlement ultimately becomes due to the taxpayer upon satisfying of the linked conditions in the subsequent year and consequential corresponding liability of the third party.

It is possible that the taxpayer may not satisfy the conditions in the future that are linked to the bestowing of the grants. If the conditions that are linked to the grant are not satisfied, the grant may be withdrawn resulting in taxing the receipt/grant in the earlier years which is actually not received by the taxpayer. This would result in an anomaly leading to a situation where the grants are taxed in an earlier year whereas the grant bestowed on the taxpayer has been withdrawn subsequently.

Further, in a subsequent year when the grant has been withdrawn, it is possible that the taxpayer could incur a loss due to withdrawal of the grant or due to unfavourable economic conditions of the business. In such a situation, there is no provision to write back the loss of a subsequent year against the profits of the earlier years which was taxed since it was offered as such.

Recommendation

It is thus suggested that the grants received by the taxpayer should be taxed when the amount corresponding to the grant becomes due upon satisfying of the conditions linked to the grant and it must also be accompanied by a corresponding liability of the other party to pay the amount. This would also be in line with the general principles of accounting discussed by the Supreme Court in the case of CIT v. Excel Industries[6].

> Without prejudice to the above suggestion, a provision dealing with write back of losses incurred in the subsequent years against the profits offered to tax in the earlier year should be introduced under the Act. Further sufficient time should be given to the taxpayer to revise return of the earlier year in such a case.

3.17. Stay of Demand

CBDT had earlier vide office memorandum dated 29 February, 2016, modified the guidelines for stay of demand at the first appeal stage issued under Instruction No. 1914 of 1996. CBDT made it mandatory for the tax officer to grant stay of demand once the taxpayer pays 15% of the disputed demand, while the appeal is pending before the Commissioner of Income-tax (Appeals). CBDT vide office memorandum dated 31 July, 2017, has further modified Instruction No. 1914 of 1996 and has revised the standard rate prescribed in the office memorandum dated 29 February, 2016, from 15% to 20% for grant of stay at the first appeal stage.

It may be noted that the reasons stated in the office memorandum dated February 29, 2016 modifying the guidelines stated in Instruction No. 1914 dated 21.03.1996 was that "It has been reported that the field authorities often insist on payment of a very high proportion of the disputed demand before granting stay of the balance demand. This often results in hardship for the taxpayers seeking stay of demand". Para 4 of the aforesaid memorandum

[6]CIT v. Excel Industries Ltd. 358 ITR 295 [SC] (2013)



further stated that "In order to streamline the process of grant of stay and standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed before CIT(A), the following modified guidelines are being issued in partial modification of Instruction No. 1914:"

Thus, the basic objective for modifying the Instruction No. 1914 (supra) and prescribing a payment of 15% of the disputed demand was to reduce the hardship for the taxpayers seeking stay of demand. The memorandum dated February 29, 2016 further provided situations which warranted payment of a lumpsum amount higher than 15% (e.g., in a case where addition on the same issue has been confirmed by appellate authorities in earlier years or the decision of the Supreme Court or jurisdictional High Court is in favour of revenue or addition is based on credible evidence collected in a search or survey operation etc.) [Para 4B(a)]. On the contrary, CBDT has increased the pre-deposit limit from 15% to 20% vide office memorandum dated 31 July, 2017 stating that the standard rate of 15% prescribed earlier was found to be on the lower side. It is observed that the increase in pre-deposit limit from 15% to 20% without any reasonable justification in all the cases (taxpayers whose case does not fall in para 4(B)(a)) will lead to hardship for the genuine taxpayers.

It is suggested that the pre-deposit limit for stay of demand at the first appeal stage be reviewed and reduced to 10% of the disputed amount.

Further, in case of matters which are already covered in the favour of assessee (by virtue of favourable Tribunal or High Court orders), it should be clarified that, such demand should not be adjusted under section 245 of the Act against refunds due to the taxpayer for any other years as held by various High Courts[7]. Also, 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).

The above clarifications will certainly provide a much needed relief to the taxpayers who are generally hard pressed by the field officers for recovery of demand despite of the fact that the issue is covered in their favour in earlier years.

Further, it should be clarified that the aforesaid Memorandum should be applicable even in cases where appeal is pending before the Income-tax Appellate Tribunal (which is as such the first appellate authority for taxpayers opting for the DRP route).

3.18. Non-Resident related provisions

3.18.1. Business connection - Significant Economic Presence ('SEP')

Section 9(1)(i) of the Act has been amended by the Finance Act, 2018, to provide that 'significant economic presence' in India shall also constitute 'business connection' and is applicable from financial year 2018-2019. CBDT in August 2018 had invited comments from the stakeholders with respect to 'revenue' and 'user' threshold for constituting significant economic presence. The Government had later extended the date for submission of

[7] HDFC Bank Ltd (354 ITR 77), Mauri Suzuki India Ltd (347 ITR 43)



comments upto September 30, 2018, based on which Income Tax Rules relating to 'Significant Economic Presence' as per section 9(1)(i) of the Act would be finalized. Given that it might take substantial time frame to finalise guidelines relating to SEP,its applicability should be deferred. Further, before implementation of SEP profit attribution mechanism should be put in place and also for loss making enterprises.

Introduction of SEP is a Base Erosion and Profit Shifting ('BEPS') initiative and the same is being discussed at OECD, G20 etc. Therefore, India should wait for global consensus and final OECD report instead of levying a unilateral taxation in the form of SEP as introduction of SEP provisions without an international consensus may pose challenges like double taxation, compliance and administrative cost, uncertainty, litigation, etc. Further, it may give rise to business models by non-residents wherein effectively tax cost is passed on to the Indian customers (e.g. billing the Indian entities under "net of tax" contracts, wherein effectively, the tax costs will be passed on to the India customers).

In view of the above, either the SEP provisions should be abolished or its implementation should be deferred till the global consensus is formed on taxation of digital economy.

Having said the above and without prejudice thereto, the following suggestions are made in relation to the provisions of SEP under the Act:-

- **SEP provisions should cover only digital transactions and not transactions relating to physical goods**

Explanation 2A(a) to Section 9(1)(i) of the Act covers within its purview 'transaction in respect of any goods, services or property carried out by a non-resident in India' to determine the SEP. This provision is so broadly worded that it may cover not only digital transactions but also transactions relating to physical goods, within its ambit. However, in clause (b) the term 'through digital means' has been referred to tax digital transactions only.As per the Memorandum explaining the provisions of the Finance Bill, 2018, the Government's objective behind the introduction of SEP related provisions is to tax digital transactions. However, the manner in which Explanation 2A(a) to section 9(1)(i) has been worded, it may cover non-digital transactions within its ambit.

Therefore, it is suggested that it should be appropriately clarified that SEP related provisions will apply to digital transactions/businesses.

- **Clarity with respect to the following is further required: -**

  (a) ***Revenue-linked condition clause (a) of Explanation 2A***

  (i) Clarify that physical/non-digital transactions are not intended to be covered

  (ii) Without prejudice to (a) above, cover only those transactions of physical goods/ services which are undertaken using "digital means" or which involve download of data/ software

(iii) Clarify the meaning and scope of "transaction in respect of goods, services or property carried out by non-resident in India" where "the payment arises from such transaction"

(iv) Clarify that transaction between non-residents with no direct nexus with India are excluded- unintended spiral effect to cover source of source

(v) Clarify that payments received by non-resident as a collection agent of the other person are not covered

(vi) Clarify that outsourcing in India is outside the scope of SEP

(vii) Without prejudice, threshold of revenue in clause (a) should be kept sufficiently high to befit the description of SEP

(b) ***User-linked condition in clause (b) of Explanation 2A***

(i) Delete clause (b) since user data is primarily monetised to earn ad revenue which is already subject to Equalisation Levy

(ii) Without prejudice to (a) above, provide guidance on determination of "users in India". Coverage should be restricted only to "active users".

(iii) Clarify that scope of "solicitation". Solicitation with users for own business activities (i.e. for captive use) should not be covered

(iv) Clarify scope of "engaging in interaction". Exclude certain websites/apps which are not interactive from the scope of clause (b)

(v) Consider 'users' separately for each business segment of a taxpayer

(c) ***Rule for attribution of profits to SEP***

(i) Follow arm length principles by treating SEP as a separate and independent enterprise. Adoption of a global formulary approach or presumptuous basis of taxation is contrary to ALP principles and also has the vice of being passed on to customers as a transaction cost. Unlike indirect tax levy, such cost does not provide input credit to the customer and enhances the cost of business

(ii) Function, Asset and Risk (FAR) analysis to capture digital presence in the form of digital operations which can be identified to be in India

(iii) Separate guidance may be required for loss making entities which have a thrust on "value creation"

(iv) User headcount in clause (b) to exclude users who have contributed to revenue in clause (a)

(v) Exclude Equalisation levy revenue which is exempt under section 10(50) of the Act



(d) ***Miscellaneous***

(i) Clarify that general principles of "business connection" are applicable to SEP

(ii) Clarify Equalisation Levy (EQL) will take precedence in case of overlap of EQL with SEP

(iii) No WHT obligation in case of B2C transactions

(iv) Annual threshold of Rs. 1 crore per payer for B2B cases

(v) Separate cell for dispute resolution or redressal of SEP cases

Further, introduction of the SEP provisions would require taxpayers to maintain additional details with respect to revenue from the digital means, number of users vis-à-vis systematic and continuous soliciting of its business activities or engaging in interaction with users. Maintaining such data and reporting of the same would trigger incremental efforts for non-residents. It would also result into increase in compliance cost for such non-residents. Therefore, it is suggested to provide upfront clarity with respect to data to be maintained to track active users, revenue from the digital means, etc.

3.18.2. Scope of "business connection"

The Finance Act, 2018 has amended the definition of 'Business Connection' to align it with BEPS Action Plan 7 to include any business activity carried out through a person who, acting on behalf of the non-resident has and habitually exercises in India, an authority to conclude contracts or habitually concludes contracts or habitually plays the principal role leading to conclusion of contacts by that non-resident.

Issues

- The amendment has substituted the earlier clause (a) of Explanation 2 to Section 9(1)(i) of the Act. However, on substitution, the exclusion for the purchase of goods or merchandise for the non-resident' appears to be inadvertently deleted. This would result in a significant number of cases where non-residents who are involved only in purchase activities to constitute business connection in India.
- A person acting on behalf of the non-resident having or habitually exercising an authority to conclude contracts on behalf of the non-resident was deemed to have business connection in India. The scope of business connection has been expanded to also cover cases where the person acting on behalf of the non-resident plays the "principal role" leading to the conclusion of the contract on behalf of the non-resident. While the scope is amended to keep in line with the changes relating to BEPS and Multilateral Instrument (MLI), there is a need to provide definition to the term "Principal role". The term "Principal role" is very subjective. A mere liaisoning by the person to facilitate negotiations or signing of the contract may also come under the ambit of this term.



- It is further provided in clause (a) that the contracts should be:
    - (i) in the name of the non-resident; or
    - (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that the non-resident has the right to use; or
    - (iii) for the provision of services by that non-resident.

Further as per clause (a) of Explanation 2A, transaction in respect of any goods, services or property carried out by a non-resident in India above the specified limit of amount may result into SEP. The term 'property' is not defined in the provisions. There is no clarity whether such property means a capital asset or business assets. 'Property' is a wide term and may include various class of assets which may be taxable under the other specific provisions of the Act. There are specific provisions under the Act which deal with the transfer of capital assets. It is accordingly suggested that the term 'property' should be defined to cover business property only.

Recommendations

- The exclusion provided in earlier clause (a) of Explanation 2 to clause (i) of section 9(1) of the Act for the purchase of goods or merchandise in India should be reinstated.
- It is suggested that the term "Principal role" be defined to crease out ambiguities and interpretations. It should also be clarified that the following situations should be out of the scope:
    - Where the contracts are concluded by the agent in India post obtaining formal approval of the Non-resident
    - Power to appoint sub-agents should not be construed to having a 'principal role'
    - Passive participation in the conclusion of contracts
    - Also where the agent does not have any power to conclude contracts, he should not be treated as a "Dependent Agent".
- It is accordingly suggested that the term 'property' should be defined to cover business property only.

3.18.3. Provide Capital Gain Exemption on Buy Back of Rupee Denominated Bonds (RDBs)

Issue

- Any transfer, made outside India, of a capital asset being Rupee Denominated Bond (RDB) of an Indian company issued outside India, by a non-resident to another non-resident is exempt under section 47(viiaa) of the Act. But no exemption is provided for buyback of RDBs by Indian companies from non-resident investors. The terms of the issue of such bonds generally permit the Indian issuing company to buy them back, if so



permitted by RBI. It may be recollected that RBI had permitted Indian companies in past to buy back FCCBs which were trading at discount in overseas stock exchange. The buyback at discount benefits the Indian economy by reducing the outflow of foreign exchange (For example, if bond with face value of $ 100 is bought back at $ 75, it results in foreign exchange savings of $ 25 for India). But the exemption is restricted to transfer from one non-resident to another non-resident. It does not cover transfer by non-resident to Indian issuing company. Since the transaction takes in case of listed bonds through stock exchange mechanism, the non-resident seller will be unable to ascertain whether purchaser on the other side is non-resident or Indian issuing company. This creates ambiguity and practical challenge for non-resident sellers.

Recommendation

- It is suggested that the capital gains exemption under section 47(viiaa) of the Act be expanded to cover transfer of bonds from non-resident to Indian issuing company as a part of buyback.

3.18.4. 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

- 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.
- Intra-group transfers as part of group re-organizations (other than amalgamation and demerger) should also be exempt from the indirect transfer provisions. Suitable amendment should be made in the Act to incorporate relaxations for transfer of minority stakes which do not result in transfer of control of underlying Indian asset, and



where the transfer of stake is within the same group, thereby permitting group reorganisation

- 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.

  It is recommended that 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.

- 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) of the Act 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) of the Act 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).

- The indirect transfer related provisions does not apply to any investment held by a non-resident, directly or indirectly, in a FII registered as category I or category II FPI under the SEBI (FPIs) regulations, 2014, with effect from 1 April 2012. It is suggested that thisexemptions should also be extended to category III FPI.

- 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. It should be clarified that the same threshold will apply for reporting of transactions under Section 285A of the Act.

- The onus of reporting has been cast on the Indian entity. Generally, the Indian entity may not have information relating to overseas indirect transfer, therefore, the onus of reporting should not be cast on the Indian entity. Considering that the provisions relate



to indirect transfers, the onus, if at all, should be cast on the parties to the transaction and not the Indian entity.

- Provisions of Section 234A, 234B, 234C and 201(1A) of the Act should not be applied in cases where demand is raised on a taxpayer on account of the retrospective amendment relating to the indirect transfer. An appropriate amendment should be made in the respective provisions of the Act.
- The CBDT Circular no. 28/2017 dated November 7, 2017, does not extend the benefit of exemption to indirect investors in entities other than specified funds (such as Foreign Direct Investment (FDI), Foreign Venture Capital Investor (FVCI), Category III AIF and Category III FPI entities) and accordingly, indirect transfer provisions continue to apply to investors in such entities. While the circular provides relief for certain types of foreign investment routes, the benefit should also be extended to such foreign investment routes wherein income has been charged to tax in India.
- Presently, there is an exemption only for investors holding less than 5 per cent of the total share capital or voting power in a company or entity that directly owns the assets situated in India as per Explanation 7 to section 9(1)(i) of the Act. There would be a number of transactions which would get covered under the indirect transfer provisions. Further, these transfers would be happening overseas; and in many cases may be for internal restructuring. Certain provisions of the Act provide 20% threshold for substantial interest and hence Explanation 7 to section 9(1)(i) of the Act be amended to provide threshold of atleast 20% instead of 5%.

3.18.5. 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.

3.18.6. Clarification of the Terms 'Transfer of Title, Risk and Reward'

Issue

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.

3.18.7. Clarity on Issue of Deduction of Tax at Source on Export Commission Paid to Non-Resident Agents

The 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 which 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.

From perusal of the circular no.7/2009, it is understood that the intention of the Government behind withdrawal of circular no. 23/1969 is not to override the provisions of section 5 and section 9 of the Act. However, the withdrawal of aforesaid Circulars does not



necessarily mean that a non-resident would now be liable to tax in India in the situations described in Circular No 23. The taxability of a non-resident taxpayer, under the Act, would need to be evaluated, independent of the position stated in the above Circulars, having regard to the provisions of the Act and relevant judicial precedents. In general, the tax position described in Circular No 23 can be viewed as merely clarifying the position of law and in a number of instances, Courts have reached a similar conclusion independent of Circular No 23. Thus, 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 precedence 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 requested that the Government may clarify that the commission payment to non-resident agents is not taxable in India if they do 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.

3.18.8. 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.

- It appears that the above provisions may also cover payment for a number of e-commerce transactions like access to databases, etc. which is not royalty in true sense. Even internationally, a large variety of e-commerce transactions are not covered within the ambit of "royalty". Some examples of such payments are:-
  - Transactions relating to access to online subscription database;
  - Payment by portal companies to ISPs for website hosting;
  - Payments for downloading content online;
  - Payment towards securing space from cloud for order completion, inventory information etc. without the Indian Payee acquiring rights/control over space, etc.
  - Goods on digital medial (e.g. e-books, music videos, etc.). These goods otherwise would not have amounted to "royalty". Say, where a book is purchased from a book shop may not amount to royalty, however, when purchased from an online website could amount to "royalty".
  - Distribution rights are also at times treated as "royalties" e.g. movies/ programmes distributed through Apps or e-commerce website.
- 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.
- Hence, given the above, it may be provided that transactions of the above nature be excluded from the definition 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. It is recommended to suitably exclude the payment for the use/access to online databases, reports, journals etc. and any other such payments made by the payer from the purview of royalty.
- 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 also clarify that the transactions of the nature mentioned above are excluded from the definition of "royalty".
- Alternatively, the amendment should have only prospective application.

3.18.9. 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 results 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.

The Supreme Court in the case of Vodafone International Holdings B.V. [(2012) 345 ITR 1 (SC)] has observed that tax presence is a relevant factor in order to determine whether a non-resident has an obligation to deduct tax at source under Section 195 of the Act. The amendment by the Finance Act, 2012, however, seeks to expressly extend the scope of tax deducted at source (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.

Recommendation

- The amendment (inserted by way of an Explanation) should be removed as it causes undue hardship to persons who genuinely do not have any income chargeable to tax 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.

3.18.10. 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.

3.18.11. 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.

3.18.12. Assessee in default under section 201

Issue

- Various Indian companies make payments to foreign companies for services rendered (FTS/Installation/Consultancy etc.). This arrangement is inevitable for capital intensive technology driven companies due to inadequate vendors in India. The payments in such contracts are made based on NO PE certificate and tax residency certificate obtained from the foreign company. It may be noted that the final tax position (i.e. having a PE or not) of a foreign company in India depends on fact of the case and such facts would not be available with the Indian company. However, if later during the assessment proceedings of foreign company in India, the tax authorities hold that foreign company has a PE in India, the Indian company is held as assessee in default under section 201 of the Act for non-withholding of tax on payments to such a foreign company. It is emphasised that even though the Indian company exercised due diligence while determining TDS liability on the payment to a foreign company it is still liable to face consequences for default in non-withholding of tax.

Recommendation

- It is suggested that appropriate provisions should be introduced in the Act to provide that where the resident company exercised due diligence while making the payment to non-resident by collecting No PE declaration, TRC and Form 10F from the foreign company, no proceedings under section 201 of the Act should be initiated against the



Indian company for said payments. The requirement of obtaining a No PE certificate may be incorporated in the provisions of the law.

3.18.13. Ease tax compliance of filing tax return and transfer pricing compliance for non-residents

Issue

Section 115A of the Act provides gross based taxation in case of income earned by way of interest, dividends, royalty and fee for technical services for non-resident assessee not having permanent establishment in India. As per section 195 of the Act, in case of a non-resident, the entire tax liability of such assessee will be deducted at source by the payer on accrual/ payment and, there would be no additional tax payable by such assessee in India on such income. Despite the fact that the entire tax liability of non-resident on income referred under section 115A of the Act will be deducted at source by the payer, such assessee are still required to obtain a Permanent Account Number (PAN) and file a return of income in India.

The Finance Act 2016, in order to reduce compliance burden, amended section 206AA of the Act so as to provide that the provisions of said section shall not apply to a non-resident, not being a company, or to a foreign company, in respect of any payment, other than interest on bonds, provided non-resident provides the alternative information as prescribed.

In view of the above, in order to encourage investment in India and reduce compliance on non-residents, it is recommended that where a foreign investor's only source of income in India is from income taxable under section 115A, and, the entire tax liability of such investors is deducted at source and paid by the payer, then, the requirement for following compliance should be eliminated:

- Filing of return of income
- Filing of transfer pricing audit report where the assessee has undertaken transfer pricing compliance in home country and such transaction is at arm's length.

Recommendation

It is suggested that the provisions of section 115A(5) of the Act (non-filing of income tax return) should be extended to income earned in the nature of Royalty/ FTS wherein tax has been withheld as per the rates prescribed in section 115A of the Act.

3.18.14. Clarification regarding 'Indian Concern' under section 115A

Issue

Section 115A(1) of the Act refer to the term 'Indian concern'. However, the said term is not defined. This leads to a controversy on whether Indian branch qualify as Indian concern and thereby whether the provisions of section 115A(1a) and 115A(1b) are applicable to payment made by such Indian branch. As the term is not defined, there may be an unintended tax disadvantage for an Indian branch of foreign entities intending to raise funds through

advances/loans or paying fees for technical services/royalties to non-residents, as compared to other entities registered in India.

Recommendation

It is suggested that the definition of the term 'Indian concern' or an explanation that the said term includes 'Indian branch' may be introduced in the provisions of section 115A of the Act.

3.19. Mergers & Acquisitions

3.19.1. 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. There are rulings in case of Ranganathan Industries Private Limited (Chennai) ITA 2434/Mds/2004, Caplin Point Laboratories Ltd. (Chennai) ITA 667/Mds/2013, Adani Gas Limited (Ahm) ITA Nos. 2241 & 2516/Ahd/2011, SKOL Breweries Ltd. (Mum) ITA 313/Mum/07, wherein it has been held MAT credit can be carried forward by the amalgamated company/ successor company in case of demerger.

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.

3.19.2. 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.

3.19.3. 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.
- The amendment will facilitate smooth operational reorganization across the economy including infrastructure sector if the benefit of this provision is provided to service providers such as Telecom Infrastructure Service Provider (TISP) and Direct-to-Home (DTH) operators etc. Further, e-commerce sector should also be included in this provision as such businesses require acquisition/consolidation for growth and expansion/ diversification.
- More so, section 72A(2) of the Act prescribes stringent condition about continuity of holding of assets by the amalgamating company for at least two years prior to transfer and by the amalgamated company for five 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 five years is quite a long period.
- As per the provisions of section 72A of the Act, business loss and unabsorbed depreciation of demerged company can be transferred to resulting company on demerger. However, there is ambiguity in relation to the period for which such losses are available to 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.
- It is recommended to provide that such losses transferred on demerger should be available for a period of eight years after demerger, as in case of amalgamation.

3.19.4. 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 by providing that the restriction posed by section 79 of the Act will not apply to intra group reorganization where a holding company transfer shares of its subsidiary to another subsidiary since the ultimate (beneficial owner) remains the same.

3.19.5. Section 2(19AA) – Tax Neutral Merger

Issue

Currently, Section 2(19AA) of the Act provides that demerger shall be tax neutral, if transfer of assets and liabilities is at book value. However, Ind AS 103 provides that if the demerger is not under common control transactions, assets and liabilities shall have to be transferred and recorded at fair value. Thus, there is ambiguity on tax neutrality of demerger transactions which are not common control transaction in terms of Ind- AS 103.

Finance Act, 2018 has already removed effect of fair value accounting under Ind-AS (applicable in transaction which are not common controlled) for MAT purposes under Section 115JB of the Act. Any gain arising on fair value of undertaking by the demerged company is exempt from the provisions of MAT. Similar exemption should also be provided for non-taxability of any gain arising on said fair valuation.

Recommendation

It is recommended that a clarification should be provided in Section 2(19AA) of the Act that if resulting company is recording assets and liabilities in terms of Ind-AS 103, then the demerger shall be tax neutral.

3.19.6. Taxation of Long Term Capital Gains on Transfer of Unlisted Securities

The Finance Act, 2012 had amended Section 112(1)(c) of the Act to provide a concessional long term capital gain tax of 10% on transfer of capital assets being unlisted securities in the

hands of non-residents (including foreign companies). A clarificatory amendment was further made in section 112(1)(c) of the Act by the Finance Act, 2016 to provide that long term capital gains arising from the transfer of a capital asset being shares of a company not being a company in which the public are substantially interested, shall be chargeable to the tax at the rate of 10%.

Issues

- The reduced rate of 10% under section 112(1)(c) of the Act is not available to a resident shareholder.
- The amendment made by the Finance Act, 2016 restricts the applicability of the section to 'shares' of company not being a company in which public are substantially interested as against other securities.

Recommendations

- It is suggested that the benefit of 10% rate be extended to resident shareholders also on sale of shares of a company not being a company in which public are substantially interested.
- It is further recommended that the word 'shares' following the phrase 'company not being a company in which public are substantially interested, should be replaced by 'shares and securities'.
- It should be further clarified that the section will also be applicable in case of shares and securities of a private company which is deemed to be a public company.

3.19.7. Deeming Fair Market Value as Full Value of Consideration for Transfer of Unquoted Shares

The Finance Act, 2017 has expanded the scope of section 56 by inserting a new clause (x) in sub-section (2) of section 56, so as to provide that receipt of sum of money or any property by any person, without consideration or for inadequate consideration in excess of Rs. 50,000 shall be chargeable to tax in the hands of recipient under the head "Income from other sources". The Finance Act, 2017 has further inserted section 50CA in the Act to provide that the sale consideration for transfer of shares other than the quoted shares shall be deemed to be the fair market value; determined in accordance with the prescribed method, if the actual consideration is lower than such FMV.

Over the past few years, several measures have been put in place to target certain abusive transactions and arrangements. The General Anti-Avoidance Rule (GAAR) is by far the most important and prominent of these, but there have been several more targeted anti-abuse provisions that have been introduced in recent times, which are posing several challenges to industry. The most serious of these relate to the newly introduced sections 56(2)(x) and 50CA of the Act. As aforesaid, these seek to bring to tax notional incomes in the hands of the recipient and transferor in cases where the transaction takes place at a price lower than a specified fair market value.

Although the need to target abusive transactions is undoubtedly an important objective, it is submitted that such provisions are so far-reaching in their scope that several ordinary and legitimate commercial transactions end up triggering significant tax costs. Since these are taxes on notional, rather than real income, they end up significantly increasing tax costs for businesses. For instance, commercial negotiations based on innumerable factors affect the pricing of shares and other assets. To tax such transactions merely because the negotiated prices differ from the price determined on the basis of a statutory formula is unduly harsh, especially since they apply to unrelated parties as well. With the GAAR now in force, specific abusive transactions can be appropriately targeted under its provisions, without having to resort to such catch-all provisions. We therefore submit that both sections 56(2)(x) and 50CA be deleted.

3.19.8. Other Issues

- Under an approved Resolution Plan under Insolvency and Bankruptcy Code, 2016 (IBC), there could be several instances where assets (including shares) of a company are transferred in distress. However, the aforesaid provisions could render many such transactions as unviable, both from a sellers' and buyer's perspective in cases where the prices are lower than the formula based approach set out in section 56(2)(x) and 50CA of the Act. For e.g., a buyer may have to pay tax on the difference between book value and purchase consideration, when in fact no gain/benefit has been received by the buyer who is already taking a significant risk by investing in distressed businesses. On the other hand, the seller may have to pay capital gains on the difference between FMV and the sale consideration, when in fact the seller is actually incurring a loss. In many cases, the tax cost itself may be higher than the sale/purchase consideration. This is grossly unjust and could deter business sentiment and undermine the policy objectives particularly at a time when the Government is trying to revive the distressed sector.
- Section 50CA of the Act provides that the sale consideration for transfer of shares other than the quoted shares shall be deemed to be the fair market value; determined in accordance with the prescribed method, if the actual consideration is lower than such FMV. The term 'quoted share' is defined to mean "the share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business". There is no clarity on the term 'regularity from time to time' used in the above definition.
- The literal interpretation of section 56(2)(x) of the Act will make all genuine transactions like allotment of shares under initial public offer (IPO), follow on public offer (FPO), contribution of assets into a partnership firm, issue of bonus shares, issue of right shares to existing shareholders or infusion of further capital, preferred allotment of shares, disinvestment of PSU by Govt. of India, etc. taxable in the hands of recipient as they are less than fair market value, to attract investors. In the above scenarios, the shares (being covered by the definition of 'property') comes into existence only on allotment of such shares and therefore question of receipt of such shares from any other person (something which is non-existing) is not possible. It is infact an allotment of fresh shares by the Company and not a transfer of shares by one shareholder to another shareholder.



Thus, capturing allotment of shares within the purview of section 56(2)(x) of the Act does not seem to be the intent of the Government and needs to be clarified.

- Currently property received by a trust which is created solely for the benefit of the relative of the individual does not fall within the ambit of section 56(2)(x). There is no clarity with respect to taxability under section 56(2)(x) in a case where trust is created solely for the benefit of the transferor and his relatives.
- The provisions of section 56(2)(x) are not applicable in case of transfer of property or assets (such as shares or securities) from a relative, whereas in the case of transfer of shares to a relative for lower consideration or nil consideration, the differential between FMV and transfer price becomes taxable in the hands of transferor under section 50CA of the Act.
- CBDT has issued final rules for the determination of fair market value (FMV) of unquoted equity shares for the purposes of section 56(2)(x) and section 50CA of the Act. The rules for valuation of unquoted equity shares have been introduced as anti-abuse provisions, intended to curb transfers of unquoted shares at nominal value despite such shares holding underlying assets of substantial value. However, it would be inequitable to apply the rule prescribing fair market valuation of underlying assets; in cases where control in the company has not changed. The genuine cases of internal restructuring wherein the ultimate ownership does not change should be provided exemption from adopting fair market value. It is observed that adopting the fair market value of the underlying assets would be inequitable in case of rearrangement within the same owner group as the essence of the transaction is not intended as a pure sale in such cases. It has to be appreciated that it would be impossible for a minority shareholder to be able to materialise the transaction based on fair market value of the underlying assets. Practically, a nominal shareholder may not have access to such information and hence, may not be able to compute value according to this rule. It has also to be appreciated that the information pertaining to the assets of the unlisted company like immovable property, jewellery etc. would not be available in public domain and would pose serious challenges in complying with the valuation mechanism as prescribed by amended Rule 11UA of the Rules.

Recommendations

- It is suggested that suitable amendment be made in the Rule 11UA to provide that the fair market value of the underlying assets for valuation of an unquoted equity share should only be adopted in cases of transactions resulting in change in control and management in the company. Further, to determine, “control’ or “ownership of the company”, precedence can be taken from prevalent practices/rules followed under the Act and may be appropriately provided for in the rules. It may be considered to exempt valuation of unquoted equity shares at FMV if the transferor held less than 25% of the shares.
- It is submitted that there should be a specific carve out to the effect that the exclusion list under section 56(2)(x) of the Act should also be widened to include any receipt of



property by an assessee under the IBC framework in accordance with Resolution Plan as approved and administered by the NCLT. Similarly, provisions of section 50CA of the Act should not be made applicable in the hands of the seller for transactions pertaining to transfer of shares which are consummated under the IBC framework in accordance with Resolution Plan as approved and administered by the NCLT. The aforesaid carve outs are also warranted because the entire proceedings under the IBC are conducted through a transparent process with sufficient regulatory oversight as that of NCLT and, hence, they do not fall within the mischief which is sought to be curbed by provisions of section 56(2)(x) and 50CA of the Act.

Granting of above tax reliefs/concessions will ensure participation of serious resolution applicants which will be in the best interests of all stakeholders. The Resolution Plans approved after factoring in these reliefs/concessions will result in quick revival of assets, freeing up liquidity for banks for further lending, increased economic activity, job savings /creation, increased contribution to the exchequer and will have multiplier effect on the associated economy. The re-rating of assets post approved Resolution Plan will also improve balance sheets of the banks thereby lowering capital infusion requirement from the Government. Further, a quick and timely resolution to the stressed assets with positive outcome implemented in a transparent manner will improve India's "Doing Business" ranking thereby ensuring participation from global players and resultant capital inflows.

- Section 56(2)(x) of the Act should be amended so as not to apply to the issue/ allotment of new shares by a company, but only to transfer of shares, because the intent was always to bring within the tax net, transfer of shares for nil or inadequate consideration.
- It is suggested that a suitable amendment be made to exclude receipt by the trust created/established for the benefit of individual and/or his relatives from the ambit of section 56(2)(x) of the Act.
- It is recommended that the provisions of section 50CA of the Act should not be made applicable on transfer of unquoted shares between related parties or relatives (similar to exclusion provided in section 56(2)(x) in case of relatives).
- It is suggested that clarification be provided in section 50CA of the Act to determine the trading regularity of shares.

3.19.9. Final rules relating to valuation of unquoted equity shares for the purpose of section 50CA and section 56(2)(x) of the Act

The Final Rules seek to determine the FMV of unquoted equity shares of the company by adopting the independent fair valuation of jewellery, artistic work, immovable property and shares and securities held by such company while all other assets and liabilities of such company would continue to be valued at book value.

Our recommendations on the valuation rules are set out below:

- The Final Rules do not envisage a scenario in cases of cross holdings amongst companies. Consider a situation where Company A and Company B hold shares in each



other as "Investments" in their respective balance sheets and shares of Company A are subject matter of transfer. In this situation, as per the Rules, the FMV of shares of Company A will depend on FMV of shares of Company B and vice versa. As a result, there will be a continuous resilient loop in such cases. Suitable guidelines in this regard should be formulated.

- The aforesaid issue would also arise in cases of circular chain holdings. For instance, consider a situation where Company A holds shares in Company B which in turn holds shares in Company C which in turn holds shares in Company A. If shares of Company A are a subject matter of transfer, the valuation of shares of each company will be dependent on the other which will again result in a circular loop. Suitable guidelines in this regard should be formulated.

- There are several cases where shares of a company are sold in distress. In such cases, the book value of the company is significantly higher than the real economic value. In such cases, valuation of equity shares should, at the option of the taxpayer, be made at (a) book value as determined under these rules, or (b) FMV as determined under any internationally accepted valuation methodologies, whichever is lower. Similar option should also be provided to companies which are incurring persistent losses since, say, last 3 years. This approach can be implemented by enabling the Assessing Officer to adopt such lower value in cases where it is demonstrated that the value determined under the Rules is higher than the actual fair value. An advance determination of such value by the Assessing Officer may also be provided for.

- This section could also pose several practical challenges for shareholders (especially minority shareholders) desirous of transferring their shares – in terms of availability of audited accounts as on the valuation date, availability of details of immovable property/ arts/ jewellery, etc. and obtaining a valuation thereof.

  Given the same, an alternate manner of determining the FMV where such details are not provided to the shareholders should be provided for. Alternatively, a threshold limit could be provided for non-applicability of this section to minority shareholders.

- Furthermore, since the Rules are retroactively applicable from 1 April 2017, they may create unintended consequences for parties to the transaction, as also for persons liable to withhold tax or representative assesses who carry vicarious liability as they would have relied upon the extant valuation rules based on the book value for transactions already consummated post 1 April 2017. This would be contrary to the professed tax policy of the current Government of India of not introducing any retroactive amendment which creates higher tax burden. Thus, transactions which are already consummated prior to date of notification of new rules should continue to be governed under the erstwhile Rule 11UA.

- The Rules can possibly create conflict in respect of transactions which are covered by other provisions of the Act (say, transfer pricing), or in cases where the applicable regulatory provisions (FEMA, etc.) provide for differential FMV determination. Given the same, if the transfer price is in consonance with the price determined as per transfer



pricing or other regulatory provisions, such price should be regarded as meeting the requirements of section 56(2)(x) and section 50CA of the Act.

- Contingent liabilities should be allowed to be reduced while calculating the FMV of shares since in any typical third party deal, there is a mark down for the contingent liabilities.
- Most of the manufacturing companies have land and building as their significant assets which are not separable from the business operations. In such cases, valuing the land and building based on their FMV may lead to a value which is significantly higher than the real economic value of the business. In such cases, it is recommended that land and building be valued at book value as per the prevailing Rule 11UA. However, for companies engaged in real estate activities, valuation ought to be done based on FMV as suggested in the Final rules.

3.19.10. 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.

3.19.11. 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'.

3.19.12. Consequential cost step up for depreciation on trigger of claw back provision of s.47A in case of transfer of capital asset by holding/ subsidiary company

(a) As a logical consequence of withdrawal of capital gains exemption in hands of transferor on trigger of section 47A and similar to section 49(3) for non-depreciable assets, it should be provided in section 43(1) and section 43(6) that the 'actual cost' and 'written down value' of depreciable asset in hands of the transferee will stand recomputed as per actual cost incurred by the transferee.

(b) While section 155(7B) of the Act provides for extended time limit of 4 years from the year of trigger of section 47A to re-compute total income of transferor, provisions of section 155(7B) of the Act may be amended to provide extended time limit to re-compute total income of transferee as well (i.e. to recompute depreciation allowance from the year of acquisition).

3.19.13. 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. LLP as a form of business organization is extremely important. The mid-size and smaller businesses are finding it extremely difficult to comply with very heavy compliance requirements under the Companies Act, and of course, they are aware that this will prevent them from accessing the capital market. However, conditions for conversion of a company into LLP should be made less stringent or some relaxation should be provided in application of the same as discussed below:-
  - Tax neutrality 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.

- Section 47(xiiib) of the Act provides tax neutrality to conversion of Company into LLP. Further, section 72A of the Act provides for carry forward of losses in case of merger/demerger of two companies. There is no enabling provision for tax neutral conversion of partnership firm into LLP or merger of two LLPs. Also, there is no enabling provision under the Act for carry forward of losses in case of merger/demerger of two LLPs.

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.
- It is suggested that suitable provisions be introduced in the Act to allow tax neutral conversion of partnership firm into LLP or merger of two LLPs. It is further recommended that the benefit of section 72A of the Act be extended to merger and demerger undertaken between LLPs.

3.19.14. 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.
- It is further recommended that appropriate provisions be introduced in the Act to allow carry forward of losses in case of merger of an Indian company with foreign company.

3.19.15. Introduction of safe harbour exemption to section 56(2)(viib) of the Act for tax neutral reorganisation

S.56(2)(viib) of the Act should be amended to provide for omnibus carve out in respect of tax neutral reorganisations like issue of shares on amalgamation, demerger or transfers exempt under section 47(iv)/(v), etc without the need for the company to separately justify the value to the AO

3.19.16. 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.

3.20. Capital Gains

3.20.1. Provide clarification under section 55(2)(ac) of the Act on grandfathering benefit in case of shares received under tax neutral transfer in lieu of shares held as on 31 Jan 2018

The Finance Act, 2018 reintroduced capital gains tax on transfer of specified long-term capital assets including equity shares of a company listed on a stock exchange at a lower rate of 10% (plus applicable surcharge and cess). While section 55(2)(ac) of the Act has to a large extent ensured protection by grandfathering the gains earned up to 31 January 2018 on such long-term capital assets, ambiguity is being experienced in the following cases:-

a) Where shares of listed amalgamating company were acquired before 1 Feb 2018 and amalgamation takes place on or after 1 Feb 2018, it is recommended that specific retrospective clarification should be brought that shares of listed amalgamated company (though issued after 1 Feb 2018) should be deemed to be acquired from the date of acquisition of shares of the listed amalgamating company for the purposes of section 55(2)(ac) of the Act. Accordingly, Fair Market Value (FMV) of such asset for the purposes of section 55(2)(ac) of the Act should be the highest price of the equity shares of the listed amalgamating company quoted on 31 Jan 2018.

b) Similarly, specific clarification should be inserted that shares of the listed company received by the shareholders under tax neutral transfer under section 47 of the Act shall be deemed to be acquired from the date of acquisition of the previous owner or assets in lieu of which the shares listed as on date of transfer were acquired, as the case may be.



c) In case of shares of demerged company held on 31 Jan 2018, FMV of shares of demerged company as determined in terms of Explanation (a) to section 55(2)(ac) of the Act should be pro-rated between shares of demerged company and resulting company as per section 49(2C)/(2D) of the Act.

3.20.2. Resolve ambiguities in one-time option under section 54 for availing exemption by re-investment in two residential houses

The Finance Act, 2019 inserted proviso to section 54(1) of the Act to provide a one-time opportunity to the taxpayer to claim exemption under section 54 of the Act with respect to investment in two residential house properties where the amount of long term capital gains does not exceed Rs. 2 crores. However, certain ambiguities arise as under which need to be clarified by the Government to avoid unwarranted litigation.

(a) Where taxpayer deposits the amount in capital gains account scheme and exercises the one-time option, but ultimately he buys only one property, it is not clear whether the taxpayer will be denied deduction under section 54 of the Act on the ground that (as a result of substituted reference), the taxpayer is mandated to qualify for exemption only if he has acquired two houses. Similarly, if no option was exercised by the taxpayer but he uses the amount deposited in capital gains account scheme to buy two residential houses, whether exemption will be denied to him in respect of one house;

(b) Having bought two houses, if the taxpayer sells one of the houses within 3 years, whether entire exemption will be withdrawn or only with reference to house sold;

(c) It may also be clarified that the option needs to be exercised in the return form.

3.20.3. 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%.

3.20.4. 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.

3.20.5. 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.

3.21. Transfer Pricing

3.21.1. Limitation of Interest Benefit – Section 94B

The Finance Act, 2017 has introduced section 94B in the Act relating to limitation of interest benefit(deduction). Where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, pays interest exceeding Rs. one crore in respect of any debt issued/ guaranteed (implicitly or explicitly) by a non-resident AE, then the interest shall not be deductible in computing income chargeable under the head 'Profits and gains of business or profession' to the extent, it qualifies as excess interest.

Excess interest shall mean total interest paid/payable by the taxpayer in excess of thirty per cent of cash profits or earnings before interest, taxes, depreciation and amortization; or interest paid or payable to AEs for that previous year, whichever is less.

There will be restriction on the deductibility of the interest in the hands of the taxpayer in a particular financial year to the extent it is excess, as explained above. However, the same shall be allowed to be carried forward for a period of eight years and allowed as deduction in subsequent years. The above restrictions shall not be applicable to taxpayers engaged in the business of banking or insurance. These provisions are applicable for AY 2018-19 and subsequent years.

Issues

(a) India is a developing country with a need for foreign investment to fund various initiatives, in particular the development of infrastructure. However, the restrictions imposed under section 94B of the Act in respect of interest of overseas loans is creating uncertainty for foreign as well as Indian parties at a policy level on overseas borrowing.

(b) The rate of interest in India is high as compared to other developed nations. Certain business requires huge funding in the initial period of operations especially start-ups. Given the same, the threshold of Rs. 1 crore is low and should be increased. The threshold of interest expenditure for applicability of this section should be increased to at least Rs. 15 crores.

(c) Interest limitation rules are in nascent stage, companies must be provided transition window to re-align its debt structure. Further, aligning the capital structure is time consuming and requires regulatory approvals. It is recommended that the Earnings before interest, taxes, depreciation and amortisation ('EBITDA') capping should be initially @ 60-70% and phased reduction of the same to 30% could be provided over a span of three years.

(d) NBFCs have interest income as main source of income and huge corresponding interest expenses. So capping deduction of interest on such companies will lead to harsh consequences for NBFC's. Interest limitation rules do not apply to an Indian Company /

PE of Foreign company which is engaged in the business of banking or insurance. Like banking or insurance business, an exclusion of NBFC Companies from interest limitation rules is suggested.

(e) As per the term 'debt' provided in clause (ii) of sub-section 5 of section 94B, interest may include many other payments made on various kinds of financial arrangements and instruments. Further, there is lack of clarity on the mechanism to calculate EBITDA i.e. book profit calculated on the basis of accounting standards, Ind-AS or otherwise or as per the provisions of the Act. This may result in unnecessary litigation. The BEPS Action Plan 4 provides for a Group Ratio Rule wherein the Group's overall third party interest as a proportion of the Group's EBITDA is computed and that ratio is applied to the individual company's EBITDA to determine the interest restriction. This would take into account the actual third party debt and leverage at global level vis-à-vis third parties.

(f) Sub-section 4 to section 94B indicates "*Where for any assessment year, the interest expenditure is not wholly deducted against income under the head "Profits and gains of business or profession", so much of the interest expenditure as has not been so deducted, shall be carried forward to the following assessment year or assessment years, and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with sub-section (2)".* There could be a situation that in any of the subsequent years, the proposed section becomes inapplicable to the assessee in case the interest expense is less than Rs. 1 crore. It is suggested that a clarification be provided that set off would be available even if section is not triggered in such subsequent year.

(g) Section 94B is introduced by Finance Act 2017 w.e.f. 1-4-2018. It is not clear as to whether the provision is applicable for existing debts or only for new debts taken on/or after 1 April 2017.

(h) Sub-section (2) to section 94B of the Act defines 'excess interest' to mean an amount of total interest paid or payable in excess of thirty per cent of EBITDA of the borrower in the previous year or interest paid or payable to associated enterprises for that previous year, whichever is less. In case of domestic as well as foreign borrowings, for the purpose of interest disallowance, domestic interest would also be considered due to reading of 'total interest'. If that be the case, it would result into higher disallowance of foreign interest as compared to normal scenario where there is no domestic borrowings.

(i) Second proviso to section 94B of the Act provides "*Provided that no interest expenditure shall be carried forward under this sub-section for more than eight assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed."* The interest disallowed is allowed to be set off in subsequent years for a period of 8 years. If the company is subject to tax under MAT, it would not be able to set it off within 8 years.

(j) Section 94B of the Act provides for disallowance of interest in certain situation. Additionally, disallowance can also trigger under section 40(1) (i) and 43B of the Act.

There could be a situation that the interest may also be disallowed under section 40(a)(i) for non-deduction of taxes and/or under section 43B of the Act for non-payment of interest before the due date of filing the return of income. Clarification should be provided that interest so disallowed under section 40(a)(i) or 43B be specifically excluded from definition of "total interest".

(k) Sub section 1 of Section 94B of the Act specifically requires the lending to be from a non-resident associated enterprise for the section to trigger. However, branches or permanent establishments of foreign banks are also "non-residents" for the purposes of the Income-tax Act. Whilst branches or permanent establishments of foreign banks operate essentially as Indian companies and compete directly with Indian banks, debt by related Indian branches of banks or guarantees given by AEs towards borrowings by Indian companies from branches or permanent establishments of foreign banks would qualify for disallowance under the above provision. This place the Indian branches of foreign banks at a disadvantageous position vis-à-vis competing Indian banks.

Recommendations

- In view of the policy level issues on overseas borrowings, the restrictions imposed on the interest benefits on overseas borrowings should be done away with entirely or at least deferred for 5-10 years to give India a chance to achieve its anticipated growth through required infrastructural development and maturity.
- The de minimis threshold should be increased to Rs. 15 crores.
- It is suggested that EBITDA capping should be initially @ 60-70% and phased reduction of the same to 30% could be provided over a span of three years.
- Where assessee is having interest income, net interest expenditure must be considered for the purpose of determining applicability of section 94B of the Act.
- It is suggested that the section should be made applicable to new debts taken on or after 1 April 2017.
- It is suggested that interest should be restricted only to foreign AE interest and not total interest. Irrespective of domestic borrowings, only foreign AE interest in excess of 30% of EBDITA should be disallowed.
- It is recommended that there should not be any restrictions on number of years for carry forward of unutilised interest like depreciation claim.
- The exclusions granted to banking and insurance companies should also be extended to other sectors such as Non-Banking Finance Companies, large capital intensive companies with long gestation periods and companies in the real estate sector and the infrastructure sector (requiring significant foreign capital which may not always come in the form of equity).
- The section should be amended to specify that in guarantee cases limitation would apply only to the extent of the guarantee commission (if any) paid by the Indian entity to the overseas guarantor (being its AE) and not on the interest paid to the third party



lender.

- Appropriate guidelines may be issued to clarify what the term 'interest or of similar nature' should include or exclude as the definition provided in the existing section 2(28A) may not be adequate for the purposes of section 94B based on the definition of the term 'debt'.
- Further, the word 'implicit guarantee' should be dropped from the provisions. The term 'explicit guarantee' should also be appropriately defined to obviate future litigation on this front.
- The mechanism to calculate EBITDA should be clearly laid down. EBITDA should exclude non-taxable/exempt income/foreign dividend taxable under section 115BBD of the Act and interest towards earning of non-taxable/exempt income/foreign dividend taxable under section 115BBD of the Act should also excluded.
- In lieu of a fixed 30% EBITDA restriction, a Group Ratio could be considered in order to apply the interest deduction restriction under this provision. The Group Ratio refers to the Group's overall third party interest as a proportion of the Group's EBITDA and that ratio is applied to the individual company's EBITDA to determine the interest restriction. This would take into account the actual third party debt and leverage at global level vis-à-vis third parties.
- The borrowings by Indian companies from Indian branches or permanent establishments of foreign banks should be wholly excluded from the purview of the section 94B (either by way of direct borrowing from or by way of guarantee by AE to such branches or permanent establishments of foreign banks).
- Similar to provision of section 72A of the Act, carried forward interest expenditure should be allowed for set off in hands of transferee company in case of business organisation such as amalgamation, demerger or slump sale. Appropriate provisions be introduced in the Act to provide that the amount of unabsorbed interest amount shall be available for carry forward to the successor entity in case of business reorganization.

3.21.2. Secondary adjustment (Section 92CE)

The Finance Act, 2017 has introduced the concept of secondary adjustment on transfer pricing (TP) adjustments. A taxpayer is required to make a secondary adjustment, where the primary adjustment to transfer price has been made in the following situations:-

- *Suo moto* by the taxpayer in the return of income;
- By the Assessing Officer (AO) during assessment proceedings, and has been accepted by the taxpayer;
- Adjustment determined by an Advance Pricing Agreement entered into by the taxpayer;
- Adjustment made as per the Indian safe harbour rules; or



- Adjustment arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into for avoidance of double taxation.

'Secondary adjustment' has been explained as an adjustment in the books of account of the taxpayer and its associated enterprise (AE) to reflect that the actual allocation of profits between the taxpayer and its AE are consistent with the arm's length price as may be determined under one of the above five situations.

The additional amount receivable from the AE as a result of the primary adjustment should be repatriated by the taxpayer into India within a prescribed time limit. If the same is not received by the taxpayer within the time-limit, then the primary adjustment will be deemed as an advance extended to the overseas AE and a secondary adjustment in the form of notional interest on the outstanding amount would be subjected to tax as an income of the taxpayer.

The above requirements for repatriating the amount of TP adjustment into India and imputing a notional interest, are triggered if the primary TP adjustment exceeds Rs. one crore. The time limit for repatriation and manner of computation of interest has been prescribed by CBDT vide Notification No. 52/2017, dated 15 June 2017.

Issues

- The additional amount receivable from the AE as a result of the primary adjustment should be repatriated by the taxpayer into India within 90 days from the dates specified in Rule 10CB of the Rules. If the same is not received by the taxpayer within 90 days, then a notional interest on the amount deemed as an advance should be offered to tax as per computation mechanism provided in Rule 10CB. The above requirement for repatriating the adjustment amount into India and imputing a notional interest are triggered if the primary adjustment exceeds Rs. one crore and pertains to only primary adjustments made in respect of FY 2016-17 and subsequent years.

  The Indian regulations under section 92CE of the Act on secondary adjustment require the taxpayer and the AE to make adjustment in the books of account. However, the books of account of taxpayer and its overseas AE would be closed by the time such an adjustment is determined and it would not be practically possible to record it in the books of the relevant financial year. Also, it may not be within the control of the taxpayer to enforce recording of an adjustment in the books of accounts of the AE. Moreover, it would be beyond the jurisdiction of the Indian regulations to mandate such an action on part of the AE located outside of India. In order to address the practical difficulties in implementing such mandate, the requirement of an adjustment in the books of accounts should be done away with.

- The current provisions do not lay out the mechanics of application of Section 92CE of the Act in the following scenario:-

  - Where the taxpayer has transactions with multiple AEs, which are aggregated for a combined arm's length determination (e.g., in a Transactional Net Margin Method).



Primary adjustment in such cases is difficult to be attributed for each transaction and for each AE;

In this case, taxpayer is likely to face challenge in attributing or allocating primary adjustment between various AEs. Further, it may be a challenge to receive remittances from each AEs due to applicable local laws and regulations in the AE's jurisdictions. Guidance on the allocation mechanism of primary adjustment would help the taxpayer in correctly applying the provisions of Secondary Adjustment. e.g. allocation on the basis of quantum of transactions with each AE may be suggested as one of the criteria.

- Section 92CE(1)(ii) provides that the assessee is required to make a secondary adjustment where primary adjustment to transfer price has been made by the Assessing Officer (AO) during assessment proceedings, and has been accepted by the assessee.

  The above may not sufficiently provide clarity as to whether the following scenarios will be covered under the definition of acceptance:

a) Where the assessee has not preferred an appeal not because of the fact that such adjustment is acceptable to the assessee but to avoid litigation efforts;

b) Where the assessee has received an unfavorable order from an appellate authority and the assessee does not have the right to prefer further appeal (for e.g., in several TP issues, an appeal before the Hon'ble High Court may not be filed or may not be admitted as underlying issues are fact-based and do not involve any question of law, etc.)

There is lack of clarity on what exactly the term 'has been accepted by the assessee' means.

- The delay in repatriation may arise due to reasons not attributable to taxpayer i.e. on account of application of other legal and regulatory requirements such as application of exchange control regulations, Goods and Services Tax, customs regulations and applicability of thin capitalisation rules in the tax jurisdiction of the AE. If the deemed loan cannot be repaid by the non-resident AE to the Indian taxpayer, due to commercial, legal or regulatory issues, the loan would remain in existence indefinitely, leading to notional interest imputations.

  Making an accounting entry may have an impact on 'Book Profit' for calculations under section 115JB of the Act in the year of passing of such entry and may have some further implications if the taxpayer's F (MAT) liability exceeds the computation under normal tax provisions.

- The phrase "secondary adjustment" has been defined in clause (v) of Sub-section (3) of section 92CE of the Act to mean an adjustment in the books of account of the assesse and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price as determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee. Sub-section (2) lays down the requirement for excess monies to be repatriated to India and for interest to be levied thereon, if not repatriated within the prescribed time. However, sub-section (2) does



not refer to 'secondary adjustment' as envisaged under Sub-section (1) and defined in Clause (v) of Sub-section (3). The absence of references to sub-section (1) and/or 'secondary adjustment' in Subsection (2) results in an apparent disconnect between Sub-sections (1) and (2) which may have unintended consequences.

- In case interest imputed is not paid in the year of imputation, it is unclear as to whether it will take the colour of a "primary adjustment" and interest will be levied on such unpaid interest of last year (treating it as an advance). This will lead to a cascading effect and unnecessary burden on the assessee.
- The provisions, as presently worded, may give rise to an interpretation that even where the primary adjustment is made in the hands of non-resident, secondary adjustment follows. As a consequence, it may be interpreted as allowing repatriation of funds outside India, which may not be permitted even in terms of FEMA/RBI regulations.
- Section 92CE of the Act deems the difference between the transaction price and arm's length price as an advance (which is to be recorded in the books) and provides for imputation of interest on such advances. However, there is no specific provision to reverse the advances appearing in the books even in case where the AE relationship ceases to exist or in case where the excess money is repatriated.
- Rule 10CB(2) currently specifies interest rates that shall be applicable for computation of interest on excess money not repatriated within specified time periods. However, currently neither section 92CE nor Rule 10CB clarifies that the interest computation would start from the day the applicable 90 days period gets over (*i.e. the interest computation would start after expiry of 90 day time limits specified under Rule 10CB (1)*).

Recommendations

- An option should be provided to taxpayer to receive the entire remittances from one or more AEs selected by the taxpayer (including the AE not involved in the affected international transactions) rather than a mandatory receipt from all of the AEs involved in the affected international transactions.
- A suitable clarification be provided on the term 'has been accepted by the assessee'.
- Sub-Sections (1), (2) and (3) of section 92CE of the Act need to be revisited to streamline and appropriately link up the three sub-sections to provide adequate clarity as to the specific requirements from the taxpayers.
- Further, bilateral APAs and MAPs shall be excluded from the purview of the section 92CE of the Act since the terms of bringing money into India would already have been decided by the competent authorities of the two countries and such terms should prevail over a domestic law. It should be further clarified that the APA signed prior to insertion of section 92CE of Act should not be covered by the secondary adjustment provisions.
- The computation mechanism for levy of interest under Sub Section (2) should be clearly prescribed with detailed examples to obviate uncertainty including the trigger for such secondary adjustment or interest levy and the start date for levy of interest. Appropriate



safeguards by way of clarificatory provisions/Rules should be brought in to obviate an interest on interest situation and cascading effect.

- Necessary clarifications on accounting treatment and adjustment in books of accounts of the AE to be provided. Clarifications are also sought in cases where delay in repatriation is due to reasons not attributable to taxpayer.
- A clarification is required on whether the secondary transaction in the form of interest would be included for MAT purposes.
- Clarifications are requested for cases where the AE ceases to exist i.e. AE has been liquidated. Also, clarification may be provided for a scenario, where if at the time of making secondary adjustment, the AE relationship ceases to exist.
- It is recommended that section 92CE(2) of the Act be amended to clarify that the section applies only in case where the primary adjustment is made in the hands of the Indian AE.
- Under regulations of few other countries like South Africa, , inter-company setting off of accounts is allowed for deemed loans arising out of secondary adjustments provisions, however the same has not been provided for under Indian regulations, which make the Indian regulations more onerous. Permitting such netting off may ensure that the outstanding loan balances do not remain so till perpetuity and the interest on the same does not keep accumulating endlessly.
- It may be specifically provided that the advances appearing in the books of the parties be reversed in cases where AE relationship ceases to exist or excess money is repatriated.
- Clarity should also be provided with regard to non-applicability of provisions of section 2(22)(e) of the Act where any sum is treated as an "advance" by virtue of the secondary adjustment.
- It should be appropriately clarified that the interest computation would start from the day the applicable 90 days period gets over (*i.e. the interest computation would start after expiry of 90 day time limits specified under Rule 10CB (1)*).

3.21.3. Range to be broadened to 25%-75% - interquartile (IQR)

CBDT has notified the final rules for using the range concept and multiple year data in determination of Arm's Length Price. As per the rules prescribed by the Government for application of range, the margins in the data set (i.e., set of comparable companies) are required to be arranged in ascending order and the arm's length range would be data points lying between the 35th and 65th percentile of the data set.

Recommendation

The 35th to 65th range is a very narrow range. It is very unique and is normally not followed globally. In most cases, the arithmetic mean does not fall within this range. In fact in most cases, the mean falls within the inter quartile range. Thus, it is recommended that an inter quartile range i.e. data points lying between 25th to 75th percentile should be prescribed as it is an internationally accepted norm. This would go a long way in reducing litigation.

3.21.4. Introduce term test concept for benchmarking the consolidated margins earned by the tested party

Issue

In certain business segments where long term project is a norm (construction, power generation, Oil and gas, etc.), companies enter into long term contracts (spanning for a period of 2-5 years), the pricing is determined considering the market competitiveness and overall margins that can be earned on the entire project (also factoring the subsequent maintenance related business in such project). However, year by year margins on the project fluctuate basis the completion of the project and scope of work completed.

Recommendation

Considering the tax principle that every year is a separate year for tax assessment, the current TP regulations provide for benchmarking the margins of a legal entity year on year basis without factoring the overall margins of the entity over a period of time. This results in having TP adjustments in one year due to lower margins without any corresponding reversal in subsequent years when the margins exceed the arm's length margins. Considering this business scenario in mind, concept of term test for benchmarking the margins over a range of years can be introduced in the Act in line with the OECD guidelines.

3.21.5. Block assessment to be considered for some issues

Under the current transfer pricing regime, assessment is carried out separately for each assessment year irrespective of the nature of the issue.

Recommendation

It is suggested that block assessment of 3-5 years should be considered for issues like royalties and other principle issues, as they are cyclical in nature and carrying out a separate assessment for every year result in wastage of time and resources of the taxpayer and the tax department. A mechanism for detailed assessment in the first year of the prescribed block which should be made applicable for the remaining years of the block be evolved. This would help us to align our practices with global best practices. Such block assessment will free up administrative resources for the revenue also and will also reduce the litigation burden of the taxpayer.

3.21.6. Detailed guidelines on issues like location Savings, Marketing Intangibles, Cost contribution arrangements, Intra-group services, benchmarking of loans and guarantees

A plethora of litigation on transfer pricing matters in India revolves around the following issues:-

- compensation for location savings,
- compensation for development of marketing intangibles and their economic ownership and related returns,
- compensation for other intangibles where significant functions related to development, enhancement, maintenance, protection and exploitation (DEMPE) are carried out in

India,

- Cost contribution arrangements
- intra-group service charges,
- inbound and outbound loans and guarantees, etc.

There are no specific guiding principles currently in the Indian Transfer Pricing (TP) regulations to determine arm's length compensation for the above transactions/ situations (except for receipt of low value intra group services, introduced recently under the revised safe harbour rules).

As regards marketing intangibles there are some important rulings where the Tribunals and Courts have laid down certain important principles, but these rulings do not provide clear guidance on what methodologies/approaches can be adopted by the taxpayers for determining arm's length price. There are also several contradicting judgments on these matters.

Recommendation

In the absence of any guidance or industry benchmarks in public domain for testing such transactions, it is suggested that detailed guidelines in line with the Organisation of Economic Co-operation and Development (OECD) Base Erosion Profit Shifting (BEPS) Action Plans 8-10, where India has also provided its consensus need to be introduced in the Indian transfer pricing regulations.

3.21.7. Roll Back of Advance Pricing Agreement (APA)

The 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 Frequently Asked Questions (FAQs) clarifying certain issues. In this regard, some of the aspects that need to be further addressed are as under.

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.

This provision should be relaxed to the extent that taxpayers with similar transactions with no substantial changes in 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, this provision should be made applicable to similar nature of transactions and with different AEs.

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. It is recommended that this provision should be relaxed and should not result in the cancellation of the entire APA.

Roll back of APA is allowed only for four preceding years. Considering the time span of litigation in India, in various situations more than four year old cases would still be open. To make dispute resolution mechanism more effective, it is recommended that the APA rollback should be allowed for all the open years.

3.21.8. Safe Harbour Rules

The Safe Harbour Rules (SHRs) have been revised in 2017applicable for Assessment Year (AY) 2017-18 to AY 2019-20. Under the revised SHRs, safe harbour ratios were rationalised, safe harbour for receipt of low value adding intra group services (LVIGS) was introduced, upper turnover threshold of Rs. 200 crore introduced for all contract service providers [IT, ITeS, KPO, R&D for IT and generic pharmaceutical drugs], safe harbour rates on loans advanced in foreign currency have also been introduced. Most of these revisions are welcome, however, there are still some issues in the SHRs that need to be addressed and are given below:-

Issues and Recommendations

The definitions of various eligible international transactions under the SHRs like KPO services vis-a-vis ITeS, Software development services vis-à-vis contract R&D services relating to software development, leave a lot of room for subjective interpretations and there is lack of clarity on categorization or classification of these services. Clear and more objective criterions may be introduced for classification of services. For e.g., the artificial barrier between contract IT services simpliciter and contract IT R&D services should be removed to have one uniform rate for all contract IT services.

The prescribed safe harbour rates for outbound loans are otherwise fair, yet the obligation of having the credit rating of the overseas borrower being approved by CRISIL, is an additional cost burden for taxpayers who wish to opt for the SHRs. Thus, it is suggested that the requirement of credit rating of the overseas borrower to be approved by CRISIL should be removed.

Further, the arm's length prices or ratios prescribed under the SHRs should be rationalised for manufacturers of auto components, to make the same attractive enough for such taxpayers to opt for the SHRs.

Considering that the SHRs are applicable only till current financial year 2018-19 (AY 2019-20), the SHRs may be extended for further period (say 2-3 years) with the revisions as discussed above.

3.21.9. Three-tiered Transfer Pricing Documentation - Clarity on adoption of Local File

Issue

Though the rules for furnishing of Country by Country report and Master File have been prescribed last year, no rules have yet been prescribed for preparation and furnishing of Local file. Thus, there is no clarity on whether OECD recommendations on Local file would be adopted in Indian TP regulations or not and whether there would be any different threshold for preparation and maintenance of the same.

Recommendation

Draft rules should be released for public consultation (giving adequate time) detailing Local File requirements and applicable threshold, which may ideally be higher than the currently prescribed threshold for TP documentation i.e. Rs. 1 crore.

3.21.10. Master filing by offshore entities - Compliance requirement not clear (Rule 10DA)

Issue

There are contrary view points on whether the overseas entities are required to file Master File individually or whether a designated Indian group entity can file the form on behalf of all such overseas entities also, as being presently done for Indian group entities

Recommendation

Clarifications should be brought in this regard and preferably, an Indian group entity should be allowed to file a master file on behalf of all Indian and overseas group entities required to undertake such compliance in India

3.21.11. Extension of time limit for filing master file in line with global timelines (Rule 10DA)

Issue

Due date for filing the Master File by entities (Indian and overseas) is November 30th. Being part of global multinational, the Master File has to be aligned with the Master File to be submitted by the Group Holding Company in its tax jurisdiction and hence filing of Master File by such entities in India by the said due date is practically difficult where the due date of filing for the Group Holding Company falls after 30th November as the Master File may not have been finalized by them as on 30th of November.

Recommendation

It is recommended that the deadline for filing master file in India should be brought in line with the global deadlines.

3.21.12. 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 favour 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.

3.21.13. 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.

3.21.14. Allow appeal before Commissioner of Income tax (Appeals) against order of penalty under section 271AA

Issue

Section 271AA of the Act provides that (without prejudice to the provisions of section 270A or section 271 and 271BA), if a person in respect of an international transaction/specified domestic transaction

- Fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of section 92D;
- fails to report such transaction which he is required to do so; or
- 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.

It may be noted that there is no mechanism under the provisions of the Act to allow filing of appeal before the Commissioner (Appeals) against the order passed by the Assessing Officer

imposing the above-mentioned penalty.

Recommendation

It is suggested that the provisions of section 246A of the Act be amended to allow the taxpayer to file an appeal before the Commissioner of Income Tax (Appeals) against the aforesaid penalty order passed by the assessing officer.

3.22. Financial Services

3.22.1. 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. Category III AIF's are also regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012 made under the Securities Exchange Board of India Act, 1992 along-with Category I& II AIF's. 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.

Recommendation

It is recommended to include Category III AIF's under the provisions of section 115UB in order to provide clarity on taxation of Category III funds.

3.22.2. International Financial Services Centre

The Finance Act, 2016 made various amendments in the Act with a view to incentivise the growth of International Financial Services centres into a world class financial services hub. However, certain issues which still need to be addressed to provide a competitive tax regime to Indian IFSC are given below for consideration of the Government:-

Issues

- Section 115JB(7) of the Act states that where the assessee is a unit located in an IFSC and derives income solely in convertible foreign exchange, a lower MAT rate of 9% shall apply as compared to the present MAT rate of 18.5%. The current MAT rate of 9% does not make the Indian IFSC globally competitive.

- Section 115-O(8) of the Act states that no tax on distributed profits will be charged in respect of the total income of a unit in an IFSC that derives income solely in foreign exchange on any amounts declared, distributed or paid as dividends (interim or otherwise) out of its current income on or after 1 April 2017**.** Although the Memorandum Explaining the provisions of the Finance Bill 2016 states that the amount of dividend on which DDT is not leviable by virtue of section 115-O(8) is exempt in the hands of the person receiving the dividend, there is some ambiguity as section 10(34) has not been consequentially amended to exempt the income in the hands of the shareholder.
- Mutual funds are permitted to operate in an IFSC. However, additional income-tax on income distributed by mutual funds has not been waived on the same footing as dividend distribution tax.
- Several of the tax exemptions for units located in an IFSC are tied to the condition that income is derived solely in convertible foreign exchange. Income earned from shares of domestic companies may not be received in convertible foreign exchange. Portfolio Managers, Alternate Investment Funds and Mutual funds are permitted to invest in shares of domestic companies vide SEBI Circular No. SEBI/HO/MRD/ DSA/CIR/P/2017/45 dated May 23, 2017.
- Tax holiday under section 80LA of the Act inter alia mentions that deduction from gross total income shall be available in respect of income from any unit in the IFSC from its business for which it has been approved for setting up in such a centre in a Special Economic Zone. There is some ambiguity as regards FPIs as they earn income in the nature of capital gains, they do not set up a unit in an IFSC and they do not engage in business. As per SEBI(IFSC) Guidelines 2015, SEBI registered FPIs can operate in an IFSC without any additional documentation or prior approval process. Further, the tax holiday period of ten years under section 80LA of the Act is very short when compared to tax breaks provided globally e.g. Dubai Offshore Financial Centre provides a tax break for 50 years.

Recommendations

- It is suggested that MAT should be abolished for a unit located in an IFSC to compete with tax breaks offered by IFSCs globally (e.g. Dubai (0%), Malaysia (3%).
- It is suggested that section 10(34) of the Act be amended to specifically clarify that dividend income is exempt in the hands of the shareholder even though the company has not paid DDT by virtue of section 115-O(8) of the Act.
- It is suggested that the provisions of Chapter XII-E of the Act may be amended to waive additional income-tax on income distributed by mutual funds operating in an IFSC.
- A carve out may be made in respect of availability of exemptions to a unit located in an IFSC if the sole reason for deriving income other than in convertible foreign exchange is on account of investing in shares of domestic companies.



- It is suggested that it may be suitably clarified that given the nature of the industry in which Foreign Portfolio Investors operate, tax holiday under section 80LA of the Act will be available to FPIs, although the income earned is in the nature of capital gains and a unit is not set up in an IFSC.
- It is suggested that the tax holiday period for unit in IFSCs may be suitably increased.

3.23. Tax Deducted at Source (TDS)

3.23.1. 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 casted 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 month end and year end basis on estimated basis for reporting purpose and are reversed subsequently. The Tribunal has also held the same in certain cases. This will also go a long way towards ease of doing business and in reducing the litigation.

3.23.2. TDS on rent by individual and HUF – Section 194IB

The Finance Act, 2017 has inserted section 194IB of the Act to provide that individuals or HUF (other than those covered under section 44AB of the Act), to deduct tax at source @ 5% on payment of rent to a resident exceeding Rs. 50000 per month or part of month during the previous year.

Issues

- Applicability of the said provision would cause genuine difficulty for small persons. The said provision is likely to cause hardship to the middle class taxpayers, who have taken premises on rent for residential accommodation/carrying on business. It will unnecessarily burden them with additional compliance burden of deducting and deposit tax on rent paid. Further, it is also not clear as to how the said provision is to be applied for one time rent payment like hiring hall etc.

Recommendations

- The threshold of Rs. 50,000 per month should be increased to Rs. 1,00,000 per month and a higher threshold for one time payments needs to be provided for.
- Since purpose of this provision is to gather information about payee's receiving rent exceeding Rs.6 lakhs p.a., it is suggested, instead of bringing in TDS, a provision should be made to provide annual statement of information, whereby, payer provides information of payment of such rent made by them, along with name and PAN number of the person to whom payment is made.
- Without prejudice, this provision should not be made applicable if rent is paid by cheque and PAN of Payee is available and payee furnishes such information annually to tax office.

3.23.3. 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 and Recommendations

- 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.
- Conjoint reading of the Section 199 of the Act and Rule 37BA of the Rules framed thereunder suggests that credit for the tax deduction should be given/granted on the basis of information relating to deduction furnished by the deductor (i.e. Form 26AS) and the information in the return of income of the claimant. The requisite details in respect of the tax deducted at source are available in the Form 26AS. The taxpayer may furnish the information relating to tax deducted at source in the return of income based on the details available in Form 26AS leading to inference that both the information furnished by deductor and information in the return of income are as per Form 26AS.

3.23.4. CBDT Circulars on issuing of TDS certificate

The CBDT vide Circular No 3/2011 dated 13 May 2011 and Circular No 1/2012 dated 9 April 2012 has mandated for all deductors to issue Form 16A which is generated from TIN (Tax Information Network) website.

- Further the CBDT in para 3 of Circular No 3/2011 specifically mentioned as under:-

"3. The Department has already enabled the online viewing of Form No. 26AS by deductees which contains TDS details of the deductee based on the TDS statement (e-TDS statement) filed electronically by the deductor. Ideally, there should not be any mismatch between the figures reported in TDS certificate in Form No. 16A issued by the deductor and figures contained in Form No.26AS which has been generated on the basis of e-TDS statement filed by the deductor. However, it has been found that in some cases the figures contained in Form No. 26AS are different from the figures reported in Form No.16A. The gaps in Form No. 26AS and TDS certificate in Form No. 16A arise mainly on account of wrong data entry by the deductor or non-filing of e-TDS statement by the deductor. As at present, the activity of issuance of Form No.16A is distinct and independent of filing of e-TDS statement, the chances of mismatch between TDS certificate in Form No.16A and Form No. 26AS cannot be completely ruled out. To overcome the challenge of mismatch a common link has now been created between the TDS certificate in Form No.16A and Form No. 26AS through a facility in the Tax Information Network website (TIN Website) which will enable a deductor to download TDS certificate in Form No.16A from the TIN Website based on the figures reported in e-TDS statement filed by him. As both Form No.16A and Form No.26AS will be generated on the basis of figures reported by the deductor in the e-TDS statement filed, the likelihood of mismatch between Form No.16A and Form No.26AS will be completely eliminated".

- CBDT Instruction No. 4/2012 [F. No. 225/34/2011-ITA.II] dated 25 May 2012 states that "where the difference between the TDS claim and matching TDS amount reported in AS-26 data does not exceed Rs Five thousands, the TDS claim may be accepted without verification." CBDT Instruction 1/2012 dated 2 February 2012 and Instruction 2/2011 dated 9 February 2011 provides similarly**.**
- CBDT Instruction No. 4/2014 [F. No. 225/151/2014/ITA.II] dated 7 April 2014 at para (5.2.a) reads "AO should verify whether TDS credits claimed by the taxpayer are available in the 26AS. If the credits are available in 26AS, a suitable rectification order.....should be passed".
- CBDT's Action Plan for the First Quarter of FY 2015-16 dated 24 March 2015 refers to "….(b) Giving credit for prepaid taxes, reflected in Form 26AS post processing….".

The above clearly demonstrates that there would not be any variation between TDS credit reflecting in the Form 26AS and TDS credit as per Form 16A. Further, in addition to these circulars, the CBDT in Central Actions plan of 2015 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.



It is therefore suggested 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 the Form 16A should be dispensed with. It must be ensured the tax officer grants TDS credit as per Form 26AS and do not insist for production of Form 16A.

Section 155(14) of the Act requires taxpayer to submit Form 16A within two years from the end of assessment year in case credit for TDS is not granted by AO for non-filing of TDS certificates with the return of income. In view of the above suggestion, sub-section (14) of section 155 of the Act should be deleted.

Further, section 203 of the Act which requires deductor to issue TDS certificates to the deductee should be amended to clarify that section 203 requires every person deducting tax to furnish certificate of tax deducted however such certificate is not necessary for claiming credit for tax deducted at source and the credit for tax deducted at source shall be granted in manner specified in Rule 37BA of the Rules.

3.23.5. Credit for TDS in the hands of a person other than deductee – Rule 37BA

As per Rule 37BA(2) of the Rules, where under any provisions of the Act, the whole or any part of the income on which tax has been deducted at source is assessable in the hands of a person other than the deductee, credit for the whole or any part of the tax deducted at source, as the case may be, shall be given to the other person and not to the deductee, provided that the deductee files a declaration with the deductor and the deductor reports the tax deduction in the name of the other person in its withholding tax returns.

It has been further provided in the Rules that the declaration filed by the deductee shall contain the name, address, permanent account number of the person to whom credit is to be given, payment or credit in relation to which credit is to be given and reasons for giving credit to such person and that the deductor shall keep the declaration in his safe custody.

It is however requested that specific inclusion of merger/demerger/amalgamation under Rule 37BA of the Rules will provide additional comfort to the deductor and create an obligation to transfer tax credit to the resulting entity. The suggested amendment in the aforesaid Rule can help in facilitating seamless transfer of tax credit and avoid unwarranted litigation.

3.23.6. 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. Further, it shall be pertinent to note that the employees deputed to India pays tax as applicable for services rendered in India.
- 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. It should be further clarified that such an arrangement would not trigger a creation of permanent establishment for the foreign enterprise in India.

3.23.7. 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.

3.23.8. 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.

3.24. Personal Tax

3.24.1. Taxation of long term capital gains (LTCG) on sale of equity shares of a company or a unit of equity oriented fund or a unit of business trust

Issue

The Finance Act, 2018 has withdrawn the exemption under Section 10 (38) of the Act and introduced a new Section 112A in the Act so as to provide that LTCG arising from transfer of such long-term capital asset exceeding Rs. one lakh will be taxed at a concessional rate of 10 percent.

The long-term capital gains will be computed by deducting the cost of acquisition from the full value of consideration on transfer of the long-term capital asset. The cost of acquisition for the long-term capital asset acquired on or before 31st of January, 2018 will be the actual cost. However, if the actual cost is less than the fair market value of such asset as on 31st of January, 2018, the fair market value will be deemed to be the cost of acquisition. Further, if the full value of consideration on transfer is less than the fair market value, then such full value of consideration or the actual cost, whichever is higher, will be deemed to be the cost of acquisition.

Recommendation

In order to encourage taxpayers to invest in mutual funds and shares, the gains from sale of such units/ shares should be made more tax-friendly by removing the taxability on such sale of long term capital assets.

3.24.2. 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 many stock options come with a rider that employees cannot sell/transfer the shares exercised by them under Employee Stock Option Plan ('ESOP') for a particular period. This is primarily intended to retain the employees from leaving the employment once the options are exercised. Ownership of the property carries with it certain basic rights, such as a right to have the title to the property, a right to possess and enjoy it to the exclusion of everyone else, and a right to alienate it without being dictated to. The employees do not have economic freedom with respect to such shares.
- 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. Section 17(2)(vi) of the Act seeks to tax a notional benefit when the actual gain is not even realized by the employee, and is not certain either. It is possible that the actual sale of shares could result in a loss for the employee. Since tax paid earlier cannot be set off against the capital loss, the employee suffers a double loss, namely tax outgo and loss on sale of shares.

  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 realisablevalue, 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.

3.24.3. Taxation of National Pension Scheme

Issue

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.

Recommendation

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.

3.24.4. Taxation of contribution to Superannuation Fund in excess of Rs. 1.5 lakh - Section 17

Issues

- Section 17(2)(vii) of the Act 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. This will also encourage one of the key focus areas of the Government of creating a pension-based society.

3.24.5. 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).

3.24.6. Increase in limit of Standard Deduction

Issues

- The Finance Act, 2018 has introduced a standard deduction from salary income uptoRs. 40,000 in lieu of reimbursement of medical expenses and transport allowance. Further, the benefit of additional deduction of Rs. 5800 is also reduced by the increase in cess rate from 3% to 4%.Standard deduction has been further increased to Rs. 50000 by the Finance Act, 2019.
- Further, basic exemption limit has also not been increased which was much expected by the salaried class.

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.
- Alternatively, the exemption towards reimbursement of medical expenses and transport allowance should continue in addition to standard deduction.

3.24.7. Education Allowance and Hostel 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.
- The hostel allowance granted by the employer to an employee to meet the hostel expenditure on his child is currently exempt uptoRs. 300 per month per child upto a maximum of two children. This exemption limit was fixed in the year 2000 with retrospective effect from 1 August 1997 and is very minimal considering the cost of inflation.

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.
- The exemption limit of Rs. 300 per month of the hostel allowance should be raised upwards to at least Rs. 5000 per month.

3.24.8. 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.

3.24.9. 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 Floe (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.

3.24.10. Provision of Treaty benefits while calculating TDS under Section 192

Issues

- Under the current tax regime, there is no provision under the Act which enables an employer to consider admissible benefits under the respective Double Taxation Avoidance Agreements (e.g. credit for taxes paid in another country/ treaty exclusions of income etc.), while computing tax to be deducted under Section 192 at the time of payment of salaries to employees. Further, the foreign tax credit rules notified by the CBDT in June 2016 also does not contain explicit provision for providing credit for taxes paid in another country by the employer at the time of deduction of tax on salary payments.
- 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 employees complete their assignments and leave India prior to obtaining their tax refunds which also creates hardships with respect to receiving back the 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. This amendment would also be in line with the existing provisions under section 234A, 234B and 234C of the Act which provides for claiming relief under section 90/ 90A/ 91 of the Act at the time of calculating



the tax in default on which interest is to be calculated.

3.24.11. 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.

3.24.12. Align tax treatment for Retirement/Pension Schemes of Mutual Funds and National Pension Scheme

Issue

Deduction is allowed under section 80CCD of the Act in respect of contribution to pension scheme of Central Government, Mutual Fund Pension Schemes qualify for tax benefit under section 80C of the Act, which gets clubbed with several other financial products such as EPF, PPF, NPS, Life Insurance Premia, ULIP, Tax Saving FDs, Home Loan repayment etc.

Recommendation

It is recommended that investment in Retirement Benefit/Pension Schemes offered by Mutual Funds be allowed deduction uptoRs. 150000 as in case of National Pension Scheme to provide a level playing field to the Mutual Fund industry.

3.24.13. 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 at least Rs. 3 lakhs to augment savings in the economy to promote economic growth.

3.24.14. 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.

3.24.15. 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 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. 20,000.

3.24.16. Electronic Meal Card

Issues and Recommendations

- In 2001, taxation of subsidized/free meals as perquisite was introduced vide Finance Act 2001. The perquisite rules provided that any expenditure incurred by the employer on providing free/ subsidized meals to its employees during working hours beyond Rs. 50 per meal per employee was taxable in the hands of the employees. It is important to note that no change has been made in the prescribed exemption limit till date. In the year 2001, when the current limit of Rs 50 per meal for exemption purposes was first legislated, an employer could easily provide a sumptuous meal to his employees within the limit of Rs. 50 without having to levy any tax on the employees. The average cost of a meal at various outlets in 2017 which ranges between Rs. 225 to Rs. 375 per meal clearly highlights the insufficiency of the present limit of Rs. 50 per meal. It is recommended that tax-exemption limit of Rs. 50 per meal should be revised to at least Rs. 200 per meal, to factor in rising inflation and to keep the meal benefit meaningful and relevant for the employee.
- Many employers these days provide this facility through electronic meal swipe cards/digital vouchers. 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. It is submitted that there are no policy considerations that justify making a distinction between electronic vouchers/cards and paper vouchers. Electronic vouchers/cards are identical in all relevant aspects to paper vouchers and hence, any distinction between the two for the purposes of the perquisite valuation rules is not warranted. Accordingly, it may expressly be clarified that the words "paid vouchers" used in the proviso to Rule 3(7)(iii) includes paper as well as electronic vouchers (i.e. electronic cards). It is accordingly recommended that the said exemption along with increased limit should be extended to electronic meal vouchers/cards.
- The prices of food products have been fluctuating significantly over past years and it is inevitable that the prices will keep on fluctuating in future as well. It is pertinent to note that the Act has already recognized the concept of indexation to adjust for inflation for the purpose of computing tax on long term capital assets. Considering the intent of the legislature to allow the benefits to the employees for availing facility of a sumptuous meal, it is recommended that the amount of exemption limit be linked with the Consumer Price Index (Food).

3.24.17. 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.

3.24.18. Notify enhanced exemption limit for gratuity – Section 10(10)(iii)

Issue

- Government vide notification S.O. 1420 (E) dated March 29, 2018 increased the limit of amount of gratuity payable to an employee under sub-section (3) of section 4 of the Payment of Gratuity Act, 1972 (39 of 1972) from the existing limit of Rs. 10 Lakh to Rs. 20 Lakhs. However, no notification to enhance exemption limit for the purposes of section 10(10)(iii) of the Act has yet been notified by CBDT.
- Consequent to aforesaid anomaly, there is disparity in exemption as per section 10(10)(ii) of the Act and as per Section 10(10)(iii) of the Act.

Recommendation

It is requested that the enhanced exemption limit of Rs. 20 lakhs for the purposes of section 10(10)(iii) of the Act be notified by CBDT to be made effective from March 29, 2018.

3.24.19. Provide clarification on taxability of interest accrued on the balance lying to the credit of an individual in a recognized provident fund post cessation of employment

It is recommended that a retrospective amendment in the Act may be issued to exempt interest accrued to individuals post cessation of employment till the date of actual withdrawal from recognised provident fund account.

3.24.20. Provide marginal relief if total income of resident individual taxpayer crosses Rs. 5 lakhs threshold by a small margin

To alleviate the difficulty for small taxpayers, it is recommended that the concept of marginal relief should be introduced for small taxpayers where their total income marginally exceeds the threshold of Rs. 5 lakhs such that tax liability does not exceed the incremental income beyond Rs. 5 lakhs.

3.24.21. Increase existing deduction of interest on housing loan (Rs. 2 lakh) available for one Self occupied property, corresponding to amendment to treat two properties as Self-occupied properties

In case of those taxpayers who opt for two properties as self-occupied properties pursuant to amendment by Finance Act, 2019, it is recommended that extra benefit of deduction for interest on housing loan should be allowed for aggregate amount of Rs. 4 lakhs.

3.24.22. Simplify procedure for submission of Form 12BB

Rule 26C of the Rules (which prescribes the form and manner of collecting evidences and proofs of prescribed claims from employees while estimating salary income under section 192 of the Act) may be amended to enable furnishing of Form 12BB and supporting evidences to employer either with digital signature or through any electronic functionality created by employer which has an employee-authentication process.

3.25. Other Direct Tax provisions

3.25.1. Requirement to obtain Permanent Account Number by non-individual entities entering into financial transactions

Section 139A of the Act casts an obligation on every person to obtain a Permanent Account Number (PAN) under certain prescribed situations. Such situations are enumerated in clauses (i) to (iv) of sub-section (1) to section 139A of the Act. The Finance Act, 2018 inserted the following two new clauses viz. (v) and (vi) in section 139A(1):

"Every person, -

(i)…..

(ii)….

……..

(v) being a resident, other than an individual, which enters into a financial transactionof an amount aggregating to two lakh fifty thousand rupees or more in a financialyear; or

(vi) who is the managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person referred to in clause (v) or any person competent to act on behalf of the person referred to in clause (v)

and who has not been allotted a permanent account number shall, within such time, as may be prescribed, apply to the Assessing Officer for the allotment of a permanent account number".

Issues

Whether the amendment will also cover transactions having non-monetary consideration/exchange transactions?

Issue

The legislature has used the specific words 'sum of money' [e.g. section 56(2)(x)] wherever it was so intended (as against the use of words 'an amount' in given case). In light of this, the term 'amount' may not be considered as restricted to only 'sum of money' and may also include payment in kind (i.e. transactions for non-monetary consideration).

Basis the above, considering the current language of the clause (v) and given that obtaining PAN is a compliance requirement, the scope of term 'financial transaction' may include exchange transactions as well.

Recommendation

It would be apt to make a suitable amendment in the provision to clarify that the said reporting requirement will not cover transactions having non-monetary consideration/exchange transactions.

Whether under clause (vi) of Section 139A(1), all managing directors/directors of a company, all partners of the firm, etc. are required to obtain PAN?



Issue

The Finance Act, 2018 has categorically incorporated two separate clauses (v) and (vi) in Section 139A which casts an obligation on every person to obtain a PAN under certain prescribed situations.

Clause (v) provides as follows:

- Every person, being a resident, other than an individual, which enters into a financial transaction of an amount aggregating to two lakh fifty thousand rupees or more in a financial year.

Clause (vi) provides as follows:

- Every person, who is the managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person referred to in clause (v) or any person competent to act on behalf of person referred to in clause (v).

CBDT[8] has issued a draft notification proposing amendments in Rule 114 of the Rules and Forms 49A/49AA of the Act. The draft notification proposes that the PAN application shall be made by the specified persons on or before 31 May, immediately following the financial year in which such transaction is entered into. Issue may arise in case where an entity satisfies the requirement of clause (v), whether all the specified personnel (e.g. all directors in case of company, all partners in case of a firm) would be required to comply with PAN requirement irrespective of their involvement in the financial transaction.

Clause (vi) when read with the opening words of the section i.e. 'Every person' in Section 139A(1), it seems that it would cover every person referred to in clause (vi) to meet the requirement of obtaining PAN. Further, clause (vi) also covers '*any person competent to act on behalf of the person referred to in clause (v)*'. It seems that it envisages to cover any person who is competent to act on behalf of the person referred to in clause (v) irrespective of whether the person has/was actually involved in any financial transaction. Thus, on a literal reading of the clause (vi), merely basis the competency of the personnel to act on behalf of the entity specified in clause (v), such person may be required to apply for PAN.

It would result into an unnecessary burden on large entities if every officer is required to take PAN. It would be a cumbersome compliance burden on the large entities.

Recommendation

A suitable amendment should be made to provide that only one of the officers/executives of an entity should be required to take PAN.

3.25.2. 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

[8]CBDT draft notification (F No.370142/40/2016-TPL (Part-I)



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'sfavour, 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. It is further suggested that proper guidelines be laid to introduce accountability and further avoid overlapping of responsibility between TRACES/CPC officers vis-à-vis the jurisdictional officers in such cases. It is further suggested that refund struck with the department due to adjustment against erroneous demand, non-grant of due TDS credit etc. be made eligible for interest @ 12% per annum.

3.25.3. Restriction on Set-off of Loss from House Property

The Finance Act, 2017 has inserted sub-section (3A) in section 71 of the Act to provide that loss from house property up to Rs. 2 lakhs only will be set-off against the income under other heads in the same financial year. Loss above Rs. 2 lakhs is eligible to be carried forward for a period of eight years and can be set-off against income from house property only.

Issues

- This provision contradicts with the intention of the government to incentivise housing sector and promote investment in real estate sector. This could act as a dampener for promoting investment in the Housing sector.
- Considering that in most of cases, the prices of properties have gone down by more than 20-25% in the past 3 to 4 years, the owners are already burdened with the reduction in the value of property combined with interest cost. This provision would further compound the misery of the owners as apart from the huge loss of capital and outflow of interest, their tax burden would also increase substantially.
- Generally, middle class and lower middle class people invest in property by obtaining loan from banks. The amount of interest paid is always higher than rental income earned from such property.



- The owners of the property had entered into these loan arrangements for purchase of the property based on the prevailing tax provisions at that time and change in the prevailing provision in respect of loans taken before the change would have retrospective implications as the owners are not in a position to reverse the transaction.
- As a specific example, it discourages the middle class from investing in a house property as a backup post retirement (including government employees) (where the house may be let out temporarily). Further, the amount of Rs. 2 lakhs as interest threshold is quite low compared to interest payout made by the taxpayers in initial years of loan. The above threshold should be at least increased to Rs. 4 lacs.
- Further, the loans are obtained for 15-20 years and the interest payments in EMIs are very high until 10th year. In eight years, they will not be able to set off the interest resulting in permanent loss to them.

Recommendations

- The limitation provided by the Finance Act, 2017 limiting the set-off of loss of house property to the extent of Rs. 200000 should be removed.
- It is observed that the amendment has a retrospective effect which is against the commitment made by the Government to not make any retrospective amendment. If any change is required to plug the tax benefit, it is recommended that houses purchased after 1 April 2017 or housing loans obtained after the said date should be covered under the provisions of section 71(3A) of the Act and suitable amendment be made accordingly.
- It should be further clarified that interest deduction for self-occupied property and let out property, a separate limit of Rs. 2 lakh each, aggregating to Rs.4 lakh should be made, so that the interest deduction for self-occupied property and let out property both is available to the extent of Rs. 2 lakh each. Alternatively, the time limit of eight years should be removed for carry forward and set off and the loss should be allowed for an indefinite period like unabsorbed depreciation allowance.

3.25.4. 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 (i.e. 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.

3.25.5. Deduction under section 80G

Issue

Deduction under section 80G of the Act is allowed in respect of donations to certain funds, charitable institutions etc., however, the deduction is restricted to the extent of 10% of gross total income. Even though there are many magnanimous donors who are willing to contribute funds to charitable institutions after ensuring that their donations are properly utilised, the overall ceiling of 10% of gross total income under section 80G of the Act impedes their way to contribute liberally and encourage more and more institutions.

Recommendation

- The ceiling of 10% on gross total income may be removed.
- Donations to Chief Minister's Relief Fund be allowed 100% exemption and accordingly suitable amendment be made in the provisions of section 80G of the Act.

3.25.6. Increase in de-minims limit for payment of advance tax

Issue

- The de-minimis limit of Rs. 10,000 for payment of advance tax has been last amended by Finance Act, 2009. In view of the above and considering the inflation in the economy it is proposed to increase the de-minimis limit for payment of advance tax.

Recommendation

- Current threshold of payment of advance tax where the tax payable is in excess of Rs. 10,000 should be increased to Rs. 1,00,000.

3.25.7. Manner of computation of advance tax to include deductibility of Foreign Tax Credit (FTC)

Issue

- Section 209(1)(d) of the Act provides that while computing the advance tax payable, income-tax which would be deductible or collectible at source during the financial year under the provisions of the Act from any income which has been taken into account in computing the current income shall be reduced from the advance tax so computed. However, the current provisions of Section 209 of the Act do not cover deductibility of foreign tax credit in the computation of advance tax payable.

Recommendation

- Section 209 of the Act should be amended to expressly provide for deductibility of FTC in addition to taxes deductible or collectible at source from the advance tax computation.

3.25.8. 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.

3.25.9. 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.

3.25.10. Filing of return of income

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.

3.25.11. Deduction to be allowed on merits even if claim is not made in tax return

Issue

- Section 80A(5) of the Act denies deduction to an assessee, in case he has failed to make a claim in his return of income for any deduction under sections 10A, 10AA, 10B, 10BA or under any provision of Chapter VI-A under the heading "C- Deductions in respect of certain incomes". Provisions are highly punitive and are applied even in case of bonafideassessees. As per Circular No.14 dated 11/4/1955 the assessing officer is bound to allow deduction even if the same has not been claimed by the assessee. It is a settled law that beneficial provisions/deductions etc. should be interpreted liberally. Various High Courts have consistently ruled that if an assessee has omitted to make a claim in tax return, then the same can be made during the course of assessments/appellate proceedings. However, 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.

3.25.12. E-assessment

CBDT, vide Instruction No. 03 of 2018 dated August 20, 2018 has modified the earlier Instruction No. 1 of 2018 dated February 12, 2018, and mandated e-proceeding for all assessment proceedings to be framed under section 143(3) of the Act in financial year 2018-2019. It has been observed that several difficulties are being faced by the large corporate taxpayers in dealing with e-assessment for the following reasons:-

Issues

a. Size limit of 5 MB for uploading submission & documents is inadequate;

b. Income-tax e-filing system does not allow assessees to edit the response once it is uploaded. Cases of typo errors, upload of wrong file cannot be rectified;

c. Notices are issued seeking multiple documents/information (often 15-20 queries) with a limited period of 7 days to respond. Earlier, submissions were being filed in parts to comply with the notice. Under e-assessment, the same is not possible as only one response can be filed against one notice.

d. Several technical glitches on e-filing website defeat the purpose of e-assessment in providing a seamless system for submitting responses and accessing the record. Further,

multiple identical notices are being issued. There is no clarity as to which notice stands complied for and how do companies respond to other notices to ensure compliance on record.

e. Utilizing DSC of Director for every submission is a cumbersome process. There is no option available for Electronic Verification Code (EVC) or for appointing an authorized signatory to upload submissions.

Recommendation

- It is recommended that for large corporates, e-assessment be replaced with a hybrid model of assessment where certain submissions, either in whole or in part, are uploaded online while the others exceeding the size limit be allowed to be submitted in hard copy. This will increase digitization and at the same time afford an opportunity to the assessee to adequately represent itself.

3.25.13. 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.

3.25.14. Tax effect of Appellate Orders

Issue

It is often observed that the assessing officers do not provide tax effect of appellate orders favourable to assessee for long period of time. Lot of follow ups and reminders are required to get refunds. Further, considering the fact that there is a time limit for payment of tax, filing returns, completing assessment, etc., there should be a provision mandating the assessing officer to grant refund within certain specified days of receipt of appellate orders.

Recommendation

It is suggested that there should be provision in Income Tax Act to make assessing officer accountable to grant refunds within 30/45 days of receipt of appellate order.

3.25.15. 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.

3.25.16. Relief from interest under section 234B

Issue

Section 234B of the Act provides for levy of interest for default in payment of advance tax. The interest liability is computed on the basis of delay in payment of installments prescribed. The newly incorporated entity should not be obligated to pay advance tax for the installments due prior to the date of incorporation. However, it has been observed that in practice, interest is levied by the income tax department.

Recommendation

It is suggested that interest under section 234B of the Act should be levied only for remaining installments after the date of incorporation. Appropriate amendment in this regard be carried out.

3.25.17. Non-levy of interest under section 234C in case of capital gains for MAT

Issue

Section 234C of the Act provides for payment of interest by assessee in case of shortfall between tax payable on returned income and advance tax paid (paid on estimated income) in specified quarterly installment. However, no interest is payable where there is failure on the part of the assesse to estimate or under estimate the capital gains and tax thereon is paid by March 31 of the financial year. It is to be noted that said exemption from payment of interest under section 234C of the Act in case of capital gains is applicable only for income computed under the normal provisions of the Act. No such benefit is available where capital gains form part of book profit for the purpose of computation of MAT. Thus there is an excess levy of interest under section 234C of the Act on capital gains under MAT.

Recommendation

It is suggested that the benefit of the exemption from payment of interest on capital gains (where tax thereon is duly paid by March 31 of the financial year) be also extended to capital gains included in book profit for MAT purposes through suitable amendment in section 234C of the Act.

3.25.18. Clarity on interest under section 234C on interest on income tax refund

Issue

Interest under section 234C of the Act is levied for earlier quarters where interest on income tax refund is received during the year. It is a settled law that interest on income tax refund is chargeable to tax only on actual receipt. This causes hardship to the taxpayers

since he is required to pay interest for the period for which he has not received any income. The charging of interest should be aligned with the time of receipt of interest income on income tax refund.

Recommendation

Suitable amendment be made in section 234C of the Act to provide exemption from levy of interest on interest income on income tax refund for the period/quarter prior to receipt of such refund.

3.25.19. Search and seizure provisions

The Finance Act, 2017 has introduced a series of amendments in the Act expanding the enforcement powers of the tax authorities. The most noteworthy of these are the amendments to sections 132 and 132A of the Act which govern search and seizure operations.

"Reasons to believe" to conduct a search, etc.

It has been stated in the Memorandum explaining the provisions of the Finance Bill, 2017 that on account of some ambiguity created by certain judicial pronouncements in respect of disclosure of 'reason to believe', the Finance Act has amended the provisions of section 132 and section 132A of the Act to provide that 'reason to believe' or 'reason to suspect' shall not be disclosed to any person or any authority or the Appellate Tribunal.

While the amendments are made with a noble intent - to crack the whip on tax-evaders who take shelter under technical anomalies in the law and get away without paying any taxes, the same also confers unbridled powers to officials, and have seemingly tipped the scales in favour of the law enforcement agencies. Such unfettered powers without fastening accountability has raised concerns in business and investor community. It is humbly submitted that the Government must now ensure that such sweeping powers are tempered with more judicious use of search and seizure operations, coupled with checks and balances such that the rights of the taxpayer are protected.

Given the above, we respectfully submit the following recommendations on this issue:-

- The "reasons to believe" must be compulsorily recorded in writing and the same should be approved by the Commissioner, Principal Commissioner and the Directorate General of Income-tax (Investigation) before conducting a search operation. Each of the approving authorities must record their satisfaction independently based on the available information.
- The recorded reasons must also give a detailed description of the information in possession, the time when such information was found along with detailed reasoning as to why it is believed that the subject matter forms part or will form part of unaccounted income of the taxpayer.
- The reasons should be disclosed by the tax authorities during the course of assessment/ appellate proceedings. The same may also be admitted as "additional evidences" during the appellate proceedings. Non-disclosure of reasons would severely hamper the



fundamental rights of the taxpayer as he would have no wherewithal to challenge the underlying basis; thus, grossly violating the principles of natural justice.

- As stated by the Finance Minister during the Parliamentary debate, it should be clarified that such reasons can be placed before the Courts in the event of a challenge to formation of belief; in which event the Court would be entitled to examine the relevance of the reasons for the formation of belief.
- Taxpayers' concerns should be addressed through effective implementation of the new provisions and ensuring that the provisions are not misused. An orderly system to ensure that the officers do not act on whim, unsubstantiated suspicion or rumours needs to be put into place. Measures such as implementation of a strict internal code for granting authorisation for search, administering a strict audit mechanism, releasing timely instructions, updating of search manuals, guidance on code of conduct for search officials, etc. can go a long way in providing a non-adversarial tax regime to the taxpayers.
- On many occasions, it is found that the tax authorities extend the inquiry post-search operations to legal issues which are unconnected and are already settled in earlier years either in assessment or appellate proceedings. The tax authorities should not extend the course of their search and seizure operation to issues which are unrelated/ unconnected other than those forming part of recorded reasons.
- In order to ensure that the tax officials exercise their powers judiciously, provisions which enable fixation of accountability on tax officials / informants in cases where an assessee is acquitted by the High Court / Supreme Court must be introduced. In this regard, a reference may be drawn from parallel statutes (example, Section 22 of Central Excise Act, 1944 and Section 136 of the Customs Act, 1962) which fixes accountability on the tax officials in cases of vexatious search and seizure operations. Similar provisions in the Income-tax Act, 1961 will help in preventing misuse and overreach.

"Provisional attachment" of property

It has been stated that to protect the interest of revenue and safeguard recovery in search cases, the tax officers will now have the power to attach provisionally any property belonging to the assessee. This is in addition to vast powers which the tax officers already have under the existing provisions of the Act. (say, section 281B of the Act which also provides for attachment of property)

Any seizure/ attachment of assets is extremely disruptive for a taxpayer and hence such power must be exercised extremely judiciously. In addition to the guidelines/ safeguards mentioned in The Second Schedule, the following guiding principles should be adhered to before attachment of any property:

- Any provisional attachment of property of the taxpayer must be approved by a Panel of 3 members; say the Principal Director General, the Directorate General of Income-tax (Investigation) as well as by an independent member (say, a retired judge of High Court or Supreme Court).



- A show-cause notice must be issued to the taxpayer so as to provide him an opportunity to defend his case as to why a particular property should not be provisionally attached.
- Pursuant to explanation provided by the taxpayer in response to the show-cause notice, the tax authorities must pass a speaking order if it intends to proceed with the provisional attachment. Also, such order must be made appealable.
- The value of attached properties should not exceed the amount of tax which the taxpayer has supposedly evaded.
- Section 281 of the Act already grants sufficient powers to the tax authorities wherein certain transfers are regarded as void if made during the pendency of any proceeding under the Act. Thus, the provisions pertaining to attachment of properties during the course of search operations must be exercised only in rare circumstances where the tax authorities have reason to believe that the taxpayer will transfer/ sell the assets.
- The attached property should be released if the taxpayer makes satisfactory arrangements for payment of applicable taxes and interest.
- Also, relevant provisions should be introduced so as to ensure that such powers are not indiscriminately used.
- The third report of the Tax Administration Reform Commission (TARC) has also suggested that search and seizure operations should be limited to cases where hardcore tax evasion is suspected. To ensure this, economic intelligence should be better developed and exchanged. Non-invasive surveys based on credible information and a technology-based tax collection system, which is non-intrusive, should be used to identify non-filers.

3.25.20. Prescribe mandatory time limit for processing of rectification and stay applications

Issue

It has been observed that the rectification application and stay applications filed by the taxpayers are not processed timely by the tax officers due to which the tax payer is refrained further taking further action and the environment of uncertainty is developed. The taxpayers also suffer from actions of the tax officer such as notice for additional demands, coercive recovery, and unnecessary pressure to pay demands. This causes serious liquidity problems for the taxpayers.

Recommendation

It is suggested that a statutory mechanism for ensuring disposal of rectification and stay application filed by the taxpayers within a prescribed time limit should be introduced. It is further suggested that amendment be made in section 154 of the Act to provide that in case the tax officer does not pass the rectification order within a specified period of say 6 months from the date of filing of application, rectification application shall be deemed to be allowed. Further, similar provision should also be introduced in the Act to ensure timely disposal of stay applications filed by the tax payers.

3.25.21. Prosecution proceedings – Failure to pay TDS

Issue

Section 276B of the Act lays down the prosecution provisions for failure to deposit TDS. It has been observed that there have been cases selected for prosecution under the said provision by the income tax department, even in cases where the delay may not have been for significant period (say less than a month or two) and interest under section 201(1A) of the Act has been duly paid.

Recommendation

It is suggested that prosecution proceedings should be avoided in genuine cases. It is further suggested that parameters for identifying genuine cases of delay should be introduced.

3.25.22. 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.

3.25.23. 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 assessee 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. One instance of under-reporting is mere excess of income assessed over income returned, for which a 50% penalty is applicable. This implies that any disallowance made by the AO will be a case for levy of penalty, regardless of whether the disallowance is on account of a false or genuine claim, capable of different interpretations. It also creates a perception of the effective tax rate being much higher.



- There is no clear-cut explanation/definition of what constitutes misrepresentation or suppression. Further, no obligation has been cast upon AOs to prove the mala fide intention of assessees, though they have the power to levy the penalty.

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 addition to the 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. Accordingly, the provisions of section 270A of the Act need to be suitably modified to restrict scope of under-reporting or misreporting to only mala fide cases and to ensure that genuine assessees are not harassed. At a minimum, the earlier provisions for levy of concealment penalty or furnishing inaccurate particulars can be retained. Also, the onus to prove mala fide intention should be on the assessing officer, before levying the penalty. Suitable amendments in the Act be made to give effect to the above.

3.25.24. 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. The constitutional validity of section 234E of the Act has been challenged in different High Courts through various writ petitions and the Courts have in turn granted a stay against collection of such fees. 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

It is recommended that the provisions of section 234E be dropped as there are sufficient compensatory and penal provisions under the law viz. section 201, 271C and 221 of the Act. Alternatively, fee under section 234E of the Act be reduced to Rs. 50 per dayuptomaximum of Rs. 5,000 or amount of TDS/TCS (whichever is lower).

3.25.25. Rationalization of procedures followed by Centralised Processing Centre ('CPC')

(a) Issue of refunds to non-residents

Issue

In many cases, where the refund amount is in excess of Rs. 50,000, the refund is not credited directly into the assessee's bank account but the cheque is sent to the physical

address in India. In many cases, the non-resident may not have an address in India or the non-resident individuals may have sold the only house he had in India but has not yet changed the address in the PAN records for want of time or for want of the supporting documents required for the change of address in PAN records (especially w.r.t. attestation of documents). Even in those cases where the non- resident has an address in India and the cheque is duly delivered at that address, it cannot be deposited into the bank account because it requires the assessee to sign behind the cheque and fill up certain details. This results in the cheques lying uncashed and then becoming outdated.

Recommendation

It is suggested that all refunds should be credited directly into the bank accounts of the assessee instead of a physical cheque being sent.

(b) Non-granting of credit for TDS

Issue

Often, the TDS that appears in the Form 26AS for Year 1 is not claimed by the tax payer in his return of income for that year but is claimed in Year 2. In such cases, in Year 1, the TDS is shown as carried forward to Year 2 and in Year 2, it is shown as brought forward from Year 1. This primarily happens in cases of professionals, where the assessee follows the cash method of accounting and the deductors follows the accrual method of accounting. Despite this facility being made available in the ITR forms to carry forward the TDS to the subsequent year, the intimations under section 143(1) of the Act are received for the Year 2 where credit is not given for the TDS. Upon filing application for rectification under section 154 of the Act, the same working is received back by the assessee without any change in the TDS credit. The reason given in the order under section 154 of the Act for rejecting the application is "Credit claimed does not match with 26AS". At the same time, in such rectification orders, interest under section 244A granted earlier is reduced and this in turn results in a demand being raised on the assessee. Subsequent rectification requests are also rejected with identical reason and demand.

Recommendation

It is suggested that the systems of CPC be updated immediately to overcome this issue.

(c) Adjustment of old demands against recent refunds

Issue

It has been noticed in many cases that suddenly, some very old demands are shown to be outstanding against the assessee. In such cases, for demands of some of the earlier years, one can download the AO's computation sheet but for some years, these sheets are not available. In such situations, the assessee has to then personally follow up with the jurisdictional AO's office for the computations. If the matters pertain to very old years, it becomes very difficult to locate the records and obtain copies. As a result, the refunds due to the assessee get locked up for several years.



Recommendation

It is proposed that as soon as a demand is uploaded onto the system, the assessee should get a notification so that he/she can immediately take action in the matter instead of having to do so after a few years.

(d) Filing of returns by taxpayers covered by presumptive taxation

Issue

Taxpayers offering income on presumptive basis are not required to maintain books of accounts. However, they may have a PE in India for the year, but have opted to offer tax under the presumptive taxation regime. However, while processing the return of income, CPC issues notice under section 139(9) of the Act proposing to treat the return of income as invalid as the Balance Sheet & Profit and loss account details are not filled up.

Recommendation

It is proposed that the CPC takes remedial action in cases mentioned in the Justification section and does not treat the returns as defective.

3.25.26. 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 assessee".

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 inter dependent 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.
- 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.

3.25.27. Allow assessing officer to appeal against the order of Dispute Resolution Panel

Issue

After the amendment made by the Finance Act, 2016, an assessing officer is not allowed to appeal against the order of DRP. The amendment was made by the Government by omission of section 253(2A) and section 253(3A) of the Act through Finance Act, 2016. The objective of the amendment as stated in the Memorandum Explaining the provisions of the Finance Bill, 2016 was to minimize litigation.

The DRP that was intended to be a quality assessment filter, has lost its effectiveness due to the amendment brought in 2016 by the Finance Act. The Revenue has now been barred from appealing against its directions. There is an apprehension that this will restrict the freedom of DRP in passing directions favourable to tax payers. For the last two years, when DRP directions were appealable even by the Revenue, a distinct fairness in its directions was evident. DRP directions, therefore, should again be rendered appealable by the Revenue.

Recommendation

It is recommended that the assessing officer should be allowed to appeal against the order of DRP. Suitable amendments in the Act be made accordingly.

3.25.28. Revision of the order

Issue

The Finance Act, 2015 amended section 263 of the Act to provide that an order passed by the Assessing Officer shall be deemed to be erroneous insofar as it is prejudicial to the interests of the Revenue if, in the opinion of the Principal Commissioner or Commissioner the required conditions are fulfilled. These provisions give wide powers to Principal Commissioner. Similar changes have not been made in section 264 of the Act for orders which are prejudicial to assessee. Sections 263 and 264 of the Act were introduced with similar intent, i.e., to revise orders passed by lower authorities that are prejudicial to the interest of either the revenue or the assessee. Such amendment to section 263 alone makes the provisions biased in favour of the revenue.

Recommendation

It is recommended that the earlier provisions of section 263 of the Act be reinstated. Alternatively, section 264 of the Act should be amended suitably to bring it in lines with section 263 of the Act.

3.25.29. Extend Powers of the Income Tax Appellate Tribunal to grant stay of demand beyond 365 days

Issue

Section 254 of the Act restricts power of ITAT to grant stay of demand for more than 365 days from the date of initial application, even if the delay in disposing of the main appeal is



not attributable to the assessee. It has been observed that due to numerous cases involved, the main appeal remains undisposed for more than a year due to reasons not attributable to the assessee.

Hon'ble Gujarat High Court in case of ITO vs Anil GirishbhaiDarji (239 Taxman 146) and DCIT vs Vodafone Essar Gujarat Ltd. (376 ITR 23) has held that the Tribunal has the power to extend the stay of demand beyond a period of 365 days. However, extension of stay of the demand beyond the total period of 365 days from the date of grant of initial stay would always be subject to

-subjective satisfaction of the Tribunal;

-on an application made by the petitioner to extend the stay; and

-on being satisfied that the delay in disposing of the appeal within a period of 365 days from the date of grant of initial stay is not attributable to the assessee.

Recommendation

It is recommended that provision of section 254 of the Act be amended to grant ITAT power to provide stay of demand for period exceeding 365 days where the delay is not attributable to the assessee.

3.25.30. Waiver of interest under section 201(1A) – circular no. 11 of 2017 to be codified

Issue

CBDT circular no. - 11/2017, dated March 24, 2017, has issued guidelines wherein CBDT has provided powers to Chief Commissioner of Income-tax/Director General of Income-tax to grant waiver of interest under section 201(1A) where *inter alia* application has been filed under MAP, subject to specified conditions. The above benefit should also be extended to the assessee who have filed application before Authority of Advance Ruling and Advance Pricing Agreement. In case of AAR, time limit of six months for passing of an order has been prescribed in the Act, however, it has been observed that due to practical challenges, AAR proceedings have taken more than five years in most of the cases.

Recommendation

In view of the above, provision must be inserted in the Act to grant powers to CCIT and DGIT to grant waiver of interest under section 201(1A) to entities who have accepted the ruling of MAP, AAR or APA. The waiver of interest shall be from the date of filing application for MAP, AAR or APA till the receipt of the order from respective authorities. Alternatively, CBDT could issue new circular providing similar benefit to persons filing application with AAR or APA.

3.25.31. Change in due dates for payment of advance tax

Issue

As per section 211 of the Act, companies have to pay 15% advance income tax on or before the 15th June each year. This causes unnecessary hardship, since it is extremely difficult to compute taxable income within 75 days from the commencement of the financial year –



projections for depreciation (due to new acquisition or sell), TDS certificates that may be received, for example, cannot be ascertained accurately. Moreover, projections of profitability tend to vary from month-to-month.

Also, the requirement to pay 100% of the amount computed as income tax on or before 15th day of March each year results in curtailing cash inflows of companies.

Recommendation

The provision requiring payment of 15% as advance income tax on or before 15th June in each year be removed.

The schedule for payment of advance tax should be fixed in such a way that not more than 75% is payable as advance income tax on or before the 31st March each year, and 100% by 15th June of next financial year.

This will enable assessee to pay tax more correctly. Revenue collection of government will not be affected, as government will receive last instalment of advance tax in June, instead of first instalment. It is suggested that suitable amendment be made in the Act in this regard.

The amended dates for advance tax payment are suggested as follows:-

- First instalment - 15 September – 25%
- Second instalment – 15 December – 30%
- Third instalment – 15 March – 30%
- Fourth instalment – 15 June of next financial year – Jan 15%

3.25.32. 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**

3.25.33. Suggestions to minimise litigation

a) Create a separate vertical in Tax Administration for handling litigation before Tribunal, AAR, High Courts and Supreme Courts. The involvement of specialised vertical will



significantly improve the quality of pleadings and arguments on behalf of Tax Department, minimise litigation on frivolous issues, act as a check against unwarranted high pitched additions and initiation of penalty in a mechanical manner.

b) Create online repository of case status and pending issues at different levels which will assist both Tax Department and taxpayers to ascertain status of similar issues in past appeals.

c) Empanelment of competent lawyers to protect public interest

d) Capacity building measures where Departmental Representatives should be appointed for a fairly long time (say 5 years), there should be regular training programs for tax officials

e) Statutory time limit of 2 years for disposing appeals by Tribunals should be introduced instead of present persuasive time limit of 4 years

f) Statutory time limit of 90 days for passing order from the date of conclusion of hearing seems to be stringent having regard to current case pendency status at ITAT and hence, time limit may be suitably increased to 180 days

g) The CBDT should frequently issue Circulars or FAQs on contentious issues for the guidance of AOs so that they do not take any positions or file appeals contrary to the CBDT's views

h) Expand scope of s.158A and s.158AA to permit 'tagging' with similar issues in other taxpayer's cases

i) Make revision orders passed under section 264 of the Act by Commissioner of Income-Tax appealable to Tribunal

j) Liberalise immunity from penalty under section 270AA of the Act - taxpayer may be permitted to seek immunity on select issues by paying up tax and interest thereon while permitting him to contest other issues in further appeal, scope of immunity under section 270AA of the Act may be expanded to any assessment order passed on or after the date of amendment

k) The CBDT should provide clear guidance to AOs on circumstances in which penalty should not be initiated.

INDIRECT TAXES

CUSTOMS

4.1. Provide MEIS & SEIS utilization towards IGST on imports

In terms of para 3.02 of the Foreign Trade Policy 2015-20 (FTP 2015-20) read with Notification No. 24/2015-Customs & 25/2015-Customs, dated 08/04/2015 as amended, the Merchandise Export from India Scheme (MEIS) and Service Export from India Scheme (SEIS) scrips can be utilized for the payment of following:-

- Basic Customs Duty and Additional Customs Duty specified under Sections 3(1), 3(3) and 3(5) of the Customs Tariff Act, 1975
- Fee as central excise duty on domestic procurement of inputs or goods
- per para 3.18 of the FTP 2015-20

Accordingly, at present the MEIS and SEIS scrips cannot be utilized for the payment of IGST & GST Compensation cess on imports and CGST, SGST/UTGST, IGST & GST Compensation cess on domestic procurement. The non-availability of utilizing the scrips towards the payment of IGST, has lead to financial burden on the importers. Accordingly, the FTP 2015-20 and Customs Law needs to be amended for allowing the utilization of MEIS & SEIS scrips towards the payment of GST on imports.

4.2. Constitute Customs Advance Ruling

Chapter VB of the Customs Act, 1962 was amended by Finance Act, 2018 to provide the formation of new 'Customs Authority of Advance Rulings' for the faster decision making and to reduce the overall time period within which the Advance Ruling can be obtained by the applicant.

As on date, the aforesaid 'Customs Authority of Advance Rulings' has not been formed and the applications are still being filed with the existing Authority of Advance Rulings constituted under Section 245-O of the Income Tax Act, 1961. The existing Authority of Advance Rulings constituted under Section 245-O of the Income Tax Act, 1961 is common for both Customs and Income Tax applications and as result the average time period for obtaining advance ruling is 6 to 12 months. Hence, as a trade facilitation measure, whereby the applicant can obtain advance ruling within shorter time frame, the separate 'Customs Authority of Advance Rulings' needs to be constituted and made operational without any further delay.

4.3. Discontinue Levy of Extra Duty Deposit (EDD) by Special Valuation Branch (SVB) Customs

In terms of Customs Circular No. 5/2016-Customs, dated 09/02/2016 the practice of levying EDD is to be discontinued. Further, in case the importer does not submit the required documents within 60 days of the requisition, then SVB can levy EDD @ 5% only upto 3 months.

EDD continues to be levied beyond the period of 3 months, even if the information has been submitted by the importer. The SVB applications are not disposed off in timely basis which results in levy of EDD till the time the same gets disposed off.

It is recommended that a suitable instruction/ amendment to be made to provide that once an importer submits the requisite information, the discontinuation of EDD should be strictly followed and an alternate remedy should be provided where the EDD continues to be levied.

4.4. Provision to empower proper officer to issue a supplementary notice

Section 28(7A) of the Customs Act, 1962 as inserted by Finance Act, 2018 empowers the proper officer to issue a supplementary notice which would be deemed as the show cause notice (SCN) issued under the main provisions of Section 28. However, neither the meaning of supplementary notice has been defined under the said act nor the circumstances and manner under which supplementary notice may be issued is prescribed. There is a possibility of ambiguities arising around the scope of supplementary notice.

Recommendations

- It should be clarified that supplementary notice would not be issued after the reply to initial SCN has already been submitted by the noticee.
- The objective of supplementary notice should not be to cure the defects of initial SCN as may be identified basis a perusal of the submissions made by the noticee to initial SCN.
- The scope of supplementary notice should be restricted to only such issues which are not covered in the initial SCN.
- The "supplementary notice" should be defined in the Customs Act, 1962 and the circumstances and manner in which it may be issued may be prescribed expeditiously to prevent misuse of the provision by the authorities on ground.

4.5. Scope of Customs Act, 1962 to offences committed outside India

Chapter I of Customs Act, 1962 has been expanded by Finance Act, 2018 to the offences or contravention committed under the aforementioned Act outside India by any person.

The objective is to extend the scope of powers granted under the Customs law beyond the existing limits. However, the limits of such powers are not defined clearly which could lead to misuse due to ambiguities.

Recommendations

- It is recommended that suitable clarification be issued with regard to purpose and scope of this proposed amendment to extend the applicability of Customs law.
- Specific aspects such as type of persons covered within the ambit of extended laws, nature of offences and specific powers that may be exercised by the field officers, etc. should be clarified.



- Suitable clarifications would ensure that the officers on-ground don't use the extended powers for any purposes other than those intended.
- It should be specifically clarified that parties who are not present in India nor have any role in compliances under Indian Customs law shall not be subjected to these powers. This is required in order to ensure that the powers conferred under the amendments are not abused or cause harassment for parties not having any presence in India.

4.6. Frequent tariff duty rate changes and consequent possibility of disputes

Government has notified multiple tariff duty rate changes in the last one and half years. Each of these duty rate changes results in a possibility of fresh focus on classification practice from the past and consequent possibility of duty demands.

Such tariff duty rate changes are undertaken with strategic view of the future, but they also result in avoidable disputes for the past period where customs department and the trade has been following a particular practice which gets new attention and focus in light of the change in tariff rate.

Any upward revision of duty rates should be accompanied with protection for reopening of assessment practice of the past period which can possibly protect disputes for the past period. Such protection can be considered to be granted under Section 28A of the Customs act subject to 'reasonable care' being demonstrated by the importer and any other anti-abuse provisions to safeguard the revenue interest of the government.

4.7. Amendment to Notification 104/94 relating to exemption to containers of durable nature

The Custom notification no. 104/94 dated March 16, 1994, forms the basis of duty free import of laden marine containers and other durable packaging material in India subject to re-export conditions. However the assessment practice between the marine containers and other durable packaging material is not aligned and is inconsistent. Marine containers are not required to be declared in the bill of entry and are not assessed to duty. For all the other types of durable packaging material practice and interpretation around compliances is open to interpretation which brings uncertainty in global supply chain which requires specialised, durable packaging material to be used for movement of specific type of goods.

The compliances, disclosures and assessment practice for movement of laden, durable, packaging material should be aligned for consistency, seamless integration of India in global value chain and ease of doing business.

Customs notification 104/94 dated March 16, 1994 should be amended to ensure the following:-

- Laden, durable, packaging material used as instrument of international trade should not be required to be disclosed as a separate line item of assessment in the bill of entry.
- Post import disclosure and compliance requirement, like container cell at major ports of import, should be notified for effective control on movement of such packaging material.

Separate bond should not be required to be produced for each shipment and bill of entry as it results in delay in assessment and increases the dwell time of the shipment just because of packaging material used for bringing the goods into India.

4.8. Payment of IGST in case of de-bonding of capital goods

As per notification no. 22/2003 – CE dated 31.03.2003, indigenous procurement of capital goods by STPI units were exempt from payment of Excise Duty. Also as per notification no. 52/2003 Cus dated 31.03.2003, Import of capital goods by STPI were exempt from payment of Custom Duty and CVD. Thus No duty was required to be paid at the time of procurement.

Issues

- The issue is with reference to the duties payable at the time of clearance of the goods for which exemption was availed, at the time of debonding thereof and the credit of such duties to the extent permissible under the erstwhile laws.
- As per notification 22/2003-Central Excise which was last amended vide notification 23/2018-CE dated on 5th Dec, 2018, "such clearance of capital goods may be allowed on payment of an amount equal to the excise duty but for exemption on the depreciated value thereof".
- Also customs circular no. 50/2018 dated 06.12.2018, has made specific clarification that-
    - For Excise- clearance of capital goods and goods other than packaging material unsuitable for repeated use which were procured without payment of Excise duty prior to 30.06.2017, on payment of Excise duty availed as exemption
    - For customs- when duty has to be paid on the imported goods such as when these are cleared from the EOU, the same would be the duty/tax for which exemption was availed at the time of their import
- If STPI unit would have paid duty at the time of import then they would have availed the credit to the extent permissible. Now if de-bonding of goods are allowed on payment of IGST then it would be possible for companies to claim credit of such duty. If Excise/CVD is paid then it becomes cost to company.

  Thus it is requested to allow companies to discharge IGST on de-bonding or to lay down the procedure to claim refund of excise duty/CVD.

4.9. IGST Exemption on goods imported for Mega Power Projects

During the Pre-GST regime, the custom benefits allowed exemption on goods imported for mega power project under the following duty heads: (i) Basic Custom Duty (ii) Additional Duty (CVD) (iii) Additional Duty (SAD) vide Notification No. 12/2012-Customs, dated 17.03.2012 & Notification No. 21/2012-Customs, dated 17.03.2012. However, due to introduction of the GST Regime, exemption stand curtailed under GST Law.

Post GST Implementation, only Basic Custom Duty is exempted vide Notification No. 50/2017-Customs, dated 30.06.2017, however, 18% IGST (9801) is applicable on all goods



imported under the Mega Power Projects [Notification No. 1/2017-Integrated Tax (Rate), dated 28.06.2017].

This has increased the cost of developing the mega power projects in India. Hence, it is requested to grant exemption from IGST payment on all the goods imported for mega power projects.

4.10. Provide credit of GST against excise duty on petroleum products

Currently, petroleum crude, motor spirit (petrol), high speed diesel, natural gas and aviation turbine fuel is out of the purview of GST. Accordingly, input tax credit of GST paid on procurements is not allowed against the output tax liability to the supplier of the said products and is an additional cost for the producers of oil and gas. Until introduction of GST on petroleum products, it is recommended that producers of petroleum and natural gas should be allowed to claim credit for GST on all inputs being paid by them to be allowed to be set-off against output excise duty on these products. Appropriate suitable amendment may be carried out in the CENVAT Rules.

4.11. Allow Labelling requirement in Non-bonded premises for imported goods

Prior to GST, there was a concept of levy of Customs duty on imported goods based on Maximum Retail Price. As a result, labelling activity was required to be carried out in customs bonded warehouse. This was governed by DGFT and labelling was carried out as per Legal Metrology Act.

Post implementation of GST, Customs Duty is paid on the transaction value and not calculated on Maximum Retail Price. Now retailers can label their products anywhere before selling it to the customer. This effectively removes the requirement of labelling in customs bonded warehouse. While many processes were upgraded under GST, some remained unchanged like labelling goods in customs bonded warehouse.

This results in customs officials inspecting the same consignment twice and effectively more documentation work for customs department and companies, extra cost in maintaining custom bonded warehouse, double handling of articles and waste of manhours on loading etc. All of this results in slowing down the pace of customs clearance and impact lead time for companies.

It is recommended that importers may be allowed to label products in non-bonded warehouse. This will facilitate faster customs clearance, reduction in cost for maintaining double warehouses, record keeping, man hours, double handling of documents without any impact on revenue.


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