FICCI

PRE-BUDGET MEMORANDUM 2020-21



Pre-Budget Memorandum
2020-21



Federation of Indian Chambers of Commerce and Industry

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ECONOMIC OVERVIEW

The global economy once again is going through a period of a synchronous slowdown – not only has the moderation been broad based in case of advanced economies but the emerging markets and developing economies are also going through a phase of a more marked deceleration. Trade tensions continue to persist and remain one of the key downside risks to global prospects impacting both demand and investment sentiment. Trade volume has noted a growth of just about 1 percent in the first half of 2019 – which is the lowest since 2012. Also, significant geo-political concerns, arising on account of –Brexit, protests in Hong Kong, tensions in Middle East - remain on fore.

Global growth estimates have been downgraded consistently since the beginning of this year. The International Monetary Fund (IMF) in its World Economic Outlook (October, 2019) has cut the global growth forecast for 2019 to 3.0 per cent - which is lower by 0.3 percentage points from the April, 2019 estimate and the lowest since 2008-09. The estimate for 2020 has been pegged at 3.4 percent which is 0.2 percentage points lower than April, 2019 forecast. A similar sentiment is reflected in the forecasts put out by other multilateral institutions as well.

With 90 percent of the world expected to slowdown in 2019 according to IMF, India has not been unscathed. The country, at present, is also witnessing real signs of a slowdown. Macro headwinds remain predominant due to a host of domestic and global factors.

India's GDP growth has reported a conspicuous slowdown. The latest quarterly GDP numbers reported a growth of 5.0 percent in Q1 2019-20 - which was a twenty five quarter low. Sharp moderation in private consumption, capital formation and exports of goods and services on a y-o-y basis led to slower growth during the quarter.

The demand pulse has weakened significantly and is also corroborated in FICCI's latest surveys. Nearly three quarter of the surveyed companies in our latest Business Confidence Survey reported weak demand as a problem area. Six months back, this figure was about 60%.

This along with other factors is clearly manifesting in to a moderation in industrial sector. The latest monthly index of industrial production data reported (-) 1.1 percent growth in the month of August 2019 - a deceleration vis-à-vis 4.6 percent growth recorded in July 2019. Numbers indicate a more broad based moderation in August with most sub segments reporting a slowdown in growth during the month. Key segments like manufacturing, capital goods, and infrastructure exhibited negative growth in August 2019.

The signs of slowdown in domestic demand are visible both in urban and rural areas. Weaker job creation along with uncertainty around existing jobs has had an impact on personal consumption demand in the economy. Consumers are delaying discretionary spending on back of ambiguity in terms of income and wealth. While existing job scenario in the urban areas has been hit, rural wage growth has been severely impacted by the agrarian distress which is having a severe bearing on the rural consumption growth story.

The Indian automobile industry, for instance, has witnessed a discernible slowdown and some really worrying numbers have come to fore over the past few months. While the moderation had been building up for almost a year now, the latest sales numbers indicate deceleration touching historic lows. Sales across all major segment including passenger cars, commercial vehicles, two wheelers, tractors have reported a significant decline. The latest numbers report a decline of 30.6 percent in August in passenger car sales – which has been the worst performance in over two decades. Weak demand, tight credit situation etc. has led to a massive pile up of inventories.

Other lead indicators of industrial activity have been worrisome too. A slowdown has been visible in some other sectors as well including cement, steel, garments etc. Also, revenue earning freight traffic of major commodities for railways has witnessed a further downtick for the fifth consecutive month in August, 2019- turning negative for the first time since December 2016. Growth in revenue earning freight traffic declined 6.1 percent in the month of August, 2019. Furthermore, IHS Markit India's Purchasing Managers Index has reported moderation in both, manufacturing as well as services indices for the month of August 2019.

The recovery in investment remains elusive owing to weak business sentiments. Our survey results indicate that businesses have shied from undertaking fresh investments owing to feeble demand, high financial costs, liquidity concerns and impending uncertainties on global front.

Given the current situation, both Government and Central Bank have been keeping a close watch on the situation. In fact, the set of measures announced by the Hon'ble Finance Minister through the months of August and September 2019 were quite comprehensive and should impart some momentum to the economy going ahead.

With inflation remaining range bound, the Central bank has shifted to an accommodative stance and the repo rate has been cut by 135 bps since February this year. However, the transmission of these rate cuts by banks remains extremely slow but we are encouraged by the recent statements made by Governor and Finance Minister urging banks to hasten the process of transmission. Also, the Rs 70, 000 crore infusion towards recapitalization of banks is a positive move and will lend extra support to banks for lending out to corporate/retail borrowers.

Furthermore, the decision of the government to further consolidate and strengthen the banking sector of the country was also a major step announced recently. For an economy that is aiming to reach the US$ 5 trillion mark, a very strong and stable banking sector that can efficiently meet the credit requirements is a prerequisite. There are many benefits associated with bank consolidation including greater lending capacity, deployment of better technology, larger branch network, enhanced national and global presence. A fewer large banks can benefit from economies of scale.

Also, the announcement to ensure that all future GST refunds will be cleared within 60 days augurs well for industry. This along with the strict monitoring of the delayed payments by Government and CPSEs would lessen the financial burden on the companies.

The easing of FDI norms in sectors like contract manufacturing, single brand retail and coal mining is a positive step as well.

Additionally, the relaxation of ECB guidelines for affordable housing and reduction in interest on Housing Building Allowance in line with the 10-year G-Securities Yield is a major step towards achieving mission PMAY. The provision of Rs 10,000 crores to provide last-mile funding for completion of the ongoing housing projects (which are not NPAs or facing bankruptcy proceedings under NCLT) will give a major push to resolve the problem of stalled projects in the country.

On the external front, India's exports scenario has remained muted. As mentioned, global trade outlook for the current year remains weak. IMF projects a global trade growth of 1.1 percent for the full year 2019, which is expected to recover to 3.2 percent in 2020. Global uncertainties, especially trade tensions will continue to impact the export performance during the year. Also, oil prices continue to display volatility on back of concerns in the Middle-East and this might have a repercussion on the current account deficit.

India's total merchandise exports contracted by 1.5 percent over the period April-August 2019-20 vis-à-vis 15.7 percent growth reported over the same period last year. Imports, on the other hand, contracted by 4.4 percent during April-August 2019-20 vis-à-vis 18.7 percent growth reported in the corresponding period previous year.

Nonetheless, despite the pessimism about trade prospects, India is in a position to grab the space being vacated by China. American importers have already started reaching out to other countries as Chinese goods become more expensive. Importers have also reached out to Indian sellers in sports goods, toys, stationery, cables and electronics parts categories.

Moreover, the new export-related incentives, finance, credit and facilitation announced recently should help in achieving a turnaround in our exports.

The Government continues to display a strong commitment to meet the overall objective of taking India to a higher growth trajectory. In fact, the first Union Budget of the current Government for 2019-20 announced in July 2019 was directionally positive with clear emphasis on kick-starting the virtuous cycle of domestic/foreign investment and connectivity. Also, the Budget highlighted the commitment of the government on keeping the fundamentals right for all sections of the society by focusing on important aspects like ease of living for citizens, education and access to technology.

The government had also revised down the fiscal deficit target to 3.3 percent for the year 2019-20 in the Union Budget compared to 3.4 percent target put out in the Interim Budget (announced earlier in 2019), reiterating its commitment in adhering to fiscal austerity path. The targeted fiscal deficit of 3.0 percent of GDP is likely to be achieved in FY 2020-21. However, while fiscal rectitude is important it should not be at the expense of undertaking extreme cuts in expenditure.

The government is under huge pressure to boost demand by breaching the fiscal deficit. It is in any case going to be difficult to meet the fiscal deficit target, despite the huge windfall transfer of excess reserves of Rs 1.76 lakh crores from the RBI, because revenue projections

in the budget are based on unrealistic nominal GDP projection of 12% growth – 4% GDP deflator and 8% real GDP growth.

The country is at a juncture where it needs to push itself on a higher growth path on sustainable basis and a necessary condition for this would be incurring adequate capital expenditure. This will also put more money in hands of the consumers.

Amid the current situation, it remains important that government continues to tread on the reform path and assures that our economy stays anchored amidst the new emerging challenges. While most of the factors have a cyclical undertone, however to get out of the current situation it is important that policy moves keep the focus on structural reforms. There is an urgent need to re-energize the engines of growth and pump prime the economy by enhancing consumer spending and creating conditions for higher private sector investments and exports. Also, the focus has to be on lowering the cost of doing business in India.

FICCI hopes that in the Union Budget 2020-21 the government will continue to take steps towards bridging the existing gaps and give out positive signals to boost consumption and investments. In fact, even as the measures announced so far take effect, the Union Budget 2020-21 will be a perfect opportunity to make a re-assessment and give a further booster shot the economy.

The suggestions made in the first part of this Pre-Budget memorandum mostly pertain to the macro economy and is divided in two sections – the first section makes recommendations to address some immediate challenges at hand – such as breaking the weak demand- low investment nexus, addressing the issues liquidity and trust deficit and announcing measures to stimulate exports. The second section, on the other hand, focuses on some broad sector specific recommendations. More detailed proposals (tax related) for various sectors are given in the second part of the memorandum.

1. Recommendations to Address Immediate Challenges

1.1. Stimulate Household Consumption and Savings

The demand pulse in the economy has been muted for some time. There has been a persisting distress in the rural economy. Also, the liquidity crunch triggered last year made matters worse. There is a need for a stronger positive signaling to turn around the ground level situation.

The government should consider revising upwards the direct income tax slabs for individuals. 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. Overall deduction limit under 80C should be enhanced to Rs 3 lakh and separate exemption limits may be considered for long-term and short-term savings within the section. Likewise, 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. The deduction under Sec 24 for interest on housing loan should



also be enhanced to Rs 3 lakh (from current Rs 2 lakh). These measures would leave more disposable income with households and thus boost overall consumption in economy.

1.2. Capital Availability for Investments

There is a need for strengthening the financial economy if the country has to grow at 8-9 percent. The immediate challenge being faced by the banking sector is the huge volume of non-performing assets, which has affected the intermediation costs for the banks and also their lending capacity. The cost and terms of financial intermediation must improve to ensure smooth flow of funds to the real sector. Also, it remains extremely important that besides banks, alternative sources of funding are strengthened.

- The government should announce setting up a Development Financial Institution for industry focusing, especially on large scale infrastructure projects.
- Also, withholding tax on External Commercial Borrowings needs to be done away with as has been done for Masala Bonds.
- Consider divesting government stake in the public-sector banks to enable banks to raise capital from the market. Government can look at having 26% share as a floor and bring in the concept of a golden share to exercise control over critical decisions.
- Set up a National Asset Management Company (NAMCO)/ Bad Bank as a new special purpose asset management company (AMC) that will take over stressed assets from the banking system and focus on recovery or rehabilitation of these assets.

1.3. Non-Bank Financial Companies

The crisis in the NBFC sector adversely affected the liquidity condition in the economy. While steps have been taken by the RBI and the government to resolve the liquidity problem, there is a need to take steps towards strengthening the financial system in entirety by addressing the structural problems.

- Refinancing of Small and Medium NBFCs by MUDRA: Small and Medium size NBFC which constitute more than 90% of the sector in numbers are totally dependent on banks for fund raising as they do not access capital market or external borrowings. For them, availability of refinance is a crying need of the hour. We strongly recommend MUDRA to take up this role.
- Liquidity window for NBFCs on similar lines of US TARP: In 2008, post Lehman crisis, US government treasury established the Troubled Asset Relief Program (TARP). Under this program, the government treasury bought real estate and mortgage related loan assets of all sizes including the ones which were troubled from the market which helped stabilize the markets. On similar lines, Government of India should consider buying loan assets of all sizes including real estate and mortgage related from NBFCs / HFCs. Given that financial market players such as Mutual Funds, Pension Funds, Insurance Companies, Banks are reluctant with regard to exposure to NBFCs, government must step in and address the situation.

- A direct liquidity window from RBI for NBFCs can help rebuild confidence in the system: RBI has come out with Draft Guidelines on 'Liquidity Risk Management Framework for NBFCs and Core Investment Companies'. While this is a good move, it is equally important to have a broader framework that would enable NBFCs to tap funds from RBI against their High-Quality Liquid Assets during periods of stress. Guidelines for a contingency funding window on commercial terms for NBFCs must also be looked at simultaneously to the proposed regulatory framework for liquidity risk management.

1.4. Re-energize Exports

If India has to be a 5 trillion-dollar economy by 2025, exports of goods and services should at least be around 1 trillion dollars. With current level of performance, India will not be able to pursue an export-led growth needed to drive the high GDP growth. India needs to adopt a more strategic approach, especially with rising protectionism around the world.

- The government must announce new strategic industrial and trade policy with special incentives for attracting industries exiting China and include special efforts to export to underrepresented markets, especially in Latin America and Europe.
- India needs 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. This may also include mapping of specific markets to specific MSME clusters. Detailed information should be made available to exporters through an Export Information Portal. Suitable allocation in the Union Budget may be made for this Market Intelligence Cell.
- Ensure that negotiations under various FTAs/ RTAs lead to greater market access for Indian industry in partner country(ies). Comprehensive trade and economic cooperation agreement with EU should be expedited as it will provide greater market access for our exports, including textile and apparel exports. Negotiate existing FTAs at the time of their review and sign new better FTAs.
- Many countries have used trade agreements to induce domestic reforms – India could do the same. Instead of setting up huge new bureaucratic structures – as is being proposed in the HLAG report it may be easier and more cost-effective to add trade promotion offices to India's embassies abroad and consider how best to establish a strategic trade office reporting to the PM. It must also address the real exchange rate appreciation – which taxes exports and subsidizes imports. This is more effective than import tariffs – which must be used very selectively.

1.5. Plan for Disinvestment

The disinvestment target for the current year is Rs 1, 05,000 crore. Reports indicate that Niti Aayog has already prepared a list of around 46 CPSEs and their idle assets – land, industrial units et.al – that are ready for monetization. This must be pursued vigorously. We must look at complete divestment as partial disinvestment does not find much interest amongst investors. Further, there must be careful consideration in appointing advisers, who have international presence as well as network. Appointing the lowest bidder may not ensure

effective discharge of responsibility and also casts questions on capability. The Chinese Govt used to put out a fee and invite bids on it – qualitatively qualify the advisers. Also, in case of IPO, while price is market determined, Government does not usually offer a discount on the share price which is good enough to attract investors. Also, government should announce a five-year plan to reduce government stake in PSUs with the idea of keeping the Maharatnas and key strategic companies and selling the rest.

1.6. Incentivize Employment

Over the years, job creation has not been commensurate to the pace of growth and much fewer jobs are being created. This is a big challenge for India.

- Special export zones for sectors like textiles, leather, gems and jewellery, footwear, toys must be announced which benefits like subsidized land, duty free imports, tax holidays, etc. Direct tax incentives can be given to businesses that reward employment generation. For instance, recently China introduced schemes that gave incentives or tax refunds to companies that did not lay off worker in the wake of US-China trade war. Additionally, the government may create plug and play units for some sectors like garments where all facilities are provided on minimal rent basis to young entrepreneurs for initial 3-5 years.
- There is a need to develop a Vision on Mass Entrepreneurship in Rural India as a vehicle for job creation. For this purpose, develop a National Mass Entrepreneurship policy by bringing together different Central and State government ministries, industry and other stakeholders
- Tourism industry can offer employment to many and its potential must be fully leveraged. Government should look at developing specific tourist destinations that can help attract many more domestic and foreign tourists. Be it Hampi in Karnataka, Fatehpur Sikri and Chitrakoot in UP, Desert Circuit in Rajasthan (Jaisalmer, Bikaner, Barmer, Jodhpur), Shamuka beach and Chillika lake in Odisha, Haridwar and Rishikesh in Uttarakhand or Khajuraho in Madhya Pradesh, India can be in an enviable position if such locations can be further developed will all the needed facilities – stay, connectivity, guides.

1.7. Reduce Cost of Doing Business

One of the key challenges facing industrial sector in India stems from factor market regulations, namely in the areas of land, labor, capital, power and logistics, which increase the cost of doing business and reduce the competitiveness of Indian industry. Estimates put India's logistics cost between 14 per cent of GDP compared to a ratio between 8-10 per cent for countries like the US, Hong Kong and France. For instance, the turnaround time at ports has reduced but is still high at around 64 hours vs. Taiwan (10), Korea (12), Singapore (19), China (20) and Malaysia (22).

There is a need to implement and expedite the factor market reforms at the Central as well as State levels.

- While industry welcomes the government's plan to consolidate labor laws into four labor codes, there is a need to initiate additional measures to liberalize labor regime in the country. The government should review and restructure the existing Contract legislation to allow free engagement of contract labor by enterprises.
- High power costs is one of the key concerns for Indian industry. In case of power, cross-subsidizing retail tariff should be stopped or capped at a moderate limit. This will help reduce the tariff burden on large industrial consumers and boost Make in India initiative of the Government of India.
- India's growing energy demand poses a severe challenge of balancing it with the energy supplies without putting pressure on growth and fiscal health. Unfortunately, India's dependence on import of oil continues to rise, which has a bearing on the overall economy through pressure on inflation as well as current account balance. To ensure energy security of the country in the future, there is a need to maintain a suitable mix of energy sources including that of renewable and non-renewable sources.

Announce a vision of energy mix of 2030 with breakup of type of technology including storage and formalize yearly renewable bidding trajectory up to 2030. Further, Renewable Purchase Obligation (RPO) from 2023 to 2030 should be formalized with enforceable mechanism. Develop a policy for triggering demand of renewable energy by all segments of consumers – industrial, agricultural, commercial, residential and state discoms. This could be done by mandating adoption in residential and public buildings with appropriate modifications in respective building by-laws, enforcing RPOs across all obligated entities including DISCOMS, implementing innovative models like RESCO/OPEX through demand aggregation, particularly in commercial, industry and institutional segments, etc.

2. Broad Recommendations Pertaining to Sectors

2.1. Agriculture

Indian agriculture sector needs transformation in terms of not only productivity enhancement but also for creating a robust ecosystem right from the production to the consumption stage. There is a need for unleashing second green revolution focusing on high value horticultural and livestock products. This is critical for India's overall food security, better management of food inflation as well as to enhance farmers' incomes, while dealing with climate change.

- To enhance yields and mitigate risk arising from an adverse monsoon, there is a need to step up investments in irrigation (including micro irrigation) across the country. Micro irrigation has potential to cover 69.5 m ha area in the country (from the current level of about 10 mn ha)
- 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 Rashtriya Krishi Vikas Yojana (RKVY) to

enable small producers to hold produce till market prices are remunerative enough to sell

- A plan for national warehouse grid along highways should also be launched
- Integrate FPOs into value added supply chain
- There is a need to increase the level of mechanization through institutionalizing custom hiring centres (CHCs) and developing innovative financial products. Access to CHC services is not uniform across categories of farmers. Most of the users are large and medium farmers, with only limited access for small and marginal farmers, who together constitute over 86% of all farm holdings
- Government should have a special focus on deploying technology that could strengthen Agri statistics to reduce information arbitrage on data on sowing, crop condition, prices and stockholding.
- Additionally, we need to plan for a major improvement in the agro-processing industry. With India being one of the largest producers of several agri-products, we should also be seen as global leaders in the processed food industry. At present, food industry is governed by over seven different Ministries and authorities such as MOFPI, MOCA, FSSAI, MOHW, BIS etc. There is a need to form an inter-ministerial group having members from all mentioned ministries and institutions to have more regular and closer consultation when laws are made on common topics. An integrated approach by the different ministries will ensure a clear and speedy decision making.
- Expand PM-Kisan and MGNREGA and reduce input subsidies as well as MSP's for specific commodities. This would put more income in the hands of farmers and landless labor – boost rural demand and give farmers greater choice in cropping patterns.

2.2. Infrastructure

India has been making steady progress in scaling up the infrastructure across the country. However, infrastructure gap is still huge with imbalances and lack of integration amongst the different modes of transport, leading to sub-optimal utilization of available infrastructure.

- Government must announce a few major projects in sectors such as roads and highways, sub-urban metros and airports. The multiplier impact on the economy through generation of demand and new jobs from large scale infrastructure projects will be huge. As the infrastructure sector gets going, demand for steel, cement, power, commercial vehicles, capital goods will all go up. Monetization of existing infrastructure assets should be pursued to accelerate funding for new projects.
- An institute of excellence in PPP to serve the requirements of capacity building should be set up. The Union Budget for FY15 had provided Rs 500 crore to set up an institution called "3P India". Subsequently, the Kelkar Committee on PPPs had also strongly argued for such an institution which will enable research, review, roll out activities to build

capacity, and support more nuanced and sophisticated models of contracting and dispute redressal mechanisms.

- Announce creation of unified land transportation agency and multi-utility infrastructure for efficient use of city spaces, assets and resources. A National Urban Mobility Mission be launched that would include transport solutions for urban areas, including public transport through metro, bus, electric vehicles as well as planning for walking and cycling tracks for public. Engage with States to implement such mission.
- Infrastructure financing is highly constrained currently. One suggestion towards this is to make a small portion of SLR maintenance, mandatorily invested in securities issued by Infrastructure Finance Companies. Since SLR is core to the long-term operation, there should be no incremental burden on banks. This will help provide tenor-based funding to the sector that is critical to the revival of growth of the economy.
- Further, long-term tax-free bonds should be allowed to be issued for the infrastructure sector by AAA private sector issuers.

2.3. Manufacturing

An accelerated growth in industry can enable India to grow at much higher rate and contribute to creation of greater employment opportunities. It is imperative to create an enabling policy environment for growth of industrial sector while simultaneously addressing various structural issues hindering the sector's growth.

- Introducing Regulatory Impact Analysis: There is a need to have an independent system of regulatory impact analysis for reviewing the existing and the new regulatory requirements related to manufacturing sector. This would provide the cost-benefit analysis of regulation and would enable phasing out of redundant rules. Expert Committee on Prior Permissions and regulatory mechanism chaired by Mr Ajay Shankar has recommended this system and DIPP shall bring out a mechanism in consultation with all concerned departments.
- Phased Manufacturing Programme (PMP): PMP has been introduced in a few sectors like mobile handsets, electrical equipment. Similar programmes shall be launched where the dependence is high on imports. Respective departments shall come out with plan to encourage manufacturing in their sectors with high import dependence. For example, PMP can be extended to manufacturing of air conditioners, medical devices, etc.
- Offset policy: At present, only the Defense has an Offset Policy. Industry has argued for the policy to be extended to all sectors importing large quantities of products and machinery. It is important to work out details of implementation of the policy to ensure that offsets result in higher domestic production. Technology transfer and appropriate utilization of Offsets are extremely important. The offset policy is important in attracting investment into manufacturing. In defense, offset policy has been introduced as a leverage to promote local industry. Some mechanism for coordination between various departments on Offset policy is essential and details for implementation of the policy shall be worked out by Ministry of Commerce and Industry to ensure that offsets result



in higher domestic production. In the implementation of the Offset policy, preference for manufacturing in India along with technology transfer is most important.

- Cluster Development: India has almost 5,000 clusters spread across the country, large number of which include unorganized manufacturing. There is a need to modernize these clusters. Additionally, cluster programmes are currently administered by several ministries (Textiles, Leather, Food, MSME, Heavy Industry (auto) under different terms and conditions. There is a need for central industrial planning for all clusters, both at the Central and State levels. Following measures can be adopted for effective development of clusters in India.
    - Set up a Cluster Stimulation Cell at the apex level in the MSME Ministry that will work to promote cluster associations. Sub-cells operating at district level should also be made operational.
    - Appropriate infrastructure (both physical and digital) should be developed in these clusters through adequate funding that can be garnered through a mix of budget allocation and making available institutional credit at concessional rates.
    - Cluster level skill development programs should be developed. Vocational training specific to cluster manufacturing will help the locals in getting employment in the cluster itself.
    - Promote and encourage e-marketplace for these clusters. Online platform for sale of cluster-based products should be developed by involving private players.
- Correct all duty inversions in manufacturing, especially for capital goods sector
- India needs a light-touch industrial policy by selecting 8-10 strategic industries to promote- but with an export oriented incentive structure not just protect domestic markets.
- For Industry 4.0 readiness, allocate a fund of INR 250 Cr to develop 20 ITIs as Centres of Excellence for Industry 4.0 related technologies

2.4. MSMEs

The most significant challenge faced by MSMEs is the access to finance. It is estimated that almost 40 percent of MSME lending is being done through the informal sector, where the interest rates are much higher than that of formal sources. Moreover, there are other challenges that small firms face in areas of ease of doing business, access to technology, marketing and exports.

- Change in definition of MSMEs based on annual turnover as against the current classification based on investments in plant & machinery. The Micro, Small and Medium Enterprises Bill was introduced by government in Lok Sabha on 23 July 2018 providing for change in the criteria of classification of MSMEs from the existing 'Investment in plant and machinery or equipment' to 'Annual turnover' of enterprises. As per the amendments, any business with a turnover of up to Rs. 5 crore would be considered as a 'micro enterprise'. A 'small enterprise' would be the one whose annual turnover is more



than Rs. 5 crore to Rs. 75 crore. Those businesses with turnover over Rs. 75 crore but up to Rs. 250 crore would be deemed as a 'medium enterprise'.

- Enhance priority sector lending target for micro enterprises (from current 7.5 percent of Adjusted Net Bank Credit to at least 12 percent)
- 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 working committee of Export Promotion Councils (EPCs) should be constituted to promote and increase product-based exports from MSMEs. Each EPC can raise sector specific issues in MSME segment and subsequently committee should address such issues.
- A universal Export Information Center/Portal should be created through which MSMEs can get all required information at one place. Linking websites are not very useful for MSMEs as they do not have much time to go to various websites/centers.
- Testing should be made convenient and cheaper for MSMEs. At present Indian Testing Certificates are not globally accepted. It is required that a mechanism/tie-up should be developed that testing can be done at Indian Centers whereas certificates for the same test could be issued from various global testing centers which are acceptable in respective countries
- While the government has introduced platforms like TREDS and these are progressing well and helping MSMEs get their receivables in a timely manner, we still feel that there is a need to have a relaxed framework for NPA recognition for MSMEs and that the government should not gradually withdraw the announced liberal framework under which GST registered MSMEs got a reprieve through an extension from 90 days to 180 days for NPA recognition till 1st Jan 2019. Perhaps we can look at an extension of this relaxed framework for at least one more year.
- The emerging financial technology (fintech) players are reshaping how MSMEs can access working capital and cash flow-based finance. Promotion of Fintech companies for working capital loans for MSMEs is typically characterized by relatively high interest rates along with requirement of pledging marketable collaterals with the lender. In this regard, we look forward to a specific policy for raising ECB by Fintech companies for on lending to MSMEs. We also ask for classification of bank lending to Fintech companies for on lending to MSMEs under the Priority Sector.

2.5. Real Estate

- The liquidity & cost of capital concerns of the developers need urgent redressal with the reintroduction of Input Tax Credit for under construction properties. While the government has taken measures to provide fiscal incentives & liquidity through NHB, we have seen only one REIT listing so far. The government can further push the REIT agenda

by reducing the timelines of investment from three years to one year for long-term capital gains taxation.

- One of the largest impact of the liquidity crunch has been faced by the real estate sector. The special window of INR 10,000 cr announced by the government should help address some part of that. However, this funding is only available to non-NPA and non-NCLT projects. The current reality is that there are several real estate projects which might be currently NPA but are economically viable and only stuck due to absence of viable last-mile funding. It might therefore be more fruitful to include all economically viable projects under this scheme, irrespective of the current cash flow status
- Affordable housing: The government can enhance the eligibility criteria for the Credit Linked Subsidy Scheme (CLSS) and GST rate benefits to help a larger section of consumers in urban centres. For affordable housing, the annual household income criteria across all consumer categories should be enhanced such that it is in sync with house prices in major urban markets like Mumbai and Delhi.
- Enhance tax incentives for home purchases. Unlimited interest on home loans for second homes which was available till 2016 can unfreeze the buyers' strike which the sector is facing currently. This can change struggling real estate sector, construction sector, HFC sector which has funded these projects.

DIRECT TAX

Section I – The Taxation Laws Amendment Ordinance, 2019 Related

2.1. Allow MAT credit to companies opting for concessional tax regime

At the outset, we would like to commend the Government for announcing a path breaking, sweeping reduction in tax rates for domestic companies in India. The rate cut mark a significant structural reform of the corporate tax rate structure in India, which will make India competitive and an attractive destination for investments.

To this effect, the Government promulgated The Taxation Laws Amendment Ordinance, 2019 (hereinafter referred to as 'the Ordinance'), amending the provisions of the Income-tax Act, 1961 and the Finance (No. 2) Act, 2019. It is noteworthy that the government has given an option to companies to migrate to a very competitive tax rate structure under section 115BAA of 25.17% (inclusive of applicable surcharge and education cess). The provisions of MAT shall not be applicable to companies opting for the concessional tax regime under section 115BAA of the Act.

Further, 115BAB of the Act has been inserted to provide an option to the domestic companies engaged into manufacturing activities, incorporated on or after 1st October, 2019 to pay income tax at the rate of 15% (17.16% inclusive of applicable surcharge and cess).

Also, domestic companies availing such an option -

- Shall not be allowed to avail any incentive/exemption offered under the Income Tax Act,1961 ('the Act') including additional depreciation.
- Shall not be allowed to set off any loss carried forward from earlier year, if such loss is attributable to any of the exemption/incentives including additional depreciation.
- Once such option has been exercised by any Company, there is no option to opt out of the concessional income tax rate.

Central Board of Direct Taxes (CBDT) has recently clarified that the tax credit of MAT paid by the domestic company exercising option under section 115BAA of the Act shall not be available consequent to exercising of such option.

It may be noted that MAT credit is an accumulation of excess of MAT paid over the tax payable under regular provisions in the preceding years by the taxpayer. Under the provisions of the Act, MAT credit is treated at par with taxes deducted at source (TDS) or advance tax. The Courts too have treated MAT credit at par with that of taxes deducted at source (TDS) or advance tax. Thus, MAT Credit constitutes a vested right of a taxpayer (just like TDS and advance tax) permitted to be set-off against the taxes payable under the normal provisions. This right is granted expressly by the provisions of the Act and must be honored. The CBDT Circular No. 3 of 2006 also supports the view that MAT Credit should be allowed when tax is payable under normal provisions of the Act.

The options with many corporates with accumulated MAT credit are either:

- to move to new lower tax regime after foregoing accumulated MAT credit earned from cash deposit of taxes or
- to keep paying existing higher tax rates to utilise the accumulated MAT credit.

Historically corporates had made investments in plant & machinery & other capital expenditure linked to taxation rates & laws prevailing at that time. Upon start of commercial production, the companies had accumulated depreciation (Under Income Tax) and had to accordingly pay MAT, and credit of which is lying in the book as assets. If lower tax rate of 22% plus surcharges is now selected by the company, this will impair the MAT credit lying as assets in the books of existing Companies.

Further, the companies having MAT credit will be devoid of level playing field viz-a-viz the new manufacturing companies incorporated after 1st October 2019 as follows: -

- MAT paid & appearing as asset in books forms an integral part of business and is complimentary to investments made in business. Existing companies in order to have MAT credit fully utilized will have to provide for taxation at higher rate of 30% plus surcharges versus new manufacturing company in same industry and size will have to provide lower tax provisions at 15% plus surcharges. This will comparatively reduce Earning per share for existing company and their valuations will get substantially undervalued.
- As MAT is not applicable on New Manufacturing Companies, existing companies still having unabsorbed carry forward depreciation may have to continue to deposit the MAT till this depreciation is fully absorbed. This will further increase the value of MAT credit in books on existing companies.

While companies who do not have any MAT Credit to avail themselves of the relief, may choose to migrate, those carrying such balances due to liabilities in the past, may not be able to opt for the benefit of this regime for themselves. This will be regarded as discriminatory, suiting only a few, which ostensibly is not the purported objective of this concessional regime.

The consideration of MAT credit utilisation significantly weigh in on matters relating to financial and cash flow modelling which has been duly considered based on its availability to set-off as per the existing provisions under the Act. Anything contrary to the above, would tantamount to retroactive operation of law, i.e. denial of the credit for excess MAT paid in earlier years which in effect operate as discharge of actual tax. This shall result in huge cash and financial losses to the companies since the write-off of such MAT credit (currently reported as an asset) would directly impact the profits of the companies. This is likely to impede investments and expansion plans of corporates thereby defeating the very objective of introducing the new concessional tax regime.

Thus, while an option of a newer tax regime is available under section 115BAA to domestic companies, unless set-off of MAT credit is allowed to such companies, section 115BA may purely prove to be an academic one.

The taxpayers opting for 115BAA and section 115BAB are required to sacrifice benefits of tax deductions and incentives. Such taxpayers should not be further penalized by taking away the benefit of MAT Credit arising from minimum taxes paid by such taxpayers with an assurance of availing MAT credit against normal taxes.

The taxpayer has vested right to claim MAT credit in the year when such MAT is paid by the taxpayer. Set off takes place in subsequent years when normal tax is higher than MAT. If the MAT credit set off is not allowed against normal tax by construing MAT payable as Nil then it may lead to forced retrospective revocation of right granted to the taxpayer in prior years to claim set off of such MAT credit in future. This is neither anticipated by taxpayer nor desired by the Government.

Given the overall balance of MAT credits lying with corporates currently, its significance in the overall gamut of things should not be ignored. The global investment community views India favourably not just for its growth outlook, but also for its stable, reliable and certain legal and taxation regime and underplaying this may significantly wean away existing players and hurt investor sentiment.

In view of the above, we believe MAT Credit must continue to be available to companies opting to be governed by the new scheme of taxation introduced by the provisions of section 115BAA of the Act.

It is suggested that appropriate clarification should be issued by the Government that MAT Credit shall continue to be available to companies opting to be governed by the new scheme of taxation introduced by the provisions of section 115BAA of the Act.

Assuming that MAT credit is sought to be denied on the ground that it may likely cause a high pressure on the cash flow impact of the finances of the Government, as the next best option, in consultation with the industry, the MAT credit outstanding as at the beginning of the year of exercise of option under section 115BAA of the Act may be granted over a period of three years in equal instalments. This approach may have the advantage of avoiding litigation; achieving fairness; phasing out the pressure on Government finance; making the concessional tax regime option attractive for taxpayers with immediate impact; reducing litigation on interpretation of incentive provisions; protecting the industry against pressure on its financial statements, etc.

Other Issues from Ordinance

2.2. Clarify that activity of "manufacturing or production" includes generation of power/ electricity

a. Amendment introduced in the Ordinance

(i) Section 115BAB of the Act providing for concessional tax rate of 15% is applicable to a domestic company set-up and registered on or after 1 October 2019 and which commences manufacturing on or before 31 March 2023. Section 115BAB of the Act provides that the company should be engaged in the activity of "manufacture or production of article or things".

b. Issue

(i) Thus, section 115BAB of the Act is restricted in its application to a company engaged in manufacturing or production.

(ii) In this behalf, there are multiple judicial precedents which support the view that generation of electricity/power qualifies as manufacture of goods or production of article or thing.

(iii) In the case of NTPC Ltd. v. Dy. CIT [(2012) 54 SOT 177 (Delhi) (URO)] dealing with whether generation of electricity qualifies for additional depreciation under section 32(1)(iia), the Delhi Tribunal concluded that power represents "article or thing". It reached to this conclusion after considering Supreme Court judgement in case of Commissioner of Sales Tax, Madhya Pradesh v. Madhya Pradesh Electricity [1970 AIR 732] and State of A.P. v. National Thermal Power Corporation (NTPC) Ltd [127 STC 280]. In these cases, the SC held that power is goods subject to Sales Tax Act. The decision of the Delhi Tribunal has been upheld by the HC[1] and SC[2]. Relevant observations of the Delhi Tribunal are as under:

> *"21. On due consideration of these two decisions (Madhya Pradesh Electricity Board and NTPC Ltd), it is implicitly clear that the Hon'ble Supreme Court has explained the meaning of electricity, the Hon'ble Court has considered the definition of goods as given in Article 366(12) of the Constitution of India. It also took into consideration the sales-tax Act of the State of Andhra Pradesh as well as Madhya Pradesh and also considered the dictionary meaning. Thereafter Hon'ble Court has observed that goods means, all kind of moveable properties. The terms moveable property when considered with reference to goods as defined for the purpose of sales-tax cannot be taken in a narrow sense and merely because electric energy is not a tangible or cannot be moved or touched like, for instance, a piece of wood or a book it cannot cease to be moveable property when it has all the attributes of such properties. It is capable of abstraction, consumption and use of which if done dishonestly is punishable under section 39 of the Indian Electricity Act.* ***If there can be sales and purchase of electric energy like any moveable object than there was no difficulty in holding that electric energy was intended to be covered by the definition of goods.***
>
> *22. The expression "article, thing or goods" are not defined in the Income-tax Act, 1961. Learned Commissioner while treating the electricity as not an article or thing has not made reference to any provisions of the Income-tax Act, 1961, he simply construed the meaning of electricity as not article or thing on the basis of his own inference drawn from the nature of this*

[1] (2014) 45 taxmann.com 527 (Del HC)
[2] (2017) 88 taxmann.com 561 (SC)



item but ***if we evaluate the conclusion drawn by the Learned Commissioner in the light of the decision of the Hon'ble Supreme Court given in the case of Indian Cine Agencies (supra) , Madhya Pradesh. Electricity Board (supra) and State of Madhya Pradesh vs. NTPC then it would suggest that electric energy has all trapping of an article or goods. The process of its generation is also akin to manufacture or production of an article or thing."***

c. Recommendation

(i) In order to provide clarity and certainty, it is recommended that the provisions of section 115BAB of the Act be amended to provide that companies engaged in the business of generation of power/ electricity shall also be entitled to the benefits provided under the said section.

(ii) Alternatively, a clarification may be issued to provide that "manufacture or production of an article or thing" will also include the activity of generation of power/ electricity.

2.3. Inadvertent omission in Section 115BAB of the Act to "production"

a. Amendment introduced in the Ordinance

(i) While Clause (a) of section 115BAB(2) of the Act refers to commencement of 'manufacture' on or before 31 March 2023, clause (b) therein provides that the company must not be engaged in any business other than manufacture or production of any article or thing or research in relation to or distribution of the article/ things manufactured/ produced.

b. Issue

(i) In absence of word 'production' in clause (a), ambiguity may arise whether the condition of manufacturing will be a necessary condition to be fulfilled by each company. If a view taken is that a company engaged in production does not answer to the description of the activity of manufacture, the eligibility may be questioned by tax authority.

c. Recommendation

(i) It seems that the absence of the term "production" from Clause (a) above is inadvertent and hence, to avoid unnecessary conflict/ litigation, it is recommended to also include a reference to production in Clause (a) as below:

"(a) the company has been set-up and registered on or after the 1st day of October 2019, and has commenced manufacturing ***or producing*** *on or before the 31st day of March, 2023, and ....."*

(ii) Incidentally, the Press Note dated 20 September 2019 mentions that the benefit would be available to companies commencing 'production' on or before 31 March 2023.

2.4. Restriction on "use" of any plant or machinery previously used for any purpose in Section 115BAB of the Act – Shift of emphasis from "transfer" to "use" can have enormous consequences

(i) As per one of the conditions imposed in section 115BAB of the Act, the company should not "use" any plant or machinery previously used for any purpose. The new provision uses the language of "use" instead of "transfer" to new business of machinery or plant previously used for any purpose as used in several existing ITA incentive provisions such as sections 10AA, 80IA, 80IB, 80IC of the Act.

(ii) Shift of emphasis from the word 'transfer' to "use" in section 115BAB of the Act results in unintended limitations and irritants in business appraisal of the company in various scenarios.

(iii) Restriction w.r.to 'use' of second-hand asset would unintendedly apply to cases of asset being taken on hire even if it is for a very short term period such as electric generators, etc, assets received under bonafide business reorganisation, cases where part of the manufacturing is outsourced to a third party on job work basis, etc.

(iv) It is, thus, recommended to place condition of second-hand plant and machinery along the lines of other incentive provisions under the ITA which has been tested over time instead of introducing some new ambiguous language which shall result in new interpretational issues and unintended consequences.

2.5. Restriction on user of any second hand building previously used as hotel or convention centre in Section 115BAB of the Act appears to be misplaced

a. Amendment introduced in the Ordinance

(i) Section 115BAB of the Act providing for concessional tax rate of 15% is applicable to a domestic company set-up and registered on or after 1 October 2019 and which commences manufacturing on or before 31 March 2023. As discussed above, the section imposes various restrictive conditions to ensure that new manufacturing company is genuine and not set-up merely by way of any split-up or restructuring activity.

(ii) One such condition imposed in section 115BAB(2) of the Act is that the company does not use any building which was previously used as hotel or a convention centre.

b. Issue

(i) This condition is unique to section 115BAB of the Act and does not apply to section 115BAA of the Act. There was no such condition also in section 115BA of the Act which provides for similar concessional rate tax regime for certain companies.

(ii) Incidentally, similar condition is found in section 80ID of the Act which provides for profit linked deduction in respect of profits and gains derived by



an undertaking from business of hotel or business of building, owning and operating a convention centre located in specified areas. As per condition laid down in section 80ID(3)(ii) of the Act, the eligible business should not be formed by way of transfer to a new business of building previously used as a hotel or a convention centre.

(iii) It is submitted that while the condition relating to building was relevant in the context of section 80ID of the Act which granted profit linked deduction to hotels or convention centres located in specified areas, such condition seems to be misplaced in the context of a manufacturing/production company referred to in section 115BAB of the Act. Further, section 115BAB of the Act also does not extend benefit to hotels/convention centres.

(iv) Despite this, if such condition is retained in the provision, it may create ambiguity/ may apply in unintended manner in following cases:

- Where a building previously used as hotel or convention centre is converted into building to be used as an office or manufacturing facility and such a place is used by the taxpayer.
- Unfortunately, as a result of this condition, the taxpayer could be questioned on its eligibility to benefit under section 115BAB of the Act if, in order to support business purposes, the employees of the manufacturing company make use of hotel premises or convention centre for activities such as business seminar; business conference; business dinner; BOD meeting etc.

c. Recommendation

(i) There is apparently no logical reason why such a restriction on user of building previously used as hotel/convention centres is placed. It would be best to delete the condition, and/or to clarify the intention behind this provision. In all fairness, if at all, the condition should, be applied only when the user is integrated to the core manufacturing activity though, we are unable to think of such contingency.

2.6. Consequences of breach of conditions of Section 115BAB of the Act – whether taxpayer can fall back on Section 115BAA of the Act? Also, clarify that consequences restricted only to the year of breach of conditions

a. Amendment introduced in the Ordinance

(i) For availing the benefit of concessional tax regime under section 115BAB of the Act, the company needs to exercise the option in its first tax return and once the option is exercised, same cannot be subsequently withdrawn by the taxpayer, either in the same or any other previous year.

b. Issue

(i) While section 115BAB of the Act stipulates conditions to be satisfied by a company exercising the option to avail lower tax rate of 15%, there is no clarity on the consequences that may follow in the event of breach of any of the conditions which result in the company falling outside the scope of s. 115BAB (Illustratively, where a company post exercise of the option u/s 115BAB carries on some non-qualifying operations). Doubts have arisen whether such a company will be taxed at normal rate of 30% (plus applicable surcharge and cess) or whether it can avail the benefit of s.115BAA which provides for lower effective tax rate of 25.17%? This question is also pertinent if dispute arises in the assessment where the Tax Authority denies the benefit of s.115BAB by alleging breach of some condition.

(ii) For availing the benefit of section 115BAA of the Act, the company needs to exercise the option in the return of income. A company availing section 115BAB of the Act benefit would have exercised option in favour of section 115BAB of the Act in its first return. There is no statutory mechanism provided for the company availing section 115BAB of the Act benefit to fall back on section 115BAA of the Act benefit in case of any breach of section 115BAB of the Act condition or in the event of dispute arising in its assessment.

(iii) It may be noted that a company fulfilling section 115BAB of the Act conditions would also be compliant with section 115BAA of the Act condition of computing total income without availing any tax incentives. Even if there is breach of formative condition or there is use of second-hand plant & machinery beyond 20% threshold, the company's computation would be in line with section 115BAA of the Act and hence, it should not be deprived of section 115BAA of the Act benefit, if for any reason, it is denied benefit of section 115BAB of the Act.

(iv) Further, it is not clear as to what will be the impact of venial breach of condition by the taxpayer. Say, for instance, in a particular year, the use of second hand plant and machinery marginally (say, 22%) exceeds the permissible limit of 20% of the total value of the plant and machinery used by the taxpayers. The company was otherwise eligible to claim the benefit of section 115BAB of the Act in all the past and subsequent years. It needs to be suitably clarified that the company shall not be eligible to claim the benefit of confessional tax regime only in the year of breach of condition and it's claim to avail benefit of concessional tax regime in future or past years shall not be impacted.

c. Recommendations

(i) It is recommended that, to provide clarity and certainty, a company which loses shelter of section 115BAB of the Act may, at its option, be allowed to be governed by section 115BAA of the Act.

(ii) Alternatively, a company exercising its option under section 115BAB of the Act may also be concurrently permitted to exercise its option under section 115BAA



of the Act to enable claim of benefit of either provision so long as conditions stipulated therein are fulfilled.

(iii) Furthermore, it may be clarified that in case of breach of conditions in a particular year, the claim of the taxpayer to avail concessional tax regime in future or past years shall not be affected if it otherwise fulfils all other conditions in those years.

2.7. Applicable tax rate on excess income arising on account of TP adjustment – Section 115BAB(4) of the Act

a. Amendment introduced in Ordinance

Section 115BAB (4) of the Act provides as follows:

"(4) where it appears to the Assessing Officer that, owing to the close connection between the company and any other person, or for any other reason, the course of ***business between*** *them is so arranged that the* ***business transacted*** *between them produces to the company more than the ordinary profits which might be expected to arise, the Assessing Officer shall, in computing* ***the profits and gains of such company*** *for the purposes of this section take the amount of profits as may be reasonably deemed to have been derived therefrom:*

Provided that in case the aforesaid arrangement involves a specified domestic transaction referred to in Section 92BA of the Act, the amount of profits from such transaction shall be determined having regard to arm's length price as defined in clause (ii) of Section 92F of the Act."

b. Issue

(i) Concessional tax rate of 15% introduced under section 115BAB of the Act is applicable on total income of the taxpayer which will also include all adjustments made pursuant to application of transfer pricing provisions.

(ii) Further, section 115BAB(4) of the Act provides for adjustment wherein the tax authority is of the view that owing to close connections between the domestic company and the transacting parties, the domestic company has reported income which is in excess of the regular income. Accordingly, the excess profits shall not be considered for the purposes of computing "profits and gains of such company" for the purposes of section 115BAB of the Act.

(iii) Thus, the issue that arises is how to calculate the tax payable on income which is hit by the provisions of section 115BAB(4) of the Act i.e. whether it shall be eligible to claim concessional tax rate of 15% or would normal tax rates apply to it.

c. Recommendations

(i) It may be clarified whether the excess income arising on account of TP adjustment under section 115BAB(4) of the Act shall be chargeable at

concessional tax rate under section 115BAB or normal tax rate, as the case may be.

(ii) Further, assuming that company is not eligible to 15% tax rate under section 115BAB of the Act on such income; on fair consideration of provisions, a company which has fulfilled all other conditions should be allowed to fall back to section 115BAA of the Act such that it can avail tax rate of 22%.

2.8. Clarify applicable rate of surcharge in case of special incomes under section 111A, 112 of the Act etc. for companies exercising option under section 115BAA/BAB of the Act

a. Amendment introduced in Ordinance

i. Subject to the provisions of Chapter XII of the Income Tax Act, 1961 (such as section 111A, 112, 112A of the Act etc.), income tax shall be payable at the rate of 22%/ 15% on total income by domestic companies exercising option under section 115BAA/ 115BAB of the Act respectively.

ii. The Ordinance provides that the applicable rate of surcharge for income chargeable to tax under section 115BAA or 115BAB of the Act shall be 10%. The relevant provision is worded as under:

> *"Provided also that in respect of **any income chargeable to tax under section 115BAA or section 115BAB** of the Income-tax Act, the tax computed under the first proviso shall be **increased by a surcharge**, for the purpose of Union, calculated **at the rate of ten percent of such "advance tax".**"*

b. Issue

(i) Incomes chargeable to special rate of tax under the provisions of Chapter XII of the Income Tax Act, 1961 such as short-term capital gains (STCG) taxable under section 111A of the Act, long term capital gains (LTCG) under section 112/ 112A of the Act etc. continue to remain outside the scope of concessional tax regime of section 115BAA/ BAB of the Act. Thus, they are taxable at special rates of tax as prescribed under the respective provision.

(ii) As discussed above, surcharge @ 10% as introduced by the Ordinance is applicable to income chargeable to tax under section 115BAA/ 115BAB of the Act.

(iii) Since incomes taxable at special rate of tax such as STCG under section 111A of the Act, LTCG under section 112, 112A of the Act etc. are not chargeable to tax under section 115BAA/ BAB of the Act, question may arise on the applicable rate of surcharge for such incomes.

(iv) As per the existing provisions of the Income Tax Act, 1961 read with respective Finance Act, incomes taxable under section 111A, 112, 112A of the Act etc. are subjected to surcharge rate of 7% or 12% depending on the relevant threshold of total income. For instance, for total income upto Rs. 1 Crore, no surcharge



applies. For total income between Rs. 1 Crore and 10 Crore, surcharge @ 7% applies and for total income exceeding Rs. 10 Crores, the surcharge @ 12% applies.

(v) Thus, appropriate clarification may be issues by the Government.

c. Recommendations

(i) In view of the foregoing, it is recommended that flat surcharge of 10% should apply to total income chargeable to tax under section 115BAA/ BAB of the Act whereas surcharge @ Nil/ 7%/ 12% should apply if the special incomes such as STCG under section 111A, LTCG under section 112, 112A of the Act etc. (i.e excluding the income chargeable under section 115BAA/ 115BAB of the Act) exceed the relevant threshold as prescribed for total income.

(ii) Without prejudice to the above, if the above alternative is not feasible, flat surcharge @ 10% may apply to all incomes earned by company exercising option under section 115BAA/ 115BAB of the Act, including income taxable at special rate of tax.

2.9. Clarify surcharge rates on income earned under section 115AD of the Act by FPI/ FIIs structured as trusts and classified as 'individuals' under the Act

a. Existing provision

(i) Finance (No.2) Act 2019 (FA 2019) increased surcharge rate for individuals, HUFs, AOP/ BOIs from 15% to 25% where total income is between Rs. 2 Crores to Rs. 5 Crores and 37% where total income is more than Rs. 5 Crores with effect from AY 2020-21.

(ii) The maximum effective tax rate after considering the increased surcharge in case of specified taxpayers having total income of more than Rs. 5 Crores increased to 42.7% from the erstwhile rate of 35.88%. Thus, the effective tax rate increased by around 7%.

(iii) The enhanced surcharge had unintended impact on FIIs structured as trusts who were saddled with enhanced surcharge on capital markets transactions.

b. Amendment introduced in Ordinance

(i) With a view to appeasing overseas investors and with the intention to spur the slowing economy, the Ordinance endorses the withdrawal of higher surcharge for non-corporates on certain capital market transactions for both domestic and foreign investors in terms of announcement vide Press Release dated 24 August 2019.However, while making amendment in respect of FIIs, the Third proviso to section 2(9) of the Finance (No.2) Act 2019 refers to 'association of persons and body of individuals'.



c. Issue

(i) Most of the FPIs/ FIIs are structured as trusts. The judicially recognised position is that trusts cannot be regarded as AOP or BOI (Refer, for instance, CIT v. Marsons Beneficiary Trust (1991) 188 ITR 224 (Bom), CIT v. Venu Suresh Sanjay Trust (1996) 221 ITR 649 (Mad)).

(ii) CBDT Press Release dated 31 July 2012 issued in the context of return filing by private discretionary trusts clarified that judicially, discretionary trust has been considered as an "individual". In the given context, where FPIs structured as trusts are classified as "individual" under the Income Tax Act, 1961, ambiguity may arise on the applicable rate of surcharge for capital gains income earned by them taxable under section 115AD(1)(b) of the Act. Question may arise whether the withdrawal of surcharge is effective for FIIs in view of non-applicability of the third proviso which refers to AOP and BOI. Question may also arise on the correct rate of surcharge applicable to such FIIs.

d. Recommendation

(i) In light of the above, it is recommended that clause (aa) of third proviso to section 2(9) of Finance Act, 2019 withdrawing the enhanced surcharge rates for FPIs may be amended to include reference to individuals and Artificial Juridical Person (AJP) also. This will give clarity on applicable surcharge rates for FPIs structured as trusts and classified as individuals/ AJP. Language may be amended as under:

> *" in the case of every individual or association of persons or body of individuals, whether incorporated or not, or every artificial juridical person having income under section 115AD of the Income-tax Act -"*

The concessional tax regime of the ordinance has evoked good response from the taxpayers, including MNCs. On a first feel, 15% tax regime has been found to be very attractive, and it is possible that the MNCs may have a serious review of the same in the process of their decision making of business expansion.

At the same time, there is a concern on possibility of being able to fulfil some of the conditions on an ongoing basis. Some of the conditions appear to be creating a handicap in bonafide cases as well. The fine print of the Ordinance has raised number of issues on which the industry would need categorical clarification from the law maker or CBDT. Uncertainty of clarification, and prospects of litigation may dissuade the industry from entering the regime. It is hence of paramount significance that the concerns are sorted out at the earliest, so as to keep up the tempo. We suggest that, as an immediate step, the CBDT may nominate an expert body comprised of administrators and experts to clarify, in consultation with the industry, address all those initial questions which have arisen or are likely to arise. Proactive step of clarifying issues in the form of Q&A in consultation with the industry will go a long way in establishing the credibility of the regime.

2.10. Other Recommendations

- Benefit of reduction of tax rate has not been made available to firms/LLPs. The income tax rates for unincorporated bodies i.e. Firm, Limited Liability Partnership (LLPs), etc., should also be aligned with reduced corporate tax rates. This would facilitate ease of doing business in any entity form and would provide a level playing field to these entity types.
- Newly inserted section 115BAB of the Act provides for concessional tax rate of 15% in case of newly incorporated domestic companies subject to fulfilment of certain specified conditions which are:-
    - The company is incorporated on or after October 1, 2019;
    - Has commenced manufacturing on or before March 31, 2023;
    - Not engaged in any business other than manufacture or production of article or thing and research relating to those article or thing;
    - Is not formed by splitting up or reconstruction of a business already in existence;
    - Does not use any machinery or plant previously used in India for any purpose.

  Since the intention of the Government is to extend the benefit to any company created after October 1, 2019 and which commences production on or before March 31, 2023, it should be clarified that the section would be applicable to software development companies. Appropriate clarification should be issued to provide that the benefit of section 115BAB of the Act is applicable to a software development company.
- There is lack of clarity, as to whether where a company gets goods manufactured from a job worker or a contract manufacturer, whether it would be eligible to avail the reduced rate of 15%. The government should clarify that reduced tax rate would be available in cases where goods are manufactured on job-work basis or under contract manufacturing; covering situations where manufacturing activity is undertaken on a principal to agent basis or principal to principal basis.
- Accumulated additional depreciation be allowed to be added to the WDV of the block of assets as per the Act and companies be then allowed to claim benefit in subsequent years on the same as normal depreciation.

Section II – Other Direct Tax Issues

2.11. Mandate for acceptance of payments through prescribed electronic modes

Section 269SU of the Act mandates every person carrying on business having turnover, sales or gross receipts in excess of Rs. 50 crores in the immediately preceding financial year, to provide facility for accepting payments through prescribed electronic modes.

In case of non-compliance with the above provisions, it has been provided that section 271DB of the Act will be inserted that provides for levy of a penalty of Rs. 5,000, for every day during which such failure continues. However, no penalty shall be imposable if the person proves that there were good and sufficient reasons for non-compliance.

These provisions shall be effective from 1 November 2019.

Corresponding changes to the Payment and Settlement Systems Act, 2007 have also been proposed stating that no charge shall be collected from anyone by bank or system provider either directly or indirectly, for using the modes of electronic payment prescribed under section 269SU of the Act.

Issue

CBDT would be coming out with the prescribed electronic modes in due course. In this regard, we wish to invite your attention to the fact that certain electronic modes of payments like UPI, wallets, etc., would be relevant typically in case where there is retail participation. In case of financial entities/institutions dealing primarily with institutional clients, these natures of payments may not be relevant, as the payments made by these clients would generally be substantial in nature and would be done only thru NEFT/RTGS, etc. Considering the same, we would request to make the other electronic modes as optional modes for these natures of persons, else this would only add to the cost of doing business in India and would not serve the intended purpose.

Recommendation

- It is recommended that CBDT while prescribing the electronic modes should give flexibility to businesses in terms of having an option to pick and choose and offer a few of the total available electronic payment modes basis their preference rather than mandating that all electronic payment modes should be offered by all businesses. This would help to avoid any undue hardship faced by them in abiding by the law.

2.12. Dividend Distribution Tax and Taxation of Dividend – 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.

2.12.1. Cascading effect of DDT on dividend received from Foreign Companies-Section115-O

As per the amendment in Section 115-O of the Act vide Finance Act 2013, dividend taxed as per Section 115BBD of the Act received by the Indian company from its foreign subsidiary (i.e. where equity shareholding of the Indian company is more than 50%), then any dividend



distribution by such Indian Holding Company to its shareholders in the same FY to the extent of such foreign dividends will not be liable to DDT.

Issues

- 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.

2.12.2. 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.

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

Issues

- 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.
- 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

- 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.
- 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%).
- 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.

2.14. 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 taxpayers 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.

2.15. 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.

2.16. 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.

Recommendation

- 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.

2.17. 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[3] 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.

[3]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.

2.18. 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.

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

2.19.1. 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.
- Hotel Buildings constitute the 'plants' for the hotel industry as their usage is round the clock for 24 hours. The industry has to make very heavy investments in renovation, upgradation and upkeep of the hotel buildings. Section 32 of the Act should therefore be amended to restore the depreciation rate to 20%.
- The main revenue generating asset of any Hospitality Industry i.e. a Hotel, essentially relates to its property - buildings. Though the Act had granted certain relief on profits generated by Hotels set up in a backward State with the intention of improving Tourism, no benefit is extended to existing Hotels including Heritage Hotel buildings, which needs continuous updation and construction. Due to various local laws and the laws relating to Heritage buildings several Hotels have to undertake various construction and strengthening projects which ensures the compliance of various laws. However this is only at the cost of stopping the business for the entire hotel or a section thereof. However, such hotels do not get any benefit in taxation and it takes quite a number of years to recoup the cost of capital and investments. It is recommended to allow additional or accelerated deduction from business profits on preservation of Heritage Hotels on entire civil construction expenditure.
- 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'.

2.19.2. Deduction of ESOP Expenditure

Issue

ESOPs are granted to employees to reward/remunerate them for their contribution to the organisation and to retain talent. As per the Guidance Note issued by Institute of Chartered Accounts of India ('ICAI'), the SEBI Guidelines and the IndAS the main objective to issue shares under an ESOP is to remunerate the employee for his services. The SEBI guidelines and the IndAS requires a company to recognise the charge incurred for issue of ESOPs as an employee compensation in the Financial Statements/Books of Account of the Company over the vesting period. However, the issue with respect to deductibility of employee cost incurred for grant of options to employee has been a matter of litigation before the Courts. The tax authorities are not allowing such employee compensation expense as an allowable business expenditure under section 37 of the Act, inspite of the various judicial precedents favourable to the assessee.

Under the Ind AS the companies are required to account for the such employee cost for grant of ESOPs under fair value method which is a fair method used internationally to account for such cost. To put an end to the litigation, CBDT should come out with clear guidelines on the allowability, calculation and treatment of ESOP expenditure. It is further recommended that CBDT should also allow companies to claim deduction for the employee remuneration cost on the basis of fair value method, to ensure less complications and hassles in the calculations and to avoid unnecessary litigation and dispute on this subject. ESOP cost charged by the parent company to the group companies should be allowed as a deduction to the group companies.

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.

2.19.3. 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.

2.19.4. Provide deduction in respect of Expenditure on Brand Building

World class brands lend a huge intangible value to products and services enabling them to command a premium and loyalty from consumers. Moreover, successful brands reflect the innovative capacity of their countries and they enrich their national economies. For example, the net sales of Samsung is equivalent to 20% of GDP of South Korea. In fact, a successful global brand is a sustained source of wealth creation. Also, world class brands can contribute increasingly to import substitution, value added exports as well as larger value capture from global markets. In fact, this can transform the country from one dominated by foreign brands to a player of substance in the global arena.

The creation of world class brands demands tremendous staying power with substantial investment commitments over the long run. It requires deep consumer insight, continuous nurturing of R&D, differentiated product development capacity, brand building capability, cutting edge manufacturing and an extensive trade marketing and distribution network. This will also result in job creation and retention of value in the country.

It is recommended that a larger deduction of say 10% of turnover should be admissible for new brands for the first 10-15 years of their commercial launch. Alternatively, a weighted deduction of 200% of the relevant deduction. This will create a level playing field for domestic enterprises.

Moreover, this will help in making the Indian brands globally competitive and thereby control the current account deficit problem on a sustainable basis.

2.19.5. Allowability of Payment of Premium of Leasehold Land as a Revenue Expenditure

Under the Ind AS 16, the upfront premium paid on leasehold land held under operating lease are being treated as prepaid expenses and would need to be charged to the Profit and Loss statement under the head “rentals” on a proportionate basis over the life of the lease period.

These upfront lumpsum premium lease payments for leasehold land are essential business expenditure and do not generate any capital asset and hence are purely revenue in nature.

These are just like payments made under any operating lease to utilise the leased property for the purposes of the business of the lessee and hence should be allowed just like any business expenditure for tax purposes.

Recommendation

Appropriate clarity should be provided to the effect that upfront premium payments for leasehold land, shall be allowed as deductible expenditure under the Act in the year of its debit to the statement of Profit and Loss.

2.19.6. 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.

2.19.7. 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.

2.19.8. 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.

2.19.9. 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.

2.19.10. Deduction in respect of employment of new employees – 80JJAA

Taxpayers can claim a deduction equal to 30% of the amount of additional employee cost for three assessment years under section 80JJAA of the Act.

Issue

Additional employee means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year, but does not include an employee who total emoluments are more than Rs. 25,000 per month. Salary levels across have increased substantially from 2016.



Recommendation

Threshold of Rs. 25000 per month should be raised to atleast Rs. 50000 per month for the purposes of section 80JJAA of the Act. This would provide impetus to industry to employ higher number of employees which would be in line with the employment generation objective of Government.

2.20. General Anti Avoidance Rule - Chapter X-A

2.20.1. 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.

2.20.2. 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.

2.20.3. 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.

2.20.4. 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[4], 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[5], 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.

2.21. Provisions in relation to Start-ups

Issues

2.21.1. Withdrawal of exemption under section 56(2)(viib) upon non-compliance by start-ups with any of the conditions laid down in DPIIT Notification dated 19 February 2019

- As per DPIIT Notification, the start-up is required to satisfy various conditions in order to avail the exemption to section 56(2)(viib) of the Act.
- The conditions to be satisfied at the time of issuance of shares and for availing exemption under section 56(2)(viib) are divided into (i) recognition conditions and (ii) threshold conditions.

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



- The Notification also provides for satisfaction of certain end use conditions for the purposes of claiming/retaining the exemption.
- The second proviso to section 56(2)(viib) of the Act provides for withdrawal of exemption if 'any' of the conditions specified under the DPIIT Notification No. G.S.R. 127(E) dated 19 February 2019 is not fulfilled.
- Thus, as per plain reading of the proviso, the claw back provisions are attracted even upon the non-fulfilment of recognition or threshold condition in subsequent years by the start-ups i.e. post the issue of shares. For example, if the aggregate of share capital and share premium exceeds Rs. 25 Cr in any of the years subsequent to the issuance of shares, it could result in withdrawal of the exemption.
- However, the DPIIT Notification suggests that only when end use conditions are not satisfied (after the issue of shares), the exemption shall be withdrawn retrospectively.
- Thus, the second proviso to section 56(2)(viib) of the Act may be amended to provide explicitly that the exemption shall be retrospectively withdrawn only if the start-up fails to comply with the "end-use condition(s)" in DPIIT/DIPP Notifications which the start-up is expected or mandated to comply in subsequent years post issuance of shares.
- In other words, the claw back provisions under the Act should not apply if there is breach of recognition or threshold condition by the start-up in subsequent years.

2.21.2. Granting relaxations from inquiry under section 68 to Cat-II AIF investors and genuine investments received by start-ups

- Finance Act 2012 amended section 68 of the Act to require unlisted companies to explain 'source of source' in respect of share application/ capital/premium, etc. and also introduced section 56(2)(viib) of the Act to tax excessive premium received by unlisted companies from residents. But in both provisions, exception was carved out for share capital raised from VCF/VCC.
- Finance (No.2) Act 2019 has amended section 56(2)(viib) of the Act to extend the carve out to all the Category I and Category II SEBI registered AIFs. However, similar consequential amendment is not made to second proviso to section 68 of the Act. Since Category I and II AIFs are regulated entities like VCC/VCF, they should be carved out from second proviso to section 68 of the Act as well.

2.21.3. Recalibrating requirement of turnover of start-up from Rs. 25 Cr to Rs. 100 Cr to align with DPIIT Notification

- Section 80-IAC of the Act was inserted to implement the proposal under Start-up Action Plan issued in January 2016. Section 80-IAC of the Act provides three year profit-linked incentive to eligible start-ups wherein income earned by eligible start-up can be claimed as deduction while computing total income. One of the conditions for eligibility of start-ups to qualify for benefits of section 80-IAC of the Act is that the total turnover of business does not exceed Rs. 25 crores for the tax year when the deduction is claimed. The DPIIT Notification of 2019 has amended turnover condition for qualifying as start-

ups. The limit of total turnover of the start-up has been increased from Rs. 25 Cr to Rs. 100 Cr. The DIPP Notification borrows the definition of "turnover" from section 2(91) of the Companies Act, 2013.

- While the DPIIT Notification dated 19 February 2019 has increased the limit of turnover from Rs. 25 crores to Rs. 100 crores to enable larger number of start-ups to avail benefits and incentives, the turnover limit under section 80-IAC of the Act has not been amended.

Recommendation

- Explanatory Memorandum to Finance Bill 2016 to indicate that deduction under section 80-IAC of the Act is granted to support start-ups in their "initial phase". As the DPIIT Notification of 2019 has expanded the scope of start-ups to cover larger number of entities in their nascent and growth stage, section 80-IAC of the Act should be amended to align with policy of DPIIT. Thus, the turnover limit under section 80-IAC of the Act should be increased from Rs. 25 Cr to Rs. 100Cr to align with DPIIT conditions.

2.21.4. Other recommendations for amendment in DPIIT Notification of 2019

- Issue of shares to Cat I (except VCC/ VCF) and Cat-II AIF investors, which are exempt, should be excluded from calculation of threshold of aggregate share capital and premium of Rs. 25 Crs in case of start-ups
- Accordingly, suitable amendment may be incorporated in DPIIT Notification dated 19 February 2019.

2.22. 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)6 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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[6] [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[7].

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.

2.23. 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

[7]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[8]. 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).

2.24. Non-Resident related provisions

2.24.1. 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

[8] 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.

The Organisation for Economic Co-operation and Development (OECD) issued Action Plan 1 to address Base Erosion and Profit Shifting (BEPS) issues in the digital economy (DE). The report proposes three options to tackle the DE BEPS (1) Significant Economic Presence (SEP) (2) withholding taxes on digital income from goods or services ordered online and (3) Equalisation Levy. India already has detailed withholding tax provisions under its domestic tax law. It also introduced Equalisation Levy in 2016.

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 Withholding tax 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.

2.24.2. 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.

Issue

- 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.

Recommendation

- 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.

2.24.3. 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.

2.24.4. 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.

2.24.5. 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.

2.24.6. 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.

2.24.7. 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.

Recommendations

- 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.

2.24.8. 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.

2.24.9 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.

2.24.10. 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.

2.24.11. Relieve payer from being treated as representative assessee under section 163 if non-resident payee has paid taxes on its income

Issue

As per the existing provision in section 161, where the non-resident himself pays taxes in India, there is no corresponding provision to relieve the liability from the hands of representative assessee with respect to existing or future tax demands raised on non-resident's income.

Recommendation

In line with the amendment made in section 201 and section 40(a)(i) of the Act by the Finance Act, 2019 where the payer is not treated as assessee-in-default once payer's TDS default is made good by the non-resident payee, similar relief needs to be introduced to

relieve the payer from being assessed as 'representative assessee' of the NR payee where the NR payee has filed return in India and paid taxes payable, if any, as per returned income.

2.24.12. 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.

2.24.13. 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.

2.25. Mergers & Acquisitions

2.25.1. 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.

2.25.2. 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.

2.25.3. 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.

2.25.4. 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 more than 49 percent 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.

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

Section 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 assessing officer.

2.26. Capital Gains

2.26.1. 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.

2.26.2. 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. It is not clear can such taxpayer exercise option in future year.

(c) It may also be clarified that what is the exact time of exercise of option.

Such difficulties may be addressed either by way of legislative amendment and/or through a circular.

2.26.3. 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.

2.26.4. 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.

2.26.5. 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%.

2.26.6. 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.

2.26.7. Extension of capital gain exemption to Foreign Currency Denominated Bonds

Issues

Indian corporates have been raising funds from a source outside India by way Foreign Currency Denominated Bonds (FCDB) through External Commercial Borrowing. There is no specific exemption on transfer of FCDB from non-resident to non-resident outside India.

Nature of Foreign Currency Denominated Bonds are similar to that of Rupee Denominated Bonds (RDB)/Masala Bond. RDB are given specific exemption under section 47(viiaa) of the Act wherein, any transfer of capital asset, being RDB of Indian company issued outside India, by a non- resident to another non- resident shall not be regarded as transfer.

On similar lines, transfer exemption between non-residents to another non-resident should be extended to FCDB also.

Further, transfer of bonds, being Global depositary receipts, by one non-resident to another non-residents are also not considered as transfer under section 47(viia) of the Act.

Recommendation

Transfer exemption between non-residents to another non-resident should also be extended to non-resident investor investing in FCDB.

2.26.8. 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.

2.26.9. 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'.

2.26.10. Consequential cost step up for depreciation on trigger of claw back provision of section 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).

2.26.11. 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.

2.26.12. 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.

Recommendations

- 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.

2.27. Transfer Pricing

2.27.1. 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

- 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.
- 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.
- 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.
- 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.



- 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.
- 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.
- 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.
- 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.
- 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.
- 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".

- 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.
- The section is open to interpretation on the applicability of the section in case the company incurs the losses. It is submitted that a suitable clarification is required on this issue.

2.27.2. 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.



2.27.3. 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.

2.27.4. 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.

2.27.5. 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.

2.27.6. 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.

Recommendations

- 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.

2.27.7. Safe Harbour Rules

The Safe Harbour Rules (SHRs) have been revised in 2017 applicable 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

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

- 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.
- The SH rate of 1% prescribed for corporate guarantee may be further rationalized and reduced to 0.5%. The reduced SH rate should be slab-based commensurate with the credit rating of the borrower as was prescribed under Rule 10TD(2A) of the Rules for interest rate on intra-group loans.
- A taxpayer, opting for Safe Harbour must undergo scrutiny as per the prescribed rules. For a large MNC having multiple transaction, it may not be feasible to go for Safe Harbour for the eligible transactions and through normal route for transaction not covered/eligible under Safe Harbour. This works as a deterrent for the taxpayer to go under Safe Harbour route. The scope and purpose of the Safe Harbour rates may be



widened to use the Safe Harbour rates, as reference rates while preparing transfer pricing documentation and during assessment proceedings, to be duly accepted by department.

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

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 transfer pricing 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.

2.27.9. 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.

2.27.10. 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.

2.27.11. 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.

2.28. Financial Services

2.28.1. 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.

2.29. Tax Deducted at Source (TDS)

2.29.1. 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. In most of the cases, even the identity of the payee is not known and a consolidated liability is provided on an entirely ad-hoc basis. Owing to such ad-hoc nature of such liabilities, they are mostly reversed at the start of the succeeding year and whenever identity of the payees and amounts payable to them becomes clear, liability for the same is provided subsequently.
- 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 causes hardship to the assesses.

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.

2.29.2. TDS on cash withdrawals – Section 194N

(i) As cash withdrawal does not represent income of the account holder, Section 199(1) read with Rule 37BA of the Rules may be suitably amended to clarify that the credit for tax deducted under section 194N of the Act shall be given in the year in which the amount is withdrawn by the account holder from the bank account as referred to in section 194N of the Act;

(ii) It should be clarified that in case of joint account holders, banks may issue TDS certificate to the first account holder and TDS credit may be given accordingly;

(iii) Section 196 of the Act specifies that no tax shall be deducted on sums payable to the "Government" on any income accruing/arising to it. Likewise newly introduced section 194N also carves out cash withdrawals by "Government" from TDS @ 2%. However, the term "Government" is not defined in the Act which often leads to friction between entities claiming themselves to be 'Government' and banks. For effective, smooth and proper TDS compliance, it is recommended that CBDT should provide guidance on what constitutes "Government" and if possible, an exhaustive list of entities which fall under the category of 'Government' may be issued by way of a Circular.

2.29.3. TDS on payment in respect of life insurance policy – Section 194DA

(i) Under the erstwhile provisions prior to amendment by Finance (No.2) Act 2019, the life insurance companies were liable to deduct TDS @ 1% on the gross amount paid to the policy holders.

(ii) However, as per amended section 194DA post Finance (No.2) Act 2019, TDS is required to be made @ 5% on the 'income' component. Since TDS is an onerous obligation, the term "income" may be defined explicitly for the purposes of TDS liability under section 194DA of the Act as sum paid or payable to the policyholder as reduced by aggregate of premiums received till the date inclusive of service tax and GST (as explained in Explanatory Memorandum).

(iii) This is for the reason that computation of income in the hands of recipient policyholder is a debatable issue i.e. - whether income is taxable as capital gains (with indexation benefit) or as income from other sources. TDS being a provisional collection of tax, computation of 'income' for TDS purposes may be simplified.

2.29.4. 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.

2.29.5. 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.

2.29.6. 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.

2.29.7. 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.

2.29.8. Deputation of Employees

- Increasing globalisation has resulted in fast growing mobilization of labour across various countries.
- Typically, the company deputing the personnel initially pays the salary and other costs on behalf of the company to which such personnel are deputed, which are thereafter reimbursed by the latter company.

Issue

The issue which had cropped up before the Indian tax authorities due to the increasing deputation agreements being entered cross border was whether such reimbursements made by Indian entity to an overseas entity towards salary and other costs in relation to the deputed employees should be taxable in India as being payment in the nature of fees for technical services.

Recommendation

- Since the employees deputed to the Indian company work under the control and supervision of the Indian company and hence are essentially 'employees' of the Indian company, the amounts paid by the Indian company to the foreign company are merely 'cost reimbursements' for the salaries paid on the Indian company's behalf. 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.

2.29.9. Enhancement of Limits for TDS - Section 194C and others

Issues

- Under Section 194C of the Act, TDS is applicable in respect of contracts for manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. However, in a large number of instances, it is observed that the material which is purchased from the customer represents a small fraction of the total cost and this provision has created huge operating problems, since the transaction may be a 'principal–to principal' contract for purchase and sale of goods and the profit margin may be very small.
- Currently, any payment for contract services rendered which exceeds Rs. 30,000 at a time or Rs. 100,000 per annum requires the person responsible for making such payments to deduct tax at source under Section 194C of the Act.

Recommendations

- It is suggested that the provisions of Section 194C of the Act be should be applicable only in such cases where the material purchased from the customer is substantial in nature, i.e., say it exceeds 40% of the total material cost (inclusive of raw materials and packing materials).
- It is recommended that the threshold limit should be increased to Rs. 50,000 for single payment under Section 194C of the Act.

2.29.10. 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.

Recommendation

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.

2.29.11. Provide for consequential amendment in section 194LC to dispense withholding obligation in respect of interest payment on rupee denominated bonds

In order to avoid litigation, in respect of exemption granted by section 10(4C) of the Act for interest payable on Rupee Denominated Bonds issued outside India between 17 Sep 2018 and 31 March 2019, suitable consequential amendment may be made in section 194LC for dispensing withholding requirement on interest income covered under section 10(4C) of the Act.

2.29.12. Extension of eligible period of concessional tax rate under section 194LD

As per section 194LD of the Act any person who is responsible for paying to a person being a Foreign Institutional Investor (now Foreign Portfolio Investor), any income by way of interest payable on a rupee denominated bond of an Indian company or a Government security, shall, at the time of credit or payment of such income, deduct income tax thereon at the rate of 5%. Interest payable should be on or after the 1st day of June 2013 but before the 1st day of July 2020.

Recommendation

In view of the expiration of the said period and to boost the foreign investments in India under the bond market, it is suggested to extend the period to 1st July 2023. (by three years).

2.30. Other Direct Tax provisions

2.30.1. 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 transaction of an amount aggregating to two lakh fifty thousand rupees or more in a financial year; 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)

(vii) who intends to enter into such transaction as may be prescribed by the Board in the interest of revenue

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 and Recommendations

Taxpayer who "intends" to undertake certain specified transactions to obtain PAN

- The additional circumstance added in section 139A(1) by Finance (No.2) Act 2019 is that the taxpayer will have to obtain PAN if taxpayer "intends" to enter into such transactions as may be prescribed by Board in the interest of revenue.
- There is ambiguity in language of the provision. Literal reading would mean that provision requires taxpayer to obtain PAN merely on the basis of 'intention' of Taxpayer to undertake prescribed transaction, irrespective whether or not the transaction is actually undertaken/consummated.
- A suitable amendment should be made to bring out that person is liable to obtain PAN before entering into or execution of prescribed transactions.

2.30.2. Set Off of Refunds against Tax remaining Payable

Issue

Adjustment of refunds due to assessees against erroneous demands shown outstanding in their cases causes great heartburn. Even where the assessee lodges his objection on the CPC

portal pointing out that the demand sought to be adjusted against the refund was not outstanding and therefore is being erroneously adjusted, there is no remedy by which the CPC can take note of the same.

It is settled by several judicial pronouncements that where any demand outstanding against the assessee relates to a point which stands squarely covered by a decision in the assessee's favour, such demand cannot be adjusted against any refund due to the assessee. Courts have logically explained in this regard that the assessee in such a case would have been undisputedly entitled to stay on recovery of such demand, and merely because the department is in possession of the assessee's funds due to him as legitimate refund, it cannot be adjusted against such a demand.

Recommendation

It is suggested to amend the section so as to provide that no set-off of refund under this section shall be made by any income-tax authority without giving intimation in writing to such person of the action proposed to be taken under this section, and without dealing with the objections, if any, filed by such person in response to such intimation served on him. Systems should be amended/put in place to stop assessees' funds being adjusted without authority of law. 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.

2.30.3. 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.

2.30.4. 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.

2.30.5. 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.

2.30.6. 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.

2.30.7. 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.

2.30.8. 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.

2.30.9. 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.

2.30.10. 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.

2.30.11. 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 bonafide assessees. 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.

2.30.12. E-assessment

Section 143(3A) of the Act provides that the Central Government may make a scheme (E-assessment scheme/the scheme) (has been notified vide Notification No. 62/2019, dated 12 September 2019) for the purposes of making assessment of total income or loss of the assessee under Section 143(3) of the Act so as to impart greater efficiency, transparency and accountability by:

- Eliminating the interface between the Assessing Officer (AO) and the assessee in the course of proceedings to the extent technologically feasible;
- Optimising utilisation of the resources through economies of scale and functional specialisation;
- Introducing a team-based assessment with dynamic jurisdiction.

Issues

- Section 143(3B) of the Act provides that the Central Government for the purpose of giving effect to the scheme made under Section 143(3A) of the Act may direct that any of the provisions of this Act relating to assessment of total income or loss shall not apply



or shall apply with such exceptions, modifications and adaptations as may be specified in the notification.

Section 143(3B) of the Act clearly states that the Central Government may direct that existing provisions of the Act relating to assessment will either not apply or apply to the E-assessment scheme with specified exceptions, modifications and adaptations.

CBDT via Notification No. 62/2019, dated 12 September 2019 notified that various provisions of the Act including Section 92CA of the Act dealing with transfer pricing assessments shall apply to the assessment made in accordance with the said Scheme subject to the exceptions, modifications and adaptations provided in the Notification.

However, the Notification does not provide clarity with respect to transfer pricing assessments i.e. who will refer the case to transfer pricing officer (TPO), timeline of completion of transfer pricing assessments, procedure to be followed in e-assessment scheme once reference is made to TPO, etc.

- The Notification does not provide any procedure to apply such scheme to DRP assessment i.e. who will send the draft order to the taxpayer, timeline of completion of DRP assessments, procedure to be followed in E-assessment scheme once reference is made to DRP, etc.
- Further, the notification does not give any direction with respect to re-assessment proceedings. Thus, the applicability of E-assessment scheme to the re-assessment proceedings is not clear.
- The Notification does not provide any direction with respect to applicability of Section 263/264 of the Act on order passed under E-assessment scheme. Thus, the applicability of provisions of section 263/264 to E-assessment orders is not clear.

Recommendations

- It is suggested that detailed procedure should be issued for transfer pricing assessments to be conducted through e-assessment scheme.
- It is suggested that detailed procedure should be issued for DRP assessment through e-assessment scheme.
- Clarification should be issued on the applicability of E-assessment scheme to the re-assessment proceedings and Section 263/264 of the Act to E-assessment orders.

2.30.13. 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.

2.30.14. 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.

2.30.15. 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.

2.30.16. 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.

2.30.17. 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.

2.30.18. 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.

2.30.19. Prescribe Tax Refund Procedure

Issue

Currently, there is no statutory time limit for grant and payment of refund by the tax authorities. Further, the challenges faced by taxpayer in obtaining tax refund creates an unfavourable scenario for them.

Having a time-based procedure for grant and payment of refund would help in re-building tax payer's confidence on the tax system. These areas need to be codified since the current situation is not satisfactory.

Recommendation

It is recommended that time limit for issuance of tax refund be prescribed.

2.30.20. 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 taxpayers.

2.30.21. 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.

2.30.22. 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.

2.30.23. 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).

2.30.24. 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.

2.30.25. 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.

2.30.26. 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.

2.30.27. 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.

2.30.28. 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.

2.30.29. 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.

2.30.30. 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%

2.30.31. 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**

2.30.32. 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.

2.30.33. Withdrawal of registration of charitable trust in case of non-compliance of 'material' conditions of other applicable laws – Section 12AA

(i) Section 12AA of the Act is amended by Finance (No.2) Act 2019 to provide that registration of charitable trust can be cancelled in case of non-compliance of 'material' conditions of other applicable laws**.**

(ii) The above requirement should be deleted for the following reasons

- Adequate provisions under the Act to cancel registration of non-genuine charitable trusts or where activities are not in line with the objects of the trust.



- The respective authorities under other laws have enough powers/rights to take action against the trust for not abiding by the respective law
- It may not be a correct practice to implement other laws through the Act.
- Determination of 'material' non-compliance is subjective and increases scope of litigation.

2.30.34. Tax on buyback of shares in case of listed companies

Finance Act, 2019 has amended section 115QA of the Act to include such tax on buyback of listed shares.

- The scope of applicability of the buy-back tax provisions should be narrowed down to exclude certain kinds of listed entities which fulfil stipulated objective criteria/parameters indicative of the genuine cases where the buy-back may not be considered to have been undertaken as a tax avoidance exercise, for companies having a steady dividend pay-out record, achievement of certain performance parameters such as EPS, Return on Equity, Return on Capital, Debt-Equity Ratio, etc., companies which are in immediate need of funds, etc.
- Grandfathering provisions to be introduced under Section 115QA of the Act or Rule 40BB of the Rules akin to section 55(2)(ac) of the Act from company's perspective such that the "amount received" for the purpose of determining "distributed income" under Section 115QA of the Act may be deemed to be the market price of shares prevailing on stock exchange as on 4 July 2019.

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

Currently, section 56(2)(x) of the Act provides that where any person receives any sum of money or property without consideration or for a consideration less than Fair Market Value (FMV), the recipient may have to pay tax on the basis of FMV. Further, section 50CA of the Act provides that where unquoted shares are transferred at a price less than FMV, consideration for the purpose of computing capital gains in the hands of seller shall be deemed to be the FMV. For both these provisions, FMV is determined on the basis of the prescribed method.

Section 56(2)(x) and 50CA of the Act has been amended by the Finance Act, 2019 to restrict its applicability on prescribed transactions undertaken by certain class of persons, which shall be prescribed by the CBDT. Such amendment is intended to remove genuine hardship in cases where consideration for transfer of shares is approved by certain authority and person transferring the share has no control over such determination.

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 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.

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.
- In case where the shares are acquired under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, offer price of the shares is determined much prior to the date of acquisition of shares on account of offer period to the public. Similarly, in case where a transaction requiring approval from regulatory authority (SEBI, RBI, IRDA etc.) for transfer of shares, the date of acquisition is different from date of agreement fixing the consideration for shares. Exemption on the lines of immovable property provided under section 50C and 56(2)(x)(b) of the Act may also be provided for acquisition of shares.
- Definition of 'quoted shares' present in section 50CA of the Act suggests that shares of company which are listed outside India may be considered as 'unquoted shares'. On transfer of shares of company listed outside India may also call for determining the fair market value in terms of Rule 11UAA of the Rules. It is practically impossible to obtain the Balance Sheet of foreign companies on the date of transfer of shares. Further, it is



not possible to obtain the Balance Sheet of companies whose shares are held by such foreign companies for computing FMV as per Rule 11UAA of the Rules.

- 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.
- 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.

- Provisions of section 50CA of the Act may not be made applicable to transfer of shares (other than quoted shares) of companies which are under resolution plan under the Insolvency and Bankruptcy Code, 2016 and such plan is approved. Similarly, section 56(2)(x) of the Act, *interalia*, may also not be made applicable on receipt of shares and securities of companies which are under resolution plan under the Insolvency and Bankruptcy Code, 2016 and such plan is approved.
- It is recommended that where the date of agreement for fixing the consideration for transfer of shares is different than actual transfer of shares, at the option of the taxpayer, in determining the applicability of section 50CA and section 56(2)(x) of the Act, Rule 11UA value prevailing on the date of agreement fixing the consideration be considered.
- 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 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 recommended that, in the definition of 'quoted shares', shares of foreign companies which are listed outside India be included and accordingly, provisions of section 50CA of the Act are not made applicable to foreign companies whose shares are listed outside India.
- Section 50CA of the Act may be amended to provide carve out for shares of foreign companies listed outside India.
- Instead of providing positive list of exempt transactions, the list should be formulated as a negative list, wherein only certain cases which are indicative of tax abuse practice are subjected to the anti-abuse provisions of section 56(2)(x) and section 50CA of the Act, leaving off the other transactions out of its application, akin to the negative list of transactions which were notified for the purposes of non-applicability of section 10(38) of the Act.

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

The 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 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.

Section III – Exemptions and Deductions

2.31. 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.

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. 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.

2.32. Tax Incentives and Benefits

2.32.1. 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 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.

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.

- Total Income for the purpose of section 115BAA and 115BAB of the Act has to be computed without claiming deduction under section 35(2AB) of the Act. Scientific research is the lifeline of business in all countries of the world and must be encouraged by way of continuation of deduction for expenditure on scientific research.

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.
- It is recommended that deduction for expenditure on scientific research as prescribed under section 35(2AB) of the Act should be continued for companies opting to pay tax at concessional rate as per section 115BAA and 115BAB of the Act.

2.32.2. 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.

2.32.3. 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.

2.32.4. 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**.**

2.32.5. Provide for amendments to encourage electric vehicles

(i) Investment linked incentive for sunrise industries announced in budget speech of Union Budget 2019-20, but corresponding amendment in section 35AD of the Act was not made. Existing section 35AD of the Act (that covers semi-conductor wafer manufacturing) may not cover most of the items referred in FM's speech, like solar photo voltaic cells, lithium storage batteries, solar electric charging infrastructure, computer servers, laptops, etc. The same may be specifically introduced in section 35AD of the Act.

(ii) R&D in sunrise industry may be incentivised by extension of weighted deduction benefit under section 35(2AB) of the Act.

(iii) End users may be given higher depreciation benefit on purchase of electric vehicles.

(iv) Setting up of battery/charging stations may be incentivised by giving higher depreciation on the equipment/charging system.

(v) In respect of deduction available to individual taxpayers for interest on loan taken for purchase of electric vehicles u/s 80EEB, the Explanatory Memorandum to Finance (No.2) Bill 2019 states that the deduction is available only in respect of first EV purchase, while the Act does not specify any such stipulations. Proper clarity should be provided for certainty and to avoid any possible litigation.

Section IV – Personal Income Tax

2.33.1. Tax Rates - Individual Taxpayers

Income up to Rs. 2.5 lakh per annum (p.a.) is currently exempt from tax for individual taxpayers up to the age of 60 years. This limit has remained constant since financial year 2014-15, though, higher exemption limits have been prescribed for senior citizen and super-senior citizen taxpayers up to Rs. 3 lakh p.a. and 5 lakh p.a. respectively.

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.

Though, Finance (No. 1) Act, 2019 provided some relief to small/middle-class taxpayers by enhancing the tax rebate to Rs. 12,500 which effectively translates into payment of NIL tax by individuals having income below Rs. 5 lakhs, no changes were made to the existing slab of income and tax rates. Also, Finance (No. 2) Act, 2019 did not increase/ modify the existing income slab rates.

In various countries across the globe, the tax rates are more relaxed. For instance, tax rate in Japan upto JPY 1,950,000 (approx. Rs. 13,00,000) is 5 per cent; tax rate in UK upto GBP 34,500 (approx. Rs. 30,00,000) is 20 per cent with personal allowance of GBP 11,500 (approx. Rs. 10,00,000) available.

Further, keeping in mind the current economic scenario additional net disposable income resulting from reduction in personal tax rates, could enhance consumption and spur overall demand for goods and services.

FICCI recommends the following revised tax slabs for individual taxpayers.

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

2.33.2. Roll Back of Enhanced surcharge for high-income earners

The Finance Act, 2019 has increased the surcharge from 15% to 25% on individuals having total income between Rs. 2 crore and Rs. 5 crore and from 15% to 37% when the total income exceeds Rs. 5 crores. This has resulted in a maximum marginal rate of 39% and 42.744% respectively being applicable to such category of individuals.

The premise for levying of higher surcharge is that high income earning individuals should contribute more towards the nation building. However, such increase is substantial and is likely to have an adverse impact in terms of higher tax outgo especially by entrepreneurs of



successful businesses/start-ups, highly qualified Indians who work in multi-national companies and have option of being deputed anywhere in the world, expatriates who are working in India under the Tax Equalisation arrangement (i.e. their India tax liability being paid by the Company on their behalf as one of the benefits of an international assignment to India).

Also, with recent Tax Ordinance Taxation Laws (Amendment) Ordinance 2019 dated 20th September 2019 reducing the corporate tax rates substantially, there is now a huge gap between the corporate tax rate and maximum marginal tax rate applicable to individuals (including such enhanced surcharge).

It is recommended to consider a rollback of the enhanced surcharge in entirety (in line with the rollback on capital gains arising from sale of listed equity shares/ units of equity oriented mutual funds/business trusts effected through aforementioned Tax Ordinance) or be moderated to a comparatively lower level to help India remain a competitive tax jurisdiction vis-a-vis other lower tax jurisdictions for hiring of specialist talent and to ensure continued flow of skilled resources to support the development of the nation and strategic programmes like Make in India.

2.33.3. 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.

2.33.4. Additional deduction for affordable house - Section 80EEA

An additional deduction of upto Rs. 1.5 lakh p.a. was introduced vide Finance (No. 2) Act 2019, for first time home buyers in respect of interest payable on a housing loan sanctioned during the period 1 April 2019 to 31 March 2020 with stamp valuation of the property not exceeding Rs. 45 lakh. However, it is difficult to buy a house in a metro city or Tier 1 city at



such relatively low threshold. Thus, this deduction is likely to benefit only lower income borrowers in Tier 2 and Tier 3 cities/towns.

It is further recommended that the stamp duty value of the house property for said additional deduction be enhanced from Rs. 45 lakh to atleast Rs. 65 lakh atleast for metro cities and certain Tier 1 cities (e.g. Bengaluru, Hyderabad, Pune etc.) to incentivise purchase of an affordable house across India.

Also, one of the stipulated condition for availing such additional deduction is that a loan shall be sanctioned during the period 1 April 2019 to 31 March 2020 i.e. during current financial year only. Thus anyone who avails a housing loan post 31 Mar 2020 would not be eligible for such deduction. On the other hand, the Government endeavors to achieve housing for all by the year 2022. It is recommended that the period during which loan shall be sanctioned for availing said deduction may be atleast extended until 31 March 2022 vis-a-vis 31 Mar 2020.

2.33.5. 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.

2.33.6. 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. Finance Act, 2019, has increased the exemption to sixty percent of the accumulated corpus (from forty percent earlier) upon withdrawal/ superannuation whilst balance corpus of forty 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.

2.33.7. 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.

2.33.8. Increase in limit of Standard Deduction

Issues

- The Finance Act, 2018 has introduced a standard deduction from salary income upto Rs. 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.

2.33.9. 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.

Recommendations

- 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.

2.33.10. Tax Exemption in respect of Leave Travel Concession (LTC) - Section 10

Issues

- Presently, the economy class air fare for going to anywhere in India is tax exempt (twice in block of four years). However, this exemption is being allowed only for travel within India.
- Lately, owing to low airfares and package tours, a number of Indians prefer going abroad, instead of availing LTC, particularly to neighbouring countries like Thailand, Malaysia, Sri Lanka, Mauritius, etc., as the fares thereto are at times less than for travelling to some far away destination within India.

Recommendations

- It is therefore recommended to grant tax exemption for economy class airfare for travel abroad also, so long these are within the overall airfare tax exemption conditions for travelling in India. Further, considering the current prevailing trend in respect of foreign travel, there is a need to include overseas travel as well for the purpose of exemption or at least to exempt proportionate expenses pertaining to travel within India in case of joint travel (within India and overseas destination).
- Further, under Rule 2B of the Rules, the amount exempt in respect of LTC by air is to the extent of the economy fare of National Carrier i.e. Indian Airlines. It is suggested that word "National Carrier" should be deleted from Rule 2B.
- Moreover, as per the current provisions, Leave Travel Concession/Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years. It is suggested that the concept of calendar year should be replaced with FY (April – March) in line with the other provisions of the Income Tax Law and further exemption should be made available in respect of at least one journey in each FY.

2.33.11. Taxation of Social Security Contributions in the hands of Expatriates - Section 17

Issues

- In respect of an expatriate employee deputed to India, the home employer and employee may be required to contribute to social security schemes under the local law of country. In most cases, the contributions made to these schemes may not vest on the employee at the time of making the contributions and thereby do not provide any immediate benefit to the employee. Further, the employee contributions may also be mandatory under the law of the home country. Both the employer and employee contributions may be available as a deduction from taxable income in the home country of the expatriates.
- However, currently there is no provision under the Act, which provides for the taxability or otherwise in respect of such contributions from taxable income, though there have been several favourable judicial precedents to this effect such as CIT v. L.W. Russel [1964] 53 ITR 91 (SC), Gallotti Raoul v. ACIT [1997] 61 ITD 453 (Mum), ITO v. Lukas 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.

2.33.12. 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.
- Further, Authority for Advance Rulings has in the recent past held that Foreign Tax Credit may be considered at the withholding stage by the Indian employer while determining withholding tax on salary income for employees qualifying as Resident and Ordinary Resident in India.

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.

2.33.13. Timeline for filing a revised tax return and consequently time lines for completion of tax assessment

Issues

- The Finance Act 2017 curtailed the time limit to file a revised return from the existing time available of two year from end of financial year to one year from end of financial year.
- This impacts many tax payers who have moved abroad for employment and qualify as Resident and Ordinary Resident (ROR) of India in the financial year of departure from India or any other ROR tax payer who has overseas income.
- This is because of the relief to be claimed (if any) on any overseas income offered to tax could depend on the tax return to be filed in the host country/country of source of income. It is possible that the tax return filing deadline is such country may be later than the timeline for filing the revised tax return. E.g. Mr. A moving to USA on 1 Jan 2020 and qualifying as a ROR of India for FY 2019-20. His Jan - March 2020 US income will be taxable in India subject to relief under the Indo-USA Double Tax Avoidance Agreement (DTAA). This relief can be determined based on his US returns for calendar year 2019 as well as 2020 and the deadline to file the US tax return for calendar year 2020 is 15th April 2021 (and further extendable as per US domestic tax law). However, tax filing timeline for FY 2019-20 would be 31st July 2020 which can be amended up to 31st March 2021 as per the aforesaid amendment.

Recommendations

- Considering the hardship, referred to in the above example and other similar cases of other jurisdictions as well, that can be caused on this account the deadline for filing a revised return should be restored to two years from end of the relevant financial year.
- As a consequence of this, the reduced due dates for completion of scrutiny and other assessments would also need to be rolled back and restored as they were earlier i.e. 21 months from the end of the relevant Financial Year.

2.33.14. 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.

2.33.15. 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 upto Rs. 150000 as in case of National Pension Scheme to provide a level playing field to the Mutual Fund industry.

2.33.16. 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.

2.33.17. 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.

2.33.18. 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. 50,000.

2.33.19. 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).

2.33.20. 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.

2.33.21. 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.

2.33.22. 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.

2.33.23. 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.

2.33.24. 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.

Section V – Indirect Taxes

CUSTOMS

3.1. 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.

3.2. 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 Act. The existing Authority of Advance Rulings constituted under Section 245-O of the Act 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.

3.3. 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.

3.4. 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.

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.

3.5. 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 March 17, 2012 and Notification No. 21/2012-Customs, dated March 17, 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 June 30, 2017, however, 18% IGST (9801) is applicable on all goods imported under the Mega Power Projects [Notification No. 1/2017-Integrated Tax (Rate), dated June 28, 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.

3.6. 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, input services and capital goods 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.

3.7. Facilitations for Authorized Economic Operator ('AEO') status holders

AEO programme aims to enhance international supply chain security and facilitate movement of legitimate goods. Under this programme, an entity engaged in international trade is approved by Customs as compliant with supply chain security standards and granted AEO status & certain benefits. The Government of India on time to time liberalized simplified and rationalized the AEO accreditation process to promote Ease of Doing Business and to emulate global best practices. However, considering the development in trade there is a need to provide further facilitations to AEO status holders. Certification process is a time taking process and no timeline for processing the application is prescribed. This delay in certification impacts import cycle time, which in turn affects the project timelines.

We recommend that appropriate guidelines be issued under the relevant laws prescribing necessary timelines for processing registration applications in a timely manner.

Additionally, we recommend that the AEO certified importers:

- Be exempted from first check during customs clearance. Any query regarding such clearance to be raised as part of post audit;
- To get facilitation in other allied regulations such as SCOMET/e-waste etc.

SECTORAL ISSUES

STEEL AND OTHER FERROUS PRODUCTS

4.1. Rollback of import duty on Petroleum 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.

Recently, Ministry of Environment and Forests issued the guidelines for Regulation and Monitoring of Imported Petcoke in India by eligible entities. Accordingly, Petcoke (Ch 2713) is allowed to be imported to those units only which are adhering the environment norms and such eligible units are required to take the consent from concerned State Pollution Control Board (SPCB) / PCC for permitted quantity to be imported and its use. Since, Petcoke import is restricted to the extent of eligible units with permitted quantity, it is recommended that duties on Petcoke import can be restored back to its original level of 2.5 % as it will help refinery to reduce their utilities cost.

4.2. 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.

4.3. Reduction in basic customs duty on Met Coke

Met Coke, is one of the vital inputs for the Steel Industry. It has always been attracting the lower and concessional rate of customs duty. However, the basic customs duty has been enhanced from 2.5% to 5% w.e.f. 01.03.2015. Additionally, anti-dumping duty has also been imposed on its imports with effect from 25.11.2016. 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 vis-à-vis similar products of other countries like China. Moreover, high inputs costs has led to an inverted duty structure in the domestic industry and acting as a deterrent to India's Make in India initiative, as domestic producers have less incentive to import this raw material and boost indigenous production. Rather, imports of finished steel goods are preferred.



It is, therefore suggested that the Basic Customs duty on Metallurgical Coke be reduced from 5% to NIL.

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

In the budget of 2014-15 the exemption available to Coking coal was removed by the Government by making it at par with other coals and thus imposed 2.5% of Basic Customs Duty on coking coal. This amendment has adversely affected the steel manufacturers in India and 'Make in India' drive. Coking coal is one of the principal raw materials being used in the manufacture of Steel and predominantly used for making Coke for use in steel making and thus forms a major part of the final price of the steel. Levy of 2.5% of Basic Customs Duty on Coking coal and simultaneously fixing the import duty of 5% on Coke has adversely affected the costing of the steel.

It is requested to restore the exemption of NIL rate of duty allowed earlier to Coking coal without any technical definition of coking coal.

4.5. 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.

4.6. Exemption of Import duty on Ferrous and Stainless Steel Scrap

The requirements for Ferro Nickel – a key Stainless steel raw material, are met completely through imports as Nickel sufficiently is not available within the country. Stainless Steel Scrap too is not available indigenously in sufficient quantities and almost 75% of the stainless steel scrap requirement in the country has to be met through imports. Thus, the domestic steel companies have to rely on imports of this key raw material. Imposition of BCD 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 should be reduced from the existing rate of 2.5% to 'NIL'.

4.7. 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.

4.8. 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

4.9. 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 increased considerably over the last one year.

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%. Moreover, Provisional Safeguard duty on steel products needs to be imposed with immediate effect for stipulated time to protect them from escalating protectionist measures by other countries.

4.10. 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 2017-18 &

2018-19. 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.

4.11. Reduction of Import Duty on Moly Oxide

Moly oxide is a critical input used in the production of Ferro Molybdenum. However, the moly oxides available in South East Asia are approximately 1500 metric tons which is very negligible considering the domestic requirement of 10,000 metric tons. Also, only imports of the same from South East are duty free. There is 0.5% duty on the Moly Oxides imported from Chile and 2.5% on the imports from Europe, China, USA, Iran. Therefore, it is recommended to reduce import duty on Moly Oxide to NIL from the current 2.5%.

4.12. Reduction of Basic Customs Duty on Stainless Steel Scrap (HS Code 72042190)

Stainless steel scrap is the most important raw material required by the stainless steel industry as it is the most cost efficient way of meeting the nickel requirements. Currently it attracts 2.5% BCD. The domestic stainless-steel industry uses the environmentally friendly Electric Arc Furnace route which necessitates the use of stainless-steel Scrap. The usage of stainless-steel scrap is therefore an absolute must not only from the perspective of cost saving but also from the perspective of the technology being employed. The availability of stainless-steel scrap in the country is extremely limited and bulk of the stainless-steel scrap requirement has to be compulsorily imported. Almost 75% of the stainless-steel scrap requirement in the country has to be met through imports. This is because stainless steel, owing to its corrosion resistant characteristic and high strength, has an extremely long life span (at least 30 years) as compared to any other substitute material. Most of the growth in stainless steel consumption in the country has come about in the last 10-12 years because of which the stainless steel scrap generation in the country is extremely low.

Major stainless steel producing countries like China, Korea, Japan, EU and USA have zero import duties on SS Scrap. Interesting point is that from ASEAN and FTA (Japan, Korea) countries while the stainless steel Flat Products are coming at Zero duty, the most essential raw material (SS scrap), not available in India, attracts 2.5% duty. Thus, creating inverted duty structure. Unlike other commodities, scrap is not manufactured by any industry. It is automatically generated as items manufactured out of stainless steel reach the end of their useful life and have to be junked. There is therefore no domestic industry whose interest can be materially affected as a result of reduction in import duties on SS scrap. It is recommended to reduce basic custom duty on stainless steel scrap from 2.5% to zero.

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

Defective goods falling under Chapter 72 of the Customs Tariff are liable to customs duty @ 15%. In view of the narrow margin of difference between the rates of import duties of prime quality and seconds/defective goods, there has been a surge of imports of 'seconds' and 'defective' steel products in the country. This is putting pressure on the industry already



grappling with the challenge of subdued demand and rising cost of production; alongside raising the quality concerns for long-term infrastructure and construction projects using steel. In order to suppress the imports of defective steel into the country, the rate of seconds / defective goods needs to be increased. It is suggested that customs duty on seconds and defective goods falling under Chapter 72 be raised to 40%, as also mandated by World Trade organization's (WTO) guidelines, according to which import duty can be imposed to the extent of 40%.

FINANCIAL SERVICES

I – INSURANCE

Direct Tax

4.14. 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.

4.15. 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.

4.16. 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.

4.17. 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.

4.18. 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.

4.19. 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.

4.20. Unexpired risk reserve

As per clause 5(c) of the First schedule of the Act, amount carried over to a reserve for unexpired risks (URR) is allowed as a deduction, while computing the taxable profits of a general insurance company. The amount permitted as a deduction is prescribed in Rule 6E of the Rules. It is submitted that the aforesaid provision was originally inserted with the then prevalent regulatory regime for creation of such Unexpired Risk Reserves in the books of accounts by general insurance companies. Further, there were very few insurance products in the market at that time broadly classified into three classes viz. Fire, Marine and Miscellaneous. Therefore, this simplistic URR computational method was sufficient IRDAI has subsequently modified the regulations for creation of such Unexpired Risk reserves.



However, the Act provisions and the Rules have not been correspondingly modified. At present, with the opening up of the market and growing economic requirements, there are more than thousand products in the market and are categorized into many classes (Lines of Business). Comprehensive products contain insurance covers which are a package/ bundle/ combination of one or more categories of covers. And therefore, the URR computation as per Rule 6E requires a review.

The restriction of deduction at 50% of reserve for unexpired risk in all other cases of insurance (viz other than marine insurance and fire/ engineering insurance which provides for terrorism risk) is not reasonable considering the nature of business of the general industry sector. In most cases, the quantum of URR created in the books of accounts will far exceed the quantum of URR allowable under Rule 6E. Presuming an increasing trend in premium growth, it would effectively result into a year-on-year timing difference whereby a material portion of URR for a particular year would be disallowed, resulting into an accelerated tax liability for that year. This is particularly true given that URR disallowances could involve a large quantum on an annual basis.

URR allowance effectively means only a timing difference, accelerated tax payments over a prolonged period of time would have a net negative cash impact and reduce return on both policy holders' and shareholders' funds. Secondly, there is a material percentage of the business relating to long-term insurance policies (i.e. covering more than one-year period.

The Hon'ble Supreme Court of India in case of ***Shri S Rajaseekaran vs UOI*** vide order dated July 20, 2018 made third party insurance cover for new cars mandatory for three years and five years for two wheelers and instructed General Insurance companies to implement the same from September 1, 2018. Other examples of multiple year policies could include health insurance, property insurance, etc.

As stated above, the negative impact on the cash flow on account of timing differences is accentuated in the case of multiple year insurance policies owing to high URR creation in the year of issuance of the policies. Further, there could be an additional risk of a permanent disallowance owing to the peculiar requirement of Rule 6E, namely, the amount of URR disallowed in a particular year is allowed as deduction in the subsequent year only if such URR is reversed in the immediately succeeding year.

In case of such multiple year policies where the URR created in year 1 will need to be reversed proportionately during the tenure of the policy, any non-reversal of URR pertaining to year 1 in the books of account in the immediately succeeding year can potentially result in a permanent difference. Such a disallowance would be substantial, inequitable and would place a material tax burden on the general insurance company.

It is further submitted that URR is created / reversed in the books of accounts in a scientific manner in accordance with the regulations enacted by IRDAI. Such reserves are to be reported to the IRDAI and subject to close scrutiny and supervision. The reserves do not result into any unfair tax benefits through artificial reduction / deferment of taxable profits of the insurance companies.



The following grounds provide the rationale for revision of URR for Insurance and reinsurance companies:

a. Multiple year insurance policies have been designed in Motor, Health and Property risks.

b. Computing systems and actuarial methods are well evolved.

c. Empirical formula requires revisiting.

d. Consistent growth of Insurance business has increased the complexity of calculations.

e. Foreign Reinsurance Branches have also been granted registration to transact reinsurance business in India

Accordingly, URR created in the books of account as per the IRDAI guidelines should be fully allowed as deduction for tax purposes.

4.21. Provide clarification on Applicability of Grandfathering Provisions

In terms of Section 10(38) of the Act, any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of business trust ***("long term capital asset"***) was exempted from the levy of income tax. This exemption was withdrawn vide the Finance Act, 2018, and a new regime of taxation was introduced for gains arising from the transfer of long term capital assets, by way of insertion of Section 112A and clause (ac) to Section 55(2) of the Act.

In terms of Section 27(2) of the Insurance Act, 1938, ***("Insurance Act"***), all insurers carrying on general insurance business, including the Company, are required to invest and keep invested all of its assets in accordance with the provisions of the Insurance Act and the rules thereunder, subject to certain conditions. These conditions inter alia mandate that investments cannot be in a single company (and have to mandatorily by diversified) or be in any private companies. Given this mandate of the Insurance Act (and the restrictions thereunder), and to play an active role in the nation's capital markets, the Company undertakes investments in various listed companies including by way of procuring equity shares of a company or units of an equity oriented fund or units of a business trust. These investments are primarily made with a long-term outlook. On the issue of applicability of the exemption under Section 10(38) to general insurance companies, the CBDT had vide its letter F. No. 153/24/2006-TPL dated 21st February, 2006 ***("CBDT Circular"***) clarified that the exemption under Section 10(38) is equally applicable to general insurance companies.

Vide the Finance Act, 2018, and to effectuate the changes introduced by the Union Budget 2018, a proviso was added to Section 10(38) of the Act, which read as follows:

> *"Provided also that nothing contained in this clause shall apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018".*

Hence, the exemption which was hitherto available for income arising from transfer of long term capital asset, came to be withdrawn for any transfer made on or after 1st April, 2018. Such change was introduced as a part of "a new regime for taxation of long-term capital

gains on sale of equity shares" after a prolonged period of exemption in terms of Section 10(38) of the Act.

The intent behind the introduction of Section 55(2)(ac) was to grandfather all gains which have arisen in relation to long term capital assets, acquired when the exemption under Section 10(38) was in operation. Such intent is evident from the speech of Hon'ble Finance Minister while announcing the Union Budget 2018. Relevant portion of the speech is reproduced below:

"155---However, recognising the fact that vibrant equity market is essential for economic growth, I propose only a modest change in the present regime---However, all gains up to 31st January, 2018 will be grandfathered"

Following illustration helps to understand the impact on General Insurance Industry due to withdrawal of Section 10(38) exemption:-

Particulars	**General insurance company [in case the grandfathering benefit is denied]**	**Other assessees**
Cost of acquisition of asset (on 05.05.2006)	Rs. 30	Rs. 30
Total consideration earned for transfer of asset (on 01.01.2019)	Rs. 400	Rs. 400
Cost of asset on 31.01.2018 (fair market value)	Rs. 350	Rs. 350
Value at which tax to be discharged	Rs. 400- INR 30 = Rs. **370**	Rs. 400-INR 350 = Rs. 50

General insurance companies are required to pay tax at a higher rate on gains from long term capital assets, the denial of the grandfathering benefit provided by Section 55(2)(ac) will lead to double impact for these companies, inasmuch as these will now be required to pay tax on a much higher value.

As stated above, the CBDT vide Circular clarified as under:

> *"The exemption available to any other assessee under any clause of Section 10 of Income tax Act, 1961 [including clause (38) of Section 10 regarding long term capital gains] is also available to a person carrying on non-life insurance business subject to fulfilment of the condition, if any, under a particular clause of Section 10 under which exemption is sought. General insurance companies are, therefore, on par with other assessees who are entitled to or are eligible for exemption under section 10 of the Income-tax Act of long-term capital gains"*

While this exemption was withdrawn *vide* the Finance Act, 2018, by virtue of Section 55(2)(ac) of the Act (which indexes the cost of acquisition to be as that applicable on 31st

January, 2018 for determining the gains on transfer of such long term capital assets), it was ensured by the Legislature that the gains which are earned on these long term capital assets over the period of 14 years [when such income was exempt under Section 10(38) of Income tax Act] are not brought to tax. Thus, the grandfathering clause of Section 55(2)(ac) of the Act was just a consequence of the withdrawal of the said exemption.

It is also noteworthy that the intention to introduce the grandfathering clause was to grandfather all gains up to 31st January, 2018, which is also clear from the Budget Speech of the Hon'ble Finance Minister while announcing the Union Budget 2018, when he said that "*all gains up to 31st January, 2018 will be grandfathered.*

In absence of clarification on applicability of grandfathering provisions set out in Section 55(2)(ac) of the Act, it would essentially mean that general insurance companies will be taxed not only for the gains earned by it from transfer of long term capital asset since revocation of the exemption, but in effect , all gains which have accrued to such long term capital assets over the years, including the period when such income was exempt under the provisions of Section 10(38) of the Act.

This would lead to bringing to tax gains which accrued when the exemption was in effect, which does not seem to be the intent of the Legislature, especially considering that a grandfathering provision under Section 55(2)(ac) of the Act was specifically introduced when such exemption was withdrawn.

This view is also fortified from the fact that it was the intent of the Legislature to bring about only a **modest change** in the taxability of such long term capital assets and to grandfather all gains up to 31st January, 2018, which is evident from the speech of Hon'ble Finance Minister while announcing the Union Budget 2018. Relevant portion of the speech is reproduced below:

> *"155. Madam Speaker, currently, long term capital gains arising from transfer of listed equity shares, units of equity oriented fund and unit of a business trust are exempt from tax. With the reforms introduced by the Government and incentives given so far, the equity market has become buoyant. ...There is therefore a strong case for bringing long term capital gains from listed equities in the tax net. However, recognising the fact that vibrant equity market is essential for economic growth, I propose only a **modest change in the present regime**. I propose to tax such long term capital gains exceeding 1 lakh at the rate of 10% without allowing the benefit of any indexation. **However, all gains up to 31st January, 2018 will be grandfathered**"*

Hence, while introducing the above changes, the intent of the Government was to bring long term capital gains from listed equities within the tax net, while only making a modest change in the existing regime (of exemption) and to clearly grandfather all gains made in up to 31st January, 2018. The introduction of grandfathering clause makes it absolutely clear that the intention of the Government was to never retrospectively tax such income, which were exempt in terms of Section 10(38) and such intention should equally be advanced in the case of general insurance companies.

Furthermore, as enshrined in Article 14 of the Constitution of India, there should be an equality of treatment under equal circumstances, and all person ought to be treated equally before law. It is trite law that the principle of equality enshrined in Article 14 also extends to taxing statutes and the law should not be interpreted to lead to discrimination between similarly placed class of persons.

In view of the above, since both general insurance companies and other assessees are identically placed with respect to gains arising from transfer of such long term capital assets, in terms of the principle embodied in Article 14, the benefit of grandfathering provided under Section 55(2)(ac) should be equally made available to both these classes.

The Legislature being mindful of this fact has provided grandfathering provision under Section 55(2)(ac) to ensure that long-term investors are not penalised for holding onto these long term capital assets for an extended period of time.

Hence, given the above, and with a view to avoid penalizing general insurance companies for not disposing off its long term capital assets at regular intervals, it should be clarified that the benefits of grandfathering provision contained in Section 55(2)(ac) also apply to such companies.

Given that the intent of the Government is to grandfather all gains which had accrued in relation to long term capital assets which were acquired when the exemption under Section 10(38) was in operation, it is requested that a clarification be issued, by way of a circular or instruction or order or any other suitable legal directive, setting out that the grandfathering clause under Section 55(2)(ac) of the Act is applicable to general insurance companies.

4.22. Allowance of Incurred but not reported reserves (IBNR) & Incurred but not enough reported reserves (IBNER)

The provision for IBNR and IBNER claims are made only in relation to the claims incurred during the previous year. The provision for IBNR and IBNER claims made are in respect of the liability incurred by the Insurance company and not based on any future liability.

These provisions are made by Actuary based on historical data, past experience and survey reports. The methodology to determine the liability is also certified by the Actuary in accordance with guidelines and norms issued by the Institute of Actuaries of India and Insurance Regulatory and Development Authority of India.

Thus, the provision for IBNR and IBNER claims are based on scientific calculation with a proper rationale. IBNR represents claims which have become due for the loss/damage that have occurred in the relevant accounting year.

In certain circumstances, the damages/losses are not reported or not enough reported, such claims are known as claims incurred but not reported (IBNR) or claims incurred but not enough reported (IBNER). These liabilities are based on actual loss incurred and only incremental effect is taken at the end of each Financial Year based on Actuals of previous year. These provisions are thus ascertained liability.

Under the Act, there are special provisions for computation of income of General Insurance Companies. The Income of General Insurance Companies is computed under Section 44 of the Act read with Rule 5 of the First Schedule to the Act.

Sec. 44 of the Act is reproduced below for ready reference:-

> ***"44.*** *Notwithstanding anything to the contrary contained in the provisions of this Act relating to the computation of income chargeable under the head "Interest on securities", "Income from house property", "Capital gains" or "Income from other sources", or in section 199 or in sections 28 to 43B, the profits and gains of any business of insurance, including any such business carried on by a mutual insurance company or by a co-operative society, shall be computed in accordance with the rules contained in the First Schedule"*
>
> It will be appreciated from above that section 44 is a special provision governing computation of taxable income earned from business of insurance. It opens with a non obstante clause and thus, has an overriding effect over other provisions contained in the Act. It mandates the assessing authorities to compute the taxable income from business of insurance in accordance with the provisions of First Schedule.

Rule 5 of First Schedule to the Act which is applicable in case of general insurance companies, reads as under:

"The profits and gains of any business of insurance other than life insurance shall be taken to be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 (4 of 1938) or the rules made thereunder or the provisions of the Insurance Regulatory and Development Authority Act, 1999 (4 of 1999) or the regulations made thereunder, subject to the following adjustments:—

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

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

(ii) any provision for diminution in the value of investment debited to the profit and loss account, shall be added back;

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

On perusal of the above Rule 5, it will be appreciated that the profits & gains of general insurance business shall be shall be taken to be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 (4 of 1938) and regulations of IRDAI.

Further, Rule 5 (a) of the First Schedule makes it clear that in order to attract the adjustments under the said sub rule, the amount should firstly, be an expenditure or allowance. Secondly, it should also be one which is inadmissible under any of the provisions of sections 30 to 43B of the Act.

It is submitted that the Provision for IBNR & IBNER claims is as per Insurance Regulatory and Development Authority (IRDAI) Guidelines and as such has to be taken into consideration to arrive at the Profit before tax and appropriations as disclosed in the Profit & Loss Account prepared in accordance with the provisions of the Insurance Act, 1938 (4 of 1938) or the rules made thereunder or the provisions of the Insurance Regulatory and Development Authority Act, 1999 (4 of 1999) or the regulations made thereunder.

Thus, it will be appreciated that the provision for IBNR & IBNER claims are mandatory as per the IRDA guidelines and therefore, such provisions do not require any adjustments since they do not fall under any of adjustments specified under Rule 5 of First Schedule to the Act.

It is submitted that the Provision for IBNR & IBNER claims is as per Insurance Regulatory and Development Authority (IRDAI) Guidelines and as such has to be taken into consideration to arrive at the Profit before tax and appropriations as disclosed in the Profit & Loss Account prepared in accordance with the provisions of the Insurance Act, 1938 (4 of 1938) or the rules made thereunder or the provisions of the Insurance Regulatory and Development Authority Act, 1999 (4 of 1999) or the regulations made thereunder.

Thus, it will be appreciated that the provision for IBNR & IBNER claims are mandatory as per the IRDA guidelines and therefore, such provisions do not require any adjustments since they do not fall under any of adjustments specified under Rule 5 of First Schedule to the Act.

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

One of the major lines of business of the General Insurance Industry is Motor insurance. This segment provides insurance coverage to the damage to the vehicle under the "Own Damage" section and damage to life and property of third party by the insured vehicle under Third Party segment.

Third party insurance is mandatory under the Motor Vehicle Act. A claim under Motor Third Party Insurance can be filed in Motor Accident claim tribunal "MACT". The insurance company pays to the victims or the legal heirs the compensation as decided by the MACT or the higher Appellate authorities. Along with the compensation so awarded by the MACT, insurance company is also required to pay interest on the decretal amount, which is calculated on the amount of compensation from the date of filing the claim to the date of payment of the awarded amount.

Motor Accidents Claim Tribunal ("MACT") awards to victims of motor vehicle accidents include compensation and interest thereon. Generally, most of the victims are poor and are unlikely to have taxable income.



As per Section 194A of the Act, TDS is deductible if the interest amount on MACT awards exceeds Rs. 50,000 for a financial year. General Insurance Companies deduct TDS on interest component to ensure compliance with the provisions of the Act.

The interest is paid for delay in payment of the claim and is therefore compensatory in nature. Being a compensatory payment, the same cannot be regarded as an interest payment to the claimant.

Interest component have been held by various High Courts (Mumbai, Ahmedabad and Madras) as a capital receipt in the hands of the recipient & in few cases has also ordered insurance companies to refund TDS deducted to the claimants being compensatory in nature.

Further, Ahmedabad ITAT has also suggested that Central Board of Direct Taxes shall issue appropriate administrative instructions for ensuring that **"what was brought as a measure of relief for taxpayers is not used by the field officers as a source of taxation".**

This would resolve the dilemma being faced by General insurance companies wherein Courts are insisting and directing insurance companies to settle the entire claim compensation including interest thereon to the victim whereas the Act requires to deduct TDS on MACT Interest compensation.

TDS non-deduction would result in disallowance of expenses and other consequential provisions under the Act. Hence, it is requested that Interest on MACT Compensation should be outside the ambit of Section 194A of the Act.

II – NON-BANKING FINANCIAL COMPANIES (NBFCs)

Direct Tax

4.24. Treatment of Recognition of Income

Section 43D of the Act is a special provision for taxability of interest income in relation to prescribed categories of bad and doubtful debts and provides that interest income shall be chargeable to tax in the previous year in which it is credited by such public financial institution or scheduled bank or a co-operative bank or received whichever is earlier.

With a view to provide a level playing field to certain categories of NBFCs who are adequately regulated, amendment has been inserted in section 43D of the Act so as to include deposit-taking NBFCs and systemically important non deposit-taking NBFCs within the scope of this section. It is also proposed that a corresponding amendment will be made in section 43B of the Act for claiming interest deduction by the debtor. Accordingly, the debtor will be eligible to claim the deduction on interest only if such interest is paid on or before the due date of furnishing the return of income of the relevant previous year.

With effect from April 1, 2018, certain categories of NBFC are also required to prepare its financial statement in accordance with Indian Accounting Standards (Ind-AS) notified under provisions of the Companies Act, 2013. Ind-AS standards broadly follows principles of global IFRS which provides fair-valuation approach. Accordingly, interest income in relation to bad and doubtful debts are to be recognised in profit and loss account as per Ind-AS even

though there are no recoveries thereon. Such income as per the prevailing RBI guidelines were not recognised under previous GAAP. Hence, despite the amended Section 43D of the Act, Ind-AS accounting principles create an anomaly which is contrary to the stated objective of section 43D of the Act. Section 43D of the Act was introduced with an objective to tax interest income on sticky loans on receipt basis. It is recommended that appropriate amendment be made in section 43D of the Act to provide that interest accrued by NBFCs and NBFC-ND SI on credit impaired assets in accordance with Ind AS 109 shall be taxable only in the year of actual receipt. This will bring the much-desired relief to NBFC sector.

4.25. 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. Thus, interest income received by banks and other financial institutions is not subject to tax deduction at source ("TDS"). Non-applicability of TDS on interest components paid/ payable to Banks put them as a more preferred lender when compared to NBFCs as computation of interest in every EMI becomes more tedious for the borrower. NBFCs are institutions similar to banks and accordingly, the benefit of the provisions of section 194A should also be extended to NBFCs i.e. the interest income earned by NBFCs should be exempted from any TDS requirement. The NBFCs will continue to discharge their tax liability by way of advance taxes. Hence this provision will be revenue neutral.

Additionally, given the number of customers deducting TDS for NBFCs at times, the TDS deposited by the customer does not necessary gets reflected on government TDS portal and hence, claim of TDS for NBFCs gets partially rejected. Given the same, the Government should extent the said exemption to NBFCs as well. This will provide additional liquidity to the NBFC and removal of significant administrative hassles of reconciliations of thousands of TDS deductions at the transaction level.

Other consequent and additional challenges that arise to NBFCs due to TDS on interest are listed below:-

- Liquidity impact: Generally, NBFCs engaged in financing activities operate on a very thin margin on the interest and many of these NBFCs have high cost of operations and low profitability. Deduction of taxes at source (by virtue of section 194A) on the gross interest income earned by such NBFCs puts them in a disadvantageous position as it creates cash flow constraints. Moreover, at times the tax deductible on the gross interest income is much higher than the profitability of the NBFCs i.e; to utilize the TDS of 10% on gross amount approximately 35% profit margin needs to be earned at the current tax rates. This results into significant refund position to the taxpayers.
- Large volumes: NBFCs carry on the financing business mostly with retail customers who could be large in number spread across various geographies and sectors, including unorganized sectors. Due to the large customer base, it becomes almost impossible for NBFCs to regularly follow up with every customer for TDS certificates every quarter



(details of which are mandatory for claiming the same in the Income-tax return). Also, practically it is very difficult to collate and collect details from such customers.

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.

4.26. Align Provision for bad & doubtful debts for NBFCs in accordance with banks

Section 36(1)(viia) of the Act provides that a bank shall be allowed a deduction of provision of bad and doubtful debts to the extent of 8.5 percent of the total income (computed before making any deduction under this section and Chapter VIA) and 10 percent of aggregate average advances made by rural branches of such bank. Finance Act, 2016 extended similar benefit to NBFCs and permitted them to deduct provision of bad and doubtful debts to the extent of 5 percent of the total income (computed before making any deduction under this section and Chapter VIA).

Such disparity is unwarranted as the NBFCs are making active contribution to the Indian Government's objective of financial inclusion by providing financial access to the un-banked population in rural areas. Hence, NBFCs having its branches and service centres in rural areas and lending to the rural sector in the form of agricultural loans, equipment finance, etc. should also be equated to lending by rural branches of banks. It is believed that this measure will infuse the required liquidity support to the NBFC.

It is recommended that the existing threshold of deduction of 5 percent of the total income under section 36(1)(viia) of the Act applicable to NBFCs should be increased to 8.5 percent and also to allow rural branches of NBFCs to claim deduction of 10 percent of average rural advances made by rural branches of NBFC so as to bring it at par with the banks.

4.27. Carry Forward and Set off of Accumulated Losses in Amalgamation or Merger

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.

Amalgamation of banking companies is specifically included in section 72A of the Act. Hence, carry forward of accumulated business losses and unabsorbed depreciation of amalgamating banking entity can be claimed by the amalgamated banking entity. However, NBFCs have been kept outside the ambit of such provisions.

Given that the Government is keen to implement consolidation exercise in the Banking and Financial Services (including the recent policy announcement of Mega merger of PSU banks



it is recommended that provisions of section 72A of the Act are extended to NBFCs also to facilitate consolidation initiatives in this sector.

4.28. Provide alignment between format for reporting prescribed by Ministry of Corporate Affairs and Income Tax Return

As per Section 129 of the Companies Act, 2013, the financial statements shall give a true and fair view of the state of affairs of the company or companies, comply with the accounting standards notified under section 133 of the Companies Act and shall be in the form or forms as may be provided for different class or classes of companies in Schedule III. The Schedule III to the Companies Act, 2013 (2013 Act) provides general instructions for preparation of the balance sheet and the statement of profit and loss of a company. The Ministry of Corporate Affairs has issued a road map for implementation of the Indian Accounting Standards (Ind AS) converged with the International Financial Reporting Standards (IFRS) and introduced Ind-AS implementation for NBFC for accounting period on or after 1 April 2018.

As a consequence, Schedule III was also amended (vide Notification dated April 6 2016) to include general instructions for preparation of financial statements of a company whose financial statements are required to comply with Ind AS. The amendment divides Schedule III into two parts i.e. Division I and II.

- Division I is applicable to a company whose financial statements are required to comply with the current accounting standards;
- Division II is applicable to a company whose financial statements are drawn up in compliance with Ind AS.

Further, MCA also issued a notification dated October 11, 2018 amending certain sections of existing Division II and introduced a new Division III format applicable in case of NBFC. Accordingly, NBFCs (including HFC) are required to prepare its financial statement for financial year 2018-19 onwards in accordance with Division III format issued by MCA.

However, no such amendment has been carried out in ITR 6 format and NBFC needs to fill the Balance Sheet and Profit and Loss account as per existing Division II format (applicable to entities other than NBFC).

This will pose below challenges:

- Division II format requires listing of Current and Non-Current assets and liabilities whereas Division III format does not require such segregation.
- Disclosing any figures in BS/PL of ITR 6 not flowing directly from audited financial statement creates another exercise of unwarranted reconciliation.

It is recommended that Division III format introduced by MCA for NBFC be incorporated in existing ITR 6 format. This will ensure seamless reporting of the Financial Statements in the Income Tax Return Format by the NBFC sector. The present ITR format is as per Division II format which is not applicable for NBFCs.



4.29. Exclude section 56(2)(x) of the Act to shares received by NBFCs as a part of loan restructuring

Section 56(2)(x) of the Act provides that where a company in which the public are not substantially interested receives any property, being shares of a company in which the public are not substantially interested, for a consideration which is less than the fair market value (FMV) of such shares by an amount exceeding INR 50,000, the FMV of the shares in excess of the consideration is taxable in the hands of the company receiving the shares, under the head 'Income from other sources'. The manner of determination of the FMV of unquoted equity shares i.e. the book value approach for the purpose of section 56(2)(x) of the Act has been provided in Rule 11UA(1)(c)(b) of the Rules.

NBFCs provide loans to MSMEs, which comprise of several unlisted companies. At times, NBFCs as a part of a 'loan restructuring or settlement exercise' receive equity shares of the borrower company in lieu of the loan provided to such unlisted companies either by way of acquisition of shares of the promoters or by way of fresh issue of shares by the unlisted company. The loan restructuring or settlement exercise is undertaken in most cases as the borrower company is unable to fulfil its repayment obligations (i.e. principal and interest). Thus, shares of companies that are facing financial hardships are acquired by the NBFC. Valuation for such transfer/ issue of shares is done by adopting the Price earning ratio, Discounted Free Cash Flow or any other similar valuation mechanism. Thus, there is a possibility that the value determined as per the Rule 11UA(1)(c)(b) of the Rules (i.e. book value approach) would be higher than the value of the shares actually received by the NBFC.

If the provisions of section 56(2)(x) of the Act were to be applied to such transaction, it would give rise to a tax liability in the hands of the NBFC which would lead to an absurd outcome given that the intention behind introduction of the provisions of section 56(2)(x) of the Act is to capture a transfer of property from one person to another at an artificial price [as mentioned in the Explanatory Memorandum to the Finance Act, 2010 (which introduced section 56(2)(x) in the Act)]. Further, it would be unjust to tax the notional amount i.e. the difference between the FMV as per Rule 11UA(1)(c)(b) and the consideration in the hands of the NBFC. More so, because the shares of the borrower company are unlikely to fetch a substantial value in the open market and accordingly, the NBFC has minimal chances of recovering the original loan sanctioned. It is clear that the aforementioned loan restructuring exercise is not undertaken to transfer shares at an artificial price/ circumvent the law. Thus, giving due consideration to the spirt behind introduction of section 56(2)(x) of the Act, subjecting NBFCs to the provisions of section 56(2)(x) by virtue of such exercise would cause undue hardship to NBFCs.

It is recommended that that Rule 11UA(1)(c)(b) should be amended so as to provide that in addition to the 'book value' methodology already contained in the said Rule, the assessee (in the instant case, NBFC) may, at its option, use any other appropriate valuation mechanism where the shares are to be received by the assessee as a part of a bona fide transaction in the course of its business activities.

4.30. Exclusion from applicability of provisions of section 269ST

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.

4.31. Exemption to NBFCs registered with RBI from the purview of Section 269T

Section 269T of the Act discourages the repayment of any loan or deposit made otherwise than by way of an Account Payee Cheque or Draft, where the repayment amount exceeds Rs. 20,000/-. If any loan or deposit is repaid in contravention of section 269T, a penalty equal to the amount of repayment of loan or deposit can be imposed by Joint Commissioner under Section 271E of the Act.

Since the nature of business of NBFC is similar to that of banks and are governed under the similar regulatory environment i.e., RBI, it is necessary that NBFCs registered with RBI should also be extended exemption from the applicability of section 269T of the Act.

4.32. 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. NBFCs are also closely regulated by the Reserve Bank of India just like banks. 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.



HEALTHCARE

DIRECT TAX

4.33. Increase budgetary allocation for healthcare

Healthcare is one of the most important pillars of nation-building, not just for its contribution to the economy, but for the impact on the health of the citizens, and for its effect on their productivity, well-being and happiness. It is well-known that public spending on healthcare is an important determinant in any country's ability to deliver quality and affordable healthcare for all.

In India, budgetary allocations for healthcare have traditionally been low. In 2019, the Union Budget allocated Rs. 64,559 crores for healthcare. These allocations and levels of per capita spending are insufficient for the enormity of the healthcare challenge facing the country.

The government may start spending an extra 0.5% of GDP every year on health amounting to about Rs. 70,000 crores per annum, till 2022 to reach at least 2.5% of GDP as envisaged in the National Health Policy 2017.

A large portion of this allocation should be reserved for spending on Primary Health and on establishing the 1,50,000 Health and Wellness Centres that were announced under Ayushman Bharat, which will play a key role in bringing down the disease burden of the country.

Government should also consider a one-time accelerated budgetary allocation for clearing past dues under CGHS and ECHS schemes in the forthcoming budget. The accrued dues are causing severe stress on working capital and cash flows for private healthcare providers.

4.34. Introduce a Healthcare Saving Fund

A Healthcare Savings Fund similar to Provident Fund should be introduced covering all salaried employees. While health insurance takes care of hospitalization (inpatient) expenses to a certain extent, for health maintenance, health checks, outpatient services etc., one incurs additional expenses which can drain regular savings. In order to encourage citizens to plan and periodically save for their health expenses other than hospitalization, the government should allow the salaried class to open a health savings fund account similar to the PF contributions scheme and such investments should be allowed as a deduction under section 80C of the Act.

4.35. Provide increase in deduction under Section 80D

In order to provide an incentive for health insurance, and encourage voluntary purchase, the present annual deduction limit of Rs. 25,000 under Section 80D should be enhanced to Rs. 50,000 for self and family, and the current annual limit of Rs. 30,000/ in respect of dependent parents enhanced to Rs. 50,000. The Government may also consider expanding the ambit of dependents eligible for this deduction.

4.36. 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 80D of the Act.

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 upto Rs. 10,000/- per employee, towards expenses incurred for sponsoring the health check expenses of their employees.

4.37. 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 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.

4.38. 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.

4.39. Extension of tax benefits under Section 35AD

Currently, benefits of deduction for capital expenditure are extended only to hospitals having a minimum capacity of 100 beds. No benefits are provided to encourage the setup of smaller hospitals/nursing homes in rural areas posing as an impediment for organizations to start chains of smaller hospitals.

There is an urgent need to boost setting up of smaller hospitals, specifically in tier 2 and 3 cities and rural areas for successful implementation of the Ayushman Bharat program. Hence, the benefits under section 35AD of the Act should be extended to hospitals having:

(i) a minimum of 50 beds in tier 2 and 3 cities and

(ii) minimum of 25 beds in rural areas

to foster the growth in these sectors.

Further, these benefits should also be extended to existing hospitals that invest in substantial expansion. The healthcare business by its very nature needs to make continuous investments to upgrade existing capabilities.

4.40. 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.

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

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.

4.42. Provide for extension of benefit under Section 80-IB(11C)

Currently the sector is plagued with low profitability and the major players in the business are incurring heavy losses, negatively impacting the investor sentiments and in-turn the accessibility of rural India to best-in class healthcare facilities.

With dedicated focus of the government on upgrading the health of Indian citizen and no/ minimal tax incentives available to provide an impetus to the investments into the sector the benefits of section 80-IB(11C) of the Act should be considered for extension.

It is recommended that the profits earned by any hospital having a minimum bed capacity of 100 beds set-up and starting to function on or after 01 April 2020 should be allowed a deduction of 100% of the profits and gains derived from such undertaking for a period of first five years. This will further help in promoting setting up of best in class hospitals in tier 2 and 3 cities as well as rural areas.

4.43. Include hospitals under the definition of industrial undertaking under Section 72A of the Act

Hospitals have a higher gestation period and in this entire period hospitals incur losses due to massive capital expenditure as well as initial expenses. This accumulated loss cannot get utilized or adjusted against future profit if there is any restructuring in terms of amalgamation or merger of hospital entities. Currently, healthcare industry is going through a consolidation phase. Many hospitals have incurred tax losses in the earlier years, such losses are not allowed to be carried forward and set off against future years in case such hospitals undergo a corporate restructuring like merger, etc.

To ensure that healthcare industry is treated at par with other sectors, it is recommended to cover healthcare industry under definition of Industrial undertaking under the provisions of section 72A of the Act and accordingly, tax losses of healthcare industry should be allowed to be carried forward and set off against future profits even if they undergo any corporate structuring like, amalgamation or merger.

4.44. Tax incentives for Healthcare Skill Development

To encourage the private sector to take up workforce skilling activities, the government should consider providing tax incentives for Healthcare Skill Development initiatives like:

(i) provision of weighted deduction of 150% of expenses incurred on skill development project under Section 35CCD of the Income Tax Act should be extended to healthcare organizations (hospitals and diagnostic centres) for apprentice training

(ii) the government should also expand the deduction under Section 80JJAA to healthcare organizations to provide 100% deduction on stipend to professionals undergoing DNB and short-term PG Certificate Courses at private hospitals.

4.45. Additional depreciation for investments made for creating diagnostic infrastructure under Section 32 of the Act

With the rising disease burden and increasing healthcare demands due to implementation of Ayushman Bharat, there is a significant need for creating diagnostic infrastructure in the country. The government should consider providing for additional depreciation at 50 per cent for investments made for creating diagnostic infrastructure under section 32 of the Act, specifically outside the metro cities. This will be in line with the additional depreciation provided to some sectors such as industries engaged in generation of electricity and will be

well aligned with the government's vision of providing affordable healthcare to all the citizens of the country.

4.46. Compliance issue - Approval for Hospitals under proviso (ii) to section 17(2)(viii)

Currently hospitals are required to be approved by Income tax authorities under proviso (ii) to section 17(2)(viii), to ensure that the amount reimbursed by employers for any hospitalization of employees is not taxed in the hands of the employees. This approval is mainly to ensure that all medical and other facilities are available in the Hospital. The approval process is very cumbersome and any delay in such renewal of the approval causes in-convenience to the patients.

All major hospitals are National Accreditation Board for Hospitals & Healthcare Providers, Joint Commission International (NABH / JCI) accredited. Such accreditation ensures that all medical and other facilities of high standards are available in the hospitals. Accordingly, accreditation from NABH / JCI, should be a sufficient compliance for the purposes of proviso (ii) to section 17(2)(viii) and no separate approval from Income tax department should be required in this regard. Thereby reducing administrative work of both the hospital and government. This will be a good step towards ease of business also.

Others

4.47. 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.

4.48. 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.

4.49. 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.

4.50. 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.

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4.52. 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.

HOUSING & REAL ESTATE

DIRECT TAXES

4.53. 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.

4.54. Alignment of draft ICDS for real estate developers with IND-AS 115

CBDT has clarified in the FAQ issued on March 23, 2017, vide Circular No 10/2017 that ICDS IV is not applicable to real estate developers**.** Nonetheless, Finance Act, 2018 inserted section 43CB in the Act to bring certainty on the applicability of ICDS. The draft ICDS on Real Estate Transactions provides for the application of the Percentage of Completion Method when:

a) the expenditure incurred on construction and development costs is 25 % or more of the construction and development costs;

b) 25% or more of the saleable project area is secured by contracts or agreements with buyers; and

c) 10% or more of the total revenue as per the agreements of sale or any other legally enforceable documents are realized in respect of each of the contracts and it is reasonably certain that the parties to such contracts will comply with the payment terms as defined in the contracts.

As the draft ICDS provides for the percentage of completion method, this gap between the Notification issued by the MCA and the aforesaid draft ICDS is required to be bridged by bringing clarity on applicability of ICDS for real estate developers by modifying the draft ICDS appropriately to include project completion method as one of the methods to recognize revenue and thereafter issuing the final ICDS.

It may be noted that non-alignment of the proposed ICDS to be notified for real estate developers with the applicable Ind-AS 115 will cause undue hardship on the taxpayers of the real estate sector, as they would be forced to maintain two separate set of books of accounts – one for preparation of financial statements as statutorily required as per Ind-AS 115 following the project completion method for revenue recognition and the other set of financial statements for computing taxable income based on the proposed ICDS for real estate transactions which currently prescribes the Percentage of Completion Method (POCM) for revenue recognition.

It is recommended that draft ICDS for real estate developers should be modified to bring it in line with the revenue recognition principle as per IND AS 115.

4.55. 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.

4.56. 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.

4.57. Provide clarification with respect to issues under Section 80-IBA

(a) The term stamp duty value has been defined to mean "*the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property".* Accordingly, when the developer decides to undertake affordable housing project basis the provisions of Section 80IBA of the Act and secures the approval from competent authority, the developer may still comply with stamp duty value. However, project inventory shall be sold over many years and therefore stamp duty will keep varying and may even cross the prescribed threshold.

The Developer will have a situation where few units in the Housing project may comply with the provisions of the Section 80-IBA of the Act and some units may not. In such a case, the implementation of the provisions of this section will not be possible and defeat the objective behind the introduction of the provision. Suitable clarification on the application of definition of "stamp duty value" for the purpose of implementation of provisions of this section be provided.

(b) Clarity is also required on the following:-

- Where the developer who claims the deduction under section 80-IBA of the Act for first few years, transfers the project to another developer.
- If few buildings out of a housing project meet all the conditions prescribed in section 80-IBA of the Act and remaining buildings do not comply with all the requirements. It is further recommended that section should be suitable amended to provide that the deduction can pro-rata be availed for the buildings wherein the prescribed conditions are met, although all buildings form part of a single project;
- One of the conditions to be fulfilled to claim deduction under section 80-IBA of the Act is that the project is the only housing project on the plot of land. Generally, large real estate developers undertake townships/city development where these developers develop huge residential projects along with the commercial projects on the same plot of land or develop one residential project meeting the conditions prescribed by the section and other residential projects ineligible for deduction under section 80-IBA due to various conditions prescribed by the Act. In such a scenario, the condition of having only project on the plot of land may jeopardize the tax benefit for the eligible project and cause hardship to the developers. Also, in order to meet this condition, the developer may have to sub-divide the plot of land which will lead to loss of Floor Area Ratio (FAR) in the overall project. It is recommended that the condition may be suitably relaxed.
- Another condition to be fulfilled is that the project is approved by the competent authority after the 1st day of June, 2016, but on or before the 31st day of March

2019. The Finance Act, 2019 has extended the time limit to obtain the approval from competent authority by one more year i.e. approval can be obtained for housing projects till March 31, 2020. It is recommended that the extension for approval by competent authority should be further increased by two years which will help several real estate developers to obtain the benefit under the given section thereby meeting the larger objective of 'housing for all'.

4.58. 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. Further thereto, various real estate developers own the development rights in the land and do not actually own the land. Hence, to cover such transactions under 'specified agreement', the meaning of specified agreement should be extended to the assessee owning the rights in the land.

4.59. Taxation of unsold house property under the provisions of section 23(5)

Section 23(5) of the Act provide the manner of determination of annual value of house property held as stock-in-trade. The annual value of such property for the period up to two years from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, is taken to be nil. It is a known fact that various developers have not been able to sell their stock even after the certificate of completion is received due to various business exigencies and various macro-economic factors. Also, the question of whether any notional income from house property held as stock-in-trade and not let out during the whole or any part of the previous year is taxable in the hands of the developer is open to litigation and the matter is currently *sub-judiced* before the Hon'ble Supreme Court.

The application of this section leads to an extremely prejudicial treatment for the real estate developers as they have stock which they are unable to sell leading to a funds crunch and on top of that they are required to shell out money for paying tax on the notional income. It is recommended that this section should be withdrawn to reduce the genuine hardship faced by the developers.

Without prejudice to the above, tax paid on deemed rental income computed on unsold inventory under section 23(5) of the Act should be allowed as business expenditure under section 37(1) of the Act.

4.60. Eliminate double taxation - Taxability of Immovable Property received for inadequate consideration

Section 56(2)(x) levies tax on inadequate or no consideration. If an immovable property is transferred without consideration or the consideration is less than the stamp duty value of the property by more than Rs. 50,000, it is taxed as income from other sources in the hands of purchaser to the extent the stamp duty value is in excess of the consideration.

Section 50C/43CA of the Act deals with such inadequacy in hands of the seller/transferor. Both, seller and purchaser, pay tax on same income leading to double taxation.

It is recommended that section 50C/43CA of the Act may be correspondingly modified to exclude such transaction which has been taxed under Section 56(2)(x) of the Act.

HYDROCARBON

CUSTOMS AND EXCISE

4.61. Clarification on exemption from Compensation Cess on goods imported by SEZ

Goods imported by SEZ are exempted from IGST levied under section 3(7) of the Customs Tariff Act, 1975 vide notification no.64/2017-Cus dated July 5, 2017. However, similar exemption notification is not issued for compensation cess levied under section 3(9) of Customs Tariff Act, 1975.

In the absence of such exemption notification, even though BCD and IGST is exempt when goods are imported by SEZ, compensation cess becomes payable. In “IceGate portal”, even exemption is available for BCD and IGST, compensation cess is shown as payable. It is recommended that exemption notification for compensation cess under section 3(9) of the Customs Tariff Act, 1975 on goods imported by SEZ may be issued.

4.62. Provide for levy of Custom duty only on net product retained by refinery situated in domestic tariff area from the Petroleum Gas received from Refinery situated in SEZ Area

In Refineries, many a times Petroleum gases brought to extract rich gas and lean gas returned as continuous supply process through dedicated pipelines. Thus, effectively there is supply of only the gas retained by the refinery. Such practice has been approved under GST vide circular No.53/27/2018-GST dated August 9, 2018 where it is clarified that in such a case ‘GST will be payable by the refinery on the value of net quantity of petroleum gases retained for the manufacture of petrochemical and chemical products.’ This is also in line

with circular Nos. 12/12/2017-GST dated October 26, 2017 and 29/3/2018-GST dated January 25, 2018.

It is recommended that a similar clarification be issued under customs regulations to enable transactions between DTA & SEZ Refineries also to operate on same principles.

4.63. Customs Duty rate of feedstock for refineries such as SRFO (Straight Run Fuel Oil), VGO, LSFO, LSWR etc. to be at par with Petroleum Crude oil

Due to IMO and sanction related issues, availability of heavy crude is getting limited resulting into increase in the cost. Over the years, Indian Refiners have invested substantial amount of money to take advantage of Light Heavy crude oil price differentials. With increase in Heavy crude pricing the advantage is getting eroded and sometimes may not be able to run at full thruput.

In order to reduce requirement of heavy crudes, and saturate the feed of secondary processing units, refiners can import VGO (Vacuum Gasoil), SRFO (Straight Run Fuel Oil), LSFO. However, all these products are GST products and Customs Duty is applicable as per the applicable rates. Since majority of the Refinery products are non-GST, most of the GST becomes cost in the hands of refiners. Therefore, compared to Crude as feed stock, the alternative feeds become very expensive due to custom duty and GST Component.

Since these feedstocks are substitute of Petroleum Crude. It is suggested that Customs Duty rate of such products for refinery use should be zero. i.e.at par with Petroleum Crude oil and GST rate should also be zero.

This will reduce heavy crude requirement helping in widening the Light – Heavy differential making the heavy crude processing more viable and full utilization of refinery capacities.

4.64. Provide exemption from the taxes such as Income Tax, Local Tax to all Oil Marketing Companies (OMCs) for managing third party crude oil inventory

Recently, India has signed the agreement with Abu Dhabi National Oil Company (ADNOC) to store crude oil as strategic & emergency reserve. Any sale of crude oil from such reserve is exempted from income tax and local tax.

A similar kind of exemption can be extended to all OMC's for managing third party crude oil Inventory as it will help country to build strategic & emergency reserve and will help in just in time availability of crude oil to refiners.

4.65. Allow credit of GST on inputs/input services/capital goods against output Excise and VAT liability on Petroleum Products

Currently, input tax credit of GST paid on procurements is not allowed against the output tax liability to the supplier of the abovementioned products and is an additional cost for the producers of oil and gas. Ideally all these products should be brought under the umbrella of GST. However, if these products cannot be brought entirely under GST due to certain constraints, as an immediate measure, until introduction of GST on petroleum products, it is recommended that suitable amendment should be brought in the excise and VAT laws to

allow credit of GST paid on inputs/input services and capital goods against payment of excise duty/VAT to the manufacturers/suppliers of petroleum products.

It is further recommended that CST should be made zero till the time GST is implemented for petroleum products.

4.66. Abolish Basic Excise Duty (BED) and National Calamity & Contingent Duty (NCCD) on domestic production of petroleum crude

The Hon'ble Finance Minister in her recent budget speech stated that tobacco products and crude attract National Calamity & Contingent Duty (NCCD). In certain cases, this levy has been contested on the ground that there is no BED on these items. To address this issue, a nominal basic excise duty is being imposed. Accordingly, Forth schedule to Central Excise Act has been amended to levy BED at the rate of 'Rs. 1 per tonne' on domestic production of petroleum crude. This additional levy of BED has created hardship in compliance of Excise Law in respect of each producing assets. Presently, the OID Cess, a duty of excise is being discharged through centralized concept by obtaining single Excise Registration in view of Circular No. 18/88 dated 20.05.1988 issued by Ministry of Finance.

Further, the NCCD was introduced by Ministry of Finance @ Rs 50 per MT on indigenous crude oil. This duty was to be valid for one year i.e. upto29.02.2004 so as to replenish the National Calamity Contingency Fund, but it is still continuing. Accordingly, Oil Industry has been representing from time to time for removal of NCCD.

GST has been introduced since 1st July 2017 subsuming most of the indirect tax levies including Excise duty, Service Tax, VAT, Central Sale Tax etc. However, Crude Oil, Natural Gas in addition to Petrol (MS), Diesel (HSD), ATF are temporarily kept out of GST. Hence, there is substantial stranding of taxes in the hands of company effecting cash flow negatively. Further, Company is burdened with dual compliance of GST law as well as Centre Excise & VAT law.

In view of above, it is recommended that the NCCD along with BED on production of domestic crude should be removed which would facilitate the compliance as well as ease of doing business.

4.67. Provide clarification for non-levy of service tax on Cost Petroleum

The Government of India introduced the New Exploration & Licensing Policy (NELP), to boost the production of oil and natural gas and providing level playing field for both public and private players. Under NELP, the Government of India signed several Production Sharing Contract (PSC) with Private & Public companies, each of these PSC's are placed in the Parliament. A PSC is a Public Private Partnership between the Government of India and the Oil & Gas Companies for exploration, development & production of petroleum resources and sharing of profits from such operations, if there is production of hydrocarbon. To provide impetus to the Oil and Gas companies, NELP/PSC provided for exemption from customs duty and excise duty. In addition, the NELP also provides for fiscal stability during the entire period of the contract.

PSC is an economic sharing agreement and not a service contract. Government is a partner in the venture it is entitled to receive royalty and its share of any profit petroleum either in cash or in kind if revenue is generated from sale of hydrocarbon. Similarly, the Oil & Gas Companies are also entitled to their share of profit petroleum and a recovery of cost (cost petroleum) as agreed in the PSC.

Under the PSC arrangement, the Companies spend costs relating to Petroleum Operations ie exploration, development & production of hydrocarbon. To manage the inherent risk of exploration, the PSC includes a provision to recover cost and capital spent in exploring and developing the field, if revenue is generated.

This is just a mechanism (formula) to determine the share of petroleum which will belong to Companies and to the Government. This is not linked to any service.

Central Board of Indirect Taxes and Customs (CBIC) has already issued a circular clarifying that Cost Petroleum is not a service rendered to the Government under the GST regime.

As this is a clarificatory circular it should be equally applicable to the service tax regime. Despite circular in the GST regime, the field formations are confirming levy of Service Tax on this cost recovery which is a matter of grave concern for the industry.

It is recommended that a clarification should be issued by the Government that service Tax is not applicable on Cost Petroleum similar to the clarification issued under the GST regime.

4.68. Provide clarification for non-levy of Service Tax on Profit Petroleum

Profit petroleum is the share in petroleum after recovery of cost which is shared between the Contractor and the Government. This is not a consideration for any service. VAT is already paid at the time of sale of the petroleum products (crude/natural gas) by the Contractors.

The Contractor's share of profit petroleum is an entrepreneur revenue from sale of Crude Oil/Natural Gas and not a consideration for any service. Field formations have indicated their intention to issue notices seeking to levy service tax on Contractors share of profit petroleum which will result in unnecessary litigation.

It is recommended that a clarification be issued by the Government to provide that contractors share of profit petroleum is not a payment against any service and therefore not subject to service tax.

4.69. Provide clarification on Service Tax on Royalty

Royalty is a share of the Government revenue in the production of hydrocarbons and is success based i.e. not payable on exploration failure. It is part of overall economic share of the Government & not against any service. The CBIC in FAQ on Government services mentions that royalty paid to the government for assignment of right to use natural resources is treated as a supply of services and licensee is required to discharge tax on the royalty paid under reverse charge mechanism.

There is no quid pro quo specified in this legislation under which royalty is levied that Government is required to fulfill obligation in lieu of royalty received. Treating right to use

natural resources as supply of services & levying tax is a step backward & further increase the tax burden with adverse consequences on project profitability & incremental investments.

It is recommended that a clarification be issued by the Government under Service Tax Law that royalty payments to the Government of India does not constitute supply of services.

MISCELLANEOUS ISSUES

4.70. 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. Further, the rate of 20% ad-valorem is negatively impacting oil companies since oil prices start moving northwards. This levy is against the spirit of "Make in India". It is recommended that the rate of cess should be reduced to 10% of realized crude oil price to boost the oil and gas sector.

DIRECT TAX

4.71. Provide deduction for Enhanced Oil Recovery (EOR) expenditure

Enhanced Oil Recovery, a stage of hydrocarbon production that involves use of sophisticated techniques to recover more oil than would be possible by utilizing only primary production techniques or waterflooding. These new techniques require heavy investment in Oil and Gas business. Recently, Government of India has notified policy framework to promote and incentivize Enhanced Recovery Method for Oil and Gas which provides various incentives on account of Indirect Taxes, such as, waiver of 50% in OIDA cess, waiver of royalty on incremental production on gas, etc. However, there is no incentive announced under Income Tax for the expenditure incurred in relation to EOR. To make commercially these capital intensive and risky projects viable, it is recommended that weighted deduction on EOR expenditure (to the extent of 150% of the expenditure) may be provided under the Act.

4.72. Provide deduction for Exploration and Development expenditure under section 42

In order to boost the oil production by the awardees of Open Acreage Licensing Policy (OALP), who are investing millions for the extraction of oil, it is recommended that weighted deduction for Exploration and Development expenditure may be allowed for the new blocks awarded under OALP under section 42 of the Act.

4.73. Provide clarification for TDS on cash call

For the purpose of extracting oil, company is required to enter into a Profit Sharing Contract (PSC) with Government of India. Parties to the PSC are called as the "Co-ventures" and one of them, making all the expenditure on behalf of the venture is called as the "operator". To meet the expenditure made by the operator on behalf of other co-ventures, the



contribution of the other co-ventures are taken by way of "Cash call". Cash call paid by co-ventures in a Block to "operator", who control over day-to-day operations is a capital contribution. Thus, TDS is not applicable. The Hon'ble Supreme Court in CIT vs Enron Oil & Gas Ltd., 305 ITR 75 already held that cash call is an investment. However, for some of the Companies, unwarranted tax litigations are going on for non-deduction of TDS on cash call payments.

To avoid such unnecessary litigation, a clarification is recommended to be issued that cash call is in the nature of capital contribution and no TDS is applicable on the same.

4.74. Issue regarding procurement of Withholding Tax Certificate

Every foreign company operating through branch/ project office etc. has to procure a withholding Tax certificate to determine the rate of withholding for the receipts from customers. It has been observed that the application made to the revenue department under section 195(3) of the Act by companies operating in India through a Project Office is being rejected on the grounds that section 195(3) of the Act applies only to foreign companies operating through "Branch Office" and not through "Project Office". It may be noted that the concept of Branch Office, Project Office and Liaison Office is prescribed under the Foreign Exchange Management Act, 1999 ('FEMA') for non-resident companies planning to set up an office in India.

This distinction should be restricted only to FEMA and cannot be imported into the Income tax laws. A project office is nothing but a branch office of a foreign company for the purpose of the Act and accordingly, the project office should not be denied the right to make an application under section 195(3) of the Act. Section 195 (3) of the Act states that subject to rules made under sub-section (5), any person entitled to receive any interest or other sum on which income-tax has to be deducted under sub-section (1) may make an application in the prescribed form to the Assessing Officer for the grant of a certificate authorizing him to receive such interest or other sum without deduction of tax under that sub-section, and where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom such certificate is granted shall, so long as the certificate is in force, make payment of such interest or other sum without deducting tax thereon under sub-section (1).

It is recommended that a clarification for the purpose of section 195(3) of the Act be issued to include a foreign company operating through a project office within the purview of section 195(3) of the Act read with rule 29B of the Rules.

INFORMATION TECHNOLOGY (IT) AND TELECOMMUNICATIONS

DIRECT TAX

4.75. 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.

4.76. 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.

NON-FERROUS METALS

I – COPPER

CUSTOMS

4.77. 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 8 years i.e. since financial year 2011, market share of copper imports has grown significantly, whereas the Indian primary producers' market share has been continuously on a declining trend. Hence, it makes economic sense to exempt it from the customs duty.

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.

4.78. 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

4.79. 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%.

4.80. 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%.

4.81. 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%.

4.82. 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.

4.83. 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%.

4.84. 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. 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%
7603 to 7607	Downstream Aluminium Products	7.5%	10%
7608 to 7616	Downstream Aluminium Products	10.0%	12.5%

POWER

DIRECT TAX

4.85. Introduce Group Relief

Companies engaged in the generation of power and development of infrastructure projects are generally organized as SPVs which are owned by a parent. This is essential for the purpose of project finance as also considering the distinctive nature of each infrastructure project.

As a result, for purposes of income-tax assessments, each SPV is treated as a distinct assessee and the profits/losses of one SPV are not available for set off against the profits/losses of other SPVs or of the parent. This creates a mismatch whereby while certain SPVs are necessarily incurring losses (in the initial years of any infrastructure project), the other SPVs or the parent forming part of the Group are required to pay income-tax on their profits.

This anomaly is overcome in most countries by instituting Group Taxation. The concept of Group Taxation is to permit companies or SPVs in which the equity holding exceeds a specified percentage, say 75%, to be treated along with their parent and other SPVs as one Group so that the profits and losses of individual SPVs are set off against each other and the net profit of the Group is charged to tax.

Group Relief is available under the tax laws of most countries including USA, UK, France, etc. and is an essential reform for the purpose of modernizing India's tax laws and bringing them on par with those of the world.

On the Regulatory and Accounting fronts the law has already been amended for example, under the Companies Act 2013, the parent company is mandatorily required to prepare consolidated financial statement including therein accounts of all its subsidiaries and associates. The consolidated financial statements are required to be laid before the annual general meeting (Section 129). It is recommended that group relief be introduced at least for companies engaged in the infrastructure including power sector such that at the option of the parent, the entire group of the parent and subsidiary SPV is treated as on assessee for the purpose of income tax.

4.86. Provide exception to applicability of section 79 to stressed companies

Section 79 of the Act restricts carry forward of losses where there is change of shareholding of more than 49%. Finance (No. 2) Act, 2019 provided exceptions to this section inter-alia to companies where change in shareholding takes place under Insolvency and Bankruptcy Code 2016.

Though the Budget Speech of the Finance Minister while introducing this amendment mentions about granting 'relief to stressed assets' there is no corresponding amendment to this effect.

It is recommended that there should be some clarification/exception and the above relief should be granted to 'stressed companies' who have not pursued the IBC route.

This shall give a much-needed impetus to the crisis-ridden power sector entities, which has been finding difficult to find buyers for stressed companies. Also, it shall act as a push for those companies who venture to acquire and turnaround such stressed companies.

4.87. Continue tax incentives to new investment in power sector by way of profit linked incentive or capital deduction

Profit linked incentives by way of deductions are being gradually to be phased from the Act. The said deductions are being provided to highly capital-intensive infrastructure industries which play crucial role in development of economy of India.

Extant section 80IA of the Act provides the benefit of 100% deduction of profits derived from power generation, power transmission, power distribution for ten out of fifteen years from the initial year. This deduction reduced the cost of power to the consumers and helped in the growth of economy. This deduction now is not available to those undertakings which are otherwise covered by the section but starts commercial operation after 31 March 2017.

The Finance Act 2016 introduced 'infrastructure facility' in section 35AD of the Act w.e.f 1 April 2018. Major other industries which are covered by the extant section 80IA of the Act are being covered in the definition of 'infrastructure facility' under section 35AD of the Act. However, power industry does not find place in the definition of 'infrastructure facility' and hence it will be not eligible to claim benefit of section 35AD of the Act which other important/critical infrastructure industries will be able to claim.

It is recommended to keep parity and growth of infrastructure which is one of the mottos of the Government, it is recommended that investment in power sector shall be covered by section 35AD of the Act or benefit of deduction under section 80IA of the Act should be continued for power industries.

PAPER AND PAPER BOARD

4.88. Others

Technology Modernisation Assistance Programme (T-MAP) is a pending demand of the Pulp & Paper Industry since long and it was also recommended by the Working Group on Pulp & Paper Sector for the 12th Five Year Plan. The investments in technology up-gradation and

capacity enhancement of Pulp & Paper Mills are quite high with low rate of returns. Most of the state-of-the-art technology suppliers are located in countries like Europe, Japan, etc.

In the present economic scenario, when there is tremendous pressure on the bottom line of Pulp & Paper Industry due to high raw material / wood prices, rising fuel and energy costs, and zero import duty on paper and paperboard from the South East Asian countries, under the ASEAN-India FTA, this scheme is of extreme importance to the Industry. In order to be competitive and sustain the required growth rate, the Industry requires financial assistance in the form of interest free loans for energy and environmental friendly technologies which will help the Industry and country as a whole in following ways:

- Industry will become competitive.
- Conservation of natural resources in the form of better energy efficiency and lesser usage of raw materials and inputs.
- Leading to better environment and meeting the new environmental norms/ standards set by the Government.

In view of above, it is recommended that the Government should reconsider the T-MAP Scheme for implementation.

MEDIA & ENTERTAINMENT

4.89. 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 for the film exhibition industry 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 Act 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, 1962 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.
- Impact of development of sports on Indian economy and youth of India is significant and ever increasing. India needs to provide much more boost for encouraging holding of major sports events in India. Few measures on providing certainty in taxation and by providing tax exemptions would go a long way in boosting sports events in India. Following changes to be incorporated in the Income Tax Law are also recommended:-
  - Holding of sporting events in India would not create/establish a business connection or a Permanent Establishment in India;
  - Taxation of sporting events to be held in India would be taxed at a deemed profit of gross receipt originating from India; and
  - Exemption from taxation for sporting events should be for a block period and to be notified much earlier before the event takes place.

RETAIL

4.90. Direct Tax

- Currently, company owning an industrial undertaking or a ship or a hotel are allowed to carry forward losses in case of merger/amalgamation. Retail sector in India is emerging as one of the largest sectors in the economy.
- Online retail business is the next generation format which has high potential for growth. E-commerce sector plays very important role in the growth of economy. Such businesses require acquisition/consolidation for growth and expansion/diversification, huge investments in digitization, technology set-up and distribution network leading to increase in employment opportunities.
- It is suggested that the provisions of section 72A(1) & 72A(7)(aa) of the Act are amended to include Retail sector also along with other sectors. It is also suggested to amend the definition of 'Industrial Undertaking' to include e-commerce so that it is eligible for carry forward of losses in case of amalgamation/merger/demerger. Further, the section

should be amended to replace stringent conditions with liberal ones, such as reducing period of holding assets and carrying on of business from 5 years to 3 years.

RENEWABLE ENERGY

4.91. Impose Basic Customs Duty on Cells and Modules

The Indian manufacturers are facing lot of hardships in competing with the cheap imported cells and modules as they are not subject to Customs Duty. Imposing of Customs Duty on these products will enhance the operational capability of the Indian Manufacturers. Currently the Indian manufacturers are also facing cost issue due to the Anti-Dumping Duty (ADD) on Glass and EVA, whilst on the modules imported with the usage of Glass and EVA no duty is applied.

It is recommended that customs duty be imposed on cells and modules.

4.92. Provide financial support for enhancing local manufacturing capability

Major projects face financial hardship before its implementation resulting in cost inflation or non-implementation of projects.

The manufacturing of these products/projects involve a heavy CAPEX. As is supported in other countries, a Preferred Interest rate support for manufacturing units will help the industry. It is requested that support to local manufacturing units in terms of preferred interest rates and priority sector lending be provided by the Government.

AGRICULTURE

DIRECT TAX

4.93. Suggestion

Companies whose more than 50% turnover comes from providing services directly related to agriculture produce should be taxed at a concessional rate of 17% with further no tax on storage, collateral management and warehouse management services.