FICCI

# PRE-BUDGET MEMORANDUM 2015-16

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# ECONOMY OVERVIEW

## 1.1 Current state of India's economy

India's growth prospects in 2014-15 look much better when compared to the situation a year ago. Various agencies project GDP growth to be around 5.5/5.6% this fiscal year. This is a welcome improvement from below 5.0% GDP growth witnessed in the previous two fiscal years – 4.5% in 2012-13 and 4.7% in 2013-14.

Inflation which had been a persistent worry has finally moved to a downward path. Latest numbers indicate inflationary pressure waning, with both wholesale and retail prices reporting softening. Also, the decline in prices has been broad based with an evident fall noted in food and fuel segment prices.

Further, our current account position which was a dominant risk factor until last year has been suppressed to a large extent. The global oil prices have softened and the exchange rate is projected to remain pretty much stable. Export growth has also been steady so far this year. Over the period April-September 2014, exports recorded a growth of 6.3%, vis-à-vis 6.7% growth registered over the same period last year.

In addition, the foreign investment inflows –both foreign direct investments and portfolio investments- have been sound. Over the period April-August 2014, total inflows amounted to USD 33.7 billion, up from USD 3.1 billion in the corresponding period last year. The benign global environment accompanied by a strong and stable government at home has reinvigorated the interest of the investors.

## 1.2 Progressive policy announcements from the government boosting confidence

The new government has taken a series of progressive policy measures aimed towards improving the business environment and giving a strong push to growth. The commitment of the government towards reforms has been reflected in its first Union Budget as well outside of it.

The first Budget of the current government announced in July 2014 was growth oriented and set a positive tone by emphasizing the need for tackling the most pressing macro-economic challenges being faced by the nation. The Budget was an apt mix of short term and long term measures geared towards boosting confidence of all key constituents. The announcements made in the Budget constituted a comprehensive agenda intended at taming inflation and giving a boost to investments in manufacturing and infrastructure sectors.

Several measures towards creation of a seamless logistics network were indicated in the last Union Budget. These included setting up of new airports, ports, industrial corridors and an institution to support mainstreaming of PPPs. Support measures were also announced to make available long term capital for financing such projects including setting up of Infrastructure Investment Trust (INVITS).

The manufacturing sector which has been a missing link in India's growth story was also given due weightage and support. Several initiatives towards promoting Micro, Small and Medium enterprises found mention in the Budget. A Rs. 10,000 crore venture capital fund for MSME sector and a technology center network to promote innovation, entrepreneurship and agro industry were announced. The government also lowered the eligibility limit for investments to get the benefit of investment allowance from Rs. 100 crore to Rs. 25 crore.

Furthermore, the announcements made on establishment of a Price Stabilization Fund and the commitment displayed by the Centre to work closely with States to amend their respective APMCs have been positive steps towards managing food prices. A series of initiatives- such as introduction of soil health cards, setting up of agri-tech infrastructure fund, announcing a 'protein revolution' – were also indicated with an objective of improving agriculture productivity.

The composite cap of foreign exchange in defence manufacturing was raised to 49% from 26%. This is expected to give a push to our indigenous production capacities in defence manufacturing.

Some of the other announcements in the Budget included provision of 'pucca' houses for all by 2022 with proper sanitation facility and unhindered supply of electricity, developing 100 new smart cities and launching National Multi Skill Programme called 'Skill India'.

Besides these, in its first 100 days the government has taken multiple other steps across many areas. It is heartening to see government going the extra mile to give a fresh impetus to manufacturing sector growth. Government has not only announced some new national campaigns, but is also putting effort to address some of the long pending issues.

The launch of the 'Make in India' campaign is a landmark step by the government. With this initiative India has embarked on the path to become a global manufacturing hub. The focused approach adopted by the government is laudable and some of the sectors identified are clearly the ones where India has/or can have a competitive advantage – automobile components, pharmaceuticals, textile, leather and garments, electrical machinery and food processing. A plethora of opportunities can be leveraged by tapping these strengths.

Then the 'Digital India' drive of the government is expected to take digitization to a whole new level in India. The programme aims at electronic delivery of all government services by the year 2018.

Labour issues have long been a concern for the industry and the government has taken the first step with a proposal to amend the three archaic labour laws of the country - Apprenticeship Act, Factories Act and the Labour Act of 1988. In addition, reforms aimed at removing 'Inspector Raj', simplifying compliances by clubbing and consolidating returns, bringing more transparency and accountability and stressing on skill development through overhauling Apprenticeship System have also been taken up.

Additionally, the government launched a web portal for online submission of proposals for forest clearances. This was a commendable move and is expected to bring transparency, accountability and greater effectiveness in the process of grant of clearances. These measures indicate that assuring ease of doing business is of paramount importance for the government. However, it is imperative that the announcements made are acted upon on an urgent basis to see an improvement in India's business environment.

The government also announced a financial inclusion scheme called 'Pradhan Mantri Jan-Dhan Yojana', envisaged as a combination of savings, loans and insurance products. The scheme launch has been hugely successful with over 5 crore bank accounts opened till date.

## 1.3 Forthcoming Union Budget: Focus on boosting demand and investments

The economy is certainly on the mend and the government has provided a big dose of confidence to the potential investors. However, we are still away from the point where a shift can be made to a higher growth trajectory which can be sustained going ahead. The demand situation remains weak and the capacity utilization levels across sectors have seen limited improvement.

The forthcoming Union Budget provides an opportunity to put in place levers to strengthen the demand situation in the economy. This is important to impart momentum to the capex cycle and put GDP back on high growth track. While detailed proposals for various sectors are given in the following pages, some of the broad suggestions which FICCI would like to make for government's consideration with a view to boost demand and investments in the economy are as follows-

One, government's move to lower the threshold limit of investment allowance in the last Budget was creditable. However, the period for investment allowance which is currently available for two years should be increased to five years given that projects have longer gestation period.

Two, a rebated income-tax for small start-up businesses called START (STArtup Rebated Tax), on lines of similar schemes in Singapore and China can be introduced. This will provide strong encouragement to small Start-ups and thus boost job-creation.

Three, government's plans to raise capital for Public Sector Banks through sale of shares to retail investors and common citizens of India is welcome. However, the government should raise equity for Public Sector Banks by diluting its stake to a minimum of 26% while retaining golden share for control. This will provide the much needed resources to banks to support productive investment activities in the economy.

Four, there is a need to examine setting up of at least one long term lending financial institution for businesses (for example, like IDBI in the past).

Five, the non-performing assets of banks have witnessed an increase over the past few years. For an effective resolution of stressed assets, there is a need to look beyond the existing system and address the specific nature of the problem through a specialized ARC framework. FICCI suggests creation of a specialized entity called National Asset Management Company (NAMCO) to effectively tackle the issue of large NPAs.

Lastly, implementation of Goods and Services Tax (GST) can be a game changer for the economy. Though the government is working on ironing out issues in GST framework, it is important that the process of building a consensus is expedited and the government is able to stick to the targeted date of 1st April, 2016 for making GST operational.

## 1.4 Forthcoming Union Budget: Continue moving on the path of fiscal consolidation

In addition to the above, it remains critical that we continue to move on the path of fiscal consolidation. The fiscal deficit to GDP ratio was reported at 4.6% in 2013-14 and the target for 2014-15 was kept at 4.1% in the last year's Union Budget. The fiscal deficit to GDP ratio is estimated to be further brought down to 3.6% and 3.0% in 2015-16 and 2016-17 respectively.

It is important that the government continues its endeavour to garner higher revenues and attempts to move towards a more efficient expenditure management system. In fact, some of the announcements made by the government in its first Union Budget reflect this commitment.

The announcements pertaining to taxes in the last budget were encouraging and point towards government's attempt to simplify the taxation system. Government conveyed that it is committed to provide a stable and predictable taxation regime that would be investor friendly and spur growth.

Further, the government needs to take steps to improve the tax to GDP ratio that continues to hover close to the 10% mark. Widening of the tax base and formalization of the informal economy should be given priority in the forthcoming Budget.

There is a need to tax all sectors which are presently outside the scope of the tax net albeit at much higher levels of income/wealth. There is no economic justification to not tax persons who have income above the threshold of maximum marginal rates payable by other tax payers.

Also, we would like to see that disinvestment plans of the government take full advantage of a healthy capital market. Speed and sharing of information on disinvestment plans will facilitate this objective.

On the expenditure side, an effort has been made by the government to get the focus back on productive outlays. There should be a move away from a discernible increase noted in consumptive expenditure over the past two years at the cost of declining capital expenditure.

In this context, the government has set up an Expenditure Management Commission headed by Dr. Bimal Jalan to look into expenditure reforms and provide a roadmap for rationalization of subsidies. The decontrol of diesel prices and the slew of austerity measures announced recently are a welcome step towards fiscal discipline. Further, the plan of the government to revamp the Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) is a step in right direction. There is a need to make the scheme more productive and this can be achieved by linking it to agriculture activity and rural development.

Further, existing schemes of subsidies and social programmes need to be made more efficient and less onerous on the fisc. Government should consider consolidation of social welfare programs across ministries and departments. Direct Cash Transfers can ensure better targeting of subsidies and implementation of the same should be expedited.

# SECTORAL ISSUES

## AGRICULTURE

### 2.1.1. Exemption for Services related to Agricultural Produce

As per extant Service Tax laws the agro-sector has been supported by keeping a bulk of services relating to agriculture or agricultural produce in the Negative List or in the list of exempted services. However, there are some services like Warehouse Management Services, Security Services, and Laboratory Testing Services etc. which are essential to secure storage of agri-produce and to determine quality of the agri-produce but which are subjected to Service Tax.

It is recommended that all services provided for agricultural produce be exempted from service tax.

### 2.1.2. Priority lending for purchase of Micro Irrigation equipment/systems

The ultimate irrigation potential for the country has been assessed to be about 139.9 million hectare (Mha). As per the available information, about 93.95 Mha (till end of Eleventh Five Year Plan) of irrigation potential has been created so far. Secondly, only 3.5 million hectares of the 87.2 million hectare irrigated area use micro and sprinkler irrigation in India.

The purchase of Micro Irrigation equipment/systems by farmers should be eligible for priority lending by the banks within the ambit of 'priority sector lending to agriculture'.

### 2.1.3. Agriculture Warehousing

Following recommendations to give fillip to the agriculture warehousing sector may be considered:-

(a) Increase the subsidy under Grameen Bhandaran Yojna to 35% (25% at present). For NE States / Hilly areas, SC/ST entrepreneurs and their cooperatives and women farmers, the subsidy should be increased to 40% (33.33% at present). Subsidy for smaller godowns of 50 MT size in general and of 25 MT in hilly areas as permitted, be also increased to 50% to increase the capacity of warehouse. This should be subject to construction as per the norms laid by NABARD and should be available to only rural areas, accessible by motorable roads throughout the year.

(b) Construction of godowns under Private Entrepreneurs Guarantee (PEG) scheme formulated by FCI for guaranteeing the storage should be enhanced to 15 years (for escrowing the repayments), so as to have lower EMI for the entrepreneurs who plan to get their projects financed by the banks. Financing to this sector should be considered for lower capital adequacy requirements for banks besides permission to have special dispensation to grant term loans beyond 10 years tenure.

(c) Banks should get direct lending tag under priority sector benchmark towards the loans given for construction of godowns both under PEG and Grameen Bhandaran Yojna as against indirect lending under priority sector at present.

## CHEMICALS AND PETROCHEMICALS

### 2.2.1. Background

The Indian chemical and petrochemical industry currently stands at USD 134 billion and is expected to grow at a CAGR of 8% for the next five years. The share of this sector in the manufacturing GDP was 15% during 2012-13 and it accounted for ~9% of the total India's exports. Together, Gujarat, Maharashtra and Uttar Pradesh account for more than 50% of Gross Value Add (GVA) and Gross Output of the chemical and petrochemical industry.

The current low per capita consumption across industries and segments and strong growth outlook for the key end use are the key growth drivers for this industry. Net imports have grown at ~20% between FY09 and FY13 where in the same period the domestic output has grown by ~4%. The Government has set an ambitious plan of increasing the share of manufacturing in GDP from 16% to 25% by 2022.

To meet this increasing demand either the local production will have to ramp up or the imports will have to go up. As import duties have fallen across South and Southeast Asia, large global manufacturers have set up transnational supply chains in countries with better infrastructure, ports and friendly regulatory regimes. This has led to global players shifting from manufacturing to assembly and, subsequently, to outright imports into India. Our view is that sustained growth is more likely to stem from the rise of domestic manufacturing, rather than relying on international companies. Besides simplifying regulatory processes and compliance related issues, the government will have to look at policies specific to the chemical manufacturing sector to generate sizable impact. Industry feels Free Trade Agreements (FTAs) are having a negative impact on business. FTAs create an 'inverted duty structure' making it cheaper to import a finished product rather than manufacturing or assembling it in India.

There is need to give focus to and provide support to Knowledge based segments of the chemical industry namely Speciality Chemicals. This is in view of the large talent pool in the country, coupled with huge emerging market resulting from massive urbanization, infra building and increasing aspirations of emerging middle class. Agrochemicals, Dyes, personal care chemicals are some of such segments.

Adoption of integrated cluster in cluster approach can enhance the competitiveness of domestic manufacturing for both domestic and multinationals. Government has planned some dedicated chemical and petrochemical regions through PCPIRs Policy. However the progress of PCPIRs till date has not been so promising. They have not been able to create value chains of downstream industry. The policy needs a re-look to make it play the role of a facilitator. There is also a need to facilitate small clusters to come up with common infra facilities. That will result in lowering cost of production and making the output more competitive.

### 2.2.2. Reduction of Import Duty on Feedstock for Chemical Industry

The chemical industry is becoming dependant on imports for intermediates required for pesticides, pharmaceuticals, dyes etc. This is not desirable in the long term. Ethanol serves as a major feedstock for the chemical industry. In India, it is derived from molasses, a by-product of sugar industry, and hence dependent on cyclic ups and down of sugar production. Ethanol from molasses route is considered as green feedstock and is used to manufacture green value added intermediate chemicals such as ethyl acetate, monoethylene glycol, acetic acid, acetaldehyde, amines, etc. which helps in giving the foreign exchange advantage to the country by way of their exports and acting as substitutes for imports.

Ethanol, other than its use in chemical industry is also primarily used by potable sector in the country. However, there has been a huge gap in demand and supply of ethanol, which is on account of introducing an additional use of ethanol for blending in gasoline. This has deprived the chemical industry from obtaining this important feedstock in adequate quantity and the chemical industry has to rest upon imports to fulfil its requirement. In this background, import duty on ethanol for industrial use should be fully exempted.

Methanol consumption in the country at the beginning of 12th five-year plan is estimated at 1.5 million tonnes and is expected to reach 2.5 million tonnes by the end of the 12th five-year plan. The current production capacity in the country is 0.385 million tonnes thereby creating a gap of 2.115 million tonnes which would primarily be met through imports from Middle East and China.

There exists strong opportunity in investment in methanol capacity in the country, but these are limited by feedstock (naphtha and natural gas) availability. In such a scenario, the Government can incentivise the development of downstream industry by removing the customs duty on methanol altogether.

### 2.2.3. Agrochemicals

Agrochemicals / Pesticides are an important ingredient for the agriculture sector along with good seeds and fertilizers. They need similar treatment for the purposes of levy of excise duty, as the fertilizer sector. Excise duty on pesticides (heading 3808 50 00 and 3808 91 11 to 3808 99 90) needs to be brought on par with the duty on fertilizers. Excise duty on technical grade pesticide and formulations is 12.36%. If this duty is reduced to 8% it will bring down the cost of pesticides to farmers and encourage country wide production leading to lower logistics costs.

The Agrochemicals Industry is adversely affected by non-uniform VAT structure on pesticides. The VAT on Pesticides in Punjab, Haryana, and Tamil Nadu is Nil whereas in other states it ranges from 1% to 5%. This leads to illegal movement of pesticides between states. VAT should not apply to pesticides or a uniform VAT @ 2% should be applicable to pesticides nationwide.

### 2.2.4. Oleo Chemicals

The imports from ASEAN under ASEAN-India FTA incur a preferential tariff which has a slight negative impact on the domestic business. Under ASEAN FTA, in general import duty on most Oleo chemicals has been reduced, whereas the reduction in duty on input raw materials is much less thus rendering domestic chemical manufacturing industry uncompetitive.

i) Lauryl alcohol (HSN No.3823.7020) incurs a normal import duty of 15% in India. When imported under ASEAN FTA, the reduced duty is 0%. However, there is safeguard duty of 20% when imported in India. Also Palm Kernel Fatty Acid distillate attracts 15% normal duty which becomes 10% under ASEAN-FTA.

ii) The finished product thus made i.e. Lauryl Alcohol Ethoxylate (HSN NO.3402.13.00) incurs a 10% normal duty. Under ASEAN FTA there is no rebate on Lauryl Alcohol Ethoxylate for imports from Thailand and Indonesia whereas imports from Singapore are subjected to preferential tariff of 5%. It would be better that this finished product duty is kept higher than the raw material i.e. Lauryl Alcohol/Palm Kernel Fatty Acid Distillate.

iii) Another aspect that is observed is that Lauryl Alcohol Ethoxylates when exported to Indonesia attract 15% import duty and under ASEAN –FTA, this is 13.5% which is quite high as compared to duty for same product when imported into India i.e. 5%. These anomalies need to be addressed.

### 2.2.5. Chemical Clusters

The Chemical Industry has special requirement of dealing with effluent discharge. This sector is important and there is a huge unrealised potential of growth as indicated by the present very low per capita consumption levels in the country as also for export. Most of Indian Chemical industry is in small and medium sector and same restricts the capability of investment of entrepreneurs for adoption of newer technologies. The provision of common facilities in the form of good quality power/water supply, effluent treatment/incineration, testing and other logistic facilities such as chemical storage tanks, telecom/firefighting and rail/road connectivity can facilitate the sector. Further if related industries are set up in close proximity in an industrial estate, they could be vertically integrated resulting in a saving on the transfer cost of feedstock and finished goods. This, coupled with lower investment on infrastructure as a result of sharing, would tremendously improve their cost competitiveness. This will also help in containing the environmental load linked to the chemical industry. Such clusters could also be the points where migrating industry from west lands. Existing hubs (brown field) will need slightly different approach. About 3-4 such chemical clusters based on the best models, could be set up in different regions of the country and these could become the role model for replication. Department of Chemicals and Petrochemicals is already facilitating cluster approach in plastics sector.

### 2.2.6. Technology up-gradation Fund for Chemicals Industry

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

## 2.2.7. Petrochemicals

Petrochemicals constitute a very important segment of world chemicals market, with a share of nearly 40 per cent. The industry is important as it has several linkages with other sectors of the economy. Petrochemicals have backward linkages with other industries in petroleum refining, natural gas processing and forward linkages with industries that deal in a variety of downstream products. Also, the industry offers alternatives, which serve as substitutes for natural products and hence, has the capacity to meet the constantly growing demand that would otherwise strain the natural resources.The petrochemical industry is facing financial difficulty with very poor margins and needs to be facilitated.

Following changes are suggested in the import duty rates:-

a) Import Duty on Naphtha (HS code: 27101290) be reduced to 2.5% to bring it at par with other petrochemical feedstock.

b) Import Duty on key petrochemical inputs EDC (HS code: 29031500), VCM (HS code: 29032100) and Styrene (HS code: 29025000) may be brought down to zero. There is very little production of EDC and VCM for merchant sale within the country and whatever capacity exists is essentially for captive use. There is no domestic production of Styrene and the entire Styrene requirement of the country is imported.

c) Import Duty on PET (HS code: 390760), ABS (HS code: 39033000) and SAN (HS code: 39032000) be raised from the existing level of 5% to 7.5%

d) Import Duty on ACN (HS code: 29261000) be raised from 2.5% to 5%

e) Import Duty on MEG (HS code: 29053100) may be raised from existing level of 5% to 7.5% to rationalize the tariff structure for the polyester sector. In MEG an investment of Rs 10500 Crs is being made to make India self-reliant. This is to provide feedstock to the Textile Industry where the vision is to raise production from current $ 80 Billion to $ 220 Billion by 2020.

f) Import duty on PTA and MEG to be raised from current 5% to 7.5%. PTA industry in India is making an investment of nearly Rs 12000 Cr to make India self-sufficient in PTA. This is to provide feedstock to the Textile Industry. China which is now the world's largest producer of PTA with 52% of world capacity has import duty of 6.5%.

## 2.2.8. Indian Plastics Processing Industry

This is an important segment of Indian industry with usage in packaging, agriculture as also auto, medical and other segments as they replace items such as wood, metal etc. The sector has huge unrealized potential, going by the present very low levels of consumption in the country. Per capita usage is only about 9.7 kg India as compared to about 100 kg in USA and 40 kg in China.

A. Central Excise Duty on Plastic Polymers and Articles of Plastics

Plastic products have replaced wooden products substantially:-

- 6000 MT of plastic furniture saves 140,000 cubic meter of wood or 32000 hectares of forest.
- Plastic crates have substituted almost 95% of wooden crates used in the soft drink industry.
- The only viable alternative to the wooden furniture is plastic moulded furniture. Plastics have been coming up as replacement of wood in furniture in a major way.
- Only PVC doors and windows, plastics crates, plastics furniture can save at least 17.5 million trees from cutting. Plastic based wood substitutes amenable to recycling. To conserve wood, the Government of India in 1988 had issued a directive to promote wood substitutes, including plastics in all Government and institutional purchases for furniture, Door and Window frame and Shutters.

The organized Plastic Industry is today hamstrung by the grey market – estimated to be as high as 40% -- on the one hand and under-invoiced, smuggled imports from China on the other. Reducing the central excise duty at 8% will bring down the cost spreads between organized segment and the grey market and correspondingly boost Government revenues both through better compliance and increased turnover. It is requested that Central Excise Duty on Plastic Polymers and Articles of Plastics be reduced from 12% to 8%.

B. Import Duty on Articles of Plastic

Imports of articles of plastic are taking place at low and unjustified prices. Articles of plastics are also imported under Chapters 42,56, 63,67, 90, 94, 95 and 96, the volumes whereof are also growing. It has been recommended by the Sub-group on the Plastic Processing Industry constituted by the Department of Chemicals and Petrochemicals that Customs Duty on differential between Plastic Polymers and Processed Plastics Goods should be 10%. Keeping these factors in view, it is essential that import duty structure on imports of articles of plastics is re-calibrated to increase import duty on plastic goods from current 10 % to 15%

C. Correction of Inverted Duty Structure on Titanium Dioxide and Polypropylene Granules

Customs Duty on Titanium Dioxide (Heading No. 32061100) is 10%. Custom Duty on master batches which use Titanium Dioxide is 7.5%. Thus it is a case of Inverted Customs Duty. Reduction of Custom duty on Titanium dioxide from 10% to 5% for imports from countries with whom we do not enjoy preferential / nil rate of duty for this product under respective FTAs. The higher cost of Titanium Dioxide has adverse effect on Food Packaging.

Customs duty on imports of “capacitor grade polypropylene granules” (Heading No.39021000) is 7.5%, while capacitor grade BOPP Film is attracting zero percent customs duty in view of its application in electronic sector. Thus, it is a case of inverted duty structure. Currently “Capacitor grade Polypropylene Granules” are not produced in India.

D. Technology Up-gradation Fund for Plastics sector

Existing units need up-gradation/installation of new plant and machinery in place of old plant and machinery. Technology up-gradation fund scheme (TUFS) for Plastics industry is needed badly. This will provide loan to units at subsidized rates to Plastics Processors for the purchase of new machinery for up-gradation. The Indian plastics processing and converting industry has large population of older technology machinery and thus does not have the same technological edge to remain competitive in costs and quality compared to our global competitors. The proposed Scheme aims at making available funds to the domestic plastics processing and converting industry for technology up-gradation of existing units as well as to set up new units with state-of-the-art technology so that its viability and competitiveness in the domestic as well as international markets may enhance. There is increasing competition from China and other countries not only in the international market, but also in the domestic market. To meet the challenges the industry is required to become competitive, cost effective and quality oriented. This will make the industry competitive.

### 2.2.9. Poly Vinyl Chloride (PVC)

Poly Vinyl Chloride (PVC) industry is important for national economy. Investments are not happening despite the rapidly growing Indian PVC market. The last greenfield investment for a PVC plant in India was conceived in the year 2002-03, when duty differential was a little over 15%. However, while demand has grown by almost 1.6 million tons no new capacity addition has even been envisaged. Indian import duties on PVC are lower than those in the developed world and in the ASEAN Region. Imports of PVC, which were less than 5% of the country's demand ten years ago, are now at almost 50% and growing rapidly every year and are expected to reach to $3 billion in a few years. Appropriate fiscal measures can propel investments in the PVC sector.

It is therefore proposed that Import duty on PVC resin be raised to 10% from existing 7.5%. It also has a very serious long term deleterious effect on the Indian Caustic Soda industry. The majority of Chlorine produced goes into PVC manufacture, and if there is no PVC capacity addition, there can be no Caustic Soda capacity addition, and the country will become reliant on the import of yet another basic growing product, Caustic Soda. An upward revision of basic customs duty on PVC to 10% will spur investment in the domestic PVC and Caustic Soda industry, increase skilled employment, and also provide a much needed thrust to the domestic capital goods sector.

## 2.2.10. Reduction of Import Duty on Butyl Acrylate

Butyl Acrylate is an important industrial input (polymer) which is used in various industries such as paint emulsion, auto sector, construction industry and agro chemicals. Total industry input for various segments is 137000 metric tonnes and it is growing with CAGR of 10-15%. There is no domestic production of this chemical and it is entirely imported from various countries. It attracts import duty of 7.5 per cent (with exception of imports from Singapore which is at zero per cent duty due to FTA and Indonesia/Malaysia which is at six per cent). The domestic demand of this chemical is consistently increasing and it is felt appropriate that there is level playing field for import of such an important chemical from a wide spread area. Accordingly it is proposed that import duty on this chemical is reduced to provide a level playing field as also encourage diversification in import basket which will be in the long term interest of the economy.

## 2.2.11. Polyethylene (PE)

There is disparity in Import Duty for chapter 39 between ASEAN India FTA and Singapore India CECA (Duty difference + 5% verses 1.15%). As a matter of fact availability of more advanced materials for food packaging is leading to more efficient packaging and very low wastage of food. The suggestion is to bring Thailand import duty at par with Singapore for chapter 39 (HS – 39.10.10)

## 2.2.12. UF Membrane Modules

There is need to encourage better technologies for water treatment. The UF module /purification equipment of using PVDF (842121 H S Code) has better resistance to chemicals like chlorine and is ideal for applications like waste water treatment, water recovery, recycle & zero discharge. The technology provides excellent removal of colloids, particles, and bacteria. The present technologies that have been granted nil CVD are appropriate only for limited applications. Present CVD applicable which is 10% may be reduced to nil.

## 2.2.13. Synthetic Fibre Industry

Excise Duties

Man-made fibres (MMF) have a skewed Excise Duty structure which discriminates Man-made Fibres vis-à-vis Cotton namely, 12% for MMF and Zero for cotton. World-over there is no such distinction (e.g. in China, Pakistan, Bangladesh, Sri Lanka, Thailand etc.). Ironically Man-made Fibres which are used by lower and middle classes in India, being affordable and durable, have to bear the brunt of high excise duty. The skewed excise duty structure has resulted in deceleration in growth. It is proposed that the Government may reduce the excise duty on man- made fibres / yarn value chain to 6% in the first instance to avoid inverted duty structure and CENVAT accumulation.

Customs Duty

Customs duty structure should be a cascading structure i.e. the duty differential should be progressive at each stage of value chain - 5% duty differential is proposed between raw material and end product.

a) Polyester Value Chain

| Item | Customs duty (%) | | |
|---|---|---|---|
| | Tariff No. | Present | Proposal |
| PTA | 2917.36 | 5 | **5** |

| Item | Customs duty (%) | | |
|---|---|---|---|
| MEG | 2905.31 | 5 | **5** |
| Polyester chips | 3907.91 | 5 | **7.5** |
| Polyester staple fiber | 5503.20 | 5 | **10** |
| Polyester filament yarn | | 5 | **10** |
| Polyester high tenacity yarn | 5402.20 | 5 | **10** |
| Polyester tyrecord fabric | 5902.20 | 5 | **10** |

b) Nylon Value Chain

| Item | Customs duty (%) | | |
|---|---|---|---|
| | Tariff No. | Present | Proposal |
| Caprolactam | 2933.71 | 7.5 | **5** |
| Nylon Chips | 3908.10 | 7.5 | **7.5** |
| Nylon filament yarn | 5402.45 | 7.5 | **10** |
| Nylon high tenacity Yarn | 5402.10 | 7.5 | **10** |
| Nylon tyre-cord fabric | 5902.10 | 10 | **10** |

## 2.2.14. Setting up of Centres of Excellence

Centres of Excellence (COE) are needed for dealing with specific issues/segments in the chemical industry as follows:-.

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

(b) Agrochemicals, Dyes/Colorants and Pesticides segments of industry have huge potential and need to be encouraged. More than 60% of production from these sectors in India is getting exported, indicating the potential of the sector from a global perspective. A COE for this segment will be helpful.

(c) Fire-Retardant Chemicals: Accidental fires are causing huge losses. (Estimated loss of life of 25000 persons per annum, besides huge economic cost). In modern homes where rooms contain upholstered furniture, varied electrical and electronic equipment, (made mainly of plastic components) and other consumer goods, fires can develop rapidly and violently. The focus so far has been on fighting fires, after they have taken place. There have been recent developments in the sector in relation to chemicals which retard/prevent fire. There is need to encourage and create awareness about these developments in the chemical industry. The focus of flame retardants is on fire prevention rather than fire mitigation. It is important to bring out issues related to the safety aspects and also the potential of chemicals for fire safety in a preventive mode as also in an environment friendly manner. We propose setting up a Centre of Excellence for the Fire Safety aspect.

### 2.2.15. Reverse SEZs - Setting up of Chemical Complexes in Resource Rich Countries

The concept envisages Indian Companies to invest into such a zone established in resource rich countries, to use the cheap gas/resources available to make chemical building blocks and bring them to India for the country's needs. Both countries will be benefited as investments flow to that country as also jobs get created. India receives assured supply of intermediates/chemicals for final value addition in the country

The country is deficit in cheap energy source particularly natural gas and needs to depend more and more on fuels such as LNG. The local availability of gas is very limited and unable to meet total needs and the country needs to depend on imported LNG. On the international scenario with new discovery of shale gas in the USA and recent discoveries in Africa, the local gas prices in these countries are now between $2 to 3/mmbtu.

Learning from other countries, such as China where energy and mineral needs have pushed the country to source these inputs in far flung regions, such as Brazil, Africa etc., India needs to similarly progress in order to secure its needs in energy and building blocks. The closest energy/gas availability in abundance in countries around India is as those in Africa, Middle East and on the eastern border of India. However, since these countries are politically unstable, it is always a high risk for an individual Company to set up gas based manufacture of basic building blocks in these countries. It is therefore, proposed that the Indian Government help create a Special Economic Zone (SEZ) in these countries and maintain a politically stable relationship with the local Government. Various Indian Companies would be interested to invest into such an SEZ to use the cheap gas available to make chemical building blocks and bring them to India for the country's needs. The Reverse SEZ would be blessed with political stability due to the Indian Government and economic attractiveness due to cheap availability of gas in these countries.

The biggest beneficiary would first be the Fertilizer industry which would be able to get gas, its major input at a price which would be 1/4th of its current price. It is expected that every fertilizer plant with an individual capacity of 1500 tons/day would be able to save about a thousand crores every year, thereby contributing to reduce subsidies permanently. The Petrochemical industry could look at making basic building blocks along with the Fertilizer industries in these Reverse SEZ areas such as Ammonia, Methanol and other C1 chemistry products. Cheap availability of C1 building blocks from the Reverse SEZ area will help assure large investments on downstream products in India (home market) India could also explore opportunities to make power based on crude/cheap Methanol being imported instead of LNG. Some countries so identified include Mozambique, Iran, Oman and Myanmar.

## CIGARETTE AND TOBACCO INDUSTRY

### 2.3.1. Continuation of length based Specific Duty Structure of Excise for Cigarettes

Length based specific excise duty structure is a simple, transparent method of taxation which is easy to administer and which has no potential for valuation disputes. It has enabled manufacturers to position their products at various price points, across different socio economic strata of the Indian society. It has also facilitated introduction of high quality products – benchmarked to international brands - resulting in increased demand for high quality Indian tobaccos leading to improved farmer earnings. Retention of this structure has been recommended repeatedly by eminent economists like Dr. Raja Chelliah and Dr. Vijay Kelkar.

Therefore, it is recommended that length based specific excise duty structure on cigarettes be retained.

### 2.3.2. Review of Length based Segments in the Cigarette Duty Structure

The existing excise duty structure where different length based segments are subjected to different rates of excise duty was designed keeping in mind the diverse socio economic profile of the Indian populace and the need to offer products at different price points in line with their affordability-profile. Accordingly the Industry has been offering a 'laddered' portfolio of products at multiple price points catering to the needs of all sections of the Society.

However, the Union Budget 2014 has deleted the 'greater than 75mm but less than or equal to 85mm' category and combined this with 'Others' segment presumably to simplify the excise duty structure. Given the diversity in the socio economic profile of the Indian populace, it is important to have multiple length based tax points. This facilitates the industry to make offers tailored meet the requirements of each section of the society.

Secondly, in the 'less than 65 mm segment', the excise duties have been increased by a steep 72% in the recent Union Budget. This segment had enabled the legitimate industry to hold on to Rs. 2 price point thus helping partial retention of volumes, which would have otherwise gone into illegal segment, within its fold. The recent increase has forced the industry to vacate the crucial Rs. 2 price point. This puts the legal industry at a severe disadvantage.

In order to effectively combat the menace of illegal cigarettes, there is a need for a new segment of 'less than 60mm length' with an excise duty of Rs. 200 per thousand cigarettes. Therefore it is recommended that -

i. The existing length based segments should be continued

ii. A new length segment of 'less than 60mm length' be introduced with an excise duty of Rs. 200 per thousand cigarettes

iii. In addition, the rate of Central Excise duty on the 65 mm filter cigarette slab be reduced from the existing level of Rs.1185 per thousand cigarettes to the earlier level of Rs.689 per thousand cigarettes

### 2.3.3. Curbing the growing Menace of Illicit Trade in Cigarettes

The following measures are recommended to curb the menace of duty evaded cigarettes:

(i) Licensing under I(D&R) Act, 1951 should be made compulsory for all Cigarette manufacture in the country, irrespective of the size and nature of the Units in which such manufacture is undertaken, without any exceptions.

(ii) In line with the procedural requirements for tobacco exports, buyers of tobacco from auction platforms to file with the Tobacco Board complete details of sales made to domestic customers.

(iii) Curb contraband cigarette trade to protect revenue collections. Suggested measures in this regard are:

  (a) Disallowing cigarette manufacture in EOUs and SEZs as this is misused to smuggle cigarettes into Domestic Tariff Area.

  (b) In line with extant Policy, keep cigarettes, all tobacco and tobacco products, including cigarettes and cigars in the Negative List in all Trade Treaties, FTAs, etc.

### 2.3.4. Standardise Tobacco Taxation across all types of Tobacco Products

Unlike most countries in the world, cigarettes account for less than 12% of the total tobacco consumption. In fact, with 17% of the global population India accounts for only 1.8% of global cigarette consumption. On the other hand, India accounts for about 84% of the global Non-smoking Tobacco consumption. Besides, biri and smokeless tobacco forms are known to be potentially more dangerous than cigarettes since most manufacturers produce inferior quality, cheap products with higher tar, nicotine deliveries which are more harmful for consumers. Smokeless tobacco is popular amongst women and children as the fear of detection is less and it does not attract social sanction like smoking.

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

### 2.3.5. Exempt excise duty on cigarettes used captively for testing

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

### 2.3.6. Paper Rolled Biris

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

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

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

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

### 2.3.7. Tax Benefit for Expenditure on Skill Development

Section 35CCD in the Income-tax Act, 1961 (Act) provides for weighted deduction of 150% on the expenditure incurred by a company on skill development project notified by the Central Board of Direct Taxes (CBDT). Notification No. 54/ 2013, dated 15th July, 2013 has laid down guidelines for claim of weighted deduction on expenditure incurred by an "eligible company" on skill development project undertaken in separate facilities in a training institute. "Eligible company" is defined to inter-alia mean a company engaged in the manufacture of production of any article or thing except for negative list mentioned in serial numbers (1) and (2) of the Eleventh Schedule. The serial number (2) of the Eleventh Schedule includes companies engaged in tobacco/ cigarettes business. Accordingly, the companies engaged in tobacco/ cigarettes business are not allowed to claim tax benefits under Section 35CCD of the Act.

It may be noted that large companies which are involved in multi-product businesses which include tobacco/ cigarettes, would be denied the tax benefit since it would get hit by the definition of an "eligible company" as per the abovementioned notification. Such a company may be involved in doing outstanding work in the area of skill development in the various areas listed under "services" in the notification or doing commendable work for skill development in non-tobacco/ cigarettes businesses.

It is suggested that a clarification/ an amendment to Income-tax Rules, 1962 (Rules), be issued clarifying that the tax benefit for "skill development", would be available to all companies engaged in the business of manufacture or production of any article or thing or in providing services mentioned in the notification, provided such project is not directly related to the business covered in the negative list.

## CIVIL AVIATION

### 2.4.1. Issuance of Tax Free Infrastructure Bonds

To facilitate the private airport operators to raise funds, it is recommended that they should also be allowed to issue tax free infrastructure bonds to the public. Further, the investments in these bonds should be notified for the purpose of claiming deduction under Section 80CCF of the Act and the applicability of Section 80CCF should be extended to cover the investments made from financial year (FY) 2015-2016 onwards.

### 2.4.2. Support services of airport to be termed as infrastructure

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

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

### 2.4.3. Clarification on non-exclusion of security component of passenger service fee

As part of air ticket, the airline is to collect from each passenger a certain amount of passenger service fee. The passenger service fee collected from each passenger consists of two parts, namely (1) facilitation component and (2) security component. The amount of facilitation component is the regular income of airport operator and thus, forms an integral part of its revenue. The amount of security component is held by the airport operator in fiduciary capacity in an escrow account for and on behalf of Central Government and does not form an integral part of revenue/receipt of airport operator. However, the tax officers while finalising the assessment of the airport operators are taxing the surplus amount lying in escrow account as their income.

It is recommended that a specific clarification may be issued specifying that the amount of security component of passenger service fee which is held by the airport operator in fiduciary capacity for and on behalf of the Government would not be liable to tax in their hands.

### 2.4.4. Exemption on services rendered to domestic airline operator

Generally, domestic airlines companies avail mandatory Maintenance Repair and Operation (MRO) services from Asian and European countries which results in huge foreign exchange outflow. In order to encourage MRO services for domestic airlines companies in India and reduce the fiscal deficit by conserving foreign exchange, tax benefits, similar to ones available to an SEZ unit, should be provided to MRO companies for setting up facilities to provide such services in India.

### 2.4.5. Other Tax Issues

(a) Section 10(15A) of the Act may be reinstated. This exemption was withdrawn for operating leases (for aircrafts/ engines) which are entered into after 1st April, 2007. This has put significant burden on the airline industry.

(b) As per the current provisions of the Act, airlines have to incur additional costs arising out of Tax Deducted at Source (TDS) on maintenance related payments towards labour charges and fees for technical services and royalties. The airlines should specifically be exempted from applicability of TDS on such payments.

## EDUCATION

### 2.5.1. School Education

A well educated population is a key driver for economic growth. Therefore, Government's overall plan to revive economic growth must include the imperative step of strengthening India's education system. In addition to strengthening school infrastructure to improve student retention, the upcoming budget is an opportunity for using the Centre's spend as a strategic tool to shift our system's focus from inputs to student learning. Following suggestions may be considered to achieve these objectives:-

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

A portion of the budget allocation to states should be made contingent upon the adoption of progressive human resource policies that are critical for improving student learning. In specific, the Centre can create a Rs. 1000 crore 'State Policy Reform Fund' to incentivise states that implement measures such as merit-based headmaster selection, transparent process for teacher recruitment, allotment and transfers and merit-based teacher promotions.

Central schemes such as Jawaharlal Nehru National Urban Renewal Mission (JnNURM) have successfully used a similar approach for influencing states' policies. Under JnNURM, 75% of the grant was subject to achievement of policy reforms. The scheme led to policy reforms in almost all states and cities.

B. Education quality and capacity building of existing institutions

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

Additionally, there is a need to adequately resource and build technical capacities of existing central institutions such as NCERT, NUEPA, IGNOU, CIET and NIOS.

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

Merely measuring student learning does not result in improvement. There is a need to substantially increase investment on student learning assessment surveys from the current Rs. 12 crore to Rs. 100 crore so that states have sufficient funds for instrument development and implementation, dissemination of results across stakeholders and training of functionaries in the use of assessment data for designing quality improvement interventions. Further, FICCI recommends a 50 per cent increase in the spending on the teacher education scheme as this is critical for strengthening teacher education institutes across states. There is also a need to invest in the implementation of quality improvement interventions such as headmaster training, ICT, research and evaluation.

The forthcoming budget could be a turning point in India's fight against education inequity. Government should use this as an opportunity to ring in a nationwide drive towards quality education for all.

### 2.5.2. Higher Education

A. To address the shortage of faculty in the country, the Government should expedite the launch of National Mission for Faculty Development and provide a tax relief to the tune of 50% to Universities / Higher Educational Institutions that spend on the capacity development and training of their staff.

B. Given the priority of Skill Development in the national agenda , Government should make the following provision;

- Any person enrolling for a Skills Certification course be eligible for a 20% tax rebate (only applicable for the tuition fee amount)
- Any Educational Service Provider opening a Skills Centre in a backward area should be given an exemption from income tax for the first 3 years.

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

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

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

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

G. As colleges fees have increased tremendously income taxpayers should be allowed a deduction against gross total income up to a minimum of Rs 1,00,000 per child for fees paid to a higher educational institution recognized by Government. This will mitigate the cost of Higher education.

### 2.5.3. Service Tax Exemption for Specified Auxiliary Educational Services

Prior to the announcement in the Union Budget 2014-15, 'auxiliary educational services' (which included larger number of outsourced services) as well as renting of immovable property services provided to educational institutions were exempt from service tax. After the amendments vide Notification no. 6/2014-ST dated 11 July 2014, only four services provided to specified educational institution are now exempt from service tax, namely, transportation of students / faculty, catering, security and housekeeping, and services pertaining to admission and conduct of examinations.

It is widely believed that this amendment would have an adverse impact on the education sector and would affect India's overall development due to the following important reasons (among others):

- Service tax would now be levied on many critical and high cost input services for educational institutions such as:
  - Renting of premises for setting up institutes/ offering accommodation to outstation students
  - Development of course content
  - Outsourced services such as Information and Communication Technology ('ICT'), outsourced manpower, etc.
- As there is no output service tax on educational institutions, CENVAT credit of the tax paid on these services cannot be claimed. This will substantially increase the cost of educational services being provided by the institutions. This increase in cost may range from 6% to 10%.

In view of the above, FICCI recommends that services of renting of premises should be included in the list of services provided to educational institutions which are exempt from service tax. Exemption should also be granted to services related to;

a) development of course content,

b) Information and Communication Technology,

c) outsourced manpower

## ENVIRONMENT

### 2.6.1. Tax Exemptions

There has been a general agreement and emphasis towards controlling pollution of air, water, and land. To enable the progress towards a cleaner environment it is imperative to provide incentives in the form of:

(i) Exemption of VAT on purchase of environmental monitoring equipment

(ii) Service tax exemption for the following services:

- Environmental studies conducted by consultancy firm before and after start of the project
- Environmental sample analyses by Environmental laboratories
- Services by foreign consultants on technical issues leading to prevention of pollution
- Services provided for maintenance of equipment for pollution prevention

# FINANCIAL SERVICES

## I - INSURANCE

### 2.7.1. Period of carry forward and set-off of losses in case of insurance business

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

### 2.7.2. Sum assured to premium ratio for life insurance policies

Tax benefits under the under Section 10(10D) and Section 80C of the Act in respect of life insurance policies are available only in case where premium payable for any of the years during the term of the policy does not exceed 10% of Actual Capital Sum Assured. This makes the Life Insurance policies unattractive for middle and higher age groups given that there is an exponential rise in the cost of mortality after age 45. Given uncertain macro-economic circumstances, customers are unwilling to enter into very long premium payment commitments.

It is suggested that the sum assured multiple be lowered to 5 times of the premium paid or the tax benefits should be linked with the tenure of the policy rather than the sum assured and accordingly, the tax benefit should be given only on policies with a minimum tenure of 10 years.

### 2.7.3. Deduction in respect of Insurance Premium

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

### 2.7.4. Discrimination in taxation of pension products vis-a-vis non-pension products

There is discrimination in tax treatment of pension products vis-a-vis non-pension products under the Act to the extent that any amount received from the pension fund (including interest or bonus) [on surrender or on receipt of pension under the annuity plan] is entirely taxable, however, in case of life insurance policy/ Unit Linked Insurance Policy (ULIP), the entire maturity proceeds are tax exempt, if the conditions prescribed in Section 10(10D) of the Act are satisfied. Even if the conditions prescribed under Section 10(10D) of the Act are not fulfilled; only income portion in the surrender value (i.e. surrender value – premiums paid) is taxed. Thus, there is discrimination in the taxability of pension vis-a-vis non-pension products under the Act. This also leads to taxation of return of capital in case of pension products which is highly unjustified.

Considering the importance of pension products in India due to lack of any other Social Security measures, taxability of Pension products should be treated at par with traditional and ULIP products. It is further recommended that similar provisions of reversal of deduction in case of surrender of Non-Pension products can be made applicable to the Pension products as well and only the income portion in the surrender value should be considered for taxability.

### 2.7.5. Taxability of Re-insurance Premiums earned by foreign re-insurers

It should be explicitly clarified that the re-insurance premium earned by foreign re-insurers from Indian insurance companies wherein no part of the operations of the reinsurer are carried out in India is not liable to tax in India.

### 2.7.6. No MAT to be levied on General Insurance Industry

To provide level playing field to the general insurance industry at par with life insurance business, Minimum Alternate Tax (MAT) should not be applied to general insurance companies as well. It is therefore recommended that an amendment should be made in Section 115JB of the Act to provide that MAT provisions are not applicable to non-life insurance companies.

## 2.7.7. Gains or Losses on realization of investments in case of General Insurance business

Section 10(38) and Section 111A of the Act provide exemption/ preferential rate of taxation to all investors, on the capital gains earned from transfer of listed securities. However, general insurance industry is placed at a disadvantageous position as compared to any other sector which enjoys benefit under Sections 10(38) and 111A of the Act. This is because its income is computed as per the provisions of Section 44 of the Act read with rule 5 of the First Schedule to the Act which specifically provides for an adjustment of any gains on realization of investments. It is requested that the benefit of Section 10(38) and Section 111A of the Act be granted to general insurance business, since the general insurance companies are paying Securities Transaction Tax (STT) on all transactions of securities sale and are also subject to tax on gains of such securities. This is resulting into double taxation.

Thus, it is suggested that rule 5(b) of the First Schedule to the Act should be deleted.

## 2.7.8. Adjustment of TDS in case of free look cancellations

Insurance Regulatory and Development Authority (IRDA) allows policyholders' to cancel the policy during the free look period (currently set to 15 days). In case of cancellations during free look period, the commission income accrued/ paid to agents needs to be reversed/ recovered. It should be provided that taxes that were already deducted under Section 194D of the Act and paid to the Government Treasury on the commission amounts, which no longer would be payable on account of free look cancellations, should be allowed to be adjusted in meeting the subsequent TDS liability of the insurers or alternatively, a mechanism should be laid down for claiming refund of such excess TDS deposited.

## 2.7.9. TDS on policy holders' pay-out – Section 194DA

Section 194DA of the Act was introduced vide the Finance Act (No 2), 2014, for applying TDS on policyholders pay-out where amount exceeds Rs 1 Lakh. This Section should be repealed as it is detrimental to the insurance business. Alternatively, the threshold limit of Rs 1 Lakh under Section 194DA should be enhanced since policy holders take multiple policies. Also, clarity is required on the following issues:

a) Whether Section 194DA of the Act would apply on pension plan and group insurance policy like gratuity, superannuation etc.?

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

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

## 2.7.10. Taxation of income distributed by securitization trusts to insurance companies

Given the peculiar nature of life insurance business, the profits of life insurance companies are taxable at the rate of 12.5% as per Section 115B of the Act. Insurance law permits life insurance companies to invest in the securities issued by the securitization trust. A levy of additional-tax @30% on income distributed by securitization trust to life insurance companies can have the impact of reducing the return in their hands on such investments and consequently, reducing the returns that can be distributed to its policyholders. It is recommended that the income distributed by securitization trusts to life insurance companies should also be provided a special tax treatment whereby income so distributed shall be subject to additional tax @12.5% and not @30%.

The income of a fund set up by the life insurance company under a pension scheme, which is approved by IRDA, is exempt from tax under Section 10(23AAB) of the Act. It should be clarified that no additional tax would be payable in respect of income distributed by the securitization trust on investments made from IRDA approved pension fund set up by a life insurance company.

## 2.7.11. Tax treatment on assignment of Keyman Insurance Policies

The Finance Act, 2013 has made an amendment to Section 10(10D) of the Act to provide that a keyman insurance policy which has been assigned to any person during its term, with or without consideration, shall continue to be treated as a keyman insurance policy. Accordingly, the maturity proceeds received under such a policy is not exempt under Section 10(10D) of the Act. It may be noted that CBDT vide Circular no. 762 dated 18th February, 1998 has clarified that the surrender value of the policy, endorsed in favour of the employee and in case of other persons having no employer-employee relationship, be treated as “profits in lieu of salary” or “income from other sources” respectively and to be taxed accordingly. The situation would trigger double taxation since the surrender value of the policy at the time of assignment would get taxed in the hands of the assignee and further, the maturity proceeds will be also be taxed after the amendment made to the provisions of Section 10(10D) of the Act.

It is requested that, CBDT should issue a clarification to provide that the 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.

## 2.7.12. Reserve for Unexpired risks, IBNR & IBNER provisions in respect of Outstanding Claims

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

Rule 6E of the Rules prescribe the limits for amount that can be carried to a reserve for unexpired risks - 50% of net premium in case of fire or miscellaneous insurance business, 100% of net premium in case of marine insurance business and 100% of net premium where insurance business relates to life insurance or engineering insurance and which provides insurance for terrorism risks.

Such provisions are created towards outstanding claims to ensure that sufficient funds are available to meet the dues of policyholders in future.

During the course of the assessment of general insurance companies, tax officers have been seeking to deny the deduction of such provisions for outstanding claims and reserves for unexpired risks, particularly in computation of book profit under Section 115JB of the Act considering the same as contingent liability.

Therefore, it is recommended that the provisions for outstanding claims and reserves for unexpired risk created as per IRDA regulations, being created on a scientific basis, should be exempted from the purview of Rule 6E and should be admissible as a deduction in the year of creation. Further, it should be clarified that the said provisions/ reserve made in accordance with IRDA regulations/ orders would not be treated as provisions for meeting contingent liability and should not be added back in the computation of book profit under Section 115JB of the Act.

## 2.7.13. Disallowance of Notional Expenditure in respect of exempt income computed on the total investment portfolio of non-life insurance companies

Income from insurance business has to be computed as per Section 44 of the Act read with the First Schedule. As per various judicial precedents (Birla Sunlife Insurance Company Ltd. v. DCIT [2010-TIOL-535- 1TAT-MUM.), it has been held that the tax officers cannot travel beyond the provisions of Section 44 read with the First Schedule and make disallowance by applying Section 14A of the Act in the case of an insurance company.

Therefore, it is suggested that clarification may be issued by the CBDT to specifically exclude insurance companies from the applicability of Section 14A of the Act.

## II - NON BANKING FINANCIAL INSTITUTIONS (NBFCs)

### 2.7.14. Exclusion of interest paid to NBFC from the provisions of Section 194A of the Act

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

### 2.7.15. Deduction for provision for NPAs for NBFCs and treatment of recognition of income

As per the provisions of Section 36(1)(viia) of the Act, provisions for bad and doubtful debts (if made as per RBI directions) made by banks are allowed as a deduction to the extent of 7.5% from the gross total income and 10% of aggregate average rural advances made by them. NBFCs are now subject to directions of RBI as regards income recognition and provisioning norms. Accordingly, NBFCs are also compulsorily required to make provisions for NPAs. However, the deduction under Section 36(1)(viia) of the Act is not available to NBFC. This discrimination severely impedes functioning of NBFCs. NBFCs are vital channel for credit delivery especially to the under-privileged segments of the society, it is essential that such discriminations between NBFCs and banks be eliminated. This inconsistency may be resolved by including NBFCs/NBFC-MFIs also in Section 36(1)(viia) of the Act.

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

### 2.7.16. Deduction for reserves to NBFC-MFIs (Micro Finance Institutions)

Section 36(1)(viii) of the Act provides deduction in respect of special reserve created and maintained by a specified entity, to the extent of 20% of the profits derived from eligible business. The deduction is available to a reserve created by a financial corporation engaged in the business of providing long-term finance for industrial or agricultural development in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes. NBFC-MFIs also provide long-term finance for agricultural and industry in the form of micro-credit/small loans but are not eligible for deduction under Section 36(1)(viii) of the Act. It is, therefore, suggested that NBFC-MFIs should also be included as specified entity eligible for claiming deduction under Section 36(1)(viii) of the Act.

## III - BANKING

### 2.7.17. Period for maintenance of special reserve under Section 36(1)(viii) of the Act

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

### 2.7.18. Threshold limit for applicability of TDS on Interest

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

### 2.7.19. Conversion of Indian branch of a foreign bank into a subsidiary company

The Finance Act, 2013 inserted Section 115JG in the Act to provide tax neutral conversion of an Indian branch of a foreign bank to a subsidiary company. However, the provisions of Section 115JG of the Act do not provide any clarity on certain transitional issues such as value at which closing 'block of assets' are to be transferred to subsidiary and treatment of allowability of expenses to subsidiary earlier disallowed under Section 43B in the hands of branch. It is requested that clarity may be provided on tax treatment of these issues to achieve the intended objective of conversion of branch into subsidiary.

### 2.7.20. Restoration of deduction under Section 80P to co-operative banks

Withdrawal of deduction under Section 80P of the Act has given a heavy blow to the co-operative banks which helped small and medium enterprises. It is recommended that the deduction in respect of income of co-operative banks under Section 80P of the Act be reinstated.

### 2.7.21. Other suggestions

- It is recommended that electronic filing of Form No. 15G, 15H, 60 and 61 should be introduced so that accountability is maintained and there is a check on frivolous filing and false declaration of such forms. Further, this will also reduce unnecessary paper work.
- It is recommended that Section 72AA of the Act should be amended to allow carry forward and set-off of accumulated business losses and unabsorbed depreciation allowance in case of all types of banking consolidation.
- It is recommended that Section 163 of the Act, should be amended to provide that in the following scenarios banks should not be regarded as 'representative assessee:'
  - o Provision of mere custodial services, under license issued by SEBI.
  - o Provision of services as Authorized Dealer (“AD”) for facilitating the remittance of funds, in the course its ordinary banking business.

## IV - MUTUAL FUNDS

### 2.7.22. Taxability of income from Mutual funds

Following suggestions for taxability of income from mutual funds may be considered:-

(a) Transfers of units in merger schemes of Mutual Fund should be made tax neutral in the hands of the unit-holders (similar to tax neutrality in the hands of the shareholder upon mergers of companies).

(b) To have a level playing field with insurance companies and similarity in taxation of investment in mutual fund schemes and ULIPs, switching of investment under various plans of a mutual fund scheme or inter-scheme be exempted from capital gains tax.

(c) Taxability of offshore funds in India is a grey area. Securities Exchange Board of India (SEBI) has been permitting Indian Asset Managers to manage offshore funds; however, tax issues are perceived to be a major deterrent. It is recommended that safe harbour rules should be introduced to provide that the gains earned by the offshore fund will be regarded as capital gains and further that Indian asset manager of the offshore fund will not construe business connection of the offshore fund in India.

# GEMS & JEWELLERY

## 2.8.1. Review quantitative restrictions on Import of Gold

Background

Since 1998, the Government and the RBI had removed all quantitative restrictions on the import of gold bullion thereby completely eliminating the 'un-official imports/smuggling" on gold into the country. However the import of gold has been closely monitored, by restricting imports of gold through authorized bullion banks, Government Agencies, Star Trading Houses etc.

Gold Jewellery Exports have been steadily increasing in the last few years and had increased from 20% of the Gems &Jewellery Sector Exports in FY11to a level of 36% in FY13, but has now dropped to 22% in FY14. In Feb-2014, the RBI in its move to restrict domestic use of Gold came out with the 80:20 Rule for Domestic Use: Exports of Gold Jewellery. Further it required that 15% of the total gold imported be re-exported after value addition before allowing further import of Gold

Impact

The export of Gold Jewellery has seen a 45% dip to USD 6 billion in the period April '13 – February '14 over the corresponding period last year. A large portion of the gold jewellery exported, is manufactured on job work basis, by 'artisans' and small units in the Cottage & Micro Sector and restricted supply of gold has affected their employment. Due to quantitative restrictions, the Banks are supplying gold at an additional premium of almost 10% over the international price, making it very attractive commodity to smuggle into the country

Suggestion

All existing quantitative restrictions on imports of gold (including the present 20:80 scheme) for jewellery manufacturing should be reviewed as it has proven to be counter-productive for exports - caused a 45% de-growth resulting in loss of precious foreign exchange earnings.

## 2.8.2. Tenor of Gold Metal Loan (GML) facility to be increased

Background

In the last few months due to increasing CAD, Gold has been portrayed as the prime cause for it and a number of restrictions had been imposed on imports of gold into the country. The jewellery sector can help the government reduce the CAD and help stabilize the Indian Rupee

Suggestion

RBI should allow Banks to give Gold Metal Loans for jewellery manufacturers/retailers for upto 360 days period in order to improve the foreign exchange position of the country and also ensure the survival and growth of the workers ('karigars') who are losing their jobs because of the present restrictions by RBI. The benefit of 360 days tenor for Gold Metal Loan should be given both to the jewellery manufacturer in the domestic as well as the export sector.

Impact

By allowing Gold Metal Loans for a longer period, not only will the country get another source of foreign exchange, but also postpone the outflow of foreign exchange on the present imports of Gold. Gold Metal Loans lowers the cost of borrowing internationally, as it is available from International Banks at 2-3% p.a. as compared to 5-6% interest payable on ECB Borrowings. Smuggled gold is freely available in the Indian market at a significant discount (6%) over the 'official' domestic cost of Gold, resulting in not only a loss in revenue for the government but also the possibility of potential increase in illegal activities and other threats.

### 2.8.3. Customs duty on import of Bullion

Background

India had a relatively moderate import duty on Gold since liberalization of the sector in 1998 at 1% till 2012 because of which 'un-official/smuggling' of gold had been totally eliminated and all the inflow of gold had been through the official channels with payment of Customs Duty. Since January 2012, the Indian government has been facing a high Current Account Deficit (CAD) because of significant increase in import of Petroleum, Electronics along with the increase in international price of Gold. While the import of gold for the purpose of jewellery consumption has remained more or less constant at 500 – 550 tons during the last 5 years, it is the Investment demand for gold that has shot-up from a level of 130 tons to a level of 320 tons in the last 3-4 years. In order to curb the import of gold, a ten-fold increase in Custom's Duty is being levied on gold imports, from August 2013.

Impact

The landed cost of 'official' supply of Gold is about 20% above the international price resulting in a surge in smuggling of gold. As per the GFMS Reuter's Report, about 180 tons of gold has come into India through 'un-official' channels in 2013. The impact of this 'un-official' supply valued at about US$ 10 billion, is a loss in foreign exchange inflow of a similar amount and a loss in revenue of over US$ 1 billion on account of Customs Duty.

Suggestion

Import duty of Gold to be reduced in a phased manner as CAD has slowly been controlled and fiscal deficit is less than 4.9% which was budgeted by the government. The RBI should launch a more effective gold backed savings scheme and savings that hedge the investors from inflation so as to reduce the investment demand for gold.

### 2.8.4. Buyer Credit Period to be enhanced from 90 days to 365 days

Background

On the one hand, the Companies in the Diamond Sector have to pay the Mining Companies in advance for the entire supply of rough diamonds; apart from the credit period required for the manufacturing cycle, the Manufacturer also has to extend Credit facility to the Buyer of the Finished Goods.

Impact

The credit facility duration is not sufficient to cover for the polishing and sale of diamonds which exceed 90 days and usually take up to 365 days to receive the sale proceeds. In case of sale of diamond jewellery through the Manufacturers own retail outlets, the cycle again extends up to 545 days, exposing the buyer to severe working capital risks. Because of the actual Trade Cycle being longer than what is being finance through the Bank, the Capital requirements to sustain the business increases which is restricting further growth in Exports.

Suggestion

Buyer credit period to be enhanced from 90 to 365 days to allow the Manufacturer's in the Diamond Sector to increase their export sales of polished diamonds and get a better price realization.

### 2.8.5. CVD refund by refiners importing Gold Dore

The quantitative restriction on import of gold is also applied on import of Gold Dore (classified under CTH 7108 1200), the raw material imported for being refined in India. The quantitative restriction is termed as the 20:80 scheme, whereby 20% of the gold / gold content in Gold Dore must be delivered duty-free to exporters for manufacture and export of jewellery from India. Gold is imported direct into customs bonded warehouse without paying any duty. The 20% is de-bonded duty free and delivered to exporters, and duty is paid on the balance 80% when it is de-bonded for domestic sale.

Gold Dore import is under actual user import license issued by DGFT. The uniform application of the 20:80 scheme to Gold Dore imports overlooks that refining is under excise, and subject to following procedures:

i) Refiner clears Gold Dore against full payment of CVD @ 8%; the CVD component on the 20% delivered duty free to exporters is 8% x 20% =1.6%.

ii) The excise on balance 80% sold in the domestic market is @9%, i.e. 80% x 9% = 7.2%, which is the net revenue to Govt.

iii) Of the 1.6% CVD component on the duty free release, 0.8% gets adjusted against the excise payable, leaving a balance unadjusted 0.8% for which refiner has to claim a CVD refund.

iv) Excise regulations mandate that unadjusted CVD refund can only be claimed on a quarterly basis. The refund application is submitted one month after expiry of the preceding quarter, and takes on average two months for its processing and refund. Thus total time for refund is average six months. Its cost of funding is 0.8% x6/12 x 12% = 0.5%, apart from straining refiners' cash flow.

v) The above applies only to units located in the Domestic Tariff Area, who pay excise. Units located in excise-holiday zones do not suffer this pain.

For the duration that the 20:80 scheme is in force, and without any revenue loss to Government, following measures could be considered:

(a) For refiners operating in non-excise holiday zones only, the CVD on Gold Dore is reduced to 7.2%.

(b) the above is co-terminus with the 20:80 scheme, and expires automatically whenever the 20:80 scheme is done away with.

Refiners will no longer need to claim refund of the unadjusted 0.8% since the entire CVD paid gets adjusted against the excise payable on the quantity for domestic sale. The proposal is Government revenue neutral, applies only to refiners who are located in excise paying areas, and ceases automatically as and when Government decides to do away with the 20:80 scheme.

## HEALTHCARE, MEDICAL EQUIPMENTS AND DEVICES

## I - HEALTHCARE AND INSURANCE

### 2.9.1. Measures to Improve Healthcare of Citizens

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

- Increase budget share to the healthcare sector with greater provision for the National Rural Health Mission and National Urban Health Mission

- Plan for a Universal Screening Programme for the entire country, for age group (maybe 35 – 60 years) which is at risk. The Programme can be implemented in stages under a 10 to 15 year health target. Programme should include massive awareness campaign through print and electronic media in local language, capacity building for ASHA workers & Auxiliary Nurses/Midwives and screening programmes taken up in selected Blocks (Aadarsh Gaon) in stages.

- **Incentives for Voluntary Organ Donors**

  India needs to do 2,00,000 solid organ transplants each year to meet the recipient target, which is grossly undersupplied due to the shortage of donor pool. In order to incentivize and promote voluntary donors to meet the organ shortage, donors may be provided lifetime health coverage through insurance benefits through funding.

- **Compulsory Health Insurance for Employees**

  To promote Health insurance penetration in the country, it should be mandated that organizations insure every employee for a minimum amount of Rs.1 Lakh. The employer should be allowed tax deduction on the premium paid. Moreover, the employee should have the flexibility to increase this cover; the additional premium so paid should also be made tax exempt. This should be over and above the cover extended under the ESI, CGHS and other government health insurance schemes.

- **Health Insurance Coverage for Senior Citizens**

  Medical Insurance Premium for senior citizen should be subsidized or the limit increased to Rs.50,000 per annum.

### 2.9.2. Tax Incentives

- **Service Tax Exemption**

  - There is a pressing need to increase the safety net of health insurance in India. One measure that could help is withdrawal of service tax on health insurance premiums, thereby leading to a lowering of cost/premium for the consumer. Mediclaim insurance Premium may be exempted from levy of Service Tax.
  - All input services, in cancer treatment, should be considered for service tax exemption to reduce the cost of health care providers.
  - All Healthcare Education and Training services, especially life-saving ones, should be exempted from service tax.
  - CENVAT credit should be made eligible to be availed in respect of inputs for the Rashtriya Swasthya Beema Yojana (RSBY) policies to keep the cost of servicing these policies low.

- **Direct Taxes Relief**

  - The amount of tax deduction provided for preventive health check-ups introduced by the Finance Act, 2012 should be made over and above the provision of Rs. 15,000 towards the health insurance premium paid currently under section 80D of the Act.
  - Increase in Tax holiday from current five year to ten year time frame under section 80-IB for private healthcare providers in non-metros for minimum of 50 bedded hospitals instead of current 100 beds.
  - Income Tax/ MAT exemption for at least 15 years for domestically Manufactured Medical Technology products to promote “Make in India”.
  - To incentivize hospitals and diagnostic laboratories to undergo accreditation, there should be 100 % deduction on approved expenditure incurred for securing accreditation from National Accreditation Board for Hospitals and Healthcare Providers (NABH) and National Accreditation Board for Testing and Calibration of Laboratories (NABL) respectively.
  - To encourage move towards maintenance of Electronic Health Record (EHR), financial incentives/grants should be provided to willing institutions. 250% deduction on investment made for the implementation of EHR should be extended.
  - 250% deduction for approved expenditure incurred on operating technology enabled healthcare services like telemedicine, remote radiology etc. should be allowed for improving accessibility, affordability & quality healthcare in remote areas

- For an insurance company, claims expense includes reserve towards claim which is Incurred But Not Reported ("IBNR"). Currently, IBNR reserves are computed based on appointed actuary basis IRDA guidelines. Schedule 1 of Income Tax act is silent about admissibility of IBNR reserve as allowable expense. In the absence of any guidelines, there are instances wherein Tax authorities contest this expense. This reserve should be included as allowable expense.
- Healthcare sector should be exempt from Minimum Alternate Tax

## II - MEDICAL ELECTRONICS AND MEDICAL DEVICES

### 2.9.3. Encouraging Complete or Partial in-house Manufacturing

India is a very small manufacturing hub for Medical Equipment (~2% of the USD 66B Indian Healthcare Market). To provide cost effective healthcare in India, Government should encourage complete or partial in-house manufacturing set up. In this process the following benefits are expected to attract more investment:-

(i) 150% depreciation on infrastructure investment U/S 35 of IT Act

(ii) Exemption from Excise Duty on equipment manufactured or assembled in India, wherein the value of imported raw material content does not exceed 50% of complete equipment cost. In any case excise duty on medical equipment be reduced significantly and may be prescribed at the lowest slab to enable the domestic industry to find a foothold

(iii) Zero custom duty on all imported raw materials by manufacturers, wherein the imported raw material content is limited up to 50% of complete equipment cost

(iv) R&D Cess to be Cenvatable with Excise duty

### 2.9.4. Other tax incentives

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

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

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

### 2.9.5. Exemption for Medical / Dental / Surgical Equipment

(a) Nil Basic Customs Duty be specified for Medical Equipment, Medical or Surgical Implants, Medical Devices falling under headings 9018, 9019, 9020, 9022 and 9027.

(b) Blood Glucose Monitoring Strips of heading 3822, Medical, Surgical or Laboratory Sterilisers of heading 8419 and sterile surgical catgut and similar sterile suture materials and sterile tissue adhesives for wound closure of heading 3006 should also be exempted from customs duties.

(c) Medical products classifiable under headings 9018 to 9022 and parts and accessories thereof presently levied to 5% basic duty in terms of S.No. 474 of Notification No. 12/12-Cus dated 17.03.2012, be totally exempted from import duties. The exemption may also be extended to parts, accessories, consumables or assembly components, whether required for manufacturing or to be assembled at site of use. This will remove classification disputes and allow the industry to get the desired exemption. Specifically parts and components of hearing aids should be exempted from customs duties to provide a level playing field for domestic manufacturers.

(d) To ensure that the spare parts imported to be used for maintenance of critical care devices, are used for the same purpose, importer may be asked to furnish "End Use Certificate" within a period of 12 months. Procedure for Consumption Certificate for materials imported as per Customs Notification 21/2010 to be amended to read as "Importer to submit Self Declaration for having consumed the materials in the process of manufacture of Medical Equipment".

## 2.9.6. Other Customs Exemptions/Concessions

1. All medical devices used in critical care, consumables used with devices in the specific critical care treatment procedure and their spare parts should be exempted from Customs Duty. It is recommended that the following be included in the list of critical care products:-
   - Patient monitoring systems and image guidance systems
   - Pacemakers and their leads for cardiac therapy
   - External Defibrillators
   - NT and ENT Surgery Products including electrical/pneumatic drills and the consumables
   - Deep Brain Stimulation Implanters, drug pumps, leads used in neurosurgery etc.
   - Heart Lung Machine and Oxygenators, cannula, accessories used in vascular therapy and during cardiopulmonary
   - Heart valves, Annuloplasty Rings and various Cardiac catheters
   - Respirators and Masks (industrial and healthcare)
   - Dialysis Machines equipment, dialysis pump consumables and Devices (Hemo and Peritoneal Dialysis)
   - Peripheral Vascular Stents
   - Reveal Diagnostic devices
   - External loop recorders
2. The duty levied on spare parts of the Radiotherapy equipment (currently charged at 31%) be reduced to 11% at par with the rate for the main equipment.
3. Sterilizers of Heading 8419 20 90 which are presently levied to import duty at 25.85%, may be levied a reduced customs duty to 0-5%. Sterilisers are used for sterilizing medical devices such as implants, sutures etc. They play a critical role as critical care equipment
4. Topical Skin Adhesive of Heading 3006 10 10 which is presently levied to import duty at 19.567% may be given an exemption by levying custom duty in the range of 0-5%. These are used for wound closure, instead of conventional sutures.
5. Full Custom Duty waiver for essentially required radiopharmaceuticals used in Diagnostics like Imaging and Scanning (PET-and SPECT) and Therapy some of which are not manufactured in India like Iodine 131, MIBG 131, Lutetium 177, Yttrium 90, Ge-68-Ga 68 generator, Cold Kits for Tc 99m, Rubidium 82, Ir-192.
6. Cardiovascular, cancer and neurological surgeries involves Iodophor impregnated drapes (HS 3005) for prevention of wound infection and Fibrin sealants (HS 300620) for achieving immediate sealing of blood vessels which are critical for life of the patients. These products currently are levied duties under headings 3005 and 3006 at basic of 10% and a total import duty of 21.78%. It is submitted that these may be included in the critical care category (List 4) and subjected to concessional 5% basic duty and Nil CVD.
7. Medical grade PVC (Heading 3921 90 99) required for the manufacture of dialysis products, Dextrose Anhydrous USP, for use in manufacture of Intravenous fluids be levied custom duties in the range of 0-5%.
8. Power tools/ drills, surgical blades and burs used in various neurological, orthopaedic, spinal, by-pass surgery and other skeletal surgeries, Endoscopy Camera, accessories and parts should be levied custom duty in the range of 0-5%.

9. Integrated Operation Theatre (Consisting of Routers, Booms, Pendants, Lights, Monitors, Camera, and Connectors etc.) should be charged to a reduced duty of 5% basic and Nil CVD.

10. Low temperature Hydrogen Peroxide (2847.00.00) is used in sterilizing surgical instruments.

    This is non-carcinogenic to users and patients. Existing low temperature technologies (ethylene oxide) endanger patient and user health as they are proven human carcinogens. Thus Hydrogen Peroxide technology should be considered critical care and basic Custom duty and CVD should be brought to NIL. Effective duty is 17.96% (7.5% + 5% + 3% + 3% + 4%)

11. PDS plates (3920.69.99) - PDS plate is a scaffolding support for "nasal reconstructive surgery" especially used for Septoplasty and Rhinoplasty. Most of the cases wherein these plates will be used are the ones in which there are trauma cases and there is severe damage to the nasal cavity and septum. Effective duty of 26.85% makes it really unaffordable for the patients as it increases the basic surgery cost of nasal reconstruction. This product which can help a lot of patients recover from the trauma of nasal reconstructive surgery will only be accessible to a selected section of the society in case such heavy duty rates are imposed.

12. Customs duty on most of Diagnostic reagents is 28% except EIA, CLIA, HIV and HBsAG etc. Custom duty on high-end specialised testing like tumour marker, Molecular diagnostic product should be brought down to NIL to enable these tests to become more affordable to people.

## III - In-Vitro Diagnostics (IVD) Sector

### 2.9.7. Duty Exemption for Antigens / Antibodies used in Diagnostic Kits

The import of raw materials such as antigens/antibodies or any other ingredient corresponding to the manufacture of diagnostic test kits specified in list 4 put the local manufacturer at disadvantage in comparison to imported finished diagnostic test kit specified in list 4 which is imported at nil duty. The notification should therefore include: "Bulk drugs / antigens/antibodies (monoclonal / polyclonal) / raw materials / components used in the manufacture of critical care drugs / medicines including their salts and esters and diagnostic test kits".

- The following items which were a part of the now abolished List 37 need to be included in List 4 under notification No.12/2012-Customs, dated 17/03/2012 to allow for a level playing field for both Indian manufacturers and importers.
    - AIDS (Acquired Immune Deficiency Syndrome) test kits
    - T.P.H.A kits and AIDS diagnostic kits.
    - Rapid diagnostic kit for detecting infection with malaria parasite / Tuberculosis (TB)
    - Australia antigen/ HBsAg kit.
    - HCV (Hepatitis C Virus) by any technology.
    - Dengue detection systems/kits.
- Exemptions for components for Elisa Kits to be expanded: The list that provides the benefit of lower duty may be extended to include antigen or antibody on the solid phase for coating. The other key component is the enzyme conjugate and their stabilizing buffer / solutions. It is important to put the local ELISA kit manufacturers at par with the importers because all finished ELISA kits are imported at nil duty as per item no. 36 of List 4.
- Cases of duty rationalization: With abolishing of List 37, all diagnostic devices are now covered under Chapter 90 (9027). They therefore attract high duty rates and it is recommended that they be charged to NIL duty to encourage access to newer technologies. Further duty on manufacture or import of diagnostic reagents to be reduced to encourage manufacturing in India. That apart duty structure of following items should be rationalized:

- Excise duty for manufacturing of Diagnostics Reagents may be made NIL from existing 10% to allow cost benefit to indigenous manufacturer.
- Diagnostics Reagents may be subjected to same levels of duty as Medical Equipment/Devices under Chapter 9018 as against the existing rate of 26.75%
- Duty on PCR kits may be made NIL duty as given for ELISA, CLIA Diagnostics kits, etc. from existing 26.75% in order to quantify the load of deadly viruses/bacteria such as Hepatitis C, CMV, H1N1, TB, etc. in patients for subsequent treatment and monitoring
- All diagnostics equipments including Fully Automated Biochemical Analyzers may be assessed at NIL duty or with a total duty of 9.63% as sudden reversal and imposing duty of 14.72% makes the cost of these Hi Tech Instruments significantly expensive
- Customs duties for Diagnostics kits may be based on criticality of the test rather than the technology.

  Duty exemption be based on Test rather than Analyte for critical tests- Customs Tariff for Diagnostics kits is based on technology rather than the Analyte causing anomalies e.g.: ELISA &CLIA kits are exempt from customs duty whereas IFA (Immuno Florescence) and Bio-chemistry kits are liable for duty under heading 3822 dutiable @ 26.75%. It is recommended that duty exemption be based on Test rather than Analyte for the following critical tests:

  (a) Blood Banking Panel

  (b) HIV

  (c) HBSAG

  (d) HCV

  (e) Sepsis Marker

  (f) Procalcitonin (PCT)

  (g) Tests of Auto immune diseases (ANA and ds DNA)

  (h) Diabetes –Glucose, HbA1C, microalbumin, etc.

  (i) Cardiac – Triglycerides, Cholesterol, LDL, HDL, lipids, CRP, hs-CRP, etc.

  (j) Therapeutic Drug monitoring – Tacrolimus, Sirolimus, etc.

  (k) Kidney function tests –Creatinine, Total Protein, Albumin, Urea, Uric acid, etc.

  (l) Liver Function tests – Alkaline Phosphatase, Bilirubin, Gamma GTP, SGPT, SGOT, etc.

  (m) Electrolyte balance – Sodium, Potassium, Chloride, Calcium, Phosphorus, etc.

## IV - Life sciences

### 2.9.8. Service Tax on Clinical Trials of Drugs

Services of technical testing of newly developed drugs (i.e. clinical trials) were exempt from Service tax under Notification No. 25/2012-ST dated 20 June 2012. Under the Union Budget with effect from 11 July 2014, vide Notification No. 6/2014-ST dated 11 July 2014, the said exemption has been withdrawn. Consequent to this Services by way of technical testing or analysis of newly developed drugs, including vaccines and herbal remedies, on human participants by a Clinical Research Organisation (CRO) approved to conduct clinical trials by the Drug Controller General of India shall now be taxable

With this amendment, the CROs conducting clinical trials in India for foreign service recipients have been covered under Rule 4 of POPS Rules. Hence, such services shall attract Service tax in the hands of the CROs as a service provider. This change in law is a set back to the drug research in India as withdrawal of the Service tax exemption on clinical trials or technical testing of new drugs on humans could render the said services costlier. India could lose its competitive edge in the clinical trials global market. Countries such as Malaysia, Bangladesh and Singapore are emerging as new hubs for conducting trials which could hurt the prospects of Indian CROs. Levy of Service tax on said services would indirectly impact the cost of medicines also.

It is recommended that the Service tax exemption as presently available to the clinical trial services on newly developed drugs should continue. Alternatively, appropriate amendments should be made in the POPS Rules so that clinical trials conducted for foreign service recipients should qualify as export of service thereby not attracting Service tax in India for the Clinical Research Organisations (CROs) and also enable refund of Service tax on input services availed by the CROs.

### 2.9.9. Weighted deduction under Section 35(2AB) for computing book profits

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

### 2.9.10. Safe Harbour Rule for Contract Manufacturing

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

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

### 2.9.11. Clinical Trials - Weighted deduction under section 35(2AB)

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

## HOUSING AND REAL ESTATE

### 2.10.1. Deduction of interest paid on borrowed capital

Recently, the Finance Act (No 2), 2014 enhanced the deduction available under Section 24 to a maximum limit of Rs 2,00,000 for interest on loan taken for acquisition/ construction of self-occupied house property. It is recommended that this exemption should be harmonized with the rising interest rates and increased to at least Rs 3,00,000 per annum.

### 2.10.2. Tax treatment of Real Estate Investment Trusts (REITs)

A. Dividend Distribution Tax on distribution of income by SPVs

REITs may become highly inefficient if distribution of profits by Special Purpose Vehicle (SPV) is subject to Dividend Distribution Tax (DDT). It is recommended that DDT should be done away with on distribution of dividends by SPV to REITs.

B. TDS on distribution of income by business trust

Under the REITs regime, distribution of income of business trust to non-residents is subject to TDS @ 5% under Section 194LBA of the Act. Accordingly, in Section 195(1) of the Act, after the word “not being interest referred to in Section 194LD”, the words “or Section194LBA” should be inserted, with effect from the 1st October, 2014.

C. Capital gains on disposal on units of REITs by sponsor

Under the REITs regime, long term capital gains on the disposal of units by the sponsor is taxable which is unfair keeping in view that such long term capital gains are exempt under Section 10(38) of the Act in the hands of other unit holders. It is suggested that such disparity between Sponsor and other unit holders be dealt with to provide a level playing field.

## 2.10.3. Raise the limit for deduction for principal repayment

In the case of home loan repayments, the ceiling under tax benefits is capped at Rs 1,00,000 for principal paid. The ceiling of Rs 1,00,000 under Section 80C of the Act is less, particularly when home loan principal repayments are clubbed with other tax saving instruments. Therefore, the deduction for principal repayment of housing loan under Section 80C of the Act should be either increased from the existing limit of Rs 1,00,000 or the principal repayments considered for a separate / standalone tax exemption (rather been clubbed under Section 80C of the Act).

## 2.10.4. Infrastructure status to development of integrated townships

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

In the light of above facts and in order to motivate the genuine Real Estate Companies to come forward and step into promotion and development of large integrated townships in line with above arrangements to mitigate the huge shortage of housing to all class of society and development of robust infrastructure for the Indian economy, it is requested that Integrated township development projects be brought within the definition of infrastructure or at least various facilities such as roads, water supply system etc. created after obtaining Government approvals be considered as infrastructure facility for the purpose of Section 80-IA of the Act and deduction under Section 80-IA of the Act be granted to the developers in respect of such infrastructure development.

## 2.10.5. Deduction for Ground Rent

Deduction for ground rent should be restored while computing the income under the head 'House Property'. Considering the rising value of land and proportionate ground rent in metros and other big cities, it is recommended that the deduction for ground rent be separately provided i.e. in addition to the overall statutory deduction of 30% available within the ambit and scope of Section 24 of the Act.

**INFRASTRUCTURE**

## 2.11.1. Amendment of Section 80-IA regarding upgrading existing infrastructure

Infrastructure development is a pre requisite for the growth and development of any country. Infrastructure development is available in two ways i.e. to build altogether new infrastructure or to convert the existing structure by upgrading it and also enhancing the existing capacity. Both activities entail huge investment and human efforts.

It is recommended that a suitable amendment may be made in the Act to clarify that the up-gradation/extension of the existing infrastructure facility would also be eligible for the benefit of Section 80-IA of the Act.

### 2.11.2. MAT on infrastructure companies

Infrastructure Industry in India has been experiencing a rapid growth with the development of urbanization and increasing involvement of foreign investments. Government has offered various tax incentives under Section 80-IA of the Act to the infrastructure companies to boost infrastructure. The benefit available to the infrastructure companies under the normal provision of the Act get neutralized since the companies are required to pay MAT on their book profit.

To attract more and more investment in infrastructure sector, MAT on infrastructure companies should be abolished.

### 2.11.3. Restoration of exemption under Section 10(23G)

Section 10(23G) of the Act provided for tax exemption in respect of any income by way of dividends other than dividends referred to in Section 115-O of the Act, interest or long-term capital gains of an infrastructure capital fund or an infrastructure capital company or a cooperative bank from investments made on or after 1st June 1998 by way of shares or long-term finance in approved eligible businesses including infrastructure projects, developers of SEZs, hotel projects of not less than three star category, hospital projects with at least one hundred beds for patients and certain housing projects. The above exemption played a significant role in attracting investment towards development of infrastructure projects in India. However, this exemption was withdrawn by the Finance Act, 2006.

In view of the increasing need for huge investments in infrastructure and other vital projects and to ensure low cost of raising capital for such thrust project areas, it is recommended to restore the aforesaid exemption.

## MEDIA AND ENTERTAINMENT INDUSTRY

### 2.12.1. Overview

The Indian media and entertainment industry grew from INR 821 billion in 2012 to INR 918 billion in 2013, registering an overall growth of 11.8 percent. Given the impetus introduced by digitization, continued growth of regional media, strength in the film sector and fast increasing new media businesses, the industry is estimated to achieve a growth rate of 15.3 percent in 2014 to touch INR 1059 billion. The sector is projected to grow at a healthy CAGR of 14.2 percent to reach INR 1786 billion by 2018.

Television clearly continues to be the dominant segment, however we have seen strong growth posted by new media sectors, gaming and digital advertising recorded a strong growth of 25.5 percent and 38.7 percent compared to the previous year, however, Music sector has shown a decreasing growth (-9.9 percent growth in 2013 over 2012 vs. 18 percent growth in 2012 over 2011) on the back of strong content and the benefits of digitization.

Radio is anticipated to see a spurt in growth post rollout of Phase 3 licensing. The benefits of Phase 1 cable digital access system (DAS) rollout, and continued Phase 2 rollout are expected to contribute significantly to strong continued growth in the TV sector revenues and its ability to invest in and monetize content. The sector is expected to grow at a CAGR of 18.1 percent over the period 2013-2018.

## I - TELEVISION BROADCASTING

### 2.12.2. Deduction of tax at source under Section 194H on the “15% agency commission”

One of the main sources of income of Television Broadcasting Companies ('Broadcasters') is through sale of advertisement airtime. Broadcasters sell advertisement airtime either to Advertisement agency or Advertisers. Below is the flow of advertisement air time sale transaction:

- Advertisers appoints Advertisement agency for providing various services in respect to any ad campaign including procurement of air time from broadcasters to telecast the advertisements on the television channel.

- Advertisement agency procures air time on television channels, on behalf of advertisers, from Broadcasters.
- Transaction between Advertisement agency and Broadcasters is on principal to principal basis.
- Post entering into a contract with Broadcasters, Advertisement agency releases order confirming the advertisement airtime purchase.
- Broadcasters telecast the advertisement as per the instruction of Advertisement agency and raise invoice for sale of ad airtime.
- Broadcasters mention "15% agency commission" on the invoice raised by it, which is an age old industry and customary practice.
- Advertisement agency makes the payment to Broadcasters of the invoice raised, after deducting appropriate taxes on net amount of invoice (i.e. after reducing the 15% agency commission).
- Advertisement agency in turn raises the invoice on advertisers for recovering the cost of airtime plus their own service charges.
- Advertisers make payment to Advertisement agency after deduction of appropriate taxes on the entire invoice raised by Advertisement agency including on cost of airtime.
- The two transaction namely between Broadcasters and Advertisement agency and Advertisement agency and Advertisers are separate and distinct.

Further, "15% Agency commission" mentioned by Broadcasters in its invoices for ad airtime sale raised on Advertisement Agency/Advertisers is merely a presentation in the invoices and not a real transaction. Neither the Broadcasters nor Advertisement agency recognizes the same as revenue/expense. It is customary in nature, as is also evident from the fact that even on the invoices raised directly on advertisers; the said "15% agency commission" is appearing.

Further, Broadcasters are not supposed to make any payments towards "15% agency commission" mentioned in the invoice, as there is no agreement or arrangement to pay such 15% agency commission with Advertisement agency/ Advertisers. In fact, Broadcasters do not make any payment to Advertisement agency/Advertisers in respect of the said "15% agency commission" mentioned on the invoices.

Considering the nature of the transaction, FICCI recommends a clarification/ instruction, that no taxes need to be deducted at source by the Broadcasters on the "15% agency commission" as mentioned in the invoice raised by Broadcasters to Advertisement agency/ Advertisers, should be issued.

### 2.12.3. Withholding tax on royalty/ fees for technical services (FTS) payable to non-residents

The Finance Act 2013 has increased the withholding tax rate on royalty/ fees for technical services (FTS) payable to non-residents from 10% to 25% (excluding surcharge and cess). While introducing this provision, one of the major concerns express by the Government was repatriation of profits by the Indian tax payers to their parent company by way of royalty and FTS. However, the said transaction is presently anyway subject to "Arm's Length Test" under the transfer pricing regulations.

The ground reality is that in cross-border agreements, more often than not, payment of consideration to the non-residents is net of any taxes. In other words, the Indian companies have to bear the taxes in connection with the payment of royalty/ FTS which would go up to 37% under the Act. Therefore, this could be an additional cost for the Indian companies and adversely impacts the cost competitiveness of the Indian companies and thereby its profitability. Further, most DTAA's entered into by India barring a few, have a royalty/ FTS withholding tax rate of 10% or 15%.

Given the intention, FICCI recommends that the rate of tax on royalty/ FTS should have been increased only towards parent-subsidiary transactions and the brunt of higher rate should not have been imposed on the other third party transactions (i.e. the third party transactions could be chargeable to tax at the rate of 10%/ 15%). Further the increase in rate should be limited to tax suffered in dividend distribution transaction, that is, 15%.

### 2.12.4. Parity with Manufacturing Industry under section 72 A

The disparity between the service and the manufacturing sector is very adversely affecting the growth and consolidation of Service sector.

The tax benefits under Section 72A of the Income-tax Act, 1961 in respect of amalgamation or demerger (Carry forward and set off of accumulated loss and unabsorbed depreciation allowances) are currently limited to industrial undertakings or a ship, hotel, aircraft or banking. The definition of industrial undertaking should be widened to include service industry, broadcasters and content production companies.

FICCI recommends that Section 72A should be amended to extend the benefit applicable under the provision to all segments of economy irrespective of their line of operations.

### 2.12.5. Rationalization of Indirect taxes:

The rate of taxes which range from 30% to 70%, especially the entertainment tax imposed by the states, over and above the service tax, are punitive in nature. State Entertainment tax legislations levy high taxes on the subscription earned by cable operators and DTH Operators. The non-availability of credit of central taxes against the state taxes and vice versa increases the tax burden on the entertainment industry. In addition to this, the Central Government has levied service tax at 12.36% on the transfer of copyrights which is already being taxed as 'goods' under the various state VAT legislations. Such punitive level of taxation incentivizes unhealthy practices, such as piracy, revenue leakage on account of under reporting of revenues, etc. It is important that the overall taxation level is brought down for the sector as a whole.

Exclusion of the entertainment tax Levied by the local bodies from the GST purview would result in the back door entry of Entertainment tax and shall be contrary to the basic philosophy and objectives of the GST reform and significantly undermine its benefits. Continuing with entertainment tax under GST shall also perpetuate the complexity and anomalies that arise in the current indirect tax regime and hence a supplementary tax on entertainment is unwarranted.

FICCI recommends that the Central Government, along with State governments, needs to rationalize the tax regime for the entertainment sector. It is our sincere request to consider the continuation of subsuming the Entertainment Taxes applied by State Governments under one comprehensive GST levy, as originally proposed.

## II - RADIO BROADCASTING

### 2.12.6. Tax Exemptions for Radio Broadcasting

Government should consider the following suggestions:

- Phase III of Digitization: Provide tax holiday of 5 years for new capital investment in Phase III.
- Custom Duty: Reduce customs duty on capital equipment for Radio broadcasting to 4%.
- Service tax exemption for billings to service recipients covered in the negative list

Entities covered by the negative list are not subject to levy of service tax on services provided by them. However, services provided to them are subject to service tax if the service provider does not qualify under the negative list. To avoid the cascading impact of taxes and also rationalize the tax provisions, exemption from levy of service tax should be provided for services rendered to entities that are covered by the negative list.

## III - FILM SECTOR

### 2.12.7. Service tax exemption on services of performing artists

Temporary transfer of copyrights in cinematographic films (for theatrical distribution) is exempted from service tax under the negative list based service tax legislation. With such service tax exemption on transfer of specified Copyrights, major revenue of the film producer is exempted from the payment of service tax. Thus, the service tax charged to producers cannot be passed on to other participants of the supply chain. With the introduction of the negative list regime, almost all services availed by the producer are liable to service tax and hence, all vendors will recover service tax from the producer. However, with the reduced output service tax liability, the tax chain is broken and the service tax credit is blocked with producers/ distributors thereby creating cascading impact. As a result, the amount of service tax charged to the producers becomes an additional cost to the producer impacting their profitability and sustainability.

The film industry in India already suffers from very high rate of indirect taxes in India. Additionally, in the light of the fact that the roll-out of Goods and Service Tax ('GST') is expected to be only in 2016 and not 2015, it is essential that a relief be given to the Industry, by way of withdrawal of service tax on services of performing artistes which acts as a major cost of production. So, FICCI recommends the authorities to exempt services of performing artists in films from service tax.

### 2.12.8. Exemption of service tax on Digital Cinema services

The CBEC vide notification 12/2007 ST dated 1 March 2007 had exempted the services provided by a digital cinema service distributor from the purview of service tax. However, with the introduction of the negative list based service tax legislation, the above mentioned notification has been rescinded. This has resulted in an additional burden of service tax on the film producers on top of piracy plaguing the Industry.

FICCI recommends that the exemption from service tax on services provided by a digital cinema service provider be restored.

### 2.12.9. Withholding tax on Royalty and fee for technical services

Tax on royalty and fees for technical services earned by non-resident taxpayers has been increased from 10% to 25% in the cases where India does not have a Double Tax Avoidance Agreement ('Treaty') with the country of service provider. This withholding tax rate has a significant impact on payments to be made for acquisition of content. There is a direct impact on companies distributing foreign films in India and Indian films distributed outside India with non-residents with no treaty jurisdictions such as Croatia, Fiji, Monaco etc. While the withholding rate for transactions with major treaty nations such as UK and USA is in the range of 10% to 15%, the rate of 25% is punitive for the same transactions which do not originate from treaty nations.

FICCI recommends eliminating the differentiation for the transactions with entities in nations having treaties and other entities.

### 2.12.10. Export benefits to post production services under service tax legislation

One of the activities of the Film Industry is providing post production services such as editing, dubbing, title printing, imparting special effects, processing etc. In light of the various technological advances in the Indian Film Industry, many entities are hired by foreign producers for carrying out such post production activity. In such a scenario, the content is temporarily imported into India (either physically or electronically) for carrying out the post production activity. On completion of such activity the completed content is re-exported for use outside India (either physically or electronically).

In accordance with the Place of Provision of Service Rules, 2012, when the services are performed on certain goods, the location of such provision is the Place of Provision of Service. However, as per the second proviso to Rule 4 (a) of POPS Rules, the Place of Provision for services provided in respect of goods which are temporarily imported in India for repairs, reconditioning or re-engineering for re-export shall be the location of the service recipient and not the location where the services are provided.

In this regard, it is our recommendation to amend the second proviso to Rule 4(a) of the POPS Rules by replacing the proviso to provide the service tax export benefit to post production activities.

### 2.12.11. Reversal of Cenvat credit under Rule 6(3) for any film content distributor

Temporary transfer of copyrights in cinematographic films for theatrical distribution is currently exempt from service tax; while the licensing of other rights stays exigible to service tax. The film distributors are required to reverse proportionate CENVAT credit under rule 6(3) of CENVAT credit Rules, 2004 - in the ratio of their exempted turnover to the total turnover. Due to ambiguity in the rules, tax authorities insist for a proportionate reversal of all Cenvat credit availed during the period including input services like purchase for non-theatrical rights, which are used exclusively for providing taxable services. This is not fair to the industry because Reversal of Credit under rule 6(3) was inserted to reverse proportionate Cenvat credit used for providing both exempted services and taxable services.

It is recommended by FICCI that a clarificatory Circular should be issued that reversal under rule 6(3) is applicable only on common input services used for providing both taxable and exempted service. It should further clarify that services exclusively used for providing taxable services need not be subject to any reversal under rule 6(3).

In case this is not possible, the Government should consider at least limiting the quantum of reversal of such input services which are exclusively used to provide taxable services to not exceed the very amount of such credit availed.

Justification for this is that reversal under Rule 6(3) is additional cost to the distributor impacting their profitability and sustainability. If reversal to be made on input services exclusively used for taxable service, the distributor will be at additional loss. Also in the changed business scenario, where distributors are purchasing only theatrical rights of the movies, the proportionate reversal under rule 6(3) are higher as such revenues form part of denominator for 6(3) reversal. It is further mentioned that distributor are not availing any input service credit used exclusively for exempted service i.e. theatrical distribution.

Currently, in a Rule 6(3) Scenario, authorities insist for reversing CENVAT credit on such input services used exclusively for providing a taxable output service, wherein in some cases, the quantum to be reversed as worked out by the formula in Rule 6(3) exceeds the total of such credit availed in the first place.

### 2.12.12. Reversal of CENVAT Credit for non-realisation of export proceeds

Rule 6(7) of the CENVAT Credit Rules, 2004 mandates the exporter of service to reverse CENVAT Credit pertaining to such output service which has been exported, but the convertible foreign exchange has not been received within a year from the extension time allowed by the Reserve Bank of India

In case of films, where multiple rights are being licensed out like music rights, television rights, home video rights, in-flight rights etc. which happen over a cycle of years from the date of release of the film in theatres. For the same input service that has been received once, the output service is rendered over various years with various considerations – fixed and variable. It is not hence quantifiable as to how much of input credit is attributable to one right exported and foreign exchange not received within the allowed time.

Considering the peculiarity of this nature in licensing of copyrights, it is recommended that the Government should bring a specific rule to address this type of a situation, providing that the service provider in such cases shall suffice to pay 6% of the export value not so received.

The Government should clarify that the above shall, be irrespective of what option such a distributor has opted for under Rule 6 of the CENVAT Credit Rules, 2004.

Justification is that it would be unfair to require the entire one time input credit which is attributable to so many streams of revenue on which service tax has been either fully already paid or is duly exported and consideration received in time, just because for one of such streams of revenue the foreign currency receipt has not happened within the time allowed.

Hence to address the peculiar situation, the Government should bring a specific rule that a 6% reversal of such unrealized monies would suffice compliance.

## 2.12.13. Low density of cinema theatres

There has been an increase in piracy, since the number of screens for viewing films has not increased in proportion to the increase in number of films and the number of people viewing these films. It is essential to extend benefit to cinema owners in terms of 80-IB benefit available in the IT Act to multiplexes constructed after March 2005 to encourage the set-up of multiplexes and thereby improve the density of cinema houses in the country.

In order to encourage the set-up of multiplexes in the country, FICCI recommends that the benefit under section 80-IB of Income Tax Act, 1961 ('IT Act') should be extended to multiplexes set-up after March 2005 as well.

## 2.12.14. Reduction of prescribed time limit under Rule 9A and 9B

As per Rule 9A of the Income Tax Rules, if a film producer sells all rights of exhibition of his feature film, the entire cost of production is allowed as a deduction in computing the profits and gains of such previous year. However, if the film producer does not sell all rights of exhibition of his feature film, the following two scenarios arise in terms of deduction of cost of production:

Scenario 1: Feature Film is released for exhibition on a commercial basis at least 90 days before end of the financial year. In this scenario, the film producer is eligible to claim deduction of the entire cost of production; or

Scenario 2: Feature Film is released for exhibition on a commercial basis within a period 90 days before end of the financial year. In this scenario, the film producer is eligible to claim deduction of cost of production only upto a ceiling limit and any excess cost of production is carried forward to the next financial year. This ceiling limit is the amount of revenues generated by the feature film in the financial year.

In certain cases where not all rights of exhibition of a feature film are sold and it is released for exhibition on a commercial basis within 90 days before end of the financial year, the feature film performs poorly and it is exhibited only for a short duration. Consequently, the film producer may not recover costs. In such cases in view of the prevailing IT Rules, the film producers are unable to claim a deduction of entire production cost and, the loss is to be carried forward to the next financial year. Accordingly, such film producers are unable to claim losses in the year the feature film is released for exhibition despite no further scope of income. A similar situation exists in the case of expenditure of distribution rights in view of Rule 9B of IT Rules.

FICCI suggests that the existing period of 90 days before end of the financial year (under Rule 9A and 9B of IT Rules) is suitably reduced to grant relief to assessees whose feature films have incurred losses and have been released for exhibition in the last quarter of the financial year.

## 2.12.15. Requirement of filing Form 52A before release of the movie

Under the provisions of the Act, a person carrying on production of cinematographic film shall file Form 52A i.e. statement containing particulars of all payments over Rs. 50,000 with the jurisdictional tax officer within 30 days from the end of the FY or completion of production of film, whichever is earlier. It is suggested that the Section be modified to cover only cash payments above a certain threshold limit (similar to provisions under Section 40A(3) of the Act). All payments made through proper banking channels be excluded from the purview of this Section to reduce the compliance requirements to be adhered by the producers of cinematographic films.

# IV - ANIMATION, VFX & GAMING (AVG) INDUSTRY

## 2.12.16. Proposals for Animation, Gaming and VFX Industry

For Animation, Gaming & VFX Industry the following suggestions are for consideration:

- 10 Years Tax Holiday for Animation, Gaming, and Visual Effects Industry.
- Lifting of service tax on studios developing original content.

- Removal of withholding tax: There should be removal of withholding tax on revenues accruing from sales of mobile games in non-India markets as well as removal of withholding tax on the development contracts given to mobile game developers outside India. Also, there should be removal of withholding tax paid by expats working in India for Indian mobile game development companies
- Market Development Assistance: There should be a provision of 50% reimbursable MDA (Market Development Assistance) for travel and registration fees to international market events. Government to extend support under Market Development Assistance (MDA) activity for Indian companies to exhibit by setting Indian Pavilions in the world markets. What is needed is to help bringing local production companies to international markets, collect and disseminate information and support creating the infrastructure needed for a healthy media market to develop.
- Excise duty reduction: To promote domestic gaming market, excise Duty on local manufacture should be brought down to nil (similar to film and music industry). This will enable CVD to be brought to zero also. The effective reduction in taxes would be around 15%. Import duty on consoles (Gaming hardware) to be brought down to 0% to increase the installed base to enable the local developer ecosystem to flourish.
- Animation as one of the priority sectors: Directions should be given to commercial bankers to treat Animation sector on priority and to offer concessional rate of credit.
- Encouragement for the exploitation of self-developed content in the overseas market: Encouragement should be given to entities through reduced tax rates/incentives for exploitation of self-developed content in overseas markets. Exemptions should be granted to overseas payments to foreign artists stationed overseas from withholding taxes.
- Minimum Alternate Tax: The Minimum Alternate Tax (MAT) applicability for units undertaking Animation work in SEZ should be withdrawn to encourage export of animated contents.

## MICRO, SMALL AND MEDIUM ENTERPRISES

### 2.13.1. Capital Gains Tax on one time settlement

When micro and small units settle their loan account with a Bank or Financial Institution through One Time Settlement ("OTS") facility, a substantial amount is waived for interest as well as principal amount in a particular FY. But through this process, such borrowers are subject to capital gains/ income (due to reduction of liability) in their Balance Sheet which is quite unbearable in most of the cases.

It is suggested that in order to enable them to come out of the debt trap, such reduction of liability should not be treated as capital gains/ income and should be kept out of the purview of any tax to avoid any financial burden.

### 2.13.2. Payment of Service Tax by MSMEs on Realization of Proceeds

As per the Point of Taxation Rules, the Point of Taxation shall be the time when the invoice for the service provided is issued. These provisions are adversely affecting units in the MSME sector since in many cases especially manufacturing and auto component industry, payments are received after 60 days in the normal course and sometime after 90 days of the issue of invoice. Any tax which is paid to the Government is from the resources of the MSME unit itself. Given that the finances of MSME units are already stretched they find this a huge strain on their business since liquidity is an issue and MSME units operate on very tight margins.

It is requested that a special relaxation for payment of service tax for MSMEs may be provided so that they do not have to pay taxes in advance from their resources but the payment is affected on realization of their dues from the buyers.

### 2.13.3. Service Tax for Rentals on Immovable Property for Units in MSME Sector

Rental on immovable property, used for industrial purpose for manufacturing activities by micro and small sector, casts a huge burden on the units in the MSME Sector. Large manufacturing units do not experience the burden of the Service tax on rent as they are eligible to claim CENVAT of the tax paid. MSME units are not able to set off the burden of the service tax paid on rent as most of them are not required to pay excise duty, their value of clearances being within the exemption limit.

It may appear that service tax is payable only if the annual rent is Rs 10 lakhs or more. Fact is that small units may be taking a part of premises on rent for Rs.5,000 per month but the owner may be liable to pay service tax because his total rental income from the premises crosses the exemption limit of Rs. 10 Lakhs.

MSMEs who take premises on rent mostly are beginners or young entrepreneurs who don't have finances to start their new enterprise in their own premises. They put all their available resources and energy to risk in starting a new enterprise. Micro & Small Sectors should be exempted from the purview of Service Tax for rental for their office / factory / warehouse premises for their own use.

### 2.13.4. Service Tax waiver under the National Manufacturing Competitiveness Programme

Government has announced formulation of National Manufacturing Competitiveness Programme (NMCP) in 2005 with an objective to support the Small and Medium Enterprises (SMEs) in their endeavour to become competitive and adjust the competitive pressure caused by liberalization and moderation of tariff rates. Schemes have been drawn up including schemes for promotion of ICT, mini tool room, design clinics and marketing support for SMEs. Following schemes have been launched by the Development Commissioner, MSMEs:-

i) Marketing Support/Assistance to MSMEs (Bar Code)

ii) Support for Entrepreneurial and Managerial Development of SMEs through Incubators

iii) Enabling Manufacturing Sector to be competitive through Quality Management Standard & Quality Tech. Tools (QMS/QTT)

iv) Building Awareness on Intellectual Property Rights (IPR) for MSME

v) Lean Manufacturing Competitiveness Scheme for MSMEs

vi) Design Clinic Scheme for design expertise to MSMEs Manufacturing sector (DESIGN)

vii) Marketing Assistance & Technology Up-gradation Scheme in MSMEs

viii) Technology and Quality Upgradation Support to MSMEs

ix) Promotion of ICT in Indian Manufacturing Sector (ICT)

Implementation of the Schemes is on the PPP model, and a part of financing is provided by the Government. It has, however, been reported that the consultancies provided under the aforesaid schemes in the form of training etc. are liable to pay service tax. It is suggested that since a large part of the finances for the consultancies is borne by the Government in the form of subsidy, these activities merit exemption from the levy of service tax.

## NON-FERROUS METALS

## I – COPPER

### 2.14.1. Exemption from the levy of import duty on Copper Concentrate

Copper is a critical input for various industries. The critical raw material for this industry, i.e. copper concentrate, is available very scarcely in India, making it imperative for the country to import either refined copper or copper concentrate. Given the structural constraint of non-availability of copper concentrate, Indian producers set up custom copper smelters (similar to the business models of China, Japan and Korea) based on imported concentrate. Nearly 96% of the requirement for copper concentrates is met through imports.

The customised copper smelters operate on a conversion business model with very thin margins. Copper prices on London Metals Exchange (LME) are a pass-through for the industry since they also import concentrate at ruling LME prices less the internationally negotiated Treatment and Refining Charges (TCRC). In recent years, TCRCs have faced a downward pressure due to: (a) Delays in implementation of mining projects after the financial meltdown, (b) Falling copper ore grades across the world and (c) Increased requirement for concentrates from emerging markets, especially China. Annual contract TCRCs have dropped from $535/ton in 2006 to $401/ton in 2013. The sharp reduction in TCRCs – the key value driver of the industry – along with the continued cost pressures, have affected the viability of the copper smelting industry. Over the years, the duty differential between refined copper and copper concentrate has been compressed from 30% at the turn of the century to just 2.5%. This tiny differential, in a conversion business where TCRCs are less than 5% of the turnover, is hardly adequate.

To sustain the viability of the smelting model in Indian refined copper industry, it is recommended that copper concentrate (CH 2603) be exempted from basic customs duty.

### 2.14.2. Increase in Customs Duty on Copper products from 5% to 10%

Indian primary copper producers had set up global-scale capacities to maintain their cost competitiveness with state-of-the-art technology. However, this resulted in Indian refined copper capacity (close to a million tonnes) that is significantly higher than the domestic market size (nearly 0.6 million tonnes). Despite such excess capacity in India, imports of refined copper products are steadily going up. Imports have zoomed from around 77,000 tonnes in 2008-09 to over 205,000 tonnes in 2013-14 – at a CAGR of over 26%. This is eroding the market size available for the domestic players.

In view of the rising imports and considering the excess capacity in Indian refined copper industry, it is recommended that the basic customs duty on copper products (Chapter 74) be increased from 5% at present to 10%.

### 2.14.3. Amendment to notification exempting Copper Concentrate

In the Union Budget 2011-12, Government had exempted gold and silver content in imported copper concentrate (CH 2603) from basic customs duty to encourage production of precious metals through the copper concentrate route (Notification No. 24/2011-Customs dated 1.3.2011). While this was a welcome move, the exemption is subject to the condition that the importer produces an assay certificate from the mining company specifying separately, the value of gold and silver content in such copper concentrate. In this context, it is pointed out that a significant quantity of copper concentrate is procured from traders or from trading companies of the miners. This trade route has been inadvertently left out of the notification – which needs to be corrected.

It is therefore, recommended that the notification be amended so as to make the assay certificate from the supplier of concentrate as an adequate condition rather than assay certificate from the mining company.

## II – ALUMINIUM

### 2.14.4. Inclusion of Aluminium Ingots under Interest Subvention Scheme

In order to encourage exports, Government has widened the Interest Subvention Scheme by including 134 engineering products vide a circular dated 14.01.2013 issued by RBI. While this list includes Aluminium wire rods and Aluminium sheets, it does not include the primary product, i.e. Aluminium Ingots (HS 7601). Exports of aluminium ingots from India have been nearly stagnant over the last three years at around 200 tonnes per year. These exports may get some leverage if ingots are included under the above scheme. It is, therefore, recommended that Aluminium Ingots (HS 7601) be included under the Interest Subvention Scheme.

### 2.14.5. Imposition of Export Duty on Alumina

About 85% of total alumina exports from India in 2013 were destined for Middle East countries. At the same time there is a huge import of aluminium by India from Middle East. This means that the Indian companies are helping Middle East smelters run and export back value added product to India. In India, Aluminium smelters of 1.5 million tons capacity are ready but have not been commissioned due to non-availability of alumina. In case the indigenous requirement of alumina is fulfilled from domestic sources (instead of exporting the same to Middle East), India will be able to export aluminium which will fetch more value. This will also save outflow of foreign exchange and reduce load on infrastructure. It is accordingly suggested that export duty of 5% be Imposed on export of alumina.

### 2.14.6. Increase in Basic Customs Duty on Aluminium Products from 5% to 10%

Indian Aluminium industry has seen a huge surge in imports in recent years. The threat of imports is primarily from two locations: Middle East and China. Both these locations have a huge capacity overhang. Further the cost of production for smelters in the Middle East is, typically, $400-500/t lower than that of Indian smelters.

The consumption of aluminium in India is expected to grow at 11-12% CAGR over the next decade. To cater to such huge demand potential, Indian primary aluminium industry has announced ambitious growth plans involving massive capital outlay for increasing the capacity from 1.6 million TPA at present to 5 million TPA by 2020. The rising imports are, however, endangering the very basis of these large investments and their viability. The share of domestic producer has also gone down from 60% in FY11 to 48% in FY14

The surge in imports is happening at a time when the industry has been already squeezed by subdued realizations and incessant increase in cost of production. Nearly 40% of the cost of production of aluminium comprises energy inputs, while another 15% relates to crude derivatives. Energy prices have seen rigidity in the recent years, because of the geo-political concerns. In India, there has been an additional adversity in terms of rising coal prices. In the last three years, the wholesale price index (WPI) for thermal coal has nearly doubled.

With such adversities it is recommended that the import of aluminium products into India should be controlled by increasing the basic customs duty on aluminium products of headings 76.01, 76.03 to 76.07 from 5% to 10%.

### 2.14.7. Bringing Customs duty on Aluminium Scrap at par with the duty on the metal products

For all base metals other than Aluminium, import duty on scrap in India is the same as the duty on the metal. It is only in case of Aluminium that the duty on scrap is 2.5%, while duty on aluminium products is at 5%. In most of the Aluminium downstream products, scrap and primary aluminium can be used almost interchangeably. The differential duty structure seems to be, therefore, leading to a substitution of primary aluminium by scrap – reflected in a sharp rise in imports of scrap (CH 7602). Between FY09 and FY14, import of aluminium waste and scrap has increased at a CAGR of 36%. Scrap imports are causing an immense harm to the Indian aluminium industry due to market diversion.

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

## III – ZINC AND LEAD

### 2.14.8. Increase in Basic Custom duty on Zinc and Lead Ingots, Alloys, Scrap etc.

Heavy investments have been made by domestic industry in non-ferrous metal sector, but low domestic demand is leading to excess supplies. Despite the availability of metals in the country imports are increasing in the market. In April 2014 -June 2014, the zinc import volume surged by 77% over the same period in previous year. The import trend of lead has recorded a 43% increase from last year. Import volume of Zinc alloys has doubled compared to previous year. Import of Zinc scrap has significantly increased by more than 130% since FY2010-11, and rendered the manufacture of high quality downstream products of Zinc uncompetitive.

Quality of zinc/lead produced by Indian industry compares with the best in the world and there is no incentive for domestic consumers (of zinc/lead) to go in for imports except for the cheaper price of material. Cheaper imports under Free trade agreements like from South Korea under India – Korea CEPA trade agreement where import duties on zinc, lead and value added products like alloys are now nil, result in oversupply in market and disturb balance of trade. Production capacity is underutilized resulting in loss of jobs especially in SME sector of alloying sector. Likewise cheaper imports of Zinc Oxide, is a great cause of concern for the domestic downstream industry.

It is recommended that basic Custom duty on Zinc Ingots (HS code 790111, 790112), Lead Ingots (HS code 780110), Zinc Alloys (HS code 790120), Zinc scrap (HS code 790200) and Lead Scrap (HS code 780200), may be increased from existing 5% to 7.5% and on Zinc oxide (HS code 281700) from existing 7.5% to 10%

### 2.14.9. Customs duty on Lead concentrates

Limited availability of ore in country and restrictions on new mining are leading to shortage of lead ore and concentrates and idle capacity. High import duties on concentrate make production of lead ingots costlier and face stiff competition from international players both in the domestic as well as international market.

It is suggested that basic Customs duty on Lead concentrates (HS code 260700), be reduced from 2.5% to Nil

## OIL AND GAS

### 2.15.1. Refund of Service Tax on Services Consumed in Exploration & Production of Oil and Gas

In order to ensure energy security for the economy, the Government of India has accorded high priority to the prospecting for and extraction, production of crude, Petroleum oil and Natural gas by formulation of the NELP. The Government has committed itself to exempt from taxation, the activities undertaken under NELP in order to ensure that the entire expenditure incurred by the successful bidders goes towards exploration and production not towards funding Government taxes.

In line with the said commitment, the Government has issued appropriate exemption notifications under Customs exempting specified goods imported for petroleum operations. Similarly goods which could be imported at 'nil' rates of customs duty for petroleum operations could also be purchased from indigenous manufacturers through international competitive bidding, at 'nil' rates of excise duty. The Indigenous manufacturer supplying the said goods against ICB is entitled to full credit of CENVAT on inputs used in relation to the manufacture of the said goods supplied against ICB for petroleum operations. Thus, there are no stranded taxes both in the case of imported and indigenous goods used in Petroleum operations.

However the current policy of the Government subjecting the services consumed by the said Exploration and Production (E&P) entities to service tax, drains away a substantial part of the funds committed for exploration, thus reducing the funds available for actually carrying out exploration activities. 'Crude oil' as well as 'Natural Gas' produced under NELP Contracts is not liable to duties of Excise under the Central Excise Act, 1944. Hence, service tax incurred by E&P entities in exploration and production of Crude oil/ Natural Gas end up as “stranded costs”, since the said entities cannot take CENVAT CREDIT of service tax incurred on services consumed for exploration and production of crude oil and/or natural gas.

Exploration business by its very nature, is highly capital intensive, has long-gestation period and, above all, is a highly risky business. Levying service tax on exploration activities especially at a time when – there is no surety whether hydrocarbons will be discovered; and if discovered, whether the same will be commercially recoverable is uncalled for.

It is recommended that the Government formulate a scheme for refund of service tax paid by E&P entities on the services consumed for exploration as well as production purposes. In the alternative, services provided to E&P companies which are essential for petroleum operations may be “Zero rated”, so that there is no stranding of taxes at the hands of service providers.

### 2.15.2. Tax Holiday for Exploration and Production activities relating to Natural Gas and CBM

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

### 2.15.3. Scope of 'Undertaking' for the purposes of tax holiday

The limitation of the tax holiday for oil and gas to a single undertaking based on a single PSC is regressive and inconsistent with the construct of tax holidays for other sectors. This should be amended to define an 'undertaking' (consistent with the judicial decisions) that each distinct field development evidenced by a separate development plan should be an undertaking eligible for the tax holiday. This is all the more important as the amendment has been made retrospectively and declaring each block as a single undertaking, that too with retrospective effect, will adversely affect the profitability of operators.

### 2.15.4. Extension of benefit under Section 80-IB(9) from 7 years to 10 years

It is suggested that the benefit under Section 80-IB(9) of the Act may be extended from 7 years to 10 years to companies engaged in production of mineral oil and natural gas. It may further be provided that the benefit under Section 80-IB(9) of the Act shall not be restricted only to blocks licensed under a contract awarded till 31st March, 2011 and the period be extended till 31st March, 2017.

### 2.15.5. Section 80-IA be amended to include exploration and refining activities

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

### 2.15.6. Extension of Section 42 to investment in Foreign E&P blocks

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

- Companies have entered into an agreement with the Central Government for extraction or production of mineral oils; and
- Such agreement has been laid on the table of each house of Parliament.

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

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

### 2.15.7. Taxation of non-residents on presumptive basis under Sections 44B, 44BB, 44BBA and 44BBB of the Act

A. Application of section 44BB where section 44DA applies

Finance Act, 2010 made an amendment in the proviso to Section 44BB of the Act which provided that Section 44BB shall not apply to a non-resident taxpayer in case the provisions of Section 44DA of the Act are applicable. A corresponding amendment was also made in Section 44DA of the Act. These amendments were made effective from April 1, 2011. However, there has been a controversy on the aforesaid amendment wherein Revenue Authorities contend that the amendment has a retrospective impact. On this basis, Revenue Authorities have been reopening completed assessments under Section 147 of the Act even though judicial authorities have held that the amendment is prospective in nature [BJ Services Company Middle East Limited vs DDIT (Special Appeal No 316 and 317 of 2012, Uttarakhand High Court)]. The prospective application of the amendment is also evident from of the intention of the legislature as per the notes to clauses to the Finance Act, 2010 explaining the said amendments.

It is suggested that a clarification be issued to clarify that the amendment is prospective in nature. This will help avoid unwarranted litigation.

B. Scope of 'FTS'

The term 'FTS' has been defined in Explanation 2 to Section 9(1)(vii) of the Act. The consideration received for 'mining or like project' has been specifically excluded from the definition of FTS. The services rendered by the non-resident oilfield services providers (such as seismic data acquisition and processing, provision for hire of vessel etc.) are integral to exploration of mineral oil and fundamental to the drilling operations.

The CBDT, vide instruction no 1862 dated October 22, 1990, also clarified that the services rendered in connection with prospecting etc. of mineral oil can be termed as 'mining' operations. However, it has been seen that the Revenue Authorities have not been abiding to the above instruction in holding that services rendered by the non-resident oilfield services providers are in the nature of FTS. Thus, the benefit of deemed profit regime under Section 44BB of the Act is being denied to such non-resident oilfield service providers.

In order to avoid unwarranted litigation in India on applicability of provisions of Section 44BB of the Act, it is suggested that amendment be made in Section 9(1)(vii) of the Act to specifically exclude the services rendered by oilfield service providers from the ambit of the term FTS.

C. Statutory Taxes not to form part of gross receipts

Certain Sections of the Act provide for taxation of non-residents on a presumptive basis, such as Sections 44B, 44BB, 44BBA and 44BBB of the Act. These Sections deem a specified percentage of the amounts received by the non-residents for the activities covered by the provisions as income under the Act. In the past there has been considerable litigation on whether Government dues, such as service tax, recovered by the non-residents from the Indian parties would constitute part of gross receipts [such as DIT vs Schlumberger Asia Services Ltd (317 ITR 156) (Uttarakhand HC), Siem Offshore Inc vs DIT (337 ITR 207) (AAR)]. As these statutory dues are to be paid over by the non-resident taxpayers to the Government, there is no income element therein.

In view of the above, these Sections of the Act should be amended to provide that statutory taxes and dues (such as service tax) recovered by the non-resident service provider from the Indian residents would not form part of gross receipts for computing deemed income under the Section. This will be fair and will eliminate unnecessary litigation on the issue.

### 2.15.8. Exemption from MAT

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

### 2.15.9. Clarification on depreciation on premium paid to acquire E&P assets abroad

It should be explicitly provided that the premium paid to acquire any Exploration and Production asset abroad is intangible asset eligible for depreciation under Section 32 of the Act @ 25%.

### 2.15.10. Weighted deduction for cross country natural gas/ crude/ petroleum oil pipeline network

Under Section 35AD of Act, 100% deduction in respect of capital expenditure incurred (other than land, goodwill and financial instrument) prior to commencement of operation of specified businesses carried on by a taxpayer including laying and operating a cross-country natural gas/ crude/ petroleum pipeline network for distribution is allowed. The Finance Act, 2012 further increased the weighted deduction to 150% of the expenditure in respect of certain specified businesses as per Section 35AD (1A) of the Act. It is recommended that similar weighted deduction should be allowed to specified business of laying and operating a cross country natural gas/ crude/ petroleum oil pipeline network for distribution.

## PAPER AND PAPER BOARDS

### 2.16.1. Customs Duty on Paper/Paperboards

The Indian Paper/Paperboard industry has made significant capital investments to ramp-up capacities for meeting domestic requirements. The Industry has strong backward linkages with the farming community, from whom wood, which is a raw material, is sourced. A large part of this wood is grown in backward marginal/sub-marginal land, which is potentially unfit for other use. This industry, being mainly based in backward areas, has transformed the socio economic conditions of the population residing there. It is therefore strategically important and also necessary to keep Paper/Paperboard industry, outside the ambit of FTA's (ASEAN etc.) and recognise this Industry as “sensitive” deserving special treatment. Increased imports from foreign countries are severely impacting the economic viability of many paper mills in India.

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

(a) Customs duty for import of Paper and Paperboards should be increased and brought in line with agricultural products as currently industry is sourcing majority of its raw materials from Agro-forestry – supporting millions of farmers in creating value on their marginal lands.

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

### 2.16.2. Customs Duty on Import of Pulp

In May 2012 the Government reduced the import duty on pulp from 5% to “Nil”. More than 1,250 thousand MT of pulp, valued at approximately USD 820 million (about Rs. 4,600 crore) is imported in to the country every year. The customs duty for these imports is estimated to be about Rs. 245 crore per annum.

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

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

Consequent to the customs duty exemption, pulp imports are expected to increase significantly in the near future to levels of about USD 2 billion per annum.

In view of the fact that Soft Wood cannot be grown in the country and in the absence of Bleached Chemi Thermo Mechanical Pulp (BCTMP) technology in India, requirements of Soft Wood Pulp and BCTM Pulp will have to be met through the import route only. However, in so far as Hard Wood Pulp is concerned, it would be pertinent to note that the domestic industry is working closely with the farming community for creating sustainable supply of wood – a key raw material for hard wood pulp – through re-development of waste-lands. Cheaper imports of duty free hardwood pulp would not be in the interest of Indian farmers as the benefit will flow to farmers in exporting countries like Indonesia and Brazil.

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

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

(b) 5% customs duty on pulp be reinstated only for Hard Wood Pulp.

### 2.16.3. Reduction of Excise Duty on Poly-coated Paper and paperboards

The market size in India for disposable cups is close to 40 billion cups per year out of which 10 billion cups are paper cups. The balance 30 billion is plastic cups - here too there are two varieties viz., HIP (High Impact Polystyrene) and PP (Polypropylene). Among plastic cups, 60% of the market is for PP, 30% is for Recycled HIPS and 10% is for Virgin HIPS.

Poly coated paperboard is used for manufacture of paper cups, which contains more than 90% by weight of bio-degradable food grade paperboard and is an eco-friendly substitute for plastics. The global trend is to actively discourage the use of plastics (which do not conform to requisite hygiene and environmental standards) and to replace it with poly coated paper / paperboard.

In India major consumers of this type of paper / paperboards are SSI / SME units engaged in manufacture of paper cups that are increasingly being supplied to institutional customers like the Railways, the FMCG sector and the household sector. Paper cups are used for mass consumption items such as tea, coffee, fruit juices, soft drinks, ice cream etc.

Paper and paperboard that is coated / impregnated / covered with poly coating are classified under Central Excise Tariffs 4811 51 90 (Bleached, weighing more than 150 g/m2 - Other) and 4811 59 90 (Other - Other) with an excise levy of 12% ad valorem – even as a large number of paper / paperboard items covered by Central Excise Tariff 4802, 4804, 4805, 4807, 4808 and 4810 are excisable to excise duty only at 6% ad valorem.

Further SSI/SME Units are not able to avail Cenvat credit for the excise duty paid on the base board used for manufacture of poly coated paper cups.

It is recommended that excise duty on poly coated paper / paperboards, classifiable under Central Excise Tariffs 4811 51 90 (Bleached, weighing more than 150 g/m2 - Other) and 4811 59 90 (Other - Other) be reduced to 6% from 12% - in line with most other paper / paperboards classifiable under Chapter 48. Such a move will also be a “green” initiative in line with global trends.

### 2.16.4. Incentives for investments in environment friendly “Clean” technologies by paper industry

Today technology stands out as the most critical factor in achieving sustained competitiveness and industry performance. Indian Paper Industry is a signatory to the Government of India's Charter on Corporate Responsibility for Environmental Protection (CREP). This calls for substantial investments in green technologies such as introduction of ECF (Elemental Chlorine Free) pulp manufacture, Ozone bleaching etc. to ensure a positive environmental footprint. The indigenous mills are consciously focusing on clean technologies which are cost effective with quality benefits. The Government should encourage such initiatives of the industry. But Indian Paper Industry being a traditional industry suffers from inadequate economy of scale and obsolescence of process technology.

In order to encourage manufacturers within the industry to adopt environment friendly “clean” technologies that ensure, inter-alia, reduced carbon footprints, better emission norms, better effluent treatment norms, usage of renewable sources of raw material and energy, improved waste recycling, etc., appropriate fiscal benefits should be provided.

It is recommended that-

(a) Import of capital goods required by the Paper and Paperboard industry for technological up-gradation - specially aimed at environmental protection (e.g. Elemental Chlorine Free Technologies) and for compliance with CREP - should be permitted at 'Nil' rate of Customs Duty.

(b) Exports by manufactures who have adopted environmentally friendly technology should be granted additional incentives in the form of duty credit-scrips etc.

(c) Additional benefits like entitlement for import of raw materials at a 50% concessional rate of duty, full exemption from excise and VAT taxes for paper and paperboard produced using clean technology, accelerated tax depreciation @ 150% of the normal depreciation rates under income tax laws for investments on environment friendly technology, should be provided to the industry.

These measures will not only promote preservation of ecology, it will also incentivize all players in the Indian Paper Industry to adopt 'green' technologies, thus aligning domestic industry to international eco-friendly norms.

### 2.16.5. Clean Energy Cess

Clean Energy Cess on purchase of coal was imposed in the Union Budget 2010. No doubt, the Cess was introduced on the principle of “polluter pays”. Whilst this principle may be justifiable for industries causing environmental pollution, it is to be recognized that within the industry there are players who have invested considerable sums of money on state of the art technology like elemental chlorine free paper manufacture, ozone bleaching processes, waste water management, solid waste recycling, usage of energy from renewable sources etc. to ensure environment friendly manufacture.

In view of the above, levy of a clean energy cess on coal – which impacts adversely on the cost competitiveness of manufacturers – should be restricted to only those manufacturers who do not adopt clean technologies. Manufacturers who have already adopted internationally recognized clean technologies, at considerable investment, should be incentivized and encouraged by way of being exempted from levy of any clean energy cess.

## RENEWABLE ENERGY

### 2.17.1. General

- Monetary Incentives reimbursement to State Electricity Boards / DISCOMs on fulfilling Renewable Purchase Obligations and net metering purchase or Establishment of Government sponsored body to act as intermediate buyer and seller of Renewable Energy Certificates (REC) in case of oversupply or shortage of REC to make the REC market function.
- Renewable Energy should be made an independent sector (separate from Power Sector) as many banks have reached their sectoral exposure limits, thus limiting the flow of finance to renewable energy projects.
- From an energy security, enhanced energy access and environmental benefit point of view, renewable energy should also get priority sector lending status under RBI guidelines.
- A separate budget provision within the Power Budget should be created specifically for laying of transmission system that is required for renewable energy projects. Such transmission line system is not being able to be commissioned due to lower priority in commercial attractiveness but leads to huge losses due to non-evacuation of must-run free renewable power. This therefore needs specific budgetary allocation.
- Carbon credit is an incentive available to the industries reducing CO2 emission by investing in energy efficient technology. Considering the 'global warming' impacts, it is a very important initiative on the part of industries. Energy efficient and carbon emission reduction technologies are substantially costly and results in additional investment for industries. It is very much likely that the income generated from sale of Carbon Credits may or may not compensate additional outflow laid out for earning the same.
- Section 10 of the Income Tax Act should be amended to provide exemption to income from sale of Carbon Credit entitlements. In addition, in order to provide impetus to generation of power through renewable energy sources, a specific tax holiday for the same may be provided in the Section 80-IA of the Act.

## 2.17.2. Wind Energy

- Budget should have a provision that can support interstate concessional open access and banking for wind energy as the same is becoming difficult due to lack of suitable compensation mechanism.
- Accelerated depreciation of 80% for wind projects was withdrawn from 1st April, 2012 leading to significant drop in investments in this sector. This is also curtailing the Government's target of 3000MW per year of wind power installations. Therefore, it is suggested that accelerated depreciation for wind energy sector should be restored to 80% as earlier, so as to enable competitiveness of this sector.

## 2.17.3. Solar Energy

- A one-time technology up-gradation scheme through the National Clean Energy Fund (NCEF) should be created to support the solar energy industry for technological up-gradation for improving cell efficiency and production enhancement.
- Central and State governments should provide capital subsidy / tax exemptions for development of common Infrastructure in Integrated Solar Manufacturing Hubs.
- There is a need to extend concessional power for energy intensive segments of the solar PV value chain as the percentage share of power in the cost of manufacturing of these raw materials is significant. The estimated percentage share of power for the manufacturing of raw materials are 50%, 30%, 25% and 10% for MG silicon, poly-silicon, Crystal Growing Ingots and Wafers, respectively.
- Liquidity for the solar sector should be improved through a solar energy fund, solar bonds, refinancing by pension/insurance funds, longer duration construction loans.
- Providing capital subsidy for off grid solar projects in time bound manner. Off-grid solar projects have a huge potential to address the power gap in rural areas that do not have access to the grid and can bridge the energy divide in the country.
- Bringing renewable energy including solar project under infrastructure projects to allow tapping of long term, low cost debt from insurance, pension funds.
- Providing generation based incentive for current 12th Five - year plan for solar power plants similar to wind power sector.
- Low cost funding to be extended to solar photovoltaic and solar thermal for meeting capital expenditure requirement for entire value chain (including components and machinery) through vviability gap funding for new technologies up to 40%.
- Cost of Debt should be reduced by eliminating the tax on interest received by banks and relaxing ECB norms.
- There is a need to rationalize taxes and duties on the solar thermal and solar photovoltaic value chain and to bring down cost of solar power.
    - o The issue of disparity in both import and local taxation for the local manufacturing industry had been addressed partially in the last budget by decreasing the BCD on certain items. The solar products manufactured in India still have more than 30% dutiable components that go into production. Hence, the locally made products in the Solar Photovoltaic Industry are not able to compete with the imported products of similar specifications that do not have any duty/levies if brought into India through import.
    - o States have imposed Central Sales Tax, VAT to the tune of 5% against sales of Solar PV cells/Solar PV modules, Solar SPV systems, Solar Collectors, Solar Water Heating Systems and various other systems running and operating on Solar Energy. While this is not applicable for imports, it makes the domestically manufactured

products further uncompetitive. The VAT and Central Sales Tax on these items should be permanently removed to promote manufacturing and sale of solar energy products as these are Green and Clean Energy products.

### 2.17.4. Bio-Energy

A. Bio-ethanol

- Bio-ethanol has a huge potential in India and needs to be encouraged through accelerated depreciation (AD) and/or generation based incentives (GBI) which should be at par with other renewable sources in India.
- As per orders issued by Ministry of Finance (Dept. of revenue), equipment for projects making 'power' from 'bio-sources' are exempt from excise duty (domestic) and attracts a concessional 5% custom duty on imported gear. Similar incentives should be expanded to Cellulosic Ethanol (bio-fuel) as well because this would improve the feasibility of the projects which have been planned actively.
- A preferential offtake price needs to be set up for bio-ethanol for the first few years (e.g. Rs. 50/- for a litre as blending price) as that will help investor have a favourable risk-reward ratio on projects and would attract good investments into the sector.

B. Biomass

- For the estimated 25GW of biomass potential in the country, the fuel supply chain alone could achieve employment opportunities of 150 crore man days/annum, income generation for the employed workers of Rs.35,000 crore/annum and Rs.27,000 crores per annum for the farmers, apart from producing clean energy at the tail end of the grid network. In lieu of the huge socio-economic benefits that flow from biomass power generation projects it may be appropriate to link the entire fuel supply chain of biomass based generation with Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) or with the Panchayat administration. Biomass based power generation should not be viewed only as a power sector project but primarily as a means to provide large number of jobs in rural area and enhance income levels of the farmers apart from providing huge environment benefits.
- A Generation Based Incentive scheme for biomass projects needs to be introduced to make these projects viable.
- Upfront establishment of strong and reliable payment mechanism is one of the critical factors for success of the fuel supply chain especially considering the economic situation of the marginal farmers / labours involved in this chain. In order to avoid the intermediaries and giving direct benefit to the farmers / labourers, various financial inclusion schemes in the form of direct cash transfer needs to be created with the help of power plant owners / lending banks for the power plants / local co-operative banks / lead banks in the region and even various micro financial institutions operating in the region. Such financial inclusion schemes will ultimately help in upliftment of the rural economy and also help in increasing the savings economy along with the consumption based economy.
- Considering the seasonal availability of the biomass, these projects should be considered as “Seasonal Projects” and accordingly tariffs should be set with target PLF of not more than 50% instead of current practice of 80%, which seems to be extremely challenging considering the history. Once the fuel supply chain mechanisms as proposed above are established then the target PLF can be increased progressively.
- Presently most of the villages in rural areas are grappled by load shedding and supply to agricultural sector is also restricted. It would therefore be useful to create a conducive framework for supply of power (could be in islanding mode) from these power projects to the nearby rural areas (command area of the power plant which supplies biomass), including community loads such as schools, hospitals, street light etc. This will ensure a different bonding between the power plants and the community and will also ensure the reliable fuel supply for the plant. In such situations these power plants can be given a treatment of a mini-grid project.

## RETAIL

### 2.18.1. Abatement for levy of service tax on renting of immovable property

'Construction of buildings/complexes etc., intended for sale' and 'renting of immovable property' have been made 'declared services' under the service tax regime based on the concept of a Negative List. However, while only 25% of the entire consideration is chargeable to service tax in case of construction service where the value of land is included in the consideration received from the service recipient, 100% of the entire consideration is chargeable in case of Service of Renting of Immovable Property at an effective Service tax rate of 12.36%.

Retailers are primarily engaged in the distribution of goods to ultimate customers and the output tax liability for retailers is therefore restricted to only VAT and not Service tax. Hence, central levies are not available as credit for their final output liability of. As a majority of the retailers work on a very small profit margin of about 2% or even at a loss at times, the increase in tax costs without any corresponding availability of tax credits will result in hampering the growth and the very sustainability of the Indian retail sector.

The rental income is essentially a factor of the value of land, value of goods used in the construction of the rented property, value of services used in the construction of rented property as well as interest cost. It has never been the intention of the Government to tax value of land and building or interest cost within the ambit of service. Therefore only the rental value representing the service component of the transaction of renting of immovable property should be subject to Service tax.

The differential tax treatment between purchase vis-à-vis lease of property, is contrary the global best practices prevailing in this industry. Working capital requirements are already very high in the retail sector, which is required to offer as much variety as possible to the customers. A skewed tax structure would result in the scarcity of fund available in their hand to be employed as working capital.

Given the above impact on the retail it is suggested that appropriate abatement may be provided from the taxable portion subject to Service tax on the activity of 'renting of immovable property' to account for:

(i) the lack of availability of tax credit(s) to the retailer who reimburses/bears the Service tax levied on the activity of 'renting of immoveable property'; and

(ii) the rental value realized which corresponds to and is attributable to the 'value of land and buildings'.

### 2.18.2. Service tax on reimbursement of electricity charges

With the introduction of the Negative list (effective 01.07.2012), all services, except those services which are specified in the Negative list or specifically exempted, are liable to Service tax. Owing to the wide coverage of the term “service” which also includes provision of a facility, the electricity charges which are collected by the landlords/lessors from the member retailers occupying their premises seems to be covered within this wide definition of service. Despite being reimbursements of the electricity charges, either paid or payable or subsequently payable by the landlords/lessors, under the new regime, the entire amount stands exposed to Service tax.

Amongst the heavily taxed sectors, levy of Service tax on reimbursements towards electricity charges would substantially add to the lists of sunk costs which already burden the Retail sector. The sector is subjected to multifarious taxes – at high rates without any robust credit mechanism. The Retail sector including the member retailers who are engaged in trading of goods are not subject to Service tax on their output viz. trading. The direct consequence is the denial of credit of Service tax paid on input services such as renting, reimbursement of electricity charges. Instead, trading revenues (output) are subjected to VAT which cannot be off-set against Service tax.

The activity of recovery of electricity charges on actuals for further payment to the electricity board by landlords/lessors is undertaken in their fiduciary capacity of “pure agent”.

It is therefore requested that a specific exemption may be provided that such reimbursements of electricity charges made by the member retailers to their landlords/lessors do not attract Service tax. Alternatively, exemption may be granted from the applicability of Service tax on electricity charges recovered by the landlords/lessors from the member retailers

## 2.18.3. Suggestions on Direct Taxes

(a) In order to enable mergers and amalgamations in loss making retail companies, so that the amalgamated entity is able to carry forward the predecessor losses, section 72A of the Income Tax Act 1961, should be extended to retail companies, as currently there is an ambiguity prevailing as to whether retail companies come under the definition of industrial undertaking or not, which is one of the mandatory conditions for carrying forward of losses under section 72A for any M&A.

(b) Currently 200% weighted deduction is permissible for in-house approved R&D under section 35 (2AB), however the same is restricted to manufacturing organization. Retail is not considered as manufacturing, however retail companies also incur substantial R&D expenditure, which is very much required for growth and survival of the industry. Hence this benefit should be extended to retail companies.

(c) Investment linked incentives provided to the specified businesses under section 35AD of the Act should be extended to the retail sector as well.

**SPORTS**

## 2.19.1. Budget Allocation

Budget for Youth Affairs and Sports should be increased to at least Rs. 7000 Crores for allocation amongst following items:-

– OPEX games development and training

– Grassroots development of Sports which will include the opening of Sports Schools across identified 128 cities in India

– Winter Sports development

– Skills development in Sports, Fitness and Physical Education.

## 2.19.2. Tax Incentives

Their needs to be a rebate or deduction under the Income Tax Act on par with Section 80IA for any entity investing in construction, management and creation of tangible sports assets such as stadiums, academies, sports science & medicine institutions, playgrounds and the manufacturing of sports, health & fitness equipment & apparel, and intangible assets such as training and capacity building, event management, sports and physical education.

Following items need to be included in the list of sports goods eligible for exemption from the levy of customs duties:-

– Baseball Bats, Balls and Gloves

– Netball Balls

– Automatic Ball Throwing Machines for Tennis and Football

– Simulation Games Equipment (Excluding Video Games)

## 2.19.3. Concessional Financing

Their needs to be special financing rates on the par with agriculture/exports sectors for the entity investing in construction, management and creation of tangible sports assets such as stadiums, academies, sports science &

medicine institutions, playgrounds and the manufacturing of sports, health & fitness equipment & apparel, and intangible assets such as training and capacity building, event management, sports and physical education. It will help involvement of Public Private Partnership model for the development of Sports Infra across the country especially in rural areas. The tenures of this financing should be for longer periods (20-25 years) as sports infrastructure will have longer gestation period and hence ability to service debt would be that much lower.

### 2.19.4. Regulating Sports Betting

Blanket ban on sports betting has been impossible to be sustained without a proper regulation. India is losing estimated Rs. 12-20,000 crore annually in taxable revenue through black marketing operations in sports betting. The greatest advantage of regulating sports betting is going to be the accountability for the large amounts of money transferred through illegal channels and reduction in cases of match fixing, money laundering and crimes. If gaming and betting is regulated in India, it will benefit the exchequer and could potentially fund sports development, social protection and welfare schemes and infrastructure development plans.

### 2.19.5. Sports Broadcasting

World over, primary source of funds in sports is broadcast revenue. Government should incentivise broadcasters to have sports channel in their offerings with subsidised licensing fee and providing hassle free licenses and permissions if it is for the promotion of Olympic Games, CWG, Asian Games and National Games.

## STEEL AND OTHER FERROUS PRODUCTS

### 2.20.1. Increase in import duty on Steel Long and Flat products

Currently, the imports of steel long and flat products attract a duty of 5% and 7.5% respectively. However, in view of the economic slowdown which has adversely affected the steel industry and keeping in view the investments undertaken by the domestic steel producers for increasing their production capacities, there is a need for a reasonable tariff protection to the domestic manufacturers. The current import duty levels in India are much lower in comparison to duty prevailing in other Stainless Steel producing countries. China has an average customs duty of 10% whereas Brazil has 14%. This has led to increased imports from 3,17,442 MT in 2012-13 to 2,41,132MT (Apr–Dec 2013-14). Also, in view of the comparative advantage enjoyed by China in various cost elements it is imperative to create a level playing field between domestic Stainless steel manufacturers and the Chinese manufacturers.

Accordingly, it is proposed that the customs duty on the long and flat products may be increased to 10%.

### 2.20.2. Import duty on Manganese ore, Chrome ore etc.

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

### 2.20.3. Reduction in Customs Duty on Coking Coal

Import duty of coking coal has been increased from zero to 2.5% plus 2% CVD in the Union Budget 2014-15. Coking coal is used largely by the steel industry. Negligible quantity of coking coal is available domestically, and thus the need is met mainly from imports.

The zero duty on coking coal is in place since 1978. The increase in import duty from zero to 2.5% on coking coal is going to increase the cost of steel making substantially, which can only be passed down and will lead to domestic steel being uncompetitive vis-à-vis imports. It will also contribute to inflation.

It is therefore recommended that the duty on coking coal be exempted as was the case prior to the Budget 2014-15.

### 2.20.4. Reduction in Import Duty of Iron Ore

India is currently faced with a shortage in the production of iron ore, the primary raw material for steel making. The iron ore production in the country has fallen from 218 million tons in 2009-10 to 144 million tons in 2013-14 and is likely to fall below 100 million tons in 2014-15. As a result, several Indian steel producers are importing the iron ore.

Thus, till such time that the domestic production of iron ore increases and the supply gap is bridged, import duty on iron ore may be brought down to zero, from the currently levied 2.5%.

### 2.20.5. Import duty on steel grade limestone and dolomite

For Iron and Steel Industry, limestone availability was 4320 tonnes in 2008-09 (1.9% of total production) and 7664 tonnes in 2009-10 (3.3% of total production). 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. 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, it is imperative that Customs Duty on steel grade limestone (sub heading 2521 00 10) and dolomite (sub heading 2518 10 00) be reduced from 2.5% to nil.

### 2.20.6. Reduction in Customs Duty on Ferro Nickel, Pure Nickel and Ferro Moly

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

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

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

### 2.20.7. Import duty on Electrodes, Refractory material

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

### 2.20.8. Duties on Mild Steel and Stainless Steel scrap

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

Despite the dependence of domestic industry on imported scrap, the Ministry of Finance, vide Notification No. 25/2013-Customs dated 8th May'2013, had announced increase in Basic Custom Duty on Stainless Steel Scrap (HS Code720421) and Steel Scrap (HS Code 720449) from NIL to 2.5%.

It is suggested that the duties on M S Scrap and S S scrap be restored to the original rate of “NIL”. It may be pointed out that China maintains its scrap duty at zero.

## 2.20.9. Reduction of Excise Duty on Pre-fabricated Steel Structures

Pre-engineered building / pre-fabricated structures have emerged in India for last few years to fast track steel based construction and to incorporate the latest innovative designs requiring special profiles developed by structural engineers and architects in the field of construction. It is an anomaly that while the site based pre-fabrication of structures are permitted to be used in the building / structure without payment of Excise Duty as these are not taken out of the site, the pre-fabrication activities conducted on structures at outside premises of the pre-fabricated manufacturers are excisable @ 12.36%. This has led to mass fabrication of structures at the site which do not follow the quality norms as required in structural fabrication and generally done by fabricators having little knowledge of good quality fabrication. On the other hand, the steel structures fabricated at the premises of fabricators follow state-of-the-art technology and standard operating practices of good fabrication, suffer excise duty of 12.36% and hence expensive and lack demand.

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

## 2.20.10. Excise Duty on Unorganized Sector of Stainless Steel

A substantial portion of the domestic stainless steel production comes from the huge unorganized sector called the “patta patti” sector. Out of the crude Stainless Steel production of 3 mn ton the paata patti sector contributes almost 1.1 million tons.

The organised sector pays an Excise Duty of 12.36% whereas the Patta-Patti sector is completely outside the ambit of the Advalorem Excise Duty. The unorganised sector operates on the basis of compounded levy scheme wherein they are exempted from paying excise duty on normal production and are instead subject to a compounded levy of INR 40,000/- per machine per month. Since, this levy is not dependent on production quantity and value; there is no compulsion on the Patta-Patti units to maintain production records for this purpose. This in turn gives rise to large number of malpractices resulting in revenue loss to the Government.

In order to create a level playing field, it is recommended that the Patta Patti units be subjected to advalorem Excise Duty. Also to encourage growth of the sector, the Excise Duty may be brought down to 8% from the current 12%.

## 2.20.11. Classification of COREX under Central Excise Tariff

Existing tariff entry 2705 of Central Excise schedule covers: “2705: Coal gas, water gas, producer gas and similar gases other than petroleum gases and other gaseous hydrocarbons.” Certain doubts have been expressed about classification of Corex Gas under the aforesaid entry of heading 2705. Blast Furnace gas is specifically mentioned in the Explanatory Notes of heading 2705. Blast furnace gas and corex gas both emerge as by-products in the process of manufacture of molten hot iron using, respectively, Blast furnace and Corex. The manufacturing process involved in the blast furnace technology and corex technology is similar. The by-product Corex gas is very similar in composition and use to coal gas and blast furnace gas covered under the tariff heading 2705. However, in the absence of specific mention of these gases under tariff entry 2705, a doubt is being created about coverage of corex gas as 'similar gases' under the said tariff entry. For removal of this doubt, either a clarification may be issued or the aforesaid entry in heading 2705 may be amended to specifically include Corex Gas.

## 2.20.12. Review of Exemptions (CVD and excise duty) on Grain Silos Kits

Imported Grain Silo Kits into India are exempted from payment of 12.36% CVD since these are used in agricultural processing industry. However, domestic Grain Silo Kit Manufacturers who are largely in MSME sector have to pay 12.36% as Excise duty, non-cenvatable. This is a significant cost impact particularly for a small sector player. Moreover, manufacturing sector in India faces domestic disparities viz. under-developed infrastructure and high finance cost which translate into 11-12% of additional costs.

Major material used in Grain Silo Kit is galvanized steel. India with a coated capacity of approximately 10 million tonnes compulsorily exports 30% of its production of 6 Million tonnes, fetching lower margins due to shortage of domestic demand.

Hence exemption of payment of 12.36% of excise duty by domestic manufactures Grain Silo kits would partially compensate the domestic disparities, encourage domestic production, thus creating employment opportunities and demand for domestic steel. Also, the CVD exempted on imported Grain Silo Kits needs to be re-instated to allow a level playing field for the domestic manufacturers.

### 2.20.13. Reinstatement of concession for short lead in charging freight by Railways

Steel Producers have invested in developing loading point at mine heads which fall under the purview of short lead distance to increase rail share and revenue to Railways. After the withdrawal of short lead concession, the new freight cost for iron ore movement is 128% higher than the existing freight.

Due to the unilateral change in the policy, investments in developing load point at mine head are becoming unviable impacting the return on investment.

Therefore, the concession for the short lead in charging freight for traffic booked up to 90kms should be re-instated. Alternatively, the steel companies who have invested in new projects after 2012 may be granted short lead concession for minimum five years facilitating development of railways as a major mode of steel freight and the steel industry.

### 2.20.14. Weighted deduction under Section 35AD of the Act

The steel industry is a highly capital-intensive industry. To improve the return on investment in the steel industry and to attract fresh investments, capital expenditure in steel business should be allowed weighted deduction of 150% of the expenditure under Section 35AD of the Act.

## TEA INDUSTRY

### 2.21.1. Interest subvention to promote replantation and/or rejuvenation of tea bushes

Tea Industry, in order to remain economically viable, needs to increase the land productivity through uprooting of age old tea bushes followed by replanting of new clones on a continuing basis. This warrants upfront large capital outlay coupled with loss of revenue, which majority of the tea producers can ill afford. While Tea Board, with a view to encourage replanting, tries to compensate to some extent, through a subsidy scheme, the revenue loss, the initial capital investment becomes a prohibitive factor for the tea garden Management to take up the task of uprooting and replantation in a large scale.

Presently, a concessional rate of interest is being charged on agricultural loans but only with a very low ceiling. The organized sector of the Tea Industry, therefore, cannot avail of the easy financing although the nature of activities both for the small growers and in the organized sector are identical with the only difference being in the scale of operations. With the rising cost of inputs, the existing credit limit allowed by the Commercial Banks for tea companies is not only inadequate but too meagre. Moreover, with the hardening of the rate of interest in recent times the cost of borrowing has substantially increased.

It is requested that an interest subsidy @5% on the applicable rate of interest be provided on the funds specifically borrowed by the Tea Companies and earmarked for the activities related to plantations e.g. replanting and /or rejuvenation etc.

### 2.21.2. Increase in the rate of Subsidy

Inadequate subsidy component under the various Schemes of Tea Board often fail to encourage Tea producers to take up developmental activities in their estates whether in field or in factory. Rate of subsidy should be increased to 40% across the board on all the schemes to provide fiscal incentives under the aegis of Tea Board, Ministry of Commerce.

## 2.21.3. Incentive for organic tea production

Organic tea cultivation is considered as the inevitable future of Tea Industry. Tea producers are unwilling to convert their tea production to organic mode owing to upfront large capital outlay, anticipated loss of revenue and uncertainty in price realisation.

It was recommended by the Parliamentary Standing Committee on Tea for providing subsidy to organic soil input so that organic soil management and organic tea farming could be encouraged. In the opinion of the Committee, incentive should also be given to encourage tea growers in achieving a higher crop over the targeted yield in order to attain higher land productivity.

It is requested that an appropriate financial incentive be provided to encourage organic tea cultivation.

## 2.21.4. Effect of Section 115JB on Companies engaged in growing and manufacturing tea

40% of the income from the business of growing and manufacturing Tea is taxed under the provisions of the Income Tax Act, 1961 by application of Rule 8. The remaining 60% is taxable under the respective State Agricultural Income Tax Act where the Tea Estate is situated. Therefore, 60% of the income cannot be termed as agricultural income exempt from tax u/s 10(1) and hence tea companies are unable to reduce 60% of its book profits as exempt income for computation of Book Profit u/s 115JB and end up paying tax @10% on the whole of the book profit which, added with the entire agricultural income tax liability, becomes higher than the tax liability on the total income.

Moreover, most of the companies would have a difference in depreciation as per books with what was computed as per Income Tax Rules.

It is, therefore, suggested that only 40% of the book profits of tea companies should be taxed u/s 115JB and the enabling provisions be inserted within the section.

## 2.21.5. Weighted deduction for expenditure on social welfare measures

The organized sector of tea industry in India is required to provide various welfare facilities e.g. housing, education, medical etc. to their workers and their dependants. The Inter-Ministerial Committee, constituted by the Government of India admitted, in principle, the justification for sharing of the social cost incurred by the tea industry. Regrettably, no progress has yet been made in this direction and the employers in Tea Industry have to bear the entire unjustifiable burden of social welfare.

It is requested that weighted deduction up to 200% of the actual expenditure by the tea industry on employee welfare may be permitted under the Income Tax Act.

## 2.21.6. Uniform rates of Agricultural Income Tax

Agricultural Income Tax is levied on 60% of the total income by the State Governments. The varying rate of agricultural income tax among the States creates problems for the tea companies having their tea plantations in more than one State. Maintaining a harmonious rate of tax is imperative for an identical income in a cohesive tax structure.

It is suggested that an appropriate modification of Rule 8 of the Income Tax Rules, 1962 may be carried out which would facilitate in determining a uniform rate of agricultural income tax as applicable for tea across the tea growing States. This would also lead to a coordinated tax administration.

**TOURISM**

## 2.22.1. Grant of Infrastructure status to the Hotel industry

It is suggested that like airports, seaports and railways, hotels should be included as an infrastructural facility eligible for benefits under Section 80 I A of the Income Tax Act. In fact under Section 10(23G) of the Income Tax Act, Hotels were added to the infrastructure list so that interest received by the Financial Institutions and banks for loans extended to hotels were tax exempted. However the provision itself was discontinued with effect from 1.4.2007.

Grant of Infrastructure status to the Hotel industry will lead hotels to re-invest their profits in the hospitality sector, channelize huge investment in the tourism sector and help bridge the shortfall of hotel rooms. There is a shortage of 150000 rooms that calls for an investment of around Rs 60,000 crores in the coming 5 year period. This investment will also lead to substantial employment generation

### 2.22.2. Export Industry status to the Hotel industry

The tourism sector contributes over Rs.100,000 crores to foreign exchange of the country. Deductions in respect of the foreign exchange earnings in convertible foreign exchange should be permitted. The benefits available under Section 80HHD of Income Tax Act 1956, which was discontinued after 2005-06, should be revived. It will enable further investment in this sector.

### 2.22.3. Declaration of Tourism as an Industry

Many States have already granted Industry status to tourism i.e. Tamil Nadu, Kerala, Uttar Pradesh, West Bengal, Arunachal Pradesh, Uttarakhand, Sikkim, J&K, Jharkhand, Haryana and UT of Daman & Diu, Dadar & Nagar Haveli. It is proposed that tourism should be included in Schedule 1 of the Industries Development Act 1951 and that all the remaining State Governments may be requested to recognize tourism as an Industry so that Hotels throughout the country will be able to avail of the benefits under the industrial policy of the respective state government:

- Land banks for Budget Hotels
- Exemption of duty on Stamp paper
- Exemption and concession in VAT and Sales Tax
- Property Tax, Electricity rates and Water charges levied as per Industrial rate
- Single window clearance for new hotel projects

### 2.22.4. Depreciation on Hotel Buildings

Depreciation on Hotel Buildings under section 32 to be increased to 20% from the present 10% as hotels have to make heavy investment in plant and machinery due to their running on a 24 hour basis and in renovation, up gradation and upkeep.

### 2.22.5. Service Tax on Room Rent and on Sale of Food and Beverages

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

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

The total tax outflow for the Guest works out to more than 20% on an average. Consequently, this tax levy is a significant deterrent to the Hospitality Industry which is already impacted adversely by the general slowdown of the global economy. It is recommended that the levy of Service Tax on renting of Rooms and sale of Food and Beverages be discontinued to provide some relief to the industry.

# INCOME TAX

## 3.1. Tax Rates - Companies/Firms/Limited Liability Partnership

### Issues

- The Finance Act (No. 2), 2014 had not modified the tax rates, which continue to be 30% for domestic companies and 40% for foreign companies. The surcharge for domestic companies was increased from 5% to 10% where taxable income exceeds Rs 10 crores (the effective tax rate equals to 33.99% for domestic companies inclusive of surcharge and education cess). Similarly, for foreign companies, the surcharge was increased from 2% to 5% where taxable income exceeds Rs 10 crores. The increased rate of surcharge on tax makes cost of doing business in India significantly high. This has adversely impacted the investors' sentiments and is a blow to the investments, economic growth and entrepreneurship.
- In addition to this, enhanced DDT and lowered depreciation rates, impose a further strain on companies, leading to increased pay-out of taxes thus leaving inadequate funds for generation of internal resources for ploughing back for expansion, modernization, technology up-gradation, etc.

### Recommendations

- It is therefore suggested that the corporate tax rate for domestic companies be reduced to 25 % in the forthcoming Union Budget 2015-16.
- Similarly, the income tax rates for unincorporated bodies i.e. Firm, Limited Liability Partnership (LLPs), etc., should also be reduced to 25% from the current 30%.
- It would be appropriate to remove the levy of surcharge and education cess on corporate and non-corporate taxpayers.

## 3.2. Tax Rates - Individual taxpayers

The Finance Act (No. 2), 2014 had marginally increased the basic exemption limit to Rs. 2.5 lakhs. 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.

The Parliamentary Standing Committee on Finance (PSC) in its Report on the Direct Taxes Code Bill 2010 (DTC Bill) has appropriately recommended the following revised tax slabs for individual taxpayers.

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

FICCI would, therefore, like to urge that the recommendations of the PSC should be implemented during FY 2015-16.

The Finance Act, 2013 has levied surcharge @ 10% on individuals having total income exceeding Rs. 1 crore [no change has been made by Finance Act (No. 2), 2014]. The increased surcharge on certain category of individuals would tend to discourage entrepreneurship and incentivize people to relocate to other locations. It is suggested that the Union Budget 2015-16 should withdraw the levy of surcharge on individuals having income above Rs. 1 crore.

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

### Issues

- Current rate of MAT of 18.5% is quiet high and has impacted significantly cash flow of companies who otherwise have low taxable income or have incurred tax losses. Further, this has also diluted significantly the tax incentives offered under Chapter VI-A of the Act to eligible businesses and industrial undertakings as the difference between the corporate tax rate of 30% and MAT of 18.5 % is not very high.
- Further, an Alternate Minimum Tax (AMT) was also introduced on LLPs, individuals, HUF, AOP etc. which was to be computed on their taxable income as increased by deduction eligible under Chapter VI-A and Section 10AA of the Act.
- Pursuant to above, the Companies/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 due to the narrow difference between the basic MAT/ AMT rate of 18.5% and the basic corporate tax rate/LLP tax rate of 30%.
- The MAT/ AMT credit is allowed to be carried forward for 10 years for set-off but this period is generally not always sufficient. Many companies, particularly investment companies whose core business is investments are not able to utilize MAT credit efficiently and within due time-limits provided.
- The Companies Act 2013 has been made effective from April 1, 2014 and according, to which the depreciation rates have increased vis-a-vis the erstwhile Companies Act, 1956. This would result in higher depreciation charge in the books of accounts of the taxpayers. In addition, higher depreciation could also be charged in the books of accounts of the taxpayer on account of varied reasons which include change in accounting estimate e.g. reduction in useful life of assets due to various commercial and legal reasons, change in method of charging depreciation etc. As per the provisions of Section 115JB, there is no specific adjustment required to be made in computing book profit for such depreciation. However, tax officers seek to adjust the same in computing the book profit without assigning any reasons. Since this issue would be faced by most of the taxpayers in the FY 2014-15 specifically due to applicability of Companies Act 2013, there is a need to provide clarity for the treatment of such depreciation in computing book profit otherwise the same would lead to unnecessary litigation.
- Income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund is exempt under Section 10(38) of the Act. The objective of giving such exemption was that Indian residents should invest in the capital market for long term, however, by including such income in the book profit the benefit is taken back from the Companies. Taking back such benefit from the Companies is not equitable.
- The Finance Act, 2011 broadened the scope of MAT by bringing SEZ developers and units under the ambit of MAT thereby significantly diluting benefits offered under the popular SEZ Scheme. In this regard, the Finance Minister in his Budget speech for 2014-15, stated that manufacturing is of paramount importance for the growth of the economy. He further stated that the Government is committed to revive the SEZs and make them effective instruments of industrial production, economic growth, export promotion and employment generation.
- Exemption from AMT is provided to certain specified persons if the adjusted total income of such person does not exceed Rs. 20 lakhs. The limit of Rs. 20 lakhs is inadequate considering especially the huge amount of investments made by the businesses in relation to export of goods and services.
- In computing the adjusted total income for AMT, investment linked deductions on capital expenditure for specified business (net of depreciation) is to be added back under Section 115JC of the Act.

## Recommendations

- The basic rate of MAT/ AMT should be reduced to make it equivalent to 50% of the basic corporate tax rate (i.e. 15%).
- Companies should be allowed to set-off entire past book losses including unabsorbed depreciation before they are subjected to MAT.
- The MAT/ AMT credit should be allowed to be carried forward and set-off without any time limit.
- A specific clarification should be issued to provide that higher depreciation charged in the books of accounts which is mandatorily required for preparing the books of accounts in accordance with the generally accepted accounting principles, Companies Act 2013 etc. would not be required to be adjusted in computing the book profit for the purposes of Section 115JB of the Act. Considering this issue also arose for the past years, the clarification should be issued with retrospective effect.
- Currently, sale of listed securities is free from levy of Capital Gains Tax. This has resulted in buoyancy of Capital Markets, promoted substantial FII inflows and ensured transparency. However, there is one lacuna here. If the seller of the listed shares is a company, there is no taxability of the gains but the book profits are subject to the levy of Minimum Alternate Tax (MAT). The levy of MAT at 20 per cent + defeats the very exemption from levy of capital gains tax. It is therefore suggested that profits which are exempt from levy of capital gains tax be also not taken as part of book profits for the purposes of MAT.
- Recently, the Ministry of Commerce and Industry (Department of Commerce) has recommended the restoration of original exemption from MAT and DDT to SEZ developers and units. In line with these intentions of the Government, the MAT on SEZ developers and units should be abolished.
- The threshold limit from exemption of AMT should be increased from Rs. 20 lakhs to Rs. 50 lakhs.
- The amount of weighted deduction under Section 35(2AB) of the Act should be deducted while computing MAT/ AMT. The benefit of investment linked deductions is getting diluted as MAT/ AMT at 18.5% applies on book profits.Therefore, these deductions should also be allowed while computing the book profit/adjusted total income under the provisions of Section 115JB/Section 115JC of the Act respectively.
- In computing the adjusted total income for AMT, investment linked deductions on capital expenditure for specified business (net of depreciation) should not be added back under Section 115JC of the Act.
- To attract more industrial and infrastructural investments, MAT/AMT on eligible businesses/industrial undertaking should be abolished.

## 3.4. MAT on foreign companies – Section 115JB

## Issue

- The Authority for Advance Rulings (AAR) in various decisions [such as Castleton Investment Limited (2012) 24 taxmann.com 150 (AAR), SmithKline Beecham Port Louis Ltd (2012) 24 taxmann.com 153 (AAR)] held that the MAT provisions do not make distinction between Indian and foreign companies and therefore, MAT provisions are applicable to the foreign companies. On the other hand, there are set of decisions [such as Timken Co vs DIT (2010) 326 ITR 193 (AAR), Praxier Pacific Ltd vs DIT (2010) 326 ITR 276 (AAR)] wherein it has been held that provisions of MAT may not apply to foreign companies. Accordingly, the issue of applicability of MAT on foreign companies has been a matter of litigation before the Courts.

## Recommendations

- Foreign companies having no presence in India are not required to maintain books of accounts under the provisions of the Companies Act, 2013. In order to compute MAT the starting point is to compute book profit based on the accounts prepared in accordance with the Companies Act, 2013, and therefore, the MAT provisions should not be applicable to such companies.

- Accordingly, the Section 115JB of the Act should be amended to clarify that it will not apply to foreign companies not having a place of business of India and not maintaining books of accounts in India i.e. specifically for companies which have opted for only gross basis of taxation.
- This amendment would provide much needed clarity to the foreign companies and avoid unnecessary litigation.

## 3.5. Dividend Distribution Tax - Section 115-O

### Issues

- As per the provisions of Section 115-O of the Act, the domestic holding company will not have to pay DDT on dividends paid to its shareholders to the extent it received dividends from its subsidiary company on which DDT has been paid by the subsidiary. However, the provision as it stands on today, gives relief in respect of dividend received from only those companies in which the recipient companies are holding more than half of the nominal value of equity capital.
- Further, the Finance Act, 2011 has also burdened the SEZ developers by including them in the scope of DDT.
- DDT currently is payable at the basic rate of 15%. Further, dividends distributed by domestic companies and mutual funds will be grossed up for the purpose of computing DDT, translating into an effective tax rate of about 20% (after the levy of surcharge of 10% and cess of 3%). Since DDT is a sort of surrogate tax on behalf of the shareholders, and if the shareholders were to pay tax on their dividend receipts, the tax impact thereon is likely to be lesser in most of the cases in comparison to the DDT tax burden.
- 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 ~ 20%) reduces the dividend distribution ability of domestic companies and the uncertainty with respect to its credit in overseas jurisdictions impacts the non-resident shareholders adversely.
- Currently, DDT is also levied on undertakings engaged in infrastructure development which are eligible for tax benefit under Section 80-IA of the Act. This is detrimental to the growth of the Indian Economy.

### Recommendations

- All dividends on which DDT has been paid, be allowed to be reduced from dividends irrespective of the percentage of equity holding keeping in mind that investment companies which do not necessarily own/have subsidiaries as they invest in various companies in the open market, be also made eligible for such benefit.
- 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. 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. It is therefore suggested that dividends which have suffered DDT be treated as pass through and be not subjected to levy of DDT.
- Recently, the Ministry of Commerce and Industry (Department of Commerce) has recommended the restoration of original exemption from MAT and DDT to SEZ developers and units. In line with these intentions of the Government and 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 ~ 20% (after including the education cess, surcharge and grossing-up of the dividend).

- To incentivise the investment in infrastructure sector, it is recommended that DDT on industrial undertakings or enterprises engaged in infrastructure development, eligible for deduction under Section 80-IA of the Act, should be abolished. 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.

## 3.6. 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.

### Issue

- Disallowance is made on the basis of the formula prescribed in Rule 8D without having regard the amount of exempt income earned.

### Recommendations

- The way in which the Rule 8D stands drafted leads to a situation where the quantum of disallowance may far exceed the exempt income. This could be absurd at times and runs contrary to the intention of Section 14A of the Act.

- It should be clarified that the disallowance as per the deeming provisions of Rule 8D of the Rules should not exceed the amount of exempt income earned in the relevant FY.

### Issue

- A deeming provision of the administrative expenditure @0.5% of the average investments, results in ad hoc and excessive disallowance.

### Recommendations

- This Rule is very harsh and by applying the formula under the said Rule, expenditure that has no connection with the earning of exempt income gets disallowed. A deeming provision of the administrative expenditure @0.5% of the average investments, results in ad hoc and excessive disallowance. There is even more hardship when the investments are made only at the end of the year (say 31 March) which are also subject to disallowance at 0.5% as per the deeming provisions.

- It is suggested that Rule 8D of the Rules should be amended such that the arbitrary clause i.e. clause (iii) of Rule 8D(2) of the Rules on disallowance of 0.5% of the average investments be deleted. Alternatively, the disallowance for administrative expenses should be made by estimating the time of the personnel and the resources involved for undertaking the activities which would earn exempt income. The aforesaid estimation to be done on reasonable basis after considering the facts of each case and the frequency of such activities.

### Issue

- 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.

## Recommendations

- Section 14A(1) of the Act reads as:

  "…..no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act"

- Based on the provisions of said Section, it is recommended that if there is no income in a particular year, which does not form part of the total income under this Act, then the disallowance under Section 14(A) should not be triggered. A clarification to this effect through the amendment in the Act, notification, etc. would be helpful in reducing unwarranted litigation on this issue.

## Issue

- It has been noticed that for the purpose of computing disallowance under clause (ii) of Rule 8D(2) of the Rules total interest expenditure debited to the profit and loss account is considered by the tax officers, even if the interest expenditure has no nexus with earning of exempt income.

## Recommendation

- It should be explicitly clarified that the interest expenditure which is not directly relatable to exempt income or receipt is to be excluded from the interest expenditure considered for the purpose of computing disallowance under Section 14A of the Act read with Rule 8D of the Rules.

## Issue

- The disallowance under Section 14A of the Act is required to be made in respect of expenses incurred for earning exempt income. The provisions are harsh in respect of the investments held as stock-in-trade or strategic investments made purely for acquiring controlling interest or as per the specific requirement under a statute or contract with government.

## Recommendations

- The strategic investments are generally made with the intention of acquiring controlling interest for the purpose of enhancing the business objective of the group. The investment idea is therefore business driven and not with the intention of earning dividend income. In such cases, dividend income, if any, is purely incidental in nature.

- Further, in respect of certain businesses like power, infrastructure development etc., the statute/government requires the taxpayer to execute the project only through a SPV Company. Accordingly, making an investment in a Company is a pre-requisite business model for such businesses. In such cases also, dividend income, if any, is purely incidental in nature.

- It should be specifically clarified that aforesaid investments would not be included for computing disallowance under Section 14A of the Act.

## Issue

- 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 profits 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 profits under Section 115JB of the Act. This 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.

## Recommendation

- 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 profits under Section 115JB of the Act.

## 3.7. Investment Allowance - Section 32AC

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

## Issues

- The phrase 'manufacture or production of an article or thing' has not been defined in Section 32AC of the Act which can entail litigation.
- The Memorandum explaining the provisions of the Finance Bill, 2013 states that the proposed investment allowance is meant for a company engaged in the business of manufacture of an article or a thing. However, other sectors like developing and building an infrastructure facility, telecom infrastructure service providers, processing/ assembling activities, creation of broadband facility are equally important for the growth of the Indian economy. Similarly, the investment allowance should be allowed for the other sectors for the overall growth of the economy.
- New asset for the purpose of Section 32AC of the Act would not include any office appliance including computers and computer software. It may be noted that the computers and computer software such as servers, ERP systems etc. are intended to enhance overall operational efficiency. Hence, it is ironical that modern technologies tools such as computer and computer software are excluded though they bring about efficiency in manufacture and production of goods.
- The benefit intended to be provided by way of grant of investment allowance under Section 32AC of the Act would get diluted on levy of MAT under Section 115JB of the Act.
- There is ambiguity as to whether the unutilized investment allowance (in case there is no sufficient income to absorb the investment allowance) would be carried forward to the next year or not.
- One of the eligibility criteria for grant of investment allowance is that the taxpayer must 'acquire and install' the new plant and machinery in the year of claim.The terms 'acquired' and 'installed' for the purpose of Section 32AC of the Act are not defined which will lead to doubts on interpretation and may entail litigation.Further, it is possible that 'acquisition and installation' may not be completed in the same year; installation of asset specifically for big projects may spill over to the subsequent year of acquisition. In such cases, the benefit is lost which is not the objective behind the introduction of the investment allowance.

## Recommendations

- The allowance under Section 32AC of the Act should also be extended to other sectors like those in operating developing and building an infrastructure facility, telecom infrastructure service providers, processing/assembling activities, creation of broadband facility, and conversion of LNG into RLNG etc.
- Further, it is not clear if deduction under this Section is applicable to IT (Information Technology)/ITES (IT Enabled Services) companies using various kinds of computers/ data processing machines to manufacture/develop software. Therefore, it is suggested that an explanation be inserted under Section 32AC to extend such benefit to IT/ITES

companies engaged in 'manufacturing' or 'developing' of software. Also, the definition of "new assets" under Section 32AC of the Act should be amended to cover 'computers or computer software used by IT/ITES companies for manufacturing/development of software'.

- The investment allowance eligible for deduction under Section 32AC of the Act should be reduced while computing book profit of the company under the provisions of Section 115JB of the Act. Otherwise a taxpayer may have to pay MAT though being eligible for the deduction under normal provisions of the Act. Such reduction of book profit by the deduction amount will give taxpayers the investment benefit in real terms and thereby attract more industrial and infrastructural investments.
- Specific provisions for carry forward and set off of investment allowance for an indefinite period should be brought in the Act.
- The scope of 'manufacture or production of any article or thing' and terms 'acquired', 'installed' be clearly defined to avoid any potential litigation on interpretation and implementation of the provision.
- It is suggested that the eligibility criteria for grant of investment allowance be amended and such allowance be granted in the year in which such assets are installed.

## 3.8. Depreciation – Section 32

### Issues

- Whether depreciation allowable on Goodwill.
- Oil wells are classified as buildings and therefore, depreciation at a less rate of 10% is allowed on the same.
- Need for Higher depreciation for plant and machinery.
- Whether 'non-compete fee' can be regarded as 'any other business or commercial right of similar nature', to be eligible for depreciation as 'intangible asset' under Section 32 of the Act
- In case of new plant and machinery acquired and installed after 31st March, 2005, additional depreciation to the prescribed taxpayers is allowed @ 20% under Section 32(1)(iia) of the Act. In case the new plant and machinery is put to use for less than 180 days in the year in which it is acquired, additional depreciation will be allowed @ 10%. However, there is ambiguity on allowability of balance depreciation @ 10% in the subsequent year on such plant and machinery.

### Recommendations

- In line with the recent Supreme Court decision in the case of CIT v. Smifs Securities Ltd. (2012) 24 Taxmann.com 222, a clarificatory amendment should be brought for specific inclusion of Goodwill in the definition of block of intangible assets. Further, it would be appropriate to provide clarity on allowability of depreciation on self-generated/ purchased goodwill.
- Oil/Gas well should be classified as 'Plant and Machinery' for mineral oil concerns eligible for special rate of 60% depreciation. However, tax officers consider oil well as building and allow depreciation @10% as against eligible rate of 60% applicable to such plant & machinery relying on the definition given in notes forming part of Appendix – I "Table of rates at which depreciation is admissible'' wherein 'building' has been defined to include roads, bridges, culverts, wells and tube wells. Tax officers consider that oil well is also covered as building since it is an inclusive definition.

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

- It would be in fitness of things to restore the rate of depreciation on general plant and machinery to 25% from 15% to encourage investment in new plant and machinery entailing up-gradation of obsolete technologies.
- Moreover, the Government should extend the initial depreciation under Section 32(1)(iia) of the Act to service industries as well which is currently available to only manufacturing sector.
- There is a lack of clarity as to whether payment made for non-compete fees shall be eligible for depreciation under Section 32 of the Act as 'intangible assets', which has given rise to unintended litigation. However, various judicial precedents [Pentasoft Technologies Limited vs. DCIT (264 CTR 187) (Madras HC) and ITO vs Medicorp Technologies India Ltd (122 TTJ 394) (Chennai Tribunal)] have held that non-compete fees shall fall within the meaning of 'any other business or commercial right of similar nature'. 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'.
- An amendment should be made in Section 32(1)(iia) of the Act to clarify that where new plant and machinery is acquired in a year and put to use for less than 180 days, it would be eligible for balance additional depreciation @10% in the subsequent year.

## 3.9. Disallowance - Section 40(a)

### Issues

- There has been a recent debate regarding disallowance of expenses under Section 40(a)(ia) of the Act whether it would cover the amounts which were 'paid' during the FY or only the amounts which remained 'payable' at the end of the FY. In this regard, there are conflicting decisions by various Courts [such as CIT vs Vector Shipping Services (P) Ltd (357 ITR 642), Merilyn Shipping & Transports v ACIT (146 TTJ 1), ITO vs Pratibhuti Viniyog Limited (ITA No 1689/Mum/2011)].
- In view of widespread litigation on this issue, the CBDT has clarified (vide Circular No 10 of 2013 dated December 16, 2013) that disallowance under Section 40(a)(ia) of the Act for non-compliance of TDS provisions is applicable both to amounts paid as well as remaining payable at the end of the FY.
- The Finance Act (No 2), 2014 amended Section 40(a)(ia) of the Act to provide that if specified payments to residents are made without TDS, it will result in disallowance of only 30% of the such payments and the payer is considered as an assessee in default. Prior to FY 2014-15, entire amount (instead of 30%) of the specified payments on which tax was not deducted was disallowed under Section 40(a)(ia) of the Act. In addition, no disallowance shall be made and the taxpayer shall not be treated as an assessee in default, where the resident payee has paid the taxes due on such receipt and furnished evidence in support of this such as return of income for that year, a certificate from accountant to this effect etc. This benefit is only available in case of resident payees.

### Recommendations

- It is recommended that 30% disallowance should be restricted on the part of the payment on which the tax was not deducted/ deposited at source and not of the entire payment.
- It is recommended that the provisions of Section 40(a)(ia) should clarify that if, in earlier years, the disallowance of 100% was made, then 100% of the amount should be allowed as deduction on payment of such taxes to the Government Treasury during the subsequent years (instead of 30%).
- Due to ambiguity in the provisions of Section 40(a)(ia) of the Act and contrary decisions on the issue whether such provision would be attracted on both 'paid and payable', it is recommended that amendment should be made in Section 40(a)(ia) of the Act to specifically clarify the applicability of such provisions.

- In order to align the two sub section (i) and (ia) of Section 40(a), it is also suggested that Section 40(a)(i) of the Act should be amended to provide the following:
    - 30% disallowance, instead of 100% disallowance for amount paid/ payable to non-residents,
    - no disallowance in cases where the due taxes have been paid by the non-resident payees subject to conditions as applicable in case of resident payees

## 3.10. An indirect tax on State Governments – Section 40(a)(iib)

### Issues

- Section 40 (a)(iib) of the Act, introduced vide Finance Act, 2013, provides for disallowance of any sum paid by way of royalty, license fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively or appropriated directly or indirectly from any State Government Undertakings by the State Governments. Even the dividend income on investments made by State Government, which should have been exempt in the hands of shareholder is made liable under Section 115-O in the hands of the company
- This has resulted in additional taxes on the State Government undertakings.

However, this Section is not applicable to Central Government undertakings. The object stated in the Memorandum is to protect the tax base of the State undertakings. The effect of the amendment is that it discriminates the State Government undertakings from the Central Government undertakings as well as other taxable enterprises.

### Recommendation

- It is suggested that this amendment should be repealed as this has resulted in lack of level playing field between the Central and State Government undertakings. Also, this amendment is a matter of constitutional impropriety and an encroachment on State revenues.

## 3.11. Deemed Dividend - Section 2(22)(e)

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

## 3.11.1. Taxability of genuine inter-corporate loans and advances as deemed dividend

### Issues

The provision suffers from many inequities:

- It taxes a loan, though it may be quite a genuine one, which is duly repaid within its scheduled short time. Moreover, there is no corresponding tax-relieving provision at the time of recovery of the loan.
- The tax is attracted, notwithstanding that the loan may be advanced at a fair commercial rate of interest and notwithstanding that preponderant majority of persons owning the concern which received the loan are not even shareholders of the lending company.

### Recommendations

- At present, no tax is payable by the shareholder on dividend received from companies and only the company pays DDT. Therefore, levy of tax on deemed dividend in the hands of shareholder at the normal rate is unjustifiable especially when all other deemed dividends are also subjected to DDT. If this suggestion is not accepted, then adequate provisions should be made to exclude genuine transactions from the consequences of these provisions.

- Illustratively, genuine loans and advances, given on current market rate of interest and which are re-paid during the year, should be excluded from the scope of deemed dividend as these are not a subterfuge for payment of dividend.
- Loan given as part of business transaction and Inter-corporate deposits should specifically be excluded from the application of Section 2(22)(e) of the Act to avoid unnecessary litigation..

## 3.11.2. Accumulated profits not to include capital reserves - Section 2(22)(e)

### Issue

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

### Recommendation

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

## 3.11.3. Taxability of deemed dividend in the hands of recipient not being a registered shareholder

### Recommendation

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

## 3.12. Amortization of certain preliminary expenses - Section 35D

### Issues

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

## Recommendations

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

## 3.13. Deduction of employees' contribution to Provident Fund etc. – Section 43B

## Issue

- 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 upto 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.

## Recommendation

- 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. Even the Courts in the various cases [CIT vs Kichha Sugar Company Limited (ITA No 50 of 2009) (Uttarakhand HC), CIT vs Aimil Limited (2010) (321 ITR 508) (Del), CIT vs Nipso Polyfabriks Limited (2013) (350 ITR 327) (HP)] have held that deduction for employee contribution to PF would be allowed even if the employee contribution is deposited after the statutory time limit but before the due date of filing the return of income.

## 3.14. Conversion of interest into share capital eligible for deduction under Section 43B

## Issues

- As per Section 43B of the Act, specified expenditure is allowed as deduction only in case of actual payment. Such specified expenditure includes interest on loan / borrowings / advances payable to financial institution / banks.
- Typically, in Corporate Debt Restructuring Packages, the interest payable to financial institutions / banks is converted into loan or share capital of the borrower. On such conversion of interest into loan, taxpayers used to claim the deduction of interest under Section 43B of the Act. In order to curb this practice, Explanation 3C and 3D were inserted in Section 43B of the Act by Finance Act, 2006 to clarify that deduction of interest is not available at the time of conversion into loan. Subsequently, CBDT (vide Circular No 7/ 2006 dated 17th July, 2006) clarified that deduction under Section 43B of the Act would be available when such converted interest is actually paid to the lender.
- However, there is no such clarity on the availability of deduction of interest when it is converted into equity shares of the borrower. Recently, the tax officers have started denying the deduction claimed by the taxpayer under Section 43B of the Act at the time of conversion of interest into equity shares, by extending the applicability of Explanation 3C and 3D of Section 43B to such conversion.
- The tax officers while adopting this position place reliance on the decision of Kolkata Bench of Tribunal in the case of Glittek Granites Ltd (25 Taxmann.com 267) wherein it was held that interest converted into share capital of the borrower company would not amount to actual payment for claiming deduction under Section 43B of the Act. The decision of the Tribunal seems to be unreasonable since on conversion of interest into equity shares, the lender

becomes the shareholder of the borrower company and gets various rights, such as, voting rights in conduct of the business of borrower company, right to receive dividend, bonus/ rights shares, preferential right in recovery, right to attend the general meeting of the company, etc. Also, unlike in the case of conversion of loan where deduction is made at the time when converted loan is repaid, deduction will never be available to the taxpayer on conversion of interest into equity shares. This would cause undue hardship to the borrower since the deduction of interest converted into equity shares will never be granted to the taxpayer.

## Recommendation

- It is suggested that Section 43B of the Act should be amended to clarify that where interest payable is converted into share capital, the same would amount to actual payment of interest under Section 43B of the Act. This clarification would result in reducing unnecessary litigation and hardship caused to the taxpayer.

## 3.15. Profits and Gains of business on presumptive basis – Section 44AD / 44AE

## Issues

- Section 44AD of the Act provides for deemed profit tax regime for defined eligible businesses. However, sub-Section (6) of Section 44AD specifically excludes professionals from the ambit of deemed profit tax regime.
- This causes undue hardship to professionals who face the burden of maintaining books of accounts and getting the same audited, if required
- The limits specified under Section 44AD and Section 44AE have become antiquated with respect to threshold of turnover under Section 44AD and limit on number of carriages under Section 44AE.

## Recommendations

- In order to reduce the burden of maintenance of books of accounts by professionals, it is suggested that Section 44AD of the Act be extended to cover eligible professions within its ambit. Monetary limits may also be specified (similar to limits prescribed under Section 44AA of the Act) for granting the benefit of deemed profit regime to such professions.
- The threshold limits under Section 44AD and 44AE must be revised keeping in view the level of inflation and growing business.

## 3.16. Taxability of Unsold Flats in the hands of Real Estate Developers

## Issues

- In case of real estate developers, most of the developers have unsold stock which also includes a chunk of finished flats, apartments and units etc. The finished units remain unsold either due to indifferent market conditions or due to some legal complications etc. Thus, the real estate developer may continue to hold such constructed flats as its stock in trade at the end of the year for the purpose of business. Such unsold construed flats as per the specific exclusion provided in Section 22 of the Act would not attract tax under the head 'income from house property' which comes within the purview of exception provided in Section 22 of the Act, in as much as, it exclude the property that an owner occupy for the purpose of his business.
- The issue relates to the addition on account of annual letting value (ALV) of flats, constructed but lying unsold, assessed on notional basis under the head “Income from head House Property” in the hands of real estate developers. The Delhi HC in the case of CIT vs. Ansal Housing Finance and Leasing Co. Ltd. (2013) 354 ITR 180, has held that the notional ALV of closing stock of flats/ apartments is liable to be assessed as “income from house property” because the real estate developer is owner of such flats/ apartments.
- However, it has not been appreciated that the real estate developers are not in the business of renting out of flats and letting out vacant or other properties. Thus, such real estate developers cannot be taxed in respect of ALV of

flats notionally because they (as owners) are occupants of the flats, and such occupation is limited for the purpose of business, as a builder.

## Recommendation

- It is recommended that a clarification may be issued by the CBDT to provide that property held as stock-in-trade by the real estate developer for the purposes of its business would not to be assessed to income tax on a notional ALV basis under the head “Income from House Property”. This would be in accordance with the provisions of the Section 22 existing as on date and would leave no room for subjective interpretation by the tax officers/ Courts.

## 3.17. Deductibility of discount on issue of ESOP

## Issue

- The deductibility of discount on issue of ESOP as allowable business expenditure under the Act has been a matter of litigation. Recently, the Special Bench of Bangalore Income-tax Appellate Tribunal (Tribunal) in the case of Biocon Ltd. vs. DCIT (155 TTJ 649) held that ESOP is one of modes of compensating the employees for their services and is part of their remuneration. Further, by undertaking to issue shares at a discount, the company does not pay anything to its employees but incurs obligation of issuing shares at a discounted price on a future date in lieu of their services, which is expenditure covered under Section 37 of the Act. However, in absence of clear guidelines on tax treatment of such discount laid down under the Act, the issue has led to unwarranted litigation.

## Recommendation

- It should be explicitly provided in the Act that discount on issue of ESOP is a deductible business expenditure. Further, the principles regarding the determination of ESOP discount and its timing for claiming expense while computing taxable income under the Act should be clearly laid down to avoid any ambiguity.

## 3.18. 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.

## Recommendations

It is recommended that the Explanation 2 to Section 37 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 on account of the following:

- The expenditure of CSR is made towards the betterment of the society and cannot be considered as an application of income.
- The Ministry of Corporate Affairs (MCA) has listed certain guiding principles concerning CSR, which helps one to understand the intention of the Legislature. It states that CSR is not charity or mere donation; CSR is way of conducting business, by which corporate entities visibly contribute to the social good; CSR should be used to integrate economic, environmental and social objectives with the company's operations and growth.
- Even the Courts in India have held that if the expenditure is incurred in advancement of taxpayer's business, the same is allowable as business expenditure under Section 37 of the Act.

- The Act already allows deduction of expenses of the nature referred to in the CSR rules under different Sections such as Section 35AC, Section 35(2AA), Section 80G, etc. This strengthens the argument that CSR expenditure is not an application of income but is expenditure and the same should be allowed as deduction more specifically when such expenditure is mandated by law.

## 3.19. Non-resident related provisions

## 3.19.1. Tax neutrality in case of overseas reorganization

### Issues

- The provisions of the Act are framed to provide tax neutrality only in cases where the amalgamated company is an Indian company. Section 47(vii) of the Act provides that a transfer of shares by the shareholder of an amalgamating company would not be liable to capital gains tax subject to the following conditions:
  - The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
  - The amalgamated company is an Indian company.
- Clearly, the above exemption would be allowed only in case a foreign company is merged into an Indian company and not vice-versa. In other words, if an Indian company merges into a foreign company and the payment of consideration to the shareholders of the merging company is in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as envisaged in Section 234 of the Companies Act, 2013, the amalgamating company and its shareholders would be subject to capital gains tax in India.
- In the emerging global scenario it is important that the merger of Indian companies into foreign companies should be legally recognised and made pari-passu with the merger of foreign companies into Indian companies, particularly for income tax purposes.

### Recommendation

- It is suggested that the requirement of transferee company to be an Indian Company under Section 47(vi) and (vii) of the Act should be removed.

## 3.19.2. Retrospective insertion of Explanations – Indirect Transfers

### Issues

- The Act provides that a capital asset being any share/ interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India if such share or interest derives, directly or indirectly, its value substantially from assets located in India. This was introduced by insertion of Explanation 5 to Section 9(1)(i) of the Act by the Finance Act, 2012 with retrospective effect from 1 April 1962.
- The terms 'substantially' and 'value' are not defined in the Act. The absence of any definition of these terms is leading to significant subjectivity, uncertainty and litigation. Hence, it is reiterated that an objective criterion must be laid down to evaluate whether or not an overseas asset is deemed to be located in India so as to trigger indirect transfer provisions. In this context, it may be clarified that an offshore entity should be regarded as deriving its value substantially from India if at least 50% or more of the fair market value of all the assets owned directly or indirectly by such offshore entity are located in India. The valuation mechanism should also be appropriately prescribed in the Rules to avoid any uncertainty on the computational matters. The above recommendation is in line with PSC Report and Shome Committee report on DTC Bill.

## Recommendations

- At the outset, it is noted that the tax on 'indirect transfers' is a new levy and should therefore have prospective application. It is therefore submitted that the PSC Report and Shome Committee's recommendation that the provisions relating to taxation of indirect transfer as introduced by the Finance Act, 2012 are not clarificatory in nature and would widen the tax base and consequently should only have prospective application, be accepted and the Act be amended suitably.
- While the intention of the amendment may have been to bring within the tax net offshore transfers structured to avoid India tax, even genuine offshore transactions having some assets indirectly in India could get taxed.
- Accordingly, it is humbly re-emphasized that the following exclusions should be carved out from the provisions of indirect transfer of capital assets in India:
    - No Indian tax should be imposed where the shares of the foreign company are listed and traded on a stock exchange outside India. The PSC Report on DTC Bill and the Shome Committee Report also support the above position;
    - Only "transfer of a controlling interest" in a foreign entity deriving its value substantially from assets located in India should attract tax in India. In this regard, a threshold limit of transfer of more than 50% beneficial interest in the capital of a foreign entity and/ or transfer of more than 50% voting power of a foreign entity could be prescribed to define "transfer of a controlling interest". As a matter of fact, the PSC Report on DTC Bill and the Shome Committee Report also recommend that transfer of small shareholding outside India should not be brought within the India tax ambit;
    - Even in case of a foreign entity deriving its value substantially from assets located in India, only such portion of the gains ought to be taxable in India as are relatable to Indian assets. It may not seem proper to tax entire gains relatable to global assets in India. The apportionment mechanism should be brought out in the Rules to avoid any uncertainty on computational matters.
    - No tax should be levied on group restructurings, wherein the ultimate parent remains unchanged. The PSC on DTC 2010 and the Shome Committee Report recommend that transfers occasioned on account of group restructuring outside India should not be taxable in India;
    - No tax should be levied on repatriation of funds by the offshore company/ entity to its investors on account of buy back, redemption, capital reduction or liquidation by the offshore company to the extent the repatriation amount relates to the amount realized by the offshore company on sale of Indian assets on which taxes have been duly discharged, or on which no taxes or lower taxes are due on account of tax provisions or treaty benefits available, as may be applicable; and
    - Transactions which are otherwise not 'transfer' as per law (for example - gift) or transactions, which do not result in any transfer per se, (for example primary infusion in company for acquisition of shares) should not be covered in the deeming fiction created by amending Section 2(47) of the Act. Also, intra group transfers where the intimate control is not transferred outside the group even if there is a change in the parent of the foreign company should be excluded. Also, distribution in specie on liquidation or closure of the parent should be excluded.
    - In line with the Shome Committee's recommendations, it should expressly be clarified that dividends distributed by a foreign company which derives its value substantially from assets located in India ought not to be covered by the 'indirect transfer' provisions to avoid any interpretation issue.

## Issue

- Pursuant to the announcements made in the Union Budget, 2014 by the Finance Minister, the CBDT issued an order dated 28th August, 2014 under Section 119 of the Act for constituting a Committee to look into matters relating to 'indirect transfers'.As per the aforesaid order, where the tax authority considers that any income is taxable in India for indirect transfer cases falling prior to 1st April 2012, such authorities would need to obtain a prior approval of the Committee before initiating any action.

### Recommendations

- It is suggested that CBDT should lay down the policy framework for guidance of Committee in dealing with interpretation of provisions in relation to 'indirect transfers' and selection of cases.
- It is also suggested that for even new cases surfacing post 1st April 2012, the requirement of prior approval of the Committee should be made applicable

## 3.19.3. Taxability of P-Note holders under indirect transfer provisions

### Issue

- There are no provisions in the Act which exempt the Participatory-Note ('P-Note') holders from the applicability of the provisions of indirect transfer on sale of P-Notes outside India

### Recommendation

- Therefore, it is recommended that the provisions should be made in the Act so as to explicitly exempt the P-Note holders from the applicability of the provisions of indirect transfer so as to provide certainty to Foreign Institutional Investors (FII) (who pay taxes in India on their income earned/derived in India) to encourage more foreign investments in India.

## 3.19.4. 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.

### Issues

- 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'.
- Taxability of the software usage/ licensing payments in the hands of non-resident software companies/ vendors as royalty would also go against the internationally accepted principles of taxation.
- Taxation of such software usage payments in the hands of non-resident software companies/ vendors would result in passing on of the costs to their Indian domestic counterparts as well as other Indian customers (business as well as personal consumers) causing significant hardship to the Indian industry.
- This will also significantly impact the global competitiveness of India Inc.
- The retrospective application of the amendment is grossly unfair and would further aggravate the situation.

### Recommendations

- 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.

### 3.19.5. 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 could get expanded to cover payments which are not intended to be covered and may lead to application of the tax provision which could be detrimental to the taxpayers at large. The mere fact that a transaction involves use of equipment by a service provider, without the customer having control/ physical possession of such equipment, payment for such facility/ services cannot be treated as royalty. For example, where a person boards a bus or train by purchasing the requisite ticket, it cannot be said that the person is making payment for availing the bus or train on hire as he does not have the control over such equipment. Rather the customer is merely availing the facility of transportation, the consideration for which facility is not in the nature of Royalty.

#### Recommendations

- It is suggested that Explanation 5 to Section 9(1)(vi) of the Act inserted by the Finance Act, 2012 may be omitted altogether, as this is clearly against the basic principle of the definition of the term royalty provided under Explanation 2 clause (iva) and as also understood internationally.
- Alternatively, in order to avoid ambiguity, the amendment should be modified to objectively provide the rationale behind the insertion of the Explanation 5 and should list out the specific transactions, which it seeks to cover.
- Alternatively, the amendment should have only prospective application.

### 3.19.6. Clarification on definition of process royalty – Section 9(1)(vi)

In Section 9(1)(vi) of the Act, Explanation 6 was inserted, with retrospective effect from the 1st June 1976, clarifying that the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

#### Issues

- The amendment may result in inclusion of charges for the use of transponder capacity or connectivity/ bandwidth within the definition of 'Royalty'.
- Services in the nature of provision of transponder capacity or connectivity/ bandwidth are merely facilities provided. As per international tax practices and OECD Commentary, payments for such facilities should not be treated as 'royalty'.

- Explanation 6 even includes payments towards provision of basic telephone service within the ambit of the term 'royalty'. The business income derived by the telecom providers, if classified as royalty, will significantly alter the tax consequences on the receiver of the consideration for the services provided and will burden the payer with TDS compliances.
- Taxation of foreign companies for such facilities and subsequent passing on of the tax cost to India Inc would entail a significant tax outgo for India Inc, especially companies operating in the field of media and entertainment (satellite and broadcasting companies), IT and ITES companies and telecom.
- This would also impact their global competitiveness.
- The retrospective application of the amendment is grossly unfair and would further aggravate the situation.

## Recommendations

- In line with international practices and the OECD Commentary, it is suggested that the terms 'transmission', 'up-linking', 'amplification', 'downlinking' could be specifically defined in the Act to remove ambiguity on its scope/ coverage in the definition of 'royalty'
- The definition of the term 'transmission' should explicitly clarify that payments for the use of a 'facility' as a service charge, without any control on the process and where the payer is only interested in the service and not in the use of process, should not be covered within its meaning.
- A clarification should be provided that basic services such as telephone/mobile charges and broadband/ internet connectivity charges, payment to cable operators for viewing the television channels, electricity charges, wheeling/transmission charges paid to state electricity grid or to private electricity transmission companies would be outside the ambit of royalty.
- Alternatively, the amendment should have only prospective application.

## Issues

- With the insertion of Explanation 4 and Explanation 6 to Section 9(1)(vi) of the Act, there is an ambiguity as to whether subscription charges paid for download of e-content, access to online database, reports, journals etc. can fall within the purview of "Royalty".
- It has been held by various Courts that the information that is available in public domain is collated and presented in a proper form by applying the taxpayer's methodology and the payment for the same is not to be construed as royalty. It is in line with the international standards and supported by the OECD commentary, which provides that data retrieval or delivery of exclusive or other high value data cannot be characterized as royalty or FTS.
- Taxation of foreign companies/ publishers for providing access to such online database or in the form of CD as royalty and subsequent passing on of the tax cost to Indian industry would entail a significant tax outgo for India Inc. and will especially impact the education system in India.
- The retrospective application of the amendment is grossly unfair and would further aggravate the situation.

## Recommendations

- It is suggested that the terms 'transmission by satellite, cable, optic fibre or by any other similar technology' could be specifically defined in the Act to remove ambiguity on its scope/ coverage definition of 'royalty' and also a detailed circular may be issued elucidating the types of payments covered within the purview of the said terms and thus constituting royalty.
- It is recommended to suitably exclude the payment for the use/ access to online databases, reports, journals etc. and any other payments made by the payer from the purview of royalty, which are essentially made for the use of a

'facility' as a service charge and where (a) the payer is only interested in the service and not in the use of process/ technology used for transmission (b) does not have any control on the process/ technology used for transmission.

- Alternatively, the amendment should have only prospective application.

## 3.19.7. Taxation of Income by way of Royalty or FTS - Section 115A

The Finance Act, 2013 has made an amendment in Section 115A of the Act to provide that tax rate in respect of income by way of royalty and FTS received by a non-resident under an agreement entered after 31st March, 1976, is to be increased from 10% to 25%.

### Issues

- In case where India has entered into a Double Taxation Avoidance Agreement ('DTAA') with the other country, the tax rate mentioned in the DTAA would apply if it is more beneficial to the taxpayer. It may be noted that most DTAA's entered into by India, barring a few, have a rate of 10% or 15% for taxing royalty/ FTS.
- The tax rate of royalty/ FTS under Section 115A of the Act was earlier reduced from 20% to 10% vide the Finance Act, 2006. The Hon'ble Finance Minister, in his speech mentioned as follows:-

  > “To encourage technological up gradation, I propose to reduce the withholding tax on technical services from 20% to 10%.”

- It is pertinent to note that India still requires import of technological services/ royalties in order to accelerate its growth. In case of royalty/ FTS provider being a resident of a country not having a DTAA with India, the tax rate will increase from 10% to 25%. Further, the reality is that in technology agreements, more often than not, the royalty/ FTS agreements provides for payment of consideration to non-residents net of any taxes. Such taxes borne by an Indian company are further grossed-up and the actual tax liability borne by them is increased.

  Such major hike in rate of tax on import of technology would adversely affect the cost competitiveness of the Indian companies.

- It has been also observed that amendment is effective from FY beginning 1st April 2013 onwards and the increased rate of tax would apply to all the technology/service agreements entered after 31st March, 1976. It will severely impact the cost of the Indian businesses wherever the tax cost is to be borne by the taxpayer.

### Recommendation

- It is recommended that the rate of tax on royalty/ FTS payments should be rolled back to 10%.

## 3.19.8. Amendment to the Explanation inserted after Section 9(2)

### Issues

- Section 9 of the Act provides for situations where income is deemed to accrue or arise in India. Vide Finance Act, 1976, source rule was provided in Section 9 through insertion of clauses (v), (vi) and (vii) in sub-Section (1) for income in the nature of interest, royalty / FTS respectively. It was provided, inter-alia that in case of payments as mentioned under these clauses, income would be deemed to accrue or arise in India to the non-resident under the circumstances specified therein.
- The intention of introducing the source rule was to bring to tax interest, royalty and FTS, by creating a legal fiction in Section 9 of the Act, even in cases where services are provided outside India as long as they are utilised in India. The source rule, therefore, means that the situs of rendering of services is not relevant. It is the situs of the payer and the situs of the utilisation of services which will determine the taxability of such services in India.
- This was the settled position of law till 2007. However, the Supreme Court, in the case of Ishikawajima-Harima Heavy Industries Ltd (288 ITR 408) held that despite the legal fiction in Section 9 of the Act, for any such income to be

taxable in India, there must be sufficient territorial nexus between such income and the territory of India. It further held that for establishing such territorial nexus, the services have to be rendered in India as well as utilised in India.

- This interpretation was not in accordance with the legislative intent that the situs of rendering service in India is not relevant as long as the services are utilised in India. Therefore, to remove doubts regarding the source rule, an Explanation was inserted below sub-section (2) of Section 9 of the Act with retrospective effect from 1st June 1976 vide Finance Act, 2007. The Explanation sought to clarify that where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-Section (1) of Section 9 of the Act, such income shall be included in the total income of the non-resident, regardless of whether the non-resident has a residence or place of business or business connection in India.
- However, the Karnataka HC, in the case of Jindal Thermal Power Company Ltd. v. DCIT (TDS) (286 ITR 182), has held that the Explanation, in its present form, does not take away the requirement of rendering of services in India for any income to be deemed to accrue or arise to a non-resident under Section 9 of the Act. It has been held that on a plain reading of the Explanation, the criteria of rendering services in India and the utilisation of the service in India laid down by the Supreme Court in its decision in the case of Ishikawajima-Harima Heavy Industries Ltd. remains unaltered and unaffected by the Explanation.
- With a view to removing any doubt about the legislative intent of the aforesaid source rule, the Finance Act, 2010 substituted the existing Explanation with a new Explanation to specifically state that the income of a non-resident shall be deemed to accrue or arise in India under clause (v) or (vi) or (vii) of sub-Section (1) of Section 9 of the Act and shall be included in his total income, whether or not:
  - the non-resident has a residence or place of business or business connection in India or
  - the non-resident has rendered services in India.
- This was made effective retrospectively from 1st June, 1976. The retrospective nature of the amendment is a cause of concern amongst taxpayers since it would lead to reopening of past assessments.

### Recommendation

- The relevant provisions of Section 9 of the Act, in force since 1976, have been interpreted by the Supreme Court in India requiring the taxpayer to also satisfy the condition of 'rendering of service in India' for being taxable in India. It would therefore be only fair to make this provision apply prospectively. Alternatively, a provision be inserted to clarify that past transactions would not be re-opened or contested by the tax officers on the strength of this provision.

## 3.19.9. Taxation of Foreign Dividends and Capital Gains - Section 115BBD and Section 47

- With the rapid growth and development of the Indian economy over the last two decade, many Indian entrepreneurs have expanded their horizons outside India. A large number of Indian Corporate Houses have been making huge investments abroad to tap the foreign markets. The Indian outbound investments have been steadily growing year after year. While some outbound investments have been made directly, many have been structured through holding companies based in low taxed jurisdiction.
- Owing to high tax rates in India, the profits from overseas business are not repatriated back to India. In order to curb such issue, special tax regime was enacted under Section 115BBD of the Act for taxing dividend income @ 15% from specified foreign companies (with shareholding of the Indian company of 26% or more).
- Further, capital gains tax regime for unlisted companies are not beneficial as compared to exemption on long term capital gains from sale of shares of companies listed on Indian stock exchange. Also, the gains derived by overseas holding companies from divesture in overseas operating companies are also retained at overseas holding company level.

### Issues

- The benefit of reduced rate of tax on dividends as per Section 115BBD of the Act is restrictive and is available only to Indian companies only and not to other persons. Further, it is applicable only for the FY 2013-14.
- Long term capital gains earned by Indian holding company from transfer of shares in foreign companies is taxable in India @20%.
- There are no provisions under the Act for availing underlying tax credit on dividends and such tax credit can be availed only through a few tax treaties.
- Capital gains arising pursuant to certain business restructuring overseas (viz. amalgamation of foreign companies held by Indian company, demerger) are not exempt.

### Recommendations

- The reduced rate of tax on dividends received from a specified foreign company should be extended for FYs post FY 2013-14 onwards and it should also be extended to all persons (including a company) as defined in Section 2(31) of the Act.
- Alternatively, tax on such dividends should be treated akin to MAT, creditable against the normal tax liability and payable only if the tax on normal income is less than the tax on such dividends.

## 3.19.10. Cascading effect of DDT on dividend received from foreign companies - Section 115-O

- As per the amendment in Section 115-O of the Act vide Finance Act 2013, dividend taxed as per Section 115BBD of the Act received by the Indian company from its foreign subsidiary (i.e. where equity shareholding of the Indian company is more than 50%), then any dividend distribution by such Indian Holding Company to its shareholders in the same FY to the extent of such foreign dividends will not be liable to DDT.

### Issue

- As per Section 115BBD of the Act, dividend received from a specified foreign company i.e. a foreign company in which the holding of the Indian company is 26% or more in the nominal value of equity share capital, is subject to tax at a lower rate of 15%. However, as per provisions of Section 115-O of the Act, where dividend is received from a foreign subsidiary (i.e. more than 50% equity shareholding) which is subject to tax @15% under Section 115BBD of the Act, then such dividend will be reduced from the DDT base on any further dividend distributed by the Indian company. In other words, where the Indian company holds 26% to 50% in nominal value of the equity share capital of the foreign company, then such dividend would not be excluded for computing DDT base of the Indian parent.

### Recommendation

- It is suggested that the requirement relating to shareholding of more than 50% in the foreign subsidiary for the purpose of Section 115-O of the Act should be reduced to 26%, in the specified company to remove the cascading effect of DDT. Also, the objective of incentivizing repatriation of funds shall be successful when the dividend received from a specified foreign company and distributed by the Indian company is not liable to DDT, thereby removing the cascading effect.

## 3.19.11. Requirement for non-residents to comply with TDS obligations - Section 195

The Finance Act, 2012 extended the obligation to deduct tax at source to non-residents irrespective of whether the non-resident has:

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India.

The aforesaid amendment was introduced with retrospective effect from 1 April 1962.

## Issue

- The amendment will result in a significant expansion in the scope of TDS provisions under the Act and will cover all non-residents, regardless of their presence/ connection with India.

## Recommendations

- In the decision of the Supreme Court in the case of Vodafone International Holdings B.V. [(2012) 345 ITR 1 (SC)], it was observed that the provisions of Section 195 of the Act would not apply to payments between two non-residents situated outside India subject to certain conditions. The Supreme Court also referred to tax presence as being a relevant factor in order to determine whether a non-resident has an obligation to deduct tax at source in India under Section 195 of the Act.
- The amendment by the Finance Act, 2012, however, seeks to expressly extend the scope of TDS obligations to all persons including non-residents, irrespective of whether they have a residence/ place of business/ business connection or any other presence in India. The amendment should be modified to restrict the applicability of TDS provisions to residents and non-residents having a tax presence in India.
- Alternatively, the amendment should be made effective only prospectively. Making such a provision applicable with retrospective effect will operate harshly on persons who may have made payments based on the law prevalent prior to the amendment.

## 3.19.12. 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 face 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.

## Recommendations

- The Vijay Mathur Report on non-resident taxation (January 2003) which advocates treating non-residents with a branch office at par with residents for the purpose of deducting tax on income chargeable to tax. Illustratively, it provides as follows:

  > "4.13.2 Non-residents having Branch Office/ Project Office in India and performing work covered under section 194C should be considered at par with the residents for TDS purposes and as such the same rate of TDS should apply to payments made to them. The Working Group recommends that suitable amendment should be made for this purpose."

- In line with the aforesaid principle, it is recommended that payments which are in the nature of business income of non-residents having an India branch office or 'a place of business within India' should be subject to similar TDS requirements as in case of payments to domestic companies. Further, at the beginning of a tax year, the non-resident taxpayer who has an India branch office or 'a place of business within India' should be permitted to admit PE and opt for a TDS mechanism as is applicable to a resident company. It would go a long way in facilitating ease of doing business in India and the tax officer would be in a position to better monitor and regulate such non-resident companies. Further, it would also achieve the stated objective in the Kelkar Report (December 2002) to abolish the system of approaching the tax officer for obtaining certificates for deduction at lower rates and minimize the interface between the taxpayer and tax officer.

### 3.19.13. Mandatory application to tax officer to determine sum chargeable to tax - Section 195

- Finance Act 2012 has introduced sub-Section (7) to Section 195 of the Act under which it is mandatory to make an application to the tax officer to determine the appropriate proportion of sum chargeable under the Act.
- This provision will apply to notified persons/ cases and will apply regardless of whether such transaction is chargeable to tax or not.

#### Issue

- Compulsory clearance from the Revenue Authorities on notified overseas payments adds to the compliance burden and can impact legitimate commercial activities.

#### Recommendations

- The Supreme Court in the case of GE India Technology Centre observed that, there exists no obligation to deduct tax under Section 195 of the Act unless sum payable to the non-resident is 'chargeable' under Act.
- Considering, the volume of international transactions/ payments, the imposition of a requirement to obtain clearance from the tax office would prove very onerous and slow down the pace of commercial transactions. It is submitted that the present system of reporting together with TDS provisions are sufficient to ensure appropriate deduction of tax on overseas payments. Hence, Section 195(7) of the Act should be deleted.
- Without prejudice to the above recommendation, the list of persons/ cases to be notified under this provision should be tailored so as to not affect genuine commercial transactions.

### 3.19.14. Information to be furnished for making remittance abroad

#### Issue

- As per Section 195(6) of the Act read with Rule 37BB of the Rules, a person making remittance to a non-resident is required to submit Form 15CA electronically on the website designated by the income tax department and is further required to get a certificate from a Chartered Accountant in Form 15CB in respect of the particulars filled in Form 15CA.

#### Recent Amendment to the Rules

- Rule 37BB of the Rules provides the information that is required to be furnished by a person while making payment to a non-resident. This information is required to be furnished in Form No. 15CA and a certificate from a Chartered Accountant (CA) is required to be obtained in Form No. 15CB. Further, Form No. 15CA shall be furnished electronically on the website designated by the Income-tax department and thereafter a signed copy (in physical form) shall be submitted prior to remitting the amount.
- In August 2013, the CBDT had amended Rule 37BB of the Rules vide its Notification No. 58 of 2013, dated 5th August 2013, to broaden the requirement of collecting information and reporting requirements for all remittances outside India. The Rule also prescribes to provide information in cases where amounts are not liable to be taxed under the Act.

- The CBDT has issued notification no. 67 of 2013, dated 2nd September 2013, which has further revised the scope and the format of reporting of information under Rule 37BB of the Rules. It provides that the person responsible for making any payment including any interest or salary or any other sum chargeable to tax under the Act shall be required to furnish details in the prescribed forms.The notification also provides a specific list of payments which are not required to be reported under the revised rule. The amended Rule shall come into force from 1 October 2013.

## Issues

- There is ambiguity with respect to whether the amended rule will apply to transactions which are not chargeable to tax such as import of goods or payments in the nature of FTS/ royalty, which are not taxable in India by virtue of beneficial DTAA provisions. “Import of goods” is one of the transactions, which was included in the specified list, notified vide notification no. 58 of 2013 and then deleted from the specified list notification no 67 of 2013.

- Form 15CA has to be filed online, however, there is no mechanism in the system to edit or rectify the inadvertent errors made while inputting the data in the fields and the taxpayer has to again fill in Form 15CA and upload it on the website. This leads to creation of duplicate form 15CAs, wherein both the forms with the correct details and earlier form with errors remain in the system.

- Form 15CA can be uploaded/ signed on the e-filing portal of Income-tax Department, using Digital Signature Certificate (DSC) of the person who is authorized to sign the return of income as per Section 140 of the Act. Accordingly, Form 15CA can be uploaded using the DSC of the managing director or director of the company. In case frequency of payments of foreign remittances is large and further, if the payments to foreign offices/ suppliers are made through offices at various locations across the country of a single company, it poses great difficulty as it is not feasible for a managing director or a director to put his DSC on each and every remittance made from various locations.

- The amended Rule 37BB provides that the Revenue Authorities may require the AD to furnish the signed print out of Form 15CA for the purpose of any proceeding under the Act. However, the rule is silent on the period during which the signed Form 15CA may be requisitioned by the Revenue Authorities. This casts substantial onus on the AD to archive, retain and retrieve these documents.

- The amended Rule 37BB states that any person responsible for paying to a non-resident any interest or salary or any other sum chargeable to tax under the provisions of the Act is required to furnish the prescribed information. Hence, it appears that if the payment is not chargeable to tax under the Act, no information is required to be furnished. However, there is ambiguity in respect of reporting requirement pertaining to exempted salary or interest payments vis-à-vis the new forms that specifically prescribe to report only such payments which are chargeable to tax.

- The companies may face a practical difficulty while remitting the payments. The Banks AD may go by the 'Specified list' and may not accept the argument with respect to “chargeable to tax” for those items which are not mentioned in the 'Specified list'. Further, to prove non-chargeability under the Act or DTAA, the Bank/ AD may ask the client to obtain a CA Certificate or tax officer's Certificate or tax officer's order as the case may be.

- One may argue that the specified list provided in Explanation 2 to amended Rule 37BB is “for removal of doubts” and accordingly, it is clarificatory in nature. Thus, the list of payments specified in Explanation 2 is an illustrative list and not an exhaustive list. In other words, those payments which are not chargeable to tax under the Act even though not specified in the list should not be required to be reported. However, practically it would be challenging to convince the Bank/ ADs regarding the same.

## Recommendations

- It is recommended that a clarification be issued with respect to applicability of the said rule and compliances required there under for exempted interest and salary payments, import of goods/ raw materials as well as payments such as royalty/ FTS which are exempt under the DTAA provisions/ not chargeable to tax under the Act. Further, it is recommended that payments for import of goods/ raw materials should be added in the specified list of transactions not required to be reported under the revised rule.

- It is recommended that due modification be made in the system of the Revenue Authorities so that the data wrongly punched in can be rectified before uploading Form 15CA.
- It is recommended that Form 15CA should be allowed to be accessed and uploaded to the e-filing website of the Revenue Authorities by persons duly authorized by the managing director/ director of the company. TRACES provide the facility of multiple log-in for single TAN. Under this facility, apart from the main users, four sub-users can be created to do a particular activity/ task. The similar mechanism can also be explored and implemented for filing of Form 15CA. The requirement for the AD to produce the signed Form 15CA before an income tax authority for the purposes of any proceeding under the Act, without any time limit may be removed. The earlier position as per CBDT Circular 4/ 2009 dated 20th June 2009 may be reinstated wherein the payer may be required to submit the duly signed Form 15CA in duplicate to the AD and AD will in turn forward a copy of the undertaking to the tax officer concerned.

## 3.19.15. Tax Residency Certificate (TRC)

- The Finance Act, 2012 had provided that in order to be eligible to claim relief under the DTAA, a taxpayer is required to produce a TRC issued by the Government of the respective country or the specified territory in which such taxpayer is resident, containing certain prescribed particulars. Subsequently, the CBDT prescribed the details to be included in the TRC.
- The Finance Act, 2013 has done away with the requirement of obtaining prescribed particulars in the TRC. In other words, the taxpayer can continue to obtain the TRC as issued by the foreign authorities. The Finance Act, 2013 also introduced a provision to clarify that the taxpayer shall now be required to furnish such other information or document as may be prescribed.
- The CBDT subsequently issued a notification amending the Rule 21AB of the Rules, prescribing the additional information required to be furnished by non-residents along with the TRC. The details are required to be furnished in Form 10F.

## Issues

- Even though the requirement to furnish TRC containing prescribed particulars has been dispensed with, however, depending on the jurisdiction, obtaining a TRC certificate may also be a time consuming and difficult process. TRC requirement increases the administrative difficulty for non-residents, especially from the perspective of non-residents having very few/ limited transactions connected to India.
- The deductor would like to obtain the TRC at the time of the transaction/ depositing the tax (to ensure that the payee is eligible for DTAA benefits), the payee would typically be able to obtain TRC only after the relevant year.
- As per the Rule 21AB of the Rules, an Indian resident who wishes to obtain TRC from Indian Revenue Authorities, is required to make an application in Form No. 10FA to the tax officer, containing prescribed details. However, no time limit for issue of TRC is specified from the date of application by the taxpayer. Furthermore, the issue of TRC in Form No. 10FB has been left to the discretion of satisfaction of the tax officer, without providing a substantive definition for satisfaction in this regard.
- Rule 21AB of the Rules does not clarify the authority for signing Form 10F, which causes confusion to the taxpayers and the Revenue Authorities.

## Recommendations

- The requirement to obtain TRC for a taxpayer to prove that he is a resident of the other state shall be deleted as there may be circumstances wherein the taxpayer who is a bona fide tax resident of the other contracting state is unable to procure a TRC owing to circumstances outside his control. At assessment stage, it is anyway incumbent upon the tax officer to ascertain complete details before allowing DTAA benefits. In such a scenario, even though the tax officer may otherwise be satisfied that the DTAA benefits must be allowed, only owing to the procedural lapse of not obtaining the TRC which is beyond the taxpayer's control, the tax officer would be compelled to deny DTAA benefits, which will cause needless hardship.
- Without prejudice, even if the requirement to obtain TRC must stay, it is recommended that the TRC should be made mandatory only for cases where the total payment to a non-resident exceeds Rs. 1 crore in a FY. This would mitigate hardship in respect of small payments.
- It is also recommended that the requirement to furnish TRC should be cast upon the payee at the time of the assessment of the payee and the deductor/ payer should not be made liable to collect TRC from the payee at the time of TDS.
- The time limit to issue TRC in Form 10FB should be specified and to further specify that in case the tax officer refuses to issue a TRC, the application of the taxpayer should be disposed by the tax officer by passing a speaking order and clearly specifying the reasons for rejecting the application of the taxpayer.
- It may be specified that persons prescribed under Section 140(c) of the Act for the purpose of signing the return of income would be eligible to sign Form 10F.

## 3.20. Credit in respect of foreign taxes

## Issues

- Section 209 of the Act rightfully allows reduction of TDS/ Tax collected at source (“TCS”) while computing advance tax liability, however, the same is restricted only to TDS/ TCS under provisions of the Act and does not cover taxes paid in other foreign countries vis-à-vis income earned by the taxpayer from such country and offered to tax in its return of income in India.
- However, in terms of provisions of Section 90/ 91 of the Act, the taxpayer is allowed to claim credit of foreign taxes against its tax liability at the time of filing of its return of income. Further, the interest provisions in Section 234A/ 234B/ 234C of the Act for shortfall in payment of advance tax also provide for reduction of foreign taxes while computing such interest liability.
- As a consequence of above disconnect, the taxpayer ends up paying excess advance tax, resulting in a refund situation post claiming of credit of foreign taxes.
- The Act does not contain any guidelines with respect to foreign tax credits with DTAA countries, thus leading to double taxation of a particular stream of income and denial/ reduction of foreign tax credit.
- As per existing provisions of the Act, foreign tax credit is restricted to the tax liability of the taxpayer in India and in certain cases, the taxpayer is not in a position to claim any foreign tax credit because of losses under the Act or in some cases he is only able to claim partial tax credit. The provisions under the prevailing tax law does not allow for carry forward of the unutilized foreign tax credit resulting in permanent loss to the taxpayer in respect of the foreign tax credit which he is unable to claim.
- In case of countries like USA, Canada and Switzerland the local governments at the provincial/ state level also levy taxes on income hence taxes on income levied by such jurisdictions also amounts to double taxation of income, however, the relief of taxes paid is being denied by the Revenue Authorities in India on the ground that such local taxes are not covered by the applicable DTAA.

## Recommendations

- Section 209 of the Act dealing with payment of advance tax should be amended to expressly provide that advance tax liability should be computed after reducing credit for taxes deducted in foreign country as the credit is otherwise admissible in terms of Section 90/ 91 of the Act.
- It is recommended that with Indian companies increasingly going global, clear legislation as part of the domestic law be incorporated which could potentially address, among others, the following aspects:
    - conflict in determining source of income
    - change in characterization of income
    - varying audit periods
    - varying basis of audits
    - mechanism for allowing full tax credit
- A mechanism should be expressly provided in the Act for allowing credit for taxes on income levied by overseas provincial/ local tax jurisdictions by amending Section 90 of the Act.
- A suitable amendment may be made in the Act by inserting a provision which allows carry forward of unutilized foreign tax credit to be set off against the tax liability of the taxpayer as per the Act in the succeeding years.

## 3.21. Advance Ruling – Chapter XIXB of the Act

### 3.21.1. Time limit for withdrawal of application

#### Issue

- Section 245Q of the Act provides an option to the applicant to withdraw the application within a period of 30 days from date of making an application. Such a time limit fails to serve any purpose since practically, even the first hearing does not happen within the time span specified. It is however seen that the applicant is not precluded from withdrawing the application even after the specified time with the permission of AAR.

#### Recommendation

- In such a scenario and keeping in mind the interest of justice, it is hereby suggested that the period should be suitably extended so as to enable the applicant to withdraw its application any time before the application is admitted/ heard.

### 3.21.2. Time limit for Commissioner of Income tax to furnish observations and records

#### Issue

- Section 245R of the Act stipulates to provide a copy of the application to the jurisdictional Commissioner of Income tax (CIT) and if necessary to call for relevant records. Further, the Rule 13(2) of the Authority for Advance Rulings (Procedure) Rules, 1996 also empowers the AAR to call for relevant records along with comments from the CIT, if any, on the contents of the application. However, the Section as well as the Rule is silent on the time frame within which the CIT is required to furnish the relevant records called and provide his comments, if any, on the content of the application. It is seen in many cases that the CIT does not reply within a reasonable period of time which delays the procedure for the admission of the application.

#### Recommendation

- In view of speedy disposal of the matters, it is suggested that a time limit should be introduced within which the CIT is required to furnish the relevant records called and provide his comments, if any, on the content of the application.

## 3.21.3. Time limit for disposal of Advance Ruling

### Issue

- Sub-Section (6) of Section 245R of the Act stipulates a time limit of six months from the date of application to pronounce the Advance Ruling. However, as deduced from the Rulings pronounced and reference to handbook issued by the AAR, it appears that the time limit is flexible and not mandatory to follow.

### Recommendation

- As the AAR was set-up with an underlying intent to expedite the disposal of income-tax issues, it is hereby suggested that the time limit so specified should be adhered to and made mandatory.

## 3.21.4. Binding Nature of the Precedent

### Issue

- Section 245S of the Act which provides for the binding force of the Ruling pronounced by the AAR, fails to address whether the AAR would be bound by an earlier Ruling pronounced by it. With judicial precedents specifying that the Ruling only has a persuasive value, it is seen that the recent Rulings of AAR taking divergent views from the stand already taken earlier by the AAR for similar legal and factual situations.

Recommendation

- In view of the above, to establish consistency, correct legal position and to avoid conflicting Rulings on similar facts, it would be appreciated if the Legislature suitably incorporates provisions giving effect to the binding nature of the earlier Rulings of the AAR. Alternatively, in case the current bench of the AAR does not agree with a Ruling pronounced earlier, the matter may be referred to a larger bench as done in the Tribunal.

## 3.22. General Anti Avoidance Rule - Chapter X-A

- The General Anti Avoidance Rules (GAAR) had first been introduced in the DTC in 2009 to curb 'Impermissible Avoidance Agreement' (IAA) entered into by a person to avoid taxes. The GAAR had been introduced to deal with aggressive tax planning involving use of sophisticated structures. The Finance Act, 2012 had inserted Chapter X-A, dealing with the provisions of GAAR to be effective from 1 April 2014. Subsequently, Finance Act 2013, amended provisions of Chapter X-A and the current GAAR provisions would come into force with effect from 1st April 2016. The CBDT has also notified certain rules relating to application of GAAR.

## 3.22.1. Factors relevant for determining impermissible arrangements

- The Finance Act 2013 has amended Section 97(4) of the Act to provide that factors like, period or time for which the arrangement exists, the fact of payment of taxes and the fact that an exit route is provided by the arrangement, may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not.

### Recommendations

- Apart from the circumstances provided for clarifying whether the arrangement lacks commercial substance, the following additional points may also be considered relevant for determining whether the arrangement is an impermissible avoidance arrangement:
  - the form and substance of the transaction in which the scheme was entered into or carried out;
  - whether the transaction is a single isolated transaction or a series of transactions;
  - the change in the financial position of the taxpayer that has resulted or will result from the transaction; and

- the change in the financial position of the party connected to the relevant taxpayer that has resulted or will result from transaction.

## 3.22.2. Scope of the term 'significant' in Section 97(1)

The Finance Act, 2013 provides an additional condition under Section 97(1) that an arrangement shall also be considered to be lacking commercial substance, if it does not have a significant effect upon business risks, or net cash flows apart from the tax benefit.

### Issues

- It is a fact that any prudent businessman would undertake a transaction with a third-party which will definitely have a bearing on the business risks/ net cash flows of him/ other party. The intent behind the insertion of this provision is to go behind the taxpayers who undertake a transaction which does not have an effect on their business risks/ net cash flows.
- The terms 'significant' is not defined under the Section to quantify the actual risk/ net cash flow in order to conclude that the arrangement lacks commercial substance.

### Recommendation

- The term “significant” needs to be defined appropriately to avoid potential litigation.

## 3.22.3. DTAA vis-a-vis domestic tax laws

The Finance Act, 2013 has inserted a new sub-Section (2A) in Section 90 of the Act so as to provide that the provisions of newly inserted Chapter X-A i.e. GAAR should apply, the same would override DTAA provision, even if such provisions are not beneficial to the taxpayer.

### Issues

- Insertion of this provision would nullify the international & global principle on “treaty overriding domestic tax laws”.
- Treaty is a commercial contract/ agreement between two countries and vide such contract, the Governments of the countries agree to share the taxation revenue arising on transactions between residents of those countries. Treaty is meant to facilitate trade between countries. Such an important agreement cannot be overridden by any specific country domestic tax laws.

### Recommendation

- This amendment should be withdrawn since the same is against the internationally accepted principles. Given the resultant implications on the non-resident taxpayers, this amendment should be rolled back.

## 3.22.4. Appeals against directions of Approving Panel

The Finance Act, 2013 has introduced new Section 144BA providing that the directions, issued by the Approving Panel shall be binding on the taxpayer and the Commissioner, and no appeal under the Act shall lie against such directions.

### Issues

- The direction issued by the Approving Panel is as per the provisions of the Act. Therefore, taxpayer should be provided with a right to appeal against such directions with the Tribunal.
- In the absence of any right to appeal under the Act, the taxpayer will only have an option to file a writ to challenge the directions of the Approving Panel.

## Recommendation

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

## 3.22.5. Other recommendations of the Shome Committee

The Committee under the Chairmanship of Dr. Parthasarathi Shome, after considering the suggestions of various stakeholders, submitted its final report on GAAR to the Government. The Government considered the report of the Committee and accepted some of the recommendations with a few modifications. However, some of the recommendations do not find any reference in the Finance Act 2013. Some of the concerns and suggestions in relation to invocation of GAAR are given below:

- Substantive investments have come to India by way of portfolio investment or foreign direct investment from two jurisdictions Singapore and Mauritius based on the effective assurance that, on exit, no tax would be levied in accordance with the relevant DTAA. Now, it would be unfair to many stakeholders, both domestic and international, to say that no tax exemption would be provided if they exit after 1 April 2015.

- Rationalization of GAAR

## Issues

- From a foreign investor's standpoint, it is critical to have certainty on whether or not offshore foreign investors investing into India would be entitled to treaty benefits, as may be applicable. If GAAR is invoked, treaty benefits could be denied. Moreover, the language of the conditions triggering GAAR including 'misuse or abuse of provisions of tax laws', 'lacks commercial substance', 'not for bona fide purposes' and 'substantial commercial purpose' etc. are very widely worded and subjective. This could be amenable to various differing interpretations even among the Revenue Authorities. This would result in significant uncertainty on whether or not offshore India investment structures set up by foreign investors would be respected and treaty benefits granted. These provisions could also impact transaction closure/ costs owing to uncertainty on TDS/ representative assessee related liabilities etc.

- Grandfathering for existing structures/ arrangements/ investments

  We would like to reiterate our position to grandfather existing structures/ arrangements/ investments as part of the GAAR provisions and agree with the Revenue authorities' perspective that sham, tax avoidant schemes/ structures must not enjoy protection/ legitimacy by virtue of grandfathering.

  As per Press release dated 14th January, 2013 issued by Government of India, it has been stated that investments made before August 30, 2010 i.e. the date of introduction of the DTC Bill, will be grandfathered. Further, it has been stated that GAAR is proposed to be effective from 1st April, 2016. However, we would also like to re-iterate that GAAR may impact many bona fide structures that have been legitimately put in place.

  As per the recently notified Rules (notification no. 75/ 2013), the provisions of GAAR shall not apply to any income accruing or arising to, or deemed to accrue or arise to, or received or deemed to be received by, any person from transfer of investment made before the 30 August 2010. Further the Rules also specify that, without prejudice to the above, GAAR provisions shall apply to any arrangement irrespective of the date on which it has been entered into, in respect of the tax benefit obtained from an arrangement on or after 1st April, 2015.

  Our jurisprudence has always distinguished between tax planning and tax avoidance/ evasion; the sanctity of legitimate tax planning has been upheld by the Supreme Court of India on multiple occasions. Owing to the rigour of the proposed GAAR regime, many structures, which may erstwhile have been considered legitimate may get impacted. Such structures have been in existence for several years and many commercial/ legal arrangements would have been implemented on the basis thereof at significant cost. It would be prejudicial and unfair to the taxpayer to mid-way subject him to provisions, which did not exist in law when the transactions were entered into.

## Recommendations

- It is suggested that certain objective criteria/ conditions should be laid down, which if fulfilled would not result in the triggering of GAAR provisions and its consequential implications on any offshore entity including denial of treaty benefits.
- Further, it is recommended that the language clarifying the objective criteria/ conditions should also include examples (like incurrence of minimum specified expenditure by the overseas entity) where GAAR provisions would not be triggered.
- It is humbly submitted that in the interest of fairness and consistency, the proposed GAAR provisions should not be made applicable to existing structures/ arrangements/ investments, which are legitimate as on 31st March, 2015 and ought to be grandfathered. For instance, any offshore investment vehicle, which is incorporated under a valid local law prior to 31st March, 2015, holds a valid tax residency certificate but for the applicability of the GAAR provisions, would have been entitled to treaty benefits, ought to be grandfathered.
- As per the recently notified Rules, the provisions of GAAR shall not apply to an arrangement where the tax benefit arising to all the parties to the arrangement in the relevant AY (AY) does not exceed Rs. 3 crore in aggregate.This threshold limit should be further enhanced so as to capture only highly sophisticated structures.
- Many countries do not apply GAAR where SAAR is applicable. It is a settled principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes.

  It is recommended that it should be provided that where GAAR and SAAR are both in force, only one of them will apply subject to prescribed guidelines.
- Provisions for avoiding the taxation of the same income in the hands of the same taxpayer across tax years, if the GAAR provisions are invoked are missing in the amendments brought in so far.

  It is recommended that provisions should be enacted in a manner which would ensure that the same income is not taxed twice in the hands of the same taxpayer in the same year or in different AYs.

## 3.23. Tax Incentives and Benefits - Section 35AD

### 3.23.1. Profit linked incentives for specified industries vis-a-vis investment-linked incentives - Section 35AD

Section 35AD of the Act, extends investment linked incentives to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses. Further, once investment linked incentive for the capital expenditure is availed under this Section, no benefit shall be allowed in respect of such specified business under Chapter VI-A (Deductions in respect of certain incomes) and Section 10AA of the Act.

## Issue

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

## Recommendations

- The profit-linked incentives currently given for infrastructure and crucial sectors should be continued till the end of 12th Five Year Plan i.e. till 2017 to encourage investment and growth of India's infrastructure sector.
- It should be considered to do away with MAT for the infrastructure industry as levy of the same defeats the very purpose of extending tax incentives to the industry, especially given the high rate of MAT now.

## 3.23.2. Dilution of tax incentive under Section 35AD by insertion of Section 73A

## 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 the insertion of Section 73A of the Act, which restricts the set-off/ carry forward of losses by specified business only against the profits and gains, if any, of any other specified business carried on by the taxpayer in that AY and the amount of loss not so set-off can only be carried forward and set-off against profits from specified business in the subsequent AYs.

## Recommendation

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

## 3.23.3. Clarification on amendment to Section 35AD(3)

## Issues

- It appears that the above 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.
- Accordingly, it appears that if a taxpayer carrying on a specified business does not claim deduction under Section 35AD, he may opt for deduction under the relevant provisions of Chapter VI-A or Section 10AA, if the same exist for such business and it is more beneficial.

## Recommendations

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

## 3.23.4. Investment linked tax incentive under Section 35AD is a restrictive tax incentive

### Issues

- Section 35AD of the Act extended investment linked tax incentive to a taxpayer engaged in building and operating anywhere in India a 2-star or above category hotel. The same is a restrictive tax incentive to the industry as only such taxpayers are eligible which are engaged in both building and operating the hotel. Similar restriction exists for the hospitals, wherein the tax incentive is available for 'building and operating' anywhere in India a hospital with at least 100 beds for patients.'
- Thereafter, vide Finance Act, 2012 w.e.f. 1st April 2011, a new Section 35AD(6A) was inserted, which extended investment linked tax incentive to a taxpayer engaged only in 'building' hotel (and transferring the operation to another person). However, similar benefit was not extended for taxpayer engaged in building hospital.
- As can be seen from a plain reading of Section 35AD of the Act, it appears that the benefit under the Section would not be available in case the person building the hospital is different from the person operating it. This does not seem to be in harmony with the objective, specifically given the typical operating structure of the industry wherein very often the developer or builder of the hospital is different from the taxpayer who is operating and managing the hotel/ hospital. Considering the said anomaly was removed by the Finance Act, 2012 vide Section 35AD (6A) for hotel industry by granting investment incentive to a builder (though not operating the hotel), similar benefit ought to be extended to a hospital industry.
- Further, if a person does not build the hotel/ hospital, but acquires the same by purchase or rent or otherwise for purposes of operation and management thereafter, such taxpayer would not be entitled to the benefits of this Section.
- If any asset for which such deduction is allowed, is used for other than the specified business, before the period of eight years after the asset acquisition, then such deduction allowed, as reduced by the amount of depreciation allowable as if no deduction under this Section was allowed, shall be deemed to be the business income of the taxpayer of the FY in which the asset is so used.

### Recommendations

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

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

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

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

- Consequential amendments should also be considered in clause (iv) and (v) of sub-Section (8)(c)of Section 35AD of the Act.
- The condition of non-transferability of the asset should be reduced to at least four years since even usage of the asset for four years indicate that the taxpayer intended to use the asset for the specified business. Higher period of non-transferability puts restriction on the transfer of independence of the taxpayer's business decision and therefore, will prove to be counter-productive to the business growth.
- It should be clarified that if an asset is not used for the specified business due to obsolescence, etc. and at the same time not used in any other business, then the deduction allowed under this Section shall not be reversed.

### 3.23.5. Deduction in respect of Capital Expenditure on Specified Businesses - Section 35AD

#### Recommendation

- It is recommended that the weighted deduction of 150% be extended and made generally applicable to the entire list of business covered in the Section 35AD since all the said businesses are extremely important for the Indian economy like natural gas/ crude pipe line distribution, hotels etc. This would help to remove the discriminatory tax treatment between various specified businesses.

#### Issue

- Currently, there are no benefits available for rural/ semi-urban healthcare infrastructure (other than for building and operating hospitals with at least 100 beds under section 35AD).

#### Recommendation

- It is suggested that a weighted deduction for healthcare infrastructure expenditure (other than hospitals) incurred in rural/ semi urban areas should be also provided.

### 3.23.6. Deduction to specified businesses - Section 35CCD – IT Enabled Services

Section 35CCD of the Act provides for a weighted deduction of 150%, on expenditure incurred by an "eligible company" on skill development project. Further, the guidelines for claiming deduction under Section 35CCD of the Act have been provided under Rule 6AAF, 6AAG and 6AAH of the Rules, wherein the term 'eligible company' has been defined to inter-alia mean a company engaged in providing specified service. However, such specified services do not include IT/ ITES.

Therefore, it is suggested that the list of specified services under Rule 6AAH of the Rules should be appropriately amended to specifically include IT/ ITES within its ambit.

### 3.24. Tax Incentives - Weighted deduction under Section 35(2AB) and 35(1)(iia)

#### Issues

- Section 35(2AB) of the Act extends deduction of a sum equal to twice 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 aforesaid Section extends the weighted deduction of expenditure incurred only in respect of "in-house research and development facility". India is globally recognised as an attractive jurisdiction for outsourcing owing to its affordable, skilled and English-speaking manpower. Outsourced R&D work is becoming a key area of growth for the Indian services sector however there are no specific tax benefits available to units engaged in the business of R&D or contract manufacturing. There certainly exists a need to provide impetus to such activities in the form of tax and fiscal benefits.
- Further, specifically in the pharma sector, pharmaceutical discovery is a lengthy, risky and expensive proposition. In this business environment, necessitated by the current business needs, sometimes companies incur expenses towards scientific research outside their R&D facility.
- Another anomaly existing in the current provisions is that any expenditure incurred outside the approved R&D facility by pharma companies' i.e. towards clinical trials (including those carried out in approved hospitals and

institutions by non-manufacturing firms), bioequivalence studies conducted in overseas CROs and regulatory and patent approvals, overseas trials, preparations of dossiers, consulting/ legal fees for filings in USA for new chemicals entities (NCE) and abbreviated new drug applications (ANDA) as approved by the Department of Scientific and Industrial Research (DSIR) which are directly related to the R&D, etc. are currently not covered. Furthermore, Indian companies incur substantial costs in defending their patent rights and applications in and outside India and these sums are not eligible for deduction.

## Recommendations

- It is suggested to extend tax benefits to units engaged in the business of R&D or contract manufacturing to provide impetus to R&D in India.
- Presently, there are no specific provisions which enable carry forward of R&D benefits separately. Considering the time taken in R&D activity, and its benefit available after a very long gap, it is suggested that it should be clarified that the unutilized R&D deduction should be available for carry forward and set off indefinitely (as in the case of unabsorbed depreciation).
- Benefits should be provided for units engaged in the business of R&D and contract manufacturing by way of deduction from profits linked to investments. Benefits in the form of research tax credits which can be used to offset future tax liability, similar to those given in developed economies can also be introduced.
- It is further suggested that the existing provisions should specifically allow weighted deduction in respect of expenses incurred outside the R & D facility which are sometimes necessitated by the industry's business needs. Additionally, it could be clarified that where the risk of doing research is assumed by a company, the entire cost of R&D activities (whether outsourced or undertaken in-house) is eligible for weighted deduction in the hands of company undertaking the risk.

## Issues

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

## Recommendations

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

## Issue

- Section 35(2AB) has been gradually amended to provide increased tax benefits on expenditure incurred towards in-house R&D facilities i.e. from 125% to 200%. However, Section 35(1)(iia),which provides tax incentives in respect of payments made to R&D company, has remained fixed at 125%. In fact, the conditions specified by the DSIR for grant of approval for a recognized R&D facility/ company under Section 35(2AB) and Section 35(1)(iia) of the Act respectively are the same and hence, the tax benefits provided under Section 35(1)(iia) of the Act should be at parity with the tax benefits provided under Section 35(2AB) of the Act in terms of quantum of benefits.

## Recommendation

- In order to be fair between an R&D company recognized by DSIR under Section 35(1)(iia) and an in-house R&D facility under Section 35(2AB), the tax benefits under Section 35(1)(iia) should be increased to 200% from the present level of 125%.

## Issues

- As per the recent DSIR guidelines, it has been clarified that eligible capital expenditure on R&D will include expenditure on plant, equipment or any other tangible item only. Accordingly, capital expenditure on intangibles will not be eligible for weighted deduction.
- However, as per AS 26 issued by the ICAI, development costs for the purpose of R&D are required to be amortised/ capitalised as intangible assets. This leads to disallowance of development expenditure which is inextricably linked to R&D units, but are capitalized as intangible assets due to requirements of AS 26.

## Recommendations

- It is suggested that DSIR guidelines should be modified to provide weighted deduction for expenditure incurred on internally developed intangible asset within the ambit of Section 35(2AB) of the Act.
- It is also suggested that any initial costs paid for acquiring an R&D intangible, which is converted by an R&D unit into tangible research oriented product should also be allowed for weighted deduction under Section 35(2AB) of the Act.

## 3.25. Carry back of losses - Section 72

## Issue and Recommendation

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

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

## 3.26. Deduction under Section 80JJAA of the Act

## Issues

- Currently, Section 80JJAA of the Act endows incentive to an Indian company which derives profits from an industrial undertaking engaged in the manufacture or production of goods in a factory, by providing a deduction for an amount of 30% of the additional wages paid to the new workmen for a period of three years beginning with the year in which new workmen is employed. The deduction is available subject to the satisfaction of the conditions specified in the Section.
- The Section was inserted in the Act with the intent to create more employment opportunities.
- One of the conditions stipulated by the Section is that new workman should be employed for a period of 300 days or more during the previous year of employment. In a situation, where workman joined in July and worked till March of the relevant previous year of employment i.e. worked for less than 300 days in Year 1 but for full year in Year 2 and Year 3 and assuming all other conditions prescribed in Section 80JJAA of the Act are complied with, the company is still not eligible to claim deduction in any of the years.
- The deduction is not available to companies engaged in the service sector irrespective of the same being major contributor of the employment in the Indian economy.

- In case of an existing undertaking the 10% increase in the number of regular workmen is calculated as a percentage of existing number of “workmen” and not “regular workmen” as on the last day of the preceding year, which minimizes the chances of falling within the eligibility criterion of 10%.
- Wages is not defined under Section 80JJAA of the Act. It is not clear as to whether bonus or statutory contributions made by the employer are to be included for computation of wages for the purpose of claiming deduction under Section 80JJAA of the Act.
- The deduction under this Section shall not be available if the factory is hived off or transferred from another existing entity or acquired by the taxpayer company as a result of amalgamation with another company.

## Recommendations

- It is recommended that workmen in respect of whom the period of continuous employment of 300 days or more is attained in the previous year succeeding the previous year in which the workmen is employed, the deduction under Section 80JJAA of the Act be granted from the succeeding previous year.
- For the purpose of calculating the percentage increase in the new regular workmen employed during a year - as per proviso to clause (i) of Explanation to Section 80JJAA of the Act, parity should be maintained i.e. only the existing number of ''regular workmen” as against existing number of 'workmen employed' as on the last day of the previous year should be considered as a base.
- The wages to be considered for the purpose of computation of deduction under this Section should be clearly defined.
- The benefit of deduction under Section 80JJAA of the Act should be extended to taxpayers engaged in the business of providing services. It will provide impetus to the growth of the service industry in India and will also generate employment opportunities.
- The deduction should not be denied in case of genuine amalgamation of the taxpayer company with another company. Certain provisions in the Act do not levy tax on genuine amalgamations of the companies which indicate that legislature approved such amalgamations as genuine and did not levy tax for the growth of the businesses. In order to carry ahead the cause of economic growth in the country the deduction should not be denied in cases of genuine merger/ demerger/ amalgamation cases.

Apart from above, certain issues which emanate out of the amendments made in Finance Act, 2013 is as under:

## Issues

- The benefit of the deduction should be allowed to all undertakings engaged in the manufacturing of article or thing and not only to factory units to bring all such entities at par as far as allowing the deduction linked with employing of workmen is concerned. Disparity created by the amendment in Section 80JJAA of the Act by the Finance Act, 2013 is unjustified.
- The objective of introduction of such deduction was to provide more employment opportunities. Generally, while recruiting factory workers, certain middle/ high level personnel are also required to be recruited for supervising/ directing such workers. Accordingly, the recruitment of new middle/ high level personnel should not be deprived from availing such deduction.

## Recommendation

- The earlier provision be restored back allowing deduction to an undertaking engaged in manufacture or production of article or thing. It is recommended that addition of any category of employee should be eligible for such deduction.

## 3.27. Deductibility in respect of subscription to long-term infrastructure bonds - Section 80CCF

### Issue

- Section 80CCF of the Act provided for a deduction to an individual or HUF in respect of subscription towards long term infrastructure bonds (as may be notified by the Central Government) to the extent of Rs. 20,000. This benefit of deduction was introduced by Finance Act, 2010 and was further extended in respect of aforesaid subscriptions made during FY 2011-12. The rationale of providing this deduction was to promote investment in the infrastructure sector.

### Recommendation

- It is recommended that benefit of Section 80CCF of the Act be restored to cover the investments made from FY 2015-2016 onwards and further, the limit be extended to Rs 50,000.

## 3.28. Limited Amnesty Scheme

### Issue

- While the Government is anxious to see that foreign direct investments route is made easier, there is no step to mobilise gold and unaccounted cash in India itself to bring them to the mainstream of the economy. Limited amnesty for voluntary surrender of such income by way of subscription for infrastructure bonds would go a long way to contribute to infrastructure development, while it will reduce the impact of parallel economy.

### Recommendation

- It is suggested that an amnesty scheme be introduced so that unaccounted wealth is brought into the mainstream economy. Amnesty scheme shall enable taxpayers to voluntarily come forward and declare their unaccounted wealth.

## 3.29. Steps to bring idle assets to mainstream

### Recommendations

- To curb the circulation of black money in the economy, it is suggested that unaccounted money be brought back into the system by allowing it to be invested in the proposed Real Estate Investment Trusts (REITs) and Infrastructure Investment Trust (INVITs).
- Section 69 of the Act deals inter alia with taxability of unexplained investments. Unexplained investment is the investment which has not been recorded in the books of account and for which the taxpayer offers no explanation about the nature or source of investment.
- It is suggested that such unexplained investment not be taxed at specified tax rate under the aforesaid Section, instead such money should be allowed to be invested REITS or INVITs and be taxed when the taxpayer exits such investment.
- This shall give much needed impetus to such trusts and shall be conducive to the growth of the economy.

## 3.30. Mergers & Acquisitions

## 3.30.1. Transactions without consideration or for inadequate consideration – Section 47/ 56(2)

### Issues

- The Finance Act, 2010 inserted clause (viia) in Section 56(2) of the Act with a view to curb abusive transactions.

- Section 47 of the Act and other provisions of the Act exempts certain transactions from taxation. However, proviso to Section 56(2)(viia) of the Act excludes only a part of such exempted transactions from its applicability. Consequently, those transactions which may otherwise be exempt under Section 47 of the Act are still liable to tax under Section 56(2)(viia) of the Act.
- Section 56(2)(viia) of the Act is applicable to receipt of shares without consideration or with inadequate consideration. These are anti-abuse provisions intended to curb tax avoidance. Consequently, it should be applicable to transactions liable to tax and not otherwise. Thus, this Section should be applicable to receipt of shares which are not covered under Section 47.
- Without prejudice to the above recommendation, it needs to be clarified that the following transactions would be excluded from its ambit:

  Issue of shares including:

  - right issue
  - Preferential allotments
  - Conversion of financial instruments
  - Bonus shares
  - Split/ subdivision/ consolidation of shares.
  - Receipt pursuant to stock lending scheme.
  - Receipt by Trustee Company.
  - Buyback of shares.
  - By offshore investors in cases where purchase price is determined by Indian laws in force (e.g. SEBI rules, FEMA guidelines).

  Being anti-abuse provision, it should be applicable to transactions between associated concerns and not to other transactions. The amendment will adversely impact genuine cases where the shares are transferred at a pre-determined price for agreed commercial and bonafide considerations. For example:

- Joint venture or investment agreements particularly for unlisted company, frequently make provisions for put and call options to be exercised at agreed prices, which are compliant with all relevant exchange control and related laws, though they may not necessarily be at fair market value. This is, often, to permit Indian promoters to enjoy some upside benefit if their companies perform better than the rate of return expected by the investor. To levy income-tax liability on such promoters purely on a notional unrealized gain, when they acquire shares from the investors at the negotiated price is clearly unwarranted and, possibly, unintended.
- Likewise, there may be default forced sale provisions in such agreements that allow a non-defaulting party to acquire shares from a defaulting party at a price below market value. Again, to tax the non-defaulting acquirer for the discount would be unfair and possibly, also unintended.

## Recommendations

- All transactions which are specifically exempted from capital gains tax under Section 47 of the Act or other provisions of the Act should be kept outside the purview of the said Sections 56(2)(viia) of the Act.
- Section 56(2)(viia) of the Act should be suitably amended to provide that it applies to receipt of properties being shares in closely held company from related/ connected entities. It must be clear that it is not applicable to genuine business/ commercial transactions.

- Section 56(2)(viia) of the Act should be suitably amended to provide that the Section should be applicable only if the shares being received by the taxpayer are in existence and held by another person.
- Rule 11UA of the rules should be suitably amended to value unquoted equity shares on a fully diluted basis.

## 3.30.2. Amalgamation/ Demerger into parent/ subsidiary/ co-subsidiary - Section 47

### Issues

- Section 47 of the Act exempts certain transactions from being taxed under the head 'capital gains' by specifying such transactions not to be regarded as 'transfers' under Section 45 of the Act.
- Sub-Section (vii) of Section 47 of the Act states:

  "any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if-

  (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where shareholder itself is the amalgamated company

  (b) the amalgamated company is an Indian Company."
- Section 42 of the Companies Act 1956/ 19 of the Companies Act, 2013 does not allow a subsidiary company to hold shares in the parent company. Pursuant to such merger, in case where subsidiary was holding shares in transferor company, the parent company cannot allot shares to it.
- Section 2(19AA) of the Act defines 'demerger' and specifies conditions which are conflicting in nature. First condition requires that at least 75% shareholders of transferor company should become shareholders of transferee company. Second condition provides that shares should be issued to the shareholders of the transferor company on a proportionate basis. If one logically reads the two conditions, it means that shares should be issued on a proportionate basis to the shareholders of demerged company, to whom shares are issued under first condition. However, to avoid litigation, clarity needs to be provided.
- Section 41 of the Act provides that certain income subject to conditions, relating to business of predecessor, will be taxable in hands of successor even though it arises post succession. However, similar provision is not there in Section 43B, 35DD etc. of the Act where expenses need to be claimed post restructuring in hands of successor.

### Recommendations

- Section 47(vii) of the Act should be extended to specifically cover:
  - shareholder of amalgamating company being subsidiary of amalgamated company
  - Amalgamation of direct subsidiary with step-down subsidiary,
  - Amalgamation involving amalgamating company holding shares in amalgamated companies.
- Section 2(19AA) of the Act be amended to provide that the shares of the resulting company should be issued on a proportionate basis to the shareholders of demerged company to whom shares are issued under first condition. It should be clear that proportionate basis does not apply to all the shareholders.
- A new Section be inserted in chapter IV providing that in case of reorganization, deduction in relation to:
  - to expenditures incurred in pre-reorganisation period but allowable during post-reorganisation period and
  - expenditures incurred during the previous year but allowable on certain criteria, for e.g. payment basis under Section 43B of the Act, etc. will be allowed to successor as it would have been allowed to the predecessor.

## 3.30.3. Conversion of one type of share into other type of share of the same company - Section 47

### Issues

- Section 47(x) of the Act provides that, any transfer by way of debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company, will not be treated as a 'transfer' for the purposes of Section 45 of the Act. Section 49(2A) of the Act provides that, where a share or debenture in a company, became the property of the taxpayer on such conversion, the cost of acquisition to the taxpayer shall be deemed to be that part of the cost of debenture, debenture-stock or deposit certificates in relation to which such share or debenture was acquired by the taxpayer. However, the period of holding of earlier instrument has not been considered while calculating the period of holding for the new instrument.
- It is noteworthy that while inserting clause (x), the intent of the legislature was that no taxable capital gains can arise at the time of conversion of convertible debentures, deposit certificates or shares of the company into debentures or shares of that company, since it amounts to conversion of an asset held by a taxpayer from one form to another and no other party involved to whom any transfer is made. In fact, clause (x) of Section 47 of the Act was further amended by the Finance Act, 1992 to include 'bonds' in the said provision.
- However, it appears that there has been an inadvertent omission in both the foregoing provisions, i.e., conversion of preference shares or warrants into equity shares of a company have not been specifically covered under the said provisions. Similar to Section 49(2A), Section 55(2)(b)(v) of the Act provides that cost of shares received on conversion should be cost of the shares which were converted. Thus, there does not seem to be any difference in taxing of conversion of debenture or share. However, legislature has missed to provide exemption to conversion of preference shares.
- With a view to encourage the development of Indian capital markets and the issuances of Indian Depository Receipts (IDRs) by foreign companies, the SEBI, vide its Circular No CIR/CFD/DIL/6/2013, provided a framework for partial two-way fungibility of IDRs into underlying equity shares. The said circular, inter-alia, provides that an IDR holder has an option to convert the IDRs into underlying shares.

### Recommendations

- Section 47(x) of the Act should be amended to include cases of conversion of one type of shares or warrants into shares or other type of shares.
- Section 47(x) of the Act should be amended to include cases of conversion of loan / ECB into shares or other type of shares. This could be limited to loans which have terms / features similar to debentures and bonds.
- Section 47(x) of the Act should be amended to also include cases of conversion of IDRs into shares.
- Section 2(42A) of the Act should be amended to provide that the period of holding of earlier instrument should be included for computing the period of holding of new instrument.

## 3.30.4. Transfer of capital asset between holding company and subsidiary –Section 47

### Issues

- Under the existing provisions of clause (iv) and (v) of Section 47 of the Act, transfer of a capital asset by a holding company to its subsidiary company and vice versa is not regarded as a 'transfer' for the purposes of capital gains if inter-alia, the parent company holds whole of the share capital of subsidiary company.
- In order to carry out business in today's challenging business environment, business houses create multilayer corporate structure for complying with various regulatory and contractual requirements as well as risk ring fencing for its lenders.

## Recommendation

- It is therefore, suggested that benefits of clause (iv) and (v) of Section 47 may be extended to step down subsidiaries where the parent company holds whole of share capital of such subsidiary directly or through other 100% held subsidiary.

## 3.30.5. Non-Compliance of conditions applicable to certain re-organizations - Section 47

## Issues

- Section 47A(1) of the Act provides that in case holding company does not continue to hold 100% of shares of the subsidiary company or converts / treats the transferred asset as stock-in-trade, within a period of 8 years from the date of the transfer of capital asset, the gains exempted under Section 47(iv)/ (v) of the Act shall be taxable in the hands of the transferor company in the year of transfer. It shall be noted that a period of 8 years is too long.
- Further, in any case such income should be taxable in the year of event specified in the Section and not in the year of transfer of capital asset.

## Recommendations

- Section 47A (1) of the Act should be amended to reduce “period of 8 years” to reasonable period.
- Further, in any case, such income should be taxable in the year of event specified in the Section and not in the year of transfer of capital asset.
- Words 'profits & gains' in Section 47A(1) of the Act should be replaced with the word 'income'.

## 3.30.6. Carry forward and set off of accumulated losses in amalgamation or merger - Section 72A

## Issues

- Currently, Section 72A of the Act allows carry forward of loss and accumulated depreciation in case of amalgamation/ demerger of the following type of companies:
  - a company owning an industrial undertaking or a ship or a hotel with another company,
  - a banking company,
  - one or more public sector company or companies engaged in the business of operation of aircraft
- Apparently, the benefit is not available to all the companies engaged in the business of providing services. Considering the facts that many multinational companies have entered in the Indian service market and it has become imperative for the small companies to consolidate their resources to survive, the benefit applicable under the provision of Section 72A of the Act should be extended to all companies irrespective of their line of operations.
- More so, Section 72A(2) of the Act prescribes stringent condition about continuity of holding of assets by the amalgamating company for at least 2 years prior to transfer and by the amalgamated company for 5 years post transfer. Similarly it requires that the amalgamating company should be in the business for at least 3 years prior to the amalgamation. The conditions in the hands of the amalgamated company are sufficient to control misuse of the provisions and therefore, the conditions applicable to the amalgamating company should be deleted. Also, holding of assets and continuation of business for 5 years is quite a long period.

## 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.

## 3.30.7. Conversion into Limited Liability Partnership/ conversion of firm into company - Section 47

### Issues

- Chapter X of the LLP Act allows following conversions:
  - Partnership firm (Firm) into LLP (Section 55 of the LLP Act)
  - Private limited/ unlisted public company into LLP (Section 56/ 57 of the LLP Act)

  In view of the above, the Finance Act 2010 provided tax neutrality to conversion of Company into LLP under Section 56/ 57 of the LLP Act. However, there is no provision allowing tax neutrality to conversion of firm into LLP under Section 55 of the LLP Act.

- Section 47(xiiib) of the Act provides tax neutrality to conversion of Company into LLP subject to certain stringent conditions. Such conditions should be made less stringent or some relaxation should be provided in application of the same as discussed below:
  - It is available only to a Company having Turnover of less than Rs. 60 lakhs for 3 years prior to such conversion. In the current economic scenario, this limit of Rs. 60 lakhs needs to be removed. There is no reason, why companies with large turnover, which otherwise qualify, should not be eligible for conversion with tax neutrality.
  - Another condition is that all the shareholders of the company, immediately before the conversion, should become partners of the LLP. This condition should be made applicable only in respect of equity shareholders and not preference shareholders, since preference shares are in the nature of quasi equity.
  - Further, it is necessary that the aggregate of the profit sharing ratio of the shareholders of the company, in the LLP shall not be less than 50% at any time during the period of five years from the date of conversion. This condition should be applicable only to voluntary transfers and not to all the transfers. Say, this condition should not apply in case of dilution resulting from death or disqualification of a partner or amalgamation of a corporate partner.
  - For claiming tax neutrality, it is provided that accumulated profits of the company as on the date of conversion should not be paid to the partners of the LLP for a period of three years from date of conversion. Under the Act, LLP is considered akin to a partnership firm and there is no restriction on distribution of the profits of the partnership firm. Further in case of firm, there is no requirement to show reserves and surplus separately, but the same is credited to partner's capital account. Thus, there should not be any restriction on LLP in relation to payment out of profits. Further, the term accumulated profits is not defined and may include other reserves also.
  - MAT payment under Section 115JB of the Act is prepayment of taxes actually becoming due in subsequent years under normal provisions of the Act. Consequently, Section 115JAA of the Act allows credit for such payments in the year the company becomes liable to pay tax under normal provisions of the Act. There is no reason, why such credit should not be allowed to LLP, which is converted from a company eligible to such credits, if it is paying taxes under normal provisions of the Act.
  - Section 47(xiii)/ (xiiib) and (xiv) of the Act requires that the members of the firm/ shareholders of the company should continue to maintain profit sharing/ shareholding for 5 years. It should be noted that 5 years is a fairly long time and therefore, it should be restricted to 3 years.

- Section 47A(4) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiiib) of the Act, the gains on conversion of company/ transfer of shares shall be the profits & gains taxable in the hands of the LLP/ shareholders in the year of such non-compliance. Similarly, proviso to Section 72A(6A) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiiib) of the Act, the losses/ unabsorbed depreciation of the company utilized by the LLP shall be income of the LLP for the year of such non-compliance.
- Section 47A(3) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiii) or (xiv) of the Act, the gains on conversion of partnership or proprietary concern shall be profits & gains taxable in the hands of the Company in the year of such non-compliance. Similar to Section 72A(6A), 72A(6) deals with cases covered under Section 47(xiii) and (xiv).

## Recommendations

- Section 47(xiii) of the Act should be suitably amended to include conversion of a Firm into LLP along with conversion of Firm into a Company.
- 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.

## 3.30.8. Continuation of deduction under Section 80-IA in case of re-organization

## Issues

- Section 80-IA of the Act provides deduction in relation to profits of certain undertakings. It was well settled that in the case of restructuring of any entity owning such undertaking, the benefits of deduction will be available to entity owning the undertaking post restructuring.
- Board Circular Letter F.No. 15/5/63-IT (AI), dated 13th December, 1963 specifically provided that in the year of corporate restructuring, the benefit shall be available to transferor entity upto the date of transfer and to the transferee entity for the remaining period of tax holiday.
- Sub-Section (12) provided that in the year of restructuring deduction will not be allowable to the transferor entity but same will be allowed to the transferee entity as it would have been allowed, had the restructuring not taken place. In totality, this will restrict the total period of deduction to not more than the total period for which the deduction should have been allowed under the provisions of the Act.

- However, sub-Section (12A) was inserted in Section 80-IA with effect from 1st April, 2008 to provide that nothing contained in sub-Section (12) shall apply to reorganization post 1st April, 2007. A view is expressed that post insertion of sub Section (12A), benefit of deduction under Section 80-IA of the Act will not be available to the amalgamated/ resulting entity.

### Recommendations

- Section 80-IA(12A) of the Act be deleted to enable restructuring of eligible entities.
- Section 80-IA(12) of the Act should be amended to provide for allowing deduction to the amalgamating/ demerged entity for the period till transfer date and to the amalgamated/ resulting entity post transfer.

## 3.30.9. Status of widely held company to be considered on date of transaction - Section 2(18)

### Issues

- Section 2(18) of the Act defines widely held company. This definition has wide implication on carry forward of loss, taxability under Section 56(2) of the Act and in various other provisions.
- It includes a listed company, only if its shares are listed on exchange as on last date of the relevant year. Further, it includes subsidiary of listed company, only if the shares of such subsidiary were held throughout the relevant year by the listed company. These provisions lead to situations which does not seem intended.
- Therefore, it stands logical that the conditions of listing, holding of shares etc. should be subject matter of test on the date of transaction and should not be stretched to be continuing till the end of that FY.

### Recommendation

- Section 2(18) of the Act should be suitably amended to provide test of conditions on the date of relevant transaction.

## 3.30.10. MAT Credit - Section 115JAA

### Issues

- MAT credit is akin to advance payment of tax.
- Benefit of MAT credit cannot be denied to successors in case of reorganization.

### Recommendation

- Section 115JAA of the Act should be amended to provide that successors in case of amalgamation, demerger or any other form of reorganization should be eligible to claim benefit of MAT Credit.

## 3.31. Amendment to Section 2(14) and Section 2(47) of the Act

- Section 2(14) - Retrospective insertion of Explanation expanding scope of the definition of capital asset – it was clarified with retrospective effect that the term 'property' includes any rights in relation to an Indian company, including rights of management or control or any other rights whatsoever.
- The Finance (No. 2) Act, 2014, has amended the Section 2(14) of the Act wherein, it has been specified that securities held by FIIs and FPIs shall be regarded as capital assets.
- Section 2(47) - Retrospective insertion of an Explanation to the effect that the term 'transfer' includes disposing or parting with an asset or any interest therein or creating any interest in any asset, notwithstanding that such transfer of rights is effected or dependent upon or flowing from transfer of shares of a foreign company.

## Issues

- It is not very clear as to what is meant to be covered by the term 'any rights'. The term is very wide and is defined in an inclusive manner.
- The amendment in Section 2(14) read with Section 2(47) of the Act may even cover unintended consequences. For example, creation of management or control rights upon equity infusion in an Indian Company could be treated as transfer.
- Further, 'the rights in relation to an Indian company' should not include rights of the company. For example, company may have its significant asset in the form of certain rights such as hotel license, lease rights, etc. Acquisition of shares in an Indian Company holding such rights should not be treated as creation of interest in such assets which is deemed as 'transfer'. Lifting of corporate veil in such a manner could lead to severe consequences.
- Explanation 5 to Section 9(1) of the Act seems to be inserted for covering indirect transfer of shares in Indian Company. However, the amendment may cover all income through or from such shares.

## Recommendations

- Explanation to Section 2(14) of the Act should be amended as under:

  'Rights in an Indian Company' should be restricted to management and contractual rights.
- Explanation. to Section 2(47) of the Act should be amended as under :
  - Words “or creating any interest in an asset” should be deleted.
  - The transactions which are otherwise not 'transfer' as per law (for example – gift) or transactions which do not result in any transfer per se, (for example primary infusion in company for acquisition of shares) should not be covered in the deeming fiction created by amending Section 2(47) of the Act.

## 3.32. Amendment to Section 68

The first proviso to Section 68 of the Act provides that in case of closely held company share application money shall be considered as income of the company unless the investor provides necessary explanation to the satisfaction of the Assessing Officer.

## Issues

- This amendment is not needed and desirable. Any tax avoidance which is structured through excessive securities premium could be brought under the purview of GAAR provisions through adequate methodology and rules. The overall principles enunciated under GAAR provisions to treat an arrangement as Impermissible Avoidance Arrangement should be applied to the share subscription transaction for determining the taxability of securities premium account in the hands of company.
- This amendment may overlap with provisions of Section 56(2)(viib) of the Act and may be taxed twice.

## Recommendation

- It is suggested that the first proviso to Section 68 should be deleted.

## 3.33. Amendment in characterization of unlisted shares and units of non-equity mutual funds as short/ long term asset - Section 2(42A)

## Issues

- The Finance (No. 2) Act, 2014 has amended Section 2(42A) of the Act, which provides that unlisted shares and units of non-equity mutual funds should be considered short term capital asset if the same are not held for more than 36 months.

- Under the earlier provisions, if shares/ units were held for more than 12 months, the same were considered to be long term capital asset and was liable to lower rate of tax. Therefore, the investor would have acquired the shares/ units on the basis that the same could be sold after 12 months and tax impact will be at a lower rate. This impacts the investor confidence about reliability of tax policies.

### Recommendations

- It is recommended that this proposal should be dropped and the erstwhile holding limit for unlisted shares and a unit of a mutual fund (other than an equity oriented mutual fund) as a long term capital assets should be continued i.e. more than 12 months.
- Alternatively, the amendment should be made applicable from 31st March, 2015 (instead of 10th July 2014) so as to avoid undue hardship to the investors who purchased shares/ units before 1st April, 2014 but could not redeem such shares/ unit before 10th July, 2014.

## 3.34. Change of rate of tax on sale of units of a mutual fund - Section 112

### Issue

- The concessional rate of tax of 10% on long term capital gain is no more available to the units of a mutual fund. This amendment in Section 112 would again impact debt schemes of Mutual fund (MF)

### Recommendation

- This proposal should be dropped and accordingly beneficial rate of tax (i.e. 10%) should continue to be made applicable as earlier on such schemes.

## 3.35. Grossing-up of a dividend distribution tax in relation to mutual fund - Section 115R

### Issues

- The Finance (No. 2) Act, 2014 has amended Section 115R wherein the DDT in relation to the unit holders is required to be grossed up. Accordingly, the DDT to be paid after grossing up of the amount distributed as dividend.
- This amendment in Section 112 would impact debt schemes of Mutual fund (MF)

### Recommendation

- This amendment should be deleted and the erstwhile method of computation of DDT should continue to be applied on income distributed by a mutual fund. Grossing up effect is especially very steep in the case of mutual funds on account of the higher DDT (vis-à-vis Dividend on shares).

## 3.36. Capital Gains

## 3.36.1. Issues under Section 54EC of the Act

### Issues

- Section 54EC of the Act provides tax exemption on capital gains arising from the transfer of a long term capital asset, if invested in long-term specified assets within a period of six months from the date of such transfer. The investments in such bonds, in a FY and the subsequent FY, should not exceed Rs. 50 lakhs.
- Further, there might be a situation where, the specified assets are not available during the said period of six months. Also, it may be possible that the price/ rate/ cost at which the specified asset is available during the stipulated period may not be viable for the taxpayer to invest.

- Purpose behind granting of exemption is to promote investment in specified assets. There does not seem to be any rationale behind prescribing the monetary limit of Rs. 50 lakhs per investor or specifying the stringent time line of 6 months. Especially in the context that such funds would in any case be used for meeting the infrastructure requirements.

## Recommendations

- Currently, huge amounts are required to be deployed in the infrastructure sector to give the sector the much needed boost and this vehicle could be used for raising such infrastructure development funds.Thus, there is a need to revisit the limits prescribed.
- Moreover, the interest income on such bonds, which are presently fully taxable, should be awarded 'non-taxable' status.
- Proviso to Section 54EC(1) of the Act which restricts the investment in such bonds not exceeding Rs. 50 lakhs in a FY should be deleted.
- Recently inserted Second Proviso to Section 54EC(1) of the Act should also be deleted which restricts the investment in the FY of transfer and its subsequent FY, with respect to the asset transferred, in such bonds not exceeding Rs. 50 lakhs.
- The time period of 6 months should be liberalized and the exemption should be permitted for the investments made before the due date of filing of return of income under Section 139(1) of the Act.

## 3.36.2. Cut-off date for ascertaining cost and Index factor - Section 48/ 55

## Issues

- Section 55 (2)(b) (i) and (ii) of the Act provides that in case of asset acquired before 1 April 1981, taxpayer has an option to replace cost of such asset by market value thereof.
- Section 48 of the Act provides that for computation of long term capital gain, “indexed cost of acquisition” is deductible from the full value of the consideration received from the transfer of certain capital assets. Indexed cost means cost of acquisition adjusted for inflation index. Again, base for ascertainment of index factor is 1st April, 1981. Cost Inflation Index is notified every year having regard to 75% of average rise in the Consumer Price Index for urban and non-manual employees for the immediately preceding previous year to such previous year. It may thus be seen that such indexation benefit is notional and does not take care of full inflationary impact and causes inequities to the taxpayers. Thus, the cut-off date for cost replacement and base for index being 30 year old needs to be revised.
- Further, in case of taxpayer, acquiring assets through specified modes, period of holding of earlier transferor is added to period of holding of taxpayer, however, index benefit is allowed only from the date of holding of the asset by the taxpayer. This seems to be an unintended anomaly and needs to be set right.

## Recommendations

- Cut-off date for cost replacement in Section 55 of the Act and for index factor in Section 48 of the Act should be shifted to 1st April 2001.
- Index benefit even to the taxpayer acquiring assets through specified modes should commence from the date of acquisition in the hands of original purchaser.

## 3.36.3. Rate of Tax applicable to Short-term Capital Gains - Section 111A

## Issues

- Section 111A of the Act provides that short-term capital gains on sale of shares of listed companies or units of equity oriented fund should be taxed at 15%. The rate was 10% till 31 March 2009.

- The difference between normal income and capital gain arising on transfer of assets is well recognized even under the Act. It is a known fact that owner of an asset incurs a lot of expenditure for maintaining an asset. In case such asset is used in business, deduction is allowed for such maintenance and other expenses. However, no such deduction is allowed if such asset is a non-business asset. Thus, it makes a strong case that rate of tax in case of capital gains should be different from the rate applicable to other incomes. This distinction is recognized to some extent in Section 111A and 112 of the Act. However, for short term gains on assets other than listed shares, such difference is not recognized.

### Recommendations

- The rate for listed shares should be restored to 10% as was the position till 31st March 2009.
- Section 111A of the Act should be amended to provide the rate of tax for short term gain on transfer of assets other than listed shares to be at 20%.

## 3.36.4. Abolition of tax on gains arising from transfer of listed securities

### Issues

- In case of the taxpayer who is an investor and is also engaged in the business of trading in securities, there is an ongoing dispute as to the taxability of the gains arising on account of the transfer of the shares held as investment.
- As per National Stock Exchange, India is one of the costliest destinations to trade in securities. STT, along with other taxes, and high brokerage structure makes trading in securities in India almost five-six times higher than in advanced countries.

### Recommendations

- At present, only the long term capital gains arising on transfer of listed shares routed via a recognized stock exchange are exempt. Various courts have laid down guidelines to determine the nature of the gains. The guidelines are based on the facts of the particular case and cannot be applied to all the cases, therefore, leaving the issue unresolved and causing undue hardships to the taxpayers.
- The Shome Committee Report on 1st September 2012 on GAAR recommended that the Government should abolish the tax on gains arising from transfer of listed securities, whether in the nature of capital gains or business income, to both residents and non-residents.
- Hence, it is recommended that the capital gains tax levied on the transfer of listed securities be abolished.
- Alternatively, suitable amendments should be brought in the Act, to provide a clear distinction between the income from trading activities & income from investment activities.

## 3.36.5. Insertion of Section 50D in the Act

Section 50D is inserted to provide that in cases involving transfer of assets, if the consideration is not determinable, fair value of the consideration received or accruing shall be deemed to be consideration.

### Issues

- Method of determining fair value is not specified under the Act.
- Section overlaps with certain other Sections providing similar mechanism for determining consideration, e.g. Section 45(3) dealing with transfer of a capital asset.

### Recommendation

- Method for determination of fair value should be specified under the Act. Applicability of Section 50D of the Act should be restricted to the transactions not covered under other similar provisions.

## 3.37. Additional Income-tax on distributed income for buy-back of unlisted shares – Section 115QA

The Finance Act, 2013 has introduced additional income tax of 20% to the extent of distributed income paid to the shareholder in a buy back scheme for purchase of its own shares. It has also been provided that income arising to the shareholder as a result of such buy back will be exempt from tax.

### Issues

- The Memorandum to the Finance Bill, 2013 states that the purpose of introducing such provisions is to curb avoidance of payment of tax by way of DDT. However, these provisions would also cover genuine transactions within its purview which is against the intent of the law.
- The rate of DDT is 15% under Section 115-O of the Act. However, levy of additional tax on distributed income by way of buyback is at the higher rate of 20%.
- The provision suffers from many deficiencies:
  - Distributed income has been defined as consideration paid by the company on buy back of shares as reduced by the amount which was received by the company for issue of such shares. The reduction of issue price from consideration paid for computation of distributed income may not be appropriate as it would lead to double taxation under the following situations:
    (a) Where the shareholder has acquired the shares through secondary transaction by paying cost which is higher than the issue price received by the company.
    (b) Where shares are allotted to an individual by his employer/ former employer. In such a scenario, the benefit is taxable as a perquisite under Section 17(2)(vi) of the Act. In case, when such shares are sold subsequently by the individual (either under a buy back or otherwise) for the purpose of computing the individual's capital gains, the cost of acquisition is taken as the FMV considered for the perquisite valuation as per Section 49(2AA) of the Act.
- In light of the definition of 'distributed income', the company will have to pay the tax on the difference between the consideration paid upon buyback of shares and the amount received upon issue of such shares.
- In case the company has raised capital from different persons at different prices at different points of time, the provisions of the Chapter do not provide whether (i) the company would need to take average price of such shares for the purpose of calculating the distributed income (i.e. determine distributed income at Company level) or (ii) it would need to calculate the distributed income separately in respect of each shareholder participating in the buy-back after taking into account the respective cost of acquisition of each such shareholder or (iii) the company would need to determine the distributed income vis-à-vis per share.
- In case the company has to calculate the distributed income separately in respect of shareholder, then tracking the actual issue price in case of each shareholder participating in the buyback could get onerous in the following instances:
  - shares are in demat mode, where the company's shareholder register would reflect only the name of the depositary participant and not the names of each shareholder/ beneficiary; and
  - in case there have been multiple corporate actions/ business reorganizations/ mergers & demergers, etc. involving the company as this would alter the initial issue price for each share.

## Recommendation

- In view of the above, the formula for computation of distributed income may be prescribed at the company level for each buy-back (rather than specific to shareholders).The buy-back distribution tax should be made akin to DDT.

## 3.37.1. Determination of cost of issue in case of corporate actions

## Issues

- The Act does not provide for the manner to determine amount received by the company on issue of shares at the time of corporate actions such as bonus issuance, share split, share consolidation, merger of company, etc. In these cases, whilst the company has not received actual cash flow, there would be a change in fair value of the share due to such corporate actions, which will impact the cost/ number of shares held by the shareholders.
- It has been provided that the income arising to the shareholders in respect of buy back of unlisted shares by the company would be exempt in the hands of the shareholder. This would result in denial of carry forward/ set-off of losses resulting from buy back.
- The construct of Chapter XII-DA in the Act does not enable the shareholder to take benefit of indexation on the cost of acquisition, since the company is paying tax on such distributed income without considering indexation benefit. This is very much detrimental to the interest of long term shareholders since they will be losing out the indexation benefit, even if they are holding the shares for a long time. The provision totally ignores the holding period of shares by the shareholder.
- It has been provided that the additional income-tax payable by the company shall be the final tax on similar lines as DDT. In Section 115-O of the Act, for computing the DDT, on distribution of dividends by the company to its shareholders, the recipient holding company is allowed credit for dividends received. No such similar provisions are there in Section 115QA of the Act.
- The profit arising on buy back of shares in the hands of the shareholder company, will remain in its books and may be liable for DDT on subsequent distribution of dividend by the company out of its accumulated profits (which includes profits on buy back of shares). This would lead to double taxation.
- As explained in the Memorandum, the purpose of introduction of this provision is to curb avoidance of DDT. Therefore, provision should tax what was being avoided, i.e. dividend. Companies Act, 1956/ 2013 does not allow utilization of securities premium for payment of dividend. Even Section 115-O of the Act does not levy tax on such distribution. Section 115-O of the Act levies tax on dividend as defined under Section 2(22) of the Act which restricts quantum of dividend to the extent of accumulated profits. Buy back is permitted even out of securities premium which, by no stretch of imagination can be considered to be accumulated profit, hence it should not be made liable to tax under new provisions.
- Section 46A of the Act is specifically dealing with this type of transactions and therefore, clarity on applicability of Section 46A of the Act needs to be provided.
- The transaction of buy back, though, taxable as distribution tax under the newly inserted provisions of the Act, may still be taxable as capital gains in the foreign jurisdiction. A mechanism may be provided under the Act for allowing credit of the taxes paid under Section 115QA of the Act to avoid double taxation.
- The provision is applicable with effect from 1st June 2013. The provision gets triggered on payment and therefore, the provision may become applicable to buy back which commenced before 1st June 2013 but got completed and final payment for the same is made after the applicable date.
- Considering the commercial and regulatory difficulties for structuring exit through IPO, put/ call options, etc., buy-back of shares provides the Venture Capital (VC)/ Private Equity (PE) funds with a likely and feasible exit avenue on which they can possibly rely upon. Levy of distribution tax on exit through such route would be unfair to the VC/ PE funds.

## Recommendations

- This amendment (provisions inserted through Chapter XII-DA) should be rolled back or the applicability of the provision should be restricted to cases involving avoidance of DDT.
- Alternatively, the rate of tax on distributed income as per the provision of Section 115QA of the Act should be restricted to 15% as applicable to DDT.
- The computation of distributed income should be based on cost of shares in the hands of the shareholder and not the issue price of the company in case of situations stipulated above. Further, it should be specified that in case where shares are bought back by an employer/ former employer, distributed income would mean consideration paid by the company on buy back of shares as reduced by the fair market value which was considered for the purpose of perquisite valuation under Section 17(2)(vi) of the Act.
- Appropriate guidelines should be issued with respect to determination of the issue price under situations highlighted above.
- A mechanism for availing credit of such tax should be notified as imposing such tax as a final tax, with no credit available is grossly unjustified.
- The applicability of the provision should be restricted to buy back commenced after 1st June 2013.
- It is recommended that VC/ PE funds should be specifically exempted from applicability of the said chapter.

## 3.38. Long-term capital gains deduction for investment in one residential house - Section 54

## Issue

- The Finance Act (No. 2), 2014, has amended Section 54 wherein the Long-term capital gains deduction for investment in residential house property will be available only where such investment is made in one residential house property situated in India.

## Recommendations

- Restricting the reinvestment to only one residential house leads to huge taxes payable by individual taxpayers. Therefore, the Government may relook at removing the limit of investing in only one residential house.
- The Government may also look at providing more clarity in this Section on whether the said exemption will be available, if more than one residential house is sold simultaneously.

## 3.39. Taxability of immovable property received for inadequate consideration - Section 56(2)

Section 56(2)(vii)(b) of the Act provides that receipt of immovable property by an individual or HUF for a consideration which is less than stamp duty value of the property by more than Rs. 50,000, will be taxable as income from other sources on the stamp duty value in excess of the consideration.

## Issues

- Section 56(2)(vii) of the Act in respect of transfer of immovable property for inadequate consideration was originally inserted by Finance Act, 2009, but later on deleted by Finance Act, 2010 with retrospective effect from date of insertion. There does not seem to be any reason for reintroduction of the same.
- The provision levies tax on inadequacy of consideration. Section 50C/ 43CA of the Act deals with such inadequacy in hands of the seller/ transferor. Section 56(2)(vii) of the Act will tax the same inadequacy in the hands of the purchaser as 'income from other sources', where sale consideration is less than the stamp duty of the property by an

amount exceeding Rs. 50,000 as stamp duty value less sale consideration. Both, seller and purchaser, pay tax on same inadequacy of consideration and thus, there is double taxation to that extent.

## Recommendations

- Clause (ii) to Section 56(2)(vii)(b) of the Act should be deleted as it will lead to double taxation, which could not be the intended objective of the Government.
- Alternatively, Section 50C/ 43CA of the Act may need to be correspondingly modified to exclude such transaction which has been taxed under Section 56(2)(vii)(b) of the Act.

## 3.40. TDS on transfer of immovable properties (other than agricultural land) - Section 194IA

Section 194IA of the Act provides that every transferee at the time of payment or credit of sum as a consideration for transfer of immovable property to resident transferor shall deduct tax @ 1% on such sum.

## Issues

- This provision may lead to lot of practical difficulties. Some of the issues are elucidated below:
  - Considering that the tax would be required to be deducted on the gross transaction value rather than net gains, transferors will have a cash-flow impact in situations where the sales are at a loss or at no gains and cases where capital gains are exempt for the seller. This may lead to a refund situation which can only be claimed by the seller at the time of filing his return of income.
  - The provision will pose severe hardship for real estate companies who would be burdened with the task of collecting and preserving the physical copies of voluminous number of TDS certificates for making and substantiating the claim for TDS.
  - There are going to be difficulties in complying with the provision, in cases where the properties are bought by availing loan from the bank and payment is made directly by bank to the real estate companies or the transferors as the case may be.
- This amendment is for widening the tax base and to bring the transferors in tax net. Considering, the existing inflation, even a builder building one single building will have turnover of more than Rs. 1 crore and will be liable to tax audit under Section 44AB and will be under tax net.
- Threshold limit of Rs. 50 lakhs for the applicability of the provision is very low. The provision will pose onerous compliance requirement even on small purchasers.

## Recommendations

· It is suggested that the provision of Section 194IA of the Act should be deleted.

· Alternatively, the provision should be made applicable to secondary transactions and not to first purchase from the builder/ developer.

· Further, threshold limit for the applicability of the above provision should be increased from Rs. 50 lakhs to Rs. 1 crore.

## 3.41. Financial Services

Venture Capital Funds/ Private Equity Funds (“PE”) and Venture Capital Companies

### 3.41.1. Pass through Status to certain Alternative Investment Funds ("AIFs") - Section 10(23FB)

The Finance Act, 2013 has accorded the tax pass through status only to the funds registered under the sub-category of "Venture capital funds" ("VCF") within "Category 1" Alternative Investment Funds ("AIF") in terms of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 ("SEBI AIF Regulations").

#### Issues

- The Finance Act, 2012 amended Section 10(23FB) of the Act providing tax pass through status to a VCF/ VCC for any income earned from a VCU referred to in the SEBI VCF Regulations. The beneficiary of a VCF/ VCC is taxed as if it has made the investments directly in the VCU. The above amendment in Section 10(23FB) of the Act read with Section 115U led to the removal of sectoral restrictions encapsulated under the erstwhile Section 10(23FB) of the Act, and thereby extended the pass through status to income earned by VCF/ VCC registered under the SEBI VCF Regulations from Venture Capital ("VC") investment across all sectors. This amendment was greatly appreciated by the industry as a move, which would provide significant tax certainty to investors and thus greatly foster development of domestic VC funds. As a matter of fact, this was in fact the position from AY 2001-2002 up to AY 2007-2008 after which the sectoral restrictions were first introduced in Section 10(23FB) of the Act.
- Subsequently, in May 2012, the SEBI VCF Regulations were repealed and SEBI AIF Regulations were enacted wherein AIFs were broadly classified into three categories viz. Category I (e.g. VCFs, social venture funds, SME funds), Category II (PE funds, debt funds, etc.) and Category III (hedge funds, etc.) based on their eligibility criteria, investment restrictions and the positive effect they would have on the economy. The AIF regulations provided that only Category I AIFs would be deemed to be VCF or VCC for the purposes of Section 10(23FB) of the Act. Consequently, post the enactment of the SEBI AIF Regulations, all Category I AIFs were sought to be entitled to the tax pass through status under Section 10(23FB) read with Section 115U of the Act (apart from VCF/ VCCs, which were registered and grandfathered under the erstwhile SEBI VCF Regulations and which are already covered under the Act). However, Category II AIFs were not covered.
- Furthermore, post the Finance Act 2013, it was provided that only the 'VCF' sub category of Category I AIF would be entitled to the tax pass through status. Other sub categories of Category I (e.g.: infrastructure funds, social venture funds etc.) would not be entitled to the tax pass through in terms of Section 10(23FB) read with Section 115U of the Act. This has resulted in the following disparities:
    - Whilst all funds registered as Category I AIF would have the positive spill-over effects on economy, the tax pass through status is accorded only to the VCF sub-category of AIF-I – therefore, there is a disparity inter se in the tax treatment of different types of Category 1 AIF funds;
    - Category II is not entitled to tax pass through status; and
    - Grandfathered VCF/ VCC who continue to be governed by the VCF Regulations will enjoy complete tax pass through status for any income earned from VCUs thus creating a disparity between grandfathered VCFs and the non-VCF Category I, Category II and Category III AIFs.
- Such disparities will trigger needless confusion thereby increasing the possibility of litigation between the funds and the Revenue Authorities and result in additional compliance costs.

#### Recommendation

- It is suggested that all Category I (irrespective of sub-category) and Category II AIFs (constituted as trusts) should be brought within the scope of Section 10(23FB) of the Act.

## 3.41.2. Interest income of business trust receivable/received from special purpose vehicle - Section 10(23FC)

### Issue

- The Finance Act (No. 2), 2014, has introduced Section 10(23FC) wherein the interest income receivable/ received from special purpose vehicle is eligible for pass through.

### Recommendation

- It is recommended that the all income (interest income, capital gains etc.) arising in the hands of the business trust set-up in accordance with the SEBI should be eligible for the tax pass through status.

## 3.41.3. Income characterization – Capital gains vs. Business income

### Issues

- Venture capital investments typically come from high net-worth sophisticated and long term investors and institutions. Unlike several other types of investments, venture capitalists provide fund to build up resources and enterprises with the intention of enhancing the long term growth and value of companies and target returns on their capital by increasing shareholder value through expansion and development of the company. The objective of VC funds is to make long term investments, as distinguished from other investors such as hedge funds and traders, who deal in securities with much shorter holding periods with the intention to make short term windfall gains. For example, VC funds, by their very nature, are long term investors with comparatively low frequency of transactions. VC funds are not permitted to make investments out of borrowed funds. Moreover, under the extant regulatory framework, a SEBI registered VC fund cannot undertake any activity other than investment activity. Accordingly, the purpose of a VC Fund is to make investment as against engaging into the business of dealing in shares.

- Therefore, any income of a SEBI registered VC/ AIF funds (other than Category III AIF which are undertaking derivatives or complex trading transactions) from sale of shares/ securities should be in the nature of 'capital gains' and not 'business income'.

### Recommendation

- The provisions of the Act should be suitably amended to explicitly provide that income from sale of investments by SEBI registered VC/ AIF funds (other than Category III AIF which are undertaking derivatives or complex trading transactions) would be treated as 'capital gains' and taxed accordingly, including a pass through basis in the hands of the investors. This would simplify the system of taxation, bring certainty and eliminate needless litigation on the income characterization issue.

## 3.41.4. Issue of shares at a value higher than fair market value to VCF/ VCC - Section 56(2)

### Issues

- Though Finance Act 2012 specifically carved out sub category VCF under Category I AIF from the provisions of Section 56(2)(viib) of the Act, certain unintended consequences as stated below have arisen which impact the VC industry at large. The industry being tightly regulated by SEBI is facing certain unintended consequences which include:

    - Certain unintended transactions (for e.g.; – capital reserve arising pursuant to merger) may also get covered within the purview of Section 56(2)(viib) of the Act, which is not desirable.

    - It is quite common for VC investors to enter into “ratchet structures” with the issuer company /promoter wherein convertibles are issued and conversion price is formula based and linked to the company's performance, adjustment of shareholding percentage etc. In certain scenarios, such ratchet could result in the company issuing shares to parties (other than VCF/ VCC) at high premium attracting tax implications in the hands of the issuer company under the above amendment. Thus, the provisions of Section 56(2)(viib) of the Act could adversely affect bona fide, arm's length ratchet structures agreed with resident promoters/ other investors wherein they are required to infuse funds or convert at a substantial premium for the adjustment of shareholding.

- Also, this issue is relevant for the angel investment industry investing in start-up ventures, where the immediate valuation of the entity may not be a benchmark for the investment being made by angel investors. Startup ventures, at the stage where angels invest, usually have no revenues or profits and the valuation is based on the potential and promise of the idea, the background and competence of the founding team, etc. and is usually a simple matter of negotiation between the founders and the angel investors. It is often wrong for one party or the other but it is simply impossible to create a frozen logic for such investments, be it DCF or a valuation by merchant bankers, etc. Any such mechanism, or others that may be proposed, would be impractical and unfortunately push the parties concerned to contrive adherence, an extremely undesirable outcome as both founders/ angel investors would like to operate within the letter and the intent of the law.

  a. Subjecting the valuation of the investment to an FMV by Revenue Authorities does not work, as explained above. The Revenue Authorities would not have the domain understanding to value the innovation (in fact even two different angel investors would value the same company differently). This will subject all investments in startup companies to re-evaluation and will open a plethora of disputes / appeals. This will scare angel investors away.

  b. This provision characterizes the investment by Angels as Income in the hands of the investee company, which is fundamentally incorrect. The Angel Investor's investment is to grow the company and create revenues/ income in the company. By changing the nature of the inflow into the company, the company and the investor sign away 30% of the investment (less the FMV) to tax: starving the company of critical cash flow investment. So investors who are investing tax paid monies will not invest as this will attract another round of tax albeit through the investee company. This amounts to double taxation

- As this Section only applies to domestic investors, it discriminates against them as compared to foreign investors, who are not subject to this clause.

  - The above provision may also hinder the ability of investee companies to make genuine arm's length inorganic acquisitions.

  - Exclusion under Section 56(2)(viib) of the Act should apply to shares issued to all Category I and II AIFs and not only to the sub category “venture capital fund”.

- It is also noted that despite the fact that the above provisions have been introduced for shares issued from April 01, 2012 onwards, VCUs are being issued with tax demands on premium received prior to April 01, 2012. This causes an unnecessary burden on portfolio companies and increases their litigation and compliance costs. Accordingly, it is represented that appropriate instructions should be issued to tax officers to refrain from this practice.

- There may be instances where the company receives consideration in one tax year but issues shares in the following tax year or in certain cases does not issue shares but refunds the share application money to the shareholder, there is lack of clarity in such cases as to the year in which the provision would apply or whether the provision would apply at all.

- It would be prejudicial to subject the Issuer Company to such adverse provisions which did not exist in law when the transactions were entered into.

## Recommendations

- Given that the said provision is intended to effectively be an 'anti- avoidance' provision, the following situations where no 'tax- avoidance' ought to be involved merit exclusion. Consequently:-
  - Applicability should be restricted to issue of shares in consideration for cash.
  - The issue of shares pursuant to otherwise exempt transactions such as merger, demerger, inorganic acquisitions etc. should be excluded from the purview of Section 56(2)(viib) of the Act.
  - It is recommended that it should be suitably provided for in the Section that it would apply only in the year of issue of shares.
  - It should be suitably clarified to provide that the Section does not require every closely held company that issues shares to a resident to suo-motto offer such income to tax. Further, the tax officer should be empowered to invoke this Section only if at the time of assessment, the tax officer is of the view that premium charged by the company from the resident shareholder is in excess of the fair market value of shares issued.
  - The provision should not be made applicable to bona fide ratchet structures.
- Investments made by an Investor who is part of a recognized, formal Angel group, should be exempted from this clause, subject to the following definitions and stipulations.
  - An Angel Investor group may be defined as a formal group, of which the angel investors are members and collectively invest their own money (directly or through their investment vehicle) in an unlisted entity, at the seed stage, in which there is no family connection and where the investment by an individual is less than Rs. 5 crores and by the angel group, less than Rs. 10 crores.
  - Seed stage is defined as a business whose turnover is below Rs. 25 crores; the limits on investments and turnover threshold for the seed stage should be indexed to inflation.
  - The value of the shares may be determined as of the date of the issue of the shares or any date earlier than the date of issue of shares, not being a date which is more than 180 days earlier than the date of issue of shares.
  - The investee company should not have received more than Rs.10 crores before the Angel round from any source.
  - The valuation of the company, at the time of the angel investment, should not exceed Rs. 50 crores (as valued by the angel group).
  - Angel Groups would ensure that no investments are made in companies where family members are involved. All Angel Investors all invest through a single shareholder Agreement in which the Angel group entity also holds a percentage of the same investment. This would ensure there is a body reviewing and updating activity in the investee company and will also be subject to Audit.
  - Investor KYC information (like PAN nos.) will be made available to the Angel Group & Investee companies.
  - Investment by business incubators which have been recognized or promoted by the Government of India should be exempted
  - Recognition of an Angel Group could be on the following basis:
    a. Number of years in existence: at least 3 years
    b. Number of investor members in the Group averaged over the last 2 years: At least 150 members
    c. Number of investments made in different companies: at least 25
    d. the Angel Group is an entity with a proper Secretariat & operations : for at least 3 years

e. Angel Group entity be recognized either by the Finance Ministry or any other appropriate entity of the government

- The provision should not be made applicable to all Category I and II AIFs.
- The provision should not be made applicable to any issuance of securities under any arrangement/ instrument/ transaction existing prior to the said amendment.
- Specific instructions should be issued to tax officer to refrain from challenging the share premium paid by VCF to VCU on subscription of shares prior to April 1, 2012.

## 3.41.5. Taxation of Securitization trust

The Finance Act, 2013, has provided a special taxation regime in respect of taxation of income of securitization trusts whereby income earned by securitization trust regulated by SEBI/ RBI will be exempt. Securitization trusts distributing income to its investors (other than those exempt from tax) will be liable to pay tax on income distribution. However, income received by an investor from securitization trusts will be exempt from tax. Certain issues involved in this new taxation regime are given below:-

### Issues

- The effect of this change is a mortal blow to the Pass Through Certificates (PTC) market. Banks, insurance companies, NBFCs and other taxpaying entities will be severely impacted. RBI has guidelines on securitization of standard assets which banks and NBFCs have to follow mandatorily. Also, NBFC-MFI (Microfinance Institutions) securitize a large part of their portfolio with banks, financial institutions, larger NBFCs and corporate and accordingly, tax on distribution of income by securitization trusts would severely impact them also.
- The special tax regime would create challenge under Section 14A of the Act as it would entail disallowance under the said Section in the hands of the investor who has effectively borne additional income-tax under Section 115TA of the Act.
- No credit can be taken by the investor in respect of the distribution tax. As such it becomes a straightforward loss of income for the PTC holder.
- The distribution tax is a tax on gross income; however the net income of the investors in securitized instruments is only a small fraction of the gross income.
- The trustee would need to maintain a list of investors at any given point of time. This is required as there could be a tax exempt investor who could have sold his investment to a taxable investor or vice versa. This change will impact the distribution tax to be payable by the trustee in the subsequent payout.
- There are no grandfathering provisions with respect to existing structures. As transactions worth thousands of crores which were structured through SPVs without apprehending what is proposed in the Budget should not be subjected to a new tax regime.

### Recommendations

- In order to offer level playing field to all investors, it is recommended that the income distributed by trusts should not be subject to distribution tax and should be offered to tax by the investors as per the normal tax regime. This will enable the investor to claim credit of such taxes against its normal tax liability. In such cases, unending litigation on disallowance under Section 14A of the Act will also culminate, since such income will no longer be exempt in the hands of the investor.
- It is recommended that the existing transactions (entered before June 1, 2013) should be explicitly excluded from this new taxation regime.

## 3.41.6. Loss on equity derivative business

### Issues

- The Delhi HC in the case of CIT vs. DLF Commercial Developers Ltd. (2013) 35 taxmann.com 280, held that determination of stock derivatives value is dependent on shares and hence, the provisions of Section 73 of the Act are applicable to derivative business. Accordingly, the loss on account of derivative transactions is not allowed to be carried forward and set-off against non-speculative business income. The HC observed that eligible derivative transactions on recognised stock exchanges are not treated as speculative transactions for purpose of computing business income. However, such exclusion, which may be relevant for computation of business income, will still be relevant in interpreting the provision dealing with set-off and carry forward of loss. The Delhi HC ruling unsettles the principle that Explanation to Section 73 of the Act deals only with purchase and sale of shares and is not applicable to exchange traded derivative transactions.

- Further, Explanation to Section 73 of the Act is severely impacting the corporate arbitrageurs as under an Arbitrage business, a broker buys shares and sells corresponding futures. Both the segments are two legs of one integrated activity and are not separate stand-alone segments. Therefore, as a result, if there is a profit in the cash segment, there would be a loss in the futures segment or vice-versa. Under an Arbitrage, the Broker does not carry out speculative deals of independent Futures & Options transactions and it also does not carry out independent purchase or sale of shares. However, the Assessing Officers are treating the two activities as separate and treating the loss made in the physical segment as Speculative Loss and the Profits made in the F&O Segment as Business Profits. Thus, a set-off of the two is not being given leading to huge litigation and undue problems for brokers/ arbitrageurs. The ratio of the Delhi HC judgment (supra) that Explanation to Section 73 of the Act is applicable to derivative business has created further doubts on treatment of loss made in the F&O segment as non-speculative loss.

### Recommendations

- An amendment should be made in Section 73 of the Act to specifically provide that a transaction in respect of trading in derivatives carried out in a recognized stock exchange by a company is not to be treated as speculative business transaction for the purpose of Explanation to Section 73 of the Act.

- Further, an amendment should be made in Section 73 of the Act to provide that all transactions of the nature mentioned in Section 43(5)(c) of the Act are excluded from the scope of Explanation to Sec 73 of the Act, this would ensure that all arbitrage and jobbing transaction by any entity are treated as one activity, i.e. business transaction.

- Alternatively, an amendment may be made in Explanation to Section 73 of the Act to provide that only purchase and sale of shares (other than on a recognised stock exchange) of other companies, shall, for the purposes of this Section, be deemed to be carrying on speculation business.

## 3.41.7. Taxation of long term capital gains on transfer of unlisted securities by non-residents - Section 112

### Issues

- The Finance Act, 2012 had amended Section 112(1)(c) of the Act to provide a concessional long term capital gains of 10% on transfer of capital assets being unlisted securities in the hands of non-residents (including foreign companies).

- However, the manner in which the term 'unlisted securities' has been defined may lead to the unintentional consequence of the 10% concessional tax rate not applying to gains arising on transfer of shares of private companies held as long term capital assets.

- Unlisted securities have been defined vide Explanation (ab) to Section 112(1) of the Act as follows "Unlisted securities means securities other than listed securities". Explanation (aa) defines

  *"listed securities" as follows:*

  *"Listed securities mean the securities which are listed on any recognised stock exchange in India".*

- Further, Explanation (a) to Section 112(1) of the Act, provides that "the expression 'securities' shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulations) Act, 1956 (32 of 1956)". The relevant extract of the expression 'securities' as defined in Section 2(h) of the Securities Contracts (Regulations) Act, 1956 ("SCRA") is as under:

  "Section 2(h) - Securities include –

  Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

  ii……………"

- For the purposes of Section 112 of the Act, it therefore becomes imperative to examine the scope of the term "securities" under the SCRA. Based on various judicial precedents, it has been held that the shares of a private limited company were not securities as defined in Section 2(h) of the SCRA. It was held that the shares must be marketable to qualify as a security under the SCRA. As the shares of a private company are not freely transferable, they were not held to be marketable and hence not a security for the purposes of Section 2(h) of the SCRA.

- Therefore, based on the above interpretation of the term 'securities', the aforesaid benefit of the concessional rate of 10% under Section 112(1)(c) of the Act may be available only on long term capital gains arising on transfer of unlisted marketable securities i.e. long term capital gains arising on the sale of shares of a private company may not qualify for the above concessional rate of taxation.

- The intention of the legislature was to extend the benefit of the 10% concessional tax rate on long term capital gains arising on transfer of unlisted securities by any non-resident. However, based on various judicial precedents on interpretation of the term "securities" as per SCRA could lead to litigation on this matter. There appears no basis to exclude gains arising from transfer of private companies from the above favourable regime. Moreover, a significant portion of the investments made by the PE funds in India is actually in private limited companies for several regulatory/ commercial reasons.

## Recommendation

- In order to create certainty and avoid undue litigation, it is requested that all long term capital gains arising to non-residents on transfer of all unlisted securities should be subject to concessional tax rate of 10% under Section 112(1)(c) of the Act with retrospective effect from April 1, 2013. In this regard, we suggest that the term "securities" in Explanation (a) to Section 112(1) should be defined as under:

  *"shares, scrips, stocks, bonds, debentures, debenture stock, warrants or other securities of like nature issued by a private company, public company, any other body corporate and funds registered with Securities and Exchange Board of India ('SEBI') under SEBI (Alternative Investment Funds) Regulations, 2012 and SEBI (Venture Capital Funds) Regulations, 1996 and includes other securities as specified in Section 2(h) of SCRA"*

# 3.41.8. Clarification on lower TDS rates on corporate bonds and government securities - Section 194LD

## Issues

- Rate of TDS in respect of interest earned by FIIs and Qualified Foreign Investors ('QFIs') on bonds issued by Indian companies and Government securities has been reduced from 20% (for FIIs)/ 40% (for QFIs) to 5% vide Section

194LD of the Finance Act 2013. This is a welcome change by the Government to encourage foreign debt in India. However, the benefit of reduced rate was made available only if:

- The coupon rate on corporate bonds does not exceed the rate as notified by the Central Government; and
- The benefit will be available in respect of interest income accruing to FIIs and QFIs between the period June 01, 2013 and May 31, 2015 irrespective of the date of investment.

- Currently, on technical reading of the provision, a FII/ QFI shall not be able to avail the benefit of the concessional tax rate if its coupon rate exceeds the notified rate of Central Government. Thus, in order to encourage foreign debt investment in India, it is represented that the benefit of reduced TDS rate shall be made available to all FIIs/ QFIs irrespective of the notified rate (i.e. the coupon rate as notified by the Government).
- Section 194D of the Act inter-alia states that the benefit is available to interest payable on "bonds" of Indian companies.

## Recommendations

With the intent to encourage foreign debt investment in India by FIIs/ QFIs, it is represented that:

- Section 194LD of the Act to be amended to state that benefit of reduced TDS rate shall be available to all FIIs/ QFIs irrespective of the notified rate (i.e. the ceiling coupon rate to be notified).
- Without prejudice to above, it is represented that interest up to the notified rate be subject to beneficial rate and any incremental coupon above the notified rate be subject to normal tax rates as applicable under the Act or treaty (as opposed to the entire interest income being taxable at the normal tax rates as per the Act/ treaty).
- Language of Section 194LD may be amended to explicitly cover "debentures" in addition to bonds as well especially considering private corporate debt is typically raised through debentures.

# 3.42. Transfer Pricing

## 3.42.1. Transfer Pricing - Marketing Intangibles

## Issues

- Marketing intangibles are crucial sources of value and its value is derived from the company's levels of Advertising, Marketing and Promotion expenditures (AMP) which adds intrinsic value to a company. Revenue authorities are increasingly scrutinizing the cross border transfer, use and further development of intangibles relating to brand and licenses. The ruling of the Delhi HC in the case of Maruti Suzuki India, which discusses the creation and compensation for marketing intangibles only, underlines this trend. Further, the Special Bench of the Delhi Tribunal in the case of LG Electronics India Pvt. Ltd. held that transfer pricing adjustment in relation to AMP expenditure incurred by the taxpayer for creating or improving the marketing intangible for and on behalf of the foreign Associated Enterprise (AE) is permissible. It also held that the said function can be construed as provision of service by the taxpayer to the AE for which, earning a mark-up in respect of AMP expenditure incurred for and on behalf of the AE, is appropriate.
- In light of the amendment introduced vide Finance Act 2012 which specifically includes marketing intangibles in the expanded definition of international transactions and the Special Bench ruling in the case of LG Electronics India Pvt. Ltd., substantiating the arm's length compensation for the transfer price of the intangibles would pose great challenges without specific guidance relating to these aspects in the Indian transfer pricing regulations.

## Recommendation

- Accordingly, in line with the Organization for Economic Co-operation and Development (OECD) principles, guidance should be issued to recognize certain methodologies/ approaches for evaluating the arm's length character of transactions involving marketing intangibles.

### 3.42.2. Transfer Pricing of Manufacturing Intangibles

#### Issues

- Compensation for use of manufacturing intangibles has generally been in the form of royalty payouts and is commonly benchmarked by adopting the aggregated approach.
- However, this approach is increasingly challenged by the Revenue Authorities, who insist on adopting transaction-specific approach, and the taxpayer is required to substantiate the economic and commercial benefits derived from the royalty payout.

#### Recommendation

- With the removal of the limits exchange control that was prescribed by the FEMA regulations, it is necessary that guidance be provided to test such transactions particularly in cases of start-up or loss making companies.

### 3.42.3. Transfer Pricing of Intra Group Financial Transactions/ Management services

#### Issues

- Management services are services where an entity in a multinational group renders shared services in the nature of legal, administrative, human resources, information technology, finance, sales/ marketing, etc. to its group affiliates.
- One of the important issues that draws the attention of the Revenue Authorities is the arm's length nature of the compensation paid for such intra-group services to related entities. The entire onus to substantiate the arm's length payment and establish 'cost-benefit' analysis by way of maintaining service agreements, basis of charge out rates, allocation keys, evidence of services/ benefits received etc., is upon the taxpayer.

#### Recommendation

- In the absence of any guidance or industry benchmarks in public domain for testing payments towards intra-group services, detailed guidelines for maintaining specific documentation outlining the various costs incurred in relation thereto and the related benefits derived there from, should be introduced in the regulations.

### 3.42.4. Issue of shares – Vodafone controversy

#### Issues

- Recently, the Revenue Authorities have been alleging that issuance of shares to overseas associated enterprises is subject to transfer pricing provisions. This step of Revenue Authorities has shaken the investors' confidence in India.
- The matter reached the High Court wherein, the contentions of the Revenue Authorities were as under:
  - Shares are issued by the Indian company to its associated enterprises at an undervalued price by questioning the valuation methodology;
  - Notional interest is to be computed by treating the shortfall resulting from undervaluation of shares as loan advanced by Indian company to its associated enterprise.
- However, the Bombay High Court in the case of Vodafone India Services Pvt Ltd (Writ Petition No 871 of 2014) rejected the contentions of the Revenue Authorities and quashed such transfer pricing adjustment on issuance of shares.The High Court affirmed the contentions of the taxpayer and held that that the undervaluation of shares at the time of issuance does not give rise to any income; the same is on capital account, which can never be brought under the ambit of taxation.

## Recommendation

- It is recommended that a circular should be issued by CBDT to clarify the law in light of the Bombay High Court decision in the case of Vodafone India Services Pvt Ltd (Writ Petition No 871 of 2014), directing the Revenue Authorities to respect the legal form of the transaction, not apply transfer pricing provisions and abstain from such re-characterization of under receipt of consideration for issuance of shares as loan.

## 3.42.5. Interest on Inter-company loans and Guarantee fees

## Issues

- Transfer pricing of cross-border financial transactions deals with inter-company loans, debentures, corporate guarantee charges, cash-pooling arrangements, debtors discounting, etc., and intends to arrive at arm's-length outcome in a related-party scenario. Typically, interest rates on loan transactions between third parties depend on factors like borrowers' credit rating, loan tenor, prevailing market conditions, loan seniority, security to lender(s), etc.

- The Comparable Uncontrolled Price (CUP) method, which is commonly used for arriving at arm's-length interest rates for intra-group loan transactions, demands a high degree of comparability and necessitates complex adjustments. Pricing a guarantee is even more challenging in the absence of comparable data and warrants application of sophisticated transfer pricing techniques. In India, lack of guidelines often leads to application of arbitrary methods for pricing of inter-company financial transactions. The Tribunal has laid emphasis on the credit quality of the borrower while holding that inter-company loans should attract arm's-length interest charge. Further, vide the Finance Act, 2012, the definition of international transactions has been expanded to specifically include capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business which would now give rise to a whole gamut of such financial transactions to be reported by the taxpayer.

## Recommendation

- Given the increasing global trend of cross border financing and inter-company lending, it is of paramount importance to introduce appropriate guidance governing the pricing of inter-company funding. Further considering the increased amount of litigation pertaining to the inter-company loans and guarantee transaction, with no clear view of the higher appellate authorities, appropriate clarification on the approach/ methodology to be adopted for analyzing these transactions is required.

## 3.42.6. Transfer Pricing Methods - Profit Split Method (PSM)

## Issue

- PSM is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The method involves valuation of non-routine intangible, assigning the combined profit or loss according to each party based on allocation keys and using of projected financials. Lack of clarity on valuation of intangibles and use of complex analysis for splitting the profit or loss has been experienced as the major reasons for the reluctance in using this method in India, both from a taxpayer and revenue perspective.

## Recommendation

- Issuance of guidance for application of this method and valuation norms can bring about clarity to the taxpayer on usage of this method.

### 3.42.7. TP documentation and scrutiny requirement

#### Issues

- The documentation requirements are attracted if the aggregate value of the transactions exceeds Rs. 1 Crore.
- The monetary threshold for mandatory 'transfer pricing' audit is Rs. 15 Crore.

#### Recommendations

- These monetary limits have remained static after the introduction of transfer pricing regulations in the Act and seem to be on lower side especially in case of companies, which has associates in various countries. This limit for maintenance of mandatory documentation and initiating scrutiny proceedings requires an upward revision. Also, documentation requirements should enable the Revenue Authorities to arrive at arm's length price without subjecting the concerned parties to undue cost, time and harassment.
- It is suggested that the threshold for maintaining TP documentation should be increased to Rs. 5 Crore and for mandatory TP audit should be increased to Rs. 25 Crore.

### 3.42.8. Adjustments for differences in functions and risks

#### Issues

- The Indian TP regulations provide for making reasonably accurate adjustments to take into account differences between international transactions and uncontrolled transactions, considering the specific characteristics relating thereto.
- However, in practice there is no guidance or clarity on the manner in which these adjustments are to be made. For example, adjustments in areas such as differences in levels of working capital, differences in risk profile, differences in volumes, pricing on marginal cost, startup losses or capacity utilization and so on, have generally not been permitted by the Revenue Authorities in the course of transfer pricing audits as upheld in certain Tribunal decisions as well.

#### Recommendation

- Accordingly, suitable guidance on the manner of carrying out economic and risk adjustments to comparable and taxpayer's data is necessary. Further, the Revenue Authorities should be encouraged to duly consider in the course of transfer pricing audits, business strategies and commercial or economic realities such as market entry strategies, market penetration, and non-recovery of initial set-up costs, unfavorable economic conditions and other legitimate business peculiarities while determining the arm's length pricing

### 3.42.9. 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. We have judicial precedents which favor and contradict the use of custom valuation in transfer pricing. In the case of Coastal Energy Pvt. Ltd., the Chennai Tribunal endorsed the Transfer Pricing Officer (TPO) decision to apply the customs data for transfer pricing analysis. Similarly, in the case of Liberty Agri Products Pvt. Ltd. the Chennai Tribunal again held that arm's length price on imports for transfer pricing purposes is to be determined using the rate for customs. Contrastingly, a decision from the Delhi Tribunal in the case of Panasonic Ltd. and the Mumbai Tribunal in the case of Serdia Pharmaceutical highlighted the distinctive objective of Customs valuation and the necessity for separate arm's length analysis as per transfer pricing provisions. Further, in a Chennai Tribunal decision in the case of Mobis India Ltd, the Tribunal held that customs valuation was not acceptable as comparable for ALP determination as the purpose of customs valuation does not fit in the scheme of TP analysis under the Act.

- These contradicting decisions necessitate a greater need for convergence of transfer pricing mechanism under the Act and the Customs Regulations.

## Recommendation

- There is a need for a common platform that would provide a 'middle-path' of arm's length price that is equally acceptable under Customs Law and under the Transfer Pricing.

## 3.42.10. Safe Harbour

- On 19th September 2013, the final Safe Harbour Rules (SHRs) were released after considering the comments of various stakeholders.

- Safe Harbour has been introduced for Software development Services (IT services), Information Technology Enabled Services (ITES), Knowledge Process Outsourcing services (KPO services), Contract Research and Development (Contract R&D) relating to IT services and generic pharmaceuticals, for manufacture and export of core and non-core automobile components and for financial transactions like loan and guarantees.

## KPO services and Contract R&D services - Issues and recommendations

- Cost plus margins proposed are too high and above the taxpayer's expectations - The Safe Harbour ratio of 25% in the case of KPO services seems to be in a higher range. A downward reduction in the currently prescribed rates would encourage more taxpayers to opt for the Safe Harbour regime.

- Clarity required in categorization (e.g. for ITES v/s KPO and for IT services v/s Contract R&D relating to IT) – Contrary to industry expectations, the categorization between ITES and KPO services and IT services and contract R&D relating to software development has not been done away with. To provide distinction from routine business process outsourcing services, the definition of KPO services includes only those services that require "application of knowledge and advanced analytical and technical skills". The definitions of various eligible international transactions, including that of the ITES and KPO and IT services and contract R&D services relating to software development, as provided in the SHRs leave lot of room for subjective interpretations and consequent controversies/ disputes on categorization of services.

- Moreover, the provisions in the SHRs relating to tax officer's review of taxpayer's continued eligibility in subsequent AYs also add to the uncertainty on categorization of services and eligibility for the Safe Harbour.

- It is recommended that additional/ clear criterions are introduced for classification of services. In any case, if such classification is made, it should not be merely based on the nature of services provided and there should be certain other criteria to determine the classification e.g. value of outcome of the activity performed vis-à-vis the ultimate customer etc.

## Advancing of intra-group loans – Issues and recommendations

- The credit rating of the borrower is one of the prime considerations for any loan transaction and this has also been duly recognized by the Rangachary Committee (RC) report by recommending different interest rates (for loans above Rs. 50 crores) for High, Medium, Low and Junk category of borrowers.
- Adoption of 30th June as the date for establishing Base Rate - Considering the dynamic nature of the financial market, the interest rate prevailing as on the date on which loan is granted is of prime importance. Accordingly, interest rate closest to the date of lending, as may be available, should be adopted.
- Benchmarking interest rate year on year - Typically the interest rate should be fixed at the time of entering into the loan arrangement. It should be eligible for Safe Harbour throughout the term of the loan and not just the AYs opted for by the taxpayer for Safe Harbour (valid maximum upto a period of 5 years starting with AY 2013-14 during which SHR are applicable).

## Providing intra-group guarantees – Issues and recommendations

- Downward revision of proposed Safe Harbour rate for guarantee commission/ fees: The rate of 2/ 1.75% in the case of guarantees below and above Rs. 100 crores respectively is on the higher side. In many cases the guarantee fee charged by banks could be much lesser.
- The credit rating of the borrower is one of the prime considerations for any guarantee transaction and this has also been duly recognized by the RC report by recommending different interest rates (for loans above Rs. 100 crores) for High, Medium, Low and Junk category of borrowers.
- The above SHRs may not necessarily cover Wholly Owned Subsidiaries. It should cover transactions with all AEs.

## General issues and recommendations

- Requirement for contemporaneous documentation will continue to apply in its entirety even in case a taxpayer has opted for SHR - Accordingly, the basic objective of simplicity and easy compliance is not being met by the SHR provisions. However, the RC report has recommended that the taxpayers opting for Safe Harbour should be required to maintain only basic documentation like the details of international transaction, shareholding structure, nature of business and industry and functional analysis. It is therefore recommended that the SHR be amended to provide that the taxpayers opting for Safe Harbour should be exempted from all the documentation requirements and should be required to maintain only basic documentation as recommended by the RC.
- It is recommended that a clarification should be issued that the Safe Harbour would not become a basis for the Revenue Authorities to challenge the arm' length pricing of the taxpayer in prior years.

## 3.42.11. Specified Domestic Transaction

- Section 92BA of the Act has been inserted vide Finance Act, 2012 by which the coverage of transfer pricing has been expanded to include certain 'Specified Domestic Transactions' if the aggregate amount of all such transactions entered by the taxpayer in the previous year exceeds Rs. 5 crores.

## Issues

- The term 'specified domestic transaction' has been defined to inter alia mean any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of Section 40A of the Act. Such expenditure could possibly include capital expenditure made to such a related person. It should therefore be clarified that these provisions pertain to revenue expenditure only.
- This amendment also covers a scenario wherein the payment of remuneration by the company to its director or relative of such directors is also required to be at arm's length. The same casts an onerous responsibility on the company vis - à- vis justification of the arm's length nature of such payments.

- Currently, there are no provisions relating to corresponding adjustment in transfer pricing regulations in respect to specified domestic transactions. It is important that if any adjustment [upward or downward] is made under the domestic transfer pricing provisions, then corresponding adjustment in the hands of the other party should be invariably be made.
- Presently, three different Sections referred to in Section 92BA and Section 92A of the Act prescribe varying thresholds for determination of 'related party' which are as under:
    - Substantial Interest – Not less than 20% of voting power – Explanation (b) to Section 40A(2)
    - Associated Enterprises - Not less than 26% of voting power- Section 92A(2)(a) & (b)
    - Associated Person - Not less than 26% of voting power - Section 80A read with Section 35AD(8)

## Recommendations

- The threshold limit of Rs. 5 crores for applicability of transfer pricing regulations to specified domestic transactions should be increased to avoid undue hardship for small businesses.
- Necessary guidance for benchmarking directors' remuneration should be provided, as by the nature itself these could be very peculiar transactions depending on the extent of ownership, technical ability, seniority etc.
- This amendment seeks to cover a situation wherein there could not be any loss to the exchequer. The same is not in line with the suggestion provided by the Supreme Court in the case of Glaxo Smithkline. The Supreme Court had provided the situation wherein transfer pricing should be applicable in case of transactions between a profit making and a loss unit/ company. The other scenario which was envisaged by the Supreme Court was transactions between units/ taxpayers having different tax rates. Other than the scenarios contemplated above, a corresponding adjustment should be allowed and hence provided for in the statue.
- It should be suitably clarified that the transfer pricing provisions would only apply to revenue expenditure referred to in Section 40A(2)(a) of the Act, and not to payments made to persons specified in Section 40A(2)(b) of the Act.
- 'Any other transaction as may be prescribed' covered under Section 92BA of the Act may be notified and should be made applicable from prospective effect to avoid undue hardship to the taxpayers.
- Necessary amendments should be made in the domestic transfer pricing provisions to provide for the corresponding adjustments.
- It is suggested that the threshold for determination of 'related party' prescribed in the aforesaid Sections should be harmonized and necessary amendments in this regard should be carried out.
- The words “close connection” appearing in Section 80-IA(10) of the Act needs to be clarified to avoid ambiguity in the application of provisions of Section 92BA of the Act.
- Further, clarity should be provided with regard to inter-unit allocation of costs between eligible and non-eligible units i.e. whether corporate cost allocations from a non-tax holiday unit of a company to a tax holiday unit of the same company would get covered within the provisions of Section 80-IA(8) and consequently need to be reported as a specified domestic transaction.
- The Advance Pricing Agreement (APA) provisions are being made applicable to only international transactions. The same should also be made applicable to domestic transactions covered by transfer pricing regulations.

## 3.42.12. Amendments in electronic version of Form 3CEB (Transfer Pricing Accountant's Report)

### Issues and Recommendations

- The software utility designed for electronic version of Form 3CEB does not provide reporting of transactions in any currency other than Indian rupees. It is suggested to provide reporting of transactions undertaken by banks in foreign currency to provide reporting of transactions in foreign currency.
- Currently, voluminous transactions are required to be manually punched in electronic versions of Form 3CEB available on income tax website. This results in mammoth manual efforts and increases chances of erroneous reporting. Therefore, it is suggested to provide excel utility of Form 3CEB on the income tax website for reporting of certain transaction terms in text form.

## 3.42.13. Penalty for failure to keep and maintain information and document etc.

### Issue

- The Finance Act, 2012 has substituted Section 271AA with effect from 1st July 2012 which reads as under:-

  "271AA. Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an international transaction or specified domestic transaction-

  i. fails to keep and maintain any such information and document as required by sub-Section (1) or sub-Section (2) of Section 92D;

  ii. fails to report such transaction which he is required to do so; or

  iii. maintains or furnishes an incorrect information or document,

  the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person."

  While the quantum of addition itself is disputable in transfer pricing assessments, fixing the penalty on the assessed income would increase the burden of the taxpayer considerably.

  Due to retrospective extension of scope of international transaction, the tax officer or Commissioner (Appeals) can ask the taxpayer to pay penalty under the said Section 271AA @ 2% of value of international transaction due to failure to keep information in addition to another 2% under Section 271G for not furnishing the information besides regular penalty under Section 271(1)(c) of the Act. This would result in multiple tax demand on arbitrary values.

### Recommendation

- It is, therefore, suggested that penalty should be restricted to tax in dispute and not linked to the value of transaction.

### Issue

- While the Finance Act, 2014, extended the power to levy penalty under Section 271G to the TPO for failure to furnish information/ TP documentation, which was earlier restricted to tax officer or the Commissioner (Appeals), interestingly, there has been no amendment to Section 271AA (which prescribes the power to levy penalty for failure to keep and maintain information and document, etc. in respect of certain transactions), currently provided only to the tax officer or the Commissioner (Appeals), possibly seeking to limit powers to levy penalty for matters relating to non-compliance with statutory provisions, only to tax officers/ Commissioner (Appeals), while extending powers to levy penalty to TPOs for matters relating to proceedings in the course of conduct of TP audits.

### Recommendation

- Considering that clause (iii) to Section 271AA also states that penalty shall be levied for maintaining or "furnishing" incorrect information or document, as the act of "furnishing" is typically associated with a TP audit proceedings, it is recommended that there should be some consistency on this front.

## 3.43. Assessment and Procedural Aspects

It may be noted that FICCI has submitted its paper on "Dispute Resolution in Tax Matters" to the Ministry of Finance, which highlights the existing system of resolving the disputes between the taxpayers and the tax administration, identifies the shortcomings and suggest possible measures which could expedite the dispute resolution in a fair and transparent manner and consequently lessen the hardship of the taxpayers. Accordingly, it contains various suggestions to bring upon improvement in the assessment, appellate and other procedural aspects.

It is, therefore, requested that the points mentioned in the above said document may be duly considered while formulating proposals for the Union Budget 2015-16. Some of the other suggestions on the issues faced by the taxpayers which requires due attention are submitted below:-

## 3.43.1. Filing of return of income

### Issue

- All companies are required to file their return of income electronically. As per Rule 12 of the Rules, the electronic return shall not be accompanied with the computation of tax liability or any other document (other than the specified reports to be filed electronically). It should be noted that it is not possible to file the computation of income with the return, the taxpayer cannot state the basis or rationale for adopting a particular tax position in the return on any aspect. Such computation or basis for preparation of return of income can be filed by the taxpayer only during the assessment proceedings. Hence, non-filing of such documents with the return of income should not be viewed as non-disclosure of material facts or furnishing inaccurate particulars of income or concealment of income.

### Recommendation

- Based on the above, it is suggested that appropriate amendments should be made to the provisions of the Act (such as Section 147 and Section 271 of the Act), to clarify that where any information or document relating to the tax position adopted by the taxpayer is not filed with the return of income but is submitted by the taxpayer during the assessment, it would be taken into account for the purpose of determining whether the taxpayer has disclosed all material facts for the purpose of assessment.

## 3.43.2. Signing of return of income/ Appeals - Section 140(c)

### Issues

- Section 140(c) of the Act read with Rule 45(2) and Rule 47(1) of the Rules provides that in case of a domestic company, the return of income and appeal documents before the appellate authorities are required to be signed by the Managing Director of such company or any other director (only in case Managing Director is not available for unavoidable reasons).

- However, under indirect tax laws, the company's returns and appeal documents before the Appellate Authorities could be signed by any authorised signatory of the company.

- Further, under the Act, even the return of income/ appeal documents etc of a foreign company could be signed by the authorised signatory of the company.

### Recommendations

- It is suggested to align the procedures for signing of documents relating to income tax of a domestic company with the provisions currently applicable for a foreign company under the Act.

- In this regard, the provisions of Section 140(c) of the Act read with Rule 45(2) and 47(1) of the Rules should be amended to enable an authorized signatory to sign the appeals, return of income and all other documents under the Act for a domestic company.

### 3.43.3. Compulsory filing of return of income in relation to assets located outside India

Finance Act, 2012 has made it mandatory for residents (other than not ordinarily resident in India) to file return of income in India under proviso 4 to Section 139 of the Act, if they have any asset (including any financial interest in any entity) located outside India or signing authority in any account located outside India irrespective of the fact whether the resident taxpayer has taxable income or not.

#### Issues

- There is no minimum threshold prescribed for foreign asset/ financial interest reporting. In absence of minimum threshold, there could be diligent reporting of minimal values of bank account balances etc., defeating the purpose of data collection, and overburdening the tax department with irrelevant information. On the other hand, taxpayers may inadvertently ignore certain details (given the low values), which may trigger a non-compliance and may not be intentional. This could be avoided by prescribing a minimum threshold.

- Finance Act, 2012 also provided the time limit of 16 years for reopening of assessment proceedings under proviso 2 to Section 147 of the Act, where any person is found to have any asset (including financial interest in any entity) located outside India, which poses serious hardships for taxpayers who have returned to India after staying abroad for long, as it is not reasonable to expect them to have the documentation retained for the past 16 years to explain the bonafide. Hence, this will even cover the genuine taxpayers who would have paid tax on the foreign assets while their stay abroad but are unable to prove their bonafide in absence of any documentation for a such a prior period.

- There are no guidelines on as to what would come within the purview of 'any asset, 'financial interest in any entity'. In the absence of any guidance the term may have wide connotation leading to litigation. Clarity would be required on whether assets such life insurance policies, stock options benefits, overseas social security schemes and pension plans, paintings, works of art, collection items (such as stamp collection/ coin collection) etc. are covered. The reporting requirement could end up to be a meaningless collection of data if suitable guidelines are not issued.

- The provision casts unnecessary burden on the spouse/ family members, accompanying the foreign nationals working in India, as they are also required to file their return of income in India [for which first they are required to obtain Permanent Account Number (PAN)], as they qualify as ordinarily residents in India based on their physical stay in India, even if they are not working or earning any income.

- In practical situations, many executives of a company are appointed as authorized signatory of company account situated outside India while discharging their duty as an employee of that company. Details of such accounts may not be available with such executives. It has now become mandatory for every resident to report details in the income tax form if they have signing authority in any account located outside India. Such a requirement poses hardship for the taxpayers who are signatory to accounts held by the entities in which they are employed/ directors.

#### Recommendations

- It is strongly recommended that a minimum threshold be prescribed for reporting of foreign assets.

- The period of 16 years for reopening of cases should be made applicable only for any AY beginning from on or after AY 2012-13.

- It should be suitably clarified as to what would constitute “any asset” and “financial interest” under the provisions of the Act.

- In order to minimize this undue hardship with foreign nationals and to make the guidelines more effective, there needs to be clarity on the following aspects:
  - Who is required to report?
  - What is required to be reported?
  - Threshold beyond which reporting becomes mandatory?The above clarity will ensure that the reporting requirement would not end up to be a meaningless guideline of collecting unnecessary data.
- It is recommended that an exception be provided to a resident who is a signing authority to a foreign account by virtue of his employment/ directorship.

## 3.43.4. Claim made during the assessment proceedings

### Issue

- The tax officers reject the claims made by the taxpayers during the course of the assessment proceedings which are omitted to be claimed by the latter in their return of income. The rejection of claim by the tax officer is made on the basis of the judgment of the Supreme Court in the case of Goetze India Ltd. vs. CIT (2006) 284 ITR 323 (SC). The said Supreme Court judgment has been distinguished by various courts in plethora of judgments and also not in consonance with the Circular No. 14 dated 11th April, 1955 issued by CBDT.

### Recommendation

- It should be suitably clarified in the Act that the tax officer is duty bound to allow the legitimate claim of the taxpayer made before him during the course of the assessment proceedings and assess the total income/ loss after allowing the said claim.

## 3.43.5. 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. This would adversely add to the compliance burden of the taxpayer especially when there is already a requirement to get a comprehensive audit done as per Section 44AB of the Act.
- The conditions prescribed for referring the case for special audit are not interdependent i.e. even one of the conditions could trigger recommendation for special audit. The applicability of this provision merely on the basis of volume of the accounts or multiplicity of transactions in the account is unreasonable since in such a case, all big companies with voluminous transaction could be referred for special audit. The amendment will result in unwarranted litigation.
- Reasons such as volume of accounts, multiplicity of transactions in the accounts, specialized nature of business activity of taxpayer etc. are not defined categorically to state the quantum/ threshold etc. for initiating a special audit.

## Recommendations

- Applicability of this provision should not be invoked merely on the basis of volume of the accounts or multiplicity of transactions in the account. The provision should be amended to require satisfaction of all the conditions cumulatively for directing for special audit under Section 142(2A) of the Act.
- The terms such as "volume of accounts", "multiplicity of transactions in the accounts" and "specialized nature of business activity of assessee" would need to be defined very clearly in the Section in order to avoid litigation/ ambiguity in the interpretation of the Section.

## Reassessment Procedures

## 3.43.6. Time Limit for filing return based on notice of reassessment - Section 148

### Issue

- The Finance (No.2) Act, 1996 amended Section 148 of the Act doing away with the minimum period of 30 days within which a taxpayer was required to submit his return of income in response to a notice for reassessment. With this amendment, the period within which the taxpayer is required to submit the return of income for the purpose of reassessment is left to the discretion of the tax officer.

### Recommendation

- It is suggested that time limit of not less than 90 days be provided to the taxpayer for filing return of income from the date of service of notice upon the taxpayer. It is also suggested that the printed form of notice under Section 148 of the Act should be amended likewise.

## 3.43.7. Refunds

### Issues

- While the tax is collected in advance and in a timely manner, when it comes to issue of refund orders, the same is not provided to the taxpayers without rigorous follow up.
- Where the taxpayers have huge refund receivable from the Revenue Authorities, they are still required to pay the advance tax without adjusting such outstanding refunds. On one hand, there is substantial time gap between the date of filing of return of income and issue of tax refund, and on the other hand, the taxpayer has to pay tax every quarter in advance. Thus, the taxpayer faces liquidity issues as the amount is locked-up for good period of time.

### Recommendations

- A proper mechanism or procedure needs to be put in place with accountability fixed on the tax department to ensure that refunds are disbursed without time lag. Further, a specified time limit should be provided to the Revenue Authorities to grant refund as per return of income or due to effect of rectification/ appellate order. In the event, such refund is not issued, similar to penal provisions of Section 220 of the Act, penal provision with respect to interest entitlement for refund due including interest under Section 244A of the Act not granted to company should also be provided.
- It is further suggested that a mechanism can be introduced, wherein the refund due can be set off against the advance tax liability of the taxpayer.

## 3.43.8. Extension of stay of demand before the Tribunal – Section 254(2A)

### Issues

- The third proviso to Section 254(2A) of the Act, as amended with effect October 1, 2008, provides that if an appeal filed by the assessee before the Tribunal is not disposed of within 365 days from the date of the first stay order, the stay shall stand vacated, even if the delay in disposing of the appeal is not attributable to the taxpayer.

- There have been contrary decisions regarding the extension of stay of demand beyond 365 days, if the delay in disposing of the appeal is not attributable to the taxpayer. Recently, the Delhi HC in the case of CIT vs Maruti Suzuki (India) Limited (WP No 5086 / 2013) held that the Tribunal does not have the power to grant stay of demand beyond a period of 365 days, even where the delay in disposal of appeal was not attributable to the taxpayer. The Delhi HC further held that in case the appeal is not disposed of by the Tribunal within 365 days, the taxpayer can exercise writ jurisdiction under Article 226 of the Constitution of India and file stay application before the HC.However, the Bombay HC in the case of Ronuk Industries (333 ITR 99) and Narang Overseas (295 ITR 22) have held that stay of demand can be extended beyond 365 days if the delay in disposing of the appeal is not attributable to the assessee.Further, the constitutional validity of the third proviso to Section 254(2A) of the Act has been challenged in the case of Mitsubishi Corporation and is currently pending before the Delhi HC.

### Recommendation

- The contrary rulings of various HCs are resulting in mixed views and unnecessary litigation, which should be reduced. Further, in cases where stay exceeds the prescribed period, the taxpayer has an option to file a writ petition before its jurisdictional HC for seeking stay. However, writ option is costly and results in undue hardship to the taxpayer. Considering that the objective of any provision or law cannot be to cause undue hardship to the taxpayer without any fault on his part, the third proviso to Section 254(2A) of the Act should be amended suitably to provide that the Tribunal can extend the stay beyond 365 days, only in case the delay in disposing of the appeals is not attributable to the taxpayer.

## 3.43.9. Time limit for completion of appeals by appellate authorities

### Issue

- The Act does not specify any time limit within which the appeals filed before the appellate authorities must be disposed of. This results in undue hardship and never ending litigation cost to the taxpayer.

### Recommendation

- It is suggested that suitable provision may be incorporated in the Act to prescribe specified time limits for disposal of appeals in a timely manner at all appellate levels.

## 3.43.10. Delay in passing of order giving effect to the order of CIT(A)/ Tribunal/ Court

### Issue

- Considerable delay is seen in giving effect to the order of the Commissioner (Appeals)/ Tribunal/ Court by the tax officer, particularly where relief/ refund is allowed by the Commissioner (Appeals)/ Tribunal/ Court. Due to the delay in giving the effect of appellate order, substantial refund/ relief to be allowed to the taxpayer is withheld by the tax department. Though Section 244A of the Act provides for payment of interest for the delay in grant of refund, no time limit has been prescribed within which the appeal effect is to be given by the tax officer. As a result, the tax payments made by the taxpayer on funds borrowed at heavy rate of interest is unnecessarily held up by the tax department.

### Recommendations

- Provisions may be inserted to require the tax officer to give effect to the order of Commissioner (Appeals)/ Tribunal/ Court within a reasonable period, say six months.
- Alternatively, the taxpayer should be given an option to adjust the amount of refund (along with interest) while making payment of advance tax for the current year.

## 3.43.11. Scope and Powers of Dispute Resolution Panel ('DRP') – Section 144C

### Issues

In line with the objective for which DRP was set up and the following suggestions are made:

- It is suggested that the constitution of DRP should act like an independent judicial body rather than just a departmental body lending support to tax officers. The members of the DRP should have statutory powers and authority like members of the ITAT or AAR.
- Settlement powers should be bestowed upon the DRP Panel so as to enable them to expedite the long litigated matters and close them in a timely manner.
- Tax officers should also be made accountable for their orders.

## 3.43.12. Tax Administration Reform Commission (TARC)

The TARC, constituted to examine and suggest reforms focusing primarily on tax administration, has come up with some path breaking recommendations which should be given consideration. Accordingly, it is suggested that the following recommendations given by TARC should be implemented:

### Customer focus

- Setting up of a dedicated organization (with resources and personnel) to deliver taxpayer services
- In redressing taxpayers' grievances, the decision of the Ombudsman should be binding on the tax officers.

### Structure and governance of tax administration

- Various recommendations have been laid down by TARC to bring synergy between CBDT and Central Board of Excise and Customs (CBEC), so as to add value to the respective departments and also eliminate duplication of work.

### People function

- TARC has suggested a need to facilitate better understanding regarding complex business transactions among the tax officers and staff of CBDT.

### Dispute management

- Clarity in laws and procedures, timely intervention by the CBDT to clarify contentious matters, avoidance of tax demands which are not on merits, pre-dispute consultation, proper control over quality of show cause notices/ demands/ questionnaires issues to the taxpayers and an approach to resolve conflicts before conclusion of audits.
- Current practice of raising demands irrespective of merits should be discontinued. Pre-dispute consultation should be followed as a practice before issuing tax demand notice.
- Mandate of DRPs should be extended to cases of residents as well.

### Key internal processes and Information Communication Technology

- Changes such as single form for wealth tax return and the return of income, PAN being developed as a common business identification number, strict time frame of granting of refund, guidelines for grant of foreign tax credit etc. are recommended.

## 3.43.13. Alternate Dispute Resolution Routes

### Issue

- In order to resolve excessive tax litigation in India, alternate dispute resolution routes such as AAR, Advance Pricing Agreement (APA), Settlement Commission and Mutual Agreement Procedure (MAP) under the DTAA's have been introduced by the Government. However, such dispute resolution routes have not been able to curtail litigation in a timely and effective manner.

### Recommendations

### AAR/ APA/ Settlement Commission

- It is suggested that the backlog in relation to pending AAR/APA applications should be cleared so that the investor community's confidence in the ability of the system to provide clarity expeditiously is strengthened.
- The Chairman of the AAR should be a full-time member and the availability of the members of AAR and the appointment criteria currently envisaged in Section 245O of the Act needs to be broad based.
- The time limit for passing orders should be adhered by the AAR.
- Similarly, the scope, mandate and functioning of the Settlement Commission also needs to be reframed in the light of providing a meaningful and time bound dispute resolution mechanism.

The Indian Revenue Authorities have been taking a stand to deny filing of bilateral APA for settling transfer pricing disputes in the absence of Article 9(2) in the DTAA's entered between India and other countries, which allows corresponding transfer pricing relief in the host country. It is suggested that a taxpayer should be allowed to file a bilateral APA even in cases where Article 9(2) is not provided in such DTAAs.

### Mutual Agreement Procedure (MAP)

- It is suggested that MAP proceedings should be more transparent and the settlement mechanism should be initiated within reasonable time frames.
- A monitoring mechanism should be put in place to keep a track of the number of cases which are resolved after the meetings of the Competent Authorities of the two states, say on a quarterly basis.
- A clarification is required to be issued by CBDT providing adequate safeguards to ensure that the Competent Authorities initiate MAP proceedings year to year basis. This will ensure that MAP application is not filed for each subsequent year(s), thereby saving time and cost of taxpayers and the Competent Authorities.
- Furthermore, with a view to maintain the spirit of MAP settlement, it should be clarified that in case there is possibility of taking two views for taxability, then penalty should not be levied on the taxpayers.
- It is suggested that the tax officers should be formally instructed that in case where the taxpayer has made appropriate MAP filings and provided required bank guarantees, stay of demand shall be granted to the taxpayers in all cases.

## 3.43.14. Provision for refund of income-tax

### Issue

- Judicial precedents have held that the taxpayer would be entitled to get refund of income-tax recovered either before the expiry of time limit to file an appeal before the Tribunal or during the pendency of disposal of stay application. However, in the absence of express provisions to this effect under the Act, it is seen that in many cases, the Revenue Authorities adopting a coercive approach against the taxpayer (such as recovery proceedings) whereby the taxpayer is required to pay the income-tax, irrespective of merits of case.

## Recommendation

- Thus, it is suggested that the Legislature should suitably include an express provision whereby the Revenue Authorities are either:
  - restricted to proceed with the income-tax recovery proceedings; or
  - refund the income-tax paid during the recovery proceedings, without adjusting against the income-tax arrears, if any, before the expiry of time limit to file an appeal before Tribunal or during the pendency of disposal of stay application in such cases.

## 3.43.15. Interest payable by the taxpayer under Section 220

## Issues

The Finance (No.2) Act, 2014, has amended Section 220 to provide that any tax demand raised on the taxpayer shall be deemed to be valid till the final disposal of the appeal by the last appellate authority. This amendment seems to have been made by relying on the theory of continuity of the proceedings and the doctrine of relation back. Thus, such amendment has the effect of keeping interest clock running till the disputes are finally resolved by the highest appellate authorities. This change is harsh and inefficient in as much as:

- The amendment has the effect of calling upon the taxpayer to pay interest even for the period for which there is no tax demand outstanding.
- The rate of interest under Section 220 of the Act @12% per annum is too high and further the same is not tax deductible.
- The disposal of appeals by the appellate authorities typically takes several years. Therefore, this amendment will cause undue hardship and uncertainty on the amount in dispute to the taxpayer in appeal.

## Recommendations

It is suggested that:

- The amendment made by the Finance (No.2) Act 2014 should be rolled back.
- Alternatively, deduction should be allowed for such interest payment under the Act in the year of payment irrespective of the year to which the liability pertains.

## 3.43.16. Rate of Interest on Tax Refunds – Sec 244A

## Issue

- Under Section 244A interest is computed @ 6% per annum on tax refunds payable by the Government however in cases of interest payable by the taxpayer 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 taxpayers respectively may be prescribed.

## 3.44. Maintenance of Books of Account in Digital Form - Section 2(12A)

## Issue

- The present law requires the taxpayers to maintain books of account in physical form thus causing a lot of hardship to the taxpayers in the world of digitization and also leading to wastage of valuable resources.

## Recommendation

- Section 2(12A) of the Act needs to be amended to include books maintained in digital form also as 'books or books of accounts' for the purpose of the Act. Major corporate entities manage their books of account on automated systems only and the proposed amendment would encourage maintenance of accounts in digital form enabling effective management of cumbersome records.

## 3.45. Procedure for surrender of PAN

## Issues

- In case of firms/ companies who have discontinued their business, have to file return under Section 139(1) of the Act, since no procedure has been prescribed for surrender of PAN for such discontinued firms/ companies.

- This also leads to penalty under Section 271F on account of non-filing of return of income.

## Recommendation

- It is suggested that written guidelines and procedure shall be introduced for surrender of PAN, wherever it is genuinely necessary for the taxpayer to surrender, for instance in the case of discontinuance of business etc.

## 3.46. Expediting issuance of Income tax Clearance Certificate

## Issues

- A Liaison Office (LO) can be opened for a period of 3 years. After completion of 3 years, LO has two options – either to continue its operation or close down its operation. Where it wants to close its operations, submission of income tax clearance certificate (ITCC) with Reserve Bank of India (RBI) is a mandatory requirement. Similarly, where a Company wishes to liquidate, it is also required to obtain ITCC. In absence of a specific provision under the Act, 1961, taxpayer finds it difficult to obtain an ITCC, from its tax officer and that too, in a reasonable period of time.

- Section 230 of the Act also provides for issuance of ITCC in case of an individual who is not domiciled in India and is going outside India.

## Recommendations

- It is suggested that a provision in the Act shall be introduced for issuance of ITCC to cases like liquidation of Companies, LO closure, etc.

- A time limit should also be prescribed within which the Assessing Officer should issue the ITCC.

## 3.47. Personal Tax

## 3.47.1. Taxation of Employee Stock Option Plans for migratory employees - Section 17

## Issues

- Section 17(2)(vi) of the Act, read with Rule 3 of the Rules deal with taxation of Employee Stock Option Plans (ESOPs). It is provided that the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate shall be taxable as perquisite in the hands of the employee. For this purpose, the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the taxpayer, as reduced by the amount actually paid by, or recovered from, the taxpayer in respect of such security or shares.

- In this connection, what has not been appreciated is that ESOP shares stand on a different footing because on the date of exercise, the shares are subject to lock-in condition and cannot be considered to be a benefit and therefore, ought not to be fictionally treated as benefit and brought under the ambit of perquisites for taxation purposes. The Supreme Court, in CIT v. Infosys Technologies Ltd., [2008] 2 SCC 272, at page 277, had aptly held:

> *"During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs. 165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."*

- It may be mentioned that only when Fringe Benefit Tax (FBT) was introduced by the Finance Act 2005, these provisions were changed for the purposes of taxation of ESOPs under FBT regime. Unfortunately, those very provisions have now been brought back by way of insertion in sub-clause (vi) of sub-Section (2) of Section 17 of the Act, after the abolition of FBT, which has caused a lot of anxiety. It is imperative that the earlier tax treatment be restored to facilitate the employers in retaining talented persons in the organization.

## Recommendation

- It is suggested that ESOPs should not be subject to tax on notional perquisite value and taxed only on capital gains arising from the sale of shares, as was the position till 31st March 2006.

## Issues

- Notwithstanding the above recommendation, taxation of ESOPs creates an issue in the case of migrating employees, who move from one country to another, while performing services for the company during the period between the grant date and the allotment date of the ESOP. The domestic tax law is unsettled on the taxation of such migrating employees and does not clearly provide for such cases.

- There was a specific clarification on proportionate taxability of benefits under the erstwhile FBT regime, where the employee was based in India only for a part of the period between grant and vesting. However, there is no specific provision in this regard under the amended taxation regime from 1st April 2009.

- Recently, it has been held by Delhi Tribunal in case of Robert Arthur Keltz (2013) 35 Taxmann.com 424 (Del) that only the proportionate benefit of ESOP pertaining to the services rendered by taxpayer in India should be taxable in India and not the entire benefit.

## Recommendation

- A specific clarification should be inserted with respect to taxability of only proportionate ESOP benefit based on residential status of the individual, where an employee was based in India for only a part of the period between grant and vesting.

## 3.47.2. Taxation of contribution to superannuation fund in excess of Rs. 1 lakh - Section 17

## Issues

- Section 17(2)(vii) inserted by the Finance (No.2) Act, 2009, provides that the amount of any contribution to any approved superannuation fund by the employer in excess of Rs. 1 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.

## Recommendation

- It is recommended that employer contribution to approved superannuation fund be made fully exempt from tax.

## 3.47.3. Revival of Standard Deduction

## Issues

- A standard deduction was earlier available to the salaried individuals from their taxable salary income. However the same was abolished with effect from AY 2006-07.
- On the other hand, business expenses continued to remain as permissible deductions from taxable business income.
- It has to be appreciated that standard deduction is not a personal allowance and used to be given as a lump sum for meeting employment related expenses. In many countries like Malaysia, Indonesia, Germany, France, Japan, Thailand etc., allowance in the form of standard deduction is available for salaried employees for expenses connected with salary income. To illustrate in Thailand the deduction is as high as 40% of income subject to certain limits.

## 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.

## 3.47.4. Transportation Allowance - Section 10

## Issues

- The transport allowance granted by the employer to the employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty is currently tax exempt up to Rs. 800 per month in terms of Section 10(14) of the Act read with Rule 2BB of the Rules.
- This exemption limit was fixed in 1998 and seems quite nominal considering the ever rising fuel costs and resultant conveyance costs.

## Recommendation

- The exemption limit of Rs. 800 per month needs to be considerably raised upwards, say to minimum of Rs. 2,000 per month to bring it in line with the rising conveyance costs.

## 3.47.5. Education Allowance

## Issues

- The education allowance granted by the employer to the employee to meet the cost of education expenditure upto 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 quite nominal considering the ever rising cost of education.

## Recommendation

- The exemption limit of Rs. 100 per month needs to be considerably raised upwards, say to minimum of Rs. 1,000 per month to bring it in line with the rising inflation and cost of education.

### 3.47.6. Reimbursement of Medical Expenditure - Section 10

#### Issues

- Any sum paid by the employer in respect of any expenditure incurred by the employee on the medical treatment of self/ family is currently exempt from tax, to the extent of Rs. 15,000 per annum.
- This limit was last revised long back and needs to be revisited in light of the rising medical and hospitalization costs especially for private hospitals.
- The expenditure incurred by/ for retired employees in respect of medical treatment on self/ family is currently not exempt from tax.

#### Recommendations

- The current tax exemption limit of Rs. 15,000 per annum needs to be increased to at least Rs. 50,000 per annum. This could to some extent help to bring the exemption up to speed with the rising medical costs.
- Further, the exemption in respect of expenditure on medical reimbursements/ hospitalization expenditure in approved hospitals should also be extended to retired employees.

### 3.47.7. Deduction in respect of Health Insurance Premia under Section 80D

#### Issues

- Currently, a deduction up to Rs. 15,000 for self/ family and Rs. 15,000 for parents is available to an individual under Section 80D of the Act from taxable income, towards health insurance premium paid by him. The limit for parents is increased to Rs. 20,000 if the parents are senior citizens.
- Unlike many other countries, India does not have a comprehensive health-care system for its citizens. There are Government hospitals but the facilities available are woefully inadequate while the private hospitals are very expensive. Also, the penetration and awareness of health insurance in India is very slow. Most individuals buy insurance only to save taxes.

#### Recommendation

- Therefore, there is a need to raise the above limit to achieve two-fold objective of giving a tax incentive while also encouraging people to obtain larger healthcare cover in wake of the rising costs.
- It will be immensely helpful if, till the Government introduces adequate healthcare systems, the quantum of deduction under Section 80D of the Act is increased. A reference to General Insurance Corporation to find out how much they charge as premium for insurance of a family under a comprehensive hospitalization scheme will give an indication about the reasonable higher limit of the deduction.

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

#### Issues

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

## Recommendations

- It is therefore recommended to grant tax exemption for economy class airfare for travel abroad also, so long these are within the overall airfare tax exemption conditions for travelling in India. Here, it is pertinent to note that in a recent ruling by the Chandigarh Bench of the Tribunal, in the case of Om Prakash Gupta vs. ITO (ITA no. 938/CHD/2011-taxsutra.com) it has been held that amount received by the taxpayer on account of Leave Travel Concession (LTC), which was received by taxpayer on account of travel to both Foreign and Indian destination and the journey concluded by visit to a place in India, is not eligible for income tax exemption as the taxpayer has also travelled to a foreign destination. However, considering the current prevailing trend in respect of foreign travel, there is a need to include overseas travel as well or at least to exempt proportionate expenses pertaining to travel within India in case of joint travel (within India and overseas destination).
- Further, under Rule 2B of the Rules, the amount exempt in respect of LTC by air is to the extent of the economy fare of National Carrier i.e. Indian Airlines. It is suggested that word "National Carrier" should be deleted from Rule 2B.
- Moreover, as per the current provisions, Leave Travel Concession/ Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years. It is suggested that the concept of calendar year should be replaced with FY (April – March) in line with the other provisions of the Income Tax Law and further exemption should be made available in respect of at least one journey in each FY.

## 3.47.9. Taxation of social security contributions in the hands of Expatriates - Section 17

## Issues

- In respect of an expatriate employee deputed to India, the home employer and employee may be required to contribute to social security schemes under the local law of country. In most cases, the contributions made to these schemes may not vest on the employee at the time of making the contributions and thereby do not provide any immediate benefit to the employee. Further, the employee contributions may also be mandatory under the law of the home country. Both the employer and employee contributions may be available as a deduction from taxable income in the home country of the expatriates.
- However, currently there is no provision under the Act, which provides for the taxability or otherwise in respect of such contributions from taxable income, though there have been several favourable judicial precedents to this effect such as CIT v. L.W. Russel [1964] 53 ITR 91 (SC),Gallotti Raoul v. ACIT [1997] 61 ITD 453 (Mum), ITO v. Lukas Fole (Pune) (2009-TIOL-556), CIT v. NHK Japan Broadcasting Corporation [Civil Appeal No. 1712 of 2009 – SC].
- Recently, even the Delhi HC pronounced the decision in case of Yoshio Kubo, wherein it was held that employer's contribution to overseas social security, pension and medical/ health insurance do not qualify as perquisite under Section 17(1)(v) of the Act and are not taxable in the hands of the employees.

## Recommendation

- It needs to be clarified under the Act, that employer contributions to such social security schemes should be exempt in the hands of the individual employee based on the principle of vesting. Further, the employee contributions should be available as a deduction where the same are mandatory and constitute diversion of income by overriding title.

## 3.47.10. Provision of treaty benefits while calculating TDS under Section 192

## Issues

- Currently, there is no provision in the Act, enabling the employer to consider admissible treaty benefits (e.g. credits for taxes paid in another country/ treaty exclusions of income), while TDS under Section 192 of the Act from salary income.

- This creates cash flow issues for the expatriates who are initially subject to deduction of tax by their employers and then are required to claim large refunds on account of treaty benefits at the time of filing their return of income. Many of these expatriates may complete their assignments and leave India prior to obtaining their tax refunds which also creates issues with respect to credit of their refund amounts.

### Recommendation

- Since the credit is otherwise admissible in terms of Section 90/ 91 of the Act, a suitable amendment may be incorporated in Section 192 of the Act providing for the employer to consider such credits/ exclusions at the time of deducting taxes.

## 3.47.11. Threshold limit under Section 80C of the Act

### Issues

- Over the years, investments made in various avenues available under Section 80C of the Act have helped the Government to raise funds as well as the individuals to save tax.
- However, with too many investment/ expenditures clubbed into the existing overall limit of Rs. 150,000 (including contribution to pension funds under Section 80CCC, pension scheme under Section 80CCD of the Act), individuals sometimes are discouraged from making further investments.

### Recommendations

- There must be a clear distinction between long-term and short-term savings. So far there has not been any significant support in tax policy to actively encourage “long-term savings” which is very much needed. Life insurance and pensions are the main segments of the financial services that address the needs of individuals in the long-term. It would be equally desirable to have many more such tax-exempt investment avenues to mobilize funds for infrastructural and overall economic development. Therefore, the Government may consider separate exemption limits for such important avenues.
- Further, the Government may look at increasing the overall deduction limit to at least Rs. 200,000 to boost further investment and increase tax savings for the individual.
- Term deposits for a period of 5 years or more with a scheduled bank, in accordance with a scheme framed and notified by the Central Government, by an individual/ HUF is eligible for inclusion in gross qualifying amount for the purpose of deduction under Section 80C of the Act. For other eligible investments such as bonds and mutual funds, the lock in period is 3 years and to ensure parity, the period of term deposits for claiming deduction under Section 80C of the Act should also be reduced to 3 years from existing 5 years.

## 3.47.12. Overall deduction in respect of amount paid under pension/ annuity plans – Section 80CCE

### Issue

- As per Section 80CCE of the Act, the overall ceiling for deduction is Rs.1.5 Lakhs for the payments covered by Section 80C, payment towards annuity plans covered by Section 80CCC and payment towards NPS covered by Section 80CCD.

### Recommendation

- The overall ceiling limit of Section 80CCE should be enhanced to augment savings in the economy to promote economic growth.

## 3.47.13. Employer's contribution to New Pension Scheme - Section 80CCD

### Issue

- Employer's contribution to New Pension Scheme (NPS) by non-Central Government employers eligible for deduction up to 10% of salary in a FY, irrespective of the employees' date of joining of employment.

### Recommendations

- While the Finance Bill, 2014 has now provided clarity on the applicability of deduction on NPS to non-Central government employees in employment prior to 1st January 2004, it has been made effective prospectively, i.e. AY 2015-16 onwards.
- However, the proposed amendment to Section 80CCD of the Act could potentially result in tax demands on employees/ employers who have already allowed deduction to employees up to last year and lead to unavoidable litigation. This would make the clause partially harsh for individuals for the prior years. Therefore, the Government should clarify this clause and allow the deduction for prior applicable years as well.

## 3.47.14. Deduction for Educational Expenses - Section 80D

### Issue

- Education of children these days imposes a heavy burden on the middle class. A good beginning was made in 2003 by providing deduction for tuition fees under Section 80C of the Act. But Section 80C of the Act is particularly a provision granting incentive for savings and also considering the long list of eligible investments in this Section, there is very little relief to the individual on account of the education fees incurred by him.

### Recommendation

- It is therefore recommended to de-link deduction for educational expenses for children from Section 80C and provide under a separate provision like Section 80D of the Act for medical insurance. A reference to the Ministry of Education to find out the tuition fee for an average middle class household will give an indication about the limit of the deduction.

## 3.47.15. Deduction in respect of rent paid by taxpayers not receiving a House Rent Allowance - Section 80GG

### Issue

- Under Section 80GG of the Act, the maximum deduction available to individuals who do not receive an HRA, in respect of rent paid is only Rs. 2,000 per month. The said limit was last revised in 1998 and is very low in light of the huge rental costs especially in the metro cities.

### Recommendation

- The exemption needs to be increased to at least Rs. 10,000 per month in view of the huge rental escalation. As in the case of HRA exemption, the Government may also consider introducing separate limits for metro and non-metro cities.

## 3.47.16. Deduction in respect of interest on deposits in savings account - Section 80TTA

### Issue

- Section 80TTA was inserted by the Finance Act, 2012 to provide deduction of up to Rs.10,000 in the hands of individuals and HUFs in respect of interest on savings account with banks, post offices and co-operative societies carrying on business of banking. However, it is unlikely that salaried individuals would keep their entire savings in a savings bank account, which earns a much lower rate of interest as compared to term deposits. They are likely to transfer some portion of their savings to several deposits to earn comparatively better returns.

### Recommendation

- It is suggested that the scope of Section 80TTA of the Act should be widened to incorporate all types of deposits (such as term deposits, recurring deposits etc.) made within the banking channels, thereby inducing savings for the growth of the economy.

## 3.47.17. Electronic meal card

### Issues and Recommendations

- As per the revised perquisite rules reinstated in December 2009, if food and non-alcoholic beverages are provided during working hours at office or business premises or through non-transferable paid vouchers usable only at eating joints, the value of facility to the extent of Rs. 50 per meal is exempt from the tax. This limit of Rs.50 is very meagre and needs to be revised.
- Many employers these days provide this facility through electronic meal swipe cards. However, the current rules expressly provide exemption to paid vouchers and not electronic cards though such cards were expressly exempted under the erstwhile FBT regime subject to conditions. Accordingly, their treatment is not free from doubt.
- The said exemption along with increased limit should be extended to electronic meal vouchers.

## 3.47.18. Exemption for payment of Leave Encashment - Section 10

### Issue

- The exemption limit for leave encashment paid at the time of retirement or otherwise is notified by the CBDT in accordance with the powers given under Section 10(10AA) of the Act. The current limit of Rs. 3 lakhs was notified in 1998) and needs to be raised substantially with immediate effect.

### Recommendation

- It is, therefore, suggested that the limit should be raised to Rs.10 lakhs in line with the increase in the limit of gratuity.

## 3.47.19. Income of minors - to increase exemption limits under Section 10(32) of the Act

### Issue

- As per Section 10(32) of the Act, in case the income of an individual includes the income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of Rs.1,500 in respect of each minor child if the income of such minor as includible under Section 64(1A) exceeds that amount. The current limit of Rs. 1,500 was fixed by the Finance Act, 1992 and needs to be raised substantially with immediate effect.

### Recommendation

- It is suggested that the limit of exemption under Section 10(32) of the Act should be raised to at least Rs. 10,000 for each minor child.

## 3.47.20. Rajiv Gandhi Equity Scheme - Section 80CCG

The Finance Act, 2013 made amendment in Section 80CCG of the Act to extend the scope of deduction to provide that the individuals with gross total income up to Rs. 12 lakhs are eligible to invest under the Rajiv Gandhi Equity Savings Scheme ('RGESS'). The scope of investment has been extended to include listed units of equity oriented funds. The deduction under this Section is available to the extent of Rs. 25,000. The deduction will now be available for three consecutive FYs beginning with the year in which the listed equity shares or listed units of equity oriented funds were first acquired.

## Issue

- Currently, RGESS is available only to a “New Retail Investor” i.e. an individual who has not opened a demat account or has not previously transacted in equity or derivatives.

## Recommendations

- Deduction under the Section may also be made available to small investors who have only few investments in their demat account (rather than no investments).
- With a view to accelerate the investments in capital markets by the new retail investors, the deduction to the extent of Rs. 50,000 in a FY instead of the present limit of Rs. 25,000 be allowed to a new retail investor without any limit imposed on the gross total income.

# 3.48. Other Direct Tax provisions related to interest

## 3.48.1. Calculation of interest for delay in deposit of taxes deducted - meaning of 'month' - Section 201

### Issue

- As per Section 201 (1A) of the Act, interest on late deduction of TDS is calculated @1% for every month or part of month from the date on which tax was actually deductible to the date on which tax was deducted and interest on late deposit of TDS is calculated at 1.5% for every month or part of month from the date on which tax was deducted to the date on which tax is actually paid. However, for the purpose of calculating period of delay, the Revenue Authorities calculate interest on a calendar month basis. For instance, where tax was deductible on 30 June and the tax so deducted was remitted on 8 July, interest has to be paid for June and July (i.e. 2 months) for a one day delay.

### Recommendation

- In order to mitigate this hardship caused to the taxpayer, it is suggested that 'month' be defined as a period of 30 days to avoid litigation on this issue. This would make the reckoning of period while interpreting the tax law more meaningful and clear.

## 3.48.2. 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. This would be in line with the ruling of the Supreme Court in the case of CIT v. Pranoy Roy [2009] 179 TAXMAN 53 (SC)

## 3.49. 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 |
| Gross receipts of profession | 25 |

### 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 |
| Gross receipts of profession | 50 |

## 4.50. Relaxation on mandatory requirement of PAN - Section 206AA

Section 206AA of the Act provides that if PAN is not furnished by payee, the rate of TDS would be 20% or rate in force or rates specified in relevant provisions of the Act, whichever is higher. The provisions further lay down that no certificate under Section 197 of the Act shall be granted unless the applicant has stated his PAN in the application. It also further lays down that declaration in Form 15G/ 15H for Nil deduction of tax would not be valid unless PAN is furnished in such declaration. Further, it has been specified that where the recipient of the income has furnished invalid/ incorrect PAN, it shall be deemed that such person has not furnished PAN and accordingly, tax would be required to be deducted at the highest of the specified three rates while making payment to such persons.

### Issues

- A plain reading of the provisions of Section 206AA of the Act also suggests that in case the foreign company does not have a PAN in India, the provisions of the Act would override the provisions contained in the respective DTAA, resulting in a situation of treaty override. This is likely to create hardships for the foreign company in availing appropriate tax credit in its country of residence (for the excess tax deducted over and above the specified rate in the DTAA) and also result in protracted litigation, which increases the cost of doing business in India and therefore, discourages foreign entities from entering into transactions in India.

- These provisions may act detrimental not only to the recipients of income but also may be detrimental to the payer of such income. A payer may have deducted tax as per the provision of the Act at the specified rates under a bonafide belief that the PAN furnished by the income recipient is correct. In case the same is found to be invalid/ incorrect, the payer may have to deduct tax @ 20% or higher. In case the payer has already made the payment of the sum to the receiver, then it would create the problem of recovery of the differential amount from the recipient of the income.

- Further, considering the uncertainty in the Indian tax systems, it is seen that the foreign entities generally prefer a tax protected agreement wherein the tax liability is to be borne by the payer of the income. In such cases, the cost to be borne by the payer of the income would escalate by substantial amount as not only the rate of tax would go up but even such higher rate would be required to be grossed up. This will create liquidity issues for the payer of income thereby increasing costs of the payer for doing business in India and importing foreign technology.

## Recommendations

- We suggest that quoting of PAN should be made optional for the following category of persons:
  - Individuals, including senior citizens, farmers/ seed growers, transporters etc. whose total income do not exceed the exemption limit or are illiterate
  - Foreign companies
- In addition, the onerous responsibility and consequences faced by the payer of the income in case the recipient furnishes incorrect/ invalid PAN should also be relaxed.

## 3.51. Tax Deducted at Source (TDS)

### 3.51.1. Reduced Withholding tax on Income by way of interest under Section 194LC

In order to enable low cost finance to Indian companies, the Finance Act, 2012 has inserted Section 194LC in the Act which provides for lower withholding tax @ 5% on interest payments by Indian companies on borrowings made in foreign currency (under a loan agreement or by way of issue of long term infrastructure bonds). The Finance (No 2) Act, 2014, amended the section to include all long term bonds (including infrastructure bonds).

#### Issue

- Apart from loans and bonds, debentures are also widely used for raising funds by the Indian companies. Currently, there is no clarity whether interest payment on such debentures would be eligible for reduced withholding tax rate under section 194LC of the Act.

#### Recommendation

- The concessional tax rate of 5% on interest should be made applicable on other debt securities including debentures, trade credit issued/ availed by any Indian company. Further, it is also suggested that the rate of tax on interest through all kinds of foreign currency borrowings (including issue of bonds and debentures) should be completely eliminated in the long-run to promote foreign exchange inflows into India.

### 3.51.2. TDS credit

#### Issues

- The E-TDS system is undergoing issues and there is mismatch of data between TDS certificates issued by deductors, TDS statements uploaded on TIN system and bank payment details, PAN of the deductees. As a result, deductees do not get the full credit for tax deducted. Further, based on the mismatch the tax authority is issuing orders upon the deductor thereby causing unnecessary adversity to the deductor/ taxpayer.
- The E-TDS system mandates all the deductors of taxes to process TDS Certificates in Form 16A's only through TIN-NSDL website. The software of the tax department automatically picks up the address of the deductee from the address appearing in the PAN database maintained by the tax department. As a result, all the TDS certificates are getting issued at the address declared in the PAN application made by the deductee. This has resulted into severe hardship for the companies which have a multi locational set up, since, all the TDS certificates get dumped at the Registered office of the company (being PAN based address). The accumulation of TDS certificates at the registered office of the deductee makes it difficult for them to co-relate/ reconcile them with the accounts which are maintained at different locations and also the units are not able to identify whether the TDS certificate is received from the party or not.

## Recommendations

- In view of the above, it is suggested that TDS certificates issued by the deductors, which are furnished by the deductees in the tax assessment, should be given due cognizance and refund claims based on such TDS certificates should be processed. Further, the tax officer can suitably issue proper notice for the clarification rather than hurriedly issuing orders to the taxpayer concerned.
- It is recommended that suitable instructions be issued by the lawmakers providing an option to the deductee to indicate their TAN in the invoice and further a column/ field may be added in the TDS returns asking the payers to furnish the TAN against each deductee (this should however be an optional column), wherever TAN has been provided by the deductee, at the time of submission/ filing of TDS returns by the payers. At the same time, it is also recommended that E-TDS software of the tax department may be amended so that when the TDS returns are processed to generate the TDS certificates, the address should first be automatically picked from the TAN database in respect of the deductee maintained by the tax department and in case no TAN is mentioned in the TDS return, then the address should be picked from the PAN database. This would facilitate generation of the TDS certificate at the TAN address, wherever TAN is provided by the deductee.
- It is recommended that credit for TDS should be allowed to the taxpayer in the year in which such TDS certificate is issued to the taxpayer/ payee or in the year in which TDS credit appears on the online database of the payee without having the requirement to claim tax credit in the year in which corresponding income has been offered to tax. This would address the various problems being faced by the payees today in claiming due credit for TDS.

## 3.51.3. TDS on interest component included in Tribunal Awards to victims of Motor Accidents

### Issue

- The Revenue Authorities generally treat the amount of interest paid on delayed compensation awarded under Motor Vehicle Act, 1988 as 'interest' liable for TDS under Section 194A of the Act

### Recommendation

- It is suggested that such interest be excluded from the purview of TDS under Section 194A of the Act.

## 3.51.4. 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. 75,000 per annum requires the person responsible for making such payments to deduct tax at source under Section 194C of the Act.
- Also, any payment for commission or brokerage as per Section 194H of the Act, which exceeds Rs.5,000 (at a time or in aggregate per annum) requires the person responsible for making such payments to deduct tax at source under Section 194H of the Act. These limits were fixed many years ago and TDS on such small amounts involves deployment of relatively large amount of resources in terms of manpower, systems and other costs at the taxpayer's, end without any significant benefits to the revenue.

## Recommendations

- It is suggested that the provisions of Section 194C of the Act beshould 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 and Rs. 100,000 for aggregate annual limit under Section 194C of the Act and the threshold limit for deduction of tax at source on commission/ brokerage be increased to Rs. 25,000 from the present Rs. 5,000.
- On similar basis, considering the inflation quotient, the threshold limits for other TDS provisions should also be enhanced as follows:-

| Section | Category | Enhancement requested |
|---|---|---|
| 194A | Interest on Bank Deposits | TDS limit of existing Rs.10,000 to be increased to Rs.1.00 Lakhs since the basic exemption limit of Income increased substantially and the senior citizens are affected in this category. |
| 194C | Payment to Contractors | Existing Rs.30,000 (single payment) and Rs.75,000 (aggregate) to be enhanced to Rs.1.00 Lakhs and to Rs.2.50 Lakhs respectively. |
| 194H | Commission or Brokerage Payment | Existing threshold limit of Rs.5,000 be enhanced to Rs.50,000 for the year. |
| 194I | Payment of rent | The existing limit of Rs.1.80 Lakhs per year to be enhanced to Rs.3.00 Lakhs. |
| 194J | Payment to Professionals | The existing limit of Rs.30,000 to be enhanced to Rs.1.00 Lakhs |

## 3.52. Exemption to charitable and other such organizations - Section 2(15)/ 10(23C)

- It may be mentioned that originally the term 'charitable purpose' under the Section 2(15) of the Act was defined to include relief of the poor, education, medical relief and the advancement of any other object of general public utility. However, the Finance Act, 2008 amended the said definition by inserting a proviso to Section 2(15) of the Act as under:

  *“Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity”*

- Further, the Finance Act, 2011, had amended Section 2(15) of the Act to provide that 'the advancement of any other object of general public utility' shall continue to be a 'charitable purpose' if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business do not exceed Rs. 25 lakhs in the previous year. This has been done by inserting a proviso to Section 2(15) of the Act to read as under:

*"Provided further that the first proviso shall not apply if the aggregate value of the receipts from activities referred to therein is twenty five lakh rupees or less in the previous year;"*

## Issue

- The aforesaid amendment is vehemently opposed by trade organizations, chambers of commerce, Non-Government Organization (NGO) and other charitable organizations, as it was felt that it would have wide repercussions on the genuine charitable organizations which are rendering laudable service in the country. These are not-for-profit organizations and to be eligible for tax exemption under Section 11 to 13 of the Act, provide for rigid regulations for charitable institutions as regards inter-alia, investments, application of income, accumulation of profits, audit, timely filing of returns with reports from Chartered Accountants, bar against any private benefit etc., and the tax exemption could be withdrawn for violation of any of such conditions.

## Recommendations

- We are of the view that the underlying objective of tax exemption for charitable organizations should be the end use of its income and not the generation of income. In this perspective, it is pleaded that the chambers of commerce, trade organizations, NGOs and other not-for-profit organizations should be explicitly exempted from tax, provided that the income generated by them are exclusively utilized for charitable purposes and that they are strictly adhering to the requirements under the Act.

- Alternatively, we would like to suggest that at least second proviso to Section 2(15) of the Act be substituted to read as under:

  *"Provided further that the first proviso shall not apply if the aggregate value of the receipts from activities referred to therein is not more than 49% of the aggregate receipts."*

## Issue

- The dichotomy is in respect of different tax treatment to organizations engaged in carrying out specified activities for charitable purpose like relief to the poor vis-à-vis organization carrying out any activity of general public utility though charitable in nature. For instance, the sale proceeds from education material/ books by a NGO working towards the charitable purpose of education may not necessarily affect its tax exempt status. However, where an NGO engaged in 'any other object of general public utility', say an old age home earns revenue from sale of books or literature or providing some assistance to its members on subject matter aligned to their main object may impact its tax exemption status, where value of such sale proceeds/ consideration exceeds Rs. 25 lakhs.

## Recommendation

- The law should provide greater clarity on the tax treatment given to organizations falling within the purview of the residual clause of 'advancement of general public utility'. There is a dire necessity to provide a thumb rule on what would constitute 'charitable purpose' under the residual clause. The nature of activity and the application of income towards the said activity should be the emphasis of grant of tax exemption status rather than the activities from which income is derived.

## Issues

- The restrictive provisions were inserted with an intention of prohibiting indiscriminate claim of exemption under the pretext or guise of being engaged in charitable activities. However, this has also impacted the low profile organizations genuinely working towards the betterment of society as their activities are falling within the purview of 'advancement of any other object of general public utility'.

- Even though the Government has provided marginal relief by increasing the limit, such a relief may not be adequate for the organizations to eventually become self-sustainable. This would result in huge dependence on external grants and donations for carrying their charitable activities.

## Recommendation

- The law should suitably be amended and the limit prescribed should be increased to enable the genuine organizations to become self-sustainable.

## Issue

- The Finance (No.2) Act, 2009 had inserted clause (vii) in Section 80G(5) of the Act to protect donations upto 31 March 2009 if any institution or fund established for charitable purposes, loses exemption due to the first proviso to Section 2(15) of the Act.

## Recommendations

- It is suggested that a similar provision be made in Section 80G of the Act to the effect that donation to such institutions/ funds/ trusts will continue to be exempt in respect of the donations and the donor will be eligible for tax deduction benefit under Section 80G of the Act, even if the trust loses exemption owing to its receipts from commercial activities exceeding the monetary limit or the specified percentage of the total receipts as suggested above.
- It may also be clarified that these will not lose recognition under Section 12AA of the Act if the receipts exceed the said specified limits/ percentage. In other words, in case of excess receipts, the exemption should not be denied in relation to other activities.

## Issue

- Under Section 2(15) of the Act, charitable purpose includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. Different views are expressed by various experts with respect to “vocational training activity” as to whether same amounts to education or not. Some views are expressed that since it is systematic process of learning which enables an individual to earn his livelihood, therefore it is “education”. However since there is no clear cut jurisprudence on this issue, the Revenue Authorities take a cautious approach and do not treat it as “education”.

## Recommendation

- It is strongly recommends that Section 2(15) of the Act be suitably amended to provide that “education” includes vocation training.

## Issues

- The Finance (No. 2) Act, 2014, has inserted Explanation after sub-clause (iiiac) of Section 10 (23C) of the Act whereby the eligible educational institutions, hospitals and other institutions under this Section shall be considered as substantially financed by the government only if the government grant to the institution exceeds such percentage (to be prescribed) of the total receipts (including voluntary contributions) during the previous year.
- Definition of 'substantially financed by the government' to provide clarity and reduce litigation on that front

## Recommendation

- It is suggested that percentage to be prescribed to define 'substantially financed by the government' should be liberal (around 20%) to bring within its ambit several genuine organizations in the education and healthcare space.

## Issue

- The Finance (No. 2) Act, 2014, has amended Section 10(23C) of the Act wherein the funds, institutions, universities, etc. approved/ registered under Section 10(23C) and 12AA of the Act cannot claim exemption under any other provision of Section 10 of the Act, except for agricultural income or under Section 10(23C) of the Act.

## Recommendation

- The amendment of not availing general exemption provisions to charitable organizations (which have been denied exemption) would debar them from availing benefit of certain genuine provisions like Section 10(11) – interest on PPF, 10(15) – interest on tax-free bonds etc. It is recommended that some of such general exemptions should be restored for organizations in case their income becomes taxable (as in case of profitable entities).

## Issues

- The Finance Act (No.2) 2014, amended Section 11 and 10(23C) of the Act to provide that where acquisition of asset is treated as an application of income, then deduction of depreciation on such asset shall not be allowed for computation of income of trust.
- Prior to the amendment, charitable institutions used to treat acquisition of assets as application of income under Section 11 of the Act whereas depreciation on such assets was claimed under Section 32 while computing income of such trust.
- The aforesaid amendment made in Section 11 and 10(23C) of the Act is harsh in nature and has a far reaching impact on charitable institutions.Such issue has also been dealt by Appellate Authorities [in cases such as Tiny Tots Education Society (330 ITR 16) (P&H), Commissioner of Income-tax v. Market Committee, Pipli (330 ITR 16) (P&H)] wherein it was held that provisions for application of income under Section 11 of the Act will come into play once income is determined after taking depreciation into account, thus, the question of double deduction does not arise.

## Recommendation

- It is suggested that amendment made by Finance Act (No. 2), 2014 in Section 11 and 10(23C) of the Act with respect to depreciation should be repealed.

## Issues

- As per the amendment made by the Finance Act (No 2) 2014 in Section 12AA, registration of a charitable institution may be cancelled where the activities carried out by such institution are not in accordance with the provisions of Section 11 and 12 of the Act. As per the Memorandum to the Finance Act (No 2) 2014, where income of the trust does not ensure benefit to trust or it is for the benefit of a particular religious community or caste or income is applied for the benefit of specified person etc., registration of a charitable institution may be cancelled.
- It is important to note that cancellation of registration is a harsh step since registration of charitable institution under Section 12A of the Act is only a condition precedent for applicability of Section 11 and 12. Thus, registration by itself does not grant exemption under Section 11 and 12 as held in various decisions of the Appellate Authorities [such as DIT vs Garden City Educational Trust (2011) 330 ITR 480 (Kar)].

## Recommendation

- In view of the above, it is suggested that where activities are not carried out as per provisions of Section 11 and 12, only exemption under the said Section should not be granted for that particular year instead of cancelling registration under Section 12AA of the Act.

# 3.53. Definition of Association of Persons (AOP) to be modified - Section 2(31)

## Issues

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

- Since the definition is not provided by the statute itself, one has to refer to the legal jurisprudence for understanding the meaning of term 'AOP' which results in unwarrantedd litigation and subjectivity. Recently, the Delhi HC in the case of Linde AG, Linde Engineering Division and Anr vs DDIT (W.P. no 3914/2012) held that apart from presenting a 'common face' as members of a consortium, high level of common management, element of mutual agency and joint action for mutual purpose is also necessary to form an AOP. The essential characteristics of an AOP flowing from the various judicial precedents including this recent decision can be illustrated as follows:-
  - Two or more persons join together or associate together;
  - The parties should come together out of their own free will (out of volition);
  - The association should be for common purpose or common action;
  - Mutual rights and obligations;
  - Incurrence of common expenditure;
  - There should be joint execution and/ or supervision of the work;
  - Possibility of reassignment of work amongst members;
  - Some kind of scheme for common management.
- Whether an AOP is constituted or not would have to be decided on a conjoint reading and analysis of the above factors to the facts and circumstances of the case. No one factor can be said to be decisive for determining AOP and the priority of the factors is also not laid down in law.

## Recommendation

- It is suggested that the term AOP may be appropriately defined to lay down the essential aspects for constituting an AOP. This would provide some certainty and help to reduce litigation for the consortiums formed by non-residents to execute contracts in India.

## Issues

- A large number of big infrastructure contracts are awarded by Public Sector Undertakings/ Government companies to non-residents. Many developers also require contractors to bid in a consortium with a view to ensure that specific components of the project get executed by an earmarked contractor who has requisite capabilities in this regard and yet, derive the comfort that the entire project (comprising of several parts) will be successfully commissioned by the consortium of contractors, although each contractor will be executing its specific part only. The consortium members/ contractors undertake their respective scope of work separately/ independent of each other and do not share profits/ losses with each other. Further, there is a separate consideration earmarked for each contractor and the payment is made directly to respective contractor by the customer. Thus, contractors enter into consortium and agree to jointly undertake the work for better co-operation in their relationship with the developer/ provide comfort to developer and for no other purpose.

  Consequently, the intention behind consortium/contract split arrangements is never to constitute a partnership/AOP but to meet the business requirements of the developer.
- With a view to provide clarification in this regard, CBDT had issued instruction no 1829 dated September 21, 1989, wherein, it was clarified that companies forming the consortium for execution of power projects on turnkey basis will not constitute an AOP under the Act and offshore supply of goods by non-resident contractors engaged in execution of turnkey projects shall not be liable to tax in India, if the title to the goods is transferred outside India. However, in the year 2009, the said instruction was withdrawn on account of misuse of such instruction by various non-residents.

- The principles outlined in the aforesaid instruction have also been accepted by the Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd and Hyundai Heavy Industries Co. Ltd. (2007) 161 Taxman 191 (SC). Further, Delhi HC in the case of Linde AG, Linde Engineering Division and Anr vs DDIT (supra) has also followed the aforementioned principles and held that offshore supply of goods by non-resident contractors are not taxable in India, if the title of such goods is transferred outside India. The HC further held that if the offshore services are inextricably linked to such offshore supplies, then such services are not taxable in India.
- However, the Revenue Authorities are taxing such non-residents as AOP at the withholding tax/ assessment procedure stage on the basis of a few favourable AAR rulings and withdrawal of the abovementioned circular. Further in this regard, there are various tax complexities that are associated with assessments of AOP, including double taxation of non-residents in India and their country of residence (with no possibility of double taxation being avoided). The said position of the Revenue Authorities is causing hardship to the industry and is also resulting in pessimism as regards the uncertain tax environment in India. Large amount of working capital is also getting blocked up in TDS/ payment of tax demands consequent to completion of assessments.

## Recommendation

- In light of the above, it is strongly recommended that the aforementioned instruction should be reissued and the clarification be made applicable to the infrastructure sector and EPC contracts. The reissuance of the “1989 clarification” would go a long way in instilling confidence amongst the non-resident contractors as regards the stability/ fairness of the Indian tax regime, which, in turn, would also encourage non-resident contractors to set up their manufacturing hubs in India and thereby result in a multiplier effect on the Indian economy.

## Issue

- As per Section 86 of the Act, share of the member in the income of an AOP is not includible in total income of the member. However, such income is not excluded while computing the MAT liability of the member, unlike in the case of a partner of firm whose share in the profits in the firm is exempt in the hands of the partner as per Section 10(2A) of the Act and no MAT is payable by the partner on such profits under Section 115JB of the Act. The reference to Section 86 in Section 115JB of the Act is missing. It is unfair to have such a discriminatory tax treatment between a partner of a firm and a member of an AOP.

## Recommendation

- It is recommended that Section 115JB of the Act should be amended to specifically provide that the share of income of a member from an AOP, which is otherwise exempt under the provisions of Section 86 of the Act, should be excluded while computing the liability of the member under 115JB of the Act.

# WEALTH TAX

## 3.54. Wealth Tax

## Recommendation

- It is suggested that the provisions of Wealth tax may be amended to incorporate the proposals made in the draft DTC, 2013, for example, the threshold for levy of wealth could be enhanced from the current level of Rs 30 lakhs to Rs 50 crores as proposed in the draft DTC, 2013 etc.

## Issue

- A residential property owned by the company is charged to wealth tax if it is given to its employees drawing salary exceeding Rs. 10 lakhs.

## Recommendation

- It is equally important that residential accommodation provided by a company to its employees drawing salary exceeding Rs. 10 lakhs should not be brought within its tax net. It has to be appreciated that companies need to provide accommodation to its employees considering the remote location of its factory/ offices and other reasons like attracting talented persons. Such residential accommodations should not be construed as non-productive assets.

## Issue

- Vacant Industrial land held for more than two years from the date of acquisition is considered as non-productive asset and charged to wealth tax.

Recommendations

- Vacant industrial land earmarked for future expansion should be outside its preview, even if it is kept vacant after two years of its acquisition.
- Further, considering the changing face of service industry on account of size and infrastructure requirements, the exemption of initial two years should be allowed to land held for all business purposes instead of limiting the exemption to industrial purposes only.

Recommendation

- It is suggested that wealth of senior citizens should be specifically be excluded from the levy of wealth tax.

## Issue

- Government companies are charged to wealth tax and not treated at par with statutory bodies which are exempted from wealth tax.

## Recommendation

- The bodies incorporated under the Central or State Act are exempted from wealth tax but Government companies are charged to wealth tax. It is therefore suggested that the government companies should also excluded from levy of wealth tax.

# INDIRECT TAXES

## MEASURES TO RATIONALIZE INDIRECT TAXES

### 4.1.1. Ease of Doing Business

### A. Due Date for Payment of Service Tax

Currently due date of payment of service tax in government treasury is 6th of the following month. It is practically very difficult for the assessee to reconcile its monthly accounts and compute the service tax liability by 5th of the next month.

Further, payment of service tax for March is required to be deposited in the government treasury by 31st March itself which is practically difficult as in certain cases the value of services is computed as a percentage on sale and the sale continue till 31 March of the year. Accordingly, the assessees are forced to deposit service tax on ad-hoc basis as actual amount cannot be computed before the close of the sale.

The payment schedule creates practical difficulties in case of organizations having multiple branches / locations over the country but paying service tax on a centralized basis due to time required in collating and reconciling the necessary data. Further, in view of non-availability of provisions for adjusting service tax liability against subsequent payment, the amount even if paid on estimated basis will get blocked till the refund, if any, is granted by service tax authorities.

It is requested that the payment date may be extended to 15th of the next month so that assessee gets sufficient time for reconciling and deposit of correct amount. This will avoid deposit of any short or excess service tax amount which necessitates filing of refund or adjustments in subsequent returns.

Further, for deposit of service tax for March, no interest should be charged from the assessee in case at least 80% of the total monthly service tax is deposited basis the estimated value of services.

### B. Acceptance of Digitally Signed Invoices for Availing CENVAT Credit

Computerization and communication technology has developed manifold and many industries have implemented the best available ERP Software like SAP after making huge investments. In large sector industries thousands of invoices are generated on daily basis and signing each page of the invoices manually consumes lot of time and effort. Signature on each of the document engages the managerial time.

Section 5 of the Information Technology Act, 2000 also recognises the use of the electronic signature. The relevant extract of the Act is reproduced herein as under:-

> “Where any law provides that information or any other matter shall be authenticated by affixing the signature or any document should be signed or bear the signature of any person then, notwithstanding anything contained in such law, such requirement shall be deemed to have been satisfied, if such information or matter is authenticated by means of digital signature affixed in such manner as may be prescribed by the Central Government.
>
> Explanation: For the purposes of this section, "Signed", with its grammatical variations and cognate expressions, shall, with reference to a person, mean affixing of his hand written signature or any mark on any document and the expression "Signature" shall be construed accordingly.”

There are lot of disputes being raised by the department denying the credit on such computer generated invoices in the absence of signature of the service provider or the manufacturer.

It is suggested that industries should be allowed to print digital signature in the invoices and it should be possible to avail CENVAT credit against such invoices.

## C. Multiple Registrations

At present, an assessee has to take 4 Registrations from the Excise Authorities for conducting his business in the same premises (1st stage dealer, 2nd stage dealer, Import reselling & manufacturing Depot). It increases administrative cost of doing business

One Registration should be sufficient as long as all the 4 such businesses are in the same premises

## D. CBEC Website – Updated Notifications

The CBEC website provides the text of notifications (Customs/Central Excise/Service Tax) issued from time to time. Thus while an amending notification can be accessed, it is not possible to view the complete notification as amended. In the absence of updated versions of the notifications, a tax payer has no access to the official text of the amended notifications.

With a view to facilitate the businesses, it is suggested that the website should display not only the amending notification but also the original notification as amended.

## E. Clarity in Tax Laws

One of the primary reasons for disputes in tax matters is lack of clarity in tax laws and procedures. Tax authorities avoid issue of clarificatory circulars on contentious issues forcing the assessees to agitate the matter in tribunals and courts. Several issues, arising from the introduction of the new service tax regime based on the concept of a negative list with effect from 1st July, 2012, still remain unresolved. Clarifications are also awaited on several issues placed before the Forum set up by the Prime Minister's office last year under the Chairmanship of Dr Parthasarathi Shome.

Government should be proactive in providing clarifications so that the disputes are nipped in the bud. It should come out with status notes, position papers on contentious issues after due consultations with the stakeholders to set at rest uncertainties, if any. Even if the matter is sub-judice, Government should declare its position as to its understanding and intent of the legislation. It should direct its field officers to follow the interpretation as declared unless it's overturned by a competent judicial forum.

## 4.1.2. Structural Reforms

## A. Merger of Duties and Cesses etc.

Revenues collected by the Government against various taxes/levies are allocated for rendering public facilities viz. Education, Healthcare, Infrastructure, Defence, Agriculture, Subsidies etc. The expenditure for each head is decided by Government from time to time, on the basis of various prevailing factors.

Separate levy of 2% Education Cess (EC) and 1% Secondary & Higher Education Cess (SHEC) is causing innumerable complications in documentation, credit availment and accounting particularly in the case of indirect taxes. Tax invoice contains 3 heads for duty/cess whereas Bill of Entry has 4 heads for duties/cess. Consequentially, the computation becomes complicated and documentation also becomes cumbersome.

To overcome such hardships, it is suggested that the rates of the main duty be rationalized to the extent of EC and SHEC and levy of these cesses separately be abolished. For example, instead of the present excise duty structure of BED 12% + EC 2% + SHEC 1% = Total 12.36% duty, it can be simplified as single Basic Excise Duty rate of 12.36%. With the level of automation achieved by the customs and central excise department, the allocation of revenue for the purposes for which the cesses were levied can be made at the backend by the automated systems. It is further suggested that these allocations need not be made transaction by transaction but can be made as a fixed percentage from the total excise or customs collections credited to the consolidated fund of India. This will result in a major simplification of the revenues collection process.

## B. Streamlining of Instructions / Circulars by issue of Annual Master Circulars

A key reason for litigation is the lack of clarity on the stand of the Revenue on certain specific issues (including contrary stands being taken by various officers within and across jurisdictions). As a result, tax authorities of different jurisdictions adopt different stands in dealing with similar issues, thereby resulting in lack of consistency and unnecessary litigation.

Taxpayers are often confused about what position to adopt, and are often forced to litigate (by the revenue) in case they adopt a beneficial "no tax position", based on available precedents.

On a related matter, even where instructions are issued, adjudicating authorities in certain situations refrain from following the instructions/clarification provided by the CBEC (potentially those in favour of the taxpayer), which they are otherwise bound to follow, as per the legal provisions. This approach adds to litigation, which is otherwise avoidable.

As a step towards improving taxpayers' services it is requested that all the Departmental manuals be updated and a master circular be issued on 1st April of every year consolidating / replacing individual circulars issued in the preceding year. The Reserve Bank of India follows this practice and the master circular acts as a one-point reference of all instructions. Similar practice could be adopted for consolidation of clarifications/ instructions issued under indirect tax laws with a view to improve compliance. This will make taxpayers as well as departmental officers aware of the necessary technical positions as well as procedural requirements.

## C. Measures for a Genuine Non Adversarial and Conducive Tax Environment

There is too much pressure on the tax officers to maximise revenue collections leading to arbitrary adjustments / additions, denial / delay in sanction of refunds / drawback, disputes and unwarranted litigation. Assessment orders passed by the tax officers reflect the revenue biased approach. Too much emphasis on revenues is forcing the tax officers to adopt coercive arm twisting methods to squeeze revenues by holding out threats of arrest and prosecution.

Revenue generation is dependent on the economic activity in the country; revenues cannot be enhanced by prescribing artificially high targets for the tax officers. Government should make earnest efforts to move away from the aggressive revenue approach and provide a genuine non-adversarial and conducive tax environment.

Some of the measures which can improve the tax environment are:-

(a) Revenue estimates and targets should be arrived at realistically in accordance with the state of the economy.

(b) Revenue realized should not be a factor for evaluating the performance of an assessing officer. Performance of the tax officers should be evaluated on the basis of the quantum and quality of work rendered in all areas including traits like judiciousness and facilitation.

(c) The practice of seeking "voluntary" deposit of duties and taxes short levied during the course of audit / investigations should be discontinued. Such deposits are never voluntary and are invariably made under threats of arrest and prosecution.

## D. Safeguards against Coercive Measures

With the powers to issue summons being granted to the lower level officers, in the past few years the field formations have been issuing summons to personnel from the senior management of the taxpayers seeking information on transactions, tax issues, position taken by the assesse, etc. There have also been threats of issuing summons to the Chief Executives of MNCs based overseas.

Being more concerned with managing the business affairs of the company, the senior management staff is generally not involved with the day to day tax compliances and accounting of the assesse, and therefore does not have any knowledge of the nitty-gritty details of the issues being investigated.

There have been instances reported of field officers threatening senior management with arrest / prosecution unless disputed amounts of tax discovered during investigations / audit are immediately paid up even before an opportunity is provided to the assessee by issuing him a show cause notice to explain the “short payment / non-payment” etc.

It is suggested that instead of summoning the senior management, summons should be issued to tax or function officers/managers who are responsible for the day to day indirect tax compliances and payment of taxes. Summons to senior management should be considered as the last resort only in cases where the taxpayer is not being cooperative or where the culpability of the senior functionary is suspected.

It is requested that adequate safeguards be provided in order to ensure that coercive measures are not used to demand excise, service tax, and customs duties in case of disputes involving duty payments/credits. Suitable administrative measures need to be put in place to deter the officers from routinely summoning senior executives and issuing threats of arrest and prosecution while seeking to demand payment of disputed tax amounts. Guidelines be prescribed listing out the specific Dos and Don'ts for the officers to observe in situations where the officers feel that there has been a short payment or a non-payment and they seek to recover the amounts even before a show cause notice is issued. Correspondingly there should be a charter of rights for the taxpayers to ensure that the officers do not misbehave with the taxpayers.

### 4.1.3. Time Limit for Adjudiction of Show Cause Notices

At present, no statutory time limit is prescribed for adjudication of show cause notices issued by the officers of the Customs, Central Excise and the Service Tax department. As a result, there are certain cases, where the show cause notices are not adjudicated by the authorities for a number of years. This practice is more common where the show cause notices are issued pursuant to audit objections raised by C&AG. These show cause notices are transferred to call books and not adjudicated for a long period of time. This creates an uncertainty for the noticee as a number of business decisions are kept on hold due to lack of clarity on the issues for which the dispute is raised by the department vide issuance of show cause notice.

It is suggested that some time limit be prescribed for adjudication of Show Cause Notices issued by the department so that the issues are not kept open indefinitely. Suitable amendment should be made in law to provide that if the Show Cause Notice issued by the department is not disposed of within the specified time limit for reasons not attributable to the noticee, the notice shall be deemed to have never been issued and the matter settled in favour of notice.

### 4.1.4. Pre Deposit and Stay of Recovery Before Appellate Authorities

As per the Finance Act, 2014, a new Section has been introduced under Excise, Customs and Service Tax law which prescribes a mandatory fixed pre-deposit of 7.5% of duty/ penalty demanded for filing appeal with Commissioner (Appeals) or the Tribunal at the first stage and another 10% of duty demanded or penalty imposed for filing second stage appeal before the Tribunal.

It is normally seen that a large number of demands are being issued by the department without following the settled case laws in similar issues. Further, some demands are issued for mere procedural lapses and huge penalties are also imposed by the department in such cases. In a majority of such cases, at Tribunal level, demands are invariably quashed or amounts are drastically reduced and appeals against such orders by the revenue are dismissed with consequential benefit of refund of pre deposits. As per reply given to a question in Lok Sabha, only 19.7% of the decisions rendered by the CESTAT in 2011-12 were in favour of the Revenue. More than 80% of the decisions of the Tribunal are against the Revenue Authorities. There can be no justification to indiscriminately compel every appellant to make a pre-deposit for his appeal being entertained.

No doubt the Indian judicial system including quasi-judicial authorities, are at present, burdened with a huge load of cases. But there can be better means to provide speedy as well as fair justice. Such measures can include ensuring better quality in adjudication proceedings, increase in manpower and fixing responsibility for frivolous, un-sustained demands, setting a reasonable but mandatory time limit for completion of adjudication and appeal proceedings at all levels etc.

In view of the above concerns, it is suggested that the concept of merit based pre-deposit be re-introduced and the mandatory pre-deposit should be withdrawn.

If the aforesaid suggestion is not acceptable, FICCI would like to submit following suggestions for consideration:-

(a) Given the adverse success rate of the litigation in favour of Revenue, there should be no pre-deposit for filing appeals before Commissioner(Appeals)

(b) The provisions of pre-deposit should not apply in the following situations:

- Matters where duty demanded is less than Rs. 25 Lakh. This would reduce the cost of administration in monitoring payments and refund of pre deposits in large number of low value appeals
- In case of appeals filed by individuals
- In case, the appellant has received a favourable order of Tribunal in his earlier matter
- In case of education institutes, charitable institutions etc.
- In case of financially stressed companies, i.e. companies which are unable to pay their debts and to their creditors and any additional cost may lead to the bankruptcy
- Where order has been passed by the Adjudication Authority or Appellate Authority:
  - without following principles of natural justice
  - without jurisdiction
  - with errors in computation of demand which are apparent

### 4.1.5. Option to Submit Bank Guarantee in lieu of Mandatory Pre-deposit in Cash for Admission of Appeals

All appeals will now have a proof of payment submitted for payment of pre-deposit @ 7.5% or 10% as the case may be and this pre-deposit will carry a mandatory interest @6% payable by Government. Considering the increased litigation it is in the interest of both Government and the Assessee to have an option of making this pre-deposit in the form of non-revocable Bank Guarantee (BG). This way assessee will save cash and government will save on interest and banking sector will get benefited from BG business.

Provision of paying mandatory pre-deposit through BG should be an option to be provided under the new Section 35-F of Central excise act, 1944 and pari-materia sections under Customs and Service tax.

### 4.1.6. Processing of the Recommendations of the Tax Administration Reform Commission

The Tax Administration Reform Commission was set up by the Ministry of Finance to review the application of the tax policies and tax laws in the context of global best practices and to recommend measures for reforms required in the tax administration. The Commission has submitted two reports so far and a third one is expected in November, 2014. It is requested that the recommendations of the Commission which will result in improving the environment of doing business may be considered by the Government for implementation.

### 4.1.7. Delay in Processing of Refunds and Non-payment of Interest

There is inordinate delay in processing of refund claims, particularly refunds of Special Additional Duty (SAD). Further, despite the claims being in line with the procedure (with complete documentation), these are invariably rejected on frivolous grounds, forcing the taxpayers to appeal before the appellate authorities. SAD refunds are rejected without appreciating the spirit of SAD refund wherein Sales Tax is paid. In addition to the above, there is unexplained delay in adjudication of the refund cases.

No interest is paid for delayed refunds unless it is insisted upon. Generally assessees are reluctant to ask for interest because of fear of vindictive action. Further refunds get rejected on trivial issues and no interest is paid once the refund is allowed in the Appeal.

While the CBEC has introduced various mechanisms for providing refund of certain taxes, at the ground level, the implementation of the same has not been effective. With the authorities rejecting the claims, there is a large pendency of refund claims causing undue impairment to the business. Therefore, it is suggested that the CBEC provide specific guidelines in adjudication of the refund claims, which seek to grant the genuine claims and also a specific timeframe within which the claims ought to be disposed of. A suitable IT backed transparent monitoring mechanism needs to be evolved to ease the situation.

On passing of delayed refunds of any sort, interest should be automatic like payment of duty with interest by the assessee. It should be in line with the practice in Income Tax cases.

### 4.1.8. Advance Rulings

Earlier, only Joint Ventures and resident public limited companies were eligible to apply for Advance Ruling. Now, such eligibility has been extended to resident private limited company also.

It is suggested that the scope of applicants for Advance Ruling purpose should be further extended to include foreign companies, their project offices and branches as well.

## SERVICE TAX

### 4.2.1. Reverse Charge Mechanism

Prior to introduction of the Negative List of Services, only two types of services were taxed under the reverse charge mechanism – services provided by GTA and services provided by persons outside India in case such persons did not have any establishment in India.

With the advent of the Negative List of Services a whole host of services have been notified under the reverse charge mechanism, including services of works contracts, manpower supply and security provided by non-corporate service providers to corporate bodies. Also, penal provisions that are applicable to service providers have been made applicable to service recipients as well in case of the services that are under the reverse charge mechanism. The issue has been made more complex by the fact that for different types of services the ratio of tax payable by the service provider and the service recipient are different.

The undesirable consequences of these changes in the service tax laws include:

(i) significant increase in complexity and cost of compliance in case of corporate bodies in terms of identification of status of service provider, payment of tax per applicable ratio for the specific type of service, maintenance of records, submission of returns, Departmental audits and so on.

(ii) undermining of threshold limits and exemptions prescribed under service tax laws. This is due to the fact that in case of payment of tax under the reverse charge mechanism threshold limits are not applicable, leading to situations where the service recipient, being a corporate body, has to pay service tax in respect of specified services provided by non-corporate service providers even if such service providers are below the prescribed threshold limits.

(iii) chances of short/excess payment of service tax consequent to differences in understanding of service provider and service recipient on whether a particular service falls under the services notified for taxation under the reverse charge mechanism.

(iv) scope for dispute and litigation with the Department on interpretation and valuation. For example, whether a particular service is a manpower supply service (to be taxed under reverse charge mechanism) or not would depend on the facts of the case and is open for interpretation.

In an era of growing transparency and simplicity in tax laws the enlargement of list of services under the reverse charge mechanism is a retrograde step and has burdened the service recipient with responsibilities that are rightly those of the Department. In addition to increasing the complexity of compliance, the enlargement of the list of services under the reverse charge mechanism has also diluted the threshold levels prescribed under law since, even if a service provider is exempt from tax by virtue of being below threshold limits, under reverse charge mechanism the service recipient (body corporate in this case) will have to pay the service tax.

To remove this inequity it is recommended that the reverse charge mechanism should be resorted to in rare circumstances. For the sake of administrative convenience it is recommended that the reverse charge be restricted to services provided in India by parties outside India, services provided by non-executive directors to a company and road transportation services provided by GTA. In any case the partial reverse charge should be given up; the tax should be collected in whole either by the service provider or by the service recipient.

### 4.2.2. Assessment of Drawings and Designs Imported for the Manufacture/Assembly of Projects to Customs Duty and Service Tax

While executing large projects and plants in India, the imported drawings and designs form an indispensable and integral part of the entire project. Generally, such drawings and designs relate to installation of imported as well as indigenous equipment, manufacture of indigenous equipment, undertaking civil and structural work in India, etc.

The drawings and designs are imported in printed form on paper (referred as hard copy), which are used for the aforementioned purposes. Apart from hard copy, the same drawings and designs are also imported in electronic form i.e., on Discs (referred as soft copy), which are used for future reference purpose. There is only one consideration agreed for drawings and designs.

When hard copy is imported, it is classified under Chapter Heading 4911 of Customs Tariff and the consideration for such drawings and designs gets fully and unconditionally exempt from levy of Customs Duty by virtue of Serial no. 275 of Notification No. 12/2012-Cus dated 17.3.2012. The exemption has been in existence from 1994 onwards till date.

When soft copy is imported, the customs department is classifying them under Chapter Heading 85239090 of Customs Tariff and the consideration for such drawings and designs is being subjected to levy of customs duty on the ground that there is no exemption notification for soft copy classifiable under Chapter Heading 85239090.

The above anomalous position is arising due to the fact that drawings and designs are imported in different form through two different media and the customs implication differ based on form of media.

It is considered to be good practice to structure the tariff in a tax neutral manner. In other words, the tax liability or outcome should not vary depending upon the mode of carrying out the transaction. The tax structure should be such that the consequences are same irrespective of the method adopted for undertaking any transaction. This theory and principle has been accepted and applied by CBEC as is evident from TRU Budget Circular dated 29.2.2008, para 4.1.5 which is reproduced below:

> *"4.1.5 Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service."*

In fact, tax neutral approach is foreseen from the manner in which the Information Technology software is treated. Similar tax neutral approach needs to be given to imported drawings and designs. The soft copy should be treated at par with hard copy and hence, no customs duty should be levied on the soft copy as well.

Also, the imported drawings and designs are subjected to service tax on reverse charge basis by virtue of Section 66B read with Rule 2(1)(d)(G) on the ground that the imported drawings and designs received in the form of CD is in the nature of service. It is inequitable and illogical to treat drawings and designs as goods and services at the same time.

It is requested that a clarification / notification may be issued providing that the imported drawings and designs would not be subjected to customs duty and service tax, at the same time.

Similar dispute relating to double taxation in connection to packaged or canned software was resolved in past in following manner. On 27.2.2010, simultaneous notifications were issued under Excise, Customs and Service Tax as under:

1. Notification No. 17/2010-CE exempted packaged software from payment of excise duty provided the person providing the right to use is registered under service tax;

2. Notification No. 31/2010-Cus exempted packaged software from payment of CVD provided the person providing the right to use is registered under service tax; and

3. Notification Nos. 2/2010-ST and 17/2010-ST exempted packaged software from payment of service tax provided the benefit of above notifications in respect of excise duty and CVD is not availed.

Thus, if either one of the duties/tax was paid, the other was exempted.

In view of the above, both the issues need to be resolved for easing the difficulty being faced by the industry.

### 4.2.3. Double Taxation of Licensed Intellectual Property Right (VAT and Service Tax)

Temporary transfer or permitting the use or enjoyment of any intellectual property right is liable to service tax.

In light of various settled judicial precedents, intellectual property right (IPR) has also been held to be 'goods' and accordingly, since software supplied electronically constitutes goods, accordingly it is subjected to VAT under the respective State VAT legislations. Further the 'temporary transfer of right to use software' is construed as a service and subject to levy of Service Tax. However there is still confusion and litigation existing as many State Governments are still levying sales tax on supply of temporary IPR, given the fact that the definition of sale in few state VAT legislations includes 'right to use'.

The objective would be to do away with double taxation and bring about clarity on the fact whether IPR is 'goods' or 'service'.

It is recommended that suitable explanations should be added in the Finance Act itself to ensure that sale of IPR is taxed only once – either under VAT as goods or under Service tax legislation as taxable service.

### 4.2.4. Revision in Rates of Interest for Delay in Payment of Service Tax

According to the Union Budget 2014, with effect from 1st October, 2014, service tax assessees are required to pay interest at the rate of 24/30 percent per annum, if the delay in payment of service tax is beyond six months/one year, respectively. For delays below 6 months, the interest shall be payable at the rate of 18 percent per annum.

There are many occasions where under a bonafide belief or due to interpretational issues, service tax liability is not discharged by the assessee. In such cases, levy of interest at the rate of 30% is not justifiable. In case, the assessee has collected the service tax from the recipient of service and has not deposited the same with the Government, levy of such a higher rate of interest is fully justified. However, levy of such higher rate of interest in cases disputed because of interpretation of law is unfair and unjust. This is a castigatory measure and translates into a heavy litigation cost since the appellate process normally extends beyond a year.

It is recommended that the interest rates should be reduced from 24/30 percent back to 18 percent so as to reduce the undue cost burden on an assessee. Higher rate of interest may be prescribed for situations where the taxpayer has admitted his tax liability but still has not deposited the tax with the Government. Liabilities arising out of differences in interpretation of law, valuation or applicability of any exemption notification need to be kept out of the purview of penal rates of interest.

## 4.2.5. Levy of Service Tax on Facilities Provided by Employer to Employees

At the time of introduction of negative list regime under the Finance Act, 1994, the services provided by an employee to the employer during the course of employment were specifically excluded from the definition of the service under Section 65 B (44) of the Finance Act, 1994. However, no similar exclusion was made for service provided by employer to an employee.

It is an industry practice that employers provide certain facilities to employees during the course of employment. Few of such facilities are mandatory as per provisions of law relating to employment, like canteen. However in order to have a participation in the business from the side of employee, a small element of the cost is recovered from the employee. Such benefits are considered to be provided by the employer to the employee on a concessional rate.

Most of the benefits given by an employer to its employees are procured from outside wherein service provider is either asked to provide the facility directly to employees or is asked to visit company's premises to provide such services. In both the cases, the service provided by service provider is directly consumed by the employees on behalf of their company and company remains just a conduit to recover some subsidized rates from each of its employees. It is also evident from the way such transactions are recorded in the books of accounts of the company wherein only net cost i.e. service fee charged by service provider less recoveries from employees is shown as expenses instead of booking expenses with gross amount and showing recoveries as miscellaneous receipt / service fee. Therefore, it is not fair to break such transactions artificially into two transactions i.e. service provider provides the services to the company and company, in turn, is providing such services to its employees.

Such recovery from the employees should not be construed as a Service provided by the employer due to the fact that the employer is not in the regular business of providing such service. The concessional benefit provided by the employer to employee is only under the employment arrangement between the employer and the employee. The intention of the employer is not to trade services to the employee, the intention is to provide benefits to its employees in respect of their services. In addition, the service provider would already be charging applicable service tax in the billing to employer, and therefore there is no loss of revenue to the Government

Hence, in situations where part consideration is received by the employer from the employee towards the benefit forming part of the salary of the employee, the same should not be liable to service tax.

It is accordingly suggested that a clarification or an exemption be issued so that services provided by an employer to the employee are not subjected to service tax.

## 4.2.6. Scope of Exemption of Shipping Activity from Service Tax

Services by way of the transportation of goods in a vessel/ship from a place outside India to the first customs station of landing in India have been specifically mentioned under the negative list and are therefore beyond the scope of levy of service tax. However, under section 66E of the Finance Act 1994, the transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods is included in the list of taxable services liable to service tax.

As per the prevailing practice in international market, Liquefied Natural Gas (LNG) is transported by the sellers or buyers of LNG after taking the specialised vessels/ships on charter from ship owners. Even though the intention of the Government is to keep the shipping activity for import of goods outside the ambit of service tax, the department is treating chartering of ship/vessels for LNG import as a taxable service and is demanding service tax. As a result, RLNG supplied to consumers in priority sectors like fertilizer, power, CNG etc. is getting costlier.

It is surprising that the place of provisions of service rules have been amended to expressly provide for the levy of service tax on the service of hiring of ships and vessels whether on short term basis or long term basis. This is a case of discrimination between the activities of transport of goods through vessels/ships for the purpose of import depending upon the manner of hiring of ships. Point to point hiring of ship for imports is exempted under negative list whereas time based hiring of ships for imports will be taxable.

It is suggested that the entry in the negative list should be suitably modified to expand the scope of negative list to cover shipping/import of LNG by way of chartering of ship from ship owners by LNG importer. In other words, time based hiring of ships for the purpose of imports should also be exempted from payment of service tax in line with exemption given to point to point hiring of ship for imports.

### 4.2.7. Exemption for Services Provided to Ship Owners/Charters

Chartering and Maritime Consultants provide broadly following services to Ship owners and Charters both of whom are located outside India and ships are also located outside India:-

- The consultant will analyse commodity, shipping and freight markets, track movement of ships and cargoes and disseminate such information to the Service Recipients
- Track, collate, analyze and monitor port development & logistics data originating from reliable source and update future trends.
- Identify and provide information on port costs, bunker (fuel) trend, cost estimation & analysis.
- Monitor voyage execution for smooth and efficient operations, so as to optimize performance
- Examine lay time calculations and arrange for account reconciliation for objectives of eventual settlement.
- Techno-commercial assessment of vessel type, utilization opportunities, infrastructure development in various regions, geographical impact on global trade in bulk commodities arising from weather, piracy, war, conflict or any other causes which have prospects to impact trade

Prior to 1-7-2012 the services were classified under Business Support Services and exempt as they satisfied Rule 3 of Export of Service Rules (Recipient being outside India, service used outside India and fee received in convertible foreign exchange). Post 1-7-2012, Department is proposing to treat them as Intermediary and wants to tax them as per Rule 9 of Place of Provision of Services Rules notwithstanding the fact that service recipients and ships are outside India and fee is received in foreign exchange. Indian Chartering Consultants have to compete in international environment against overseas chartering entities. Levy of service tax would make Indian chartering consultants uncompetitive resulting in loss of business.

It is recommended that keeping in view the fact that service recipients are abroad and payments are received in foreign exchange, an appropriate mechanism be evolved so that such services are not subjected to service tax.

### 4.2.8. Service Tax Exemption to Services Used for Laying Down Gas Pipeline Network

Services in relation to laying down the Gas pipeline network are liable to service tax. Service tax on such services increases the capital cost of pipeline laying which has the effect on transmission tariff. This increases the cost of procurement of gas in the hands of sectors in vital sectors like power and fertilizer.

Considering the need of providing supportive environment for requirements of power and fertilizer, services related to pipeline infrastructure may be exempted form service tax in line with exemption given to the services required for infrastructure development like roads, airport, railways, ports etc. It will incentivize investment in pipeline infrastructure sector by way of reduction in capital cost which will ultimately benefit the consumers by corresponding adjustment in tariffs.

### 4.2.9. Service Tax Exemption to Service of Transportation of Natural Gas/LPG through Pipeline Network

Service of transportation of Natural Gas/LPG is liable to service tax since June 2005 which increases the cost of procurement of Gas in the hands of consumers in vital sectors like Power, Fertilizer and as well as retail LPG consumers.

Considering the need for providing supportive environment for requirements of Power, Fertilizer and LPG distribution, the services of transportation of Natural Gas/LPG may be exempted form service tax in line with exemption given to Services for transmission of power by electricity distribution companies (under negative list) and to services by way of transportation by rail or a vessel of the certain goods like fertilizers (vide entry no. 20 of mega exemption notification-25/2012-ST Dated 20.06.2012). It will incentivize investment in pipeline infrastructure sector and will benefit the consumers by corresponding reduction in cost of transportation of Gas/ LPG.

## 4.2.10. Service Tax on Distribution of Electricity by a Distribution Franchisee

Notification nos. 11/2010 dated 27th February, 2010 and no. 32/2010 dated 22nd June, 2010 exempted all services provided for transmission/distribution of electricity by transmission or distribution licensee / franchisee or any other person. Distribution **franchisees** were kept out of Service Tax net at par with the distribution licensees.

Finance Act, 2012 introduced new service tax regime based on negative list of services. Memorandum to the Finance Bill, 2012 stated that all the available exemptions specifically granted by exercise of powers under section 93 (1) of the Finance Act, 1994 (as is the case with exemption to, inter alia, distribution franchisee) would continue.

Thereafter, the aforesaid notifications were rescinded and the negative list of services was introduced which included 'Transmission or distribution of electricity by an electricity transmission or distribution utility' vide sub-clause (k) of Section 66D of the Finance Act.

Definition of "*electricity transmission or distribution utility*" under Section 65B (23), casts a doubt whether distribution of electricity by a Distribution Franchisee authorized by a Distribution Licensee to do so, on its behalf is also exempted from levy of service tax.

Distribution franchisee in essence is nothing but a deemed licensee 'stepping in to the shoes' of the licensee. High Transmission and Distribution (T&D) losses in electricity distribution is the anathema of the power sector. Realizing this, and as provided in the Electricity Act, 2003; private utilities were encouraged to take over the distribution of high loss areas for a fixed tenure based on competitive bidding of the input energy to be supplied by the State Electricity Utility.

The Franchisee, in this model, is responsible for all duties and obligations as that of the licensee and is imbued with all rights, authorities and powers as that of the licensee. The Franchisee is, in fact, a deemed licensee and has all the responsibilities and obligations of a licensee, including the USO (Universal Service Obligation). Further, the concerned State Governments/Electricity Regulatory Commissions have also empowered the Franchisee under the relevant sections of the Electricity Act 2003: viz. sections 126, 135(1A) and 152 of the Electricity Act.

As the stated intent of the Finance Act, 2012 was to continue with the available exemptions, the Ministry should issue necessary clarifications to the effect:

(i) that the entrusting of distribution function to a franchisee by a state licensee is to be deemed as entrusting by the State Government itself as State Government means and includes its own licensees.

(ii) that the definition of electricity transmission or distribution utility includes a transmission / distribution franchisee.

(iii) that the other services, including that provided by a distribution franchisee to distribution licensee, which are incidental or essential for transmission and distribution of electricity are an integral part of transmission and distribution of electricity.

If necessary, appropriate amendments may be made in the law to restore the position prior to introduction of the negative list regime

## 4.2.11. Applicability of Service Tax on Reimbursement Claimed by the Service Provider

At present, there is no clarity on the taxability of the reimbursement of expenses incurred by the service provider and recovered from the service recipient during the course of provision of service. While one school of thought is that the reimbursements do not have any direct correlation with the services provided, the other school of thought goes on the argument that the reason for incurring such expenses is nothing but the provision of services. Therefore, the same should form part of the value of taxable service. Further, at present the law does not make any distinction between the expenses incurred during course of provision of service and claimed as additional amount towards reimbursement of expenses and the transactions which are mere reimbursements because of certain internal policies or business reasons.

The service tax authorities are extending the provisions of pure agent in all those cases and raising demands on all transactions of reimbursements irrespective of whether these are connected with the provision of any service or are stand-alone transactions by themselves. This approach is creating more problems in the negative list regime where all transactions carried out by one person to another for a consideration are regarded as taxable.

Recently, the Delhi High Court in the case of *Intercontinental Consultants & Technocrats Pvt. Ltd., 2012-TIOL-966-HC-DEL-ST* has held that the rules governing the provisions of Pure Agent are ultra vires the legislative provisions of the Finance Act, 1994 and, therefore, no service tax needs to be paid on reimbursements.

A suitable amendment is required in the law to have clarity on the taxability of reimbursement of expenses. Whereas the expenses incurred during the provision of service may attract service tax, the independent transaction of pure reimbursement should be kept out of service tax purview. Further, in case, the service provider is claiming the reimbursement towards an expense such as air travel ticket/GTA incurred during the provision of service, the same should be taxable in the same manner (i.e. on abated value/ reduced rate of service tax) which the original service provider (airline/GTA) is liable to pay irrespective of the classification of the main service during the performance of which such expense has been incurred.

### 4.2.12. Applicability of Service Tax for Sale and Delivery of Natural Gas at Customers' Premises

GAIL purchases Natural Gas from ONGC/Petronet LNG Ltd. The gas so purchased is transmitted through Pipeline network owned and operated by GAIL for sale to various consumers. GAIL enters into contract for sale of natural gas with the customers. As per the terms of contract for **sale** of gas **(GSA**), GAIL transports the gas upto delivery point located at customers' premises, where ownership of natural gas is transferred to the customer. Gas transmission charges are shown separately on the invoices raised by GAIL in addition to other price components.

Natural Gas transportation charges as fixed by Petroleum and Natural Gas Regulatory Board (PNGRB) are being charged and shown in the invoice by GAIL. Considering the entire transaction as 'sale' transaction, GAIL is paying sales tax/VAT on the 'total price' including transmission charges under VAT/sales tax law of the State where ownership of gas is transferred.

Besides above, GAIL also transports the natural gas of other gas suppliers/sellers such as RIL, IOCL, and BPCL through its pipeline networks. GAIL enters into contract for **transportation** of gas **(GTA)** which belongs to the shippers (owner of gas). GAIL charges natural gas transportation charges as fixed by PNGRB from such shippers. It is pertinent to note that transmission charges under both the above methods are non-discriminatory and hence transmission charges are same under GSA and GTA.

Service Tax was made applicable on the category of 'transportation of goods through pipeline' with effect from 16.06.2005. Disputes have arisen on the leviability of Service tax on the gas transmission charges in the aforesaid two situations. In addition to the transportation charges, GAIL is also charging Marketing Margin from gas consumers on sale of Natural Gas on which appropriate VAT/CST is being paid by GAIL as a component of sale price. There have been doubts on the levy of service tax on this cost also.

In this context attention is invited to a circular issued by Central Board of Direct Taxes (No. 9/2012 dated 17.10.2012) based on the judgment of the Gujarat High Court dated 12.07.2011 in case of M/s Krishak Bharti Co-op. Ltd. (Tax Appeal No. 618 of 2010). It has been observed in the judgment as well as the circular that in case the seller of the gas sells as well as transports the gas till the point of delivery of the buyer where the ownership of gas is simultaneously transferred, the manner of raising the sale bill *(whether the transportation charges are embedded in the cost of gas or shown separately)* does not alter the basic nature of such contract which remains essentially a 'contract for sale'. . The Gujarat High Court held that the agreement essentially is for purchase and sale of gas. It is also observed by the Court that transportation of gas by GAIL is only in furtherance of contract of sale of gas.

In view of the judgment of the Gujarat High Court and the CBDT Circular dated 17-10-2012, the contracts for 'sale and transportation of Natural Gas' entered by GAIL, where ownership of gas is transferred by GAIL at customer's premises, are essentially contracts for 'sale' and manner of raising sales invoice does not alter the basic natural of 'sale' contracts. In these circumstances there is no question of levy of Service tax on the transmission charges shown separately in the sales invoice and on which VAT liability is being discharged.

It is suggested that to avoid litigation it may be clarified by CBEC by way of a circular that:

a) Service tax is not applicable on transportation of Natural Gas where the seller of the gas sells as well as transports the gas till the point of delivery of the buyer and where the ownership of gas is simultaneously transferred,.

b) The manner of raising the sale bill *(whether the transportation charges or any other component are embedded in the price of gas or shown separately)* does not alter the basic nature of such contract which remains essentially a 'contract for sale'.

## 4.2.13. Definition of 'Intermediary' in the Place of Provision of Services Rules, 2012

The definition of the word 'intermediary' in rule 2(f) of the Place of Provision of service Rules has been amended to include the arrangement or facilitation of a supply of goods.

Currently, intermediary activity was restricted to arranging the supply of services between two or more persons. With this amendment, place of provision of services provided by intermediaries such as commission agents for goods will be the place of location of the service provider.

As a result, the services of commission agents for goods, which are located overseas, will no longer, trigger liability under reverse charge. To this extent, the exemption allowed in Notification 42/2012.S.T. dated 29.06.2012 would become redundant. On the other hand, services of the commission agents located in India who undertake marketing for their foreign principals will now attract a charge of service tax.

Since, the impact could be far reaching, it is suggested to either restore the definition of intermediary as it existed prior to the said amendment or the place of provision of such services should be made recipient based.

## 4.2.14. Non-Taxability of Export of Testing Services

Rule 4 of the POPS Rules deals with performance based services. It states that place of provision of service shall be the location where the service is actually performed. In case of testing of software or hardware products, the place of provision of service is treated as the place where services are actually performed though the actual use and enjoyment of service is happening at overseas location.

Overseas clients outsource testing services to service providers in India. Testing is usually performed on software or hardware carried out in labs in India and the test reports are made available to the overseas clients for consideration in convertible foreign exchange. Accordingly, such services are construed as provided in India and hence, are liable to Service tax.

Sub rule 4(a) of the POPS Rules should be amended to provide an exception that in respect of testing service performed on goods, the place of provision of service is the location of the service recipient (i.e. to whom the test report or exception report, if any, is required to be delivered.)

## 4.2.15. Point of Taxation in Respect of Reverse Charge Transaction

Rule 7 of the Point of Taxation Rules, 2011 as amended with effect from 1st October, 2014 prescribes that if payment to the vendor is not made within 3 months, he has to pay service tax on the 1st day after expiry of 3 months from the date of invoice. Even in cases where the assesse fails to make the payment within 3 months from the date of invoice for want of receipt of invoice, the assesse is required to make tax payment including interest.

Putting artificial time line on availment of Cenvat credit requiring payment with penal interest goes against the spirit of value added taxation and unnecessarily burdens the business.

It is suggested that point of taxation in respect of transactions to which reverse charge applies, should be the date of payment without any restriction on time limit.

### 4.2.16. Single Registration and Return for all Services provided by the Assessee

The service tax registration is a service category based registration. The assessee has to amend the service tax registration certificate to incorporate provision of new service or receipt of new services which are liable for service tax under reverse charge mechanism. Further, each service category registration requires separate filing of return. Amendments to the existing registration to incorporate new services and filing multiple returns increases administrative burden on the industry without any value addition to the Department.

It is suggested that a single registration irrespective of types of services provided should be prescribed. For statistical purposes, an annual statement giving information of service category-wise service tax payment etc. can be prescribed.

### 4.2.17. Expansion of the Scope of Definition of "Board" under Section 65B

As per Section 66D of the Finance Act, 1994 the Negative List of Services includes:

> *"(d)(vii) Services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;"*

Under clause (6) of Section 65B, "Agricultural Produce Marketing Committee or Board" has been defined to mean any committee or board constituted under a State law for the time being in force for the purpose of regulating the marketing of agricultural produce.

In this connection it would be pertinent to note that by virtue of it being expedient in public interest, the Union Government has taken under its control several agri industries and has set up Boards for such industries. The duties and objectives of such Boards include, inter-alia, regulating the relevant agri commodity and promoting its sale – both within the country as well as exports, having due regard to the interests of all the stakeholders like the farmers / growers, manufacturers, dealers and the government. Examples of such Boards include Spices Board of India, Tobacco Board, Coffee Board of India, Coir Board and Tea Board of India.

In line with the inclusion in the Negative List of services provided by Agricultural Produce Marketing Committees or Boards, it is recommended that the services provided by Boards set up under Central enactments for similar purposes are also included under the definition of "Board" under Section 65B of the Finance Act, 1994. This will ensure that the tax cost of the services are not embedded in the export cost of the agri-products or in the cost of the agri-products sold in the domestic market, as is the case today.

### 4.2.18. Definition of "Sponsorship Services"

With effect from 1 July 2012, provisions of Section 65 shall not apply in respect of classification of services under different service categories based on definition of services. However, taxes have to be paid under the respective category which is contrary. For example, there is no definition of Sponsorship services, there is an ambiguity created in industry as to which all services are covered under Sponsorship.

Clarification may be provided on definition of sponsorship service in order to determine service tax liability under reverse charge on such services and also on other services for depositing service tax under the respective heads.

## CENTRAL EXCISE

### 4.3.1. Additional Duty of Excise on Energy Drinks/Aerated Waters, containing added Sugar etc.

An Additional Duty of Excise @5% has been imposed on "Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavoured" falling under heading 2202 10 of the Central Excise Tariff effective from 11th July 2014. This Additional Duty of Excise has been levied via a separate enactment which was initially introduced in Section 85 of Finance Act, 2005 for Pan Masala and certain notified tobacco products.

This has surprisingly impacted nutritional beverage products like Tata Gluco Plus and others covered under chapter 22 of Excise Tariff. Tata Gluco Plus (TGP) is a glucose-based ready to serve beverage, which provides instant energy to consumers and is available in a unique cup format. TGP has been brought to the Indian market through NourishCo Beverages Ltd, a Joint Venture between PepsiCo India and Tata Global Beverages Ltd. It offers the benefit of glucose energy, mineral salts and iron to provide instant refreshment and recharge.

It would be unfair to club waters, including mineral waters and aerated waters etc. with the likes of tobacco products and items as pan masala and gutkha. Aerated water simply does not carry the kind of direct health externalities that justify a surcharge under Seventh Schedule to the Finance Act, 2005 (on products which are "health hazards"). In fact, aerated beverages also provide instant energy and hydration, being a hygienic, affordable drink. Indian Council of Medical Research has observed that per capita consumption of sweetened beverage in India is too low and insignificant to warrant any health concern.

It is recommended that the aforesaid products should be de-linked from surcharges specified in the Seventh Schedule to the Finance Act, 2005 and no additional levies be imposed on such items.

### 4.3.2. Denial of Cenvat Credit of Cess paid on Sugar

Sugar is presently subject matter of multiple tax levies i.e. enhanced basic excise duty (including additional duty of excise imposed in the past), Sugar Cess and VAT. Sugar Cess is being levied at Rs. 24 per quintal.

Sugar Cess is not creditable to manufacturers of food articles and beverages and therefore, levy of Sugar Cess leads to cascading effect of taxes and higher input costs. (Industries in areas such as Biscuits, Cakes, Chocolates, Sugar Boiled Confectionary Juice based Drinks and Carbonated Beverages, Malted Milk Foods). Any non-creditable taxes are against the stated present and proposed indirect tax policy besides causing a cascading effect on tax costs and distorting the economic environment.

Given that sugar represents significant manufacturing cost for food and beverage industry, higher sugar cost has a significant impact on prices of these commodities, thereby fuelling inflation.

It has been recommended in the report of Thirteenth Finance Commission that share of special purpose cesses (such as Sugar Cess) in the gross tax revenues of the Central Government should be reduced since the proceeds of such cesses are not available for sharing with the States.

It is pertinent to understand that Education Cess (Central Levy) levied on Sugar is Cenvatable and also the State VAT levied by States like AP, Bihar, Orissa and Karnataka (1/8/2013) is also Vatable. Hence it's a paradox if Sugar Cess alone is not Cenvatable for industrial purposes.

It is suggested that the Cess paid on Sugar should be allowed as CENVAT Credit against output excise duty levied under the Central Excise Act, 1944 Or Sugar should be exempted from the levy of the Cess when sold to industrial consumers.

### 4.3.3. Increase in Excise Exemption Limit for Biscuits from Rs. 100/Kg to Rs. 125/Kg

At present lower priced-biscuits (i.e. biscuits sold at a MRP equal to or less than Rs. 100/Kg) enjoy an exemption from central excise duty. The exemption was granted in the Year 2007 taking into consideration that lower priced biscuits are a healthy, hygienic, safe and nutritious staple intended for mass consumption by the lower income strata of the society.

Since 2007 the cost of raw materials used in the manufacture of biscuits (primarily wheat flour, oil and sugar) has increased exponentially – having more than doubled, along with sharp increase in labour, transportation and energy costs. Under the circumstances the exemption limit of Rs. 100/Kg that was provided for biscuits meant for mass consumption is proving to be inadequate.

It is recommended that the exemption limit be increased from Rs. 100/Kg to Rs. 125/Kg such that the popular variants of biscuits remain within the reach of the common man. The premium biscuits variants, however, can continue to be taxed as at present.

### 4.3.4. Extension of Concessional Rate of Excise Duty on Capital Goods for Food Processing Industry

Vide Notification No 12/2104 C.E. dated 11th July, 2014 concessional rate of excise duty has been provided for process / packing machinery used in the manufacture of agricultural / apiary / horticultural / dairy / poultry / aquatic / marine produce and meat.

While the food processing industry welcomes the above initiative which will help reduce the capital cost, a large portion of processed food industry which deals with basic essential packaged foods for common man such as staples / biscuits etc., are deprived of the benefit of concessional rate of excise duty on process / packing machinery. Organised packaged food processing industry procures substantial process / packaging machinery and this discrimination within the same industry may not be warranted for.

It is recommended that concessional rate of excise duty on process / packing machinery be extended to the entire food processing industry instead of limiting the same to certain categories within the industry.

### 4.3.5. Rationalization of Excise Duty on Man Made Fibre/Filament

With the increase in excise duty from 4% in 2008 to 12% in 2013, the capacity utilization of the manmade fibre industry has come down substantially leading to losses in the industry. A reduction in excise duty rate would help in achieving potential for growth that exists in the manmade fibre based products, since demand and therefore production will increase, leading to increased revenue. Such a reduction in duty would help not only the polyester yarn / fibre manufacturers but also the texturizers, weavers, knitting industry, processors and apparel manufacturers. The reduction in the duty for raw materials such as PTA, MEG and DMT should follow as a logical sequence to avoid an inverted duty structure.

It is suggested that the excise duty on manmade fibres be reduced to 6%.

### 4.3.6. Exemption for Asbestos Cement Roofing Sheets and Pipes

Chrysotile asbestos cement roofing sheets and pipes fall under Chapter No. 6811 of the excise statutes and currently attract basic excise duty of 12%. The product previously was availing of exemption from the levy of excise duty for several years since 1991 on account of use of fly ash in its manufacture. The concession was however withdrawn in July 2009. Presently, excise duty exemption to such products is available under Notification No.12/2012-CE dated 17th March, 2012. If these are manufactured with the use of materials like blast furnace slag, red mud etc. Products made from fly ash are no longer eligible for the exemption.

It is recommended that asbestos cement roofing sheets made from fly ash may also be exempted from the levy of excise duty since these fulfil the needs of economically backward sections of the society.

### 4.3.7. Uniform Rate of Excise Duty on Cement

Till 28-2-2007, a uniform rate of excise duty was levied on cement. Presently, cement is levied to excise duty on the basis of MRP, on ad valorem basis and on ad valorem cum specific basis depending upon the manner of packaging etc. Clinkers are levied to duty on ad valorem basis. This has led to disputes being raised with the Department demanding duty on cement cleared to Industrial / Institutional buyers at MRP instead of transaction value despite a Board's circular 124/02/2008-CX 3 dated 12.06.2008 clarifying the issue.

For better compliance and to avoid litigation, it is suggested that excise duty on cement and clinker should be prescribed on ad-valorem basis only.

### 4.3.8. Warehousing Facility for Steel Products

In the steel industry, it is a practice that most of the materials are sold from stockyards / depots which are situated across the country and there is a time lag between dispatch of material from the manufacturing plant and sale from the stockyard / depot. As such, there is possibility of a difference in price prevailing at the time of dispatch of materials from the plant and the price prevailing at the time of final sale of material from stockyard.

As per Warehousing provisions of Rule 20 of Central Excise Rules 2002, the Central Government may by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty subject to such conditions etc. as may be specified.

It is requested that Iron and Steel products should be included in the warehousing provisions under the said rule 20. Such change will not only simplify the procedures, but will also eliminate disputes relating to valuation at the time of dispatch from plant while, at the same time, achieving the purpose of levy of duty on final selling price.

### 4.3.9. Extension of Exemption to all Components used in Electric Vehicles

It is suggested that excise and customs duty exemption should be extended to all parts used in Electric Vehicles, which are procured locally or imported.

Presently the benefit is available only to select parts, viz. Battery, AC/DC Motor & Motor Controller, which is resulting in additional cenvat credit, which cannot be utilized. This will also promote use of electric vehicles, in preference to vehicles using fossil fuels and save precious foreign exchange.

### 4.3.10. Process of cutting/slitting of Sheet Metals amount to “manufacture”

It is suggested that the process of cutting/slitting of sheet metals be considered as amounting to “manufacture” and hence leviable to excise duty

Presently this is causing enormous confusion & administrative hurdles where service centres operate for cutting & slitting of sheets and supply to the industry. This is in view of the fact that in some cases (like profile cutting) it is considered as manufacture and in other cases it is not considered as “manufacturing” leading to complexities/litigation.

### 4.3.11. Imposition of 4% Excise Duty on Tractors

Tractors, which are used for agricultural purposes, have been exempted from payment of excise duty since 2004-05. Due to this exemption, no cenvat credit has been allowed on the inputs and service tax used in the manufacture of tractors. This has led to lot of complications both for the Government and the industry, at the operational and legal levels.

It is suggested that excise duty @ 4% ad valorem be imposed on the tractors used for agricultural purposes. Since the cenvat credit available on the inputs and service tax credit would offset the excise levy of 4%, there would be no increase in the price of the tractors to the ultimate customer.

### 4.3.12. Soya Processed Food Products

Processed Soy Food Products are high in protein content and have an excellent nutritional value which can effectively combat malnutrition among our citizens thereby reducing the expenses on health care. Processed Soya Products have applications in nutraceuticals, pharmaceuticals and healthcare. Excise Duty on various soy products varies between 4 to 12%. To enhance the domestic consumption of soya products, it is necessary that excise duty thereon is exempted. The proposal will have revenue implications of not more than Rs.10 crores but it will accelerate sales of Value Added Soya

Products in the country by 15 to 20% per annum and will reduce expenses on healthcare incurred by the Government by a minimum of Rs. 1000 crores.

It is accordingly suggested that excise duty on soya processed food products (Lecithin – CETH 29232010, Tocopherol – CETH 29262800, Soya Sterol - CETH 29061390, Soya Protein Concentrate – CETH 21061000) may be exempted.

### 4.3.13. Breakfast Cereal Products

Cereals and Staples form about 60-70% of our diet and are a principal source of our energy, protein, fibre and vital micro nutrients like Vitamin B1 and B3. In addition to the commonly known cereals our traditional millets are also significant sources of calcium and iron which if projected, exploited to its fullest consumer potential can go a long way in eradicating some of the nutritional challenges of the country. Apart from several health benefits to the consumers, the breakfast cereals industry provides significant employment in the farm sector/rural sector as most of the inputs are agriculture based.

Currently, breakfast cereal products are being charged at the rate of 6%. Rate of excise duty imposed on most other food products like Soya Milk Drinks, Preserved Fruits and Vegetables, Milk Based Beverages, Ice-cream, Ready to Eat Packaged Food, Mineral Water, Dried Soups and Broths, Pasta, Fruit Juice, Potato Chips and so on is 2%. In line with all of these products, it is recommended that excise duty on breakfast cereals be also aligned to the rate of 2%.

### 4.3.14. Packaged Drinking Water

The packaged drinking water is a common man's product. The manufacturers of packaged drinking water make available clean and potent water to the consumers thereby ensuring that the basic need of hygiene and hydration of consumers are both met. Currently this item is levied an excise duty of 12.36 %. The benefit to the total system by way of reducing / eliminating health concerns more than offset any marginal decline that may occur in the short term as a result of reduction of excise duty. A total macro view would be necessary than a sectional view focusing only on the revenue generating potential of levy of excise duty on packaged drinking water.

It is accordingly suggested that the excise duty on packaged drinking water may be reduced to 6.18%.

### 4.3.15. Fruit Pulp based Drinks – Exemption for Intermediate Goods

With a view to encourage Fruit and Agro Industry, 'Fruit pulp based drinks' falling under Chapter 22 were exempted from excise duty. As a corollary, intermediate goods used in the manufacture of above products were also exempted from duty vide Notification No. 10/96-CE dated 23.07.96. In view of the confusion between 'fruit pulp' & 'fruit juice' based drinks, the entry under Chapter 22 was amended with effect from 19.05.97 to include 'Fruit pulp or fruit juice based drinks'. However, inadvertently corresponding changes were not made in the intermediate goods exemption which continued to refer to 'Fruit pulp based drinks'.

It is therefore suggested that exemption under notification 10/96 dated 23.07.06 may be suitably amended and aligned with the tariff to provide exemption to intermediate goods used for 'fruit pulp and fruit juice based drinks'.

### 4.3.16. Confectionery

Organized Confectionery Industry is the second largest category in the processed food industry with a turnover of nearly Rs. 1,600 crore, providing significant sustainable rural / semi urban employment. Confectionery is primarily targeted towards children. Confectionery is basically made out of Sugar, Milk and Milk Products, Glucose etc. which are agricultural produce.

The industry plays an important role in the economy of the country - specially the small scale industry - which supplies intermediary inputs like printed wrapping materials, pet jars, and corrugated boxes. The transport sector is also immensely benefited in the transportation of the confectionery items throughout India. Since confectionery products are retailed through more than 10 million retail outlets in the country, there are large spin-off benefits to the transportation sector as well as opportunities for the self- employed, the service sector and MSME.

Sugar Boiled Confectionery in India is defined by rigid price points, predominantly 50 paise and Re. 1/- per unit. The industry has been under severe inflationary pressure – both in terms of cost of inputs as well as distribution costs.

In order to provide some relief to industry, it is recommended that the central excise duty on confectionary be reduced from existing 6% to 2% - the rate of excise duty imposed on most other food products like Soya Milk Drinks, Preserved Fruits and Vegetables, Milk Based Beverages, Mudi (Puffed Rice), Ice-cream, Mineral Water, Dried Soups and Broths, and so on.

### 4.3.17. Taxation of Educational Products

Education is one of the key priority areas of Government and Sarva Shiksha Abhiyan is a Government of India flagship programme for achievement of Universalisation of Elementary Education. In the last Union Budget the Central Government has allocated Rs. 28,635 crore for *Sarva Shiksha Abhiyan* and an additional Rs. 4,966 crore towards *Rashtriya Madhyamik Shiksha* Abhiyan.

At present, Educational products like exercise books, pens, note-books, pencils and geometry boxes are subject to 2% excise duty (without cenvat credit) plus Education Cess. Additionally, most of these products suffer State VAT @ 5%.

It is recommended that in order to promote education and to make available educational aids at an affordable cost, particularly to the lower economic strata of society, all educational products meant for use by school and college students should be exempt from Central as well as State taxes.

### 4.3.18. Excise Duty on Footwear

Footwear is charged an excise duty of approximately 26% of transaction value (effective rate). The rate of excise duty on footwear is amongst the highest across any product category. Although the Union Budget for 2014-15 granted a marginal concession in the form of reduced excise duty rate of 6% on footwear with MRP between Rs. 500 to Rs. 1,000 per pair, the larger issue of rationalizing excise duty for footwear industry has remained unaddressed.

To attract new investments into domestic manufacturing, footwear industry requests for a uniform excise levy at the rate of 6% of transaction value, with input tax credit. Such rationalized levy is required, considering the peculiar market dynamics and pricing mechanism in the footwear industry.

### 4.3.19. Amendment Pan Masala Rules, 2008 to exclude Notified Goods meant for Export

Rule 11 of the Pan Masala Packing Machine (Capacity Determination and Collection of Duty) Rules, 2008 obligates a manufacturer to declare the RSP on the packages of goods falling within the purview of said rules. The proviso to Rule 11 further provide that where a manufacturer fails to declare the retail sale price before removing the goods from the place of manufacture, then such goods shall be liable to confiscation.

Rule 11 applies to the clearances made by a manufacturer of pan masala for sale only in the domestic market and not for export sales however, there is no express provision in the Pan Masala rules for not printing of RSP of Pan Masala pouches manufactured for export.

Due the lack of clarity in Pan Masala Rules, the aforesaid legal position is causing undue hardship inasmuch as a domestic manufacturer of Pan Masala or other similar products falling under Section 3A of the Central Excise Act, 1944 is unable to fulfil its export commitments as a foreign buyer is not willing to accept packages that carry the RSP or other information as would be applicable to goods sold in compliance with the Indian laws for the domestic market.

It is suggested that requisite amendments may be carried out in Rule 11 of the Pan Masala Packing Machine (Capacity Determination and Collection of Duty) Rules, 2008 to exclude from its scope, goods meant for exports.

### 4.3.20. Admissibility of Cenvat Credit of Duty paid on Pan Masala in Bulk pack for use in manufacturing of Pan Masala in Pouches

Rule 16 of Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010 allows Cenvat credit of duty paid on chewing tobacco in bulk packs used in manufacturing of chewing tobacco and Jarda scented tobacco. However, under Rule 15 of the Pan Masala Rules, 2008 which is pari-materia to the Chewing Tobacco Rules, 2010, the Government has totally disallowed the Cenvat credit of duty paid on bulk packs of Pan Masala for use in manufacturing of Pan Masala in pouches under section 3A of the Act. Since, both Pan Masala Rules, 2008 and Chewing Tobacco Rules, 2010 are same in substantive law and both govern notified goods, therefore, it is suggested to bring about parity and alignment in both the Rules so as to benefit the Pan Masala industry, which is already suffering huge burden of duty.

It is suggested that Rule 15 of Pan Masala Rules, 2008 should be codified in consonance with Rule 16 of the Chewing tobacco Rules, 2010 and credit of duty paid on bulk pack of Pan Masala should be allowed to the manufacturer of Pan Masala paying duty in terms of section 3A of the Act.

# CUSTOMS

## 4.4.1. Levy of Customs Duty on Telecom Products

Exemption from the levy of Customs duty on specified telecom products including Long Term Evolution (LTE) products has been withdrawn vide notification No. 11/2014 - Customs dated 11.07.2014. This measure is likely to adversely affect further investment in this sector. Telecom sector has been a game changer in making 'inclusive' connectivity a reality in the country in the last two decades.

The expansion of telecom services at a CAGR of 35% per year was in large part enabled by the zero import duty facility allowed as per ITA 1 agreement which mandated duty free import of telecom equipment and helped bring down the cost of capital expenditure which in turn allowed operators bring down call charges substantially making services very affordable and within reach of the common man. The low tariff was singularly responsible for the rapid double digit growth of subscribers during the last two decades. Against this backdrop, withdrawal of duty exemption in last Budget on select telecom equipment not covered by ITA 1 agreement is a retrograde step. Other countries have already moved on to ITA 2 agreement to cover for technology advancements and new telecom equipment available in the post ITA 1 era.

The new customs imposition has pushed up the cost of such new generation critical equipment, resulting in increase in the capital expenditure and thereby cost of the projects.

It is suggested that the aforesaid issue may be appropriately addressed.

## 4.4.2. Exclusion of value of services levied to service tax from the value of imported goods

Rule 10(1)(b) of the Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 provides that in determining the transaction value of imported goods, there shall be added to the price thereto the value of specified services supplied directly or indirectly by the buyer free of charge or at reduced cost for use in connection with the production and sale for export of imported goods, to the extent that such value has not been included in the price actually paid or payable.

Further, Section 68(2) of the Finance Act, 1994 provides for payment of service tax under reverse charge in respect of services received/ imported in India.

It appears the importer in India who avails of specified services from a foreign territory and directly supplies such services free of cost to the foreign exporter for use in the manufacture of goods meant for import into India, pays service tax as well as custom duties on the value of such services i.e. firstly, it pays service tax under reverse charge while making remittance to the service provider located outside India and again it pays custom duties by including the value of such services in the assessable value of imported goods in terms of Rule 10(1)(b) of the Custom Valuation Rules.

As an example, an importer arranges manufacturing / printing of packaging material from vendor A located in country X (other than India). At the same time, he arranges to get the basic design done from vendor B located in country X itself. Separate Purchase orders are issued to vendor X and vendor Y and payments are also released separately. However, once the design prepared by Vendor B is approved by the importer in India, it directs vendor B to pass on the design to vendor

A, which ultimately is used by Vendor A in the manufacturing/ printing of packaging for the importer. While making payment to vendor for design charges, service tax is paid under reverse charge considering design as a taxable service. However, the contention of the Customs is that the importer ought to have included the design cost in the assessable value declared for packaging material, imported from vendor A, in terms of Rule 10 customs valuation rules.

This appears to be a case of double taxation which cannot be the intention of the Government. It is, therefore, requested that the Government may bring an amendment to the Customs Rules so as to provide exemption from inclusion of the value of services (supplied free of cost to the foreign supplier) in the value of imported goods provided the importer has paid service tax under reverse charge on value of such services.

### 4.4.3. Rationalisation of Duties on Textile Items

Goods covered by the Chapters 51, 52, 54, 55 and 58 attract different specific duties at 8 digit HS code level. The difference in the product description under various sub–classifications cannot be determined or identified by physical inspection and requires submission of samples for tests by Textile Committee. This results in inordinate delays in clearance of goods.

It is recommended that the structure of specific duties applicable to the goods covered by the said chapters be rationalised. Further, clarifications/instructions may be issued to field formations to accept test reports of any accredited testing laboratory after matching the sample fabric affixed on the test report with the import consignment.

### 4.4.4. Abolition of duty on Oats

Since Oats is not a commodity grown in India, is not likely to compete with local industry or farmers, hence, the basic customs duty on oats be eliminated or reduced. Also given the associated health benefits, it would also help in making Oats available to consumer at affordable prices.

### 4.4.5. Enamel Copper wire and Aluminium Wire for Manufacture of High Energy Efficient Compressors

Basic Customs Duty on Enamel Copper Wire (HSN No 8544 1110) and Enamel Aluminium wire (HSN No 85441990) for manufacture of High Energy Efficient Compressors may be reduced to 5% from present 7.5% due to non-availability of assured supplies of desired quality at competitive prices within the country to support BEE programs

### 4.4.6. Determination of Quantity for levy of Customs Duty on Liquefied Natural Gas (LNG)

GAIL (India) imports LNG on Delivered Ex-Ship (DES) basis and the overseas supplier of LNG raises provisional invoice on the estimated quantity of LNG in Million British Thermal Units ('MMBTU') to be delivered in India considering “delivered Ex-ship” value. A provisional invoice of estimated quantity is raised without conducting the technical tests/estimation as it is not possible to accurately calculate the quantity of LNG which might actually reach the Indian shores. Moreover the Ship carrying LNG Cargo also consumes the same LNG (Converted in Gaseous form during transit and also to release pressure in LNG Storage tank) as fuel for running of the vessel and maintaining minus 160˚? temperature of LNG Storage tank and therefore exact quantity to be delivered cannot be ascertained at the initial stage. Further some LNG quantity is taken back by the ship as Heel Quantity to maintain the cooling of LNG tanks during return journey after unloading of LNG.

The Bills of Entries are assessed provisionally for want of original documents, test reports, certificate from independent agency certifying the final quantity delivered on Indian shore to GAIL and final invoice etc. and GAIL pays customs duty on the basis of provisional assessments made on the Bill of lading quantity of LNG.

After importation of the LNG, the independent surveyor carries out verification and inspection of LNG to ascertain the exact quantity in MMBTU delivered to GAIL in India. The surveyor issues a certificate showing final quantity landed on the Indian shore. The overseas supplier of LNG then issues the final invoice showing the exact quantity delivered to GAIL on Indian shore which is paid as full and final settlement. After receiving the final invoice from the overseas supplier of LNG, GAIL files the invoice, surveyor report etc. with the Customs authorities for finalization of assessment of Bills of Entries.

Customs authorities are, however, finalizing Bills of Entry for a quantity recorded in the Bill of Lading issued at the port of loading resulting in payment of duty on a quantity which has not been received in India and on a value which is not paid to the supplier as transaction value. Since the supplier is also paid for the quantity of LNG actually received in India under the contract, customs duty will be payable on the transaction value of the imported goods. This has been clarified in Board's circular no 6/2006-Cus dated 12/01/2006 also. The Commissioner- Appeals and CESTAT have already decided in past such issues in favour of the importers, still the custom authorities are continuing with assessment on erroneous basis causing undue litigation.

It is suggested that a circular may be issued by CBEC to suitably prescribe a method of assessment which can take care of variation in quantity of LNG shipped from abroad and received in India due to consumption en-route and other factors mentioned above. Alternatively, it may be specifically clarified that the circular no 6/2006 – Customs dated 12/01/2006 will apply to assessment of LNG also as bulk liquid cargo.

### 4.4.7. Presence of Azo dyes - Certification by International Agencies

Textile goods are required to be accompanied by a certificate from a laboratory accredited by the Government of the exporting country confirming that the goods are free from Azo dyes and other harmful chemicals. If the goods are not accompanied by such certificate, they are subjected to mandatory testing - as prescribed vide DGFT's Public Notice No. 12 (RE-2001)/1997-2002 - to ensure that the products imported are free from Azo dyes and other harmful chemicals. This process leads to delay in clearances and resultant additional costs.

Internationally, the Institute of the International Association for Research and Testing in the Field of Textile Ecology accredits mills after carrying out rigorous controls to ensure that they do not use prohibited dyes/chemicals. Once accredited, the certification remains valid for a specific period and a specific group of products. It is an internationally accepted practice to accept the accreditations and not insist for consignment wise testing.

It is recommended that the international practice of accepting the accreditation certificate issued by Institute of the International Association for Research and Testing in the Field of Textile Ecology be adopted in India also.

## CENVAT CREDIT RULES

### 4.5.1. Rationalisation of CENVAT Credit Scheme

Implementation of the concept of Negative List of Services has resulted in all activities undertaken by a person for another for a consideration being brought under the tax net. However, the restrictions, exceptions and limitations on availability of input tax credit still continue. This anomaly has led to an inequitable situation whereby the taxation of services is universal while the credit for the tax paid on input services continues to be restricted.

In order to correct this inequity and to provide much needed relief to industry the service tax laws in general and, specifically, the definition of input service should be amended to allow input tax credit without any restrictions – in line with the principles of GST. Further, in order to ensure that the CENVAT Credit scheme meets its objectives it is important that unnecessary qualifications/categorizations like 'input', 'input service' and 'capital goods' be done away with and all input side tax costs in relation to business activity should be allowed as credit.

### 4.5.2. Removal of Restrictions in Availment of Cenvat Credit on Services Related to Civil Construction

The definition of 'input service' places restrictions on availment of cenvat credit on certain services which inter-alia include services related to civil construction, services related to motor vehicles i.e. cab services, services which are used for consumption of any employee. Presently Cenvat is not available on laying of foundation or building up capital structures. Thus duty paid on steel, cement, iron, plates used for civil structure are not cenvatable.

In so far as civil construction related services are concerned many a times construction of a property is essential for provision of output services i.e. without construction of property the manufacturer or service provider cannot undertake its activities. For instance, without construction of factory building, the manufacturer cannot manufacture the goods, without construction of office complex or shopping mall, the service provider would not be able to provide renting services, without construction of a tower the telecom service provider cannot provide telecom services and without the construction of pipeline a service provider cannot provide services of transportation of goods through pipeline. Hence, in cases where the construction services form integral part of provision of services, credit should not be denied to the manufacturer or service provider.

It is recommended that necessary amendment should be made in the definition of "input service" to allow credit when the civil works are used for manufacture of excisable goods or for provision of taxable services. The credit should be denied only in cases where the immovable property is used for sale or for non-taxable purposes.

### 4.5.3. Removal of Restrictions in Availment of Cenvat Credit on Services Provided to Employees

The service industry runs on a 24X7 basis, providing employment opportunities to thousands. For such an industry, the services of transportation, provision of food to the employees, health and life insurance services are necessary pre-requisites which the employer has to provide to its employees to ensure that the output service is provided efficiently.

Therefore, FICCI recommends that the industry should not be denied Cenvat credit on such input services, as this would result in extreme hardship to this sector thereby drastically reducing their competitiveness in global market.

### 4.5.4. Credit of Service Tax on Services for Goods Manufactured Through Job Workers

As per the provisions of CENVAT Credit Rules, 2004 CENVAT credit on inputs and capital goods may be availed by a manufacturer as long as such inputs / capital goods are physically received in his factory premises under cover of a valid Central Excise Invoice and are used by him in or in relation to manufacture. Credit of service tax may be availed by an assessee on payment of the same to any input service provider, as long as the input service is received in or in relation to manufacture. The credit is, thus, only available on the basis of Invoice payments.

In the case of Brand Owners who employ job-workers exclusively for manufacture of goods, the benefit of CENVAT credit on inputs is available since the job-worker can claim the CENVAT credit and offset his central excise liabilities against the said credit. However, as far as service tax is concerned, since the payments for taxable input services are generally effected by the Brand Owner instead of the job-worker, the benefit of service tax credit is not available. This is due to the fact that the Brand Owner cannot avail the credit since he is not the manufacturer and the manufacturer, i.e., the job-worker, cannot avail the credit since he does not pay for the taxable input service. Consequently, under the Rules the Brand Owner employing job-workers exclusively is discriminated vis-à-vis Brand Owners having their own manufacturing facilities, in so far as credit of service tax is concerned.

A typical example would be one where the principal manufacturer undertakes advertising and sales promotion, market research; storage upto the place of removal for the goods manufactured by it as well as by its job workers and discharges the service tax liability thereon.

The CENVAT Credit Rules also provide for an Input Service Distributor (ISD) mechanism whereby the credit of service tax can be distributed by an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under Rule 4A of the Service Tax Rules 1994 towards purchase of input services. Hence, by definition, the ISD cannot distribute credit of service tax to job-workers in case the input services are paid for by the principal, i.e., the Brand Owner.

Accordingly, the provisions of the CENVAT Credit Rules, 2004 create an inequitable situation, in that, the benefit of CENVAT credit pertaining to inputs and capital goods is available to the assessee irrespective of whether manufacture is in-house or at job worker premises whereas the benefit of service tax credit is available only if the manufacture is at the assessee's own unit. Moreover, neither the principal manufacturer nor the job worker is entitled to take credit of the service tax paid on above services whose value is included in the assessable value for payment of excise duty. This leads to a cascading effect which is against the basic principle of Cenvat. This inequity dilutes the cost competitiveness of assessees who own brands and use job workers exclusively for manufacture of goods - more so since, the scope of the service tax has been expanded following the introduction of 'negative list' based approach to Service Tax.

It is recommended that the CENVAT Credit Rules be amended to provide a mechanism that enables availment and distribution of credit of service tax by brand owners to job-workers. This will ensure cost competitiveness of the brand owners and protect the long-term interests of job-workers.

### 4.5.5. Rule 6(3A) - Input Services Common to Dutiable and Exempted Goods or Services

As per Rule 6(3) of the CENVAT Credit Rules 2004, the manufacturer of goods or the provider of output service, opting not to maintain separate accounts for inputs of input services used in the manufacture of dutiable goods and exempted goods or taxable services and exempted service is provided an option to pay an amount as determined under Rule 6(3A). Rule 6(3A) of Cenvat Credit Rules 2004 provides that the amount attributable to input services used in or in relation to manufacture of exempted goods and their clearance up to the place of removal or provision of exempted services should be determined after considering the total cenvat credit taken on input services during the financial year. The said provision seeks to disallow cenvat credit even on input services which have no nexus with exempted goods or exempted services. This provision takes away the rightful cenvat credit available to the manufacturer and service provider. In fact, it would create a disparity between manufacturer of a taxable product and manufacturer of taxable product and exempted product to the extent of availment of cenvat credit on input services used only for manufacture of a dutiable product is concerned. Similar would be the case with service providers.

CENVAT Credit Rules, 2004 should be amended to provide that the determination of the amount attributable to input services used in or in relation to manufacture of exempted goods and their clearance up to the place of removal or provision of exempted services as provided under Rule 6(3A) of the CENVAT Credit Rules 2004 should be restricted only to the input services which are common to dutiable and exempted goods/services instead of making the same applicable to entire cenvat credit availed on input services during the month or year.

### 4.5.6. Credit of Tax on Common Input Services used for Manufacturing Notified Goods as well as Dutiable Goods

Rule 6 of the CENAVT Credit Rules, 2004 (CCR, 2004) stipulates that a manufacturer of exempted goods and dutiable goods shall not be allowed to take credit in respect of inputs and input services used in the manufacture of exempted goods. However, if said manufacturer is receiving input services or inputs for both dutiable and exempted goods, he is obliged under the law either to maintain separate account for exempted and dutiable goods and take credit only for inputs and input services meant for dutiable goods or follow one of the conditions specified in Rule 6(3) of CCR, 2004.

It is observed that the aforesaid rule has practical difficulty in application to cases where the manufacturer in the same factory manufactures notified goods [i.e. Pan Masala etc. notified under Section 3A of the Central Excise Act, 1944 read with Pan Masala Packing Machine (Capacity Determination and Collection of Duty) Rules, 2008] and also goods not falling under the aforesaid category. Here, it is relevant to mention that notified goods, under Rule 15 of the Pan Masala Packing Machine (Capacity Determination and Collection of Duty) Rules, 2008, are not eligible for CENVAT credit and non-notified goods, if dutiable, are eligible for CENVAT credit.

Although, principally, the above stated situation is covered by the Rule 6 of CCR, 2004 inasmuch as there is a combination of two classes of goods i.e. notified goods, where credit is not eligible and dutiable goods where credit is eligible. However, technically, Rule 6 cannot be applied as notified goods are not “exempted goods” in terms of definition of exempted goods under rules 2 (d) of CCR, 2004. Hence, manufactures of notified goods who are also engaged in the manufacture of dutiable goods in the same factory are not in a position to apply Rule 6, CCR, 2004 to avail credit of inputs and input services commonly used for notified goods and dutiable goods.

It is recommended that Rule 6 of CCR, 2004 along with definition of "exempted goods" as appearing in Rule 2(d) of the said rules should be amended to include goods notified under Section 3A of the Central Excise Act, 1944.

### 4.5.7. Time Limit for availing CENVAT Credit

As per notification No. 21/2014- CE (N.T) dated 11th July, 2014 CENVAT credit of the duty/service tax suffered on inputs and input services now has to be taken within a period of six months from the date of invoice/challan.

The amendment will have significant impact on the large industries where inputs and input services are large in volumes. To institute proper control, accounting for goods receipts, quality inspection etc. is being done before the CENVAT is taken. Due to the large volumes in some cases time taken in availing CENVAT exceeds much more than six months.

In case of input service, for the execution of the major engineering, procurement and construction (EPC) type of the contract certain portion of the payment is made to the vendor only after satisfactory completion of the project which may take even more than two years.

Further, in some instances due to paucity of the storage space within the excise registered premises, manufacturer stores the raw material outside the premises. The material is brought inside the factory premise in small quantities as per the requirement but CENVAT is only availed when full quantity purchased under an excise invoice is brought inside the factory premises. This process takes more than six months.

It has already been held by the Hon'ble Supreme Court in case of Collector of Central Excise Vs Dai Ichi Karkaria Ltd (1999(112) ELT 353(SC) that CENVAT credit is an indefeasible right. CENVAT is a benefit for any assesse and the same cannot be denied based on an artificial provision. This will also result in cascading effect and will defeat the basic purpose of CENVAT.

The time limit of six months for availing Cenvat credit should be withdrawn. Alternatively, the time limit should be increased to at least a year from the date of invoice. It may also be provided that the time limit would be applicable only for the invoices issued on or after 1st September 2014.

### 4.5.8. Credit in case of Partial Reverse Charge

The Cenvat Credit Rules have been amended vide Union Budget 2014 to provide that in case of partial reverse charge, the Cenvat credit on an input service shall be allowed only after the service receiver makes payment of the value of service along with service tax to the service provider. However, in case of full reverse charge, credit can be availed when service receiver pays service tax to the Government, even if the value of service has not been paid to service provider.

In this regard, it is submitted that as far as the service tax portion deposited by the assessee himself under partial reverse charge is concerned, the same should be aligned with the provisions applicable in case of full reverse charge. This is for the reason that for such portion of service tax which is deposited by assessee under partial reverse charge, the condition of payment of value of service to the service provider is not relevant. Also, the credit taking document in such case is the TR-6 Challan and not the service tax invoice raised by the service provider. So once the service tax has been deposited by the assessee with the Government under partial reverse charge, the credit should be allowed for the same.

This is particularly relevant in view of the 6 months limit for availing the credit from the date of invoice. In case the payment is not made to the service provider within 6 months of the date of invoice, though as per Point of Taxation Rules, 2010, the assessee would be liable to pay service tax under reverse charge on expiry of 3 months from the date of invoice, the credit shall not be available to assessee for the same due to non-payment to service provider.

It is therefore suggested that in case of partial reverse charge also, credit should be allowed to be availed for the service tax amount deposited under reverse charge, when service receiver pays service tax to the Government, even if the value of service has not been paid to service provider.

## 4.5.9. Denial of Cenvat Credit for Movement of Goods from one Factory of LTU to another

In terms of Rule 12A of Cenvat Credit Rules, 2004, a large tax payer can transfer cenvat credit available with one of his registered manufacturing premises to his other manufacturing premises so as to effectively utilize the credit while discharging duty on the final product. This is one of the major benefits provided to manufacturers having multi manufacturing locations and being part of LTU.

By amendment to Rule 12(4) of Cenvat Credit Rules, 2004, vide notification No.21/2014 CE (N.T), the Government has taken away this benefit. Such an action is retrograde and against the commitment of the Government to have a stable and predictable tax regime. Considering the fact that the manufacturers are already facing financial hardship, the amendment to Rule 12(4) looks to be draconian and the Government need to re-think and restore the transfer of cenvat credit from one manufacturing location to other who form part of Large Tax Payers unit.

Incidentally, this amendment is applicable only to manufacturers; service providers forming part of LTU are still eligible for the facility.

## 4.5.10. Eligibility to avail CENVAT Credit on Capital Goods in the Year of Receipt

In terms of Rule 4(2) of the CENVAT Credit Rules, 2004 the credit of CENVAT in respect of capital goods has to be distributed over two years. In the year in which the capital goods are received in the factory credit equivalent to 50% of CENVAT can be availed. The balance 50% can be availed only during the next financial year. As a result of this a lot of time and effort is expended in tracking each item of capital goods in terms of year of entry, amount of credit available in each year, etc. Apart from the cost involved in such tracking, this also leads to errors and, consequently, long-drawn disputes/litigation with the Department.

It is recommended that the CENVAT Credit Rules, 2004 be amended appropriately to enable credit of full CENVAT in respect of capital goods in the year of receipt in to the factory. This would be in line with the provisions on CENVAT credit in respect of inputs.

## 4.5.11. Credit of Duty on Goods brought to the Manufacturer's Depot / Stockyard

As per Rule 16 of Central Excise Rules, 2002, where any goods on which duty had been paid at the time of removal thereof are brought to any factory for being re-made, refined, re-conditioned or for any other reason, the assessee shall be entitled to take CENVAT credit of the duty paid as if such goods are received as inputs under the CENVAT Credit Rules, 2002 and utilise this credit according to the said rules.

As per the above provision a manufacturer can take CENVAT credit of the goods only in case the goods are brought back to the factory. However, there is no provision for bringing back such goods to the depot/stockyard of the manufacturer. A large manufacturing unit operates through number of depots/stockyards situated across the country. Bringing back goods to the factory results in increased expenditure on account of freight cost, if the factory is situated at a long distance from the customer's place.

It is suggested that the existing rule should be suitably amended so that goods can also be brought back to the depot/stockyard of the manufacturer in such situations.

## 4.5.12. Allowing Payment of Service Tax on Import of Services through Cenvat Credit

Sec 66B read with Sec 68 (2) of the Finance Act, 1994 requires the service recipient in India to pay service tax on services received from overseas supplier. As per Rule 3(4) of the Cenvat Credit Rules, 2004, Cenvat credit available with the service recipient cannot be utilized for payment of service tax in case of import of services. The service recipient is required to discharge this liability by payment in cash.

Service exporters are not able to utilize the available Cenvat credit to discharge the liability on import of services. The additional requirement of payment of cash to discharge such tax liability on “reverse charge” basis inflates the pool of unutilized Cenvat credit already available with the exporter. Such payment of tax in cash impacts the working capital requirements of the exporters. The issue gets further aggravated in the absence of efficient and effective mechanism for refund of tax.

Since the payment of reverse charge is neutral to the Revenue, it is recommended that the reverse charge liability for exporter of services be allowed to be paid through Cenvat with appropriate mechanism for re-credit the same under Cenvat Credit Rules 2004.

### 4.5.13. Cenvat Credit of Special Additional Duty for Service Providers

Cenvat credit of Special Additional Duty of Customs (SAD) paid under section 3(5) of Customs Tariff Act, 1975 on import of input goods is available only to manufacturers and not to service providers.

On import of goods made by service providers the component of SAD is a cost to the service provider whereas the same is available as credit for the manufacturer. Thus for assessees involved in Research & Development and engaged in other health services related activities, which utilise such inputs in providing output services, the said duty is a cost.

It is suggested that the provisions of availing CENVAT credit of SAD paid on imported equipment and other items may be extended to service providers also.

## GOODS AND SERVICES TAX (GST)

### 4.6.1. Introduction of Goods and Services Tax (GST)

- GST is going to be a landmark reform in the field of indirect taxation and would have a beneficial impact on the economy of the country. Government should reach out to State Governments and come out with a plan of implementation at the earliest.

- It is requested that the due consultative process with the industry should be observed and draft legislative framework should be placed in the public domain so that industry can gear up for a smooth transition to the new system of taxation.

- FICCI would like to reiterate that all the taxes levied by the Centre and the States on goods and services must be subsumed in the proposed GST including stamp duty, purchase tax, APMC fees, royalties, property tax, tax on motor vehicles, tax on goods and passengers, duty on electricity, entry tax, octroi, etc. It is further urged that the GST should be extended to all sectors of the economy without exception i.e. it must include petroleum and natural gas, real estate, alcohol and power generation sectors. Revenue Neutral Rate should be specified taking into account the interests of all the stakeholders including consumers and taking note of the expected buoyancy in tax collections in the GST regime.

- The first white paper on GST was published by the Central Government long ago. The trade and industry so far has not been updated on the status of various aspects of proposed GST like threshold limits, rates, items under the Negative List, GST compliance, the IT infrastructure, administrative structure etc. At present there is no clarity on these areas of GST, only the newspaper reports are available. The trade and industry expects a white paper on the latest status of the proposed GST incorporating the decisions which have been finalized between the Central Government and the States.

- Further for smoother & seamless transition, the draft modalities of the proposed GST may be circulated at least 6 months in advance for eliciting the industry's views.

# CENTRAL SALES TAX / STATE TAXES

## 4.7.1. Provide Special Tax Treatment for Inter-State Swapping of Natural Gas.

GAIL is supplying Natural Gas/RLNG belonging to GAIL as well as belonging to other supplier/producers such as RIL, IOCL, GSPC etc. to various consumers in fertilizer, Power, CNG and other industrial sectors throughout the country through its cross-country pipeline network. Presently, the domestic gas is available in the state of Gujarat, Maharashtra, Andhra Pradesh, Rajasthan, Tamil Nadu and in a very little quantity in Tripura and Assam. LNG import is possible in the coastal areas like Andhra Pradesh, Kerala, Maharashtra, Gujarat, Tamil Nadu, Orissa and Bengal. The Demand of Natural Gas however exists all across the country to meet the requirement of various sectors like power, fertilizer, City Gas Distribution (for transport and domestic use), Petrochemical, LPG, Steel Industry etc.

To cater this demand, aggregation of the domestic and imported Natural Gas is essential and has to be comingled and transported in the cross country common pipeline network. In the larger public interest, Domestic Natural Gas is presently supplied to the consumers as per allocation and directives given by the Government. The price of domestic gas is also controlled by the Government whereas the imported gas is procured at significantly higher price based on international exchange indices.

The gas produced/available (produced in KG D6) on east coast in AP largely belongs to M/s RIL and the Gas available on west coast largely (produced by ONGC or imported) belongs to GAIL. Gas available from different sources is invariably comingled or needs to be swapped on account of factors such as:

For comingling:-

- Cross country pipelines are connected to multiple sources
- PNGRB guidelines for common access of pipelines to all suppliers
- Nature of commodity requiring economical and safe transportation through pipeline.
- Not viable to have pipeline Infrastructure for each source separately

For swapping:-

- Connectivity of the consumers to the source of Gas vis a vis corresponding contractual arrangement between parties
- Affordability of the consumers
- MOP&NG directions for larger public interest
- Optimization of facilities related to transportation of Natural Gas.

For efficient and equitable distribution of gas from the different sources to the different States, Central Government has issued the guideline for Gas swapping vide MOP&NG order no. (L-12011/10/2011-GP). Even pooling of gas from different sources (pooling of high priced imported gas with low priced domestic gas) is required to supply of gas at reasonable price to different consumers across various sectors. The concept of gas pooling is pursued by MOP&NG also for the most optimal utilization of Natural Gas.

There were no tax implications in commingling, swapping or pooling of Natural Gas/ RLNG from different sources so long as the gas belonged to one supplier. Since commingling, swapping or pooling of Natural Gas took place in one state, it was also possible to demonstrate physical movement. However, as a result of extension of the commingling, swapping or pooling of Natural Gas/ RLNG among the sources located in different states (i.e. AP/ Maharashtra & Gujarat) or gas belonging to different suppliers (i.e. GAIL, RIL, GSPC, IOC etc.), the tax implications are going to become more & more complex and are becoming unmanageable.

As per section 3 of CST Act, 1956, sale or purchase of goods is deemed to be in the course of inter-state trade or commerce if the sale or purchase occasions the movement of goods from one state to another. Since the requirement of section 3 stipulates physical movement of goods, it is difficult to comply with this requirement due to reasons explained above.

Due to above trends, it has also become difficult to demonstrate physical movement of Gas emanating from each source corresponding to its final delivery/sale to consumers. Since tax treatment under existing VAT/CST laws is largely dependent on physical movement of goods, it is very challenging to ascertain real tax liability under these circumstances.

The recent instances of direction of Ministry of Petroleum and Natural Gas (MOP&NG) for swapping of Natural Gas available from sources located in different states which resulted in various tax implications are given below:

a) MOP&NG had directed GAIL/RIL to supply D-6 gas to AP power consumers (in AP) against contracted Gas- RLNG which is available in Gujarat.

b) MOP&NG had directed GAIL/RIL/RCF to supply D-6 gas to M/s BGL (in AP) against contracted Gas- RLNG which is available in Gujarat.

Tentative incidence of Tax for a test case similar to the instances given above clearly highlights the fact that the present system of taxation is acting as a barrier to smooth trade of Natural Gas/RLNG on PAN India level.

If the present taxation system is not suitably modified to address the issues arising out of commingling, swapping and pooling of Natural Gas/RLNG, the tax treatment of inter-state sale/stock transfer transactions will become hard to manage in future on account of the influence of the following factors which are likely to make it infeasible to demonstrate the physical flow of Natural Gas:

- There are Separate contracts with customers for sale of gas from each source of Gas (domestic and imported both).
- Difference in Purchase price and corresponding implications of purchase tax/Tax credit reversal, entry tax etc. on supply/procurement of gas from each source.
- Supply of domestic Gas strictly based on the allocation made by Government to priority sectors and industrial customers irrespective of their location/connectivity to the source.
- Addition of New sources of imported gas in various states such as Kochi, Haldia, Kakinada etc.
- Future plans for trading of Natural Gas on commodity exchanges in India under contracts requiring physical delivery.
- Increasing demand of consumers for optimization of physical supply of gas from sources based on connectivity to upstream field and connectivity to LNG terminal.

Natural Gas (like power/electrical energy) after receipt from multiple sources is transmitted in a closed and integrated pipeline network in commingled form and is supplied to connected customers from common pool in terms of energy value. The above tax implications could arise even in case of supply/transmission of electric energy/ power through inter-state grid/network. But, these issues have not emerged so far in this sector as electric energy/ power is so far exempt from CST/VAT.

Considering the importance of Natural Gas in economic development of the nation and its environmental friendly nature, there is an urgent requirement of special tax treatment/special tax regime for sale and purchase of Natural Gas under CST Act, 1956 which will benefit all the gas consumers in power & fertilizer sector. It will remove the barriers in smooth trade of Natural Gas and will also remove tax distortions in gas sector caused by double taxation and cascading effect.

With a view to develop cost effective and revenue neutral mechanism for Gas swapping in terms of MOP&NG guidelines as well as to resolve the issues emerging from comingling and pooling of gas, it is requested that the following special provisions under Central Sales Tax Act, 1956 may be introduced for facilitating Natural Gas trading such as:

- Inter-state swapping of Natural Gas between different suppliers is not treated as 'Sale' liable to tax under CST/VAT laws.
- Inter-state sale or stock transfer of Natural Gas is allowed based on the contractual movement/ allocation made by the Gas aggregator in common Gas Pipeline Network.

The above provisions would provide a workable solution for supply/transmission of electric energy/ power through inter-state grid/network if VAT/CST is levied on this item also in future.

### 4.7.2. 'Declared Goods' status to Natural Gas/RLNG

Natural Gas/RLNG is subjected to very high rate of VAT in different states. VAT rate on Natural gas/RLNG is as high as 26% and input tax credit is also not available on Natural Gas. This high rate of tax becomes a burden for consumers in Power and Fertilizers sector which is required to be subsidized by the Government.

State governments are not empowered to levy VAT in excess of 5% on the goods declared as 'Goods of Special Importance' under section 14 Central Sales Tax. Coal and crude oil (alternate source of energy) have already been declared as goods of special importance. The importance of Natural Gas in the economic development of the country cannot be considered less than that of coal and crude oil which is a more environmental friendly and efficient source of energy.

Natural Gas/RLNG may be declared as “Goods of Special Importance in Inter-State Trade or Commerce” u/s 14 of the Central Sales Tax Act so that VAT rate on Natural Gas is subject to a ceiling rate of 5% like coal and crude oil. As a result, tax burden to consumers in Power and Fertilizers sector will be reduced which will in turn result in lesser subsidy burden on the government.

If inclusion of Natural Gas in the category of “Goods of Special Importance in Inter-State Trade or Commerce” is not feasible in general then Natural gas may be covered in the category of declared goods based on its end use for “Power” and “Fertilizer” sectors in line with “LPG for Domestic use”. This will address the issue of high tax incidence on gas consumed in power sector where lot of gas based power plants are lying idle due to high cost of Natural Gas.

### 4.7.3. Inclusion of Goods Required for Natural Gas Pipeline Network in the Category of Goods Eligible for Concessional CST against form C

Under Section 8(1)(b) read with section 8(3) and 8(4) of CST Act, the concessional VAT of 2% is applicable on inter-state sale of goods used for certain specified purposes against issuance of form C. The goods used for telecommunication network were specified for the purpose w.e.f. 13.05.2002. Laying of cross country pipelines including connecting gas source to ultimate consumers is a priority for infrastructure development required for creation of National Gas Grid. As it may be observed that the goods required for use in Natural Gas pipeline network are still not covered, Natural gas transmission companies like GAIL are not able to issue form C for purchase of goods for pipeline network at concessional tax of 2%.

Since PNGRB regulated tariff is applicable to the pipeline network being expanded by GAIL across the country, it will in the interest of the consumers in particular, if the capital cost of the pipeline and corresponding tariff may be reduced by granting benefit of concessional tax against form C. Eligibility of pipeline transmission projects for inter-statement procurement of goods against form C will enable reduction in project cost which will ultimately benefit the consumers.

Considering the importance of Natural Gas transmission pipeline network for building a national gas grid, it is suggested that the goods required for Natural Gas pipeline network should be included in eligible category of goods under section 8(1)(b) read with section 8(3) of CST Act.

## 4.7.4. CST exemption on 'Deemed Exports' supplies of Non-Ferrous Products against Advance Authorization

A 2% Central Sales Tax (CST) is being levied on the Indian zinc / aluminium / copper industry, which is non-cenvatable and places Indian producers at a disadvantage vis-a-vis the imports. CST burden on such products cannot be passed on to the consumers as it is easily import substitutable and also the prices are determined globally. Considering that the industry has very thin margins of 2.5-3%, the same gets nullified by the 2% CST. Thus, due to the CST disadvantage, the industry is witnessing a surge in imports (83,000 metric tonnes of refined copper in 2009-10 to 204,000 metric tonnes in 2013-14, April to December).

Also, the Indian industries supply raw material to downstream manufacturers and exporters of electrical products. If manufacturers of such downstream industries, seek raw material domestically for the value added export, then the CST is levied on such deemed export sale of goods to these exporters. However, if they source the raw material through imports under advance license, then no such duty is applicable to them. Hence, deemed export sales become less competitive putting Indian producers at a disadvantage.

It is suggested that CST may be exempted on Deemed Exports supplies of non-ferrous products like zinc / aluminium / copper cathodes and wire rods against advance export license to the downstream industries by domestic manufacturers should be provided.

## 4.7.5. Overlapping of Periods in issuance of CST Declaration Forms & Problems in CST Assessments

As per the CST Rules ( Registration and Turnover ) , the interstate Purchaser of the goods issues CST Form C , on quarterly basis , to the corresponding interstate Seller of the goods on the basis of receipt of such goods . However, due to this provision, there are problems faced by the Seller as his Assessing Authority does not accept such C Form, issued on basis of Receipt by the Purchaser.

*Illustration: The Seller in state A sells the goods in the month of March to his interstate Purchaser in state B with 2% CST against C Form. The Purchaser in state B receives the said goods in the month of April and he includes the said Invoice of March in his C Form for the quarter ended June (Apr – May – June Quarter). He sends such C Form to the Seller in state A. The Assessing Authority of seller in state B does not accept such C Form since the Invoice date is of March, last financial year.*

Due to such overlapping of the periods and different procedures followed by the concerned two states with regard to issuance of C Forms on basis of Seller's Invoice Date and on the basis of receipt date , the trade and industry is facing serious problems at the time of CST Assessments since such C Forms are being disallowed . There is no fault of the Seller or Purchaser in such cases but of the concerned states who follow different procedures in this regard.

The Central Government should amend the relevant provisions of the Central Sales Tax Rules (Registration & Turnover) so as to allow the dealers to include the Invoices of the Seller in the subsequent quarters also. Due to such amendment to the CST Rules, the overlapping of invoices from one quarter to next in the C Forms shall be allowed by the Assessing Authorities of the Selling states in the concerned Assessments under the CST Act. The said amendment to the CST Rules may be extended to CST Form F also. This would avoid hardships to the trade and industry.

## 4.7.6. Enable SEZs to issue of Form I to Subcontractors.

Under SEZ Act and Rules, SEZ units/Developers and also the contractors and subcontractors appointed by the SEZ Units/Developers are entitled for CST exemption on interstate procurement of goods used for setting up and for authorized operations, on furnishing duly signed Form I.

However, under the CST Act there is no enabling provision or rule which provides for issuance of Form I to the vendors of contractor or subcontractor appointed by the SEZ units/Developer. This results in additional cost to the SEZ unit to the extent of CST charged by the suppliers to sub-contractor. This defeats the very intention of providing fiscal benefits to SEZ units/developers under the SEZ Act.

It is recommended to make suitable amendment to the CST Act to enable SEZ units to issue Form I directly to the vendor/manufacturer/importer of the goods even though the purchaser is the contractor or sub-contractor, as long as contractor/subcontractor also gives a declaration that such goods are received by the SEZ units/developer for its authorized operation or for use in setting up of SEZ. A copy of the Form I issued to the manufacturer can be given to the sub-contractor for him to claim the exemption as well.

Alternatively, the bill-to-ship-to model being freely used in the commercial field, it is suggested that Form I (to be issued by the SEZ entity) be amended to reflect both the supplying vendor's name as well as the contractor's name, so that the entire leg of the inter-state transaction is exempt from levy of CST and the true intent of the SEZ regime is achieved.

### 4.7.7. Central Sales Tax exemption for STP/EOU/EHTP

The 0% CST rate against Form I is limited to SEZ alone and not available to EOU/STP/EHTP units. The rationale of exempting SEZ from the levy of CST is not to export taxes and make Indian exports globally competitive.

There is no rationale for not extending the 0% CST rate facility to EOU/STP/EHTP exporters on the lines similar to that of SEZ units especially since mechanism for reimbursement of CST tax to STP/EHTPs is available. From the viewpoint of administrative ease, 0% CST rate mechanism works more efficiently than the mechanism for reimbursement.

Similar to the CST exemption provided to SEZ units, STP/EOU/EHTP units should also be allowed to avail CST exemption against Form I on interstate purchases made.

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