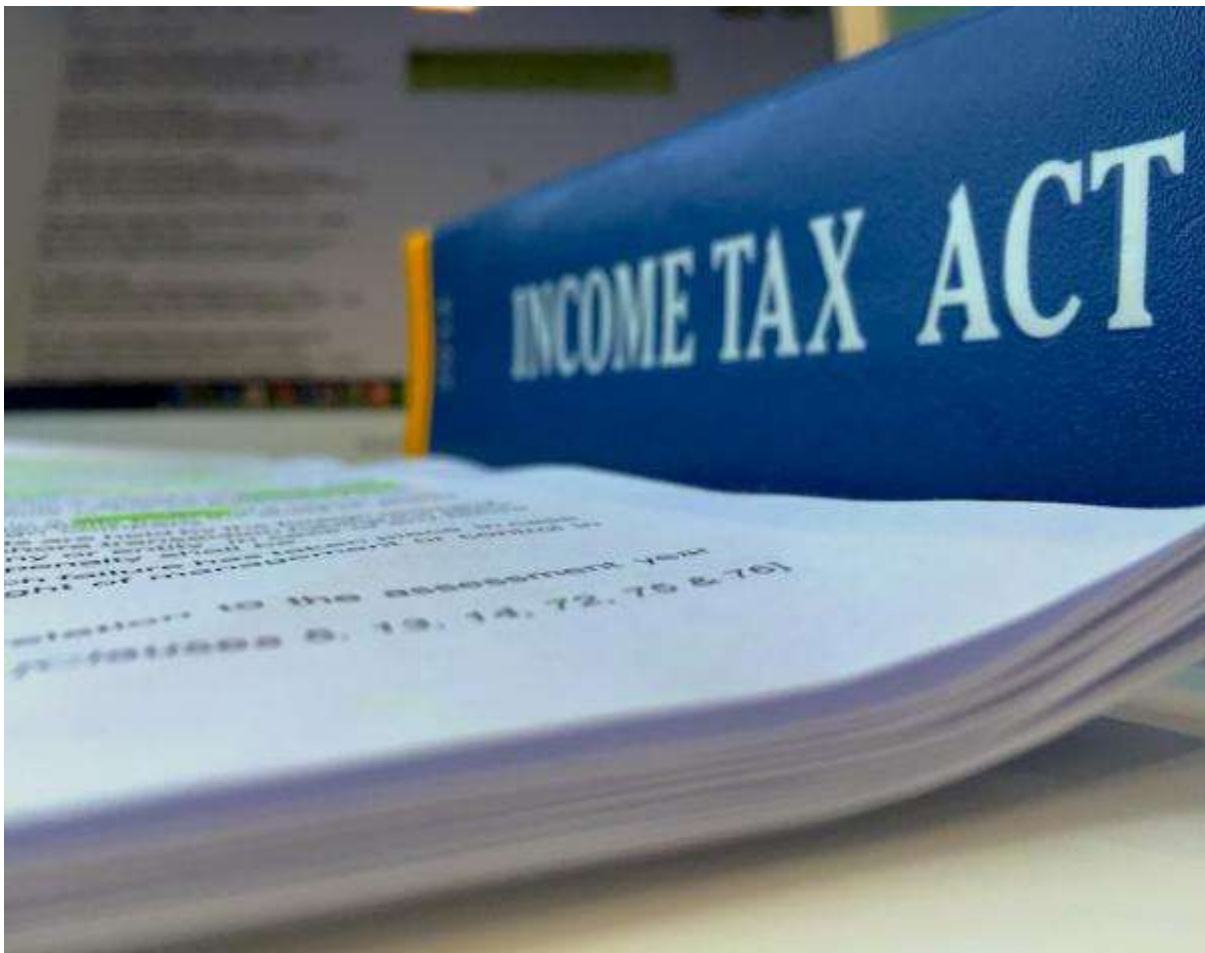


BUDGET

2015

AN INSIGHT INTO KEY DIRECT TAX PROPOSALS



PARAS SHETH & ASSOCIATES

Chartered Accountants

AMENDMENTS AT A GLANCE

CHANGES IN RATES OF TAX	2
ABOLITION OF WEALTH TAX	2
DEFERMENT OF GAAR PROVISIONS.....	2
CLARIFICATION IN RELATION TO TAXATION OF INDIRECT TRANSFERS	2
THRESHOLD FOR DOMESTIC TRANSFER PRICING RAISED	3
REDUCTION IN RATE OF TDS ON ROYALTIES AND FEES FOR TECHNICAL SERVICES	3
FOREIGN TAX CREDIT RULES TO BE PRESCRIBED.....	3
EXTENSION OF BENEFITS TO REITs	4
TAXABILITY OF INTEREST PAID BY BRANCHES OF FOREIGN BANKS TO HEAD OFFICE.....	4
NO PERMANENT ESTABLISHMENT FOR FUND MANAGERS.....	3
PASS THROUGH STATUS FOR ALTERNATIVE INVESTMENT FUND	3
CHANGES IN MAT PROVISIONS UNDER SECTION 115JB.....	4
AMENDED DEFINITION FOR RESIDENTIAL STATUS OF COMPANY.....	5
CONCEALMENT PENALTY APPLICABLE EVEN IN CASE OF TAX PAID UNDER MAT	5
REVISION OF ORDER UNDER SECTION 263.....	6
CLARIFICATION ON LEVY OF INTEREST u/s 234B FOR REASSESSMENT PROCEEDINGS / SETTLEMENT COMMISSION	7
RATIONALISATION OF PROCEDURES OF SETTLEMENT COMMISSION.....	6
ADDITIONAL DEPRECIATION	7
CEILING FOR 80D DEDUCTION RAISED	7
OTHER MISCELLANEOUS AMENDMENTS.....	8

CHANGES IN RATES OF TAX

The Finance Minister proposed to reduce the rate of tax applicable on domestic companies from 30% to 25% in a phased manner in the next 4 years. However, in the Finance Bill, no such reduction is proposed for the AY 2016-2017 or for any subsequent years.

Further, the rate of surcharge is increased by 2% in case of all the resident assessees. Following are the effective surcharge rates:

Resident Assessee	Rate of surcharge
Individuals, HUF, AOP, BOI (total income > Rs 1 crore)	12%
Co-operative societies, Firms, Local Authorities (total income > Rs 1 crore)	12%
Domestic Companies (total income > Rs 1 crore ≤ Rs 10 crores)	7%
Domestic Companies (total income > Rs 10 crores)	12%
Dividend distribution tax / Buy back	12%

ABOLITION OF WEALTH TAX

On account of lower collection of wealth-tax over the years and disproportionate compliance burden on the assessees and administrative burden on the Tax Authorities, the Finance Minister proposed to abolish levy of Wealth Tax under the Wealth-tax Act, 1957 with effect from 1st April 2016 i.e. AY 2016-2017.

DEFERMENT OF GAAR PROVISIONS

The provisions of General Anti-Avoidance Rule ('GAAR') contained in Chapter X-A were to be implemented from financial year ('FY') 2015-16.

Given that the rules in relation to Base Erosion and Profit Shifting ('BEPS') by the Organisation of Economic Co-operation & Development ('OECD') are yet to be finalised and in order to create a conducive investment environment in India, the applicability of GAAR provisions have been deferred to be effective prospectively from FY 2017-2018.

CLARIFICATION IN RELATION TO TAXATION OF INDIRECT TRANSFERS

Finance Act, 2012 had inserted Explanation 5 (along with Explanation 4) to Section 9 of the Act to negate the Apex Court ruling in the case of Vodafone¹ so as to cover the cases of indirect transfer of shares within the Indian tax net. Explanation 5 provided that *a share or interest in a company or entity registered or incorporated outside India shall be deemed to have been situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets located in India*. However, the term 'substantially' was ambiguous and was not defined under the said provision creating lacuna in taxability of such indirect transfers.

Recently, Delhi High Court² had adjudicated on the applicability of Explanation 5 and also interpreted the term 'substantially' that it would cover transfer of shares of a company incorporated overseas, which derive more than 50% of their value from assets situated in India, and not

¹ Vodafone International Holdings BV v. UOI [(2012) 204 Taxman 408]

² DIT(International Tax) v. Copal Research Limited [TS-509-HC-2014(DEL)]

otherwise. Further, Shome Committee had provided several recommendations in relation to taxability of indirect transfers.

Considering the above recommendations, it is now proposed to introduce certain clarifications and conditions on applicability of the indirect transfer taxation. It is proposed that the taxation shall be triggered only where threshold limit of the fair market value of the asset transferred exceeds Rs 10 crores and constitutes atleast 50% of the fair market value of the total assets as on the last balance sheet date. The methodology of valuation alongwith certain other rules and exemptions shall be prescribed.

THRESHOLD FOR DOMESTIC TRANSFER PRICING RAISED

The Finance Bill has proposed to raise the threshold limit for applicability of domestic transfer pricing under section 92BA of the Act from Rs 5 crores to Rs 20 crores.

REDUCTION IN RATE OF TDS ON ROYALTIES AND FEES FOR TECHNICAL SERVICES

It is proposed to lower the rate of deduction of tax at source ('TDS') applicable on royalties and fees for technical services not effectively connected to a Permanent Establishment ('PE') from 25% to 10% (section 115A read with section 9(1)(vi) and 9(1)(vii) of the Act).

FOREIGN TAX CREDIT RULES TO BE PRESCRIBED

It is proposed that CBDT shall introduce Rules in relation to manner of claiming credit of taxes paid / deducted outside India.

NO PERMANENT ESTABLISHMENT FOR FUND MANAGERS

Under section 9(1)(i) of the Act, the income of a non-resident is deemed to accrue or arise in India in case of existence of a business connection / PE in India. Once such a business connection is established, the income attributable to the activities which constitute business connection becomes taxable in India.

In the case of off-shore funds, there is an ongoing litigation as to whether the presence of a fund manager in India would constitute a business connection or a PE for the Offshore fund in India even though the fund manager may be an independent person. In order to curb the litigation and to attract the foreign funds, it is proposed to insert Explanation 6 to section 9(1)(i) which provides that the fund management activity carried out through an eligible fund manager in India acting on behalf of an eligible investment fund shall constitute business connection in India subject to fulfilment of several conditions.

PASS THROUGH STATUS FOR ALTERNATIVE INVESTMENT FUND

Under the SEBI Alternative Investment Fund ('AIF') regulations, various types of AIFs have been classified under three separate Categories viz Category I, Category II and Category III AIFs based on the investment objective. Under the existing provisions of the Act, section 10(23FB) accords a pass-through status to the Venture Capital Funds.

It is now proposed to extend the pass-through status to the AIFs i.e. the income shall be exempt in the hands of the Fund but taxable in the hands of the unit-holder / investor on its distribution.

Certain conditions are prescribed in order to fall under the aforesaid special taxation regime.

EXTENSION OF BENEFITS TO REITs

In case of Real Estate Investment Trusts ('REIT'), special taxation regime was introduced by the Finance Act (No. 2), 2014 whereby the pass-through status was accorded to the REITs with respect to interest income earned i.e. interest income shall not be taxable in the hands of the REITs but taxed in the hands of the unit holders at the time of distribution of such income.

As REITs' income primarily comprises of rental income from lease of properties, it is now proposed to extend the benefit of pass-through benefits in relation to such rental income. Such rental income shall be taxed as such in the hands of the unit holders upon distribution. The REITs shall be liable to deduct TDS at the rate of 10% at the time of distribution of such income. No TDS shall be applicable on payment of rental income to REITs under section 194IA.

It is also proposed to amend the provisions of section 10(38) and section 111A in order to treat the capital gains taxation on exit by the sponsors to be at par with the capital gains treatment on sale of listed securities i.e. short term capital gains shall be charged at the rate of 15% and long term capital gains shall be treated as exempt.

TAXABILITY OF INTEREST PAID BY BRANCHES OF FOREIGN BANKS TO HEAD OFFICE

It is proposed to amend provisions of section 9 to tax any interest payable by the PE of foreign Banks in India to the head office.

Such interest shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the PE. Accordingly, such PE shall be required to deduct TDS on the said interest payment.

CHANGES IN MAT PROVISIONS UNDER SECTION 115JB

In case of a company, if the tax payable under normal provisions of the Act is less than the Minimum Alternate Tax ('MAT') of 18.5% of the book profits computed in accordance with section 115JB, the company shall be liable to pay the MAT. There has always been an ambiguity in relation to applicability of provisions of MAT under section 115JB to the Foreign Institutional Investors ('FIIs').

It is now proposed to provide exemption under section 115JB to the FIIs who earn capital gains on sale of securities. The Explanation 1 to section 115JB which provides certain exclusions and additions to the book profits has been amended to exclude the income arising to an FII (other than short term capital gains arising on transactions on which STT is not chargeable).

As a result of the specific exclusion contemplated above, short term capital gains on off-market sale of securities may be includible in the book profit calculation under section 115JB. It also creates an anomaly as to whether the foreign entities who are not governed by the provisions of Companies Act are required to prepare the books of accounts for the purpose of MAT. Certain judicial precedents³ have held that provisions of section 115JB are not applicable to foreign companies not having a PE in India.

³ Timken 326 ITR 193 (AAR), Bank of Tokyo Mitsubishi UFJ Ltd [2014] 49 taxmann.com 441 (Delhi - Trib.)

It is also proposed to amend Explanation 1 of section 115JB to exclude the share of income of an AOP received by the member - Company from the book profit computation. Consequently, the expenses incurred in relation to the said income shall be added back in the book profit calculation.

AMENDED DEFINITION FOR RESIDENTIAL STATUS OF COMPANY

As per section 6 of the Act a company is said to be resident in India in any previous year, if-

- (i) it is a company incorporated in India; or
- (ii) during that year, the control and management of its affairs is situated wholly in India.

Certain shell companies which are incorporated outside India but controlled from India could avoid becoming a Resident Company by merely contending that the control and management of the company is not wholly situated in India. In several tax treaties (especially with the OECD countries), the residential status of a company is determined based on the principle of 'Place of Effective Management' ('POEM')⁴. In order to align the residential status of the companies under the domestic law with the tax treaties, it is now proposed to amend section 6 to provide that a company shall be said to be resident in India in any previous year, if-

- (i) it is an Indian company; or
- (ii) its place of effective management, at any time in that year, is in India

Further, it is proposed to define the place of effective management to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

The amendment shall be effective from 1st April, 2016 i.e. from AY 2016-17.

CONCEALMENT PENALTY APPLICABLE EVEN IN CASE OF TAX PAID UNDER MAT

As per Explanation 4 to section 271(1)(c) of the Act, concealment penalty is leviable on 'the amount of tax sought to be evaded'. There was an ambiguity in a scenario where concealment of income occurs in case of concealment of income under normal provisions and the final assessment is made under the provisions of section 115JB. Supreme Court⁵ in such a scenario has held that *"there was concealment but that had its repercussions only when the assessment was done under the normal procedure. The assessment as per the normal procedure was, however, not acted upon in the instant case. On the contrary, it was the deemed income assessed under section 115JB which had become the basis of assessment, as it was higher of the two. Tax was, thus, paid on the income assessed under section 115JB. Hence, when the computation was made under section 115JB, the*

⁴ The OECD commentary on model convention provides definition of place of effective management to mean the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole, are, in substance, made.

⁵ CIT vs. Nalwa Sons Investment Ltd. (SC) 194 Taxman 387.

concealment had no role to play and was totally irrelevant. Therefore, the concealment did not lead to tax evasion at all."

However, the Finance Bill, 2015 seeks to overrule such position and provides that the term "amount of tax sought to be evaded" shall be the summation of tax sought to be evaded under the general provisions and the tax sought to be evaded under the provisions of section 115JB or 115JC.

The amendment shall be applicable with effect from AY 2016-17.

REVISION OF ORDER UNDER SECTION 263

Section 263 of the Act provided the Commissioner / Principle Commissioner a power to conduct inquiries and pass an order modifying any assessment order which in his opinion is erroneous and prejudicial to the interests of revenue. There was no stipulation under the Act as to what constitutes 'erroneous and prejudicial to the interests of revenue' thereby leaving the issue open for interpretation and resultant litigation.

It is now proposed to introduce following scenarios which could be considered by the Principal Commissioner or Commissioner in order to form an opinion that the order is erroneous and prejudicial to the interests of revenue:

- (a) the order is passed without making inquiries or verification which, should have been made;*
- (b) the order is passed allowing any relief without inquiring into the claim;*
- (c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or*
- (d) the order has not been passed in accordance with any decision, prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.*

The above scenarios appear to be generic and therefore, would again create anomalous and contentious litigation.

RATIONALISATION OF PROCEDURES OF SETTLEMENT COMMISSION

Following amendments are proposed in relation to Settlement Commission procedures:

- ✓ Finance Act, 2014 amended provisions of section 245A wherein an assessee could apply for settlement of even those cases which are pending for re-assessment proceedings. It is now proposed that while making an application to the Settlement Commission for an assessment year which has been re-opened by the Assessing Officer, the assessee can make an application for other assessment years in which the proceedings could be re-opened provided the return of income for such assessment years has been furnished by the assessee [Explanation (i) to section 245A(b)]
- ✓ Time limit for completion of proceedings specified in cases where no assessment is made to be expiry of 2 years from the end of relevant assessment year [Explanation (iv)]

- ✓ Rectification of any mistake apparent from the record in relation to any order passed by the Settlement Commission to be passed within 6 months from the end of the month in which application for such rectification is made [Section 245D(6B)]
- ✓ Reasons to be recorded by the Settlement Commission while granting immunity from prosecution to the assessee [section 245H(1)]
- ✓ Section 245K provided that a person who has already once approached the Settlement Commission route for settlement / disposal of his case cannot approach Settlement Commission subsequently in his lifetime. It is proposed to amend section 245K to restrict specified related parties of that person to approach Settlement Commission.
- ✓ Seized cash to be adjusted towards the assessee's tax liability under the settlement application [section 132B]

The above amendments shall be effective from 1st June 2015.

CLARIFICATION ON LEVY OF INTEREST u/s 234B FOR REASSESSMENT PROCEEDINGS / SETTLEMENT COMMISSION

It is proposed to amend section 234B to provide that interest shall be computed for the period beginning from April 1 of the financial year and ending on the date of determination total income under section 147 or section 153A.

It is also proposed to impose the interest on additional income disclosed in the order of the Settlement Commission under section 245D(4).

ADDITIONAL DEPRECIATION

Section 32(1)(iia) provides benefit of additional depreciation of 20% on the cost of new plant or machinery acquired and installed for the manufacturing and power sector. As per the second proviso, such additional depreciation is restricted to the extent of 50% of the rate (effectively 10%) in a scenario where the plant / machinery is used for less than 180 days in a financial year.

It is now proposed that in the above scenario, balance 50% of the additional depreciation (i.e. balance 10%) shall be allowed in the subsequent AY. The amendment is effective from AY 2016-2017.

CEILING FOR 80D DEDUCTION RAISED

It is proposed to raise the ceiling of deduction with respect to the payment of medical insurance premium as under:

Particulars	Deduction ceiling
Individuals, HUF	20,000
If Individual is senior citizen	30,000
Additional deduction if medical insurance paid for parents	30,000

Further, very senior citizens (80 years & above) shall be entitled to a deduction to the extent of Rs 30,000 for medical expenditure (even where no medical insurance is available).

OTHER MISCELLANEOUS AMENDMENTS

- ✓ Section 151 to be amended to ward off the hierarchy of the Assessing officer required to issue notice under section 148. It shall simplify the administrative hurdles in the Income-tax Department to obtain prior sanction for reopening of assessments
- ✓ As a measure to curb black money, section 269SS amended w.e.f. June, 2015 to provide that no person shall accept any loan or deposit or any sum of money, whether as advance or otherwise, exceeding Rs. 20,000, in relation to transfer of an immovable property otherwise than by an account payee cheque or account payee bank draft or by electronic clearing system through a bank account. Similar amendment made under section 269T debarring repayment of such loan or deposit.
- ✓ Section 288 amended - An auditor who is not eligible to be appointed as an auditor under Companies Act, 2013 shall not be eligible for carrying out audit in respect of corporate assessees.
- ✓ Additional deduction of Rs. 50,000 is provided for contribution to pension Scheme under section 80CCD
- ✓ Section 80C amended to provide for investment opportunity in 'Sukanya Samridhi Account Scheme' to the extent of Rs 100,000. Also interest earned from the Scheme shall be exempt under section 10(11A).
- ✓ Benefit of deduction under section 80JJAA for employment of new regular workmen to all business entities and eligibility threshold reduced.
- ✓ Concessional withholding tax rate of 5% on interest payment under section 194LD extended upto 30th June, 2017.
- ✓ No interest under section 220 could be levied if interest has already been levied for TCS default.
- ✓ Incentives proposed for the State of Andhra Pradesh and the State of Telangana
- ✓ Provisions of section 206C to be amended to allow the collector to furnish TCS correction statement and also to incorporate the mechanism for computation of fee payable under section 234E of the Act.
- ✓ Section 195(6) to be amended to mandate provision of information in the TDS return in relation to all the cross-border transactions (even if they are not chargeable to tax) (applicable with effect from 1st June 2015).

DISCLAIMER:

The information contained herein is of general nature and is not intended to address any particular individual or entity. The information contained herein shall under no circumstance be construed as any kind of professional advice or opinion.