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Sharp Insights

Amendments to Finance Bill, 2016 passed by the Lok Sabha and approved by the Rajya Sabha

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In this issue:

Background

On May 5, 2016, the Lok Sabha (Lower House of Parliament) passed the Finance Bill, 2016 ("the Bill") after making certain amendments to the Bill (as presented by the Finance Minister on February 29, 2016). Further, on May 11, 2016, the Rajya Sabha (Upper House of Parliament) has approved the Bill as passed by the Lok Sabha, without any further modifications. The Bill as approved by the Rajya Sabha has been sent to the President of India for his assent and once he assents, it will become an Act from the date of its notification in the official gazette. The key amendments are outlined below:

Amendments to the Finance Bill, 2016

Unlisted shares held for 24 months or less would be treated as short-term capital asset

- As per the provisions of section 2(42A) of the Income-tax Act, 1961 ("the Act"), any capital asset held by an assessee for a period of not more than 36 months immediately preceding the date of its transfer qualifies as short-term capital asset.
- Further, in case of 'shares held in a company', the aforesaid '36 months' were replaced by '12 months'. However, the Finance Act 2014 had amended the provision to increase the period of holding for unlisted shares from 12 months to 36 months, for classifying unlisted shares as short term or long term capital asset.
- The Finance Minister in his Budget Speech had announced the proposal to reduce the holding period for unlisted shares from 36 months to 24 months. However, the proposal was not incorporated in Bill. Accordingly, the amended Bill as approved by Rajya Sabha has incorporated the reduced period of 24 months for unlisted shares. With this amendment, any shares in unlisted company held for a period of not more than 24 months immediately preceding the date of its transfer will qualify as short-term capital asset.

Tax to be collected at source on sale of motor vehicle at the time of receipt only

- The Bill proposed that every seller of a motor vehicle shall collect tax at source (TCS) at a rate of 1% of value of motor car, if such value exceeds ten lakh rupees. Such tax was proposed to be collected from the buyer under section 206C of the Act at the time of debiting the amount receivable or at the time of receipt, whichever is earlier.

- Further, as per the Bill, TCS would not have been applicable in the following circumstances:
  (a) If the motor car is purchased by the buyer in a retail sale for personal consumption; or
  (b) If the buyer furnishes a declaration in the prescribed form to the seller that the motor cars are to be utilized for the purpose of manufacturing, processing or producing articles or things or for the purpose of generation of power and not for trading purposes.
- The amended Bill, as approved by the Rajya Sabha provides that tax shall be collected under Section 206C of the Act, from **all the buyers** irrespective of the purpose for which the vehicle would be used, **only at the time of receipt of consideration from the buyer**.

Changes to new penalty regime for under-reported and misreported income

The Bill proposed a new penalty regime, through insertion of a new Section 270A (in substitution for existing provisions under section 271(1)(c)) for under-reporting and misreporting of income, respectively, at flat rate of 50% or 200% on the amount of tax payable computed at 30% on the under-reported income. With regard to this, the amended Bill has brought in certain clarity and amendments as follows:

- Though the new section proposed levy of penalty in case of under-reporting and misreporting of income by assessee, there was no corresponding provision to invoke prosecution in this case. The amended Bill as approved by Rajya Sabha amends section 276C of the Act to provide that under-reporting of income as per section 270A of the Act shall be punishable with rigorous imprisonment under the existing provisions of section 276C.
- The Bill proposed six instances under section 270A, where a person shall be deemed to have under-reported his income. Further, the amended Bill as approved by the Rajya Sabha has included one more instance of underreporting of income, which provides that a person shall be deemed to have underreported his income where the amount of total income reassessed as per the provisions of Section 115JB or Section 115JC of the Act, is greater than the deemed total income assessed or reassessed under such provisions immediately before such reassessment.
- Further, the Bill proposed a flat tax rate of 30% in respect of under-reported income in case of Individuals, HUF, AOP, BOI, Artificial Juridical person. In this regard, the amended Bill as approved by the Rajya Sabha provides that, the tax payable in respect of the under-reported income shall be as under:

- *In case return not furnished*: Where return of income has not been furnished and the income has been assessed for the first time, the tax shall be calculated on under-reported income as increased by maximum amount not chargeable to tax.
- *In case of loss*: Where the total income assessed or re-assessed is a loss, the tax shall be calculated on under-reported income as if it was the total income.
- *In any other case:* Tax on under-reported income as increased by income assessed or re-assessed originally *less* tax on income assessed or re-assessed originally.

Relaxation of limitation period for initial processing of return of income (ROI) The Bill had provided that a ROI shall be mandatorily processed before issuing assessment order under section 143(3) of the Act.

- As per the provisions of the Act, intimation under section 143(1) cannot be sent to the taxpayer after the expiry of one year from the end of the financial year in which the return is filed.
- However, the amended Bill as approved by Rajya Sabha provides that the processing of return is not necessary before the expiry of one year from the end of the financial year in which return is furnished, where a notice is issued for scrutiny assessment under section 143(2) of the Act. Thus extended period has been provided for processing of return where ROI is selected for scrutiny.

Benefit of concessional tax of 25% extended to domestic companies engaged in research and distribution of manufactured products

- The Bill proposed insertion of a new section 115BA to provide benefit of concessional tax rate of 25% to certain domestic companies engaged in the business of manufacturing or production of any article or thing, provided such company has been set-up and registered on or after March 1, 2016.
- The amended Bill as approved by the Rajya Sabha provides that benefit of concessional tax rate shall also be available to companies engaged in research in relation to or distribution of such article or thing manufactured or produced by it.
- Further, the Bill provided that taxpayer desirous of claiming the concession will need to furnish an appropriate declaration opting for the concession before the due date of furnishing the return of income. It was also proposed that taxpayer can exercise such option on year-on-year basis. However, the amended Bill as approved by Rajya Sabha provides that any

such option is required to be exercised in the year of set-up by the taxpayer, and any option so exercised once cannot be withdrawn thereafter in same or in any subsequent year.

Cost of acquisition of asset reported as undisclosed income under Income Declaration Scheme, 2016

- The Bill proposed Income Declaration Scheme, 2016, to provide opportunity to taxpayers to declare their undisclosed income and discharge applicable tax and penalty. Under the scheme, it was provided that where the income chargeable to tax is declared in the form of investment in any asset, the fair market value of such asset as on the date of commencement of this scheme shall be deemed to be the undisclosed income.
- The amended Bill as approved by the Rajya Sabha provides that, for any subsequent transfer of such assets, such fair market value of assets shall be deemed to be the 'cost of acquisition'.

Tax benefit to 'Start-ups' extended to Limited Liability Partnerships (LLP)

- The Bill proposed to insert a new section 80-IAC to provide 100 percent tax holiday benefit to an 'eligible Start-up' engaged in an eligible business, for any 3 consecutive assessment years out of a 5 year block beginning from the year of incorporation. The 'eligible start-up' was defined to mean a 'company' engaged in an eligible business.
- The amended Bill as approved by the Rajya Sabha extends the definition of 'eligible start-up' to include LLP, if it is registered between April 1, 2016 and March 31, 2019.

Clarifications on the New Indian Patent Box regime

- The Bill proposed insertion of new section 115BBF to introduce a concessional tax regime for royalty income of a resident taxpayer, in respect of a patent developed and registered in India, at the rate of 10%, on gross basis.
- There were certain ambiguities in the wordings of the above amendment which raised apprehensions amongst the taxpayers. In order to provide clarity, sub sections (a) and (b) to section 115BBF have been introduced by the amended Bill:
    a) There was an ambiguity on whether proposed regime is optional or mandatory for the eligible taxpayer. The amended Bill clarifies that the regime is optional for eligible taxpayer who has to opt for the regime by furnishing a declaration in prescribed form before the due date of furnishing return of income (ROI).
    b) The amended Bill further introduces a restriction and provides that if any eligible taxpayer opts for concessional tax regime in any tax year but opts out of the regime in any of five

tax years succeeding such tax year, it shall not be eligible to opt in to the regime for a period of five consecutive tax years succeeding the year of opting out.

- Further, there was ambiguity whether entire development expenditure should be incurred in India to qualify for the regime and, consequently, whether incurring part of expenditure outside India would have disqualified the taxpayer from the regime. The amended Bill addresses the apprehension by providing that, in order to qualify for the regime, at least 75% of the expenditure should be incurred by the eligible taxpayer in India.

Additional tax incentives for units located in International Financial Service Centre (IFSC)

- The Bill proposed to introduce certain tax incentives for units located in IFSC in order to facilitate growth of IFSC into a world class hub.
- As per the proposed amendment, the reduced rate of 9% (plus applicable surcharge and cess) for levy of Minimum Alternate Tax was applicable in case of a company, being a unit established in IFSC on or after April 1, 2016. The amended Bill as approved by Rajya Sabha has deleted this requirement and extended this benefit to all units, which have been set up before April 1, 2016.
- Further, the Bill proposed that no Securities Transaction Tax (STT) and Commodities Transaction Tax (CTT) shall be levied on transactions of securities carried out through recognized stock exchange located in IFSC where the consideration for such transaction is paid or payable in foreign currency.
- Consequently, an amendment in section 10(38) was proposed to exempt long term capital gains (LTCG) on transactions in securities undertaken in foreign currency on a recognized stock exchange located in IFSC, even where Securities Transaction Tax (STT) is not paid.
- However, there was no such amendment proposed under section 111A for short term capital gains arising from transfer of listed securities.
- This concession of not requiring to pay STT has now been extended for availing 15% concessional tax rate on short term capital gains (STCG) as well.
- In other words, benefit of exemption for LTCG and concessional rate for STCG as applicable to listed shares and securities will extend to units in IFSC, eventhough they are excluded from STT levy.

Amortization of spectrum fee

- The Bill proposed to insert a new section 35ABA to provide for amortization of capital expenditure incurred and actually paid for acquiring right to use spectrum for telecommunication services (spectrum fees) over the period of the right to use. Such expenditure may be incurred prior or post commencement of business. It was proposed that the amortization will start only after actual payment is made. If actual payment is made prior to commencement of business, amortization will start post commencement of business.
- The amended Bill as approved by Rajya Sabha relaxes the condition of actual payment and provides that amortization will start either on actual payment or payable in such manner, as may be prescribed.
- Further, as per amended Bill, if the taxpayer who has claimed and is granted amortization fails to comply with the specific conditions of the new provisions, it shall be deemed that amortization have been wrongly allowed. The Tax Authorities will have power to re-compute the total income by making rectification under section 154 of the Act, within four years from the end of the tax year in which the taxpayer fails to comply with the conditions.

Relief to Non-residents from tax deduction on income from Investment Funds

- The Bill proposed to amend section 194LBB of the Act to provide that tax shall be deducted at the rate of 10%, on the distribution of non-business income by Category I and II Alternative Investment Funds registered with SEBI, where payee is resident. Where the payee is non-resident or foreign company, tax shall be deducted at the rates in force (i.e. beneficial rate provided under the Finance Act or under applicable Double Tax Avoidance Agreement).
- There was an ambiguity whether the incomes which were not chargeable to tax (like dividends or LTCG on listed securities etc.) would also be subject to tax deduction. The amended Bill as approved by the Rajya Sabha provides that, no tax shall be deducted in respect of distribution of any income to non-residents, which is not chargeable to tax.
- However, tax deduction at 10% shall continue to apply on distribution to resident investors or payees.

Immunity from penalty and prosecution in certain cases

- The Bill proposed to insert section 270AA to provide immunity to the taxpayer from penalty under section 270A and prosecution proceedings under section 276C, initiated in respect of under-reporting of income, if the taxpayer pays the tax and interest within the time prescribed by the notice and provided that the taxpayer does not file an appeal against the order.

- The amended Bill as approved by the Rajya Sabha extends the benefits of immunity from prosecution for failure to furnish the return of income, as initiated under Section 276CC (new Section 270AA) of the Act.

Further relaxation on Tax on accreted income of Trusts

- The Bill had proposed levy of “tax on accreted income” with reference to market value of “accreted income” under certain specified circumstances of default by charitable trust such as conversion or merger or dissolution of charitable trust/ institution or failure to transfer assets to exempt entities in case of dissolution. Accreted income is defined to mean excess of Fair Market Value (“FMV”) of total assets over total liabilities of the charitable trust.
- The Bill provides certain relaxations by way of certain exclusions from the “accreted income” in case of dissolution of a charitable trust, where the trust transfers all its assets within 12 months to another eligible trust. The amended Bill as approved by the Rajya Sabha, provides further relaxation on levy of tax by excluding the following from the ‘accreted income’:
  a) Value of assets directly acquired out of agricultural income; and
  b) Value of assets acquired during the period beginning from the date of its creation or establishment and before getting registered under section 12AA in respect of which no benefit/ exemption has been claimed by the trust.
- The Bill required payment of tax on accreted income within 14 days from the “specified date” i.e. from date of receipt of order cancelling registration or date of order rejecting application from fresh registration.
- The amended Bill as approved by Rajya Sabha provides that tax on accreted income shall be paid within the 14 days from the date on which the order in any appeal, confirming the cancellation of the registration is received by the trust or the date on which the period for filing appeal before ITAT against the order cancelling the registration or order rejecting the application expires, if no appeal has been filed by the trust.
- Further, the amended Bill as approved by Rajya Sabha has made a clarificatory amendment to provide that registrations under section 12AA shall include any registrations obtained under section 12A.

Clarifications on profit linked deduction on housing projects

- The Bill proposed insertion of a new section 80-IBA which provides for deductions from profit arising from the business of developing and building housing projects. Such deduction is available subject to fulfillment of certain conditions where project is located within cities of Chennai, Delhi, Kolkata or Mumbai or within acceptable distance from municipal limits.
- The amended Bill as approved by the Rajya Sabha provides that the distance from municipal limits shall be measured aerially. Further, it is mentioned that the 'built-up area' of the residential unit shall be relevant to check whether the size of the residential unit is within threshold limit of 30 sq. meter or 60 sq. meter, as the case may be.

Weighted deduction benefit for expenditure on notified agricultural extension project extended till Assessment year 2020-21

- The Bill had proposed to limit the weighted deduction of expenditure, allowed to a company on notified agricultural extension projects, under the provisions of section 35CCC of the Act, from existing 150% to 100% w.e.f. assessment year 2018-19 onwards.
- The amended Bill as approved by the Rajya Sabha relaxes this provision by extending the benefit of weighted deduction of 150%, till financial year 2019-20 (i.e. Assessment year 2020-21). Hence, weighted deduction of 150% will reduce to 100% from financial year 2020-21 onwards (AY 2021-22).

Dividend Tax

- The Finance Bill 2016 (Finance Bill) had proposed an additional income tax of 10% (plus applicable surcharge and education cess) if the amount of dividend received by a resident individual, firm or Hindu Undivided Family (HUF) exceeds Rs. 10 lakhs on gross basis.
- The provision has been amended to clarify that the tax of 10% (plus applicable surcharge and education cess) will be levied on aggregate amount of dividends received from domestic companies which exceeds Rs. 10 lakhs.

Taxation of retirals

Employers Contribution to Recognized Provident Fund (RPF):

- Currently, employer's contribution to RPF in excess of 12% of salary is taxable in the hands of the employee. The Finance Bill had proposed to tax the employer's contribution to the RPF in excess of 12% of salary or in excess of Rs. 150,000 in the year of contribution. This budget proposal has been omitted.
- Thus, the employer's contribution to RPF will continue to be non-taxable in the hands of the employee, if the same is upto 12% of salary.

Withdrawal of accumulated balance in RPF:

- Currently, withdrawal of accumulated balance from RPF is tax exempt, subject to specified conditions. The Finance Bill had proposed that at the time of withdrawal, only 40% of the accumulated balance attributable to the contributions made by an employee on or after 1 April 2016 will be exempt. This budget proposal has been omitted. Thus, withdrawal of accumulated balance from RPF will continue to be exempt from tax, subject to specified conditions.

Approved Superannuation Fund (ASF):

- Currently, any payment made from an ASF to an employee in lieu of or in commutation of an annuity is exempt under specified circumstances e.g. death, retirement and incapacitation, etc. The Finance Bill had proposed that, any payment in lieu of or in commutation of an annuity purchased out of contributions made to an ASF on or after 1 April 2016 will be exempt to the extent of only 40% of such payment. This budget proposal has been omitted.
- Thus, any payment made from an ASF to an employee in lieu of or in commutation of an annuity will continue to be exempt from tax under specified circumstances.

Comment

As the bill has been passed by Lok Sabha and Rajya Sabha, the same would be enacted once it receives assent of the President of India.

Most of the amendments suggested by Lok Sabha and approved by Rajya Sabha are clarificatory in nature and also addresses several ambiguities which arose from the fine prints of the original Bill. However, there are still quite a few clarification required by the tax payers/ ambiguities on areas for which we have to wait and watch for further developments.

Further, from employee perspective, restoring the tax exemption on withdrawal of accumulated balance from RPF and amount received on commutation of ASF, subject to certain conditions will definitely bring cheer to most of the salaried class who are members of these schemes. Also, the budget proposal of exempting withdrawal from National Pension Scheme ('NPS') upto 40% has been retained. This will encourage higher investment in the NPS.

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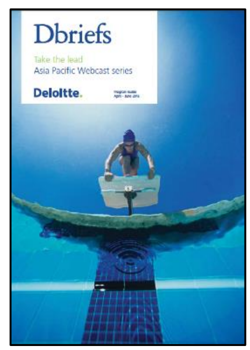

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