

Finance Bill 2011 – Important Direct Tax Proposals

Introduction

This write up captures certain important direct tax proposals of the finance bill 2011 introduced in the parliament on 28 February 2011.

Since the proposed Direct Tax Code (DTC) is under consideration of the parliament, as expected, the finance bill has proposed relatively lesser changes in the current Income Tax Act (ITA). Many proposals relate to alignment with DTC. Since the finance minister has categorically indicated the implementation of DTC from 1 April 2012, this finance bill would be the last bill to amend the current complex ITA.

Amongst the proposals, applicability of book profit tax and dividend distribution tax to units operating in SEZ and developers of SEZ is of significant importance and reflective of government's intention to retain the said taxes in DTC despite the strong resistance expressed by the industry post

introduction of DTC. Suitable amendments to SEZ Act have also been proposed in this regard.

Introduction of Alternate Minimum Tax (AMT) in the case of LLP is a surprise. Perhaps, it has been introduced to counter any attempt by units in SEZ to avoid the proposed MAT by resorting to conversion from company to LLP.

In the back drop of "Black Money" noise, the finance bill has proposed special tax proposals dealing with transactions with persons located in the jurisdictions which do not co-operate with India for exchange of information.

Unless stated otherwise in this note, the proposals will be effective from assessment year 2012-13.

Resident Individuals, Hindu undivided Family (HUF)

➤ Rates of Income Tax - Highlights

- Qualifying age for Senior Citizens reduced from 65 years to 60 years.
- New category of resident senior citizens of age 80 years and above is introduced with threshold limit of INR 5 lakhs.

Tabulated summary of changes and tax benefits:

Tax Payer	Age (years)	Threshold exemption		Tax Benefit INR
		FY 2010-11	FY 2011-12	
Very Senior Citizens	80 and above	2,40,000	5,00,000	26,780
Senior Citizens	60 ¹ and above	2,40,000	2,50,000	1,030
Women	Below 60	1,90,000	1,90,000	Nil
Other Individuals and HUF		1,60,000	1,80,000	2,060

¹ 65 years for FY 2010-11

➤ Certain tax payers to be exempt from tax filing

Currently, all tax payers whose taxable income exceeds the threshold exemption are required to furnish return of Income.

It is proposed that certain class of tax payers (likely to be salaried class in lower tax base) ² will be exempt from filing tax returns though their income is above the exempt threshold.

➤ Investment in long term infrastructure bonds – Deduction extended for assessment year 2012-13

Currently under section 80CCF of the Act, deduction up to INR 20,000 is available for investment in long term infrastructure bonds notified by the central government. This benefit was available only for AY 2011-12. It is proposed to extend the benefit to AY 2012-13 as well.

² From the budget speech it appears that salaried taxpayers in lower income slabs where tax obligations are adequately covered by tax withholding would be exempt from tax filings.

➤ **Contribution to New Pension Scheme (NPS)** ³ –

Benefit enhanced

Currently, contribution made by the Central Government or any employer to NPS in excess of INR 1 lakh (reckoned along with investments under section 80C and 80CCC) is not eligible for deduction under section 80CCD of the Act. It is proposed that the prescribed limit shall stand increased to the extent of the contributions mentioned above. However, the benefit in the case of contribution by employer shall be restricted to 10% of salary of the employee tax payer.

Corporate tax

- No change in basic tax rate. Current tax rate of 30% to continue
- Surcharge (applicable on income above INR 1 crore) in case of Domestic Companies reduced from 7.5% to 5%
- Surcharge (applicable on income above INR 1 crore) in case of Foreign Companies reduced from 2.5% to 2%
- Book profit tax increased from 18% to 18.5%

³ By another amendment it is provided that tax deduction to the employer's contribution to NPS up to 10% of Salary would be allowed. This amendment seeks to remove an ambiguity on the allow ability of the deduction. The amendment is prospective; it is arguable that expenditure was in any way allowable as deduction under section 37 of the Act, that too, without any cap.

Non Residents

Any interest received from investment in specified Infrastructure Debt Fund will attract concessional tax rate of 5%. Correspondingly, the tax withholding has been capped to 5% only. The benefit will be available to any non-resident individual and foreign company as well.

Special Economic Zones

- Profits earned by a company operating in SEZ or a company engaged in development of SEZ are not liable to book profit tax. It is proposed that such units or developers shall be liable to book profit tax @18.5% for assessment year 2012-13 and onwards.
- Similarly, a company operating in SEZ or a company engaged in development of SEZ is not liable to pay Dividend Distribution Tax (DDT) on distributed profits. It is proposed that such company shall be liable to pay DDT @ 15% with effect from 1st June, 2011. Corporates affected by this amendment may choose to declare interim or final dividend to avoid DDT for assessment year 2011-12.
- It may be recalled that under the proposed Direct Tax Code which is stated to be effective from 01 April, 2012, the above class of taxpayers were already considered as liable to the MAT and DDT. With this amendment, the government has preponed the charge of these taxes by a year.

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Alternate Minimum Tax (AMT) on Limited Liability

Partnership (LLP)

- LLP which is entitled to deduction u/s 10AA (SEZ unit) or other incentive under chapter VI-A of the Act, shall be liable to pay AMT of 18.5% in a case where the tax payable on its total income as per normal provision of the Act is less than AMT.
- This provision though similar to book profit tax (MAT) applicable to corporate taxpayer, is less stringent than MAT, for, many artificial adjustments applicable to a corporate tax payer under MAT are not applicable to LLP under the aforesaid AMT.
- The excess tax paid under AMT over the regular tax would be carried forward up to 10 years for being set-off against regular tax. The set-off in a particular year will be restricted to the amount of regular tax payable in excess of AMT computed for that year. The impact of the above proposal is that LLP will be denied deductions in respect of profit linked incentives available to a tax payer and specifically a SEZ undertaking or a developer of SEZ will not be able escape the newly introduced AMT by resorting to conversion into LLP.

Investment linked incentives – scope expanded

- Currently, certain specified businesses are entitled to claim 100% deduction of capital expenditure incurred in the year of its incurrence as against staggered deduction of such expenditure as and by way of depreciation. It is proposed to expand the scope of the specified businesses with the inclusion of the following:
 - Development of a Affordable Housing Project under a notified scheme of government.
 - Business of production of fertilizers in India⁴
- The above incentives are currently available to new hotels and hospitals. It is proposed to modify the provision such that it will be possible set off business losses from the newly set up hotels or hospitals against the business profits of existing hotels or hospitals, as the case may be.

Sunset clause for tax holiday in Power Sector extended

Pursuant to section 80IA(4)(iv), any new undertaking setup for generation and distribution of power or any existing undertaking where substantial renovation and modernization of power transmission network has been taken up is entitled to deduction of its 100% profits for 10 years subject to the condition that the undertaking is set up or takes up the

⁴ the deduction for capital expenditure restricted to a new plant or expansion

modernization, as the case may be, before 31 March 2011. It is proposed to extend the date to 31 March 2012.

Sunset clause for tax holiday in Mineral Oil

Section 80-IB(9) provides for seven year profit linked deduction of 100% to an undertaking engaged in commercial production of mineral oil, on fulfilling certain prescribed conditions, without any sunset clause. It is proposed that this deduction will not be available for blocks licensed under a contract awarded after 31 March 2011.

Taxation of foreign dividend

In the case of an Indian company any dividend income received from foreign subsidiary would attract tax at 30%. It is believed that to avoid taxation of the income in India, profits are being accumulated in the foreign jurisdiction. As an incentive to such companies to bring profits to India, as a onetime measure, it is proposed that such dividend would be taxed at the concessional rate of 15% on gross basis, with the condition that no deduction will be allowable for any expenditure incurred (say, borrowing cost) by the investing Indian Company. The provision will apply in relation to assessment year 2012-13 only. It is not clarified whether the Indian company will have an option of being governed by

normal provision of the Act to claim deduction for the expenses incurred for the purpose of earning the income in a scenario where its actual tax liability is higher under the proposed provision.

It is possible that the foreign subsidiary may be subject to dividend distribution tax while remitting the dividend to India. In such cases the taxation of dividend would entail double taxation of the income. Unless the double tax avoidance agreement with the jurisdiction of which the subsidiary is a resident provides credit for such doubly paid taxes, there may not be an incentive to remit such dividend.

Transaction with persons located in a notified jurisdictional area

In order to discourage transactions by a resident assessee with persons located in any country or jurisdiction which does not effectively exchange information with India, following anti-avoidance measures have been proposed to specifically deal with such transactions

- An enabling power to the Central Government to notify any country or territory outside India, having regard to the lack of effective exchange of information by it with India, as a notified jurisdictional area

- If an assessee enters into a transaction, where one of the parties to the transaction is a person located in a notified jurisdictional area, then all the parties to the transaction shall be deemed to be associated enterprises and the transaction shall be deemed to be an international transaction and accordingly, transfer pricing regulations shall apply to such transactions
- No deduction in respect of any payment made to any financial institution shall be allowed unless the assessee furnishes an authorization, in the prescribed form, authorizing the Board or any other income-tax authority acting on its behalf, to seek relevant information from the said financial institution
- No deduction in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any provision of the Act unless the assessee maintains such other documents and furnishes the information as may be prescribed
- If any sum is received from a person located in the notified jurisdictional area, then, the onus is

on the assessee to satisfactorily explain the source of such money in the hands of such person or in the hands of the beneficial owner, and in case of his failure to do so, the amount shall be deemed to be the income of the assessee

- Any payment made to a person located in the notified jurisdictional area shall be liable to deduction of tax at the higher of the rates specified in the relevant provision of the Act or rate or rates in force or a rate of 30 per cent

This amendment is proposed to take effect from 1st June, 2011.

Transfer pricing

- Any income arising from an international transaction between associated enterprises, of whom, at least one is non-resident, is required to be computed at Arm's Length Price (ALP) and when the actual transaction price is different from ALP, the later will be deemed to be the actual price of the transaction subject to the uniform tolerance level of 5%.

The transfer pricing provisions have thrown up extensive litigation. In the backdrop, it is proposed that

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the uniform tolerance limit of 5% shall be substituted by such limits as may be notified by the Central Government. It is likely that separate limits will be prescribed having regards to sectors, type of transactions and such other criteria.

- Currently, Transfer pricing officer (TPO) can scrutinize ALP in respect of only the transaction, which is referred to him by the tax officer. It is proposed that TPO can also scrutinize any other transaction which may come to his notice in the course of proceeding before him.
- It is proposed that TPO can exercise the power of survey and third party confirmation apart from his current powers of summoning or calling for details for the purpose of enquiry or investigation.
- In the case of a corporate taxpayer which is required to furnish transfer pricing report, the tax filing date has been postponed to 30th November from the currently prescribed date of 30th September of the assessment year. However it seems that an anomaly has occurred, for, due date for obtaining tax audit report in such

cases has remained unchanged as 30th September of the assessment year.

Liaison Office (LO) to submit annual information

- A LO shall within two months from the end of its financial year deliver to the tax department a report on its activities during the financial year in the form to be prescribed.

Charitable Trust

Currently, “the advancement of any other object of general public utility” is not a charitable purpose, if it involves carrying of any activity or service in the nature of trade, commerce or business, for a consideration, irrespective of the nature of use or application, or retention, of the income from such activity and receipts from such activities is INR 10 lakhs or more in the previous year. It is now proposed to enhance the limit to INR 25 lakhs.

Increase in tax on distributed income to mutual fund unit-holders:

- Currently, dividend distribution by money market mutual fund / liquid fund attracts Dividend Distribution Tax (DDT) of 25%. It is now proposed that in the case of a unit holder, other than individual / HUF, DDT of 30% would be payable by the mutual fund.
- Currently, dividend distribution by a mutual fund, other than money market mutual fund / liquid fund, attract DDT of 12.5% in the case of a unit holder who is individual / HUF, and in the case of other unit holders DDT of 20% is attracted. It is now proposed to increase the 20% tax rate to 30%.

The above amendments will come in force with effect from 1st June, 2011

Post amendment the DDT rates applicable to various types of mutual funds are tabulated as follows:

Type of mutual fund	Dividend Distribution Tax (%)		
	Basic rate	Surcharge & Cess	Total
Equity oriented fund	Nil	Nil	Nil
Money market mutual fund or liquid fund			
- Unit holder is individual/HUF	25	2.038	27.038
- Unit holder is any other person	30	2.445	32.445
Any other fund			
- Unit holder is individual/HUF	12.5	1.019	13.519
- Unit holder is any other person	30	2.445	32.445

Weighted deduction for approved scientific research programme

Currently, weighted deduction to the extent 175% is allowed to any contribution made to National Laboratory or a University or Indian Institute of Technology (IIT) etc. for the purpose of an approved scientific research programme. It is proposed to increase this weighted deduction to 200%.

Application before settlement commission

A taxpayer in whose case proceedings have been initiated as a result of search and seizure may approach settlement commission to settle his case subject to the condition that as per his application tax payable on income disclosed exceeds INR 50 lakhs. Quite often as a result of search, proceedings are also initiated in the case of relatives or associate concerns of the taxpayer. Such relative or associate concern will not be able to pursue application to the settlement commission if the tax payable on the income to be disclosed is less than the aforesaid benchmark amount. It is now proposed that such individual or the associate concern will be eligible to pursue application for settlement subject to the condition that the tax payable on income disclosed as per the application exceeds INR 10 lakhs.

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