Tax Alert

PHD
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Finance Bill 2012
Important Direct Tax Proposals

SYNOPSIS

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Introduction

This write up captures significant direct tax proposals of the Finance Bill 2012 introduced in the parliament on 16th March, 2012.

Implementation of the Direct Tax code (DTC), has been deferred since the parliament standing committee to whom the code was referred to, submitted its report for consideration of the finance ministry very recently. The committee has made far reaching recommendations both at micro and macro level, the consideration whereof would require considerable time before the Code is made effective. However, many provisions of the DTC such as Advance Pricing Agreement (APM), General Anti Avoidance Rule (GAAR), etc. have been introduced in the Finance Bill.

Many amendments proposed in the Bill are intended to nullify the effect of the Supreme Court and High Court judgement which the government thought as contrary to the legislative intent, the significant being the recent supreme court judgment in the case of Vodafone.

Corporate taxation rates, dividend distribution tax, surcharge have remained unchanged. No major incentives are proposed to boost economic growth and improve business sentiments in the wake of actual as well as perceived economic slowdown.

Extension of Alternate Minimum Tax [AMT] to individuals, HUF and firms is a clear signal of phase out of profit linked deductions in favour of investment linked deductions, in line with the proposed DTC.

To address the growing litigations on Transfer Pricing front, Advance Price Agreement regime is being introduced. Transactions between resident related parties are sought to be governed by Transfer Pricing provisions which are currently applicable only to the international transactions where atleast one of the parties is non-resident.

The Finance Minister in his budget speech announced to issue a White Paper on Black Money. As a sequel to the efforts to unearth unaccounted income and wealth stashed in tax heavens and other overseas jurisdiction, the Finance Bill seeks to reopen assessments up to previous sixteen years and also seeks to provide for filing of tax returns in prescribed format and disclose therein assets held outside India.

The contentious issue of taxation of capital gains arising from transfer of shares of a foreign company outside India by a non-resident investor, resulting into indirect transfer of properties situated in India has been aggressively addressed in the Finance Bill by retrospective amendment which dates back to 1st April, 1962.

Similarly, another contentious issue of taxation of royalty income arising to a non-resident upon import of computer software license and from up-linking etc. of telecom signals has been addressed by retrospective amendment which dates back to 1st June, 1976.

The Government's right to make retrospective amendment has been upheld by courts. However, it is desirable that the weapon should be used sparingly and appropriately. In any case, safeguard should be provided that concluded tax proceedings are not re-opened upon such amendment.

Tax Rates

- Except small relief to the individual taxpayers in terms of increase in the threshold exemption and enhancement of the income slab attracting 20% from INR 8 lacs to 10 lacs, the rates for corporates, firms and other entities have remained unchanged. Surcharge on the corporates @ 5% for domestic companies and @ 2% for foreign companies, for income exceeding INR 1 crore shall continue.
- The separate category for women taxpayers has been dispensed with. The threshold exemption and the tax slabs for women taxpayer is proposed to be at par with other individual taxpayers.
- No change is proposed in threshold exemption for the taxpayers in the category of Senior Citizens and Very Senior Citizens.

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Tabulated summary of the changes and tax benefits

Individuals-whether resident or otherwise

(other than women, senior and very senior citizens being resident of India)

Income Range	Tax Rate		Maximum tax benefit
	FY 11-12	FY 12-13	
1.8L – 2.0L	10%	-	2,060
2.0L – 5.0L	10%	10%	Nil
5.0L – 8.0L	20%	20%	Nil
8.0L – 10.0L	30%	20%	20,600
Above 10.0L	30%	30%	Nil
Total Benefit			**22,660**

Women-whether resident or otherwise

(other than senior and very senior citizens being resident of India)

Income Range	Tax Rate		Maximum tax benefit
	FY 11-12	FY 12-13	
1.9L – 2.0L	10%	-	1,030
2.0L – 5.0L	10%	10%	Nil
5.0L – 8.0L	20%	20%	Nil
8.0L – 10.0L	30%	20%	20,600
Above 10.0L	30%	30%	Nil
Total Benefit			**21,630**

Resident senior citizens

Income Range	Tax Rate		Maximum tax benefit
	FY 11-12	FY 12-13	
2.5L – 5.0L	10%	10%	Nil
5.0L – 8.0L	20%	20%	Nil
8.0L – 10.0L	30%	20%	20,600
Above 10.0L	30%	30%	Nil
Total Benefit			**20,600**

Resident very senior citizens

Income Range	Tax Rate		Maximum tax benefit
	FY 11-12	FY 12-13	
5.0L – 8.0L	20%	20%	Nil
8.0L – 10.0L	30%	20%	20,600
Above 10.0L	30%	30%	Nil
Total Benefit			**20,600**

Dividend received from foreign companies – Concessional tax regime extended

- By the Finance Act, 2011 section 115BBD was introduced as an incentive to expedite remission of dividend by a foreign company in which Indian company holds atleast 26% of equity stake. It was provided that the dividend received by the Indian company from such foreign company during 1st April, 2011 to 31st March, 2012 shall be subject to the concessional tax rate @15% on the gross dividend amount, instead of regular provisions of the Act that attract tax rate @30%, subject however to the condition that no deduction to be allowed for the expenses, if any, in relation to the dividend income
- The Bill seeks to extend the date from 31st March, 2012 to 31st March, 2013 for Indian companies to receive such dividend to be eligible for the concessional tax benefit

The provision shall be effective from the assessment year 2013 –14

Tax benefits to power sector

- Currently, tax holiday u/s 80IA(4)(iv) is available for business of generation and generation and distribution of power which commences operations on or before 31st March 2012. The Bill seeks to extend benefit of tax holiday for such business which may commence operations on or before 31st March 2013.
- The Bill also seeks to provide incentive to the business of generation or generation and distribution of power by allowance of initial depreciation @ 20% of actual cost of new machinery or plant (other than ships and aircrafts) acquired and installed during any financial year.

Investment linked deductions

- Currently, various specified businesses are eligible for availing deduction of capital expenditure (excluding land, goodwill, financial instruments) incurred for the business in the year of incurrence of cost instead of conventional system of depreciation allowance over a period of time.
- The Bill seeks to enlarge the scope of specified business to include the business of setting up and operating;
  - Ø inland container depot or container freight station approved under the Customs Act;
  - Ø Bee keeping and production of honey and beeswax; and
  - Ø setting up and operating sugar warehousing facility.
- The Bill also seeks to provide that some of the specified businesses currently eligible at 100% of the capital expenditure incurred, will be eligible for deduction at 150% of the capital expenditure if they commence operations on or after 1st April, 2012.
- The Bill also seeks to clarify that the business of building and operating hotel currently eligible for deduction will be so eligible

also in the cases where owner of the hotel may choose to run it by engaging an external operator.

The provision shall be effective from the assessment year 2013 –14

Tax incentive for debt funding to specified infrastructure sectors

- In continuing the zest to augment long-term low cost funds from abroad, the Bill seeks to provide concessional tax rate regime under which interest earned by a non-resident from an Indian company engaged in specified infrastructural business, will attract tax rate of 5% subject to prescribed conditions and loan agreement being approved by the Central Government.
- Consequently, the Bill seeks to provide that interest income paid by such specified company to a non resident shall be subjected to tax deduction at source at the rate of 5% instead of normal tax withholding rate.

The provision shall apply in relation to borrowings made between 1st July, 2012 and 1st July, 2015.

Weighted deduction of expenditure in specified sectors

- The Bill seeks to continue weighted deduction u/s 35(2AB) @ 200% of expenditure *(except cost of land or building)* incurred on approved in-house research and development facilities upto 31st March 2017.
- The Bill seeks to provide weighted deduction @ 150% of expenditure incurred on approved agricultural extension project notified by the Board
- The Bill seeks to provide weighted deduction @ 150% of expenditure *(except cost of land or building)* incurred on approved skill development projects notified by the Board.

The provision shall be effective from the assessment year 2013 –14

Expenditure on preventive health check

- Currently, deduction u/s 80D is allowed for premium paid towards health insurance policy and contribution made to Central Government Health Scheme.
- The Bill seeks to expand the scope of the deduction for any payment made by the taxpayer for preventive health check-up upto INR 5,000, within the overall limit prescribed in the section. Further, payment made in cash for such check-up shall also qualify for the deduction.

The provision shall be effective from the assessment year 2013 –14

Deduction for interest on savings accounts

- The Bill seeks to provide deduction upto INR 10,000 to an Individual and HUF in respect of interest on savings account with
  - Ø a banking company;
  - Ø a co-operative bank; and
  - Ø Post Office

The provision shall be effective from the assessment year 2013 –14

Securities Transaction Tax (STT) reduced

- The Bill seeks to reduce STT on delivery based transaction from the existing rate of 0.125% to 0.1%

The proposed rate will be effective from 1st July, 2012.

Wealth Tax – exemption of residential house allotted to employee.

- The Bill seeks to provide that a residential house owned by a company and allotted to an employee shall be excluded from wealth tax if annual salary of the employee does not exceed INR 10 lacs.
- Currently the prescribed limit for the annual salary is INR 5 lacs.

The provision shall be effective from the assessment year 2013 –14

Long-term capital gains tax on residential property exempt if sale proceeds invested in SME

- The Bill seeks to introduce new provision to the effect that long-term capital gains arising from transfer of a residential property (a house or a plot of land) shall be exempt from tax, if the sale proceeds of the property is invested into share capital of an Indian company engaged in a manufacturing business in which the taxpayer has more than 50% equity interest and which qualifies to be SME under the Micro, Small & Medium Enterprises Act, 2006 (eligible company)
- A taxpayer who invests only a part of the sales proceeds arising from the transfer of the property would be eligible to proportionate exemption
- The investment should be made during any period commencing from the date of transfer of the property till the due date of filing of return for the assessment year in which the transfer is effected
- The eligible company should have been incorporated on or after the 1st day of the financial year in which the transfer of property is effected
- The eligible company must utilise the amount of equity shares subscribed by the shareholder towards purchase of new plant and machineries within a period of one year from the date of subscription of the equity shares. However, in case where the amount is not invested before the due date of filing of return of the investor, the amount shall be deposited in specified bank account to be eventually utilised for purchase of the plant and machineries within the period of one year referred to above
- The investment in the shares by the investor and the investment in plant and machineries by the investing company shall be subject to a lock in period of 5 years

- Roll back of the exemption has been provided for in case the taxpayer or the company fails to comply with the prescribed conditions
- The sunset for the provision has been prescribed as 31st date of March, 2017

The provision shall be effective from the assessment year 2013 –14

Exemption from capital gains on sale of agricultural land extended to HUF

- Currently, capital gains on transfer of land used for agricultural purposes by an individual or his parent is exempt from tax if the whole of the capital gains is reinvested in agricultural land.
- The Bill seeks to confer the exemption to HUF also.

The provision shall be effective from the assessment year 2013 –14

Alternate Minimum Tax (AMT)-scope widened

- The Bill seeks to provide that AMT @ the rate of 18.5% will be payable by every person (other than company) in a case where its total income after deduction, under chapter VI-A of the Act or under section 10AA of the Act, is less than 18.5% of the income before claiming the above deduction.
- It may be recalled that in the that in the previous year AMT was introduced for the first time and was made applicable only to LLP
- AMT shall not apply to specified persons such as individual, HUF, AOP etc. whose income before claiming deduction under chapter VI or under section 10AA, does not exceed 20 Lacs

The provision shall be effective from the assessment year 2013 –14

Life insurance – tax regime tweaked

- Currently, u/s 80C of the Act, premium on life insurance policies is qualified for deduction to the extent that the premium does not exceed 20% of the sum assured. Also maturity proceeds of such policies including bonus is exempt from tax u/s 10(10D).
- The Bill seeks to provide that deduction of the premium u/s 80C of the Act will be available to the extent that the premium does not exceed 10% of the sum assured
- The Bill also seeks to provide that maturity proceeds of a life insurance policy will not be exempt from tax if, premium payable in respect of such policy in any of the years during the term of the policy exceeds 10% of the sum assured

The new tax regime will apply in respect of life insurance policies issued on or after 1st April, 2012. Thus, the policies issued prior to the above date will be governed by the current tax regime.

Daily tonnage income of shipping company

- Under the existing scheme, the operating profit of a shipping company is determined on a presumptive basis on the basis of tonnage capacity of its ships.
- The Bill seeks to revise the rate of daily tonnage income under this scheme as under:

Qualifying ship having net tonnage	Existing amount of daily tonnage income	Proposed amount of tonnage income
Up to 1,000	INR 46 for each 100 tons	INR 70 for each 100 tons
exceeding 1,000	INR 460 *plus* INR 35 for each 100 tons exceeding 1,000 tons	INR 700 *plus* INR 53 for each 100 tons exceeding 1,000 tons
exceeding 10,000 but not more than 25,000	INR 3,610 *plus* INR 28 for each100 tons exceeding 10,000 tons	INR 5,470 *plus* INR 42 for each 100 tons exceeding 10,000 tons
exceeding 25,000	INR 7,810 *plus* INR 19 for each 100 tons exceeding 25,000 tons	INR 11,770 *plus* INR 29 for each 100 tons exceeding 25,000 tons

The provision shall be effective from the assessment year 2013 –14

Minimum Alternate Tax [MAT]

The Bill seeks to provide that in the case of disposal of any revalued asset, the amount standing to the credit of the revaluation reserve (to the extent relatable to the asset) shall be added to the book profit, if the said amount is not credited to the profit & loss account at the time of disposal of the asset

The provision shall be effective from the assessment year 2013 –14

Share premium in excess of the fair market value to be treated as income

- The Bill seeks to provide that any share premium received by a closely held company from any resident shareholder shall be deemed to be the income of the company to the extent that the issue price of the share exceeds fair value of the share
- The fair market value of the share shall be higher of the value
  - Ø as may be determined in accordance with prescribed method or
  - Ø as may be substantiated by the company to the satisfaction of the tax department, based on the value of its tangible & intangible assets

- The provision shall not apply to venture capital undertaking, in respect of shares issued to venture capital fund or venture capital company

The provision shall be effective from the assessment year 2013 –14

Tax regime for investor in Venture Capital Fund (VCF) or Venture Capital Company (VCC) tightened

- U/s 10(23FB) of the Act, income of a VCC or VCF (Pass Through Entity or PTE) from investment in shares of unlisted Venture Capital Undertaking (VCU) is exempt from tax, provided the VCU is engaged in specified businesses defined in the section.
- Currently, u/s 115U of the Act, an investor of PTE is liable to tax in like manner and to the same extent as if the investment is directly made by him in the VCU at the time of actual receipt of income by the investor. Thus, it is possible for the investor to defer the tax liability by postponing the distribution of income by the PTE
- The Bill seeks to amend section 10(23FB) to provide that PTE shall have the same meaning as defined in the SEBI regulations, which effectively means that VCU in which investment is made need not be necessarily engaged in the prescribed business for the PTE to be eligible for exemption under the section
- The Bill also seeks to amend section 115U of the Act to the effect that investor shall be liable to tax in respect of income of PTE on accrual basis instead of taxation on receipt basis as per current provisions of the Act
- Further, the PTE shall be liable to deduct tax at source from the income credited or paid to the investor, whichever is earlier

The provision shall be effective from the assessment year 2013 –14

Capital gain on transfer of shares in cross border transactions

The Bill seeks to make retrospective amendment (w.e.f 1st April, 1962) in sections 9 and 195 and other provisions of the Act to provide that capital gain arising from transfer of shares of a foreign company which directly or indirectly holds the interest in shares of an Indian company or properties situated in India shall be deemed to accrue or arise in India and therefore taxable in India as per domestic law. To give effect to the proposal, the following amendments are proposed

- Any share or interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India if the share or interest derives, directly or indirectly, its value substantially from the assets located in India

- The term property includes and shall be deemed to have been included any rights in or in relation to an Indian company, including the rights of management or control or any other rights whatsoever
- The term 'transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India
- Income that arises directly or indirectly 'by means of', 'in consequence of' or 'by reason of' transfer of capital asset situated in India shall be deemed to accrue or arise in India
- Obligation to withhold tax u/s 195 of the Act applies and shall be deemed to have applied and extends and shall be deemed to have extended to all persons, resident or non-resident, whether or not the non-resident
    - Ø has a residence or place of business or business connection in India; or
    - Ø any other presence in any manner, whatsoever in India

Tax Residency Certificate (TRC) for claiming relief under DTAA.

- A taxpayer may opt for determination of tax liability in cross border transactions as per DTAA instead of such liability determined as per domestic law, subject to the taxpayer being resident of any jurisdiction outside India with whom India has entered into DTAA
- Currently, tax residency of a taxpayer for the purpose of application of DTAA is determined on the basis of such evidences (including TRC from the foreign jurisdiction) as may be considered appropriate by the tax department having regard to the surrounding facts
- The Bill seeks to provide that without obtaining TRC in the prescribed form, the taxpayer will not be entitled to avail the benefits of DTAA
- Supreme Court of India in Azadi Bachao Andolan's case had upheld the CBDT circular which laid down that TRC obtained by a taxpayer shall be conclusive evidence of tax residency of the taxpayer for availing tax benefits under DTAA. It appears that apart from codifying the requirement of obtaining the TRC, the legislative intent is to emphasize a proposition that TRC is mandatory but not sufficient to prove tax residency under DTAA

The provision shall be effective from the assessment year 2013 –14

Filing of income tax return in relation to asset located outside India

- A resident of India who is otherwise not required to furnish return of income shall be liable to furnish income tax return in a prescribed form, if he has any asset (including any financial interest in any entity) located outside India or signing authority in any account located outside India.

The provision shall be effective from the assessment year 2013 –14

Limitation period for reassessment of escaped income extended to sixteen years in specified cases

- In an attempt to tax unaccounted money lying outside India, the Bill seeks to provide that where a person is found to have any asset (including financial interest in any entity) located outside India, it shall be presumed that the asset represent his income chargeable to tax which has escaped assessment, and
- In respect of such asset, the limitation period for reassessment which is currently prescribed as 6 years has been extended to 16 years.

The provision shall be effective from 1st July, 2012

Tax withholding on transfer of immovable properties

- Any person , being the transferee responsible for paying to a resident transferor, any amount by way of consideration, for transfer of any immovable property (other than agricultural land) shall deduct tax at source @ 1% of the consideration in the case where the consideration is INR 50 lacs or more and the property is situated in any specified urban areas or where the consideration is INR 20 lacs or more and the property is situated in any other areas
- The transferee will be denied registration of the property under the Indian Registration Act, if such tax has not been deducted

The provision shall be applicable in respect of property transferred on or after 1st October, 2012

- Immovable property is defined as Land (other than agricultural land) or any building or a part of building
- This provision is likely to create hardship because no relaxation has been provided to dispense with tax deduction in the case of tax payers whose income from transfer of property is tax exempt from tax. Also in the case of property developed by the owner under the development agreement, the developer will be called upon to deduct tax though the consideration may have been agreed to be paid in kind
- The transferee would not be required to obtain Tax deduction Account Number (TAN) or furnish any TDS statement
- The transferor will get credit of the TDS to be adjusted against his tax liability, if any

Tax Collection at Source (TCS) on cash sale of bullion and jewellery

- Currently, tax is required to be collected at source by the seller at the time of sale of certain goods like alcoholic liquor, tendu leaves, scrap etc. at the specified rates.
- The Bill seeks to provide that seller of bullion and jewellery shall collect tax @ 1% of sale consideration in excess of INR 2 lacs, paid in cash, regardless of the fact as to whether the buyer is a manufacturer, trader or purchases is for personal use
- The provision would equally apply in respect of transaction between parties who may not be in business

This provision shall be applicable from 1st July, 2012

Closely held company to explain source of investments by shareholders

- Supreme Court in the Lovely Export Pvt. Ltd's case held that in respect of share capital subscription, addition to income cannot be made in the tax assessment of a company as unexplained cash credits though the company may not be able to prove capacity of its shareholders to make the investment. The court held that if shareholders are not genuine, the tax department should proceed against the shareholders instead of the company
- To overcome the above Supreme Court ruling, the Bill seeks to provide that in the case of a closely held company, the shareholder being the person resident of India, should offer explanation about the nature and source of amount invested by him to the satisfaction of the tax officer, failing which, the share capital subscribed by such shareholder shall be treated as income of the company.
- The provision shall not apply in relation to a shareholder ,being a venture capital fund or venture capital company referred to in section 10(23FB)

The provision shall be effective from the assessment year 2013 –14

Unexplained cash credits, investments expenditure etc. to be taxed @ 30%

- The Bill seeks to provide that any amount included in the total income of the tax payer on account of unexplained:
  - Ø cash credits under section 68;
  - Ø money under section 69A;
  - Ø investment under section 69B;
  - Ø expenditure under section 69C and
  - Ø amount borrowed or repaid on hundi under section 69D

shall be chargeable to tax at the rate of 30% regardless of the income slabs applicable to the taxpayer.

- No deduction of expenditure shall be allowable to the tax payer

The provision shall be effective from the assessment year 2013 –14

Donations in cash restricted

- The Bill seeks to provide that any payment exceeding INR 10,000 made in cash shall not be allowed as a deduction u/s 80G and 80GGA.

The provision shall be effective from the assessment year 2013 –14

General Anti-Avoidance Rule (GAAR)

The courts in India and foreign courts in various cases have laid down a rule of law that 'tax avoidance' is impermissible and that it is different from a legitimate 'tax planning' which is permissible. There is a thin line of demarcation between the two. Simply stated, tax avoidance may refer to an arrangement or a transaction with the purpose of avoiding or reducing tax liability, the transaction though valid within four corners of law, is not in conformity with the spirit of law. Tax planning on the other hand would refer to an arrangement or a transaction which is in accordance with, both, the letter and spirit of the law. Currently, the Act incorporates specific transaction based anti-avoidance rules such as ignoring loss in the case of dividend stripping, etc. However, principle centric general anti-avoidance rules have not been codified in the Act. Hence, courts have intervened to declare certain tax avoidant transaction or an arrangement which is part of the transaction as null and void in determination of the tax liability under the Act, based on the underlying principle of 'substance over form', the principle which ignores the form of a transaction in preference to its substance.

The Bill seeks to codify GAAR by incorporation of chapter X-A into the Act, the salient features whereof are stated here under,

Conditions for invoking GAAR

An arrangement is 'impermissible avoidance arrangement' when

- Its main purpose or one of the main purposes is to obtain tax benefit; and
- It satisfies one of the following four tests
    - Ø The arrangement creates rights and obligations, which are not normally created between parties dealing at arm's length.
    - Ø It results in misuse or abuse of provisions of tax laws.
    - Ø It lacks commercial substance or is deemed to lack commercial substance.
    - Ø Is carried out in a manner, which is normally not employed for bonafide purpose.

An arrangement will be deemed to lack commercial substance if

- The substance or effect of the arrangement as a whole, is inconsistent with, or differs significantly from, the form of its individual steps or a part; or
- It involves or includes -

- Ø round trip financing;
- Ø an accommodating party ;
- Ø elements that have effect of offsetting or cancelling each other; or
- Ø a transaction which is conducted through one or more persons and disguises the value, location, source, ownership or control of fund which is subject matter of such transaction; or

- It involves the location of an asset or of a transaction or of the place of residence of any party which would not have been so located for any substantial commercial purpose other than obtaining tax benefit for a party
- The following factors shall not be taken into account in determining whether or not an arrangement lack commercial substance
  - Ø the period or time for which the arrangement (including operations therein) exists;
  - Ø the fact of payment of taxes, directly or indirectly, under the arrangement;
  - Ø the fact that an exit route (including transfer of any activity or business or operations) is provided by the arrangement.

Onus of proving the purpose of the arrangement

The onus of proving that obtaining tax benefit is not the main purpose of an arrangement, shall be on the Taxpayer

Consequences when arrangement is declared impermissible avoidance arrangement

Illustratively, it is provided that when an arrangement is declared impermissible avoidance arrangement, the following amongst other consequences may follow

- Disregarding or combining any step of the arrangement
- Ignoring the arrangement for the purpose of taxation law
- Disregarding or combining any party to the arrangement.
- Reallocating expenses and income between the parties to the arrangement
- Relocating place of residence of a party, or location of a transaction or situs of an asset to a place other than provided in the arrangement.
- Considering or looking through the arrangement by disregarding any corporate structure.
- Re-characterizing equity into debt, capital into revenue etc.
- Any equity may be treated as debt or vice versa;
- Any accrual, or receipt, of a capital nature may be treated as of revenue nature or vice versa; or

- Any expenditure, deduction, relief or rebate may be recharacterized.

Treaty Override

- Currently, a taxpayer may opt to rely upon DTAA for determination of his tax liability in preference to the domestic law, if the former is more beneficial to him
- In a case where GAAR applies, the aforesaid option shall not be available to the taxpayer

Tax Benefit

- Tax benefit means
  - Ø A reduction or avoidance or deferral of tax or other amount payable under this Act; or
  - Ø An increase in a refund of tax or other amount under this Act; or
  - Ø A reduction or avoidance or deferral of tax or other amount that would be payable under this Act, as a result of a tax treaty; or
  - Ø An increase in a refund of tax or other amount under this Act as a result of a tax treaty; or
  - Ø A reduction in total income including increase in loss, in the relevant previous year or any other previous year

- An arrangement which results in any tax benefit shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit unless the person obtaining the tax benefit proves that obtaining the tax benefit was not the main purpose of the arrangement
- An arrangement shall be presumed to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit

Procedure for invoking GAAR

- Assessing officer at the time of assessment proceedings, having regard to the material and evidence available considers that it is necessary to declare an arrangement as an impermissible avoidance arrangement, he may make reference to commissioner in this regard who after providing opportunity to the assessee may drop the proceedings if he is satisfied with the taxpayer's explanation, otherwise, he shall make reference to Approving Panel to give directions in this regard.
- Approving Panel (comprising of 3 members of the rank of commissioner and above as may be set-up by the CBDT) shall after hearing the taxpayer issue directions.

- If the directions are confirming the arrangement as impermissible, the assessing officer shall consider the same in the assessment only after commissioner's approval.

CBDT to prescribe guidelines

- The provisions of this chapter shall be applied in accordance with such guidelines and subject to such conditions and the manner as may be prescribed

Important definitions

- "arrangement" means any step in, or a part or whole of, any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and includes the alienation of any property in such transaction, operation, scheme, agreement or understanding
- The term "round trip financing", "accommodating party", "associated person", "connected person", etc. are widely defined.

The provision shall be effective from the assessment year 2013 –14

Consideration for transmission of telecom signals by satellite deemed to be royalty

The tax tribunals in many cases held that consideration received by a non-resident in respect of up-linking etc of telecom signal and transmission by satellite cannot be taxed as income by way of royalty which is deemed to accrue or arise in India since the satellite is situated outside the Indian territory though its foot prints may be in India. Further, it is also held that the term "process" referred to in the definition of royalty refers to "secret process" only. To overcome the potential litigation that may ensue, the Bill seeks to clarify with retrospective effect from 1st June, 1976 to the effect 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

Dividend Distribution Tax (DDT) – Cascading effect eliminated

- Currently, a holding company which is required to pay DDT on the amount of dividend distributed by it to its shareholders can deduct the amount of dividend received by it from its subsidiary, if the subsidiary has paid DDT and it is the 1st level downstream subsidiary
- The Bill seeks to amend section 115-O to the effect that a holding company will not be required to pay DDT on the amount of dividend distributed by it, to the extent of dividend received from its subsidiary, when the said subsidiary or any downstream subsidiary (at any level) has paid DDT on the dividend amount

The provision shall be effective from 1st July, 2012

Fair Market Value [FMV] of asset deemed to be value of consideration in certain cases

- Courts have held that where the consideration for sale of any capital asset not determinable, the gains arising there from are not chargeable to tax, since the tax computation mechanism would fail.
- With a view to nullify the effect of the court rulings the Bill seeks to provide that in transactions where actual consideration is not attributable or determinable, FMV of the asset shall be the deemed to be the full value of consideration.

The provision shall be effective from the assessment year 2013 –14

Payment for computer software licenses deemed to be royalty

- Courts have opined that consideration paid for software licenses imported is not liable to tax in India as payment of royalty. It has been held that software downloaded on any medium is a "copy righted article" distinct from copyright itself. Since the software licenses granted by the licensor is not a transfer of copyright, the income is not taxable as a royalty, and in the absence of any permanent establishment or business connection of the non resident in India, the income is not chargeable to tax as business income accruing or arising in India. To nullify the effect of aforesaid judicial view, retrospective amendment is proposed w.e.f. 1st June, 1976 to the effect that rights in respect of any right, property or information includes any right for use or right to use a computer software (including granting of license) irrespective of the medium through which such right is transferred.
- It is also clarified that royalty includes consideration in respect of any right, property or information, whether or not—
  - Ø the possession or control of such right, property or information is with the payer;
  - Ø such right, property or information is used directly by the payer;
  - Ø the location of such right, property or information is in India.

These provisions will take effect retrospectively from 1st June, 1976 and will accordingly apply in relation to the assessment year 1977-78 and subsequent assessment years.

Increase in threshold limit for Tax Audit and presumptive taxation

- The Bill seeks to enhance threshold limit of gross turnover/receipts for application of tax audit u/s 44AB;
  - Ø for persons carrying on business from INR 60 lacs to INR 1 crore

- Ø for persons carrying on profession from INR 15 lacs to INR 25 lacs
- Threshold limit of gross turnover/receipts for presumptive taxation regime u/s 44AD is increased from INR 60 lacs to INR 1 crore.
- The Bill seeks to clarify that the presumptive taxation will not be applicable to persons
  - Ø carrying on profession as referred to in sub-section (1) of section 44AA;
  - Ø earning income in the nature of commission or brokerage income; or
  - Ø carrying on any agency business.

The provision shall be effective from the assessment year 2013 –14

Rationalisation of provisions of tax withholding

- The Bill seeks to provide that a person who fails to withhold tax from payment to a resident, shall not be in default in respect of such tax if the payee has
  - Ø furnished his return of income u/s 139;
  - Ø taken into account such sum in the return of income; and
  - Ø paid the tax on the income and the person making payment obtains a certificate from an accountant in such form as may be prescribed.
- Interest shall be payable by payer from the date of deduction to the date of filing the return of income by the payee.

These amendments will take effect from 1st July, 2012.

- The Bill also seeks to amend section 40(a)(ia) to provide that the payer shall not be denied deduction of the expenditure in relation to which tax has not been withheld, if relevant conditions are fulfilled.

The provision shall be effective from the assessment year 2013 –14

Tax withholding from remuneration (including commission) to non executive directors

- The seeks to clarify that any remuneration (including fees or commission) paid to non executive directors shall be subject to tax withholding u/s 194J of the Act

The provision shall be effective from 1st July, 2012

Tax withholding from interest on debentures

- The Bill seeks to enhance threshold for tax withholding on interest on debentures issued by a widely held company to any resident individual or Hindu undivided family, as under

Type of debentures	Upto 30-06-12	From 01-07-12
Listed debentures	2,500	5,000
Unlisted debentures	-	5,000

The provision shall be effective from 1st July, 2012.

Senior citizens- age qualification unified

- The definition of effective age for a senior citizen is now made uniform across the provisions of the Act.
- The Bill seeks to achieve uniformization of the qualifying age for Senior Citizens by amending provisions of section 80D, 80DDB and 197A from 65 years to 60 years.

The amendment shall be effective from assessment year 2013-14, except that amendment to section 197A, which shall be effective from 1st July, 2012.

Senior Citizens to be exempt from Advance Tax

- The Bill seeks to provide relaxation to senior citizens, not having income from business or profession, from payment of advance tax.

The provision shall be effective from the assessment year 2013 –14

Gift between members of HUF not liable to tax

The Bill seeks to provide that any sum or property received by HUF from member without consideration / for inadequate consideration shall not be treated as income of HUF pursuant to section 56 of the Act

The provision shall be effective retrospectively from 1st October, 2009

Advance Pricing Agreement [APA]

The transfer pricing adjustments in respect of international transactions between associated persons have been the subject matter of enormous litigation between the taxpayer and the tax department. The method prescribed for determination of Arms Length Price [ALP] suffers from many limitations, including that of availability of information on the comparative uncontrolled transactions in public domain. The government having appreciated the limitations and hardships vide this Finance Bill seeks to provide a framework of APA the salient features whereof are as follows:

- The CBDT, with the approval of the Central Government, may enter into an APA with any person, determining the ALP or specifying the manner in which the ALP is to be determined, in relation to an international transaction to be entered into by a taxpayer
- The ALP may be determined either by methods currently prescribed for determination of ALP or any other method with adjustments or variations as may be necessary or expedient
- The APA shall be valid for period not exceeding 5 consecutive years
- The APA shall be binding to the taxpayer as well as the tax department in respect of the transactions covered by the agreement. However, in the event of any change in law or facts

having bearing on the agreement, the APA will cease to be binding

- APA may be declared to be void ab-initio if it has been obtained by the taxpayer by fraud or misrepresentation of facts

This provision shall be effective from 1st July, 2012.

Transfer Pricing Officer [TPO] to examine unreported transaction

- The Bill seeks to amend the section 92CA of the Act to empower TPO to determine Arm's Length Price of an international transaction, though not referred by the tax officer , provided that the transaction is not reported in the Transfer Pricing Audit Report

The amendment shall be effective retrospectively from 1st June, 2002. However, it is provided that assessment completed prior to 1st July, 2012 shall not be altered.

Transfer pricing regulations to apply to certain domestic transactions

- Currently, transfer pricing provisions apply only to international transactions. The Supreme Court in the case of CIT Vs. Glaxo SmithKline Asia (P) Ltd, having regard to the complexities in determining the fair market value of transactions entered between domestic related parties, suggested introduction of transfer pricing regulations for domestic transactions as well.
- In response to above, the Bill seeks to provide that ALP of a domestic transaction between related parties shall be determined in the same manner as applicable to the international transactions for the purpose of allowance of business expenditure and for computation of profits of any entity of a taxpayer eligible for profit linked deductions under chapter VI or section 10AA of the Act.
- The taxpayer to whom the provision applies will have to maintain prescribed records and sufficient documentation to support the ALP derived by him in respect of the transactions, non compliance whereof may attract severe penalties.
- The taxpayer will also have to obtain audit report as regards compliance with the provisions of the Act in this regard
- The above provisions shall not apply unless the aggregate value of the transactions between the related parties exceeds INR 5 crores in an assessment year.

Transfer Pricing - Other amendments

- The Bill seeks to provide that in the case of a taxpayer who is required to obtain transfer pricing audit report, the due date of obtaining tax audit report u/s 44AB of the Act shall stand extended from 30th September following the end of the financial year to 30th November.
- The Bill also seeks to clarify, with retrospective effect from 1st April, 2002 the scope of definition of international transaction so

as to *inter alia* include transactions on account of business restructuring or reorganization.

- The Bill seeks to amend Section 147 of the Act, to provide that if taxpayer fails to report an international transaction, it would construe as resulting into reopening of assessment u/s 147 of the Act.

This provision is effective from 1st July, 2012

Issues relating to Dispute Resolution Panel [DRP]

- Currently, while the taxpayer has right to appeal against the directions given by DRP, the direction is binding on the tax officer. The Bill seeks to provide right of appeal to the tax officer as well
- It is clarified that DRP shall have right to consider any matter arising from the assessment proceedings relating to the draft assessment order regardless of whether or not the taxpayer has raised issue in this regard. Consequently, the DRP shall have power to direct enhancement of income in respect of any matter though the matter has not been referred to it by the taxpayer

The provision shall be effective from the 1st July, 2012

Fee/Penalty for delay/incorrect furnishing of information of tax withholding

In order to streamline furnishing of TDS returns the Bill seeks to provide the following.

- Fees of INR 200 per day from the due date to the actual date of furnishing the return, subject to the amount not exceeding the tax withhold amount.
- In addition to said fee, a penalty ranging from INR 10,000 to INR 1 lacs to be levied in case where TDS return is belatedly furnished after one year from the date of tax withholding, along with applicable fees and interest.

The provision shall be effective from 1st July, 2012.

Limitation period for assessment of tax withholding enhanced

- The Bill seeks to extend time limit for passing tax withholding assessment order from 4 years to 6 years.

The amendment will take effect retrospectively from 1st April, 2010.

Extension of time for issue of notice to agent of non-resident

- Currently, a notice can be issued to any person for treating him as an agent of a non-resident, for assessment or re-assessment, within a period of 2 years
- The Bill seeks to extend the period for issue of such notice to 6 years

The provision shall be effective from 1st July, 2012

Validation of demand under the Act

The Bill seeks to provide to the effect that any notices issued, tax proceedings conducted, taxes levied or collected etc., in respect of capital gains arising through or from the transfer of a capital asset situated in India on account of transfer of shares of a foreign company shall be valid and shall not be called in question on any ground that the transaction has taken place outside India, regardless of the fact that any judgement, decree or order of any court or tribunal has been passed in this regard.

This clause appears to have been targeted towards recovery of tax demand from Vodafone International Holding in whose case Supreme Court held that capital gains arising from transfer outside India of shares of a foreign company between non residents is not liable to tax in India.

The provision shall take effect from coming into force of the Finance Act, 2012

Our Comments

The Finance Bill appears to be one of the lengthiest amongst finance bills of the recent past. The proposed amendments, apart from being large in number will have far reaching impact in the time to come.

The extension of Transfer Pricing regulations to the domestic transactions will entail enormous litigation, more so, in the wake of Advanced Pricing Agreement facility (which will be available in the case of international transactions) being made available in the case of domestic transactions. It appears that taxpayers should be given some cooling period to gear up to meet with the challenges of transfer pricing compliances. In case of its implementation as scheduled w.e.f. assessment year 2013-14, the taxpayers will have to acquaint with lengthy and detailed documentation, at the earliest, in the forth coming financial year itself.

Unexpected introduction of Alternate Minimum Tax to the conventional entities such as partnership firms and proprietary concerns which are entitled to tax holiday under chapter VI of the Act for unexpired period, will witness their financial planning moving out of gear.

Drastic retrospective amendments to nullify court rulings on ambiguous provisions of the Act are likely to be perceived as unstable and unpredictable tax regime in India by international and domestic taxpayers as well.

Tax Residency Certificate related amendment appears to have target of denial of tax benefits under DTAA, particularly the investors who

channelize investments through Mauritius and other low tax jurisdictions.

The effectiveness of the provisions relating to reopening past assessments up to sixteen years in the case of persons who hold assets in overseas jurisdictions will fetch expected results only if those jurisdictions co-operate and the tax department's efforts are supported by political will. However, there could be potential misuse of the provision, should the tax department, in the guise of the provision, reopens assessment of the past years and make attempt to tax transactions which have no bearing to the foreign assets.

The proposal mandating tax withholding from payment of consideration for purchase of immovable property will cause hardship to the taxpayers who are entitled to claim exemption of capital gains income, in the wake of a suitable back-up provision to apply and obtain certificate from tax department for lower or nil tax withholding. In view of vide definition of transfer under the Act, the tax withholding may be attracted in the case of development agreements, and where under such agreement, consideration is payable in kind, there would be hardship to the transferee who will have to withhold and deposit the tax without any cash consideration flowing from him. Also, the government will have to clarify whether the scope of the provision extends also to the transaction of sale of property by a developer in ordinary course of his business.

The amendment to the effect that share premium received by a company shall be deemed to be its income when the share is issued at a price which is more than its fair market value, is likely to create difficulty to the start-up companies in which, investment by the joint venture partners at premium is commercially necessary or expedient, more so, when the premium is justifiable on the discounted future cash flows as per RBI guidelines on FDI.

One amendment which would be beneficial to the taxpayers is the provision regarding tax withholding under which a person who has failed to withhold tax from any payment to a resident, will not suffer disallowance of expenditure or other adverse consequences of default if he is able to establish that the payee has duly considered the payment in his tax return and paid appropriate tax.

Finally, the most debatable provision introduced by the Bill is GAAR. It is surprising that no threshold is prescribed for invoking GAAR, perhaps CBDT may, as per the power delegated to it to frame guidelines, prescribe appropriate monetary limit for value of the transaction that can be subjected to GAAR. The provision that when GAAR is invoked, treaty benefits will be denied, is a proposition which would be in conflict with rules of international taxation in view of very widely worded GAAR. The experience of taxpayers with DRP mechanism does not raise high hopes of justice from the Panel to be

constituted which will comprise of commissioner of income-tax and others in higher rank. GAAR, unless administered selectively and appropriately, is likely to create chaos in tax litigation resulting into environment of uncertainty of high degree which will not be conducive for taxpayer community. The current scenario of economic slowdown and lack of business confidence is likely to worsen with such provision if administered indiscriminately. The courts in India have struck down tax avoidance schemes which lack substance, hence, codification of rules giving wide power to the tax authorities is neither warranted nor desirable. Instead, the government could selectively update from time to time transaction based specific anti avoidance rules.

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For any clarification or elucidation in respect of this alert, you may kindly connect to our Direct Tax Team.

We are reachable at:
PHD & Associates
Chartered Accountants
Radha Chambers, Level 3,
Telli Park Lane, Andheri East,
Mumbai - 400 069. India.
Tel : +91 22 26820083
Fax : +91 22 26830824
www.phd-ca.com