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Budget 2015 - Highlights :

- Test of tax residence by reference to POEM
- Source rules for foreign banks having a PE in India
- Clarity on allowance of balance 50% additional depreciation
- Tax pass through to be allowed to both Categories I & II of the SEBI (AIF) Regulations
- Abolition of Wealth Tax & consequent replacement by additional surcharge of 2%
- Disincentivizing black money transactions
- Proposal to reduce corporate tax rates to 25% over a period of next 4 years
- Deferral of GAAR provisions by 2 years

Budget 2015 - Important proposals pertaining to Direct Taxes

The Union Budget 2015-16 was presented amidst high anticipations of boosting the economy and huge expectations in respect of structural reforms It is not a budget that would disappoint you, nor is it a budget that would enthuse either. It emphasises on all sections of the economy and attempts to boost the 'ease-of-doing business' in India while focussing primarily on infrastructure development and health.

'Make in India' is an initiative which was announced as one of the key campaigns seeking to make India a manufacturing hub and aiming to focus on new processes and new infrastructure that would generate employment and improvise the economy was undoubtedly in the minds of the foreign investors while they were analyzing the fine prints of the budget. Contrary to the expectations, the budget did not bring the big bang reforms.

Some of the most significant features of this year budget on the Direct taxes arena were the burial of the wealth tax regime, the deferral of GAAR, the non-applicability of MAT provisions to FIIs and a proposal to reduce corporate tax rates to 25% over a period of 4 years in a phased manner. Besides this, there were certain amendments which seemingly have a far reaching ramification like the amendment in respect of tax residence status, source rules for foreign banks having a PE in India, fund managers not to constitute a business connection in India, redefining indirect transfers and the drive against proliferation of black money and so on.

Key Budget Proposals – Direct Tax

Benefits extended to Individuals

There is no change in the basic exemption limit and tax rates for individuals/HUF. However, in view of repeal of Wealth Tax, it is proposed to increase the surcharge from 10% to 12% on persons having taxable income above INR 1 crore. The Maximum Marginal Rate would thus be 34.608%.

To promote savings amongst individuals, the following incentives have been provided as deduction from taxable income

- Investment in Sukanya Samriddhi Scheme to be eligible for deduction under section 80C, in the future can be made in the name of girl child of whom the tax payer is a legal guardian. It is also proposed to exempt withdrawal made from the scheme
- Investment in pension funds can now be made upto INR 150,000, INR 50,000 more than the existing limit.
- It is also proposed to do away with the 10% of gross total income limit for contribution to notified pension fund. It is also proposed to increased the overall cap of deductions under Section 80C, 80CCC and 80CCD(1) to INR 200,000 from INR 150,000.
- The deduction for payment of health insurance premium is proposed to be increased from INR 15,000 to INR 25,000. The limit for senior citizens is also proposed to be increased from INR 20,000 to INR 30,000.

- Currently, deduction of INR 40,000 is allowed to a resident individual for specified medical treatment of self or dependent and INR 60,000 for senior citizen, only when a certificate is obtained from a specialist in a Government hospital and is furnished with the return of income. It is proposed to increase the limit to INR 80,000 in case of medical treatment of a very senior citizen. It is further proposed to do way with the requirement of furnishing the certificate and a prescription in prescribed form for such treatment from a specialist is to be obtained.
- Currently, deduction of INR 50,000 is allowed to a resident individual with disability and INR 75,000 with severe disability. It is proposed to increase the limits to INR 75,000 and INR 125,000, respectively.

Collation of proof by the employer for providing deduction from salary income

Currently, there is no uniformity or regulation regarding the documents to be obtained by an employer from the employee for allowing deductions, exemptions and set-off of losses etc., while computing the tax to be deducted. The CBDT has now been empowered to prescribe the form and manner for collection of evidences for allowing any deduction by the employer.

Proposal to reduce corporate tax rates to 25% over a period of next 4 years in a phased manner

Though there is no reduction in tax rates this year, during the budget presentation, the Finance Minister mentioned that in a period of next 4 years the corporate tax rates will be reduced to 25% in a phased manner so as to bring parity with the global average rate of tax. To offset the loss of revenue on that count, certain exemptions available in the Income Tax Act, 1961 will also be phased out.

Tax pass through to be allowed to both Categories I & II of the SEBI (Alternate Investment Funds) Regulations

With a view to streamline the taxation regime of Alternative Investment Funds (AIFs), it is proposed to provide pass through status to all the sub-categories of Category-I and also Category-II AIFs governed by the regulations of SEBI.

While the Category-I include AIFs which invest in start up or early stage ventures or social ventures considered as socially or economically desirable, the Category-II includes AIFs which are private equity funds or debt funds.

The taxation of income of such investment funds and their investors shall be in accordance with the proposed regime which is applicable to such funds irrespective of whether they are set up as a trust, company or LLP. The salient features are –

- ✓ Income of the unit holder of a investment fund, shall be chargeable in the same manner as if it were the income accruing to such unit holders, made by the investment fund, been made directly by them.
- ✓ Income in the hands of the investment fund, other than PGBP, shall be exempt from tax, while the income in the nature of PGBP shall be taxable in the hands of the investment funds.

- ✓ Income in the hands of the unit holder, which is of the same nature as PGBP, will be exempt.
- ✓ Income which is taxable in the hands of the unit holder shall be subject to TDS at the rate of 10% by investment fund.
- ✓ In a year where the investment fund incurs losses, such loss will not be allowed to pass through to the unit holders and rather would be allowed to be carried forward to the next year by such investment funds.
- ✓ Dividend distribution tax and tax on buyback of shares will not be applicable on payment of income by investment fund to unit holders.
- ✓ Investment fund to mandatorily file the returns.

Increase in threshold for Domestic Transfer Pricing to Rs. 20 crore

It is proposed to amend the provisions of section 92BA of the Income Tax Act, 1961 so as to increase the threshold limit for applicability of transfer pricing regulations to specified domestic transactions from Rs. 5 crore to Rs. 20 crore.

Abolition of Wealth Tax and consequent replacement by additional surcharge of 2%

Wealth tax was payable on certain specified assets at the rate of 1% on the net amount of wealth in excess of Rs. 3 million. It is proposed to abolish the Wealth Tax Act, 1957 to reduce the additional compliance burden on both the administrative authorities as well as taxpayers. It is also proposed to levy additional surcharge of 2% on domestic companies and all non corporate taxpayers to offset tax loss in lieu of the abolishment of wealth tax.

Deferral of GAAR provisions by 2 years

Taking into account the representations received from various stakeholders, it is proposed to defer GAAR provisions by 2 years. These provisions will be made available from the assessment year 2018-19 and subsequent years.

A welcome move which is expected to cheer the foreign investors and international community at large as the Finance Minister in his speech also proposed that the investments made up to 31-03-2017 shall not be subjected to GAAR.

Clarity on allowance of balance 50% additional depreciation

Currently, there are a few contrary judgments in which the additional depreciation of 20% of the cost of new plants and machinery is restricted to 50% of the eligible amount, in case the asset is put to use for less than 180 days under section 32(1)(iia) of the Income Tax Act, 1961.

It is proposed to bring clarity and to put an end to the ongoing dispute and allow the balance 50% of the additional depreciation in the immediately succeeding year.

Sops for Investments in backward areas of Andhra Pradesh and Telangana

With a view to give effect to the provisions of Section 94 of the Andhra Pradesh Reorganisation Act, 2014, it is proposed to provide additional investment allowance at the rate of 15% to the newly set up undertakings after 01-04-2015 which acquires and installs new assets from 01-

04-2015 till 31-03-2020 under Section 32AD of the Income Tax Act, 1961.

Further increased additional depreciation to be allowed to the aforesaid units at the rate of 35% under Section 32(1)(iia) of the Income Tax Act, 1961.

Test of tax residence by reference to POEM

Currently, under section 6 of the Income Tax Act, 1961, a company is said to be resident in India in any previous year, if (a) it is an Indian company, or (b) during that year, the control and management of its affairs is situated wholly in India.

It is proposed to amend the said provision and provide that, a company is said to be resident in India in any previous year, if (a) it is an Indian company, or (b) during that year, the control and management of its affairs is situated wholly in India if its place of effective management, at any time in that year, is in India.

'Place of effective management' has been defined to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. A set of guiding principles to determine POEM is also proposed to be issued subsequently.

In an important clarification issued by CBDT, it has been stated that amendment to residency rules have been drafted primarily with an intention to focus on companies in India who hold meetings abroad to circumvent tax in India. It was also clarified that the CBDT would come out with guidelines that would minimize the Assessing Officer's discretion in relation to the changes made.

Source rules for foreign banks having a PE in India

There are no provisions in the Income Tax Act, 1961 dealing with the interest payments from a permanent establishment (PE) in India to its foreign head office or foreign branches, specifically in case of banks. It is proposed to provide that, in case of a non resident engaged in business of banking, any interest payable by a PE in India to its foreign head office or foreign branches shall be deemed to accrue or arise in India. Such income will be taxed in India in addition to any other income attributable to the PE in India. The PE in India will be regarded as a separate person (a departure from 'mutuality principle'). *[Insertion of a Explanation to clause (c) of section 9(1)(v) of the Income Tax Act, 1961]*

Defining Indirect transfer provisions

Considering the concerns of various stakeholders regarding the scope of amendments being introduced vide amendments brought in Explanation 5 to Section 9(1)(i) of the Income Tax Act, 1961 by Finance Act, 2012 and in order to give effect to the recommendations of Expert Committee on that aspect, it is proposed to insert Explanation 6 and 7 to Section 9(1)(i) of the Income Tax Act, 1961 and provide that, the share or interest of a foreign company shall be deemed to derive its value substantially from the assets in India –

- ✓ if on the specified date, the value of Indian assets exceeds Rs. 10 crore and represents at least 50% of the value of all the assets owned by the foreign entity

- ✓ value of an asset shall mean the FMV of such asset without reduction of liabilities
- ✓ 'specified date' shall be the date on which the accounting period of the company ends preceding the date of transfer, but where, the book value of the assets on the date of transfer exceeds by at least 15% of the book value of the assets as on the last balance sheet date preceding the date of transfer, then date of transfer shall be the specified date of valuation
- ✓ the exemption shall be available to the transferor of a share of, or interest in, a foreign entity if he along with its associated enterprises, (a) neither holds the right of control or management, (b) nor holds voting power or share capital or interest exceeding 5% of the total voting power or total share capital, in the foreign company or entity directly holding the Indian assets (direct holding company).
- ✓ in case the transfer is of shares or interest in a foreign entity which does not hold the Indian assets directly then the exemption shall be available to the transferor if he along with its associated enterprises, (a) neither holds the right of management or control in relation to such company or the entity, (b) nor holds any rights in such company which would entitle it to either exercise control or management of the direct holding company or entity or entitle it to voting power exceeding 5% in the direct holding company or entity
- ✓ the taxation of gains arising on transfer of a share or interest deriving, directly or indirectly, its value substantially from assets located in India will be on proportional basis. The method for determination of proportionality is proposed to be provided in the rules.
- ✓ exemption shall be available in case of amalgamation / demerger subject to certain conditions *[Insertion of section 47 (viab) and (vicb) in the Income Tax Act, 1961]*
- ✓ there shall be a reporting obligation on Indian concern through or in which the Indian assets are held by the foreign company or the entity. *[Insertion of section 285A in the Income Tax Act, 1961]*
- ✓ in case of any failure on the part of Indian concern in this regard a penalty shall be leviable. The proposed penalty shall be (a) a sum equal to 2% of the value of the transaction in respect of which such failure has taken place (b) a sum of Rs 500000 in any other case. *[Insertion of section 271GA in the Income Tax Act, 1961]*

Fund managers in India not to be construed as having a business connection in India

With a view to further facilitate location of fund managers of off-shore funds in India it is proposed by way of insertion of Section 9A in the Income Tax Act, 1961 that the fund management activity of an 'eligible fund' carried out by the 'eligible fund manager' will not be construed to constitute a business connection in India of the said 'eligible fund'.

'Eligible fund' for this purpose would mean that -

- ✓ the fund is not a person resident in India;
- ✓ the fund is a resident of a country with which India has entered into a tax treaty;
- ✓ the aggregate participation or investment in the fund, by persons resident in India does not exceed 5% of the corpus of the fund;
- ✓ the fund and its activities are subject to applicable investor protection regulations
- ✓ the fund has a minimum of 25 members who are, directly or indirectly, not connected persons;
- ✓ any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding 10%;
- ✓ the aggregate participation interest, directly or indirectly, of 10 or less members along with their connected persons in the fund, shall be less than 50%;
- ✓ the investment by the fund in an entity shall not exceed 25% of the corpus of the fund;
- ✓ no investment shall be made by the fund in its associate entity;
- ✓ the monthly average of the corpus of the fund shall not be less than 100 crore rupees;
- ✓ shall not carry on or control and manage, directly or indirectly, any business in India or from India;
- ✓ neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India other than the activities undertaken by the eligible fund manager on its behalf;
- ✓ the remuneration paid by the fund to an eligible fund manager is not less than the arm's length price.

Further, the 'eligible fund manager' for this purpose –

- ✓ is not an employee of the eligible investment fund or a connected person of the fund;
- ✓ is registered as a fund manager or investment advisor in accordance with regulations;
- ✓ is acting in the ordinary course of his business as a fund manager;
- ✓ along with his connected persons shall not be entitled, directly or indirectly, to more than 25% of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through such fund manager.

Reductions of tax rates on Royalty and FTS

Currently, income in the nature of royalty and fees for technical services under section 115A of the Income Tax Act, 1961 is taxable at the rate of 25%.

With a view to obviate the problems faced by small companies and to facilitate the inflow of technology, it is proposed to reduce the rate of tax on such royalty and fees for technical services from 25% to 10%.

Furnishing of information in respect of foreign remittances

Currently, a person responsible for paying to a non-resident any sum chargeable to tax is required to furnish information as prescribed in section 195 of the Income Tax Act, 1961 and rules made there under. It is now proposed to levy a penalty of Rs. 100,000 for failure to furnish information or for furnishing of inaccurate particulars.

However, in a clarification by the CBDT officials, it has been stated that not all the cases would need to be reported and that the intention behind this was to be able to seek information irrespective of whether the sum paid was chargeable to tax or not. Also, only information that would be 'prescribed' would have to be furnished.

Generation of employment - Amending section 80JJAA

With a view to facilitate generation of employment, it is proposed to amend the provisions of Section 80JJAA of the Income Tax Act, 1961, so as to provide that the tax benefit under the said section shall be available to a 'person' deriving profits from the manufacture of goods in a factory and paying wages to new regular workmen. The eligibility threshold of minimum 100 workmen is proposed to be reduced to 50 workmen.

Amendments related to Settlement Commission

Current provisions relating Settlement Commission in Explanation to clause (b) of Section 245A of the Income Tax Act, 1961 have been amended to provide that, where a notice under Section 148 of the Income Tax Act, 1961 is issued for any assessment year, the taxpayer can approach the Settlement Commission for other assessment years as well even if notice under Section 148 of the Income Tax Act, 1961 for such other assessment years has not been issued but the returns under Section 139 of the Income Tax Act, 1961 or in response to notice under Section 142 of the Income Tax Act, 1961 is otherwise filed.

Further, currently the settlement commission can amend its order within a period of six months from the date of such order. However, there is no provision for additional time where the assessee or the Commissioner files an application for rectification towards the end of the limitation period. It is proposed to amend the Section 245D(6B) of the Income Tax Act, 1961 to provide that, the order can be rectified within a period of further six months from the end of the month in which such application is filed, however, the application itself should be filed within six months from the end of the month in which the order was passed by the settlement commission.

Furthermore, currently the settlement commission has the power to grant immunity from prosecution, however it is now proposed to amend the section 245H(1) of the Income Tax Act, 1961 to provide that the settlement commission while granting such immunity shall record the reasons in writing in the order passed by it.

Revision of assessments by Commissioner

Currently, under the provisions of Section 263 of the Income Tax Act, 1961, if the Commissioner considers that any order passed by the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue, he may pass an order modifying or cancelling the assessment and direct a fresh assessment.

In order to widen the scope, it is proposed to amend the provisions of the said section and provide that the order shall be deemed to erroneous in so far as it is prejudicial to the interests of the revenue, even if the order is passed (a) without making inquiries or verification, (b) allowing any relief without inquiring into the claim, (c) not in accordance with any order, direction or instruction issued by CBDT or (d) not in accordance with the decision of jurisdictional High Court or Supreme Court.

MAT provisions relating to FIIs

It is proposed to amend the provisions of MAT to provide that income from transactions in securities (other than short term capital gains arising on transactions on which STT is not chargeable) arising to FII, shall be excluded from the chargeability of MAT.

No MAT on share of profits of the member of the AOP

It is proposed that the share of income of a member of an AOP on which no income tax is payable in the hands of such member under normal provisions shall also be excluded from the chargeability of MAT.

Summation of penalty on tax sought to be evaded both under normal provisions as well as MAT

It is proposed that the amount of tax sought to be evaded shall be the summation of the tax sought to be evaded under the general provisions as well as under the provisions of Section 115JB or 115JC of the Income Tax Act, 1961.

However, where the same amount is considered to be evaded both under general provisions as well as under the provisions of Section 115JB or 115JC of the Income Tax Act, 1961, then such amount shall be considered only once.

Further, where Section 115JB or 115JC of the Income Tax Act, 1961 is not applicable, the penalty only for the tax evaded under general provisions shall be levied.

Disincentivizing black money transactions

With a view to curb the generation of black money in real estate, it is proposed to amend the provisions of Section 269SS and 269T of the Income Tax Act, 1961 so as to prohibit acceptance or repayment of advance in cash of Rs. 20,000 or more for any transaction in immovable property. Further, it is also proposed to provide a penalty of equal amount in case of contravention of such provisions under Section 271D of the Income tax Act, 1961.