Finance Bill 2006 - Business Taxation

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The Finance Minister, while presenting the budget characterized the year that has gone by as the best of times and the worst of times. The budget is a growth oriented budget. The tax implications of the changes proposed are sweet and sour. Although some degree of rationalization has been carried out in certain areas, some of the expectations remain unfulfilled. This paper attempts to look at the implications of the changes with respect to business taxation.

Fringe Benefit Taxes

1.1 The amendments proposed under the Fringe Benefit Taxes are with reference to Assessment Year (AY) 2007-08. Therefore, no change has been made for the current year.

1.2 Under the existing provisions contained in section 115WC, the value of fringe benefits is to be determined in terms of percentage of certain expenses specified in section 115WB. Clause (b) of sub-section (1) of section 115WC provides that the actual amount of contribution by the employer to an approved superannuation fund for employees shall be the value of fringe benefits. It is now proposed that the contribution by an employer to an approved superannuation fund to the extent that it does not exceed rupees one lakh per employee in respect of whom contribution is made, shall not be liable to fringe benefit tax. The memorandum explaining the provisions in the finance bill has given the following illustration to clarify the legal intent :

An employer who has three employees: A, B and C makes contribution to their account in the approved superannuation fund in the following manner:-

Employee	Contribution to approved superannuation fund by the employer
A	Rs. 50,000
B	Rs. 90,000
C	Rs. 2,00,000

In the case of the employees A and B, the value of fringe benefits shall be taken to be nil since contributions by the employer in respect of these employees does not exceed Rs. 1,00,000 in each case. However, in the case of employee C the value of fringe benefit shall be Rs. 1,00,000 (Rs. 2,00,000 – Rs 1,00,000) for the purpose of levy of fringe benefit tax.

1.3 Section 115WB defines the term 'fringe benefits'. Sub-section (2) provides that the fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has, in the course of his business or profession incurred any expense on or made any payment for the purposes of the expenses mentioned there under. The proviso to clause (D) of sub-section (2) lists down certain types expenses which are not considered as expenditure on sales promotion including publicity. Clauses (vii) and (viii) are proposed to be inserted to provide that the expenditure on distribution of free samples of medicines or of medical equipment to doctors and payment to any person of repute for promoting the sale of goods or services of the business of the employer, shall not be included in 'sales promotion including publicity' for valuation of fringe benefits. The entire concept of fringe benefit taxes is based on presumptive taxation. It is therefore surprising that words such as person of repute have been used which could lead to litigation in future.

1.4 The expenditure on tour and travel (including foreign travel) is made a separate clause as distinguished from expenditure incurred on conveyance. While conveyance continues to attract 20% for the purpose of valuation of fringe benefits, the tour and travel including foreign travel will be valued at 5%.

1.5 The expenditure incurred on the to and fro journey from residence to office of the employees is proposed to be specifically exempted. To give effect to this, the sub-section (3) of section 115WB is proposed to be amended so to provide that any benefit or amenity in the

nature of free or subsidized transport or any such allowance provided by the employer to his employees for journeys by the employees from their residence to the place of work or such place of work to the place of residence shall not form part of fringe benefits.

1.6 Substantial relief has been provided to employers engaged in the business of carriage of passengers or goods by aircraft or by ship, the valuation of provision of hospitality and expenditure on use of hotel, boarding and lodging facilities will be carried out at the rate of 5% as against the existing 20%.

1.7 It would have been desirable had the above amendments been made w.e.f. AY 2006-07 instead of AY 2007-08.

Amendment to section 43B

2.1 A very significant amendment has been made, with retrospective effect, with respect to the funded interest loans. This will have an adverse effect in all the cases where the interest on the term loans have been rolled on.

2.2 It is proposed to insert two new Explanations, i.e. Explanation 3C and Explanation 3D to clarify that if any sum payable by the assessee as interest on any loan or borrowing or advance is converted into a loan or borrowing or advance, the interest so converted and not 'actually paid', shall not be deemed as 'actual payment'. Therefore such amount will not be allowed as deduction under section 43B in the computation of income. The irony is that these amendments are being inserted with retrospective effect from the date on which the respective provisions under clause (d) and (e) of section 43B came into effect.

Deduction of taxes paid on income earned outside India

3.1 Section 40 (a) (ii) provides that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains will not be allowed as deduction in the computation of income. The judicial opinion is divided as to whether income tax paid in a foreign county is eligible for deduction in the computation of profits or gains from business or profession. The overwhelming view is in favor of the department. Reference may be made to Kirloskar Electric Co. Ltd. v Commissioner of Income Tax (1997) 228 ITR 676 (Kar); Wipro Information Technology Limited vs. Dy. CIT (2004) 88 TTJ (Bang.).

3.2 With a view to end the judicial conflict, it is proposed to insert Explanation 1 to sub clause (ii) of clause (a) of section 40 so as to clarify that any sum paid outside India and eligible for relief of tax under section 90 or deduction from the income tax payable under section 91 is not allowable. It also provides that it is deemed to have never been allowable as deduction. However, the tax credit in respect of income tax paid in a foreign country in accordance with the provisions of section 90 or 91, as the case may be, will continue to be available. This amendment, said to be clarificatory in nature, is inserted in the Act as on 1st April 2006.

3.3 It is further proposed to insert Explanation 2 to provide that any sum paid outside India and eligible for relief of tax under newly inserted section 90A will not be allowed as a deduction in the computation of profits and gains from business or profession. This amendment will be effective from 1st June 2006.

Exemption of aircraft lease rentals

Section 10 (15A) provides for exemption from income tax of the lease payment received in respect of lease of an aircraft or an aircraft engine by the government of a foreign state or a foreign enterprise from an Indian company which is engaged in the business of operation of aircrafts. This exemption is currently with respect to an agreement entered prior to 01st April, 2006. It is proposed to provide that the exemption for lease payments shall continue with regard to agreements entered into on or before 31st March, 2007.

Health insurance premium

Presently the deduction for the premium paid to effect or to keep in force insurance on the health of the employees is available where the scheme is framed by the General Insurance Corporation of India and is approved by the Central Government. The benefit of this deduction is now being extended to other insurance companies where the scheme

is approved by the Insurance Regulatory and Development Authority. This will boost the private insurance players.

Definition of derivatives

Section 43 (5)(d) provides that an eligible transaction in respect of trading in derivates carried out in a recognized stock exchange is not deemed to be a speculative transaction. The reference here is to clause (aa) of section 2 of Securities Contracts (Regulation) Act. Through an amendment made in January, 2005 to the Securities Contracts (Regulation) Act, 1956 the said clause (aa) has been re-lettered as clause (ac). Accordingly, the reference to the definition of the term "derivative" has been re-lettered in clause (5) in section 43. This amendment has been made with retrospective effect from 01st April, 2006. This is a consequential amendment and does not have any tax implications.

Minimum Alternate Tax (MAT)

A few important changes have been carried out with reference to the Minimum Alternate Tax (MAT). The implications of these have been discussed separately in another article appearing in the journal. It is sufficient to mention here that the suggestion of the Institute of Chartered Accountants of India (ICAI) in the pre-budget memorandum with respect to credit for payment of MAT to be considered for the purposes of charge of interest under sections 234A, 234B and 234C has been accepted.

Transfer Pricing

The existing proviso to sub-section (4) of section 92C provides that no deduction under section 10A or under section 10B or under Chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this sub-section. Such an enhancement can be done where during the course of any proceedings for the assessment of income, the Assessing Officer determines the arm's length price in relation to the international transactions, as provided under sub-section (3) of section 92C. It is now proposed to extend the application of sub-section (4) of section 92C to newly established units in Special Economic Zones as provided in Section 10AA.

Section 10 (15A) provides for exemption from income tax of the lease payment received in respect of lease of an aircraft or an aircraft engine by the government of a foreign state or a foreign enterprise from an Indian company which is engaged in the business of operation of aircrafts.

Timely return filing

With a view to ensure better compliance with the law, it is proposed to link the benefit of certain deductions with the timely filing of income tax returns. This amendment will be applicable w.e.f. AY 2006-07. The assessees availing deduction/ exemption under sections 10B, 80-IA, 80-IAB, 80-IB and 80-IC need to be vigilant.

Unattended important issues

No budget can ever fulfill all the expectations. It is therefore natural that some of the expected changes do not find place in the fine print. A few of the important unattended issues with respect to business taxation are listed below :-

10.1 The hardship caused by section 40(a) (ia) remains unattended. The objective of enforcing compliance with the TDS provisions could still have been achieved if the proviso below section 40(a) (ia) allowing deduction in the year in which the payment is made was modified to provide rectification in the very same assessment year to which the expenditure related to rather than the year in which the tax deducted at source was paid. This could have been achieved by deleting the said proviso and by making necessary amendments in section 155.

10.2 The respective provisions of remuneration payable to partners of a firm need to be reconsidered. This is more so in case of professional firms which cannot take the shape of a limited company.

10.3 It has been noticed that some of the income tax authorities are applying the provisions of section 40A (3) even where cash is deposited in banks due to contractual obligations. A clarificatory amendment in this regard would have helped the tax payers.

10.4 The distinction between the speculative and non-speculative transactions relating to derivatives has no relevance. The explanatory memorandum to the Finance Bill, 2005 stated that systematic and technical changes in the stock market have resulted in sufficient transparency to prevent generation of fictitious losses through artificial transactions. It would therefore have been appropriate that section 43(5) was suitably amended.

10.5 The amendments with reference to the Fringe Benefit Taxes should have been made effective from AY 2006-07 being the first year of these taxes. It is difficult to understand the logic by deferring it to the next year. Several suggestions had been given to the Finance Ministry by various associations, chambers and by others. Unfortunately these have not found favor with the government.

Conclusion

Though the changes under the head of business taxation are not many but they are significant enough to generate meaningful discussion. ❑