Post Budget Memorandum-2006

The ICAI recently submitted the Post-Budget Memorandum, 2006 to the Government. The Government had accepted some of the suggestions contained in our Pre-Budget Memorandum - 2006 and incorporated the same in the Finance Bill, 2006. Setting off MAT credit while computing interest under sections 234A/234B/234C, pre-poning of the period for completion of assessment, interest for late payment of tax deducted at source and tax collected at source to be paid on self-assessment basis and incorporation of the reverse mechanism in service-tax are examples in this regard.

What follows is a brief summary of the suggestions contained in the Post Budget Memorandum-2006 relating to income-tax and service tax. The full text of the Memorandum has been hosted on the website of the ICAI.

1. Clause 3(i) – Amendment of sub-clause (iia) of clause (24) of section 2

The voluntary contributions received by universities, educational institutions, hospitals, charitable trusts or other institutions claiming exemption under section 10(23C) and section 11 would be now considered as income under section 2(24)(iia).

It is suggested that in respect of voluntary contributions received by a university and other institutions there is a need to insert a clause exempting corpus contributions in section 10(23C) on the lines of section 11(1)(d) of the Act.

2. Clause 3(d)(i) - Section 10(23C) - Insertion of twelfth proviso w.e.f. 1st June, 2006

The Finance Bill, 2006, proposes to introduce a time limit for making application for grant of exemption or continuance of exemption under section 10(23C) by educational and medical institutions. As per the existing provisions, no time limit as to by what time this application has to be made has been prescribed for obtaining this approval. Now,the assessees have to make an application for approval within the same financial year in respect of which exemption has to be claimed. This provision may create some practical difficulty in case for any justifiable reason the application could not be filed within the financial year.

It is suggested that for making application for grant of exemption or continuance of exemption under section 10(23C) by educational and medical institutions, there should be an enabling provision giving power to the prescribed authority for condoning the delay for justifiable reason. Further, it is suggested that there is a need to fix the time limit, say, by the last due date for filing the return instead of the last day of the financial year.

3. Clause 4(g) - Amendment of clause (38) of section 10

As per the proposed amendment the income arising on account of long-term capital gain in respect of equity shares in a company or units of equity-oriented fund on which STT has been paid will become part of book profit for the levy of MAT under section 115JB. This amendment has serious implications and goes against the reason for which the STT was imposed.

It is suggested that the long-term capital gains in respect of equity shares in a company or units of equity-oriented fund on which STT has been paid should not be part of book profit for the levy of MAT.

4. Clause 22 - Insertion of new section 115BBC - Anonymous donations to be taxed in certain cases

Under the proposed section 115BBC anonymous donations received by a university, educational institution, hospital or any fund, institution or trust shall be liable for tax at the rate of 30% without any deduction or set off under any other head. However, donations received by a trust or institution created or established wholly for religious purposes shall be outside the purview of this provision. Similarly anonymous donations received by a trust or institution which is created or established both for religious as well as charitable purposes shall not be covered by this provision unless such anonymous donation has

been received with a specific direction that such a donation is for a university, educational institution or hospital or medical institution run by such trust or institution.

It is suggested that 30 per cent of tax paid under sections 115BBC should be deemed to be application for charitable purposes. Further, in the case of genuine NGOs who may not be able to maintain the identity of their innumerable anonymous donors, appropriate relaxation may be made.

5. Clause 5(b) - Insertion of fourth proviso in section 10B

Clause 15 - Insertion of new section 80AC - Deduction not to be allowed unless return furnished

It is proposed to provide that the deduction under sections 10B, 80-IA, 80-IB, 80-IC will not be allowed in case the return is not filed within the time limit prescribed under section 139(1) of the Act. This provision will create undue hardship to certain units which are eligible for deduction and for unforeseen circumstances and for reasons beyond their control, are not able to file the returns before the due date. The Finance Act, 2005, has already inserted a proviso to section 139(1) making it mandatory for these entities claiming exemption to file return of income. A simple default of one day or two may invite additional huge tax liability besides liability of interest under sections 234A, 234B and 234C despite there being provisions to levy penalty for late filing of return under sections 271F of the Act.

It is suggested that the benefit of deduction under section 10B, 80IA, 80IB and 80IC should not be denied merely for the failure of the assessee to furnish a return of income before the due date since this is only a procedural lapse which can be rectified. Alternatively, stiff penalties ssmay be provided in section 271F for such a default.

6. Clause 7 – Amendment of section 14A

It is proposed to amend section 14A making it mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to such income which does not form part of the total income in case the Assessing Officer is not satisfied on the basis of the accounts of the assessee with the correctness of the expenditure allocated by the assessee himself. The allocation by the Assessing Officer in such a situation would be done in accordance with the prescribed method. .

The expression "having regard to the accounts of the assessee, is not satisfied with the correctness of the claim of the assessee" may lead to genuine hardships, if the power is not exercised in a judicious manner. Specific departmental guidelines may be evolved in this regard.

The methodology for ascertaining the expenditure relatable to exempt income should be deliberated upon with the Institute of Chartered Accountants of India so that the expenditure determined is proper and fair from the revenue side as well as the tax- payer side.

7. Clause 9(a) – Amendment of section 36

It is proposed to allow the amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed by the General Insurance Corporation of India or any other insurer. In this electronic age, payments can also be made by methods other than through a cheque like electronic transfer, mail-transfer, telegraphic transfer or through internet. Such payments are also capable of being tracked.

In this regard the deduction should be allowed in respect of any premium paid by modes other than by cheque also, provided such payments are capable of being tracked.

8. Clause 12 - Amendment of section 43B - Insertion of Explanations 3C and 3D

Provisions of section 43B are being amended to clarify that in case of overdue interest payable to financial institutions and if such interest gets converted into loan by the financial institution or the bank, the same would not be deemed as actual payment and as such shall not be eligible for deduction while computing profits and gains of business or profession. This amendment is being made retrospectively in respect of interest on loan from public financial institutions from the A.Y. 1989-90 and in respect of loan from scheduled banks with effect from the A.Y.1997-98.

It is suggested that it should be provided that any such interest which gets converted into loan shall be allowable u/s 43B as and when such loan which represents the interest component is actually paid by the assessee. It is also suggested that to avoid practical difficulties, the amendment may be made prospectively, namely, w.e.f. A.Y. 2007-08.

9. Clause 16 - Amendment of section 80C

Provisions of section 80C whereby a deduction of up to Rs.1,00,000 is allowed while computing the total income of an individual or HUF in respect

of the life insurance premium, contribution to provident fund etc., are being amended to include fixed deposit with a scheduled bank of a period of not less than five years. No condition has been imposed prohibiting a person from obtaining a loan against such fixed deposit. Further, in case of cumulative fixed deposit where interest would be payable on maturity, interest accrued each year will be deemed investment for that year. There may be cases where assessees may foreclose the fixed deposits due to exigencies

A restriction may be placed as not to allow premature encashment of term deposit for which the benefit of deduction has been taken under section 80C. Alternatively, in case of premature encashment, the same should be included in the income to the extent of the deduction claimed against such term deposit in the year of encashment. Also interest accrued each year should be deemed as investment for that year.

10. Clause 28(a)(i)(B) - Amendment of section 115WB - Insertion of new clauses (vii) and (viii) in sub-section (2) clause (D)(Fringe Benefits)

a) The total amount of expenditure incurred on tour and travel including the expenditure on boarding and lodging during travel should be considered as expenditure on tour and travel and be valued at 5%.

b) Suitable amendment may be made to clarify the position in relation to medical re-imbursement paid to employees.

c) Further suggestions :

- Adjustment should be allowed for any excess tax paid against FBT and vice-versa .
- A threshold limit on the lines prescribed under section 209 for payment of advance income tax should be provided.
- Liability to pay interest in case of short-fall of payment of FBT should be there only when the amount of the tax paid is less than 90% of the total tax assessed.
- Provisions regarding payment of FBT in advance may be modified as under :-

(i) The FBT may be paid in advance on the basis of yearly estimate made by each employer exactly on the line, which is presently done for the payment of income tax.

(ii) The payment should be allowed to be made along with due dates for payment of advance income tax as it will go to reduce the paper work.

- There is a need either to exempt the class of employers covered by presumptive taxation or to prescribe a mechanism for the value of fringe benefits in such cases.
- A threshold limit should be prescribed.
- The concessional rate of 5% in respect of the specified expenditure should be extended to the professionals on the line on which the concession has been given to the pharmaceuticals and computer software industry.

11. Clause 32 – Amendment of section 139A

Under the proposed amendment the Central Government proposes to acquire power to allot PAN mandatorily to certain classes of persons. It is possible that the persons to whom such mandatory allotment of PAN is made might have already got the PAN number.

Before allotting PAN on mandatory basis, there should be a mechanism to verify whether a person has already been allotted PAN.

12. Clause 33 - Insertion of new section 139B - Tax return preparers

It is proposed to introduce a new scheme under section 139B of the Act to facilitate submission of income tax returns through tax return preparers. Such tax return preparers would be individuals other than legal practitioners, chartered accountants and would be eligible to submit returns only of persons other than those of companies and persons whose accounts are required to be audited under section 44AB or under any other law for the time being in force. The Board is authorised to make a scheme for the same prescribing the education and other qualifications to be possessed, training, code of conduct, duties and obligations for such tax return preparers.

When a large number of professionals like CAs having expertise are doing this work, there is no need for such a class of persons. In any case, it may be made explicit that the provision is optional and does not affect the role of CAs in this area of practice.

The chartered accountants may also be permitted to act as tax return preparers.

13. Clause 34 - Amendment of section 140A, clause 48 - Amendment of section 234A, clause 49 - Amendment of section 234B and clause 50 - Amendment of section 234C

It is proposed to clarify the

provision of computation of interest under sections 234A, 234B and 234C of the Act in the case of MAT credit as well as foreign tax credit. It has been provided that interest under these sections is to be calculated after giving credit, if any, of MAT as well as foreign tax credit. This will settle down unnecessary controversy going on for many years where interest is being computed on the amount of tax without first giving credit of MAT and foreign tax credit, if any. Even though, this is a beneficial amendment, it is effective from A.Y. 2007-08. This will leave existing disputes pending, leading to revenue loss.

The relevant amendments may be made retrospective in an appropriate manner.

14. Section 40(a)(ia)- Amendment made by the Finance (No.2)Act,2004

The proviso below section 40(a)(ia) may be deleted and a new sub-section may be introduced in section 155 allowing rectification in that very year to which the expenditure pertains to, on the assessee producing evidence of payment of the tax deducted or evidence that the deductee has included the income received by him from the deductor in his return of income and has paid tax on the income declared by him.

Suggestions Relating To Service-tax

A. Suggestion For Changes In The Statutory Provisions

1. Section 66 – Rate of Tax

In order to ensure a better rate of voluntary compliance the levy of service tax should be maintained at a rate of 10% only.

2. Concept of Mutuality

Concept of mutuality to be re-instated by deleting the explanation inserted after clause 65(105).

3. Anomaly in drafting of section 66A(2)

Treatment of two permanent establishments (PE) of one concern as different persons may cause undue hardship to the assessee.

4. Case for deletion of section 73D

The publishing of the names of the payment defaulters will cause a tremendous loss of confidence with the service providers. Looking to the existing scenario, it is suggested that provisions of section 73D should be deleted.

5. Rationalisation of penalty for non-payment of tax under section 76

It is hereby suggested that –

(i) the penalty under section 76 for failure to pay tax be deleted ; and

(ii) the penalty under section 78 for suppression or concealment of value of taxable service be retained.

(iii) Interest under section 75 @ 13 % p.a. be retained.

B. Suggestions For Changes In The Service Tax Rules, 1994

1. Validity of Rule 5(4)

Presently, there are no substantive provisions which give powers to the Central Excise Officers for inspection and/or examination of records maintained by the assessee. In the absence of the statutory provisions the validity of Rule 5(4) can lead to unwanted litigation. Therefore it is necessary to delete the above said sub-rule.

2. Due date of payment of service tax

Due dates of service tax to be kept at 15th of the following month / quarter instead of 5th and payment for the latter half of March may be made by 15th April.

The due dates could thus be summarised as under:

Status of payer	Period	Due date
Companies	All months except March	15th of the following month
	1st March – 15th March	25th March
	16th March – 31st March	15th April
Other than Companies	All quarters except January – March	15th of the month following the relevant quarter
	1st January – 15th March	25th March
	16th March – 31st March	15th April

It is suggested that Rule 6(3) should be amended to provide for adjustment of all taxes paid in excess from the shortfall of tax paid in an earlier or subsequent period, provided there is no unjust enrichment.

In Rule 6(5) which provides for filing a reconciliation statement in Form ST-3A along with the

returns in case of provisional assessment the words "quarterly or" maybe deleted since returns have to be submitted only half-yearly under the present dispensation.

C. Suggestions With Regard To Notifications

1. Withdrawal of exemption Notification no. 59/98 dated 16.10.98 in the case of CA/CS/Cost Accountant

The rationale behind the withdrawal of the said exemption certificate is not understood. There is no change in the circumstances prevailing at the point of time when notification no. 59/98 was issued and circumstances as are prevailing presently when the said notification has been withdrawn. Levy should be with reference to service and not service provider. Discrimination is greater now due to 12.24% as against 5% in 1998.

The above-mentioned exemption notification was issued after much deliberation and on the principle of equity. Withdrawal of notification is clear cut violation of Article 14 of the Constitution of India. Discrimination has been made between two service providers though both are rendering the same taxable services. The withdrawal of exemption notification is also against the judicial pronouncements on the subject including the judgment given by the Hon'ble Kerala High Court in the case of Anthony Educational Society Vs. Union of India 1 STR 137.

2. Anomaly of withdrawal of exemption in the case of Insurance Business Services

Notification No. 3/94- Service Tax dated 30th June, 1994 has been amended vide Notification No. 3/2006- Service Tax dated 1.03.2006 Exemption provided to insurance business where premium is received from re-insurance both domestic and overseas and all insurance business where the premium is booked outside India has been withdrawn. The definition of an "insurer" is amended by substituting clause (58) of section 65 to substitute the words "in India" by the words "and includes a re-insurer" which will take effect from the date to be notified after the enactment of the Finance Bill, 2006. As the definition will be effective from the date of enactment of Finance Bill, 2006 and the exemption provided in Notification No. 3/94- Service Tax dated 30th June, 1994 has been withdrawn vide Notification No. 3/2006-Service Tax dated 01.03.2006 with effect from 01.03.2006 there exists an anomaly and exemption cannot be withdrawn before the enactment of the Bill. Hence, the anomaly needs to be redressed.

3. Distortion due to condition that service tax credit cannot be claimed by service provider availing abatement.

Credit for service tax paid to the sub-service providers should be allowed as an exception to the general rule that service provider will not be eligible to claim credit of service tax paid on input services. Notification No. 1/2006 should be amended to give effect to the above-said suggestion.

D. Other Issues Which Require Immediate Attention Of The Government: -

1. Need for Settlement Commission

On account of a large number of disputes arising in the service tax, the Settlement Commission for the same is the need of the hour.

2. Case of Abatement in the case of AMC

The following suggestions are made in respect of annual maintenance contract :

(i) On a monthly / quarterly basis when the service tax is paid on maintenance and repair services, the cost of parts / other materials may be deducted from the value of maintenance and repair services and service tax may be paid on the net amount;

(ii) A standard rate of abatement may be given like in case of mandap keepers (40% for catering), tour operator (60% for package tour which includes accommodation booking), construction services (67% for materials) etc.

3. General Clarification in cases where sub-service provider is rendering services to Main Service Provider

A general clarification is required regarding the service tax leviability in the case of a sub-service provider on the line of "Inclusion in or exclusion from taxable value of certain expenditure or cost" in draft "Service Tax (determination of value) Rules, 2006 – feedback invited – reg." dated 1st March, 2006.

4. Credit for Additional Custom Duty

The credit for additional customs duty leviable under section 3(5) of the Customs Tariff Act should be extended to the service providers.

5. Revision of returns

It is hereby suggested that there should be a provision for revising the returns, which is absent in the present dispensation.

6. Assessment

Time limit to be provided for completion of proceedings initiated by a show cause notice

E. Changes In The Export Of Services Rules, 2005

The rules envisage delivery of services outside India. It is to be noted that services being intangible cannot be delivered physically like goods which are tangible. Hence, the condition of delivery may be dispensed with. The condition that the service should be used in business outside India would meet with the requirements of exports.

Certain changes in the categorization of services – Mandap keeper services to fall under rule 3(1) instead of rule 3(2) and practicing chartered accountants, cost accountants and company secretaries to fall under rule 3(3) instead of rule 3(2).

Similarly, it is also suggested that services provided by practising chartered accountants, practising cost accountants and practising company Secretaries [clauses (s), (t) and (u) of sub-section (105) of section 65 respectively] being professional services must be categorized under rule 3(3) along with other professional services such as management consultants, consulting engineers, etc. according to which the services are considered as exported if recipient of the service is located outside India.

F. Changes In Cenvat Credit Rules, 2004

There are certain clarifications/changes which may be considered in the area of CENVAT Credit Rules, 2004. These are as follows:

(i) Clarification on the availability of input tax credit for service tax paid on reimbursable expenses or pass through transactions.
(ii) Refund of CENVAT credit to service providers.
(iii) Input credit on export services.
(iv) Obligation of manufacturer of dutiable and exempted goods and provider of taxable and exempted services – Rule 6 drafting improvements
(v) Clarification on availability of input tax credit if only part payment is made to the input service provider.
(vi) Transitional provision
(vii) Condition of receipt of capital goods in the premises of the output service provider. ❐

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