Salient Features of Finance Bill, 2005

—Ved Jain

Direct Taxes

1. Introduction

Budget day is the day of the Finance Minister. It is a day when all eyes are on him. Everybody eagerly awaits the various proposals and announcements which the Finance Minister is to unfold in his budget speech. With the globalization of world trade and India being a potential country for investment the budget evokes interest of the international community as well. This year's budget day was not different. The Finance Minister presented the second budget of the present government on 28th February, 2005. The expectation from the Finance Minister this time was very high, particularly on the tax front as he himself has announced while presenting his last budget, 2004, that next budget, will be a budget of tax reforms.

On the economic front the performance of the country's economy during the year 2004-05 was excellent. The Indian economy during the year 2004-05 grew by 6.9 per cent. The heartening feature is the growth in the industrial sector from 6.6 per cent in the year 2003-04 to 7.8 per cent in the year 2004-05. The growth would have been more impressive but for the lower growth in the agricultural sector of 1.1 per cent, mainly because of the shortfall in the south-west monsoon which has resulted in the decline of the foodgrains production by about 3 per cent. The growth of economy by 6.9 per cent has taken the GDP to 28.33 thousand crores.

Looking to the impressive growth consistently for two years the expectations from the budget was high. It was also expected that the budget shall be economically driven rather than politically driven. The impressive growth rate in the GDP and the inflation, revenue and fiscal deficit under control, the expectations were that Finance Minister will go for second generation reforms.

After going through the budget it appears that the budget presented by the Finance Minister is more politically driven rather than economically driven. The budget gives focus to the Rural India. To implement the vision of 'Bharat Nirman' the Finance Minister has proposed a business plan and has announced a gigantic task of irrigating one crore hectares of land, connecting all villages by road, constructing sixty lakh houses for the poor and providing electricity and telephone connectivity to all villages. Though certain issues concerning the industrial growth such as reduction in custom duty, earmarking of funds for infrastructure through Special Purpose Vehicle have been addressed, the industrial sector has not received that much focus which is required to sustain the impressive growth of more than 8 per cent. India being a country of more than 1000 million people, the ultimate solution to its problem of poverty, unemployment lies in giving strength to the economy rather than distributing the largesse.

On the front of investment, the Finance Minister recognizes that investment is a paramount requirement to consolidate the growth process and has indicated that the government shall enhance public and private investment in the infrastructure required for agriculture and facilitate investment in public goods such as roads, railways, power, seaports and airports but there is no concrete proposal from the Finance Minister. On the issue of foreign direct investment (FDI), the Finance Minister despite referring to the investment of US $ 500 billion in China since it opened its economy in 1980, has not come out with any proposal in the budget and has simply stated that the government will come forward with suitable proposals after due consultations. It may be a political compulsion but that confirms the fact that this budget is more politically driven than being economically driven. Despite the liberal disbursement of money for so many social welfare measures announced by the Finance Minister in the budget, it is soothing that the budget document still shows total commitment of keeping the revenue deficit as well as fiscal deficit under control.

On the revenue front the gov-

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ernment has been able to mobilize tax revenue of Rs.3,06,021 crores during the year 2004-05 as against Rs.3,17,731 crores estimated in the Budget 2004. The short fall in revenue collection is mainly on account of corporation tax and excise duty. The projection for the year 2005-06 has been kept at Rs.3,70,025 crores which includes Rs.1,77,077 crores on account of direct taxes as compared to Revised estimate of Rs.1,34,194 crores for the year 2004-05. An idea of the growth in the direct tax collection can be had from the fact that during the Financial Year 2001-02 the total direct tax collection was of Rs.68,613 crores and in the year 2005-06 it is expected to reach Rs.1,77,077 crores, i.e., more than 2.5 times within a period of four years.

The Finance Minister has put forward various proposals to amend the various provisions of direct and indirect taxes. The Finance Minister has also put on hold many suggestions for amendment to the direct and indirect tax laws. Only those suggestions which were required to be acted upon immediately have been incorporated in the Finance Bill, 2005 and the Finance Minister will be bringing a separate bill for implementing the other suggestions. Thus we all need to wait for another large set of amendments, of course, in the guise of simplification and rationalization. But the past experience and this Finance Bill, 2005 are fairly good indicators that the amendments proposed for the sake of simplification and rationalization go to make the tax laws even more complicated and difficult for one to interpret and comply the same.

The Finance Bill, 2005 has 124 clauses out of which 64 clauses are for amending the direct tax laws. The implication of these various amendments is being analysed. Unless otherwise stated, all these amendments shall be effective from 1st April, 2006, (Assessment Year 2006-07) i.e. income earned during the Financial Year starting from 1st April, 2005.

2. Personal Tax Rates

The Finance Minister has taken a bold initiative by restructuring the personal tax rates. As per the proposal, the new tax brackets and new tax rates applicable to an individual, Hindu Undivided Family, Association of Persons (AOP) or body of individuals or every artificial juridical person shall be as follows :

Upto Rs. 1,00,000	NIL
Rs.1,00,000 to Rs.1,50,000	10%
Rs.1,50,000 to Rs.2,50,000	20%
Above Rs.2,50,000	30%

However, in the case of a woman resident in India and below the age of 65 years at any time during the previous year, the new tax rates shall be as follows:

Upto Rs.1,25,000	NIL
Rs.1,25,000 to Rs.1,50,000	10%
Rs.1,50,000 to Rs.2,50,000	20%
Above Rs.2,50,000	30%

Further, in the case of senior citizens resident in India who is of the age of 65 years or more at any time during the previous year, the new tax rates will be as follows:

Upto Rs.1,50,000	NIL
Rs.1,50,000 to Rs.2,50,000	20%
Above Rs.2,50,000	30%

Further, surcharge shall be payable by the individual, Hindu Undivided Family, Association of Persons or Body of Individuals having a total income exceeding Rs.10 lakhs, at the rate of 10 per cent of income tax as reduced by the amount of the rebate available under Chapter VIIIA, i.e., rebate on account of the Security Transaction Tax.

In the case of an artificial juridical person, a surcharge of 10 per cent shall be applicable on the total tax payable irrespective of the total income and without any rebate of income tax paid under Chapter VIIIA, i.e., Security Transaction Tax. A marginal relief has been provided whereby the total amount payable as income tax and surcharge shall not exceed by more than the amount of the income that exceeds Rs.10 lakhs.

3. Increase in Threshold Limit for levy of Surcharge from Rs.8.5 lakhs to Rs.10 lakhs

In the new tax rate structure a surcharge of 10% shall be leviable where the total income exceeds Rs.10 lakhs as against presently payable when income exceeds Rs.8.5 lakhs. Thus there is an increase of Rs.1.50 lakh but effective increase is Rs.2.50 lakh as income upto Rs.11 lakhs shall not be liable for surcharge in case one makes investment in savings of Rs.1 lakh and claim deduction from income under the revived section 80C of the Act. The resultant taxable income in such case will be Rs.10 lakhs. The surcharge shall be leviable on the total tax payable as reduced by the amount of rebate allowable under Chapter VIIIA. As per the provisions of Chapter VIIIA, the rebate under Section 88B to senior citizens, under Section 88C to resident woman taxpayer and under Section 88D to individual and HUF having income upto Rs.1 lakh are being withdrawn. Thus, the only amount to be

deducted shall be rebate allowable under Section 88E in respect of Security Transaction Tax.

4. Senior Citizen, Resident Women's Rebate withdrawn

In view of the above new tax rates, the benefit of rebate in tax of Rs.20,000 to senior citizens under Section 88B and of Rs.5,000 to resident woman under Section 88C are being withdrawn.

5. Standard Deduction withdrawn

Further the benefit of Standard Deduction available to the salaried taxpayers of Rs.30,000 in case income from salary does not exceed Rs.5 lakhs and Rs.20,000 in case income from the salary exceeds Rs.5 lakhs is also being withdrawn.

6. Deduction under Section 80L withdrawn

Benefit of deduction under Section 80L of Rs.12,000 in respect of interest from bank, post office etc., and Rs.3,000 on account of interest from government securities is also being withdrawn.

7. Rebate under Section 88 to be substituted by deduction under Section 80C

As per the new proposal, the rebate in tax under Section 88 in respect of payment towards Life Insurance Premium, contribution towards Provident Fund, Public Provident Fund, National Savings Certificate, expenditure on education of children, repayment of housing loan and investment in eligible issue of capital is being withdrawn and substituted by a new scheme being reintroduced under Section 80C whereby a deduction upto Rs.1 lakh shall be allowed from Gross Total Income to an individual or Hindu Undivided Family, with respect to sums paid or deposited in the previous year out of income chargeable to tax towards life insurance premium, contribution to provident fund, purchase of infrastructure bonds, payment of tuition fees, repayment of housing loans etc. However, there will be no sectoral limit. The assessee shall be free to pay the entire amount towards life insurance premium or to claim benefit of the entire amount in one or more of the eligible investment. The present ceiling of Rs.20,000 in respect of repayment of housing loan and Rs.24,000 in respect of education of children shall not be applicable. The whole of the amount upto Rs.1 lakh if incurred towards education of children or towards repayment of housing loan shall be eligible for deduction. As per the new proposal the whole of the amount upto Rs.1 lakh shall be eligible for deduction from the total income, meaning thereby that the taxable income shall be computed after deduction of the above amount.

It is to be noted that in the proposed amendment a reference has again been made that the amount paid or deposited in the previous year is out of his income chargeable to tax. This may revive the old controversy in case the payment of such sum has been made out of the borrowings or out of the income which is not chargeable to tax. The condition of making this payment out of income chargeable to tax, which used to be earlier in Section 80C as well as in Section 88 was deleted by the Finance Act, 2002.

8. Taxpayer having income above Rs.5 lakh to get benefit of savings and that too at a higher rate

The new tax rate structure gives benefit of long-term savings under Section 80C upto Rs. 1 lakh to all individuals and HUF irrespective of the income. As such, taxpayers having gross total income of more than Rs.5 lakhs shall also be eligible to claim this benefit. Not only that, the new tax rate structure gives additional benefit to the taxpayers liable for taxation at the higher rate as compared to the present benefit at lower rate in respect of investment in savings of the same amount. As explained above, in the new scheme there will be a deduction of the amount of savings from the total income as against existing scheme where a rebate is given at a fixed percentage of amount invested in the savings. Thus, in the case of a person falling in the tax bracket of 30%, the reduction in tax liability in case the amount invested in savings is Rs.1 lakh shall be Rs.30,000 as against the person who falls in the tax bracket of 10% and 20%, the reduction in tax liability shall be Rs.15,000. This is a revival of the old scheme which was discontinued way back in 1990, on this very ground that for the same amount, the benefit in tax accrues higher to one person as compared to the benefit accruing to another person.

9. Deduction of Savings to be taxed after switching over to New Model

As per the memorandum attached to the Finance Bill, 2005, it has been stated that the benefit of allowing deduction upto Rs.1 lakh in respect of long-term savings is a transitional provision and it will be switched over to the exempt-exempt-taxed (EET) method whereby as and when the amount is received back by the taxpayer it shall be included in the taxable income. Presently there will be complete exemption. The taxability of the amount deducted shall arise only in respect of the amount invested in subsequent years after the new model is adopted.

10. Ceiling of Rs.1 lakh to include benefit available under Section 80CCC and Section 80CCD

The benefit under Section 80CCC of Rs.10,000 in respect of contribution to Retirement Pension Plan of an insurance company as well as benefit under Section 80CCD in respect of contribution to the pension scheme of the Central Government are also being aggregated with the total amount of Rs.1 lakh allowable under Section 80C of the Act, meaning thereby that the aggregate amount of deduction under Section 80C, Section 80CCC and Section 80CCD shall not exceed Rs.1 lakh.

11. Tax benefit due to change in the tax rate structure

In view of the change in the tax rate structure, certain class of taxpayers shall be benefited. The liability to pay tax in the case of individual, HUF shall get substantially reduced as can be seen from the following analysis:

i. Change in tax liability without benefit of long-term savings[1]

(Figures in Rupees)

Income	Existing Tax Liability After Rebate Under Section 88	Proposed Tax Liability	Benefit [2]
1,00,000	Nil	Nil	Nil
1,10,000	10,000	1,000	9,000
1,50,000	19,380	5,100	14,280
2,00,000	34,680	15,300	19,380
2,50,000	49,980	25,500	24,480
5,00,000	126,480	102,000	24,480
8,50,000	233,580	209,100	24,480
10,00,000	307,428	255,000	52,428[3]
11,00,000	341,088	314,160	26,928
20,00,000	644,028	617,100	26,928
50,00,000	1,653,828	1,626,900	26,928

1. Figures in Rupees
2. Effective benefit shall be lower on account of withdrawal of Standard Deduction and deduction under Section 80L of Bank Interest etc.
3. Includes benefit arising on account of increase in limit for levy of surcharge from 8.5 lacs to Rs. 10.00 lacs.

ii. Change in tax liability with benefit of long-term savings[1]

(Figures in Rupees)

Income	Existing Tax Liability After Rebate Under Section 88	Proposed Tax Liability	Benefit [2]
1,00,000	NIL	NIL	NIL
1,10,000	NIL	NIL	NIL
1,50,000	NIL	NIL	NIL
2,00,000	19,380	NIL	19,380
2,50,000	34,680	5,100	29,580
5,00,000	111,180	71,400	39,780
8,50,000	233,580	178,500	55,080
10,00,000	307,428	224,400	83,028
11,00,000	341,088	255,000	86088[3]
20,00,000	644,028	583,440	60,588
50,00,000	1,653,828	1,593,240	60,588

12. New tax rate structure not beneficial to all

The new tax rate structure proposed by the Finance Minister appears to be attractive. However, the above proposal may not be beneficial to all as can be seen from the following analysis:

a) Salaried Taxpayers

Presently a person having income from salary is entitled to a standard deduction upto Rs.30,000 besides having exemption of Rs.12,000 under Section 80L in respect of interest income from bank and post office. Further, no tax is payable in case the taxable income does not exceed Rs.1 lakh. Accordingly, if one is having a salary income of Rs.1,30,000, i.e., Rs.10,000 per month and an annual bonus of Rs.10,000 and having interest income from bank of, say, Rs.12,000, presently his taxable income will be Rs.1 lakh and no tax is payable by him as income upto Rs.1 lakh is exempt. Under the new tax rate structure, the taxable income shall be Rs.1,42,000 and there will be a tax liability of Rs.4,284.

b) Senior Citizens.

Presently, for senior citizens there is a rebate in tax of Rs.20,000 under Section 88B of the Act. Senior citizens by and large have got pension income which is eligible for standard deduction. Further, income of interest by way of investment of the money received on retirement is also eligible for deduction under Section 80L of the Act. Take the case where a senior citizens having pension income of Rs.1 lakh and income from

interest of Rs.98,000 which includes income from bank interest and government securities. As per the existing provisions, he will be entitled to a standard deduction of Rs.30,000 and deduction under Section 80L of Rs.15,000. Thus, the net taxable income will be Rs.1,53,000 on which tax payable works out to Rs.19,900. Being a senior citizen, he will be entitled to a rebate of upto Rs.20,000 under Section 88B of the Act. As such, there will be no tax liability. However, as per the new tax structure, the total taxable income shall be Rs.1,98,000 and as a senior citizen income upto Rs.1,50,000 shall be exempt and tax at the rate of 20% on the balance amount of Rs.48,000 shall be payable. This will result in a tax liability of Rs.9,792 under the new proposal as against nil liability at present. It is to be noted that at present the rebate to the senior citizen under Section 88B is Rs.20,000 which now will stand reduced to Rs.5,000 as additional income of Rs.50,000 falling in the tax bracket of 10% is being exempted.

c) Resident Woman

In the case of a resident woman taxpayer, the new tax rate structure may not be as much beneficial as at present as additional benefit in income of Rs.25,000 that too in the tax bracket of 10% shall give benefit of Rs.2,500 in tax as against rebate in tax of Rs.5,000 at present.

13. Withdrawal of Standard deduction not justified

In the new tax rate structure, the benefit of standard deduction available to salaried taxpayers is being withdrawn. The reason given by the Finance Minister in the budget speech is that in view of the higher exemption limits, the need for separate personal allowance does not exist and that is why he has proposed to remove the standard deduction. However, the issue is whether standard deduction is a personal allowance or not. Standard deduction while computing income from salary is allowed not as a personal allowance but on account of the expenditure which an employee may have reasonably incurred in performance of his duties. Earlier there used to be separate deduction in respect of various expenditure such as conveyance, books and periodicals, etc. In order to simplify and standardize this deduction on account of the expenditure incurred by an employee, the words 'Standard Deduction' was inserted and a fixed amount depending upon the salary was being allowed. Accordingly, the withdrawal of standard deduction does not appear to be justified. A taxpayer having income from business or profession shall be entitled to deduct all expenditure which he may have incurred for earning that income whereas an employee shall not be entitled to claim such expenditure though incurred in the discharge of his duty for earning the salary income.

14. Withdrawal of deduction under Section 80L may cause practical and genuine difficulties

Apparently there cannot be any issue for withdrawing the deduction in respect of interest income from bank etc., when a higher threshold limit has been proposed. However, it may cause practical difficulty as every rupee of interest earned from bank will require to be included in the taxable income and there can be some genuine difficulties as some petty amount earned on account of balance lying in some dormant bank account may get omitted to be included in the return of income as one may himself may not be aware of such income.

15. No surcharge on Cooperative Societies and Local Authorities

There is no change in the tax rate applicable to cooperative societies and local authorities. However, surcharge of 2.5% which is presently applicable to Co-operative societies and Local authorities is being withdrawn from the Asstt. Year 2006-07.

16. Firms – Tax Rate reduced but surcharge increased

The tax rate applicable to firms is being reduced from 35% to 30%. However, the surcharge is being increased from 2.5% to 10%. Hence the effective tax rate, inclusive of education cess, is being reduced from 36.592% to 33.66%, a net reduction of 2.9325%.

17. Domestic Companies – Tax Rate reduced but surcharge increased

In the case of domestic companies, the tax rate is being reduced from 35% to 30%. However, the surcharge is being increased from 2.5% to 10%. The effective tax rate reduction will be the same, as in the case of firms, i.e., 2.9325%.

There is no change in the tax rate and surcharge in the case of a foreign company which shall continue to be taxed @ 40% with surcharge @ 2.5%.

18. Increase in effective tax rate of MAT and Dividend Distribution Tax

Consequent to the increase in the rate of surcharge in the case of domestic companies from 2.5% to 10%, there is an increase in the effective tax rate for computing liability in respect of Minimum Alternate Tax (MAT) and dividend distribution tax. Presently MAT is

payable at the rate of 7.5% with 2.5% surcharge and 2% education cess. Thus, the effective rate is 7.84%. With the increase in the surcharge this will go upto 8.415%. Similarly the effective rate of dividend distribution tax payable under Section 115-O and 115-R shall go up from 13.06875 % to 14.02%, an increase of almost 1%.

19. Increase in the rate of Security Transaction Tax

The security transaction tax is being increased across the board by one-third of the existing rate. The new rates shall be as under:

	Existing Rate	Revised Rate
1) Delivery based purchase of an equity share or unit of an equiry oriented fund to be paid by the buyer	0.075%	0.1%
2) Delivery based sale of an equity share or unit of an equity oriented fund to be paid by the seller	0.075%	0.1%
3) Non-delivery based sale of equity share or unit of an equity oriented fund	0.015%	0.02%
4) Transaction of derivatives	0.01%	0.0133%
5) Sale of units of an equity-oriented fund to the mutual fund	0.15%	0.20%

The above rates shall be effective from 1st June, 2005.

20. MAT credit to be allowed

The Minimum Alternate Tax paid by a company shall now be available to be carried forward and set off in the year when the tax becomes payable on the total income computed under the regular provisions. The carry forward shall be allowed upto the fifth Assessment year immediately succeeding the Assessment year in which the credit becomes allowable. This amendment shall be effective from the Asstt. Year 2006-07 and, as such, any tax paid under MAT upto the Asstt. Year 2005-06 shall not be eligible for set off.

21. Reduction in the rate of depreciation across the board for all assets and for all taxpayers

Linked with the exercise of reduction in corporate tax rate is the reduction in the rate of depreciation. As per the proposal, the depreciation on the plant and machinery shall now be allowed at the rate of 15% as against 25% presently allowable. In the memorandum attached to the Finance Bill, 2005, it has been further stated that the rates of depreciation of other capital assets are also being rationalized in line with the reduction in the rate for a general machinery and plant. Thus, not only the rate of depreciation on plant and machinery will go down from 25% to 15%, there will be reduction in the rates of depreciation of other assets also. This will result in lower claim of depreciation. This exercise is being carried out in view of the reduction in the corporate tax rate. However, this reduction in the rate of depreciation shall be applicable to all taxpayers having income from business or profession whether it be a company or a firm or an individual or HUF. Not only that, these rates will be applicable to both domestic as well as foreign companies. There is no reduction in the tax rate so far as the foreign companies are concerned, as such they will be required to pay same rate of tax on a higher income consequent to lower claim of depreciation.

22. Increase in rate of initial depreciation

The rate of initial depreciation allowable to assessee engaged in the business of manufacturing or production has been increased from 15% to 20%. The benefit under this provision is available only to an assessee engaged in the business of manufacture or production of any article or thing. Accordingly this benefit of initial depreciation shall not be available to those not engaged in the manufacture or production and even those engaged in the process shall not be eligible. The reason given for reducing the rate of depreciation is to provide depreciation at rates that enable the investors to replace the assets before its economic life ends. The Finance Minister has calculated a period of five years within which the depreciation claim will be almost fully allowed by applying the initial rate of 20% and 15% each year. However, the total amount of depreciation allowed in the first five years will be only 65%. Further, the fact that in view of the fast changing technology, economic life of capital assets, particularly plant and machinery, cannot be assumed to be more than 3 to 4 years, need to be taken into consideration while estimating the life of asset for the purpose of depreciation.

However, the requirement of increasing the installed capacity by 10% is being deleted, as such, a manufacturer or producer shall be entitled to claim initial depreciation of 20% on each addition of plant and machinery.

23. The basis for filing return shall be gross total income, not taxable income

Presently, as per provisions of Section 139(1), every person whose total income during the previous year exceeds the maximum amount which is not chargeable to income tax, is required to furnish a return of his income. However, a

new proviso is being inserted to provide that every person being an individual or HUF or Association of persons or a body of individuals whether incorporated or not or an artificial juridical person, shall be required to file return of income, in case the gross total income exceeds the maximum amount which is not chargeable to income tax.

It has also been provided that for the purpose of this section the total income is to be computed without giving effect not only to provisions of Chapter VIA but also without giving effect to the provisions of Section 10A, Section 10B or Section 10BA of the Act. As such, those persons having income above Rs.1 lakh but are not required to pay tax because of the deduction under Section 80C in respect of life insurance premium, provident fund, etc., shall be required to file return of income. Thus, the number of persons filing return despite increase in the basic exemption limit shall go up in view of the withdrawal of Standard Deduction and deduction under Section 80L of bank interest etc.

24. All partnership firms to mandatorily file income tax returns

The scope of Section 139(1) is being widened to provide that every partnership firm irrespective of the fact whether it has taxable income or not, shall be required to file return of income before the due date. In case of failure to file the return of income before the close of the Asstt. Year, a penalty of Rs.5,000 shall be leviable under Section 271F of the Act. Making mandatory for every partnership firm to file return of income, may cause a genuine practical hardship to the small inherited family concerns being run by brothers such as retail trade as it may not have taxable income at all and the business may be too small and run in small village, town. Joining of hands in such cases may not be because of business potential but because of lack of employment opportunity and the business inherited being only source of earning the livelihood.

25. Return to be Filed by those Incurring Electricity Expenditure of Rs. 50,000 – Mobile Phone Subscribers Exempted

The One-by-Six criteria of filing return under proviso to Section 139(1) is being amended. The requirement of filing return by subscriber of a cellular phone is being withdrawn. On the other hand a person incurring expenditure of more than Rs.50,000 on consumption of electricity will be required to file the return. The above changes of filing return shall also be effective from the Asstt. Year 2006-07 only, i.e., next year not this year.

26. Exemption of interest to Non-residents

The amendment introduced by the Finance (No. 2) Act, 2004 of taxing interest earned on non-resident external account as well as foreign currency deposit amount which was to be effective from 1st April, 2005 is being withdrawn. As such, interest income from these bank accounts shall continue to be exempt.

27. Exemption on Lease Rental for acquiring Aircraft or Aircraft engine

Exemption on payment of lease rental in respect of an aircraft or an aircraft engine acquired has been extended till 30th September, 2005. As per the proposed amendment, lease payment shall continue to be exempt with regard to the agreement entered into on or before 30th September, 2005.

28. Tax Deduction at Source – TDS Certificate to be issued for one more year

In view of the delay in computerization, the requirement of issuing TDS Certificate has been revived for one more year. The amendment carried out by the Finance (No. 2) Act, 2004 of not to issue TDS Certificate in respect of TDS payment after 1st April, 2005, has been postponed to 1st April, 2006. Now for the Financial Year 2005-06, the deductor will have to issue TDS Certificate and the deductee will be required to enclose the TDS Certificate with the return of income. Consequently amendment is being made to treat the return defective under Section 139(9) if TDS Certificates are not enclosed.

29. Truck operators exempted from TDS

No tax at source will be required to be deducted from the amount paid to a sub-contractor being an individual and not owing more than two trucks at any time during the previous year. For this the transporters will be required to furnish a declaration in the prescribed form and the person making payment to the truck operator without deduction of tax at source will be required to furnish a return of the same in the prescribed form within the prescribed time.

30. Rate of tax on royalty and fee for technical service reduced from 20% to 10%

The rate of taxing royalty and fee for technical services in the case of a non-resident is being reduced from 20% to 10% in case the same is received in pursuance of an agreement made on or after 1st June, 2005. Corresponding amendment is being made in respect of the rate of tax deduction at source.

31. Banking companies to file Quarterly Return of Non-Deduction of Tax

A new section 206A is being introduced to provide that the banks, cooperative societies and public sector companies responsible for

paying to a resident any income not exceeding Rs.5,000 by way of interest shall file quarterly returns within such time as may be prescribed. Further, the Central Government shall be entitled to require any person who is responsible for paying to a resident any income of the nature which is liable for deduction of tax at source to file quarterly returns within the prescribed time. The objective of above amendment is to collect data in respect of the income on which tax is not being deducted. Initially banks, cooperative societies and public sector companies shall be filing the return in respect of the interest paid without deduction of tax at source but later on other persons may be asked to provide the information in respect of the various payments made without deduction of tax at source. This return will be obtained in computer media and will be effective tool to identify new taxpayers and track down transactions which go undisclosed.

The above provisions shall be effective from 1st June, 2005. In case of failure to file the quarterly returns, penalty at the rate of Rs.100 per day shall be leviable for every day of default.

32. Trading in Derivatives not to be deemed as Speculative Transaction

As per provisions of Section 43(5), a transaction for the purchase and sale of any commodity including stocks and shares is deemed to be a speculative transaction if it is settled otherwise than by actual delivery. The rigors of above section are being diluted to provide that an eligible transaction carried out in respect of trading in derivatives in a recognized stock exchange shall not be deemed to be a speculative transaction. The explanation for the same states that systematic and technical changes in the stock market have resulted in sufficient transparency to prevent generation of fictitious losses through artificial transactions. Therefore the present distinction between speculative and non-speculative transaction particularly relating to derivatives is not required. After accepting the fact of sufficient transparency, transaction other than those of derivatives carried out in a recognized stock exchange need not be considered speculative transactions. The distinction need to be removed for all transactions carried out in a recognized stock exchange.

33. Carry forward of Speculation Loss to be for four Asstt. Years

The period of carry forward of speculation losses is being reduced from 8 Asstt. Years to 4 Asstt. Years. However, the period of 8 years in respect of the carry forward of other losses remains unchanged for the time being, but one can expect amendment in the coming years.

34. Zero Coupon bonds will be considered as security

Income on transfer of Zero Coupon bonds not held as stock in trade shall be liable for taxation as capital gain and shall be eligible for claiming concessional rate of tax as applicable to short-term capital asset or long-term capital asset as the case may be. The company issuing Zero Coupon bonds shall be entitled to claim deduction in respect of the discount on pro-rata basis and no tax shall be required to be deducted in respect of the income payable on Zero Coupon bonds.

35. Set off of losses of Banking Company under a scheme of Amalgamation

A new section 72AA is being introduced to provide that where a banking company has been amalgamated with a banking institution, under a scheme sanctioned and brought into force by the Central Government, the accumulated loss and unabsorbed depreciation of the amalgamated banking company shall be deemed to be the loss or depreciation of the banking institution of the previous year in which the scheme of amalgamation is brought into force. Thus, the banking institution in which the banking company gets amalgamated shall have the benefit of carrying forward the losses and unabsorbed depreciation for a further period of eight years.

36. Search and Seizure: Amendment in Assessment Procedure

The time limit for making assessment or reassessment of a person other than the person who has been searched is being extended. Now the assessment or reassessment of such other person can be made either within two years from the end of the financial year in which the last of the authorization for search was executed or one year from the end of the financial year in which the books of accounts or documents or assets seized are handed over under Section 153C to the Assessing Officer having jurisdiction of such other person whichever is later.

It has been further clarified by inserting a proviso to Section 153C that the reference to the date of the initiation of the search in the case of such other person shall be construed as reference to the date of receiving the books of accounts or documents or assets seized by the AO having jurisdiction over such other person. This will mean that in the case of a person other than the person who has been searched, the reassessment shall be made upto the date the books of accounts or the documents are received by the AO and the period of six years shall be computed not with reference to the

date of the search but with reference to the date on which the books of accounts or documents seized are handed over. Consequential amendment has been made by inserting sub-section (2) in Section 153C giving power to the AO to assess or reassess income of the previous year in which the search has been carried out. The above amendments are retrospective from 1st June, 2003 and are to take care of the problem where the AO of the other person is different than the AO of the person who has been searched. However, the difficulty in completing the assessment of the person other than the person who has been searched, in case the AO of both the persons are same, shall continue to be there.

37. Clarificatory amendment for deduction of payment under VRS

An amendment is being introduced retrospectively from the Asstt. Year 2004-05 to provide that where part payments are made at the time of voluntary retirement the amortization of the amount of payment shall be with reference to each such part payment over a period of 5 years.

38. Deduction of interest on loan for pursuing Higher Education

Provisions of Section 80E are being modified to provide that deduction shall now be allowed in respect of the interest payment only on the loan taken from any financial institution or any approved charitable institution for the purpose of pursuing higher education. No deduction shall be allowed for repayment of the principal loan amount. However, the deduction will be without any limit and the entire amount of interest shall be eligible for deduction. The deduction shall be allowed for 8 years beginning from the year in which payment of interest on the loan begins.

39. Extension of Weighted Deduction for Expenditure on In-House Research and Development

The time limit for availing the weighted deduction under Section 35(2AB) in respect of the expenditure incurred on in-house research and development is being extended by two more years, i.e., upto 31st March, 2007.

40. Extension of time limit for Tax Holiday for carrying on Scientific Research and Development

The time limit for the purpose of availing tax holiday under Section 80-IB available to a company for carrying on scientific research and development is being extended by another two years. Now the companies which are approved by the prescribed authority before 1st April, 2007 shall be eligible to claim 100% deduction of the profits of such business for a period of ten Asstt. Years.

41. Extension of time limit for setting up new Industries in Jammu and Kashmir

The time limit for setting up industrial undertakings engaged in the manufacture or production or operation of a cold storage plant in the State of Jammu and Kashmir is being extended from 31st March, 2005 to 31st March, 2007 for the purpose of tax holiday under section 80-IB of the Act. The deduction is subject to a negative list of the commodities specified in the Schedule XIII.

42. Fringe Benefit Tax – A New Tax on Employer

The Finance Bill, 2005 proposes to introduce a new tax called Fringe Benefit Tax. The objective for levy of fringe benefit tax is the difficulty in isolating the personal element in respect of the benefits provided to the employees where there is a collective enjoyment of such benefits for purposes of the business but includes partially, benefit of personal nature. This difficulty is more where the employer reimburses the employee for the expenses incurred. In order to overcome this difficulty, it has been proposed that those perquisites which can be directly attributed to the employees will continue to be taxed in their hands as per the existing provisions and method of valuation. However, where it is not possible to tax the benefits provided in the hands of the employees, this new fringe benefit tax shall be levied on the employer on the value of such benefits deemed to have been provided to the employees. For this purpose a new chapter has been inserted having 13 sections starting from 115W to 115WL. As per the proposed provisions, this new fringe benefit tax shall be payable by an employer who can be either individual, HUF or a company or a firm or an Association of Persons or a body of individuals or a local authority or an artificial juridical person. In the memorandum explaining the Financial Bill, 2005, the word 'individual or HUF' is qualified by those engaged in the business or profession but no such condition is there in the Finance Bill, 2005. The tax shall be payable on the value of the fringe benefits which shall be deemed to have been provided by an employer. The fringe benefits shall mean any privilege, service, facility or amenity directly or indirectly provided by the employer to his employees including former employees by reason of their employment. Any reimbursement directly or indirectly made by the employer to his employees for any purpose, any free or concessional ticket provided by the employer for

private journeys of the employees and their family members and any contribution by the employer to an approved superannuation fund shall be considered fringe benefits. In addition to the above, in the following cases it shall be deemed that the fringe benefits have been provided, if the employer in the course of his business or profession including any activity whether or not such activity is carried on with the objective of deriving income, profit or gains, incurred any expenses on or made any payment for the following purposes to the extent specified against each head:

(A) Entertainment; 50% (B) Festival celebration 50% (C) Gifts; 50% (D) Use of club facilities; 50% (E) Provision of hospitality of every kind by the employer to any person, whether by way of provision of food or beverages, but does not include expenditure on or payment for, food or beverages provided by the employer to his employees in office or factory. 50% (F) Maintenance of any accommodation in the nature of guest house 50% (G) Conference; 50% (H) Employee welfare; 50% (I) Use of health club, sports and similar facilities; 50% (J) Sales promotion including publicity 50% (K) Conveyance, tour and travel including foreign travel 20% (L) Hotel, boarding and lodging 20% (M) Repair, running and maintenance of motorcars 20% (N) Repair, running and maintenance of aircrafts; 20% (O) Consumption fuel other than industrial fuel 20% (P) Use of telephone 10% (Q) Scholarship to the children of the employees Actual amount

On the value of above fringe benefits, the employer shall be required to pay tax at the rate of 30% and surcharge at the rate of 10% and also education cess of 2%. The effective tax rate will be 33.66 per cent. All the provisions of the I.T. Act shall apply including that of payment of advance tax. This fringe benefit tax is to be paid in 4 quarterly instalments. Every employer shall be required to compute the total value of the fringe benefit for each quarter and deposit the tax at the rate of 30% including surcharge and education cess within 15 days following such quarter. However, the tax payable for the quarter ending 31st March shall be payable on or before the 15th day of March. In case of default in making payment, interest at the rate of 1% per month shall be leviable. Every employer shall be required to file a separate return of fringe benefit and this return is to be filed before the due date prescribed for filing the return of income. The assessment procedure of the fringe benefit tax shall be the same as that of the Income Tax assessment including reassessment etc. Penalty for failure to furnish return of income and concealment etc are exactly on the same line as that of the return of income.

As stated, the objective of introducing this provision is the difficulty in isolating the personal element of the facilities provided to the employees. In this process the work load of the taxpayer as well as the department is being doubled. Now every person carrying on the business or profession shall be required to file a return of income. There is no basic exemption. As such, every individual, HUF whether having any taxable income or not but having any employee shall be liable to pay the fringe benefit tax and file the return of the same. All institutions, establishments whether they are liable for taxation or not shall be required to pay fringe benefit tax. Even a small retail shop having even one employee shall be required to pay fringe benefit tax, that too at the rate of 30% despite the fact that income of such individual may be below the maximum amount not liable for tax and so may be the case of the employee.

This model of fringe benefit tax apparently has been adopted from Australia. In Australia all the benefits provided to he employee not all these benefits as proposed in this Finance Bill, are considered as Fringe Benefits and liable for tax in the hands of the employer. There the scheme is very comprehensive and equitable. Australia is a developed country and by standards of developed countries also this model is considered to be complicated and inequitable and that is why other developed countries like the U.S.A, U.K. etc. do not have such system. In all these countries, the perquisites are taxed in the hands of the employees.[7] The proposed scheme of taxing fringe benefits in the hands of employer do not co-relate the expenditure incurred under certain heads with the benefit extended to the employees. No distinction has been made between the employer having few employees and the employer having large work force. There may be cases where the business is being run entirely by the owners may it be proprietor or all partners. There may be instances where the income of the employer as well as its employees is much below the taxable limit and still the employer will be required to pay Fringe Benefit Tax. There is no threshold limit. Even a small amount of expenditure incurred in respect of the nature specified, will make the employer liable to pay fringe benefit tax and file return. A tea shop owner employing one or two delivery boys will also be required to deposit fringe benefit tax in advance every

quarter, file return of fringe benefit, though he may not be liable to file income tax return.

Expenditure on sales promotion, entertainment has been subject matter of disputes in the past. Earlier 50 per cent of such expenditure was not allowable under Section 37(2) of the act. The Finance Act, 1997 has deleted this provision with the object of simplification only. Now the new scheme being introduced is far more complicated, nobody has thought about the amount of paper work it will generate. It is entirely a new tax. All persons whether individual, HUF, Firm, Company, Institutions, Authority, will be required to file one additional return, pay tax every quarter. Then these returns need to be processed, assessed. The number of persons and returns are going to be somewhere more than 10 millions. In case objective is to tax the perquisites, some other method, may be some rules to value these perquisites could be notified and the employer asked to include the same in the income of the employees and deduct tax at source.

In its pursuit to overcome its difficulty, the Revenue should not create another difficulty.

It is to be noted that fringe benefit tax paid by the employer shall not be allowable expenditure in the hands of the employer while computing its income.

43) Levy of Banking Cash Transaction Tax

The Finance Minister has proposed a very interesting new provision for levy of Banking Cash Transaction Tax. This proposal is being introduced as a measure to check tax evasion. As per this scheme, any person entering into a taxable banking transaction, i.e., a transaction of withdrawal of cash exceeding Rs.10,000 on any single day from any scheduled bank, a transaction of purchase of draft or banker's cheque on payment of cash exceeding Rs.10,000 on a single day from a scheduled bank, receipt of cash from a scheduled bank exceeding Rs.10,000 on a single day on encashment of a term deposit whether on maturity or not, shall be required to pay tax at the rate of 0.1% of the value of such taxable transaction. This tax is to be collected by the scheduled bank from every person entering into such transaction. The bank shall be required to deposit tax so collected every month within 15 days of the month. Banks shall be required to file a return to the AO at the end of each Financial Year. The AO shall be entitled to make assessment. In case of failure to collect tax, the bank shall be liable to pay the tax. In case of failure to pay the tax within the specified period, interest at the rate of 1% for every month of default shall be payable. The procedure of assessment, penalty and appeal shall be on the same line as that of the income tax. The tax paid shall be allowable expenditure under section 36(1) of the Income Tax Act. The banking transaction tax shall not be applicable to the State of Jammu and Kashmir.

The objective as stated by the Finance Minister in the budget for levying this tax is that cash withdrawals made from bank is part of black economy. However, this proposal, instead of being an anti-tax avoidance measure, is an anti-honest taxpayer measure. This proposal will hit more those persons who are tax abiding and routing all transactions through banks only. It is an accepted fact that those who indulge in tax avoidance do not carry out transactions through banks. They never deposit their money in the bank and, as such, do not withdraw money from the bank. On the contrary, tax abiding persons deposit their entire receipts may it be by way of salary income, rental income or sale proceeds of the business in the bank and withdraw cash from bank as and when required to meet expenditure, may it be towards wages, salaries, day-to-day household expenditure etc. The proposed measure under no circumstances will help in checking tax avoidance. It appears that this measure is being introduced as a revenue raising exercise, on the line the Security Transaction Tax was introduced last year. It would have been much better if the Finance Minister, in his proposal would have avoided this to be named as an anti-tax avoidance measure and levied a transaction charge so that the honest taxpayer while withdrawing cash from the bank and paying this transaction tax, would avoid himself being called a person withdrawing black money.

The second anti-tax avoidance proposal by the Finance Minister requiring banks, cooperative societies and public sector companies to report to the government all deposits which are exempted from TDS or interest is a good measure and can bring into tax net not only such deposits but also some of these people who are not part of the tax net.

44) Revised, Simplified Income Tax Bill

The Finance Minister in his budget speech has indicated that in due course he intends to come forward with a revised and simplified income tax bill. If this exercise of a simplified Income Tax Act is carried out in right earnest, it will be a big service not only to the taxpayers but to the nation as a whole as experience has shown that simplification helps in better compliance. ■