A date with Finance Minister P Chidambaram

ICAI recommends further relief in Budget-2004-05

The institute of the Chartered Accountants of India has submitted its Post-Budget Memorandum to the Government. It contains critical analysis of the provisions of the Finance (No.2) Bill, 2004.

ICAI President Mr Sunil Goyal, Chairman of Fiscal Laws Committee Mr H.N. Motiwalla and Secretary, ICAI Dr. Ashok Haldia met Union Finance Minister Mr P Chidambaram on August 12, 2004 and handed over the Post Budget Memorandum to him. The Finance Minister hailed the role of the Chartered Accountants in economy building.

A summary of the Post-Budget Memorandum

Given below is a summary of the Post Budget Memorandum-2004 submitted recently to the Government. The full text of the Memorandum can be found in the Knowledge Portal of the Fiscal Laws Committee in the Institute's website (www.icai.org)

The Union Budget - 2004-05 would give impetus to the growth of the economy. The Budget is in tune with the objectives of the National Common Minimum Programme (NCMP). The commitment of the Government to enforce Fiscal Responsibility and Budget Management Act is a bold initiative. The Budget gives a thrust to agriculture, primary education, rural development and health care. The proposed National Employment Guarantee Act is a welcome step in the right direction to address the issue of unemployment. The proposal to double agricultural credit and the emphasis to the allied agricultural agencies are welcome. The proposal to channelise the educational cess exclusively to education and distribution of nutritious mid day meal to the students is a step in the direction of guaranteeing a constitutional right of every citizen of India. Water Management has received focussed attention for the first time. The announcement of the first desalination project in Chennai could well be the fore-runner for many like projects.

The proposal to establish an Investment Commission to encourage domestic and foreign direct investment in core areas like telecom, civil aviation and insurance will give adequate boost to the economy. The government's policy that public sector should play their role in a competitive economy is based on sound logic. The wide ranging proposals to support efficient public sector enterprises will help these enterprises to equip themselves to face global competition. The idea to promote a consortium of banks and LIC to lend funds to develop airports, seaports and tourism spots will have beneficial effect on the growth of the economy. The enhancement of the permitted holdings of foreign direct investment in telecom, Civil Aviation and Insurance sector will bring competitiveness to these sectors which will ultimately benefit the consumers.

The Finance (No.2) Bill, 2004, contains many positive features. Provisions on dematerialisation of TDS and TCS certificates and returns are welcome. Earlier, credit was not being allowed due to little or insignificant deficiency in the TDS or TCS certificates and this was causing hardship to the tax payers as the assessee was asked to produce fresh certificates. Dematerialisation will remove these difficulties. The inter-sectoral credit as between excise and service tax is a step towards integrated VAT system. However, there are certain grey areas in respect of which we are making our representation.

Service tax coverage has been extended to cover 13 more services. The rate of tax has also been increased from 8% to 10%. The increase in the rate of service tax is quite steep considering the fact that the incidence of service tax is ultimately borne by the consumer. While appreciating the compulsions and the overall policy directions of the Government, the Institute feels that in order to ensure a better rate of voluntary compliance the levy of service tax should be maintained at a rate of 8% only. In this regard we are making appropriate suggestions relating to service tax.

Our suggestions on the specific clauses of the Finance (No.2) Bill, 2004 are given as follows:

1. Clause 3 - Insertion of sub-clause (xiii) in Section 2(24)

The proposed amendment to tax "any sum received" would totally blur the distinction between capital and revenue which is so fundamental to income tax and would bring into the tax net receipts which cannot be considered as income by any stretch of imagination. It may also be noted that the proposed clause (IV) negates the main section. Further, the clause "any sum received" must be suitably explained to clarify that it will not include any capital receipts.

It is therefore, suggested that if at all the present provision is required to be incorporated then the following changes may be made:

(i) For clause (A) substitute "Any sum received as gift by an individual or a Hindu Undivided Family from any person on or after the 1st day of September, 2004 in cash or by issue of a cheque or draft or by any other mode or by way of credit".

(ii) Clause (B) should be omitted.

(iii) Meaning of the word relative should be expanded to include to all relatives and their HUFs.

(iv) In the proposed section exclusion is confined to the sum received from any individual from a relative out of natural love and affection. However, a HUF may also receive gifts from members and this should also be added to this exclusion.

2. Clause 5 - Sub-clause (e) - Insertion of new clause (19) in Section 10

It is sought to be provided that where the death of a member of the Armed Forces (including Para-military Forces) of the Union has occurred in the course of operational duties, in such circumstances and subject to such conditions as may be prescribed, the family pension received by the widow or children or nominated heirs, as the case may be, shall be exempt from tax. It is suggested that to make the provision more responsive in its approach and relevant in its amplitude by extending it to cover the Police personnel also who are killed while on duty.

The reference to "in such circumstances" in the clause is unnecessary because over and above the death of the incumbent while on operational duty, the nature of circumstances need not be further qualified for earning the exemption.

3. Clause 6 - Insertion of new sub-section (3) in section 12AA.

(i) As the law presently stands, the Assessing Officer has sufficient powers to check about the misuse of the trust activities. Besides it may not be possible for the CIT to assess the abuse or misuse in a summary manner. It is therefore felt that in the proviso to section 143(3) reference to section 11 should be included.

(ii) On the basis of the registration granted, the charitable trust might have applied its income to charitable activities. If on a subsequent date the registration is cancelled and the trust is asked to pay tax on the entire income due to withdrawal of exemption consequent to cancellation of registration, the trust may be left with no funds to meet such demand. Hence, this amendment giving powers to the Commissioner should be prospective and not retrospective i.e., cancellation of the registration should come into effect only from the date of order and not apply from an earlier date.

4. Clause 8 - Amendment in clause (B) of the first proviso in sub-section (1)(ii)(a) of section 32

The proposed amendment is beneficial in that additional depreciation may be claimed even where there is an increase in the installed capacity by more than 10%. However, this concession cannot be claimed by the units which have come into existence on or after 1st of April, 2002 in respect of the increase of the installed capacity later on. Accordingly, it is suggested that the benefit of extra depreciation should be made available to units which have come into existence on or after 1st April, 2002 and the increase in installed capacity should be measured with reference to the installed capacity as on the last date of the previous year. Further, the second proviso to section 32(1) provides for restricting additional depreciation to 50% if the plant and machinery is installed and put to use for less than 180 days. This restriction should not be applicable to additional depreciation as this is an incentive provision and the additional depreciation is not allowable over and above the cost of the plant and machinery.

5. Clause 11 - Insertion of sub-clause (ia) in section 40 -TDS on payments to residents

The objective stated for introducing this provision is to enforce compliance with the provisions relating to tax deducted at source. However, this provision is too harsh. There are enough powers given under the Act to enforce compliance with the provisions of TDS. As such, there is no need to have further deterrent provision and to compute income which is in a manner not the actual income.

The implication of this provision would be very harsh. An idea of the same can be had by making out a small example. (Please see the detailed memorandum).

Section 28 to section 44D are meant to compute the profits of the business or profession and should not be used to enforce compliance in respect of tax liability of other persons. The applicability of section 40(a) in respect of payment to a non-resident may be justified because such non-residents are not easily traceable and as such the tax liability of such persons gets compensated by denial of the benefit to the deductor. In the case of residents the traceability of the deductee is not a problem. Moreover there can be a practical problem where the deductor has failed to deduct tax and the deductee has paid tax on such income either by way of advance tax or by way of self-assessment tax and in such a situation the deductor cannot deduct tax again from the deductee and the benefit of deduction of such expenditure shall be lost forever as the condition of the proviso for claiming the deduction in the subsequent year when tax is deducted and paid shall never be fulfilled. In case the revenue is of the view that there is not enough deterrence under the Act to enforce the compliance of TDS provision, the remedy should be sought under the TDS provisions by increasing the penalty or by way of better administration rather than computing the business income in a manner which does not bring to tax the real income earned from the business or profession but which actually results in taxing expenditure which is against the fundamental principles of income-tax. Further, in clause (iii) of section 40(a), a proviso similar to section 40(i)(a) be added.

6. Clause 13 - Insertion of sub-section (2A) in section 71

The proposed insertion provides that any loss from profits and gains of business or profession would not be allowed to be set off against income under the head salaries.

Many short-commissioned officers who are getting pension and who are running small businesses would be seriously affected by the above proposal. Provision should be made to give relief in respect of such genuine assessees.

7. Clause 17 - sub-clause (e) - Insertion of certain words in section 80-IB (11A)

The proposed insertion of the words "the business of processing, preservation and packaging of fruits and vegetables or" would indicate that such an undertaking should derive the profit from an integrated business of processing, preservation and packaging of fruits and vegetables. This is a beneficial amendment and therefore the condition of simultaneous carrying on of processing, preservation and packaging of fruits and vegetables would cause hardship.

It is suggested that the benefit should be available to an undertaking carrying on the business of processing or preservation or packaging or any of the activities taken together.

8. Clause 17 - Sub-clause (f) - Insertion of new sub-section (11B) in section 80-IB

The amendment provides that the profits derived by an undertaking from the business of operating and maintaining a hospital in a rural area shall be eligible for deduction of 100% of such profits and gains and that such deduction shall be available for a period of five assessment years beginning from the initial assessment year in which the undertaking begins to provide medical services. Another condition prescribed is that such hospital should have 100 beds for patients.

The condition with regard to the availability of the exemption only in the event of the hospital having 100 beds for patients is perhaps too rigorous and difficult for compliance. If the idea is to provide wide-spread medical services in rural areas then, looking to the economic constraints and also the quantum of investment that may be required for a well-equipped hospital even a 50 bed hospital must be qualified to earn the exemption. That apart, since the establishment and operational impediments and hassles are likely to be considerable it will be advisable to provide that exemption will be available in any five assessment of the first ten assessment years.

9. Clause 17 - Sub-clause (d) - Substitution of new sub-section (10) in section 80-IB

Under the proposed sub-section the relevant housing project should be approved before 31st May, 2007 and should be completed within four years from the date of approval. However, there is no provision for the project approved before 31st March, 2004. Hence, it is suggested that the outer limit for them should also be 31st March, 2011.

One of the conditions, inter alia, requires that the built-up area of the shops and other commercial establishments included in the housing project should not exceed 5% of the aggregate built-up area of the housing project or 2000 square feet whichever is less. It is learnt that in some cases the local authority requires a minimum of 25% area as shopping area. Having regard to such requirements, it is suggested that the condition should be 5% of the aggregate built-up area of the house project or 2000 square feet whichever is more.

10. Clause 21 - Insertion of new section 88D - Rebate of Income-tax in case of individuals having income not exceeding Rs.1 Lakh.

The rebate under Section 88-D should be uniformly made available to all individuals, with or without lowering the ceiling on the basic exemption limit.

The provisions will cause hardship to those having total income above Rs.1 lakh. Persons having income of, say, Rs.1,01,000 would be required to pay tax of Rs.9,200 plus 2% education cess i.e. a total tax liability of Rs.9,384 though the income exceeding Rs.1 lakh is only Rs.1,000. Therefore, marginal relief for those persons earning above Rs.1 lakh should be made available.

11. Clause 24 - Insertion of new section 111A

It is proposed to exempt the long-term capital gains arising from the sale of securities carried out through recognized stock exchanges in India. A concessional rate of 10% has also been proposed on the short-term capital gains in respect of such securities. This benefit would be available to the investor and not to the traders. There is a very thin distinction between the transaction which is carried out as an investor or as a trader. Till such time both were being taxed at the same rate, there were no revenue implications. However, with the difference in tax rate and short-term capital gain being taxable at the rate of 10%, it may lead to litigation. It is suggested that to avoid litigation certain conditions or parameters may be prescribed which have to be fulfilled for making a claim that the transaction was entered into as an investor and not as a trader. Alternatively, it should be clarified that the transaction as entered into in the books of account shall not be disputed by the Assessing Officer.

12. Clause 27 - Insertion of certain words in sub-section (2) of section 115R

By virtue of the proposed amendment in section 115R tax on the distributed income to unit holders would be at the rate of 12.5% on income distributed to any person being an individual or a Hindu Undivided Family and 20% on income distributed to any other person. The proposed amendment is effective from 9th day of July, 2004. However, this amendment is administratively very difficult to implement and individuals and HUFs may undergo hardship. Further, the distributable income of the individual and HUF would be affected.

13. Clause 28 - Insertion of Chapter XII-G being special provisions relating to income of shipping companies

It is suggested that the window period of three months ending 31st December, 2004 in case of existing qualifying companies should be done away with. The existing qualifying companies should be allowed to exercise the option for tonnage tax scheme at any time and not necessarily between October to December, 2004. Once such option is exercised, these companies should be required to comply with the provisions of tonnage tax scheme for a period of ten years from the year in which they have opted in. In case of a default or opting out, these companies should not be eligible to opt for the scheme for a period of ten years as already provided under the scheme.

It is also suggested that a person opting for tonnage tax within the above mentioned period may specify the years from which the block of 10 years should commence.

14. Clause 31 - Insertion of new section 142A - Estimate by Valuation Officer in certain cases

It is suggested that for all practical purposes the above new section should be made effective prospectively and not retrospectively because it will result in considerable difficulties to the assessee. Therefore, the proviso to the proposed section should be deleted.

15. Clause 34 - Substitution of clause (i) in sub-section (3) of section 194C

According to the proposed section 194C the newly inserted clause (i) and proviso to clause are conflicting to each other. It is therefore, suggested that TDS provision in this case may be made applicable for all transactions falling under this section where such sums credited or paid or likely to be credited or paid during the financial year exceeds fifty thousands rupees.

16. Clauses 29, 30, 38, 39, 41, 43, 47, 53 and 54

Vide clauses 29, 30, 38, 39, 41, 43, 47, 53 and 54 it is sought to be provided with effect from 01.04.2005 that the income-tax return would not be required to be accompanied by TDS/TCS certificates for claiming credit for tax deducted or collected.

This provision, based on past experience, is likely to cause considerable operational and practical difficulties in its implementation. The experience with allotment of Permanent Account Numbers has not been encouraging. Insurmountable difficulties associated with this task led to the Department out-sourcing the work itself. While the scheme for giving on-line credit for deduction of tax at source must be encouraged yet in the initial years it may be advisable to abide by the existing practice and procedure also. Apart from the credits as may be obtained through the electronic media, credits through paper intimation as at present may also be retained and pursued for purposes of cross verification and supplementation for some years.

17. Clause 56 - Insertion of new section 277A - Falsification of books of account/document, etc.

The proposed new section 277A provides punishment to a person other than the tax evader himself, who enables the tax evader to make or cause to be made any entry or statement in the books of account or any document which such person either knows to be false or does not believe to be true. Further, an Explanation has been inserted after the said provision whereby it shall be sufficient in any charge, under this section, to allege the "general intent" to enable the person without specifying any particular instance that any sum of tax, penalty or interest which has been or have been evaded by such person. The Explanation added to the aforesaid section, therefore, does not require specification of any instance for attracting the above section. The innocent mistakes by the assessee or any other person connected with the tax proceedings of the assessee can thus be brought to the book without proving any guilt, which is the essence of any criminal jurisprudence. There is also a likelihood of this provision being misused against the innocent persons. It is also possible that an unscrupulous tax evader when caught may put the blame on the professionals who are handling his accounts.

The objective behind the proposed provision and the Explanation thereto, appears to be, to further strengthen the hands of revenue authorities in bringing the offenders to book. No doubt, our country has suffered on account of tax evasion and any measure to curb such malpractices are welcome. However, the existing section 278 provides that if a person abets or induces in any manner another person to make and deliver an account or a statement or a declaration relating to any income chargeable to tax, which is false and which he either knows to be false or does not believe to be true, he could be prosecuted for such offence. As such, section 278 adequately meets the requirements of prosecuting the offenders on establishment of guilt, whereas according to the proposed section 277A, a general intent to defraud would be sufficient enough to imprison a person who may not be a real offender.

It is respectfully submitted that as per criminal jurisprudence and well established laws of the land, for an accused to be punished, the guilt has to be proved beyond any doubt, and mere intent would not justify punishment. Moreover, offences such as tax evasion are in the nature of economic offences, which call for levy of financial penalties and in case of willful attempt to evade taxes and penalties, they may be punishable with imprisonment under section 276C of the Income-tax Act. This section, read with the Explanation travels well beyond the criminal law, where the onus to prove guilt always rests upon the prosecution, which has to prove the commission of an offence beyond any doubt. We strongly believe that the proposed provision will have serious ramifications on the assessees, their employees, their associates, tax consultants, advocates, chartered accountants etc. This might also cause unintended hardship and harassment without meeting the underlying objective.

Taking into consideration the above facts, the Explanation to the proposed section 277A may kindly be withdrawn.

18. Clause 58 - Substitution of new section 285BA

The following changes may be incorporated:

(i) In sub-clause (a) of sub-section (1) after the word assessee the words "other than a person whose accounts are liable to be audited under the provisions of section 44AB(a) and (b)" may be inserted.

(ii) In sub-clause (d) of sub-section (3) after the word "incurred" the words "as may be prescribed" may be inserted.

(iii) The limit of Rs.50,000 per year is to low. Hence, it is suggested that a limit of Rs.1,00,000 may be prescribed.

SUGGESTIONS RELATING TO SERVICE TAX

The suggestions relating to service tax have been given under the following heads:

(a) Changes to be considered in the Finance (No.2) Bill, 2004

(b) changes to be considered by way of Notifications/Clarifications in Circulars

(c) Matters not considered in the Finance (No.2) Bill, 2004 but requiring immediate attention.

(d) Others

In this summary we cover Item (a) above. Other items are available in the detailed memorandum placed in the Website.

1. ISSUES REGARDING NEW SERVICES

The Finance (No. 2) Bill, 2004 ("Bill") proposes to extend the levy of service tax to 13 new services. In the context of the levy on the new services there are some issues which need attention. The issues are listed as under :

1.1 "Intellectual property services"

1.1.1 Definition of "intellectual property service" should be amended to clarify the intended scope

"Intellectual property right" is defined under section 65(55a) as "any right to intangible property, namely, trademarks, designs, patents or any other similar intangible property, under any law for the time being in force, but does not include copyright". The intention appears to cover only intellectual properties which are legally recognized. Further, it is not clear whether the words 'under any law for the time being in force' would be concerning only Indian law or would

include any international law. Hence, the suggested change in the definition may be effected.

1.1.2 Transfer of intellectual property rights is a sale of goods and hence should be outside the ambit of service tax

The Bill proposes to amend Chapter V of the Finance Act, 1994, the law governing service tax, to insert a new section 65(55b) to define "Intellectual Property Service" as follows :

"Intellectual Property Service" means -

(a) transferring, whether permanently or otherwise; or

(b) permitting the use or enjoyment of,

any intellectual property right."

It is well appreciated that the use of Intellectual property rights maybe considered as a service and could be exigible to service tax. However, the Bill also seeks to tax "transfer of an intellectual property right" which may not be correct. An intellectual property right such as a trade mark, patent, etc. is a moveable property and is accordingly "goods" as defined in section 2(7) of the Sale of Goods Act, 1930 (Vikas Sales Corporation v. Commissioner of Commercial taxes AIR 1996 SC 2082). Thus, a transfer / sale of intellectual property right is a sale of goods and not a provision of service.

In view of the above, transfer of Intellectual Property Right should not attract service tax since there is no provision of service in such cases. Hence the definition of Intellectual Property Right may be amended as suggested.

1.2 Construction services - Exclusion of "long distance pipeline" - the words "long distance" maybe defined or deleted so as to exclude all pipelines.

The proposed definition of "construction services" under section 65(30a) excludes "road, airport, railway, transport terminal, bridge, tunnel, long distance pipeline and dam." The words "long distance pipeline" are rather vague and unclear.

It is hereby suggested that for the sake of clarity a "long distance pipeline" may be defined as a pipeline which is more than say 1 kilometer or in the alternative the words "long distance" may be deleted so that all pipelines are excluded from the service.

2. VALUATION PROVISIONS

2.1 Travel agents (other than air or rail travel agents) - cost of tickets to be excluded from the value of taxable services.

Travel agents (other than air/rail travel agents) have been proposed to be brought under the service tax net by the Bill. However, a consequent amendment in Section 67 regarding exclusion of the cost of the tickets from the value of taxable service should be made in order to bring them on par with Air travel and rail travel agents where the cost of tickets are excluded.

2.2 Banking and Other Financial Services - discount earned on bill discounting facility being fund-based services maybe excluded from the value of taxable services.

The specified banking and financial services is proposed to be expanded to include other services, namely, lending; issue of pay order, demand draft, cheque, letter of credit, bill of exchange; providing bank guarantee, overdraft facility, bill discounting facility, safe deposit lockers or safe vaults, operation of bank accounts. Section 67 dealing with value of taxable service is proposed to be amended to exclude '*interest on loans*'. Thus there would be no service tax on 'interest on loans'. However it is not clear whether service tax would be payable on the discount earned from bill discounting. Discounting charges like interest on loans is a fund based income and hence must not be liable for service tax. The intention, it appears, is to tax all non fund based financial services and exclude fund based services in which case suitable amendment is required to state clearly that all fund based income such as interest, discount etc. would be excluded from the purview of service tax.

3. RATE OF SERVICE TAX

3.1 Rate of tax to be pegged at 8% if service tax extended to a wider base - Danger of cost push inflation

The rate of service tax is proposed to be increased from 8% to 10% an increase of over 100% over the past two years i.e. from 5% to 10%. Further, the service tax base is also proposed to be extended to cover a wider spectrum by including more services into the tax net. This would have a cascading effect inspite of the input tax credit rules (since substantial part of the levy - telephone, insurance, banking, etc. would be on the final consumer) resulting in a phenomenal increase in the cost of goods and services thereby leading to a cost push inflation. Thus, the rate of service tax should be maintained at 8%.

4. EDUCATION CESS

4.1 Education Cess to be applicable only in respect of services provided after the enactment of the Finance (No. 2) Bill, 2004

The provisions of clause 81 read with 85 of the Bill seek to impose an education cess @ 2% of the service tax. The education cess would be applicable after the enactment of the Bill. However, it is not clear whether the cess would be applicable to the payment of service tax after the enactment of the Bill in respect of services provided before the enactment of the Bill. The Trade Notice should clarify that the Education cess would be applicable only in respect of services provided after the enactment of the Bill.