Overview of Salient Features of the Finance (No. 2) Bill, 2014: Direct Taxes

The Budget, besides addressing the expectation of all, has taken bold initiatives to boost economic growth and maintain fiscal discipline. As is usual, Budget also gives an opportunity to the Government to make changes in the tax laws. This Budget is no exception. Keeping the tradition, this Finance (No.2) Bill, 2014 has proposed various amendments both in direct and indirect taxes. This Bill has 71 clauses amending various provisions of direct taxes. These amendments are analysed below. Unless otherwise stated, all these amendments are proposed to be effective from 1st April, 2014, i.e., assessment year 2015-16 relevant to the income earned in the current financial year 2014-15. Read on…

A. TAX RATES

1. Increase in threshold limit – No change in tax rates

The Finance Minister has proposed to increase the threshold limit from ₹2 lakh to ₹2.5 lakh. However, there is no change in the tax rates. The tax rates applicable to an individual, HUF, association of persons, body of individual and every juridical person shall be as under:-

Income	Tax Rate
Upto ₹2,50,000	Nil
₹2,50,001 - ₹5,00,000	10%
₹5,00,001 - ₹10,00,000	20%
Above ₹10,00,000	30%

In the case of senior citizens (of 60 years to 80 years of age), the threshold limit has been increased from ₹2,50,000 to ₹3,00,000. There is no change in the threshold limit of ₹5,00,000 in the case of very senior citizens, *i.e.*, above 80 years of age. The benefit of the rebate upto ₹2,000 to individual resident whose total income does not exceed ₹5 lakh introduced in the last year by Finance Act, 2013, by way of Section 87A shall continue to be available. Further, Surcharge at the rate of 10% where income exceeds ₹1 crore shall continue to be applicable.

In view of this increase in threshold limit and rebate of ₹2,000 under Section 87A, there will be no tax liability on a person having total income upto ₹2,70,000.

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2. No Change in Tax Rate for Other Tax Payers

The Finance (No.2) Bill, 2014 has not proposed any change in the tax rates applicable to partnership firms and companies, both domestic as well as foreign companies. The tax rates applicable in the case of a partnership firm which includes LLP will be 30%. Surcharge at the rate of 10% shall be applicable in case total income exceeds ₹1 crore. The tax rate in the case of domestic companies shall be 30% with surcharge at the rate of 5% where the total income of the domestic company exceeds ₹1 crore but does not exceed ₹10 crore and surcharge at the rate of 10% where the total income of the domestic company exceeds ₹10 crore.

The tax rate in respect of companies other than domestic companies shall be 40% with surcharge of 2% where the total income exceeds ₹1 crore but does not exceed ₹10 crore and surcharge at the rate of 5% where the total income of such company exceed ₹10 crore.

3. Grossing up of Dividend for Distribution Tax – Increase in Effective Dividend Distribution Tax Rate of 3.47%

The Finance (No.2) Bill, 2014 proposes to levy dividend distribution tax by grossing up the dividend payable for

the purpose of computing liability towards dividend distribution tax. As per the existing provision of Section 115-O, dividend distribution tax at the rate of 15% is to be paid on the amount of the dividend paid to shareholders. Further, under Section 115R, tax at the rate of 15% is to be paid on the income distributed by the Mutual Fund to its investors. Presently, the effective tax rate after levy of surcharge and education cess is 16.995% (15% tax + 10% surcharge + 3% education cess thereof) and tax at this effective rate of 16.995% is paid on the amount of dividend paid/income distributed. The Finance (No.2) Bill, 2014 proposes to gross up the dividend paid with the income distributed for computing the tax liability on account of dividend distribution tax. With the grossing up, the effective tax rate will be 20.47%, with the result, there will be an additional tax liability of 3.475%.

In the Memorandum, explaining the provision of the Finance (No.2) Bill, 2014, it has been stated that prior to introduction of dividend distribution tax, the dividends were taxable in the hands of the shareholder. After introduction of dividend distribution tax, a lower rate of 15% is being applied on the amount paid as dividend after deduction of distribution tax by the company and hence tax is computed with reference to the net amount. Accordingly, in order to ensure that tax is levied on a proper base, the dividend actually received need to be grossed up for the purpose of computing the dividend distribution tax. This explanation to the Memorandum is contrary to the reasoning given while introducing the dividend distribution tax way back in the year 1997. It may be relevant to refer to the budget speech of the then Finance Minister, the relevant paras read as under:-

> *"100. Another area of vigorous debate over many years relates to the issue of tax on dividends. I wish to end this debate. Hence, I propose to abolish tax on dividends in the hands of the shareholder.*
>
> *101. Some companies distribute exorbitant dividends. Ideally, they should retain bulk of their profits and plough them into fresh investments. I intend to reward companies who invest in future growth. Hence, I propose to levy a tax on distributed profits at the moderate rate of 10 per cent on the amount so distributed. This tax shall be incidence on the company and shall not be passed on the shareholder."*

On going through the above reasoning given way back in 1997, it is quite clear that tax on dividend

The proposed grossing up provision shall be applicable from 1st October, 2014. Accordingly, it will be advisable that corporates and mutual funds declare and pay dividend of the financial year 2013-14 including interim dividend of financial year 2014-15, if any, before 1st October, 2014 so as to save tax of 3.475%.

was abolished and this dividend distribution tax was introduced to encourage companies to retain the income for the future growth. Thus, to say that dividend distribution tax is a tax on the dividend income of the shareholder is not correct. Further, in case the present Government is of the view that dividend income should be taxed, then there is no reason why company should bear the dividend distribution tax. The dividend may be taxed in the hands of the shareholder at the appropriate tax rate applicable as the case may be with benefit of old Section 80M to avoid cascading effect of this tax in the hands of corporate. It may also be important to note that the dividend distribution tax in the present form is being retained not because any concession is to be provided to the shareholder but by way of revenue compulsion as substantial amount of dividend distribution tax is paid by the public sector companies in respect of the dividend, these PSUs pay to the Government. In case dividend is taxed in the hands of the shareholder, substantive amount of this dividend paid by public sector companies and banks (estimated at ₹90,229 crore in the receipts budget for 2014-15) to the Government will not be liable for taxation as income of the Government is not chargeable to tax and consequently collection on account of income tax will go down.

The reasoning given in the Memorandum also runs contrary to the provision of Section 14A of the Income-tax Act. As per provisions of Section 14A, no deduction is allowed of expenditure incurred in relation to the income which does not form part of the total income, *i.e.*, tax-free income. Dividend income in the hands of the shareholder, for the purposes of this Section 14A, is considered to be tax-free income and accordingly substantial amount of expenditure is disallowed in the hands of the shareholder being incurred towards earning dividend income under Section 14A. If dividend distribution tax is considered to be a tax paid by the company for and on behalf of the shareholders, as is being explained in the Memorandum, there is no justification for considering dividend income as tax-

free income in the hands of the shareholder so as to attract disallowance under Section 14A.

The proposed grossing up provision shall be applicable from 1st October, 2014. Accordingly, it will be advisable that corporates and mutual funds declare and pay dividend of the financial year 2013-14 including interim dividend of financial year 2014-15, if any, before 1st October, 2014 so as to save tax of 3.475%. Similarly, it will be advisable to Mutual Funds to distribute its income before 1st October, 2014 to save burden of increased tax liability.

B. EXEMPTIONS/DEDUCTIONS

1. 80C Deduction being increased to ₹1,50,000

The Finance (No.2) Bill, 2014 proposes to increase deduction available to an individual or HUF under Section 80C in respect of life insurance premium, contribution to provident fund, *etc.* from ₹1,00,000 to ₹1,50,000. Corresponding amendment is being made to enhance the maximum contribution in a year to Public Provident Fund from ₹1,00,000 to ₹1,50,000. With this enhanced deduction under Section 80C, a tax payer may have the benefit ranging from ₹5,150 in case the income is upto ₹5 lakh, ₹10,300 in case the income is upto ₹10 lakh and ₹15,450 in case the income is above ₹10 lakh but below ₹1 crore and ₹16,995 in case the income is above ₹1 crore.

Amendment has also been proposed in Section 80CCD in respect of contribution to Pension Scheme. As per the existing provision of Section 80CCD, an assessee being an individual employed on or after 1st January, 2014 by the Central Government or any other employer is entitled to a deduction in respect of the amount deposited by him under a pension scheme to the extent of 10% of his salary or 10% of his gross total income in the previous year. It has been proposed by the Finance (No.2) Bill, 2014 that contribution under this scheme shall not exceed ₹1 lakh per year. Further, in the case of a person other than an employee of the Central Government, it will not be necessary that his employment should have started on or after 1st day of January, 2004.

The Finance (No.2) Bill, 2014 proposes to reduce disallowance of such expenditure to 30% as against 100% at present. The explanatory note in this regard recognise the fact that disallowance of the whole of the amount of expenditure results into undue hardship.

The provisions of Section 80CCE are also being amended to provide that aggregate of the deductions under Section 80C, 80CCC and 80CCD shall not exceed ₹1,50,000.

C. INCOME FROM HOUSE PROPERTY

1. Deduction of interest on capital borrowed for self occupied property being increased to ₹2,00,000

The Finance (No.2) Bill, 2014 proposes to amend Clause (b) of Section 24 so as to enhance the deduction from ₹1,50,000 to ₹2,00,000 in respect of interest on the amount borrowed for the acquisition or construction of a self-occupied property. As per Clause (b) of Section 24, interest on the capital borrowed for the acquisition or construction, repair, renewal of property is allowed as deduction. This deduction is allowed in full in case the property is let out. However, in case the property is self occupied, the deduction is limited to ₹1,50,000, if the same has been constructed out of the capital borrowed on or after 1st day of April, 1999. With the proposed amendment, the deduction under this clause in respect of self occupied property shall get increased to ₹2 lakh. In view of this proposed amendment, the tax benefit to a tax payer, in case he has borrowed capital for acquisition or construction or a residential house and paying interest thereon, will be of ₹5,150 if the income is up to ₹5 lakh, ₹10,300 if the income is up to ₹10 lakh and ₹15,450 in case the income is above ₹10 lakh but below ₹1 crore and ₹16,995 if the income is above ₹1 crore.

2. Effective exempt income now can be ₹6,20,000

Taking into consideration all the three relaxations proposed in the Budget, *i.e.*, enhanced threshold limit, increased 80C deduction and increased deduction on account of interest on borrowed capital for self occupied property, the effective tax exempt income can be ₹6,20,000 in the case of an individual resident in India, as explained below:

	₹
Total income	6,20,000
Less: Deduction on account of interest on housing loan	2,00,000
Balance	4,20,000
Less: Deduction under Section 80C	1,50,000
Taxable income	2,70,000
Tax payable	2,000
Rebate under Section 87A	2,000
Tax payable	Nil

It has been proposed that the Government shall notify the accounting standard under the Income-tax Act, the application of which shall be limited to the computation of taxable income and disclosure for tax purposes and the tax payer will not be required to maintain books of account on the basis of such standard notified by the Government under the Income-tax Act. Accordingly the provisions of Section 145(2) are being amended so as to rename the 'accounting standards' as 'income computation and disclosure standards.'

In the case of a senior citizen the effective exempt income can be ₹6,70,000 and in the case of very senior citizen ₹8,50,000.

D. CHARITABLE TRUST

1. No depreciation to be allowed while computing income in respect of asset considered towards application of income

The Finance (No.2) Bill, 2014 proposes to amend the provision of Section 10(23C) as well as Section 11 by specifically providing that income required to be applied or accumulated for application in the case of a charitable trust or institution shall be determined without any deduction or allowance by way of depreciation in respect of any asset, the cost of which has been claimed as an application of income in the same year or in earlier years. This amendment is being made to overcome the decision of the Punjab & Haryana High Court in the case of *CIT vs. Tiny Tots Pvt. Ltd.* 330 ITR 21 (P&H) (2011) and Delhi High Court in the case of *DIT vs. Vishwa Jagriti Mission* (2013) 262 CTR (Del) 558 where it has been held that depreciation need to be allowed even in respect of an asset, the cost of which has been claimed as application of income.

2. Deduction under Section 10 not to be allowed to trust registered under Section 12AA or approved under Section 10(23C)

The Finance (No.2) Bill, 2014 proposes to insert a new sub-section (7) under Section 11 to not to allow the benefit of deduction under Section 10 [other than 10(1) and 10(23C)] to a trust or institution which is registered under Section 12AA of the Act and the said registration is in force in the said year. Similar provision is being introduced by way of eighteenth *proviso* under Section 10(23C) to the effect that trust or institution approved under Clause (iv), (v), (vi) and (via) of Section 10(23C) shall not be allowed benefit of section 10 (other than 10(1) regarding agriculture income) if such approval is in force.

As per provision of Section 10, income of certain authorities/institutions is exempt as it is not considered to be income forming part of the total income such as income of a local authority, which is chargeable under Section 10(20), income of a research foundation under Section 10(21), income of a news agency under Section 10(22B), income of an association or institution set up to control and regulate the profession of law, medicine, accountancy, engineering, architecture, *etc.* and various such type of associations. In view of the dispute arising in respect of the certain nature of income whether it is exempt or not under Section 10, these trusts or institutions get registered under Section 12AA of the Act and claim exemption under Section 11 or Section 12. In case of any dispute arising about their activities falling within the meaning of 'charitable purposes,' the exemption is shifted to a specific provision of Section 10. With the proposed amendment once such entity get registered under Section 12AA, and such registration is in force, it will not be permissible for it to claim deduction under any provision of section 10. However, agricultural income which is exempt under Section 10(1) shall still not be taxable. Similarly exemption under Section 10(23C) can still be claimed despite being registered under Section 12AA. Under section 10(23C), income of a university, educational institution, hospital, *etc.* are exempt on fulfillment of certain conditions specified therein. The educational institutions, hospitals, *etc.* by and large are also registered under Section 12AA of the Act and at the same time eligible for claiming exemption under Section 10(23C). The proposed amendment will not hit the interplay between Section 10(23C) and Section 11 of the Act. Thus these educational institutions, hospitals can claim exemption under Section 10(23C) even if such educational institutions or hospitals are registered under Section 12AA of the Act or *vice versa.*

3. Scope of power for cancellation of registration by CIT under section 12AA being widened

At present, registration of a trust or institution granted under Section 12AA can be cancelled by the Commissioner if the activities of a trust or institution are not genuine or the activities are not being carried on in accordance with the object of the trust or institution. The scope of power of Commissioner to cancel the registration is being withdrawn. Now with the proposed amendment, the Commissioner can cancel the

registration if the activities are being carried whereby its income does not ensure the benefit of general public or it is for the benefit of any particular religious community or caste or income is being applied for the benefit of specified persons or the funds are invested in prohibited modes. This proposed amendment will increase litigation. At present, once the registration is granted, the assessing officer is empowered to make assessment and to ensure compliance of all the provisions of the Act including Section 13. In case he is of the opinion that income has not been applied for the charitable purposes or there has been violation of any provision of this Act, he is well within his right to deny the benefit of Section 11 while assessing the income of such trust or institution. These powers of the assessing officer can be exercised on year to year basis. Thus, there is no reason for making this amendment empowering the Commissioner to cancel the registration. The registration of a trust or institution does not entitle the trust or institution to claim exemption automatically. The trust or institution is required to maintain accounts and get the same audited. In the audit report, there are specific columns about mode of investment and application of income and violation, if any, of Sections 11(5), 13, *etc*. The assessing officer is also entitled to verify the same and in case there is violation, to deny benefit of Section 11 and 12. Thus, there is no need to empower the Commissioner to cancel the registration for some defaults here or there.

This amendment is proposed to be effective from 1st October, 2014 and accordingly the Commissioner of Income Tax shall be empowered after 1st October, 2014 to cancel the registration by invoking the widened scope of this amendment.

4. Benefit of Section 11 and Section 12 can be claimed even for period when trust or institution was not registered

As per the provisions of Section 12A of the Act, every trust or institution is required to make an application for registration under Section 12AA. Further, benefit of Section 11 and Section 12 can be claimed by such trust or institution from the financial year in which such application is made. In case of delay in making the application, there is no provision for condonation of the delay with the result that benefit of Section 11 and Section 12 cannot be claimed for any financial year preceding the financial year in which application for registration is made.

The Finance (No.2) Bill, 2014 proposes to address this issue by allowing benefit of availing exemption under Section 11 and Section 12 to a trust or institution which has been granted registration subsequently in respect of preceding assessment years, the proceeding of which are pending before the assessing officer as on the date of such registration. The only condition is that the objects and activities of such trust or institution should be same on the basis of which such registration has been granted. It has been further provided that no action for reopening an assessment under Section 147 shall be taken by the assessing officer in the case of such trust or institution, merely on the ground that such trust or institution has not obtained registration for the said assessment years.

This amendment will have a far reaching implication. At present there are many trusts or institutions which are not registered under Section 12A of the Income-tax Act, but are otherwise eligible for claiming exemption under Section 11 and Section 12 of the Act. These trusts or institutions do not apply for registration as on date though these are eligible to get registration for fear that in the absence of registration being applicable for past years, those assessments will get reopened and benefit of Section 11 and Section 12 will be denied to them in the absence of registration under Section 12A of the Act. This proposed amendment will help these trust or institution to come forward and get registered without any fear of earlier year income being taxed for want of registration. Thus, this proposed amendment in a way is better than the power of the Commissioner to condone the delay in applying registration. The benefit of this provision, however, shall not be allowed to such trusts or institutions which have applied for registration in the past and same was refused or such registration if granted was cancelled.

This provision shall be applicable from 1st October, 2014 and accordingly all such trusts or institutions which are otherwise eligible for exemption under Section 11 and Section 12 but are not registered, it will be a good opportunity to apply and obtain registration after 1st October, 2014 without any fear of reopening of the assessment of earlier assessment years merely on the ground that it was not registered during that period.

By the proposed amendment in Section 112, the benefit of concessional rate of 10%, tax in respect of long term capital gain shall be restricted to listed securities (other than unit) and zero coupon bonds.

5. Income of a trust or institution receiving anonymous donations–anomaly in computation being addressed

Provisions of Section 115BBC in respect of computation of income of a trust or institution in respect of anonymous donation are proposed to be amended to address the anomaly in the existing provision. As per the existing provision, tax at the rate of 30% is payable on anonymous donations exceeding 5% of the total donations received or ₹1 lakh whichever is higher and tax is payable on the total income other than the anonymous donations at the normal rate. In this process the anonymous donations to the extent of 5% of the total donation or ₹1 lakh which is higher gets neither taxed at 30% nor at the normal rate. The amendment proposes to address this anomaly by providing that the tax shall be payable on the total income of a trust or institution as reduced by the amount of anonymous donations on which tax at the rate of 30% has been paid. This amendment will bring to tax the 5% of the anonymous donation or ₹1 lakh whichever is higher at the normal rate of tax.

E. BUSINESS INCOME

1. Corporate Social Responsibility (CSR) Expenditure not eligible for deduction

The Companies Act, 2013 mandates that certain companies which have net worth of ₹500 crore or more, turnover of ₹1,000 Crore or more or a net profit of ₹5 crore or more during any financial year are required to spend 2% of their profit on activities relating to corporate social responsibility. Consequent to this, there has been a debate whether the CSR expenditure so mandated to be incurred by the Companies Act, 2013, will be considered as an expenditure incurred for the purposes of the business or not. The Finance (No.2) Bill, 2014 proposes to insert an Explanation below Section 37(1) to clarify that such expenditure shall not be deemed to be an expenditure incurred by the assessee for the purposes of business or profession. Accordingly deduction of CSR expenditure shall not be allowed under Section 37(1) of the Income-tax Act while computing income of the business.

The memorandum explaining the provision of the Finance (No.2) Bill, 2014, however, clarifies that the CSR expenditure which is of the nature described in Sections 30 to 36 shall be eligible for deduction under these Sections subject to fulfillment of condition, if any, provided in these sections. In this regard, it may be relevant to note that as per the provision of Section 35AC, the expenditure incurred on a project or scheme for promoting a social and economic welfare or uplift of the public, as approved by the National Committee set up for this purpose, is eligible for deduction while computing profit and gains of business or profession. Further, expenditure incurred by way of payment to an institution for carrying out rural development programme is eligible for deduction under Section 35CCA of the Act. Payment to an institution for carrying out programmes of conservation of natural resources is an eligible deduction under Section 35CCB. Not only that expenditure incurred on agricultural extension project, as notified by the Board under Section 35CCC and expenditure incurred on skill development project, as notified by the Board, under Section 35CCD are eligible for weighted deduction of 150%.

As against continuing uncertainty on the issue of retrospective amendment and indirect transfer, the Finance Minister has brought certainty in respect of the income earned by the foreign institutional investors on sale of securities. Section 2(14) which defines 'capital asset' is being amended to provide for any securities held by a foreign institutional investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992, shall be considered to be a capital asset.

All the above activities stated in Section 35AC, 35CCA, 35CCB, 35CCC and 35CCD are eligible activities, permissible under the corporate social responsibility as specified in Schedule VII, in terms of Section 135 of the Companies Act, 2013. Accordingly, in case any corporate intends to claim expenditure incurred on Corporate Social Responsibility while computing its business income it will be advisable that it obtains approval of the project or scheme under any of the above stated provisions of the Income-tax Act. This will ensure compliance of the obligation of CSR under the Companies Act and at the same time deduction of such expenditure while computing business income for tax purposes. In fact, if approval is obtained under Section 35CCC for agricultural extension projects or under Section 35CCD for skill development project, the deduction will be one and one-half times, *i.e.*, 150 % of such CSR expenditure.

Still in case above projects or approvals are not found to be practically feasible by any corporate, the alternative option can be, to contribute the amount of the CSR to a trust or institution for carrying out the CSR

activities and such trust or institution get registered with the income tax authorities under Section 12AA so that the amount of contribution can be claimed as deduction by the corporate as eligible donation to the extent of 50% under Section 80G of the Income-tax Act. It is to be noted that under the Companies Act, 2013 it is permissible that the CSR activities are either carried out by the corporate itself or through a trust or institution.

2. Failure to deduct tax at source – disallowance to be restricted to 30%

As per the existing provision of Section 40(a)(ia), any payment made by way of interest, commission, brokerage, rent, royalty, fee for professional services, fee for technical services, payment to a contractor or sub-contractor on which tax is deductible at source but is not deducted is not allowed as deduction while computing profit of the business or profession. Thus the entire expenditure incurred on this account is disallowed and added back in the income on failure to deduct tax at source. An idea how draconian this Section 40(a)(ia) is, can be had from the following example:-

> *An individual who is engaged in the business of export of readymade garments, assuming having a sales of ₹5 crore, the exporter instead of having its own machineries and labour, gets the garments fabricated, printed, embroidery, etc. on job work basis, it buys cloth from the market and incurs expenditure on such purchase of ₹1 crore. It incurs an expenditure of ₹3 crore on account of fabrication, printing, embroidery, etc. as job charges. It incurs overhead expenditure of ₹80 lakh and earns a net profit of ₹20 lakh. The tax liability on the net income of ₹20 lakh is ₹4.43 lakh, where he pays before filing the return. Now visualise a situation that due to ignorance or inadvertence it has failed to deduct tax at source in respect of the job charges paid ₹3 crore on which tax at source is required to be deducted at the rate of 1% i.e. default of TDS of ₹3 lakh only. The income in such case, because of the operation of the Section 40(a)(ia) will be computed at ₹3,20,00,000/- since ₹3 crore paid as job charges without TDS will be disallowed and added to the income. The additional tax payable on account of this disallowance will be ₹1.02 crore. Since the income of such person is just ₹20 lakh, it will be practically impossible for such person to pay this liability of Rupees more than one crore. Such person may pay the tax of ₹3 lakh which he has failed to deduct along with interest. In such a case he will be eligible to claim expenditure of ₹3 crore in the year in which TDS is deposited, with the result that his income for that year will be loss of ₹2.80,00,000/- assuming the income of that year is also ₹20 lakh. This loss he could carry forward for next eight years. Considering that the income is around ₹20 lakh per year in subsequent years, this person need another 14 years to set off the carry forward loss which in view of provision of Section 72(3) can't be carried forward for more than eight years. Just see the hardship. For a default to deduct and pay tax of ₹3 lakh, a tax liability of ₹32 lakh i.e. more than 10 times.*

The Finance (No.2) Bill, 2014 proposes to broaden the scope of deduction of tax at source by inserting Section 194DA. As per this amendment, tax shall be required to be deducted at source at the rate of 2% by a person responsible for paying to a resident any sum under a life insurance policy including the sum allocated by way of bonus on such policy except such amount which is not chargeable to tax under Section 10(10D) of the Income-tax Act in case such payment is ₹1 lakh or more.

Considering this hardship, the Finance (No.2) Bill, 2014 proposes to reduce disallowance of such expenditure to 30% as against 100% at present. The explanatory note in this regard recognise the fact that disallowance of the whole of the amount of expenditure results into undue hardship. Further disallowance of 30% of the expenditure irrespective of the nature of such payment is not appropriate. In case of payment of interest, commission, rent, royalty, where tax is deductible at the rate of 10%, disallowance of 30% may be appropriate but in the case of payment to a contractor where tax is deductible at the rate of 2% or 1% the disallowance of 30% is not justified. The tax is deductible at the rate of 2% or 1% on payment to a contractor on the assumption that the income component in such payment is not very high. Considering this, the disallowance in respect of payment to a contractor should not be 30 % and need to be proportionately reduced. It will be more appropriate to link the percentage of disallowance with the rate at which tax is deducted at source.

This provision was introduced way back in the year 2005. Thereafter, amendments are being made almost every year. There can't be a denial to the fact that deterrence helps in ensuring compliance of the provisions of the Act. But deterrence has to be

The Finance (No.2) Bill, 2014 proposes to address the anomaly which is arising in claiming credit of Alternate Minimum Tax paid by a person other than a company. It has been proposed that credit of tax paid as Alternate Minimum Tax can be availed even in those years where the provision of this AMT are not applicable in view of the total income not exceeding ₹20 lakh.

reasonable, not to the extent where in case of default, it becomes virtually impossible to pay the liabilities arising in consequence thereof. Accordingly the best way for achieving this TDS compliance is to disallow the expenditure in case of default and to allow such expenditure in the same year by way of rectification under Section 154 on payment of such tax with interest. To save the period of limitation for rectification suitable provision can be inserted in Section 155 to allow rectification from the date of deposit of such tax with interest. This will ensure realisation of such tax and also save the undue hardship which at present is caused to such tax payers.

This amendment is proposed to be effective from 1st April, 2014, *i.e.*, assessment year 2015-16 but considering the past history it may be possible to contend that this judgment is remedial and hence will have retrospective effect. To address the hardship caused by Section 40(a)(ia) amendments were made in the past by the Finance Act, 2010 and Finance Act, 2012. All these amendments are stated in the Finance Act to be applicable prospectively. However, the Courts while interpreting these amendments have held that these are remedial and hence have retrospective effect. The Calcutta High Court in the case of *CIT vs. Virgin Creations* in ITA No. 302 of 2011 in GA No. 3200/2011, held that the amendments made to Section 40(a)(ia) by the Finance Act, 2010 of allowing benefit of the payment made before the due date of filing return is retrospective in operation. Similarly, the Delhi High Court in the case of *Commissioner of Income-tax –XIII vs. Naresh Kumar* [2013] 262 CTR 389(Delhi HC) held that the amendment made by the Finance Act, 2010 is remedial and hence will have retrospective application. In the case of *Rajiv Kumar Agarwal vs. Addl. CIT,* ITA No.337/Agra/2013 dated 29th May, 2013, Agra Bench of ITAT has held that amendment made by the Finance Act, 2012 of not treating the assessee in default in case the deductee has included such sum in its income and paid tax thereon as remedial and retrospective. In view of these judgments and particularly the explanation given in the memorandum explaining the provision of the Finance (No.2) Bill, 2014 that this amendment is being made to address the undue hardship, it can be contended that this amendment is also remedial and accordingly shall have retrospective application.

3. Scope of Section 40(a)(ia) being widened to cover payment of salaries and directors fee

Scope of disallowance in respect of payment made to a resident without deduction of tax at source while computing business income is being widened to include payment made by way of salaries and directors fee. Accordingly, if any payment is made by way of salaries and director's fee on which tax is deductible but tax is not deducted from such payment to the extent of 30% will be disallowed and added back to the income.

4. Benefit of tax deducted at source paid before due date of filing return being extended in respect of non-resident

As per the existing provision of Section 40(a)(i), in case of failure to deduct tax at source or failure to deposit such tax after deduction on the due date, in respect of any payment made to a non-resident, which is chargeable to tax such amount is not allowed as deduction while computing income of the business or profession. However, such amount is allowed as deduction in the year in which such payment is made. Thus, there was a hardship even in those cases where payment of the tax got delayed beyond the financial year but such payment was deposited before the due date of filing return. Considering this hardship the Finance (No.2) Bill, 2014 proposes to amend Section 40(a)(i) to not to disallow such expenditure in case such tax is paid before due date of filing of the return.

This amendment is also proposed to have prospective effect *i.e.,* from 1st day of April, 2015 *i.e.*, assessment year 2015-16. A similar amendment was made in the Finance Act, 2010 in respect of the payment to a resident. This amendment was also stated to apply prospectively. However, as explained hereinabove the Courts have held that such amendments are remedial and hence shall have retrospective application. Accordingly it may be contended that this amendment proposed by this Finance (No.2) Bill, 2014 is also remedial and hence will have retrospective application.

5. Business of trading in shares not to be treated as speculative business

As per the existing explanation to Section 73, in the case of a company the business of purchase and sale of shares, irrespective of the fact that such purchase

and sale of share is delivery based is deemed to be speculative business and consequently loss on such business is considered as a speculative loss except in the case of a company where gross total income consists mainly of income from house property, capital gain and income from other sources, or a company the principle business of which is the business of banking or the granting of loans and advances. This explanation has affected a lot of companies engaged in the business of share trading and share broking as losses suffered by such companies in the business of share trading are deemed to be speculative and hence not allowed to be set off against other income. Considering this hardship the Finance (No.2) Bill, 2014 proposes to exclude such companies from this explanation if the principle business of such company is trading in shares. Accordingly if a company which is in the business of trading in shares, losses suffered in such business will be eligible to be set off against other income provided the business of purchase and sale of shares is a principal business.

6. Trading in Commodity derivatives not to be speculative only if Commodity Transaction Tax (CTT) has been paid

As per the existing provision of Section 43(5), a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by actual delivery or transfer of the commodity, is considered to be a speculative transaction. The loss arising on such speculative transaction is considered to be a speculative loss. Further, in terms of Section 73, such speculative loss cannot be set off against any other income except speculative income. However, there are certain exceptions provided below sub-Section 43(5), such as hedging by manufacturer *etc.*, which are not considered speculative transactions despite being settled without actual delivery. The Finance Act, 2013 has added one such exception being a transaction in respect of trading in commodity derivatives carried out in a recognised association. The Finance (No.2) Bill, 2014 proposes to put an additional condition that not only such transaction in commodity derivatives should be carried out in a recognised association but such transaction should be chargeable to Commodity Transaction Tax. Accordingly, the benefit of this exclusion from speculative transaction in respect of commodity derivative shall be available only when such transaction is carried out in a recognised association and also when CTT has been paid on such transaction.

This amendment is the only amendment which is being made retrospectively, *i.e.*, from assessment year 2014-15. It is to be noted that this amendment does not affect those commodity transactions which are delivery based as Section 43(5) applies only in respect of a transaction which is ultimately settled otherwise than by actual delivery.

7. Investment allowance at the rate of 15% for plant or machinery exceeding ₹ 25 crore acquired and installed during any previous year

Finance Act, 2013 has introduced a scheme of investment allowance in respect of any new plant or machinery acquired and installed by inserting Section 32AC. As per this provision, investment allowance at the rate of 15% of the actual cost of the new plant or machinery acquired and installed after 31st day of March, 2013 but before 1st day of April, 2015 will be allowed, if the aggregate of actual cost of such new plant or machinery exceeds ₹100 crore. The Finance (No.2) Bill, 2014 proposes to extend the benefit of this investment allowance where the actual cost of such new plant or machinery exceeds ₹25 crore in a year. This benefit will be available on year to year basis and for investment in new plant and machinery till 31st March, 2017. The assessees who are eligible to claim deduction under existing Section 32AC, shall continue to have the same benefit. As per the amended provision, the benefit of 15% shall be available on year to year basis wherever the actual cost of the new plant and machinery in the year exceeds ₹25 crore. Accordingly the benefit of this investment allowance will not be allowed in case actual cost of the new plant and machinery during the year is ₹25 crore or less.

8. Scope of investment linked incentive under Section 35AD being widened

As per the existing provision of Section 35AD an assessee is allowed deduction in respect of the whole of the capital expenditure incurred for the purpose of any specified business during the year in which such expenditure is incurred. At present, there are 11 specified businesses which are eligible to claim this incentive under this section. The scope of the same is being widened to include following businesses:-

i. Laying and operating slurry pipelines for the transportation of iron ore;
ii. Setting up and operating a semiconductor wafer fabrication manufacturing notified unit;

Further the provisions of Section 35AD are being amended by inserting sub-Section (7A) in order to ensure that, any asset in respect of which a deduction

has been claimed and allowed under Section 35AD, such asset shall be used only for the specified business for a period of eight years. It is being provided that in case such asset is used for any purpose other than specified business then the difference of the deduction claimed in respect of such asset under Section 35AD and the depreciation in respect of such asset which would otherwise allowable under Section 32 shall be deemed to be the income of the business in the year in which the asset is used for the purpose other than eligible business.

It is also being provided that where a deduction has been claimed under this Section, no deduction shall be available in respect of such specified business under Section 10AA in the same year or any assessment year.

It may be relevant to note that as per the provision of Section 35AD, the entire expenditure of capital nature incurred for the purpose of specified business other than expenditure on land, goodwill or financial instrument is allowed as deduction during the year in which such expenditure is incurred. Such expenditure is not eligible for any further deduction under any other provision of the Act. The net implication of this Section 35AD is, that one can claim the entire capital expenditure (of course other than on land, goodwill or financial instrument) which it would have otherwise claimed over a period by way of depreciation in very first year. Thus, this Section 35AD, in fact allows depreciation at the rate of 100% in the very first year with no additional benefit in future years. The claim of entire capital expenditure in the very first year under this Section 35AD can be counter-productive in many cases, as deduction of 100% expenditure in the very first year may result into carry forward of losses which cannot be carried forward for more than eight years as against depreciation which can be claimed on year to year basis and unabsorbed depreciation, if any, can be carried forward for indefinite period.

9. Presumptive income of goods carriages being increased to ₹7,500 per month

As per the existing provisions of Section 44AE income in respect of plying, hiring or leasing goods carriages is computed on presumptive basis. The income of a heavy goods vehicle is deemed to be ₹ 5,000 per month and income of a vehicle other than heavy goods vehicle is deemed to be ₹ 4,500 per month. The Finance (No.2) Bill, 2014 has proposed to remove the distinction between the heavy goods vehicle and the vehicle other than heavy goods vehicle. Further, it proposes to enhance the presumptive income to ₹7,500 per month. The presumptive income in respect of goods carriages, irrespective of the fact, whether it is a heavy goods vehicle or not, shall deemed to be ₹7,500 every month or part of a month.

10. Extension of sunset date (time limit for claiming exemption of income) for the Power Sector

The tax holiday available to the undertaking which is set up for generation, distribution, transmission including substantial renovation and modernisation of existing network of transmission or distribution lines of power by 31st March, 2014 is being extended to undertakings which are set up upto 31st March, 2017. In view of this extension, the undertaking which begins to generate power or which lays network of new transmission and distribution lines or which undertakes substantial renovation and modernisation of existing network of transmission or distribution lines up to 31st March, 2017 shall be eligible to claim exemption upto 100% of its profit and gains for a period of 10 consecutive assessment years within the 15 years beginning from the year in which the undertaking generates power, or commences transmission or distribution of power or undertake substantial renovation and modernisation of the existing transmission or distribution lines.

11. Income of business and other sources to be computed in accordance with computation and disclosure standards

Section 145(1) of Income-tax Act provides that Income under the head 'profit and gains of business or profession' and 'income from other sources,' shall be computed in accordance with the method of accounting regularly employed by the assessee. This section thus gives an option to the assessee to choose the method of accounting to be employed by it while computing business income or income from other sources with only one condition that such method should be regularly employed.

In order to bring consistency in the method of accounting, the Finance Act, 1995 inserted sub-Section (2) empowering the Central Government to notify the accounting standards to be followed by any class of assessee in respect of any class of income. Section 211(3C) of the Companies Act, 1956 also empowers the Central Government to prescribe accounting standards to be followed by the Companies. Principle and objective of accounting standard for preparation of financial statement and disclosure under the Companies Act are different from the

principle and objective of the accounting standards to be followed for computation of income. Thus, there was a dilemma, how can a company be asked to maintain two sets of books of accounts. One set of books of accounts in accordance with accounting standards notified under the Companies Act and another set of books of accounts in accordance with accounting standards notified under the Income-tax Act. In view of this, the Central Government could not notify the accounting standard under the Income-tax Act, other than the two basic accounting standards, despite this enabling Section 145(2) being in the Income-tax Act for almost 20 years.

The Finance (No.2) Bill, 2014 now has worked out a mechanism to address this issue. Accordingly, it has been proposed that the Government shall notify the accounting standard under the Income-tax Act, the application of which shall be limited to the computation of taxable income and disclosure for tax purposes and the tax payer will not be required to maintain books of account on the basis of such standard notified by the Government under the Income-tax Act. Accordingly, the provisions of Section 145(2) are being amended so as to rename the 'accounting standards' as 'income computation and disclosure standards'. These standards will be notified by the Central Board of Direct Taxes and income of the business or profession and income from other sources wherever applicable has to be computed and disclosure made in accordance with these 'income computation and disclosure standards.' The memorandum explaining the budget expressly clarifies that these 'income computation and disclosure standards' are not meant for maintenance of the books but are to be followed only for computation of income and disclosure.

This amendment is also proposed to be effective from assessment year 2015-16, *i.e.*, current financial year 2014-15 and accordingly it will be important to understand the implication of these standards immediately and advance tax and other obligations for the current financial year have to be on the basis of the income computed in accordance with these income computation and disclosure standards.

12. International Financial reporting standards to be applicable from financial year 2015-16

The Finance Minister has made an announcement in his budget speech regarding applicability of International Financial Reporting Standards (IFRS) now known as new Indian Accounting Standard (IND AS) by the Indian companies from the financial year 2015-16 voluntarily and from financial year 2016-17 on mandatory basis. Consequent to this amendment, now companies will be required to switch over to Indian Accounting Standards (IND AS). The date of applicability of Indian Accounting Standard (IND AS) for the banks and insurance companies shall be from the date it will be notified by the regulators.

F. CAPITAL GAIN

1. Advance forfeited against sale of capital asset–to be treated as income from other sources

As per the existing provisions of Section 45(1), tax is payable in respect of the capital gain in the year in which the capital asset is transferred. Further, as per provisions of Section 51 where any capital asset was subject matter of negotiation for the transfer, any advance received at the time of such negotiation is not considered as income but is deducted from the cost of acquisition. The Finance (No.2) Bill, 2014 proposes to amend this provision. As per the proposal, any advance or other money received in the course of negotiation for transfer of a capital asset shall be considered as income from other sources and chargeable under Section 56(2)(ix) if such sum is forfeited and negotiation do not result in any transfer of such capital asset. Corresponding amendment is being made to Section 51 to provide that such forfeited advance having been taxed as income from other sources, will not be deducted from the cost of acquisition while computing capital gain at the time of actual transfer later on. In view of this amendment, any advance received for transfer of a capital asset which include immovable property, and share held as investment, the moment such advance is forfeited without any transfer of such property or share, the same will be taxable as income under the head 'income from other sources' in the year in which forfeiture is made.

2. Benefit of Section 54 and 54F – limited to one residential house and that too in India

As per the existing provisions of Section 54 and Section 54F where a capital gain arises in the hands of an individual or HUF on the transfer of a long term capital asset including a residential house, the same is not chargeable to tax if it is invested in purchase or construction of a residential house within the prescribed period. There has been a dispute going on for many years about the meaning of the word 'a residential house' whether 'a' is an article or 'a' is a number meaning one. The dispute was also going on whether this new residential house has to be in India or it can be in any part of the world. The Finance (No.2) Bill, 2014 proposes

to settle this controversy to rest by explicitly providing that the benefit under Section 54 and Section 54F will be available in respect of one residential house only and that such residential house should be in India. This is being done by substituting the words 'a residential house' with the words 'one residential house in India.' This amendment is proposed to be effective from 1st April, 2015, *i.e.*, assessment year 2015-16. It may be important to note that the memorandum explaining the provision of the Finance Bill clarifies that this benefit was intended for investment in one residential house within India. In view of this explanation, there is possibility that tax authorities may contend that this amendment is clarificatory in nature and hence shall be applicable retrospectively.

3. Exemption for investment in capital gain bonds–to be limited to ₹50 lakh

As per the existing provision of Section 54EC of the Act an exemption is provided in respect of the capital gain arising from long-term assets if the same is invested in long term specified bonds, commonly known as Capital Gain Bonds, within a period of six months after the date of such transfer. The proviso to this section restricts the deduction in respect of such investment to a sum of ₹50 lakh during any financial year. In view of this restriction of investment of ₹50 lakh in a financial year, there has been a controversy whether this benefit of ₹50 lakh can be availed in two financial years by investing ₹50 lakh in one financial year and another ₹50 lakh in next financial year, if both investments fall within a period of six months from the date of transfer of long term capital asset. (This being possible if long term capital asset is transferred during October to March). The Finance (No.2) Bill, 2014 proposes to address this controversy by inserting a new proviso to the effect that investment made in such specified bonds from capital gains arising from transfer of one or more original assets during the financial year in which the original asset or assets are transferred and in the subsequent financial year should not exceed ₹50 lakh. The implication of the above proviso will be that the total eligible investment for specified bonds will be ₹50 lakh in the year in which one or more original assets are sold and also in the subsequent financial year. This *proviso* may have an unintended implication whereby any long term capital asset sold in the subsequent year may not be eligible for claiming exemption independently of investment in specified bonds in view of the overall limitation of ₹50 lakh in two financial years.

4. Compensation received by way of interim order on compulsory acquisition to be taxed in the year in which final order of the Court is made

As per the provision of Section 45 of the Income -tax Act, capital gain is chargeable to tax in the year in which the capital asset is transferred irrespective of the fact when consideration for such transfer is received. In view of the practical difficulties arising for making payment of taxes as compensation gets unduly delayed in respect of the transfer by way of compulsory acquisition, sub-Section (5) was inserted in Section 45 by the Finance Act, 1987 to provide that capital gain arising from the transfer of a capital asset by way of compulsory acquisition under any law including any enhancement or further enhancement shall be deemed to be the income chargeable of the previous year in which said compensation or the amount is received by the assessee.

Thereafter, further issue arose about the compensation received and having been taxed in terms of the provision of Section 45(5) in the year of receipt and later on such compensation getting reduced in subsequent years by the order of the Court or the Tribunal. In order to address this issue, the Finance Act, 2003 further inserted a Clause (c) in Section 45(5), to provide that where such consideration or the enhanced compensation is reduced subsequently by any order of the Court or the Tribunal, then the assessed capital gain of that very year in which year the same was taxed will be recomputed by taking the compensation or consideration as so reduced by such Court. For enabling this re-computation amendment was also made to Section 155 by inserting sub-Section (15), allowing rectification of that assessed capital gain within a period of 4 years from the end of the previous year in which the order of the Court or the Appellate Tribunal for reducing the consideration or the enhanced compensation was passed. Thus, a complete mechanism was provided to tax the capital gain and to re-compute the same in case of compensation getting reduced.

The Finance (No.2) Bill, 2014 surprisingly proposes to tax the compensation received in pursuance to an interim order of the Court/ Tribunal in the year in which the final order of such Court/Tribunal or authority is made. The reasoning given in the memorandum explaining the provision of the Finance (No.2) Bill, 2014 is that there is an uncertainty in the year in which the amount of the compensation received in pursuance of an interim order of the Court is to be charged to tax. After the insertion of Clause (c) to Section 45(5) to re-compute the capital gain and enabling provision

of allowing rectification for an extended period of 4 years from the date when the Court order is passed under Section 155(15) there does not appear to be any uncertainty about the interim relief so as to postpone the tax on the capital gain on the compensation received in pursuance of an interim order. The person having received the amount, there is no reason to postpone the taxation of the same for an indefinite period which probably may lead to non-recovery of tax as compensation so received by way of an interim order may be spent or used irretrievably by the time final order of the Court or Tribunal is made. In case there was any issue on the interpretation of the meaning of interim order the better course would have been to clarify that compensation received in pursuance of an interim order shall be taxable in the year in which it is received.

5. Benefit of Long term capital gain on debt mutual fund after 3 years and to be taxed at the rate of 20 %

The Finance (No.2) Bill, 2014 proposes to make far-reaching amendment affecting the debt mutual fund. As per the existing provisions of the Act, debt mutual funds are treated at par by and large with the equity oriented mutual fund. In terms of provision of Section 2(42A), debt mutual fund is considered as a long term capital asset if it is held for more than 12 months. Further in terms of provision of Section 112 where capital gain arises on transfer of a long term capital asset which include listed securities or units (mutual fund), the amount of capital gain before allowing for indexation adjustment shall be 10%. In view of these two provisions, the debt mutual fund of Fixed Maturity Plan commonly known as FMP was being used for the purpose of tax arbitrage. In case of any deposit with a bank, the interest so received on such deposit is chargeable to tax at the normal rate which in the case of corporates is 30%. As against this, if one makes an investment in a debt mutual fund of a fixed maturity plan of 366 days or more, such investment is considered to be a long term capital asset in view of its holding period being more than 12 months. Accordingly, it becomes eligible for benefit of indexation. In case the return on such investment in the mutual fund is equivalent to bank deposit, *i.e.*, 10% and the cost inflation index goes up by 6%, then the long term capital gain shall be chargeable on balance 4%. Tax at the rate of 20% on such long term capital gain of 4% will mean that effective tax rate is just 8% as against 30% on deposit with bank. In case one does not want to avail benefit of cost inflation indexation, capital gain on such mutual fund is charged at concessional rate of 10% under section 112 of the Act. Thus, in this process, the debt mutual fund investors pay less tax as compared to tax payable on income of interest on bank deposits. This is known as tax arbitrage. Considering this, the Finance (No.2) Bill, 2014 proposes to amend the definition of the short term capital asset so as to consider units of a mutual fund other than units of an equity oriented fund as short term capital asset if the same is held for not more than 36 months. Accordingly, for a unit of debt mutual fund to be eligible as long term capital asset, the period of holding of such debt mutual fund unit will have to be three years or more. FMP held for period of three years or less shall be considered short-term capital asset and gain arising thereon as such term capital gain liable for taxation at the rate of 30%.

Further, despite being held for a period of more than three years, so as to qualify as a long term capital asset, units of debt mutual fund will also not be eligible for concessional rate of 10% of tax without benefit of indexation under Section 112 as debt mutual fund units are being excluded from the purview of Section 112. By this proposed amendment in Section 112, the benefit of concessional rate of 10%, tax in respect of long term capital gain shall be restricted to listed securities (other than unit) and zero coupon bonds. The implication of the above amendments will be that the income arising from the debt mutual fund in case holding is less than 3 years will be taxed as short term capital gain chargeable at the normal rate and in case such units are held for more than a period of three years so as to qualify as long term capital asset, the gain arising on such unit after benefit of indexation will be chargeable at the rate of 20%.

The amended provision still gives scope of tax arbitrage *vis-a-vis* the fixed deposit with banks. An amount of ₹100 invested in mutual fund for 3 years with a simple return of 10% per annum will give a gain of ₹30 after a period of three years. After benefit of cost inflation indexation assuming to be 6% simple per year the indexed cost will work out to 118 and the long term gain of ₹12 will be chargeable to tax at the rate of 20% with the result that the tax liability will be ₹2.40. As against this the income arising on account of fixed deposit at the simple rate of return of 10% will be ₹30 and tax liability at the rate of 30% will be ₹9. Thus, one will still save ₹6.60 in taxes. The implication of the proposed amendment will be that the maturity period of the debt mutual fund which at present is normally 366 days will be increased to 1,096 days or more so as to avail the benefit of tax arbitrage.

6. Unlisted shares to be considered short term capital asset if held for less than 3 years

At present, as per Section 2(42A) shares held in a company are considered to be short term capital asset if it is held for not more than 12 months. If the shares are held for more than 12 months, the same are considered to be a long term capital asset. The Finance (No.2) Bill, 2014 proposes to restrict this benefit to securities (other than unit) listed in a recognised stock exchange in India. Accordingly for shares held in a company other than those shares listed in a recognised stock exchange, the holding period has to be more than 36 months so as to be eligible as long term capital asset for the benefit of indexation and concessional rate of 20%.

G. INTERNATIONAL TAXATION

1. No relief on the issue of retrospective amendment

There is no proposal in this Finance (No.2) Bill, 2014 to withdraw the retrospective amendment made by the Finance Act, 2012 on the issue of indirect transfer. This retrospective amendment made by the Finance Act, 2012 has vitiated the atmosphere of investment in India and has been subject matter of a lot of criticism from all quarters. The Finance Minister in his speech has referred to this issue and has assured that this Government will not ordinarily bring about any change retrospectively which creates a fresh liability. However, in respect of the amendment made by the Finance Act, 2012 he has proposed that those cases pending in Courts or other Tribunals, the same will be resolved through the legal process. He has further proposed that all fresh cases arising out of the retrospective amendment on the issue of indirect transfers will first be scrutinised by a high level committee to be constituted by the Central Board of Direct Taxes before any action is initiated in such cases by the assessing officer. This statement by the Finance Minister means that the retrospective amendment made by the Finance Act 2012, continues to be on the statute and the assessing officer shall be well within his power to refer to the CBDT for initiation of action. The CBDT on its part, in view of the retrospective amendment being on the statute, may find it difficult not to allow initiation of the proceedings by the assessing officer. Thus, the uncertainty on the issue of retrospective amendment in respect of indirect transfers continues. This issue of retrospective amendment has been going on for more than two years. It will be more appropriate if certainty is brought at the earliest by way of a statute rather than leaving it to a committee of the CBDT.

Further, there is an urgent need to define the meaning of the 'indirect transfer.' Foreign investors will continue to be wary of cross border deals where one of the companies in the group proposed to be acquired is based in India. Even if one overseas company acquires shares of another overseas company, and many layers down the organisational structure, the seller company has a subsidiary in India in which it has substantial economic value, there could be a tax incidence in India in the hands of the seller.

2. Income of FIIs to be taxed as capital gain

As against continuing uncertainty on the issue of retrospective amendment and indirect transfer, the Finance Minister has brought certainty in respect of the income earned by the foreign institutional investors on sale of securities. Section 2(14) which defines 'capital asset' is being amended to provide for any securities held by a foreign institutional investor which has invested in such securities in accordance with the regulations made under the SEBI Act, 1992, shall be considered to be a capital asset. It is also being provided that stock-in-trade shall not include any securities held by a foreign institutional investor.

With the above amendment, the income of the foreign institutional investor will be considered and taxed as income arising from the transfer of a capital asset and hence chargeable as capital gain. The above amendment though will bring certainty but may not be good for all FIIs particularly those which have been successful in arguing that it is business income earned from a base outside India and do not have permanent establishment in India and hence there is no tax incidence in India at all. With the proposed amendment even such FIIs will have to pay tax as capital gain in India. Though long term capital gain in respect of securities sold through stock exchange cannot be subjected to tax but the short term capital gain will attract tax at the rate of 15% except in case of those FIIs which have come via Mauritius or Singapore with whom India is having a special tax avoidance treaty.

3. Range Concept – Multiple year data to be considered for determination of arm's length price

The Finance Minister has proposed to align transfer pricing regulation in India with the best available practices. In this regard he has proposed to introduce the 'range concept' for determination of the arm's length price. This will go a long way in establishing that the transactions entered into between the two

associated enterprises are at arm's length. The Finance Minister has further proposed to amend the regulation to allow multiple year data for comparable analysis while determining arm's length price.

4. Definition of deemed international transaction being amended

As per the existing provision of Section 92B(2) a transaction entered into by an enterprise with a person other than an associated enterprises is deemed to be a transaction entered into by associated enterprise, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise or the terms of the relevant transaction are determined in substance between such other persons and the associated enterprise. This is proposed to be amended to clarify that deemed international transaction shall include transaction between resident entities within the definition of an international transaction if there exists a prior agreement or the terms of the transaction are determined between an unrelated resident entity and the off-shore associated enterprise of the Indian entity. This amendment on the one hand will reduce the controversy on this aspect, on the other hand it will make the compliance requirement more difficult as it may not be possible to monitor and report such arrangements.

5. Roll back provision in the Advance Pricing Agreement (APA) Scheme

The Finance Minister has proposed to introduce a roll back provision in the Advance Pricing Agreement Scheme to allow applicability of such agreement to the international transactions undertaken in previous 4 years. In this regard, an amendment has been proposed in Section 92CC by inserting sub-Section (9A) whereby agreement entered into may, subject to such condition and procedure as may be prescribed, may also provide for determining the arm's length price in relation to the international transaction entered into by the person during any period not exceeding four previous years preceding the first of the previous year in which the APA has been entered into. This move may substantially reduce the litigation. It may be important to note that the Advance Pricing Agreement Scheme was introduced by the Finance Act, 2012 and since then more than 300 applications have been filed but agreements have been signed only in five cases. To make the advance pricing mechanism successful there is a need to depute more officials and for the tax authorities to consider the application with an open mind and dispose of the same expeditiously.

6. Concessional rate of 15% tax on dividend received from foreign companies to continue

The Finance Act, 2011 has introduced a special provision under Section 115BBD for taxing dividend received from foreign companies at a concessional rate of 15%. Initially, this provision was introduced for a period of one year only. This was extended by another one year by Finance Act, 2012 and further extended for one year by the Finance Act, 2013. This Finance (No.2) Bill, 2014 proposes to extend this benefit of concessional rate of 15% tax in respect of dividend received from foreign companies for perpetuity without limiting to a particular assessment year. As per this provision, dividend received from a foreign company in which the Indian company holds 26% or more in nominal value of the equity share capital of the company, the same will be chargeable to tax at the rate of 15%. It is to be noted that this benefit will be available only to a company and that too when such company holds 26% or more of the equity capital of the foreign company. Dividend so received by a company is not exempt from Minimum Alternate Tax. Thus, if such company does not have any other taxable income it may be required to pay the tax at the rate of 18% as against 15%.

7. No tax on transfer of government security from one non-resident to another non-resident

A new Clause (viib) is being inserted under Section 47 proposing to exempt capital gain in the transfer of a government security carrying a periodic payment of interest made outside India through intermediary dealing in settlement securities by a non-resident to another non-resident. This amendment is being made to facilitate listing and trading of government securities outside India. It may be interesting to note that the Government by this amendment is exempting from tax direct transfer of an asset, which lies in India, on the other hand it wants to tax even indirect transfer of underlying assets, that too retrospectively.

8. Transfer Pricing Officer can now levy penalty for default in furnishing information

As per the existing provision of Section 271G, a penalty equivalent to 2% of value of the international transaction for specified domestic transaction is leviable on the person who has entered into such transaction and fails to furnish any such information

or document as required by Section 92D(3) of the Act. As per the existing procedure this penalty can be levied by the assessing officer or the Commissioner (Appeals). The scope of this is being extended by empowering the transfer pricing officer also to levy this penalty in case of failure to furnish information as required under Section 92D(3). This provision shall be applicable from 1st October, 2014.

H. ASSESSMENT

1. Scope of reference to valuation officer under section 142A being widened

As per the existing provision of Section 142A, the assessing officer can make a reference to the valuation officer where an estimate of the value of investment referred in Section 69, Section 69A, Section 69B or where the fair market value of any property referred to in Section 56(2) is required to be made. The above provision has been subject matter of interpretation by the various Courts whereby it has been held that the power of the assessing officer under these provisions is limited and this power can be invoked when there is an undisclosed investment or where there is understatement of investment. In order to overcome this, the Finance (No.2) Bill, 2014 proposes to substitute this existing provision of Section 142A.

As per the amendment proposed, the assessing officer is being empowered to make a reference to the valuation officer to estimate the value including fair market value of any asset, property or investment. This reference can be made by the assessing officer irrespective of the fact whether he is satisfied about the correctness or completeness of the accounts of the assessee. The valuation officer is to estimate the value of the asset, property or investment after taking into account such evidence as the assessee may produce and any other evidence in his possession or he gathers after giving an opportunity of being heard to the assessee. In case of non-cooperation by the assessee, the valuation officer can estimate the value to the best of his judgment. The valuation officer is to give a report of the estimate within a period of six months from the end of the month in which the reference is made. The assessing officer after giving opportunity of being heard to the assessee may take into account such report in making the assessment. It has been further proposed that the time period beginning with the date on which reference is made and ending with the date on which the report is received by the assessing officer shall be excluded for computing period of limitation for completion of assessment. This amendment is also proposed to be effective from 1st October, 2014 and being a procedural amendment will be applicable to all the pending assessments as on 1st October, 2014.

2. Proceeding under Section 153C only if the assessing officer of such person is also satisfied that the seized documents have bearing on determination of total income of such other person

As per the existing provision in the case of a search, the assessment for the six years preceding the search year gets reopened automatically of the searched person under Section 153A. Further, under Section 153C where the assessing officer of the searched person is satisfied that any money, bullion, jewellery or other valuable article or things or books of account or documents found during search, belongs to a person other than the person searched, then he is supposed to hand over the same to the assessing officer having jurisdiction over such person. The assessing officer of such other person is required to issue notice and reassess income of such other person in accordance with the provision of Section 153A, *i.e.*, he has to issue notice for reassessment for all the six years preceding the year in which search has been carried out. There have been instances where the documents have been found belonging to the person other than the person searched but such documents are the documents in the ordinary course of the business and are not incriminating documents to have any bearing on the determination of income of such other person. However, in view of the mandate of the Section 153C, the assessing officer of such other person has no option but is required to reopen the assessment and complete the reassessment proceedings.

This Finance Bill (No.2) Bill, 2014 proposes to address this issue by clarifying that the assessing officer of the such other person shall initiate the proceedings in accordance with the provision of Section 153A only if that assessing officer is satisfied that the books of account or documents or assets seized or requisitioned have a bearing on the determination of total income of such other person for the relevant assessment year or years referred to in sub-Section (1) of Section 153A. The implication of this amendment will be that the assessing officer of such other person will be now required to apply mind to the documents found belonging to such other person and only if he is satisfied that these documents are incriminating material which have a bearing on the determination of the total income of such other person only then he will initiate the proceedings against such person, and that too for the

relevant assessment year for which such incriminating material pertains to. In this regard, insertion of the word 'for the relevant assessment year or years' is important. With this amendment the assessment for the six years will not get reopened automatically of the person other than the person searched as is the case at present. This amendment gives statutory recognition to the decision of the Delhi High Court in the case of *SSP Aviation Ltd. vs. DCIT* 346 ITR 177 whereby the Court has dealt this issue and has held as under:-

> *"The section 153C merely enables the revenue authorities to investigate into the contents of the document seized, which belongs to a person other than the person searched so that it can be ascertained whether the transaction or the income embedded in the document has been accounted for in the case of the appropriate person. It is aimed at ensuring that income does not escape assessment in the hands of any other person merely because he has not been searched under Section 132 of the Act. It is only a first step to the enquiry, which is to follow. The Assessing Officer who has reached the satisfaction that the document relates to a person other than the searched person can do nothing except to forward the document to the Assessing Officer having jurisdiction over the other person and thereafter it is for the Assessing Officer having jurisdiction over the other person to follow the procedure prescribed by Section 153A in an attempt to ensure that the income reflected by the document has been accounted for by such other person. If he is so satisfied after obtaining the returns from such other person for the six assessment years, the proceedings will have to be closed. If the returns filed by the other person for the period of six years does not show that the income reflected in the document has been accounted for, additions will be accordingly made after following the procedure prescribed by law and after giving adequate opportunity of being heard to such other person. That, in sum and substance, is the position."*

This amendment is effective from 1st October, 2014.

I. TAX DEDUCTION AT SOURCE

1. Tax to be deducted at source on payment on maturity of key man insurance policy, *etc.*

The Finance (No.2) Bill, 2014 proposes to broaden the scope of deduction of tax at source by inserting Section 194DA. As per this amendment, tax shall be required to be deducted at source at the rate of 2% by a person responsible for paying to a resident any sum under a life insurance policy including the sum allocated by way of bonus on such policy except such amount which is not chargeable to tax under Section 10(10D) of the Income-tax Act in case such payment is ₹1 lakh or more. As per the provision of Section 10(10D) amount received from a life insurance policy is exempt except any sum received under a key man insurance policy or an insurance policy issued between 1st April, 2003 and 31st March, 2012 in respect of which premium payable for any of the years during the term of the policy exceeds 20% of the capital sum assured and also any sum received under an insurance policy issued after 1st day of April, 2012 in respect of which premium payable for any of the years during the term of the policy exceeds 10% of the actual capital sum assured. Accordingly, with the introduction of the TDS provision, now Insurance companies shall deduct tax on payment of maturity amount of key man insurance policy as well as single premium insurance policy since the premium paid in such cases exceeds the prescribed limit. This provision will be applicable from 1st day of October, 2014 and hence tax will be required to be deducted on all such payments of ₹1 lakh or more in a financial year on or after 1st October, 2014.

2. Concessional rate of tax of 5% being extended to interest on all long term bonds

As per the existing provision of Section 194LC, tax is required to be deducted at source at the rate of 5% in respect of any interest payable to a non-resident on monies borrowed by it in foreign currency under a loan agreement or through issue of long term infrastructure bonds at any time on or after 1st July, 2012 but before 1st July, 2015.

The Finance (No.2) Bill, 2014 proposes to extend benefit of this concessional rate of 5% to any long term bond not limiting the benefit to long term infrastructure bond. Further the period is being extended by another two years *i.e.*, till 1st July, 2017.

It is also being clarified that the provision of Section 206AA for levy of higher rate of tax of 20% where the recipient does not provide Permanent Account Number to the deductor shall not be applicable in respect of payment of such interest on the long term infrastructure bonds. This amendment shall be effective from 1st October, 2014.

3. Power of survey for verification of TDS

The scope of Section 133A is being extended to allow survey for the purpose of verifying that the tax has

been deducted or collected at source in accordance with the provisions of the Act. For this purpose, an income tax authority may enter a place where business or profession is carried on or where books of accounts or documents are kept, after sunrise and before sunset. Such authority shall have the power to inspect books of account and other documents and to place marks of identification on the books of account or other documents inspected by him, take extracts and copies thereof and also record the statement of any person which may be useful or relevant to any proceeding under the Act. However, such authority shall not have the power to impound and retain in his custody any books of account or documents inspected by him nor such authority shall have the power to make any inventory of any cash, stock or other valuables.

Further the provision of Section 133A is being amended to allow retention of the books in the case of a normal survey for a period of not exceeding 15 days (exclusive of holidays) without obtaining prior approval of the Chief Commissioner or the Commissioner as the case may be as against the existing period of 10 days (exclusive of holidays).

The above amendments shall be effective from 1st day of October, 2014.

4. Statutory recognition to file correction statement of TDS

As per provision of Section 200(3) a person deducting tax is required to file quarterly statement of the tax deducted by the due date. As per the existing procedure a correction statement for rectification of the information furnished in this statement is allowed in terms of the notification dated 15th January, 2013. However, there is no statutory provision allowing filing of such correction statement. The Finance (No.2) Bill, 2014 proposes to add a *proviso* below sub-Section (3) to Section 200, allowing filing of correction statement for rectification of a mistake or to add, or delete or update data furnished in the statement.

5. Time period for treating assessee in default for TDS being extended to 7 years

As per the existing provision of Section 201(1) a person who is required to deduct tax but does not deduct or does not pay after deducting such tax is considered to be an assessee in default. However, as per Section 201(3) no order can be passed deeming such person to be an assessee in default after the expiry of two years from the end of the financial year in which the statement as required under Section 200(3) is filed in the case of a person who has filed the statement and six years from the end of the financial year in which payment is made or credit is given in the case of a person who has not filed the statement.

The Finance (No.2) Bill, 2014 proposes to extend this limitation period. As per the proposed amendment, no order shall be made directing such person to be an assessee in default at any time after the expiry of seven years from the end of the financial year in which payment is made or credit is given. Thus, this Finance Bill proposes to remove the distinction between a person who has filed the statement under Section 200(3) and a person who has not filed the statement. Further an order under Section201(1) can be passed treating the person as assessee in default for not deducting tax or not depositing the tax after such deduction within a period of seven years from end of the financial year in which payment has been made or credit has been given.

This amendment is being made effective from 1st October, 2014.

J. ALTERNATE MINIMUM TAX (AMT)

1. Incentive claimed under Section 35AD liable for AMT

The Finance Act, 2012 has introduced levy of Alternate Minimum Tax on person other than a company. As per the provision of Section 115JC Alternate Minimum Tax is payable on adjusted total income which is total income before any deduction under Chapter VIA and deduction under Section 10AA. The Finance (No.2) Bill, 2014 proposes to add deduction by way of incentive allowed under Section 35AD of the Act in respect of capital expenditure incurred by an eligible business while computing adjusted total income from long term asset. In terms of the proposed amendment, capital expenditure which is allowed as deduction less depreciation allowable on such capital expenditure under Section 32 shall be added to the total income while computing adjusted total income and hence liable for Alternate Minimum Tax.

2. Credit of Alternate Minimum Tax to be allowed even in the year in which AMT is not applicable

The Finance (No.2) Bill, 2014 proposes to address the anomaly which is arising in claiming credit of Alternate Minimum Tax paid by a person other than a company. As per the existing provision, all the provisions of AMT (including of allowable credit of AMT paid in earlier years) are not applicable to an individual or HUF if the adjusted total income does not exceed ₹20 lakh in that year. The provisions of AMT are applicable only in the

year in which adjusted total income exceeds ₹20 lakh. Accordingly credit of Alternate Minimum Tax paid in earlier years cannot be claimed by such an individual or HUF in the year in which its total income does not exceed ₹20 lakh. In order to remove this anomaly, it has been proposed that credit of tax paid as Alternate Minimum Tax can be availed even in those years where the provision of this AMT are not applicable in view of the total income not exceeding ₹20 lakh.

K. MISCELLANEOUS

1. Pass through status to real estate investment trust–infrastructure investment trust

The Finance (No.2) Bill, 2014 proposes to grant pass through status to the real estate investment trust and infrastructure investment trust by inserting Chapter XII-FA relating to Business Trusts. As per the proposal, there will be no taxation in the case of the trust. The income will be taxed in the hands of the beneficiaries.

The listed units of a business trust, when traded on a recognised stock exchange, would attract same levy of securities transaction tax (STT), and would be given the same tax benefits in respect of taxability of capital gains as equity shares of a company, *i.e.*, long term capital gains, would be exempt and short term capital gains would be taxable at the rate of 15%.

In case of capital gains arising to the sponsor at the time of exchange of shares in SPVs with units of the business trust, the taxation of gains shall be deferred and taxed at the time of disposal of units by the sponsor. However, the preferential capital gains regime (consequential to levy of STT) available in respect of units of business trust will not be available to the sponsor in respect of these units at the time of disposal. Further, for the purpose of computing capital gain, the cost of these units shall be considered as cost of the shares to the sponsor. The holding period of shares shall also be included in the holding period of such units.

The income by way of interest received by the business trust from SPV is accorded pass through treatment *i.e.*, there is no taxation of such interest income in the hands of the trust and no withholding tax at the level of SPV. However, withholding tax at the rate of 5 % in case of payment of interest component of income distributed to non-resident unit holders, at the rate of 10%. in respect of payment of interest component of distributed income to a resident unit holder shall be effected by the trust.

The dividend received by the trust shall be subject to dividend distribution tax at the level of SPV but will be exempt in the hands of the trust, and the dividend component of the income distributed by the trust to unit holders will also be exempt.

The income by way of capital gains on disposal of assets by the trust shall be taxable in the hands of the trust at the applicable rate. However, if such capital gains are distributed, then the component of distributed income attributable to capital gains would be exempt in the hands of the unit holder. Any other income of the trust shall be taxable at the maximum marginal rate.

This provision will be applicable with effect from 1st October, 2014.

2. Enquiry of the information with the tax authorities

A new Section 133C is being introduced to enable the tax authorities to verify the information in its possession relating to any person. For this purpose, such authority may issue a notice to such person requiring him, on or before a date to furnish information or document verified in the manner which may be useful or relevant to an enquiry proceeding under this Act. The amendment is effective from 1st October, 2014.

3. All Mutual Funds, Venture Capital Companies to file tax returns

Under the provisions of Section 139, various persons are required to file return of income. The scope of this being extended to include filing of return by the mutual fund, securitisation trust, venture capital companies, venture capital funds despite income of such activities being exempt under various clauses of Section 10 of the Act.

4. Signing and verification of return of income

The provisions of Section 140 are being amended, with regard to signing and verification of the return, in view of the electronic filing of return. Now, the return can be verified by signature or by electronic mode. This amendment will be effective from 1st October, 2014.

5. Interest to be paid under Section 220 even from the period during which there was no demand.

The Finance (No. 2) Bill, 2014 proposes to amend the provision of Section 220 to provide that once a notice of demand under Section 220 has been served upon an assessee, such demand shall deemed to be valid till the disposal of the appeal by the last appellate authority or disposal of proceedings as the case may be.

The implication of this amendment will be that an assessee will be required to pay interest under Section 220 even in respect of the period starting from the day when there was no demand outstanding consequent

to the relief granted by an appellate authority till the period when such order of relief is reversed by higher appellate authority consequent to which the demand notice is again issued.

This amendment probably is being made to overcome the decision of the Hon'ble Supreme Court in the case of *Vikrant Tyres Ltd vs. ITO* reported at 247 ITR 821 (SC) dated 9th February, 2001, whereby the court has held that the provisions of section 3 of the Taxation Laws (Continuation & Validation of Recovery Proceedings) Act, 1964, can't be interpreted to construe that, the revenue has authority to demand interest under Section 220 of the Act, in a situation, when the assessee has satisfied the demand in regard to tax originally assessed. The Supreme Court has held that Section 3 of the Validation Act, was enacted only to revive the old demand notice which has never been satisfied by the assessee and which notice got quashed during some stage of challenge and finally the quashed notice got restored by the order of a higher forum. With this amendment, the assessee will be required to pay interest for the period during which there was no default or delay in making payment of demand as there was no demand subsisting during that period.

This amendment will be effective from 1st October, 2014.

6. Mode of acceptance of repayment of loan and deposit can be by way electronic clearing system

The provision of Section 269SS and 269T which provides for levy of penalty for acceptance and repayment of loans and deposit otherwise than by account payee cheques are proposed to be amended by allowing acceptance of repayment of loan or deposit by use of electronic clearing system through a bank account.

7. Prosecution for failure to produce accounts and documents or get accounts audited

As per the existing provision of Section 276D, if a person willfully fails to produce accounts and documents as required by a notice under Section 142(1) or willfully fails to comply with the direction issued for special audit under Section 142(2A), he is punishable with a rigorous imprisonment for a term which may extend to one year or with fine equal to a sum calculated at the rate which is not less than ₹4 and which is not more than ₹10 per day during which default continues or with both. The word 'or' is being proposed to be substituted by the word 'and' with result that in case of such failure there will be imprisonment as well as fine.

This amendment will be effective from 1st October, 2014.

8. Furnishing of statement of information

The existing provisions of Section 285BA in respect of furnishing of annual information report are being restructured. As per the proposal, prescribed financial institutions shall be required to furnish statement of the specified financial transaction or reportable account. This information is to be furnished within the prescribed time. It will be an obligation of the person furnishing such information to inform about any discovery or inaccuracy in the information provided within a period of 10 days. In order to ensure the compliance of the above provision a penalty of ₹50,000 is being introduced by way of Section 271FAA. This penalty shall be leviable in case such person provides inaccurate information in the statement and where inaccuracy is due to a failure to comply with the due diligence requirement or is deliberate on the part of the person or the person knows of the inaccuracy at the time of furnishing the statement but does not inform the same to the tax authorities and the person having discovered the inaccuracy does not furnish the correct information within the prescribed period.

9. Uniform KYC norms and single Demat account

The Finance Minister in his Budget speech has proposed to introduce a Uniform KYC norms and inter-usability of the KYC records across the entire financial sector. The Finance Minister has also proposed to introduce one single operation Demat account so that one can access all financial assets through this one account.

10. Kisan Vikas Patra being reintroduced

The Finance Minister in the Budget speech has proposed to reintroduce the Kisan Vikas Patra to encourage small savers to invest in this instrument. This is being revived probably to encourage savings. The money invested in Kisan Vikas Patra used to get doubled in eight years and seven months. There was no upper limit of investment. Though the objective of the Finance Minister apparently is to tap untapped savings but it can also bring in a lot of unexplained money especially in semi-urban and rural areas who invest much amount of cash in Kisan Vikas Patra. Kisan Vikas Patra can be easily bought from the post office and also encashed in cash at the post office without deduction of tax at source and one does not need a bank account for buying and encashing Kisan Vikas Patra. ■