Finance Bill, 2015 – Some Provisions

The Finance Minister Mr. Arun Jaitley, in his Budget Speech, indicated that several amendments are proposed in the Finance Bill, 2015 (the Finance Bill) for revival of growth, promote investment and domestic manufacturing as well as ease of doing business. Some of these proposed amendments are discussed below.

General Anti-avoidance Rule-Deferred

Chapter X-A of the Income-tax Act, 1961 (the Act) consisting of Sections 95 to 102 as introduced by the Finance Act, 2013 provides for `General Anti-avoidance Rule' (GAAR). Under the GAAR, in certain circumstances arrangements entered into by an assessee could be declared as impermissible avoidance arrangement with tax consequences to be determined as provided in the Chapter. This Chapter was to become applicable from Assessment Year 2016-17. The Finance Bill proposes to postpone the applicability of the Chapter to Assessment Year 2018-19. The Finance Minister, in his Budget speech, has also mentioned that GAAR when implemented would apply prospectively to investments made on or after 1st April, 2017. This is also reiterated in the Explanatory Memorandum to the Finance Bill. The Explanatory Memorandum also refers to the

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It is now proposed to insert a *proviso* to provide that where the allowance of additional depreciation under clause (iia) is restricted to 50% of the additional depreciation otherwise allowable, on account of the asset having been put to use for less than one hundred eighty days, the balance 50% of the additional depreciation will be allowed in the immediately succeeding year.
This brings clarity to the provision relating to the allowability of additional depreciation. The amendment will become effective from Assessment Year 2016-17.

Base Erosion and Profit Shifting Project (BEPS) under Organisation of Economic Cooperation and Development (OECD) and states that it would be appropriate that GAAR provisions are implemented as a part of comprehensive regime to deal with BEPS and aggressive tax avoidance.

Deferment of implementation of GAAR and clarification that investments up to 31st March, 2017 will be protected is welcome.

Incentives for States of Andhra Pradesh and Telangana-*Investment Allowance and Additional Depreciation*

Special incentives have been proposed in the form of higher additional depreciation and investment allowance for setting up an undertaking or enterprise for manufacture or production of any article or thing in the notified backward areas of the States of Andhra Pradesh and Telangana.

(i) *Depreciation:* Presently, assessees engaged in the business of manufacturing or production of any article or thing or business of generation or generation and distribution of power are entitled to additional depreciation at the rate of 20% under clause (iia) of Section 32(1) of the Act. This clause (iia) is proposed to be amended by adding a *proviso* to allow additional depreciation of 35% where the assessee sets up an undertaking or enterprise on or after 1st April, 2015 for manufacture or production of any article or thing in the notified backward areas of the States of Andhra Pradesh or Telangana and acquires and installs any new machinery or plant other than ships and aircraft for such undertaking or enterprise.

To be eligible for the additional depreciation at the higher rate of 35%, the acquisition and installation of plant and machinery should be during the period from 1st April, 2015 to 31st March, 2020. As per the existing *proviso*, additional depreciation is not allowable in respect of any plant or machinery that has been used by any person in or outside India, plant and machinery installed in any office premises, residential accommodation or guest house, road transport vehicles or plant and machinery the whole of actual cost of which has been allowed as deduction while computing business profits in any one year.

(ii) *Investment allowance:* A new Section 32AD is proposed to be introduced, providing for deduction by way of investment allowance at the rate of 15% of the actual cost of new plant and machinery (new asset) acquired and installed during the period from 1st April, 2015 to 31st March, 2020 for an undertaking or enterprise set up on or after 1st April, 2015 for manufacture or production of any article or thing in the notified backward areas of the States of Andhra Pradesh or Telangana. Investment allowance is not allowable in respect of any plant or machinery that has been used by any person in or outside India, plant and machinery installed in any office premises, residential accommodation or guest house, any office appliances including computers and computer software, ship, aircraft, vehicles and any plant and machinery the whole of actual cost of which has been allowed as deduction while computing business profits in any one year.

It is proposed that if the new asset is sold or otherwise transferred within a period of five years from the date of its installation, then the deduction allowed in respect of such new asset shall be deemed to be the income of the year in which the asset is sold or transferred.

However, this provision regarding withdrawal of deduction will not apply where the transfer of the new asset is in connection with amalgamation or demerger or reorganisation of business referred to in clauses (xiii), (xiiib) or (xiv) respectively of Section 47 of the Act. These clauses deal with succession of a firm by a company, conversion of a private company or an unlisted public company into a limited liability partnership and succession of a proprietary concern by a company.

In all these cases, the restriction on sale or

transfer of the new asset for the period of five years will continue to apply to the amalgamated company or the resulting company or the successor, as the case may be.

The deduction under Section 32AD will be in addition to the deduction by way of investment allowance presently allowable under Section 32AC. Accordingly, an assessee will be entitled to claim investment allowance both under Section 32AC and 32AD, if he satisfies the conditions applicable under these Sections.

Both the above amendments will become effective from Assessment Year 2016-17.

Considering the normal depreciation of 15%, additional depreciation of 35%, investment allowances of 15% each under Section 32AC and Section 32AD, a company investing in a new undertaking in any notified backward area of Andhra Pradesh or Telangana will be able to claim deduction of up to 80% of the actual cost of new plant and machinery installed in a year. However, it may be noted that provisions of Section 115JB relating to MAT may become applicable to the company and as a result, it is likely that the company may have to pay MAT after claiming the above deductions.

Additional Depreciation Controversy Resolved

Under the second *proviso* below clause (ii) of Section 32(1), where the asset acquired during the year is put to use in the year for less than 180 days, depreciation is restricted to 50% of the depreciation otherwise available. In other words, in the year of installation, if the asset has been used for less than 180 days, depreciation is allowable in that year is only to the extent of 50%. This restriction applies also to the additional depreciation under clause (iia) of Section 32(1) and the new *proviso* proposed to be inserted under the clause (iia). There is a controversy, whether the 50% of the additional depreciation, which is not allowed due to the operation of the existing proviso mentioned above, is allowable in the immediately subsequent year.

It is now proposed to insert a *proviso* to provide that where the allowance of additional depreciation under clause (iia) is restricted to 50% of the additional depreciation otherwise allowable, on account of the asset having been put to use for less than 180 days, the balance 50% of the additional depreciation will be allowed in the immediately succeeding year.

This brings clarity to the provision relating to the allowability of additional depreciation. The amendment will become effective from Assessment Year 2016-17.

By including transfer of capital asset in the course of demerger covered under clause (vib) of Section 47 in Section 49(1)(iii)(e), the period of holding by the demerged company will be included in the period of holding by the resulting company. The amendment will become effective from Assessment Year 2016-17. It will remove the ambiguity relating to the cost of acquisition of a capital asset in the hands of the resulting company acquired by it in the course of a demerger.

Cost of Acquisition of a Capital Asset for Resulting Company

Under clause (vib) of Section 47 of the Act, any capital asset transferred by the demerged company to the resulting company in a scheme of demerger is not regarded as a transfer, if the resulting company is an Indian company.

Presently, under the Act, there is no specific provision specifying what would be the cost of acquisition and the period of holding of such capital asset in the hands of the resulting company.

It is now proposed to amend sub-clause (e) of clause (iii) of sub-Section (1) of Section 49 of the Act, to include transfer under clause (vib) of Section 47 and thereby provide that the cost of acquisition of an asset acquired by a resulting company shall be the cost for which the demerged company acquired the capital asset as increased by the cost of improvement incurred by the demerged company.

Clause (b) of Explanation 1 to Section 2(42A) defining 'Short Term Capital Asset' already provides for including the period of holding by the previous owner for computing the period of holding of the capital asset by the assessee in case the assessee became the owner in the circumstances mentioned in Section 49(1). By including transfer of capital asset in the course of demerger covered under clause (vib) of Section 47 in Section 49(1)(iii)(e), the period of holding by the demerged company will be included in the period of holding by the resulting company.

The amendment will become effective from Assessment Year 2016-17. It will remove the ambiguity relating to the cost of acquisition of a capital asset in the hands of the resulting company acquired by it in the course of a demerger.

Residential Status of a Company

Presently, under clause (3) of Section 6 of the Act, an Indian company is always a resident in India under the Act and a company which is not an Indian company (a non-Indian company) is resident in India if during the previous year the control or management of its affairs is situated wholly in India.

This provision has been on the statute book for a very long time.

This position is proposed to be altered by substituting clause (3) of Section 6. Under the proposed new clause (3) of Section 6, a non-Indian company would be a resident in India if its place of effective management (POEM), at any time in that year, is in India.

Explanation to the proposed clause (3) defines POEM to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.

The amendment will become effective from Assessment Year 2016-17.

Once a company is resident in India, its global income will be taxable in India. Accordingly, where due to POEM being in India, if a foreign company becomes resident in India, it world income would be chargeable to tax in India. This is, of course, subject to the tax treaty between India and the country where the foreign company is incorporated or registered.

The Explanatory Memorandum states that the existing definition facilitates creation of shell companies which are incorporated abroad but controlled from India. Due to the requirement that whole of control and management should be situated in India for the whole of the year, the condition has been rendered to be practically inapplicable. It further states that POEM is an internationally accepted concept and set of guidelines will be issued for the benefit of tax payers and tax administration. Direct Tax Code, 2013 had similar provision.

It is true that POEM is an internationally recognised concept. Various tax treaties have this concept in the "tie-breaker rule" to determine residence in case a company becomes a resident of two countries–in the country of incorporation/registration and in the other country due to control and management. However, even internationally there is lack of a common meaning of the concept of POEM. There is subjectivity involved.

It is now proposed to increase this limit to ₹ 20 crore with effective from Assessment Year 2016-17. This will give relief to many assesses who have transactions within the group. While the Finance Minister has attempted to remove ambiguity in certain provisions of the Act, one needs to see how some of the new provisions are applied in field.

It is likely that the proposed definition may lead to substantial litigation. Subsidiaries of Indian companies may get affected and will have to litigate. It may affect many multinational companies as well. A company may become resident in India if *at any time during the year* POEM is in India. This provision may lead to unintended consequences, particularly for companies whose holding companies or parent companies are based in India. Such companies may have group CFOs or group CEOs based in India. Whether this will result in a foreign subsidiary becoming resident? In an era of information and communication technology, under what circumstances the new provision will get triggered needs to be seen. While the intention is to target shell companies, the provision may have many repercussions. One will have to wait for the guidelines to be issued to assess the impact of the changed definition.

Domestic Transfer Pricing

Section 92BA defines `specified domestic transaction'. It enumerates various types of transactions and monetary limit which when crossed, all such transactions get covered by the provisions of Transfer Pricing Regulations. If such transactions are not at arm's length price, adjustment is made to the income of the assessee.

Presently, in order that Transfer Pricing Regulations are attracted, the aggregate of various transactions referred to in Section 92BA should exceed ₹ 5 crore.

It is now proposed to increase this limit to ₹ 20 crore with effect from Assessment Year 2016-17. This will give relief to many assesses who have transactions within the group.

While the Finance Minister has attempted to remove any ambiguity in certain provisions of the Act, one needs to see how some of the new provisions are applied in the field. ■