Amendment in Direct Tax by the Taxation Laws (Amendment) Act, 2006 – A Study

The Taxation Laws (Amendment) Act, 2006 was passed in the Parliament in May 2006. It received the Presidential assent on July 13, 2006. This article discusses the impact of certain major amendments made in Direct Tax.

The Taxation Laws (Amendment) Bill, 2005, was introduced in Lok Sabha in May 2005. The Bill was then sent to the Standing Committee of Parliament. The Committee submitted its report in December 2005. After considering the suggestions of the Committee, the Bill was passed in the Parliament in May 2006 as the Taxation Laws (Amendment) Act, 2006 (hereinafter referred to as "the Act"). The Act received the Presidential assent on July 13, 2006. The Act is effective from assessment year 2006-07.

Purposes of the Amendment

Through the Act, certain provisions of the Income-tax Act 1961 have been amended like streamlining the approval and monitoring process for certain charitable entities, scientific research associations etc., prescribing filing of return by certain charitable entities with aggregate annual receipts below Rs. 1 crore, requiring payment exceeding Rs. 20,000 by an account payee cheque or account payee bank draft, prescribing TDS on renting of plant and machinery, equipment, royalty and non-compete fee and phased withdrawal of exemption to North-Eastern Finance Development Corporation Limited over the next five years. It also excludes from previous year 2004-05 any sum received from a charitable entity or a local authority without consideration from the ambit of taxation under the head "income from other sources". It also provides aggregation of the said sums received without consideration from the previous year 2006-07 and to enhance the existing limit of Rs. 25,000 to Rs. 50,000 for inclusion under the head "income from other sources". Certain other amendments such as rounding off of demands or refunds to the nearest multiple of ten rupees, empowering the Tax Recovery Officer to exercise limited powers of the Assessing Officer, allowing for revision of penalty orders on receipt of appellate orders regarding assessment, etc., were also made through the Act.

— CA. Barun Kumar Ghosh

(The author is a member of the Institute. He can be reached at barun66@rediffmail.com)

Amendments Concerning Charitable Organisations

- Under section 10(23C) any university or other educational institution or any hospital or other institution for reception and treatment of illness of persons existing solely for philanthropic purposes and having annual gross receipts over Rs. 1 crore or any institution wholly for public religious or charitable purposes and having importance throughout any State or throughout India or any other fund or institution established for charitable purposes and having importance throughout any State or throughout India requires approval of the Central Government to qualify for exemption from tax under the section. There was previously no time limit for granting or rejecting approval or issuing notification. Now this notification will have to be issued or order rejecting the application will have to be passed within one year from the end of the month in which the application for exemption is made.
- Earlier there was no requirement of audit of accounts of the above institutions under

the Income-tax Act. Now in cases where the total income of these institutions exceeds Rs. 1 lakh (i.e. maximum tax free limit) without considering the exemption, these institutions have to get their accounts audited by a Chartered Accountant. The audit report in the prescribed form is to be furnished along with the return of income for the relevant assessment year.

- Prior to the amendment, section 12A provided for audit where the total income of the trust or institution registered under the section without considering the exemption under section 11 and 12 exceeded Rs. 50,000. Now audit is compulsory if the total income (without considering such exemption) exceeds Rs. 1 lakh.

Amendments Concerning Research Institutions

- Section 35(1)(ii) and 35(1)(iii) allow weighted deduction in respect of contribution to a scientific research association or a university, college or other institution approved by the Central Government. Amended provisions require that such approval will be granted in accordance with the guidelines and conditions laid down by the Central Government by rules to be prescribed.
- Approval as referred to above is to be granted or rejected within one year from the end of the month in which application for approval of the Institution is made by it.

Effect of Withdrawal of Notification from the Point of View of the Donors or Contributors

There already exist provisions enabling the Central Government to withdraw notifications issued under sections 35, 35 AC (contribution to National Committee for undertaking eligible projects or schemes), 35 CCA (contribution to institutions or associations for carrying out rural development programmes). The amended provisions of the above sections read with the amended section 80GGA confirm that where a person has already donated or contributed any sum to the notified or approved institutions before withdrawal of such notifications and approvals, he will not be denied the benefit of deduction under the above sections. For example, 'X' makes a donation of Rs.10,000 on May 12, 2006 to a University that carries on scientific research activity approved by the prescribed authority. Thereafter on November 30, 2006 the prescribed authority withdraws the notification under section 35. 'X' shall be eligible for deduction under section 35 or section 80GGA, as the case may be in respect of such donation. The amended provisions are in line with already existing provision contained in section 80G (Explanation 2) of the Income-tax Act.

Amendments in Provisions Relating to TDS vis-à-vis Provision of Section 40(a)

- Prior to this amendment, section 194-I provided for deduction of tax at source from rent for building or land. After this amendment tax shall be deducted at source from payment of rent for use of not only land or building, but also from payment of rent for the use of machinery, plant, equipment, furniture and fittings irrespective of the fact whether any or all of the items are owned or not by the payee. That means the payee may be a lessee who might have sub-leased the property to any other person. The amendment affects the assessees engaged in leasing business. Even if any landlord enters into two separate agreements—one for letting out the building and the other for letting out furniture and fixtures, rent under the two agreements shall be aggregated for the purpose of the threshold limit of Rs. 1.20 lakh.
- As a consequential measure a matching amendment has been made in section 40(a)(ia) so as to disallow rent in computation of business income, if the amount of tax deductible has not been deducted or after deduction the assessee has not paid the

tax so deducted within the time limit prescribed in section 200(1) (seven days from the end of the month in which the tax is deducted or in case of liability provided at the year-end, within 31st May of the next financial year).

- Similarly, the scope of section 195J has been extended to royalty paid or payable by a person, not being an individual or a HUF, to any person resident in India, if the amount of royalty exceeds Rs. 20,000. Royalty has the same meaning as in explanation to section 9(1)(vi). Like rent, non-deduction of tax at source from the amount of royalty or delay in depositing the tax deducted shall cause disallowance under section 40(a)(ia) in computation of business income of the person paying the royalty. Until now, tax deduction was required only in case of payment of royalty to non-resident.
- The tax auditor has to report the amount of rent or royalty inadmissible under section 40(a) because of non-deduction of tax or delay in deposit of such tax in revised Form 3CD.
- Moreover, under the amended section 194J, any person responsible for payment of non-compete fee covered by section 28(va) to any person resident in India is now required to deduct tax at source, if such fee exceeds Rs.20,000. However, this item is outside the purview of section 40(a).
- Though theoretically the amended provisions enumerated above are applicable from the assessment year 2006-07 and would apply from all payments made during the financial year 2005-06, they are actually applicable from July 13, 2006 when the President gave his assent.

Amendment in Section 40A(3)

The section seeks to disallow 20% of the expenditure where payment is made for a sum exceeding Rs.20,000. The previous requirement was that the payment should be made by crossed cheque or crossed bank draft. Now the payment should be made by account payee cheque or account payee bank draft. Consequential amendment has been made in Tax Audit report form.

Amendment in Provisions of Section 56 Relating to Cash Gift

- The earlier provision was contained in clause (v) of sub-section (2) of section 56, which becomes applicable for gifts received between September 1, 2004 and March 31,

2006. Gifts received in the above period from any local authority covered by section 10(20), any fund or foundation or university or other educational institution or hospital or medical institution or any trust or institution covered by section 10(23C) or any trust or institution registered under section 12AA shall not be treated as income of the recipients.

- As per new clause (vi), if the gifts are received from the above-referred institution or trust or fund on or after April, 2006 the same shall not be deemed as income in the hands of the recipients. Therefore, scholarships from university, cash award by a Municipal Corporation etc. shall not attract the deeming provision.
- The exemption of Rs.25,000 per gift is no longer applicable for gifts made on or after April 1, 2006. As per new clause (v), the limit of exemption has been enhanced to Rs.50,000. However, the limit has to be applied on an aggregate basis. If the aggregate value of all gifts received by an individual or a HUF in a financial year exceeds Rs.50,000, then the whole of the aggregate value of gifts shall be liable to tax. For example, 'X' receives two gifts of Rs. 40,000 and Rs.30,000 from 'Y' and 'Z' in financial year 2006-07. 'X' is not entitled to any exemption, because the aggregate value of two gifts exceeds Rs 50,000.
- It may be noted that gift-in-kind is still not liable to tax.

Amendments in Certain Procedural Provisions

- As per section 139, it has become mandatory for any university, educational institution, hospital, etc. claiming exemption under section 10(23C) with gross receipts of less than Rs.1 crore to file return of income, if the income of these institutions exceeds Rs.1 lakh (maximum tax-free limit) without considering the exemption. It is not out of context to state that a new form of audit report for these institutions has been prescribed in the Income-tax Rules.
- Section 155 has been amended to provide benefit to the assessees claiming exemption under section 10A or 10B or 10BA. The assessees are required to receive in or bring into India the sale proceeds in convertible foreign exchange within six months from the end of the relevant previous year or within such extended period as may be granted by the RBI or other authority. The earlier position was that if the sale proceeds are not received within six months or the extended period, the exemption was denied. Now the assessing officer is empowered to amend the assessment order within four years from the end of the financial year in which the convertible foreign exchange is brought in India. Thus exemption under section 10A/10B/10BA can be claimed even if the remittance of foreign exchange is delayed.
- There was no provision for revising the penalty order after any appeal decision. This was an anomaly. Section 275 has been amended to provide that if a penalty order is passed before any appellate order is passed by CIT (A), ITAT, High Court or Supreme Court; the same can now be revised by enhancing, reducing or cancelling the penalty to give effect to the order of the appellate authority. Such revised order is to be passed within six months from the end of the month in which the appellate order is received. Further, the assessee can file appeal against the said revised order before CIT (A).

Conclusion

On reading of the amendments brought in by the Taxation Laws (Amendment) Act, 2006, it is revealed that certain amendments are meant to be anti-avoidance measures and other amendments are meant for removing anomaly in certain provisions. ❐