

Overview of the Direct Tax Provisions in The Finance Bill 2010

PREPARED FOR MEMBERS BY THE DIRECT TAXES COMMITTEE
OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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27th February 2010

To,
The Members & Students of ICAI,

Sirs,

The newly constituted Direct Tax Committee, took charge on the 12th Feb 2010 and were immediately confronted with the reality that an important event for all professionals was exactly 2 weeks away. Considering the importance that the Finance Bill holds for the country as well as for members and students of our profession, we felt it would be appropriate to explore new avenues to be of service to the members. It was with this objective that the committee met on 22nd Feb to explore the possibility of using the immense power of the Internet to reach membership across the country. Out of this discussion came some fresh ideas which we have tried to implement. These were to have a detailed discussion which could be webcast across the country - where the significant features were analysed on the same day that budget was presented by Hon finance minister.

- To make available a brief commentary on the direct tax proposals contained in the Finance Bill in a simple downloadable format
- To elicit response from members by way of an opinion poll
- To provide a simple methodology for members to give their considered views for inclusion in the post-budget memorandum prepared by the direct tax committee for consideration by the Finance Ministry.

It gives me immense pleasure to report that the webcast which was conducted yesterday, within 8 hours of the budget being presented was an immense success despite the constraints of time that were faced by the committee. The full webcast is now available on the ICAI website and can be viewed at your leisure.

The commentary on the direct tax proposals contained in the Finance Bill has also been prepared and hosted on the website within a day of the presentation of the budget. I must express my sincere thanks to my committee members and the staff of the ICAI who have worked tirelessly to make this possible. In particular I may express my heartfelt & special thanks to CA Milin Mehta of Baroda, Ms. Chitra Suresh who gave the major inputs for this commentary. Thanks are also due to my diligent colleagues in the DT committee and in the Council, Chartered Accountants, Devraj Reddy (Vice Chairman, DTC), Sumantra Guha, Sanjay Agarwal who are part of the Committee & CAs Madhukar Hiregange, Anuj Goel, Ravindra Holani & Pankaj Tyagee. Of course none of these initiatives would have been possible without the unstinted support extended by President CA Amarjit Chopra and Vice President CA G. Ramaswamy. I am certain that with their continuing guidance and the inputs and support from members, this committee shall achieve new heights in rendering services to the members.

We all look forward to continuing to serve you in a similar manner in future.

Yours sincerely,
Jayant Gokhale,
Chairman, Direct Taxes Committee.
The Institute of Chartered Accountants of India.

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ECONOMIC SURVEY 2009-10 SURVEY OUTLINES HIGH GROWTH PATH; FISCAL PRUDENCE

The Economic Survey 2009-10 tabled in Parliament by the Finance Minister Pranab Mukherjee a day before he presented the Union Budget for the financial year 2010-11 indicated that the government is set to take measures towards the path of fiscal consolidation. The FY11 Union Budget is likely to lay a roadmap for withdrawal of stimulus measures that were taken to support the economy during the global meltdown.

The Indian economy has embarked on the higher growth trajectory and medium term prospects are very strong which could lift the gross domestic product to 9%, indicated the Economic Survey 2009-10, tabled in the Parliament a day ahead of the Union Budget for 2010-11. The economy has shown a 'V' shaped recovery. Growth in the economy had slowed down significantly following the global meltdown, prior to which it had shown a growth of 9% in the three years preceding the financial crisis. In 2008-09, India grew at 6.7%. It is estimated that India will grow at 7.2% in the current financial year, the Survey said.

The economic survey is confident that the country will grow at the rate of 8.25 to 8.75% in the next financial year that would enable a rollback in the stimulus measures and consequently help in reducing the debt burden. As industrial recovery gains momentum and with expectations of uptrend in private and investment demand, there is a possibility of even a double-digit growth, the Survey indicated. Indian exports that had slumped for several months as global demand had dropped drastically has witnessed a pick-up in the last couple of months, which is expected to spill-over for the third consecutive month in January. As the manufacturing sector showed buoyancy in the past few months, the economic growth is seen supported by sustained revival in infrastructure, telecommunications, aviation, power amongst other sectors, the Survey indicated. India's industrial output grew to a 20-year high of 16.8% in December.

The Survey, however, cautioned that higher economic growth should be achieved without negating the price situation and the government as well as monetary policy authorities should work towards ensuring that price stability was maintained. The Survey clearly states that expansion of the fiscal stance was a short-term measure and that fiscal prudence was necessary for long-term growth path. The Survey said that while the government should address fiscal rectitude, there was a need for transmission of the monetary policy measures to the real sector. The Survey has highlighted that credit growth remained sluggish in the current financial year adding there was a need to monitor credit flow to productive sectors. Credit growth as on January 29 was 14.4% on year as compared to a 19.3% growth in the year ago period.

The government is faced with a major challenge of moving towards the high growth path even as it embarks on gradual withdrawal of the stimulus measures. The Union Budget of 2010-11 seems to be growth oriented and will be a roadmap for fiscal consideration.

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FINANCE BILL, 2010

Unless otherwise specifically mentioned, the amendments proposed are to be effective from A.Y. 2011-2012 and are therefore applicable with respect to income arising on or after 1st April 2010. Specific mention is made at the relevant places, when the effective date of a proposed amendment is other than 1st April 2010. Reference to the existing provisions means the provisions of the Act immediately prior to the amendments proposed in the Bill.

Any reference to the sections, unless otherwise stated, is to the sections of the Income Tax Act, 1961.

A. RATES OF TAX

In respect of rates of tax, the following changes have been proposed in the Finance Bill, 2010:

- Basic exemption limit remains the same. The slab for 10% tax has been revised to Rs. 5,00,000/- from the existing Rs. 3,00,000/- in case of Individuals, HUFs, AOPs and BOIs.
- Surcharge of 10% applicable to domestic companies has been reduced to 7.5%. There is no change in the rate of surcharge of 2.5% in case of foreign companies.
- There is no change in tax rates of Firms, Domestic Companies, Companies other than Domestic Companies and Co-operative Societies.
- There is no change in rates of Educational Cess, Secondary & Higher Secondary Cess and its applicability.
- Rate of Minimum Alternate Tax in case of Companies is proposed to be increased from 15% (effective 16.995% with surcharge and cess) to 18% (effective 19.9305% with surcharge and cess).
- Rate of Dividend Distribution Tax remains same.
- Rates of Securities Transaction Tax and its applicability remains the same.
- There is no change in the threshold limit and rate of wealth tax.

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- Threshold limits in case of various provisions of Tax Deduction at Source have been changed.

The proposed income tax rates (including surcharge, Education Cess and Secondary and Higher Secondary Cess) for the A.Y. 2011-12 have been given in **Table 1 in the Annexure** for ready reference. These income tax rates are applicable on any income earned during the period from 1st April 2010 to 31st March 2011.

The rates of Dividend Distribution Tax, Securities Transaction Tax & Wealth Tax are given in **Table 2 in the Annexure**.

The rates of TDS and TCS are contained in **Table 3 in the Annexure**.

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B. PERSONAL TAXATION

B.1 Income Tax on transfer of property without consideration or for inadequate consideration

With effect from A.Y. 2005-06, a concept of levying income-tax on the gifts received by an individual or HUF was introduced in Section 56 (2) of the Act. This was done to combat certain misuse of the provisions where the gift was received from a non-relative. At first the said concept was introduced for taxing gift in cash alone. However, consistently the scope of the said gifts has been enlarged. With effect from 1st October, 2009, the provisions not only cover the cases of gifts in cash, but also include the cases of gifts received by an individual or HUF in kind, being gift of immovable property (land or building or both), shares and securities, jewellery, archeological collection, paintings, sculptures or work of art (“Specified Properties”). The provisions are applicable only where the value of the gift exceeds Rs. 50,000 and is given at times other than specified occasions.

Amendments are sought to be made in this scheme of taxation:

- Transfer of immovable property without consideration or for inadequate consideration was chargeable to tax with reference to the stamp duty valuation as determined u/s. 50C of the Act. The present provisions also cover cases where a person purchases the property at a value lesser than the value which is determined by the stamp duty authorities. The Bill proposes to retain tax only on transfer of immovable property without consideration. Cases of transfer of immovable property for inadequate consideration are no longer covered by these provisions since such transactions would in any case fall squarely within the ambit of S.50C.
- Section 56(2) has been amended to cover only transfer of capital assets and not stock-in-trade. Therefore, transfer of stock-in-trade would not attract the taxability provisions under section 56(2). This amendment is based on the logical reasoning that a person cannot be compelled to always earn profit in a business transaction.
- Further, the definition of the Specified Properties has expanded by including “bullion” in the definition and accordingly now the gift of bullion (earlier only jewellery was included whereas bullion was not included) also will be chargeable to tax in the hands of the recipient.

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B.2 *Transfer of shares to Partnerships and Closely Held Companies to attract the provisions of section 56(2) in the hands of the recipient*

- Hitherto, only transfer of property to individuals and HUFs were only covered by the provisions of section 56 (2), whereas the recipient firms, companies, etc. were excluded from taxation. By proposed amendment, it is sought to tax the firms and closely held companies if they receive shares of a closely held company on or after 1st June, 2010, either without consideration or for inadequate consideration.
- It must be kept in mind that even transfer of the shares which are held as stock in trade will be covered as the amendment proposed in the definition of "Property" does not apply here.
- It applies only where the value of the shares transferred or difference between the consideration paid and the fair market value exceeds Rs. 50,000.
- Cost of acquisition in the hands of the recipient firm or closely held company would be the fair market value of the shares so received.

B.3 *Insertion of a new Deduction for investment in Long Term Infra-structure Bonds - section 80CCF*

Under the existing provisions, there is a limit of Rs.1,00,000 u/s. 80CCCE which is for specific deductions in computing the total income under section 80C, 80CCC & 80CCD; a new section has been inserted for granting deduction to individual or HUF in computation of its total income.

The proposed section 80CCF provides for a deduction to an individual or a HUF upto the limit of investment of Rs.20,000/-, over and above the existing limit of Rs. 1 lakh under section 80CCE. The said investment has to be made in Long-term infrastructure bonds to be notified by the Central Government.

B.4 *Deduction for Medical Insurance under section 80 D*

Under the existing section 80D, deduction upto a sum of Rs. 15,000 on premium paid for insurance on the health (Mediclaime) of the assessee and his family. A further deduction of Rs. 15,000 is admissible if the medical insurance is taken for parents of the assessee. It is also provided in the existing provision that if the insured is a senior citizen, the said limit will become Rs. 20,000.

It is now provided that if any contribution is made to the Central Government's health scheme then the same would be also eligible for the deduction U/s. 80 D, subject to the above overall limit.

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C. TRUSTS

C.1 *Charitable Organisations*

Organisations which are existing for charitable purpose are entitled to seek exemption from the tax liabilities under the Act. However, the institutions which were engaged in charitable activities other than relief to poor, education, medical relief, preservation of environment, monuments or places of artistic or historic interest, or religious institutions [i.e. institutions which were having object of general public utility] were denied exemption, if these institutions were engaged in any activity of trade, commerce or business or activity of rendering any service for a cess or fees. Amendment to this effect of denying benefit of exemption was brought by Finance Act, 2008 w.e.f. 1.4.2009.

It is proposed in the Bill, that such benefit of exemption will not be denied to the institutions having object of general public utility, even where they are engaged in the activity of trade, commerce or business activity or for rendering any service for a cess or fee, provided the aggregate value of receipt from such activities is less than Rs. 10.00 lacs in the year under consideration.

C.2 *Cancellation of Registration of Trust*

Registration of trust was governed by Section 12A of the Act prior to the introduction of Section - 12AA vide Finance Act, 2007.

Section - 12AA(3) empowers the commissioner to cancel the registration of trust, if the registration is granted u/s. 12AA. However, the provision is silent for cancellation of registration, where the registration is granted u/s. 12A. This was unintended omission of powers of the CIT to cancel registration and accordingly amendments have been proposed to enabling the CIT to cancel registration even in cases where the original registration is granted u/s. 12A of the Act.

This change is proposed w.e.f. 1st June 2010.

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D. TAXATION OF NON-RESIDENTS

D.1 *Income deemed to accrue or arise in India*

Commensurate with generally accepted international tax practices, the Indian tax laws provide for taxation of interest, royalties and fees for technical services of non-residents in India, provided the source of such income is situated in India.

The question / dispute has been arising that where the Non-resident has rendered services from outside India whether the source of income shall be considered to be lying in India for the purpose of Section - 9. This dispute was settled by Hon'ble Supreme Court of India in the case of *Ishikawajima-Harima Heavy Industries Ltd. vs. DIT [2007] 288 ITR 408*. The Hon'ble Supreme court has held that to tax the income from fees for technical services, the services must be utilized in India as well as must be rendered in India.

The Department considered this decision and came up with a retrospective amendment (w.e.f. 1/06/1976) vide Finance Act, 2007 by introducing an explanation to section - 9. As per the said explanation it was clarified that the income from Interest, Royalty and Fees for technical services shall be chargeable to tax in India irrespective of the fact that the non-resident has no residence or place of business or business connection in India.

However even after the introduction of said explanation the question of taxability when services have been rendered outside India remained unanswered. Therefore the dispute remained unresolved. The Hon'ble Karnataka High Court in the case of *Jindal Thermal Company Ltd. 182 Taxmann 252* recently held that the services provided off shore or outside India cannot be taxed in India.

The department again considered the decision of High court vide Finance Bill 2010 proposes to change the explanation to section - 9 in view to bring the income from services rendered outside India under the tax net. In view of the proposed change only requirement for taxing income from such services shall be the utilization of services in India and not place of rendering the services.

The change is proposed w.r.e.f 1st June 1976.

This amendment has far reaching impact and it can affect the taxability of several items, which hitherto were not chargeable to tax in India.

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D.2 Computation of Income of Non-Resident providing services in respect of extraction or production of Mineral Oil

The income of Non-resident from fees for technical services or from royalty is chargeable to tax as per section - 9(1)(vi) and (vii). In case the non-resident has permanent establishment in India the income shall be computed in accordance to the provisions of the Section - 44DA.

However, when the services were provided or the royalty was receivable in respect of a project which was otherwise eligible u/s. 44BB of the Act [extraction or production of mineral oil], the question was whether the said payment would be governed by section 44DA or section 44BB. It may be mentioned that section 44BB of the Act taxes only 10 % of the gross receipt to tax.

The Advance Ruling Authority in matter of Geofizyka Torun Sp. Zo. O. in Re [AAR no. 813 of 2009] and Seabird Exploration FZ LLC [AAR No. 815 of 2009] and also in other cases has given the ruling that since Sec - 44BB is more specific provision it should prevail over section 44DA for the purpose of computation of such Income.

The Finance Bill, 2010 with the intent of clarifying the issue, proposes to amend the provisions of both the sections in such a way that when a non-resident has income from Fees for technical services or Royalties and has a PE in India his income shall be computed with respect to the royalty and fees for technical services in accordance with Section - 44DA only.

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E. BUSINESS INCOME

E.1 Disallowance on account of non-deduction/ non-payment of TDS

As per existing provisions of Section 40(a)(ia) of the Act, certain payments made to residents were not allowable as deduction where tax was not deducted or after deduction, was not paid before end of the year. In case where the tax was deducted in the last month of the year, then no disallowance u/s. 40(a)(ia) would be made, so long as the tax was deducted during the year and paid before the due date of filing the return of income.

It is now proposed that so long as the tax is deducted during the year and it is also paid on or before the due date of filing the return of income, then no disallowance will be made u/s. 40(a)(ia) of the Act. However, it must be kept in mind that in any case, the deduction of TDS is required to be made on or before the end of the year. If there is a failure to deduct tax, the disallowance will be made, notwithstanding the fact that the tax has been deducted after end of the year and paid before the due date.

E.2 Enhancement in Limit for Tax Audit u/s 44BB

Persons carrying on business / profession are required to get their accounts audited, if their turnover exceeded the threshold limit of Rs. 40.00 lacs for business and Rs. 10.00 lacs for profession. These limits were fixed w.e.f A.Y. 85-86. For giving relief to the small assesseees, it is proposed to raise the said threshold to Rs. 60.00 lacs for business and Rs. 15.00 lacs for professionals and accordingly the assesseees, who have their receipts below these thresholds will not be required to get their accounts audited under section 44AB.

E.3 Penalties u/s. 271B for Tax Audit non-compliance

Presently, if the person fails to get his accounts audited then penalty of ½% of the total sales or Rs. 1,00,000, whichever is less, is imposed. Thereby, maximum penalty of Rs. 1,00,000 is provided.

Now it is proposed to increase the ceiling to Rs. Rs. 1,50,000 in place of Rs. 1,00,000.

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E.4 Expansion of the Presumptive Tax Scheme u/s. 44AD

Under the existing provisions of section 44AD of the Act, a person carrying on any business is entitled to opt for a scheme of presumptive tax scheme, provided its turnover or gross receipts do not exceed Rs. 40.00 lacs. In such type of assessee, the assessee is required to presume its income at 8% of the turnover or gross receipts and pay tax accordingly.

It is proposed to expand the scope of the said presumptive tax scheme to the assessee having its turnover or gross receipts upto Rs. 60.00 lacs. This would help the smaller businessman to reduce their hassles of compliance.

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F. MINIMUM ALTERNATE TAX

F.1 Minimum Alternate Tax - Enhancement

Presently, the corporate entities are liable to pay 15% tax on its book profits u/s. 115JB of the Act, if the said amount is more than the tax computed under the other normal provisions of the Act. Due to the effect of surcharge, education cess and secondary and higher education cess, the effective rate of MAT worked out to be 16.995%.

The rate of the MAT is proposed to be increased to 18%. With the reduction in the surcharge on the companies, the effective rate of MAT would be 19.9305% as compared to the effective rate of MAT being 16.995% upto and including A.Y. 2010-11. It may be kept in mind that the excess MAT paid for a year is allowed as a set off, subject to the conditions, in the subsequent year, if and to the extent, the tax as per the normal computation exceeds the MAT. The set off is permissible for a period of 10 assessment years succeeding the assessment year in which the MAT is paid.

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G. DEDUCTIONS AND EXEMPTIONS

G.1 *Filing of returns by Research Association and associations carrying out statistical research*

Extensive provisions have been made in the Finance Bill, 2010, for expanding the scope of benefits given to the research so as to embrace non-scientific research (social science) and statistical research. Parity has been provided for the social science and statistical research with scientific research.

Further, the institutions which are engaged in the social science research or statistical research are also entitled to seek exemption of their income u/s. 10(21) of the Act. Continuing with the said parity, it has been provided that such institutions will also be obligated to file its return of income, provided their income (prior to claiming exemption u/s. 10) exceed the maximum amount not chargeable to tax.

G.2 *Increase in amount of weighted deduction for scientific research*

Under the provisions of section 35, a person carrying on business or profession, is entitled to the deduction of the expenditure (revenue as well as capital) incurred by it on scientific research. In specified cases, the weighted deduction is given to the person incurring the expenditure. For providing further impetus to the activities of research, the weighted deduction has been enhanced as mentioned below:

Nature of Expenditure	Applicable Section	Original Weight for deduction	Proposed weight for deduction
Contribution to an approved research association, university, college or other institution [Research Social Science and Statistical Research proposed to be added]	35 (1)(ii)	125 %	175 %
Payment to a National Laboratory, University, IIT or specified person for scientific research	35 (2AA)	125 %	175 %
For in-house research by a person engaged in the business of bio-technology or any business of manufacture of an article or thing other than XI th Schedule	35 (2AB)	150 %	200 %

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Further, as a general amendment to various sections [10(21), 35, 80GGA and 139], the institutions carrying on social science research and statistical research has been placed at parity with the institutions and organizations carrying on scientific research.

G.3 *Special Incentive to Hotel Industry U/s. 35 AD*

The Finance Act, 2009 inserted Section 35AD to allow deduction of capital expenditure (other than land, goodwill and financial instrument) incurred by the assessee engaged in the business of setting up and operating cold chain facility, warehousing facility for agriculture produce and laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution / storage.

For giving impetus to the hotel industry, the Finance Bill 2010 proposes to extend the said incentive to assessee who builds and operates a new hotel of two star or above category, provided the assessee commences the operations of the said hotel on or after 1st April, 2010. Such deduction is also subject to the following conditions:

1. Such business is not set up by splitting up, or the reconstruction, of a business in already in existence.
2. Such business is not set up by transfer of machinery or plant previously used for any purpose. However the assessee may use imported second hand plant machinery subject to certain specified conditions.

It may be mentioned that Section 35AD introduces the investment linked deductions, wherein, the entire capital expenditure (other than land, goodwill and financial instruments) is eligible for expenditure in the very year in which such expenditure is incurred. Further, set off of the losses of such businesses are not allowed against any other business. The losses arising in this business is not allowed as set off against income under any other source / head of income but is allowed to be carried forward indefinitely for setting off against the profits arising from such business only u/s. 73A of the Act. Inclusion of highly capital intensive industry like Hotel industry would encourage lot of investment in this industry.

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G.4 Modification of the Conditions applicable to cross-country pipelines

Under the existing provisions, a business of laying and operating a cross-country natural gas is eligible for deduction u/s. 35AD only if it makes available not less than 1/3rd of its total pipeline capacity for use on common carrier basis by any other person other than the assessee or an associated person of such assessee. The Finance Bill, 2010 proposes that the assessee is required to make available such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under Section 3(1) of the Petroleum and Natural Gas Regulatory Board Act, 2006 instead of 1/3rd of its total pipeline capacity. It may be mentioned that the concerned authority has provided in its regulation that gas pipeline network should have 1/3rd of the common carrier capacity, whereas petroleum pipeline network should have 1/4th common carrier capacity.

G.5 Prohibition of dual deduction U/s. 35AD and Chapter VIA

Under the existing provisions, benefit of any deduction Under Chapter VIA is denied to the businesses which are specified businesses, irrespective of any claim being made and / or allowed. The Finance Bill 2010 proposes to amend section 35AD(3) and Section 80A to provide that the deduction Under Chapter VIA will be denied for the specified business only if the deduction U/s. 35AD is claimed and allowed. The proposed amendment by the Finance Act, 2010 substituting sub-section (3) may give rise to certain interpretational issues.

G.6 Deduction for eligible housing projects U/s. 80IB(10)

Section 80IB(10) allows 100% of the profits as deduction from a housing project, provided it complies with various conditions stipulated therein. The said section provided that the housing project should be completed on or before the 31st March, 2008 (for projects for which the approval was granted prior to 1.4.2004) or before expiry of a period of 4 years from the date of approval (in cases where the approval was granted after 1.4.2004).

It is proposed to give one additional year for completion of the project. It has accordingly been provided that the projects approved prior to 1.4.2004 will have to be completed on or before 31.3.2008 (i.e. 4 years limit). Projects approved after 1.4.2004, but before 31.3.2005, will have to be completed on or before 31.3.2010. For projects which are approved on or after 1.4.2005 will have to be completed before expiry of 5 years from the end of the year in which the approval is given.

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To further relax the rigours of the conditions stipulated in section 80IB(10)(d) relating to the quantum of permissible commercial construction, some amendments have been proposed. Existing provisions allows deduction only if the built-up area of shops and other commercial establishment included in the housing project does not exceed 5% of the aggregate built-up area or 2000sq.ft. whichever is less. It is proposed to relax this condition by providing that the maximum commercial construction permissible will be higher of 3% of the total built up or 5,000 Sq. Ft. whichever is more. The amendment brings about more logical meaning to the condition.

The proposed amendment is to be effective from A.Y. 2010-11. However, it leaves open the issue of commercial construction and also completion in cases where the profits have been charged to tax or where the deductions have been claimed for the period prior to A.Y. 2010-11. It is felt that giving effect to these provisions as proposed, prospectively; may result in some unintended inequity.

G.7 New Hotel Project and Convention Centres - Deduction under section 80 ID

This section was introduced by the Finance Act, 2007, for encouraging investment in the hotels and convention centers in the National capital territory of Delhi and the districts of Faridabad, Gurgaon, Gautam Budh Nagar and Gaziabad. This provision was introduced specifically for giving impetus to investment for ensuing common wealth games. In the said section, it is provided that for becoming eligible for the deduction, the hotel should start functioning and the convention centre should complete construction on or before 31st March, 2010. A further extension of period upto 31st July, 2010 is granted in this regard.

G.8 Exemption to Research Organizations

Finance Bill, 2010 proposes to extend the exemption u/s 10(21) of the Income Tax Act, 1961 to organization engaged in social science and statistical research, which was earlier available only to those organization engaged in carrying out scientific research.

This change is proposed as a consequential to the proposed amendment in section - 35.

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G.9 *Incentive to Special Economic Zone (“SEZ”)*

The Income Tax Act, 1961 provides an incentive for units in SEZs under section – 10AA. The exemption is required to be calculated based on profits earned by such units from their export. The provision of Sec – 10AA(7) provides the way in which the exempted profit is required to be determined as under:

$$\text{Exemption} = \text{Total Profit} \times \frac{\text{Export Turnover}}{\text{Total Turnover}}$$

However, the disputes were arising on interpretation of the term “Total Turnover”. Where the assessee was considering the total turnover of the eligible unit under SEZ, the department, in absence of clarity was considering the total turnover of the business of the assessee, including the turnover from activities other than that of the SEZ unit.

With a view to settling the dispute, the Finance (No. 2) Act, 2009 amended the provisions and clarified that the total profit and the total turnover shall be considered in respect of total business of the undertaking and not of the assessee. The amendment was made effective from 1st April 2010. However, it was necessary to make the amendment with retrospective effect. Accordingly, the amendment is proposed to apply the change in law with retrospective effect from 1st April, 2006.

Overview of the Direct Tax Provisions in The Finance Bill 2010

H. TAXATION OF LIMITED LIABILITY PARTNERSHIP (LLP)

H.2 *Tax Neutrality on conversion of Company into Limited Liability Partnership*

The concept of limited liability partnership came into existence by the introduction of the Limited Liability Act, 2008. LLP enjoys both the advantages of a private limited company and also a partnership. Similarly, as compared to partnership, for LLP conditions for claiming deduction of remuneration paid to partners of LLP would be as per section 40(b). Interest and profit sharing ratio should be defined in the agreement evidencing the LLP in order to claim deduction from the profits of LLP.

Finance Act, 2009, introduced several provisions in the Act to treat LLP as a partnership firm for the tax purposes in all respects.

The Finance Bill, 2010, takes the process of amendment further, primarily for small companies having turnover of Rs. 60.00 lacs or less, by amending sections 32, 35DDA, 43, 47, 47A, 49, 72A and section 115JAA, primarily aimed at providing tax neutrality for conversion of the private limited companies and unlisted public companies into LLP.

Section 47 of the Act deals with transactions not regarded as transfer. Under the existing provisions there was no provision dealing with conversion of a company into a LLP. By introducing clause (xiib) in section 47, it is proposed that the transfer of assets on conversion of a company (private or unlisted public company) into a LLP in accordance with section 56 and 57 of the LLP Act, 2008 shall not be considered as transfer for capital gains purposes u/s. 45 of the Act. No capital gain therefore would accrue to the company upon transfer of assets from company to the LLP, despite the fact that the assets of the company would become the assets of the LLP by virtue of section 58 (4)(b) of the LLP Act, 2008.

The tax neutrality is subject to the following conditions:

- (i) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the LLP;
- (ii) all the shareholders of the company immediately before the conversion become the partners of the LLP and their capital contribution and profit

Overview of the Direct Tax Provisions in The Finance Bill 2010

sharing ratio in the LLP are in the same proportion as their shareholding in the company on the date of conversion;

- (iii) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the LLP;
- (iv) the aggregate of the profit sharing ratio of the shareholders of the company in the LLP shall not be less than 50 % at any time during the period of five years from the date of conversion;
- (v) the total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and
- (vi) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

The conditions mentioned above are cumulative and each condition is required to be satisfied. Non-fulfillment of any one condition would render the transaction as transfer of assets and taxable as profits and gains of the successor LLP chargeable to tax in the previous year in which the requirements are not complied with.

The cost of acquisition of various assets acquired by the LLP upon conversion will be the cost of acquisition of these assets in the hands of the company prior to conversion and the written down value of the block of asset shall be the written down value of the block of asset for the company as on the date of conversion.

Section 72A, is proposed to be amended to allow carry forward and set off of accumulated loss and unabsorbed depreciation allowance in the hands of the company upon conversion. It is further provided that such accumulated loss and unabsorbed depreciation will be treated as the loss and depreciation of the year in which such conversion takes place and accordingly, fresh period of 8 years will be available for set off of loss in the hands of LLP upon conversion.

Specific provisions have been made for allowing the deduction u/s. 35DDA for the VRS expenses incurred by the Company prior to conversion for the balance period in the hands of the firm upon conversion.

In the scheme of conversion of the Company into the LLP, the shares held by the shareholders of the Company will get extinguished and will be substituted by balance in their respective capital accounts. Unlike cases of amalgamation and

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demergers, the proposed amendment does not clarify the position of tax neutrality in the hands of the shareholders and that continues to be an open question. It is recommended that the said issue is clarified.

H.2 Non-eligibility for MAT Credit in case of conversion from Company to LLP

Under the Finance Bill, 2010, extensive provisions are made for providing tax neutrality to conversion of a private limited company or unlisted public company to Limited Liability Partnership (LLP). However, the provisions of section 115 JAA granting credit for MAT paid shall not apply upon conversion into LLP.

Overview of the Direct Tax Provisions in The Finance Bill 2010

I. RETURNS AND ASSESSMENT

I.1 Power of the High Court to condone the delay u/s. 256 (reference) and 260A (Appeal)

Under the existing provisions, appeal u/s. 260A of the Act against the order of the Income Tax Appellate Tribunal can be filed with the High Court within a period of 120 days from the receipt of the order of the ITAT. Prior to introduction of the appeal provisions u/s. 260A w.e.f. 1st October, 1998, there were provisions of filing reference application before the High Court u/s. 256 of the Act, which also provided for similar period of 120 days from the receipt of the order of the ITAT.

None of the provisions were granting powers to the High Court to condone the delay in case where the assessee or the department failed to file the appeal / reference within the stipulated period. However, the High Courts under their inherent powers and also under the provisions of the Civil Procedures Code, 1908, were condoning the delay.

In Hongo India Pvt. Ltd. 236 E.L.T. 417 and Chaudharana Steels 238 E.L.T. 705, the Supreme Court held in the context of sections 35H & 35G of the Excise Act, that in the absence of specific powers, the High Court has no power to condone delay. Recently full bench of the Allahabad High Court in the case of CIT v. Mohd Farooq 317 ITR 305 held the high court has no power to condone the delay. Same verdict is given in following cases by various high courts:-

- ACIT v Mahavir Prasad Verma & Others 225 CTR 305 (Chhattisgarh)
- CIT v. Williamson Tea (assam) Ltd. 319 ITR 368 (Guwahati)
- CIT v. Grasim Industries Ltd 319 ITR 154 (Bom)
- ACIT v Shubhash Traders 318 ITR 402 (MP)
- CIT v. West Coast Paper Mills Ltd 319 ITR 390 (Bom)

To obviate the difficulties likely to be created because of these ruling, a retrospective amendment (w.e.f. 1.6.81 in section 256 and w.e.f. 1.10.98 in section 260A) is proposed to grant power to condone delay to the high courts.

Similar amendments are also proposed in Section 27 and 27A of the Wealth Tax Act, 1957 for giving powers to the high court for condonation of delay in admitting reference / appeal filed under the Wealth Tax Act.

Overview of the Direct Tax Provisions in The Finance Bill 2010

I.2 Unique Document Identification Number

Section 282B was inserted by the Finance Act (No. 2) Act, 2009, with effect from the 01-10-2010

Under this provision, an income tax authority is required to allot a computer generated Document Identification Number before issue of every notice, order, letter or any correspondence to any other income tax authority or assessee or any other person and such number shall be quoted thereon. It also provides that every document, letter, correspondence received by an income tax authority or on behalf of such authority, shall be accepted only after allotting and quoting of a computer generated Document Identification Number.

It is proposed to delay the implementation of the said scheme and accordingly it is provided that the UDIN will be required to be issued only on or after 1st July, 2011.

I.3 Provisions dealing with Settlement Commission

Inclusion of Search Cases & minimum threshold of additional Income Tax payable.

Entire scheme of the eligibility, powers and procedure before the settlement commission was overhauled by Finance Act, 2007, w.e.f. 1.6.2007. In the overhauled scheme, search / requisition cases covered by the provisions of section 153A of the Act were not allowed to take benefit of the settlement commission. It also excluded the cases of related persons whose documents were seized as provided for in Section 153C of the Act.

To enable assesseees, in whose case the search action has been taken to avail of the benefit of settlement commission, the definition of "case" u/s. 245A(b) is amended to include also the search / requisition cases, provided the settlement application is filed on or before completion of assessment in such cases. It also removes the prohibition in cases where the AO has to proceed u/s. 153C of the Act.

Under the existing provisions, application can be admitted by the settlement commission, only if additional income tax payable on the income disclosed in the application exceeds Rs. 3 Lacs. It is proposed to enhance this limit to Rs. 10.00 lacs for a case being eligible to be proceeded with before the Settlement

Overview of the Direct Tax Provisions in The Finance Bill 2010

Commission. In search cases (i.e. cases u/s. 153A as well as u/s. 153C), the said limit is further raised to Rs. 50.00 lacs of additional tax payable.

Time limit for passing order of settlement

Under the existing provisions, Settlement commission shall pass an order in respect of application made on or after 1st day of June, 2007, within 12 months from end of the month in which application was made.

It is proposed to extend the time limit to 18 months from end of the month in which the application is filed. However, this extended time limit shall apply only for settlement application made on or after 1st day of June 2010.

Provisions similar to the above provisions are made in the Wealth Tax Act, 1957 for enabling settlement under the Wealth Tax Act, 1957 in search cases. Amendments are proposed in Sections 22A and 22D of the said Act.

The amendments proposed are with effect from 01-06-2010.

Overview of the Direct Tax Provisions in The Finance Bill 2010

J. TAX DEDUCTED/ COLLECTED AT SOURCE

J.1 *Increase in thresholds limit of deduction of tax from various payments*

This bill proposes to increase various thresholds limit for deduction of tax from various payments like Winning from Lottery or Crossword Puzzle, Winning from Horse Race, Payment to Contractors, Insurance Commission, Commission or brokerage, Rent, Fees for Professional and Technical Services. The proposed amendments w.e.f 1st July, 2009 made under the new provision are summarized as under:

(Amounts in Rs.)

Section	Nature of Payment	Existing	Proposed
194B	Winning from Lottery or Cross word puzzle	5,000	10,000
194BB	Winning from Horse Race	2,500	5,000
194C	Payment to Contractors [per Transaction]	20,000	30,000
194C	Payment to Contractors [Annual Limit]	50,000	75,000
194D	Insurance Commission	5,000	20,000
194H	Commission or Brokerage	2,500	5,000
194I	Rent	1,20,000	1,80,000
194J	Fees for Professional and Technical Services	20,000	30,000

J.2 *Consequences of failure to deduct tax, or after deducting failure to pay tax deducted/tax collected at source u/s. 201(1A)*

Under the existing provision of section 201(1A) of the Act, where the person does not deduct the tax or after deducting fails to pay the tax, he is required to pay simple interest at the rate of 1% for every month or part of the month. Amendments are proposed to treat the cases of failure to make payment, after

Overview of the Direct Tax Provisions in The Finance Bill 2010

deducting the tax at source more severally than the cases of pure failure. The proposed amendment to this section w.e.f. 1st July, 2010 has increased the rate of interest in cases of failure of payment after deduction to 1 ½% for every month or part of the month till the date on which such tax is actually paid. The rate of interest will remain same at one percent for the cases of actual default of deduction of tax itself.

J.3 Certificate for tax deducted or collected u/s. 203 and u/s. 206C

The tax department was proposing to grant the credit of tax at source under their Online Tax Accounting System (OLTAS), completely obviating the necessity to issue certificate of deduction of tax at source and furnishing the same with the tax returns. Accordingly, the Finance Act, 2005, section 203 and section 206C(5) were amended for abolishing the requirement for issuance of the TDS and TCS certificate.

Considering the practical difficulties being encountered, the earlier procedure of issuance of TDS/TCS certificate has been restored.

Overview of the Direct Tax Provisions in The Finance Bill 2010

TABLE - 1

Particulars	Threshold limit for Surcharge	Tax Rates	
		Without Surcharge	With Surcharge
Individual, HUF, AOP & BOI	NIL		
Upto Rs. 160000		Nil	N.A.
Rs. 160001 to Rs. 190000 *		10.30%	N.A.
Rs. 190001 to Rs. 240000 **		10.30%	N.A.
Rs. 240001 to Rs. 500000		10.30%	N.A.
Rs. 500001 to Rs. 800000		20.60%	N.A.
Rs. 800001 onwards		30.90%	N.A.
* "Nil" tax rate in case assessee is resident Senior Citizen or resident Women below age of 65 years			
** "Nil" tax rate in case assessee is resident Senior Citizen			
Partnership Firm	NIL	30.90%	N.A.
Domestic Company	1,00,00,000	30.90%	33.22%
Company other than Domestic Company	1,00,00,000	41.20%	42.23%
Local Authority	NIL	30.90%	N.A.
Co-operative Society	NIL		
Upto Rs. 10000		10.30%	N.A.
Rs. 10001 to Rs. 20000		20.60%	N.A.
Rs. 20001 onwards		30.90%	N.A.
Minimum Alternate Tax			
Domestic Company	1,00,00,000	18.54%	19.93%
Company other than Domestic Company	1,00,00,000	18.54%	19.00%
STCG on Listed Securities			
Individual, HUF, AOP & BOI	NIL	15.45%	N.A.
Partnership Firm	NIL	15.45%	N.A.
Domestic Companies	1,00,00,000	15.45%	16.61%
Company other than Domestic Company	1,00,00,000	15.45%	15.84%
STCG on assets other than listed securities			
Individual, HUF, AOP & BOI	NIL	As per slab	As per slab
Partnership Firm	NIL	30.90%	N.A.
Domestic Companies	1,00,00,000	30.90%	33.22%
Company other than Domestic Company	1,00,00,000	41.20%	42.23%
LTCG on assets other than Listed Securities			
Individual, HUF, AOP & BOI	NIL	20.60%	N.A.
Partnership Firm	NIL	20.60%	N.A.
Domestic Companies	1,00,00,000	20.60%	22.15%
Company other than Domestic Company	1,00,00,000	20.60%	21.12%

Overview of the Direct Tax Provisions in The Finance Bill 2010

TABLE - 2

Particulars	Tax Rates
Dividend Distribution Tax	
By Domestic Company	16.61%
By Money Market Mutual Fund or Liquid Fund	27.68%
By Other Mutual Funds	
- For income distributed to Individual / HUF	13.84%
- For income distributed to others	22.15%
Securities Transaction Tax	
Delivery based purchase of an Equity Share in Company or a Unit of an Equity Oriented Fund	0.125%
Delivery based sale of an Equity Share in Company or a Unit of Equity Oriented Fund	0.125%
Non-Delivery based sale of an Equity Share in Company or a Unit of Equity Oriented Fund	0.025%
Derivatives (Future & Options)	0.017%
Sale of an option in securities where option is exercised	0.125%
Repurchase of Units of an Equity Oriented Fund	0.250%

Wealth Tax	Threshold limit	Tax Rate
For every individual, HUF and Company	30,00,000	1%

Overview of the Direct Tax Provisions in The Finance Bill 2010

TABLE 3

TDS RATE FOR THE ASSESSMENT YEAR 2011-2012 (in %)

(TDS rates with effect from 1st April 2010)

Section	Nature of Payment	Threshold limit upto 30 th June, 2010 (in Rs.)	Threshold limit w.e.f. 1 st July, 2010 (in Rs.)	Individual/ HUF/BOI/AOP	Firm	Co-operative Society / Local Authority	Company
192	Salary	As per slab	As per slab	Normal Rate (incl. cess)	N.A.	N.A.	N.A.
193	Interest on Securities						
	(1) Interest on Debentures or Securities (Listed)	2500*	2500*	10.00	10.00	10.00	10.00
	(2) Interest on 8% Savings (Taxable) Bonds, 2003	10000	10000	10.00	10.00	10.00	10.00
	(3) Any Other Interest on Securities (Unlisted)	0	0	10.00	10.00	10.00	10.00
194	Dividend other than dividend covered by Section 115-O	2500*	2500*	10.00	10.00	10.00	10.00
194A	Interest other than Interest on Securities (other than below)	5000	5000	10.00	10.00	10.00	10.00
	Where the payer is						
	(1) Banking Company	10000	10000	10.00	10.00	10.00	10.00
	(2) Co-operative Society engaged in banking business	10000	10000	10.00	10.00	10.00	10.00
	(3) Post Office (deposit scheme framed by Central Government)	10000	10000	10.00	10.00	10.00	10.00
194B	Winning from Lotteries	5000	10000	30.00	30.00	30.00	30.00
194BB	Winnings from Horse Races	2500	5000	30.00	30.00	30.00	30.00

* in case of resident only

194C	Payments to Contractors						
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Overview of the Direct Tax Provisions in The Finance Bill 2010

Section	Nature of Payment	Threshold limit upto 30 th June, 2010 (in Rs.)	Threshold limit w.e.f. 1 st July, 2010 (in Rs.)	Individual/ HUF/BOI/ AOP	Firm	Co-operative Society / Local Authority	Company
	(1) In case of Contract/ Sub-Contract/ Advertising (2) Contractor/ Sub-Contractor in Transport Business	20000 ¹ 20000 ¹	30000 30000	1.00 NIL ²	2.00 NIL ²	2.00 NIL ²	2.00 NIL ²
194D	Insurance Commission	5000	20000	10.00	10.00	10.00	10.00
194E	Non-Resident sportsman/ sports association	0	0	10.00	10.00	10.00	NA
194EE	Deposits under NSS to Resident/Non-Resident	2500	2500	20.00	20.00	20.00	NA
194F	Repurchase of Units of Mutual Fund/UTI from Resident / Non-Resident	0	0	20.00	20.00	20.00	NA
194G	Commission on Sale of lottery tickets to Resident / Non-Resident	1000	1000	10.00	10.00	10.00	10.00
194H	Commission or Brokerage to Resident	2500	5000	10.00	10.00	10.00	10.00
194I	Rent to Residents (a) Rent for Machinery/ plant/equipment (b) Rent for other than in (a)	120000 120000	180000 180000	2.00 10.00	2.00 10.00	2.00 10.00	2.00 10.00
<p>1. This limit is for individual transaction. However, if aggregate payment to a contractor during the year exceed Rs. 50,000 (Rs. 75,000 w.e.f 1st July, 2010), then tax will be required to be deducted, even where individual transaction is less than the threshold of Rs. 20,000 (Rs. 30,000 w.e.f. 1st July, 2010)</p> <p>2. The Nil rate will be applicable if the transporter quotes his PAN. If PAN is not quoted the rate will be 20%. (Transporter means persons engaged in plying, hiring and leasing of Goods Carriages)</p>							
194J	Fees for professional / technical services to residents	20000	30000	10.00	10.00	10.00	10.00

Overview of the Direct Tax Provisions in The Finance Bill 2010

Section	Nature of Payment	Threshold limit upto 30 th June, 2010 (in Rs.)	Threshold limit w.e.f. 1 st July, 2010 (in Rs.)	Individual/ HUF/BOI/ AOP	Firm	Co-operative Society / Local Authority	Company
194LA	Compensation to Resident on acquisition of immovable property	100000	100000	10.00	10.00	10.00	10.00
195	Payment of other sums to a non-resident	0	0	Rate specified under Part II of First Schedule of Finance Bill, 2010 subject to provisions of DTAA			
196B	Income from units (including long term Capital Gain on transfer of such units) to an offshore fund	0	0	10.00	10.00	10.00	10.00
196C	Income from foreign currency bonds or GDR of Indian Company	0	0	10.00	10.00	10.00	10.00
196D	Income of FII from securities not being dividend, long term and short term capital gain	0	0	20.00	20.00	20.00	20.00

Note:

In order to strengthen the PAN mechanism, it is proposed to make amendments in the Income Tax Act to provide that any person whose receipts are subject to deduction of tax at source i.e., the deductee, shall mandatorily furnish his PAN to the deductor failing which the deductor shall deduct tax at source at higher of the following rates:

- (i) the rate prescribed in the Act;
- (ii) at the rate in force i.e., the rate mentioned in the Finance Act; or
- (iii) at the rate of 20 percent

The above provisions will also apply in cases where the taxpayer files a declaration in form 15G or 15H (u/s 197A) but does not provide his PAN. Further, no certificate under section 197 will be granted by the Assessing Officer unless the application contains the PAN of the applicant.

Overview of the Direct Tax Provisions in The Finance Bill 2010

TCS RATE FOR THE ASSESSMENT YEAR 2011-2012 (in %)

(TCS rates with effect from 1st April 2010)

Section	Nature of Payment	Threshold Limit (in Rs.)	Individual/ HUF/BOI/ AOP	Firm	Co- operative Society / Local Authority	Company
206CA	Alcoholic liquor for human consumption and Indian made foreign liquor	0	1.00	1.00	1.00	1.00
206CB/ CC/ CD	Timber obtained by any mode and any other forest produce	0	2.50	2.50	2.50	2.50
206CE	Scrap	0	1.00	1.00	1.00	1.00
206CF/ CG/ CH	Parking lot / toll plaza / mining and quarrying	0	2.00	2.00	2.00	2.00
206CI	Tendu leaves	0	5.00	5.00	5.00	5.00