POST-BUDGET MEMORANDUM - 2017

DIRECT TAXES
AND
INTERNATIONAL TAX

THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA
NEW DELHI

POST-BUDGET MEMORANDUM – 2017

A. INTRODUCTION

1.0 The Council of the Institute of Chartered Accountants of India considers it a privilege to submit this Post-Budget Memorandum to the Government.

1.1 In this memorandum, we have suggested certain amendments to the proposals contained in the Finance Bill, 2017 which would help the Government to achieve the desired objectives.

1.2 We have noted with great satisfaction that the suggestions given by the Committee in the past have been considered very positively. In formulating our suggestions in regard to the Finance Bill 2017, the Direct Taxes Committee and Committee on International Taxation of the ICAI have considered in a balanced way, the objectives and rationale of the Government and the practical difficulties/hardships faced by taxpayers and professionals in application of the provisions of the Income-tax Act, 1961. We are confident that the suggestions of the Direct Taxes Committee and Committee on International Taxation of ICAI given in this Memorandum shall receive positive consideration.

1.3 In this memorandum, suggestions on the specific clauses of the Finance Bill, 2017 relating to Income-tax Act have been given in detail.

1.4 In case any further clarifications or data is considered necessary, we shall be pleased to furnish the same.

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C. Detailed Suggestions

1. Paragraph A of Part III to the First Schedule – Proposed Surcharge @ 10% for income exceeding Rs 50 lakhs – Removal of surcharge to ensure parity in effective tax rates vis-à-vis small and medium companies

Surcharge @ 10% is proposed in cases where total income of an individual/HUF/AOP/BOI exceeds Rs.50 lakhs but do not exceed Rs. 1 crore. Surcharge of 15% would continue to be applicable where the total income of an individual/HUF/AOP/BOI exceeds Rs 1 crore.

The levy of such surcharge would result in inequity in the effective rate of tax (i.e., more than 30%) for individual/HUF/AOP/BOI assessees with total income exceeding Rs.50 lakhs *vis-à-vis* the rate of 25% proposed for small and medium companies. The inequity would arise not only *vis-à-vis* salaried assessees but individuals/HUFs engaged in small businesses would also have to bear the brunt of surcharge which may go against the present Government's aim of promoting ease of doing business.

Suggestion:

> *It is suggested that the proposed surcharge@10% for total income between Rs.50 lakhs to Rs. 1 crore be withdrawn to ensure equity in effective rate of tax vis-à-vis the proposed rate for small and medium companies.*

2. Paragraph E of Part III to the First Schedule – Reduction in corporate tax rate - Reduced corporate tax rate to be applicable for erstwhile firms recently converted into companies and also LLPs and companies which were set up subsequent to P.Y.2015-16

The Finance Bill, 2017 proposes a concessional rate of 25% in case of domestic companies whose total turnover or gross receipts of previous year 2015-2016 does not exceed Rs.50 crore.

The Notes on clauses to the Finance Bill, 2017 dealing with relevant provision reads as follows:

> *'Paragraph E of this Part specifies the rates of income-tax in case of companies. In the case of domestic companies the rate of income-tax shall be twenty-five per cent of the total income where the total turnover or gross receipts of previous year 2015-2016 does not exceed fifty crore rupees and in all other cases the rate of income-tax shall be thirty per cent of the total income. In the case of companies other than domestic companies, the rate of tax will continue to be the same as that specified for assessment year 2017-2018...'*

The Hon'ble Finance Minister, in his Budget speech explained the rationale of provision of such concessional rate, namely, to make **Micro, Small and Medium companies more viable and also to encourage firms to migrate to company format.**

Issues :

(i) Since the intent behind the proposed amendment is to encourage firms to migrate to company format, it appears that in case of firms which have been subsequently converted into domestic companies, the turnover of the firm for P.Y.2015-16 would be considered for application of concessional rate of tax for the company for A.Y.2018-19, i.e., a firm/LLP which had turnover/gross receipts of Rs.50 crores or less in P.Y.2015-16 would also be eligible to claim benefit of 25 per cent tax rate for A.Y.2018-19. To ensure clarity regarding this legislative intent, appropriate clarification may be inserted in the Act to this effect.

(ii) Also, a situation may arise where a company was in existence in P.Y. 2015-16 but the business had not commenced as at 31st March 2016, consequent to which there was no turnover during that year.

In such a case also, the company should be eligible for a concessional rate of tax@25% during the A.Y.2018-19.

(iii) A company which has been set up in P.Y.2016-17 or P.Y.2017-18 should also be eligible for the concessional rate if its turnover during the said years is upto Rs.50 crores. Appropriate provisions need to be incorporated for the same.

(iv) In order to encourage LLP form of organization, which is preferred over company form due to fewer compliances, the concessional rate of tax may be extended to LLPs with turnover of upto Rs.50 crores.

Suggestions:

It is suggested that:

a. *In line with the Finance Minister's speech and his intention to provide the beneficial tax rate of 25 per cent to firms that migrate to company format, it may be clarified that such benefit is available to those companies that existed as firms during the P.Y.2015-16 and subsequently converted into companies.*

b. *Companies which were in existence during the P.Y.2015-16 but had not commenced business in that year also should be eligible for the beneficial tax rate of 25 per cent on the basis of the turnover of P.Y.2016-17.*

c. *A company which has been set up in P.Y.2016-17 or P.Y.2017-18 should also be eligible for the concessional rate if its turnover during the said years is upto Rs.50 crores.*

d. *In order to encourage LLP form of organization, which is preferred over company form due to fewer compliances, the concessional rate of tax may be extended to LLPs with turnover of upto Rs.50 crores.*

e. *Appropriate provisions may be incorporated to give effect to the above.*

3. Clause 3 – Section 2(42A) – Reduction in holding period in case of immovable property, being land or building or both, to qualify as long term capital asset – Consequential amendments to be made in sections 54, 54B, 54D and 54F

The Finance Bill, 2017 proposes to amend section 2(42A) so as to reduce the period of holding from the existing 36 months to 24 months in case of immovable property, being land or building or both, to qualify as long term capital asset. The same is done to promote the real estate sector and to make it more attractive for investment.

Issues

(1) Consequential amendments for reducing the holding period of immovable property from 3 to 2 years is required to be made in sections 54, 54B, 54D and 54F in line with the proposed amendment in section 2(42A). At present, these sections restrict transfer of new assets purchased for 3 years.

(2) In order to avoid litigation, clarification is required on whether leasehold rights and tenancy rights would be considered to fall within the meaning of "land and building" to avail the benefit of reduced holding period for being treated as a long-term capital asset.

(3) Ambiguity may also arise with respect to flats in a co-operative society i.e. whether shares in a co-operative society qualify within the meaning of immovable property being land or building or both to become eligible for lower holding period of two years

Suggestions:

It is suggested that:

(1) Consequential amendments may be made in sections 54, 54B, 54D & 54F so as to enable the holding period of the new asset purchased to be reduced to 2 years from 3 years in case of land and/or building.

(2) Circular may be issued/Explanation may be inserted to clarify that leasehold rights and tenancy rights are also to be treated as falling within the meaning of "land and building" for the purpose of availing the benefit of reduced holding period for being treated as a long-term capital asset.

(3) In order to avoid any interpretation issue, it may be clarified that flats in a co-operative society are also covered within the meaning of immovable property being land or building and are hence, eligible for lower holding period of two years for computation of capital gains.

4. Clauses 3, 23 and 25- Section 2(hf), section 47(xb) and section 49(2AE) - Tax neutral conversion of preference shares to equity shares – Clarification regarding tax treatment for earlier years

The Finance Bill 2017, proposes to amend Section 47 of the Act, by virtue of which conversion of preference share of a company into equity share of that company will not be regarded as transfer. The amendment is proposed to be made by insertion of sub-section (xb) in section 47.

Consequent amendments are also proposed to be made in section 2(42A) of the Act by insertion of sub-clause (hg) in clause (i) of Explanation 1 to section 2(42A) for determining the period of holding of such equity shares, by including the period of holding of the preference shares as well.

Further, sub-section (2AE) is proposed to be inserted in section 49 to compute the cost of acquisition of the converted equity shares. As per the proposed amendment, the cost of such equity shares shall be deemed to be the cost of acquisition of preference shares.

Currently, conversion of bond or debenture of a company into shares of that company is not regarded as transfer. However, no similar tax exemption was available so far in case of conversion of preference shares of a company into its equity shares.

Suggestion:

It is suggested that

a) *Since this amendment has clarified the real legislative intent, a clarification may be given by way of Explanation in section 47 or by way of an Explanatory Circular that the above provisions would be applicable in respect of earlier years as well.*

b) *Also, conversion of warrants into equity shares may be covered under section 47.*

5. Clause 6- Section 10(38) - Exemption of long term capital gains subject to payment of STT on acquisition – bona fide transactions to be notified by the Central Government for exemption even if STT not paid on acquisition

Section 10(38) of the Income-tax Act, 1961, inter alia, provides for an exemption from tax on the income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, where such transaction is chargeable to securities transaction tax under Chapter VII of the Finance(No.2) Act, 2004.

The Finance Bill 2017 proposes to amend the said clause (38) so as to provide that any income arising from the transfer of a long term capital asset, being an equity share in a company shall not be exempted, if the transaction of acquisition, **other than the acquisition notified by the Central Government in this behalf**, of such equity share is entered into on or after the 1st day of October, 2004 and such transaction is not chargeable to securities transaction tax under Chapter VII of the Finance(No. 2) Act, 2004.

The intent of the Government behind the proposed amendment is to prevent misuse of section 10(38) of the Act whereby some taxpayers declare their unaccounted income as exempt long-term capital gains by entering into sham transactions. Further, the Memorandum to the Finance Bill 2017 states that exemption for genuine cases where the securities transactions tax could not have been paid like acquisition of share in IPO, FPO, bonus or right issue by a listed company, acquisition by non-resident in accordance with FDI policy of the Government etc. would be available and list of such transfers for which the condition of chargeability to securities transactions tax on acquisition shall not be applicable would be notified.

This anti-abuse measure appears to be targeted at gains arising from transfer of penny stock also. Therefore, appropriate provisions may be introduced to explicitly define the term "penny stock" so as to deny exemption under section 10(38) in respect of gains arising from transfer of the same.

Suggestion:

It is suggested that:

(1) Instead of the requirement of payment of STT on acquisition, it would be desirable to categorically define a

list of sham transactions which would not be entitled to exemption of LTCG. This would automatically provide benefit to genuine investors.

(2) Notwithstanding the above, alternatively, for the purposes of section 10(38), it is suggested that the exemption list to be notified should, inter alia, include:

- *Shares which get listed pursuant to an IPO/FPO;*
- *Shares issued under ESOP/ESPS scheme;*
- *Shares issued or transferred pursuant to corporate re-structuring's such as merger / demerger;*
- *Shares issued on Preferential allotment/QIP;*
- *Shares acquired pursuant to a transaction not regarded as transfer u/s Section 47 of the Act where STT was paid on the underlying shares by the previous owner;*
- *New shares received by the shareholders on consolidation / bonus / rights / split of existing shares where STT was paid on the underlying shares;*
- *Off-market share deals where such deal cannot be executed on-market due to pricing restrictions (i.e. transactions which do not meet the bulk deal / block deal parameters);*
- *Shares acquired pursuant to family arrangement/ settlement on where STT was paid on the underlying shares by the previous owner;*
- *Acquisition of shares on which STT was paid by way of transmission, succession or inheritance;*
- *Contribution of shares to LLP/ Partnership firm;*
- *Inter-se transfer of shares within the promoter group which is in compliance with Takeover Code or subject to SEBI approval.*

(3) Appropriate provisions may be introduced to explicitly define the term "penny stock" so as to deny exemption under section 10(38) in respect of gains arising from transfer of the same.

6. Clause 12 - Section 23(5) – Deemed Taxability of unsold stock of house property after 1 year of lying vacant – Non-applicability of restriction contained in proposed section 71(3A)

The Finance Bill 2017 proposes to insert sub-section (5) in existing section 23 to provide that where the house property consisting of any building and land appurtenant thereto is held as stock-in-trade and the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property, for the period upto one year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority, shall be taken to be nil. The same is being proposed considering the business exigencies in case of real estate developers and would provide much needed relief to such assessees.

Another related amendment has been proposed in section 71 by insertion of sub-section (3A) so as to provide that set-off of loss under the head "Income from house property" against any other head of income shall be restricted to two lakh rupees for any assessment year.

Now an issue has arisen in case of assessees engaged in the business of real estate sector. Normally, the interest which the builder assessee pays on borrowings which were taken for construction purpose is allowable under section 36(1)(iii) as his income is assessable under the head business and profession. However, on a combined reading of proposed provisions as contained in section 23(5) and 71(3A), i.e., if the notional income is to be treated as “Nil” during the period of one year and thereafter, as income from house property, it appears that the interest deduction would be available under section 24 and consequently, the restriction contained in section 71(3A) would apply. This would create genuine difficulty, since the businesses were so far eligible for deduction of entire interest under section 36(1)(iii). Therefore, the restriction contained in section 71(3A) should not be applicable in the case of interest deduction in respect of income from house property held as stock-in-trade.

Thus, on one hand, the proposed insertion of sub-section (5) to section 23 of the Act deems the annual value of house property held as stock-in trade, as Nil, if the same is not let out; on the other hand, the proposed amendment to section 71(3A) restricts the claim of set off of loss from house property (arising mainly on account of interest deduction) against income from any other head.

This would curtail the benefit of entire interest deduction so far available under section 36(1)(iii).

Suggestion:

> *Considering the interest deduction so far available under section 36(1)(iii) in respect of loan borrowed for construction of houses held as stock-in-trade, it is suggested that the restriction proposed in section 71(3A) may not be applicable in the case of interest deduction in respect of income from house property held as stock-in-trade. This would go a long way in avoiding any negative impact on the real estate sector.*

7. Clauses 13 and 16 – Section 35AD and 43(1) – Cash payment exceeding Rs 10,000 to be disallowed – Exceptions contained in Rule 6DD may be extended to section 35AD and 43(1) also

In order to discourage cash transactions even for capital expenditure, the Finance Bill, 2017 proposes to amend section 43(1) to provide that where an assessee incurs any expenditure for acquisition of any asset in respect which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft or use of electronic clearing system through a bank account, exceeds ten thousand rupees, such expenditure shall be ignored for the purposes of determination of actual cost of such asset.

Similar amendment is proposed in section 35AD. Further, cash payment limit under section 40A(3) is also proposed to be reduced to Rs.10,000.

Thus, the Finance Bill 2017 proposes to disallow even the capital expenditure incurred in cash thereby restricting the amount of allowable depreciation under section 32 with effect from 1 April 2018 i.e. AY 2018-19.

Issues

(1) There is no clarity whether disallowance will trigger if cash expenditure is incurred post 1st April 2017 or if asset is acquired after 1st April 2017.

(2) As per the language of the proposed proviso to section 43(1), it appears that whole of the expenditure for acquisition of any asset may be disallowed even if only a small part of the expenditure may have been incurred in cash. Say for example, expenditure on asset costing Rs.1 crore may be disallowed fully for depreciation purposes even if expenditure incurred in cash is only Rs.10,000.

(3) Permissible exceptions to the provisions of section 40A(3) and (3A) have been provided in Rule 6DD of the Income-tax Rules, 1962 having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Since similar situations may occur in case of compliance of the proposed provisions/amendments to section 43(1)/35AD restricting the maximum amount that can be paid in cash to Rs.10,000, exceptions on the lines provided in Rule 6DD may be considered.

Suggestions:

It is suggested that:

(i) *In the interest of certainty and to avoid retro-applicability of the provision, it is recommended that disallowance of depreciation should trigger only if cash expenditure as well as asset acquisition is on or after 1 April 2017.*

(ii) *Only such expenditure for acquisition of asset may be disallowed which has been incurred in cash and accordingly, depreciation under section 32 may be permitted for balance portion expended in non-cash mode.*

(iii) *Exceptions on the lines contained in Rule 6DD may also be provided with respect to the proposed amendments in section 35AD and 43(1) which proposes to restrict the maximum amount that can be paid/incurred in cash to Rs.10,000.*

8. Clause 20 – Section 44AB – Increased threshold for presumptive tax cases under section 44AD - Consequential amendments required in section 194A/194H/194I & 194J

The Finance Bill, 2017 proposes to amend the section 44AB to exclude the eligible person, who declares profits for the previous year in accordance with the provisions of sub-section (1) of section 44AD and his total sales, total turnover or gross receipts, as the case may be, in business does not exceed two crore rupees in such previous year, from requirement of audit of books of accounts under section 44AB. The said change is proposed by insertion of a proviso to section 44AB.

It is a welcome amendment. However, consequential amendments are required in sections 194A/194H/194I/194J wherein an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits **specified under clause (a) or clause (b) of section 44AB** during the financial year immediately preceding the financial year in which such interest is credited or paid, is liable to deduct income-tax under the respective section(s).

In other words, no consequential amendment has been proposed in sections 194A/194H/194I/194J wherein an individual/HUF is required to deduct tax at source if his/its turnover is exceeding limits specified clause (a) and (b) of section 44AB. The monetary limit as specified under clause (a) is still 1 crore which means that a person is required to deduct tax under the aforesaid sections despite the fact that he has opted for presumptive taxation under section 44AD and his turnover is less than Rs.2 crores, due to which he is not liable to tax audit under section 44AB.

Suggestion:

> *It is suggested that in line with the enhanced limit proposed in section 44AB for a person opting for presumptive taxation under section 44AD, consequential amendment may be made in sections 194A/194H/194I/94J by including reference to the newly inserted proviso to section 44AB.*

9. ***Clause 22 - Section 45(5A) - Special provision for computation of capital gain in case of joint development agreement (JDA) - Certain concerns to be addressed and scope to be enlarged***

The Finance Bill 2017 proposes to insert sub-section (5A) in the existing section 45 to provide that the capital gains arising to an individual or Hindu undivided family under a Joint Development

Agreement shall be taxed in the year in which completion certificate for the whole or part of the project is received, based on the stamp duty valuation on the date of issue of certificate of completion as increased by cash consideration received, if any.

However, the above provisions shall not apply where the assessee transfers his share in the project on or before the date of issue of said certificate of completion, and the capital gains shall be deemed to be the income of the year in which such transfer takes place.

Relief is proposed to be provided to individuals and HUFs on transfer of capital asset by postponing the date of taxability from the date of transfer to the date of obtaining of the Completion Certificate which was a matter of concern since quite a long time. This is a very welcome provision which addresses the concern of the tax payer in having to pay tax when he has still not realised the income from the project**.**

Issues

a) In case the owner transfers his share of the property before receipt of the Completion Certificate, then, the benefit envisaged in this amendment will not be available to him. This may cause genuine difficulty since typically in these kinds of JDAs, the owner receives several units of flats/floors as his share of property and while the project is in progress some of the units may be sold by him. Since only some of the units may be transferred when the project is in progress, the benefit of this proposal may not be denied in respect of capital gains arising from sale of his entire share of property.

b) The applicability of this section has been restricted to Individuals and HUFs. The difficulty envisaged by the legislature is faced by all assessees and therefore, this section may be made applicable to all classes of assessees.

c) Due to sluggishness in the economy and scarcity of funds, developers too are entering into this kind of arrangement wherein they forgo part of their total profits by entrusting the task of development to another developer who has the funds required for development of the property. Therefore, similar provision may also be introduced for property held as a business asset.

d) The aforesaid proposed provisions appear to be in line with the existing provisions of section 50C. However, certain safeguards contained in section 50C do not find place in the proposed section 45(5A). For example, section 50C provides that where the assessee claims before any Assessing Officer that the value adopted or assessed or assessable by the stamp valuation authority exceeds the fair market value of the property as on the date of transfer, then the Assessing Officer may refer the valuation of the capital asset to a Valuation Officer.

   Similar safeguards may be incorporated in section 45(5A) as well, in a case where stamp duty value is higher than FMV.

e) Competent authority is proposed to be defined in the Explanation below section 45(5A) to mean the authority empowered to approve the building plan by or under any law for the time being in force. This does not appear to be in sync with the definition of "competent authority" as per section 2 (p) of the Real Estate (Regulation and Development) Act, 2016.

f) The provisions of the proposed sub-section defers the taxability of capital gains to the year of issuance of the completion certificate. However, the time limit for claiming benefit under sections 54 and 54F of the Act is reckoned from the **date of transfer**.

Suggestions:

It is suggested that:

a) In a case where only some of the units of flats/floors are transferred by the owner when the project is in progress, the benefit of this proposal may not be denied in respect of capital gains arising from sale of the entire share of owner's property. The benefit may continue to be available in respect of capital gains arising from those units which are transferred after receipt of completion certificate. This would address the concern of the tax payer and at the same time, the Government would realise revenue at an early point of *time in respect of those units which were transferred when the project is in progress.*

b) *The benefit of this section may be extended to assessees other than individuals and HUFs also.*

c) *The benefit of this section may also be extended to cases where the property is held as a business asset.*

d) *The safeguards contained in section 50C may be incorporated in section 45(5A) as well.*

e) *In order to ensure symmetry and consistency, the definition of Competent authority may be the same as per section 2 (p) of the Real Estate (Regulation and Development) Act, 2016 wherein "Competent Authority" has been defined as follows- "competent authority" means the local authority or any authority created or established under any law for the time being in force by the appropriate Government which exercises authority over land under its jurisdiction, and has powers to give permission for development of such immovable property;*

f) *In order to enable the assessee to claim exemption under section 54/54F, it is suggested that the time limit under sections 54/54F are reckoned from the date of issuance of completion certificate.*

10. Clause 26 and 29- Section 50CA and section 56(2)(x)(c)- Fair Market Value to be full value of consideration in case of transfer of unquoted shares – Amendment required in view of double taxation in the hands of seller as well as buyer

The Finance Bill 2017 proposes to insert new section 50CA to provide that in case of transfer of shares of a company other than quoted shares, the fair market value of such shares determined in the prescribed manner shall be deemed to be the full value of consideration for the purpose of computing income chargeable to tax as capital gains.

Further, Explanation to the proposed section states that "quoted share" means the share quoted on any recognised stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

The Finance Bill 2017 proposes to insert new clause (x) in sub-section (2) of section 56 so as to provide that where any person receives immovable property without consideration and its stamp duty value exceeds Rs.50,000, the same would be subject to tax. Likewise, if any person receives immovable property for inadequate consideration, and the difference between the stamp duty value and actual consideration exceeds Rs.50,000, the difference would be subject to tax in the hands of the recipient under the head "Income from other sources". Clause (x)(c) provides that where any person receives any property other than immovable property -

- Without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property shall be chargeable to tax as 'income from other sources'.

- For a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration shall be chargeable to tax as 'income from other sources'.

In light of the aforesaid proposed amendment, there will be a double taxation of the same income on deeming basis as explained in the example below:

Example:

For example,' X' transfers his unquoted shares purchased at a cost of Rs.8 lakhs to 'Y' at Rs. 10 lakhs whereas the Fair Market Value of the shares as determined in the prescribed manner is Rs. 1 crore. Then in this situation, the provisions of proposed Section 50CA would be attracted in the hands of the seller, whose full value of consideration for computation of capital gains would be Rs.1 crore. Further, 'Y' who is purchaser would be liable to tax under section 56(2)(x)(c) on Rs. 90 lakhs (i.e. Rs. 1 crore less Rs. 10 lakhs) as income from other sources.

Hence, the difference of Rs.90 lakhs between the fair market value and the actual consideration will be taxable:

- under section 50CA, in the hands of seller; and

- under section 56(2)(x), in the hands of recipient.

Further, even though the recipient, at the time of sale of such shares at a later date would treat the FMV as the Cost of Acquisition, tax has been collected upfront and at times it may happen that the person may not sell shares at a later date.

Suggestions:

It is suggested that:

- *Keeping in mind the consequential double taxation arising on account of the same income being subject to tax both in the hands of seller and recipient, suitable amendment may be made to prevent unjust enrichment of the revenue.*

- *Notwithstanding the above, if provisions of Section 50CA are to be retained, value determined as per Rule 11UA may be considered as the FMV of unquoted shares.*

- *The definition of quoted shares is very subjective and complicated. In actual practice, it may involve problems of interpretation, which would invite unending litigation. It is, therefore, suggested that this section should be made applicable to transfer of shares of a company in which the public is not substantially interested.*

11. Clause 29- Section 56- Insertion of new clause (x) in section 56(2) - Reference to be included in the definition of income under section 2(24)

The Finance Bill, 2017 proposes to insert a new clause (x) in sub-section (2) of section 56 so as to provide that receipt of the sum of money or the property by any person without consideration or for inadequate consideration in excess of Rs. 50,000 shall be chargeable to tax in the hands of the recipient under the head "Income from other sources".

While clause (vii) and (viia) Section 56(2) of the Act find a mention in clause (xv) of Section 2(24) of the Act, being the definition of the term ‘income’, the newly inserted clause (x) of Section 56(2) does not find a mention in Section 2(24) of the Act.

While sunset provisions have been set in for clauses (vii) and (viia) of Section 56(2) of the Act, there has been no inclusion of clause (x) of Section 56(2) in the definition of the term 'income' under section 2(24).

Suggestion:

It is suggested that an appropriate amendment should be made in the definition of the term 'income' under section 2(24) of the Act to include any sum of money or value of property referred to in clause (x) of section 56(2).

Further, the following are the concerns in respect of the proposed section:

(i) The scope of section is proposed to be widened, but at the same time, the limit of exemption of Rs. 50,000 fixed as back as in 2006, has not been increased considering the inflation and reduction in the value of money.

(ii) Revival of Sick Companies are necessary and is in overall interest of the economy. Taxing the amount received by the sick companies may not be fair. Considering this, subvention granted by parent company to subsidiary company to recoup the financial losses or to improve the financial health of the company was considered as capital receipt.

(iii) Cases of capital contribution and distribution of assets need to be carved out.

Suggestions:

It is suggested that:

i. In order to avoid the unintended hardship to small taxpayer, the limit of exemption may be increased from Rs.50,000 to Rs. 5 lakhs.

ii. Suitable exception to carve out the case of subvention granted by parent company to subsidiary company from the purview of section 56(2)(x) may be provided.

iii. *Cases of capital contribution and distribution of assets need to be carved out, for example-*
- ► *Property settled in a trust by a settlor*
- ► *Distribution of asset by trust to beneficiaries*

12. Clause 31- Section 71(3A) - Restriction on set-off of loss from House property – Restriction to be done away with

The Finance Bill 2017 proposes to insert sub-section (3A) in section 71 to provide that set-off of loss under the head "Income from house property" against any other head of income shall be restricted to two lakh rupees for any assessment year. However, the unabsorbed loss shall be allowed to be carried forward for set-off in subsequent years in accordance with the existing provisions of the Act.

In light of the proposed insertion of sub-section (3A) in section 71, there will be following implications:

- Any person (individual or a corporate) who has income under the head “Income from House Property” cannot claim a set off of interest paid exceeding Rs. 2 Lakhs against any other source of income. Such excess would be carried forward for eight years.
- This amendment may have a far reaching negative impact for real estate sector and financial sector.
- As section 71 does not carve out individuals, the honest tax payers i.e., salaried class tax payers would be affected the most. In this context, it is relevant to note that the Finance Minister has, in his budget speech, clearly stated the following: -

  “While the Government is trying to bring within tax-net more people who are evading taxes, the present burden of taxation is mainly on honest tax payers and salaried employees who are showing their income correctly…”

This amendment would have serious repercussions on the honest taxpayer who have made *bonafide* investments in the house properties and have incurred significant amount of interest outflows from their hard-earned income. Considering that in most of cases, the prices of properties have gone down by more than 20-25 per cent in the past 3 to 4 years, the owners are already burdened with the reduction in the value of property combined with interest cost. This provision would further compound the misery of the owners as apart from the huge loss of capital and outflow of interest, their tax burden would also increase substantially.

Let us take a simple case of salaried individual paying interest on housing loan, the details of which are given hereunder:

Particulars	**Amount (In Rs.)**
Salary income	25 lakhs
Property purchased under construction in FY 2013-14	80 lakhs
Loan taken on 1 Apr 2013	64 lakhs
Year of possession	FY 2016-17
Annual rental amount	2.40 lakhs
Income from house property	1.68 lakhs (2.4 lakhs less 30%)
Accumulated interest - FY 2013-14 – INR 6 lakhs - FY 2014-15 – INR 6 lakhs - FY 2015-16 – INR 6 lakhs	18 lakhs
Interest on housing loan to be claimed for FY 2016-17	9.6 lakhs (6 lakhs for FY 2016-17 and 3.6 lakhs as pre-acquisition interest)

The total accumulated loss is Rs. 18 lakhs.

The assessee was setting off loss of Rs. 7.92 lakhs from house property against salary income of Rs. 25 lakhs till now. If the proposed amendment is effected, assessee will be losing on the interest already incurred and paid and may not be able to claim such loss in future year considering the low rentals. In this case, the hit on monthly cash flow for the individual would be approximately Rs. 20,000.

Generally, middle class and lower class people invest in property by obtaining loan from banks. The amount of interest paid is always higher than rental income earned such property and as per the current provisions, the loss could be set-off against other income. This has always been a motivator to invest in real estate. However, now restrictive provisions are proposed in respect of set-off of loss from house property. Further, the period for which such loss can be carried forward for set-off against income from house property is only eight assessment years. However, practically there would not be any positive income from house property since interest cost is very high.

Suggestion:

It is suggested that:

a. *This change in provision alters the position of taxpayer in respect of transactions done by him taking into account the prevailing tax laws. This change is also having the effect of denying the benefit of set-off of pre-construction interest against other income under other heads, if the same along with current year interest exceeds Rs.2 lakh. In other words, this change is having retroactive effect which is against the stated policy of Government. If any change is required to plug the tax benefit, the same should be in respect of housing loans taken on or after 1.4.2017 or houses purchased on or after 1.4.2017.*

b. *"House for all" is on priority list and the prime objective and initiative of the Government. The proposed provision may work against the initiative of the Government to provide a fillip to the housing sector. Availability of affordable houses on rent is also an essential priority of the government. Considering the high priority of housing sector, this restriction may be done away with.*

13. Clause 32- Section 79- Carry forward and set off of loss in case of eligible start-ups - Condition to be further relaxed

The Finance Bill, 2017 proposes to amend section 79 to provide that where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested and being an eligible start-up as referred to in section 80-IAC of the Act, loss shall be carried forward and set off against the income of the previous year, if all the shareholders of such company which held shares carrying voting power on the last day of the year or years in which the loss was incurred, being the loss incurred during the period of 7 years beginning from the year in which such company is incorporated, continue to hold those shares on the last day of such previous year.

The existing provisions provide for restrictions on carry forward of losses in case of substantial change in shareholding of the Indian company. As per the current provisions, shareholders of the company at the end of the financial year in which the loss was incurred must continue to own at least 51% of the shares in that company in the year in which such carry forward loss is to be set off; otherwise, the company loses the ability to carry forward such loss.

The Government, in pursuance of the start-up action plan and facilitating ease of doing business, proposes to introduce a beneficial regime for start-up to carry forward and set off losses. It has been proposed that as long as all the original shareholders of the Company at the end of the financial year in which the loss was incurred continue to be shareholders of such shares in the financial year in which the loss is to be set off, the benefit of carry forward of loss would be available.

Another issue is on account of turnover condition specified in Explanation (ii)(b) of section 80-IAC for a company to qualify as 'eligible start up'. The condition is that turnover of such company should not exceed Rs. 25 Crore anytime between F.Y. 2016-17 to F.Y. 2020-21. This condition also creates uncertainty for start ups in the matter of section 79 limitation as generally applicable to closely held companies i.e., whether the turnover limit has to be adhered to in the year of set-off as well.

The condition of continuing to hold all shares appears to be applicable not only to the initial promoters but also all persons investing subsequently in the start up, which may cause genuine practical hardship. This may also be practically difficult for the start-up company to achieve since PE investors generally look at time frame of 3 to 5 years for exit at a higher price. The exit may happen either through secondary sale in subsequent round of PE funding or through IPO. Any such exit will trigger section 79 limitation for the start-up company.

Suggestion:

It is, therefore, suggested that the condition of continuous holding of the promoters/investors (being persons holding shares in the year of loss) be relaxed. Inter-se transfers *between such shareholders be permitted. Also, it should suffice that the group of promoters/investors hold upto 26% of the voting power in the year of set-off. In any case, the turnover condition for a company to be an 'eligible start up' may be omitted in Explanation (ii)(b) to section 80IAC.*

Also, the period for carry forward and set-off of losses can be extended based on period of gestation in the particular industry instead of initial period of 7 years.

14. Clause 44 - Section 115BBDA – Scope of section 115BBDA, initially restricted to individuals, HuFs and Firms, expanded – Certain pooling vehicles like Mutual funds, AIFs etc. to be exempted

The Finance Act, 2016 had inserted new Section 115BBDA to tax dividend income in excess of Rs. 10 lacs in case of an Individual, HUF and Firm at the rate of 10%.

The Finance Bill, 2017 proposes to extend the scope of section 115BBDA of the Act to include all categories of persons within its purview except a domestic company, a fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv) or section 10(23C)(v) or section 10(23C)(vi) or section 10(23C)(via), a trust or institution registered under section 12AA.

The amendment as proposed in section 115BBDA of the Act only excludes certain specified persons from its purview. Therefore, by implication, all other persons are covered within the purview of Section 115BBDA of the Act.

The amendment particularly impacts some of the pooling vehicles such as Mutual funds and Alternative Investment Funds (AIFs) which represent multiple investors, to whom the income earned has to be distributed.

Pursuant to the amendment proposed, dividend in excess of Rs. 10 lakhs would become taxable in the hands of the aforesaid pooling vehicles even though the share of dividend income of each investor in such pooling vehicles may not exceed Rs. 10 lakhs.

Suggestion:

To remove such hardship, it is requested that a suitable amendment may be brought in to exclude pooling vehicles like Mutual funds, AIFs, etc. from the purview of section 115BBDA.

15. Clause 45 - Insertion of section 115BBG - Income from transfer of carbon credits to be taxed@10% - Inclusion in definition of income under section 2(24) and clarification regarding tax treatment for prior assessment years.

The proposed introduction of section 115BBG providing for a 10 percent tax on income from transfer of carbon credits is a welcome move. This would go a long way in helping to resolve the uncertainty and litigation over the taxability of income from the transfer of carbon credits going forward.

Consequent amendment is required in the definition of the term 'income' under Section 2(24) of the Income-tax Act to include the income from transfer of carbon credits.

Further, the position regarding taxability of income from transfer of carbon credits for earlier years may be clarified since there have been divergent decisions given by the courts on whether such receipts are capital or revenue in nature. If the proposed tax treatment is made applicable for earlier years also, it would garner more revenue from assessees who have not offered the same to tax on the ground that the same represents capital receipt. This would also help avoid future litigation and complete pending assessments.

The Government has also been taking several steps aimed at curbing litigation. These include coming up with schemes for dispute resolution both for legacy disputes arising out of retrospective amendments as well as other disputes that are pending in the appellate hierarchy. These measures and schemes are welcome steps and have been commended by the taxpayers. A similar scheme for income from transfer of carbon credits for the past years would go a long way towards furthering the Government's stated objective of curbing litigation.

Suggestion:

It is suggested that:

a. *Section 2(24) may be amended to include income from transfer of carbon credits in the definition of "income".*

b. *for the periods prior to Assessment Year 2018-19, an option may be given to taxpayers to voluntarily offer income from transfer of carbon credits to tax at the same 10% rate as contemplated in section 115BBG. This can help put an end to protracted litigation on the issue. Considering that such receipts have been held as non-taxable capital receipts by two High Courts, such a move will also benefit the exchequer.*

The option to pay tax on such receipts at 10% could be structured as a one-time scheme open for a limited time, say until 30 September 2017.

16. Clause 37 -Section 80-IBA – Relaxation of certain conditions from 1.4.2018 – Relaxation may be effective from 1.4.2017

Under section 80-IBA, inserted by the Finance Act, 2016 from 1.4.2017, deduction of 100% of profits derived from development of affordable housing projects approved on or after 1st June 2016 is available, subject to fulfilment of specified conditions. The Finance Bill, 2017 has proposed amendments in section 80-IBA so as to relax some of the conditions required to be fulfilled for grant of deduction. These amendments provide for:

(i) Extending period within which housing project is to be completed to five years from the date of approval;

(ii) Substituting references to "built-up area" with "carpet area" as defined in the Real Estate (Regulation and Development) Act, 2016;

(iii) Housing project located in the outskirts of metro cities (i.e. located within 25 KM periphery of municipal limits of metro cities), which were earlier required to comply with conditions applicable for housing project located in metro cities, now need to comply with less restrictive conditions as applicable to housing project located in any other place in India.

The above amendments are welcome and are likely to give a boost to affordable housing in India. However, while section 80-IBA was introduced vide Finance Act, 2016 and is effective from A.Y. 2017-18 for housing projects that are approved on or after 1st June 2016, the above amendments vide Finance Bill, 2017 are proposed to be effective only from A.Y. 2018-19.

Therefore, there is scope for litigation on the issue as to whether amended provisions will apply to projects which are approved on or after date of amendment being 1 April 2017 or also to projects approved between 1 June 2016 and 31 March 2017.

Suggestions:

It is suggested that –

(i) To avoid possible litigation as also to ensure that housing projects approved prior 1 April 2017 are treated on par with housing projects approved on or after 1 April 2017, the amendments proposed in the Finance Bill 2017 relaxing the conditions to be fulfilled under 80-IBA for availing the benefit of deduction thereunder may be introduced with retrospective effect from the date of insertion of the section i.e. from A.Y. 2017-18.

(ii) Alternatively, CBDT may issue a clarification that housing projects approved prior to A.Y. 2018-19 in respect of which profits are earned during or after A.Y. 2018-19 will be considered for tax holiday benefit as per the amended provisions.

17. Clause 46(a) – Section 115JAA – Extension of period of carry forward of MAT credit from 10 years to 15 years - Clarity regarding carry forward and set off of MAT credit in cases where the ten year period has expired on or before AY 2016-17 but the fifteen year period has still not expired

The Finance Bill, 2017 proposes to amend section 115JAA of the Income-tax Act, 1961 to provide that the tax credit in respect of Minimum Alternate Tax (MAT) paid by companies under section 115JB of the Act can be carried forward up to fifteenth assessment year immediately succeeding the assessment year in which such tax credit becomes allowable. This amendment is proposed to be effective from 1 April, 2018.

Currently, the MAT credit is not allowed to be carried forward beyond ten assessment years. The relevant provisions of Section 115JAA of the Act are reproduced as under-

"(3A) The amount of tax credit determined under sub-section (2A) shall be carried forward and set off in accordance with the provisions of sub-sections (4) and (5) but such carry forward shall not be allowed beyond the tenth assessment year immediately succeeding the assessment year in which tax credit becomes allowable under sub-section (1A).

(1A) Where any amount of tax is paid under sub-section (1) of section 115JB by an assessee, being a company ***for the assessment year commencing on the 1st day of April, 2006 and any subsequent assessment year,*** *then, credit in respect of tax so paid shall be allowed to him in accordance with the provisions of this section."* ***(Emphasis supplied)***

An issue arises in cases where the ten year period has expired with the assessment year 2016-17 owing to completion of 10 years period on the basis of the current provisions.

In such cases, having regard to the proposed amendment, a question arises as to whether the benefit which has already lapsed will get a new lease of life. The ambiguity arises since the proposed extension of carry forward period to fifteen years shall take effect only from April 1, 2018 (i.e. A.Y. 2018-19).

It may be noted that a similar amendment was made in Section 115JAA in the Finance Act, 2009 wherein the carry forward of MAT credit was extended upto 10 assessment years from 7 assessment years. The Explanatory Memorandum to the Finance Act, 2009 reads as under:

".. .the assessees, being companies, who pay Minimum Alternate Tax under section 115JB for any assessment year ***beginning on or after the 1st day of April, 2006,*** *it is also proposed to amend the provisions of sub-section (3A) of section 115JAA…"* ***(Emphasis Supplied)***

The issue discussed above did not exist when the tenure was extended from 7 to 10 years as the amendment was brought before the expiry of the available bracket for carry forward.

The memorandum explaining the provisions of the Finance Bill, 2017 states as follows:

"Section 115JAA contains provisions regarding carrying forward and set off of tax credit in respect of Minimum Alternate Tax (MAT) paid by companies under section 115JB. Currently, the tax credit can be carried forward upto tenth assessment years. ***With a view to provide relief to the assessees paying MAT,*** *it is proposed to amend section 115JAA to provide that the tax credit determined under this section can be carried forward up to fifteenth assessment years immediately succeeding the assessment years in which such tax credit becomes allowable…*

….These amendments ***will take effect from 1st April, 2018*** *and will, accordingly, apply in relation to the assessment year 2018-19 and subsequent years."* ***(Emphasis Supplied)***

It appears from the language of the Memorandum that the intent of the legislature is to provide relief to the taxpayers paying MAT by extending the carry forward period for MAT credit. However, the strict interpretation of the provisions does not appear to sync with this intent.

The issue in hand needs to be addressed so that taxpayers' whose MAT credit carry forward period has lapsed should not be at a disadvantage and suffer from the transitional impact of the proposed amendment.

Suggestion:

> *In line with the intent of the proposed legislative amendment and to ensure equity, it is suggested that appropriate clarification either by way of an Explanation in section 115JAA or by way of an Explanatory circular be issued to the effect that such benefit is available even in cases where the ten year period expired before A.Y.2017-18 but the fifteen year period has still not expired.*

18. Clause 46(b) – Section 115JAA(2A) - Restriction on carry forward of MAT/AMT credit and claim of FTC in relation to taxes under dispute - Restriction to be removed

In line with Rule 128(7), the Finance Bill 2017 proposes to insert second proviso to section 115JAA(2A) restricting quantum of MAT credit to be carried forward to subsequent years. The proposed proviso provides that where the amount of FTC available against MAT/AMT is in excess of FTC available against normal tax, MAT/AMT credit would be reduced to the extent of such excess FTC.

Similar restriction is proposed to be inserted in S. 115JD(2) on AMT credit.

Both the provisions are proposed to be effective from the 1 April, 2018 i.e. will apply in relation to A.Y. 2018-19 and onwards as specifically provided in Notes on Clause and Memorandum to the Finance Bill.

The rationale of aforesaid restriction/limitation is not clear. The restriction on quantum of MAT/AMT credit to be carried forward subjects taxpayer to duplicated MAT liability while denying the rightful carryover of MAT/AMT credit.

The FTC credit is an alternative form of tax payment. For all purposes including for grant of refund or levy of interest, FTC is treated as advance tax paid to the extent the same is creditable against tax liability in India. Once MAT liability is admitted to be tax liability on income in India, there is no justifiable reason for treating FTC separately depending on whether FTC is creditable against normal tax liability or MAT liability. The proposed amendment is inconsistent with the Government's assurance that MAT is to be effectively phased out and incidence of MAT is to be counter matched by grant of extended period of MAT credit.

Suggestion:

The proposed restriction on carry forward of MAT/AMT credit may be removed.

19. Clause 50 & 51 – Section 132(1), 132(1A) and 132A(1) – reason to believe to conduct a search, etc. not to be disclosed – retention of existing provisions to reduce undue hardship to genuine assessee

It is proposed to insert an Explanation to section 132(1), 132(1A) and 132A(1) to declare that the 'reason to believe' or 'reason to suspect', as the case may be, shall not be disclosed to any person or any authority or the Appellate Tribunal. The proposed amendment could lead to unnecessary harassment of taxpayers.

Suggestion:

It is suggested that the requirement of 'reason to believe' or 'reason to suspect' may be retained in these sections to reduce undue hardship on genuine assessees. Such reasons may also be permitted to be disclosed to appellate authorities

20. Clause 55 - Section 139(5) – Reduction in time limit for filing revised return – Retention of existing time limit for filing of revised tax return at least in cases of claim of foreign tax credit

The Finance Bill 2017 proposes to amend section 139(5) to provide that the time for furnishing of revised return shall be available upto the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

This particularly impacts claims for any Foreign Tax Credit (FTC) in respect of the taxes paid by the individual assessee(s) in the overseas tax jurisdiction. Generally the information/ final payment of foreign taxes/ tax return is unlikely to be available within the proposed timeline for filing the revised tax return i.e. by the end of the relevant assessment year.

As an example, USA follows calendar year as their tax year and the first due date of filing a USA income-tax return is April 15th of the following calendar year, meaning thereby, the USA income-tax return for calendar year 2018 will be required to be filed by 15th April, 2019.

In a case of Indian income-tax return for tax year 2017-18, the due date to file a revised return as per the proposed amendment will be 31st March, 2019.

In the above situation, the assessee may not have his final tax return available with him till 15th April 2019, hence, such assessee will not be able to claim the FTC of the final USA taxes paid by him in his Indian income-tax return as he may not have the final USA tax details by 31 March 2019.

Suggestion:

Keeping in mind the above hardship of double taxation which may arise to the individual assessee as he may not be able to claim foreign tax credit in the absence of overseas income-tax return, there is a need to retain the time limit for filing of revised tax return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier. Therefore, the existing time limit may at be retained at least in respect of revision required for claiming foreign tax credit.

21. Clause 62 - Claim of FTC pertaining to taxes which are under dispute in the foreign country – Clarification required on certain issues relating to period of limitation and documents which shall constitute evidence of settlement

Section 155(14A) proposes to provide that where the payment of foreign tax is under dispute credit of such taxes will be available in India in the year in which the dispute is settled, on satisfaction of certain conditions. To give effect to this an enabling provision shall be inserted through which Tax Authority will rectify the assessment orders or an intimation order and allow credit of taxes in the year in which the taxpayer furnishes the evidence of settlement of dispute and discharge of foreign tax liability.

However, the proposed amendment does not provide for time limit within which the Assessing Officer has to rectify the assessment order. The ***proposed amendment only gives a reference to section 154. Section 154 provides a time limit of 4 years for reassessment, excluding any***thing specifically provided under section 155. Issues may arise on what is period of limitation which may apply for section 155(14A) and how it should be applied.

The proposed amendment provides that the Assessing Officer shall amend the earlier order which denied FTC, if the taxpayer, within six months from the end of the month in which the dispute is settled, furnishes to the Assessing Officer, evidence of settlement of dispute and evidence of payment of tax. Time threshold of six months from date of dispute settlement gives a very small window for taxpayers to claim the benefit for previous years, hence, giving a limited scope to the benefit.

It is also not clear as to what could constitute sufficient evidence on the part of taxpayers to claim the FTC benefit on dispute settlement.

***Suggestions*:**

(i) *The time limit applicable for rectification of order may be clarified. Since all the sub-sections in section 155, provide for the time limit to be applied and some of the sub-sections provide for a different time limit, it may be expressly clarified that what is the period of limitation which may apply to cases covered by the proposed section 155(14A).*

(ii) *It may also be clarified that the period of limitation (e.g. if it 4 years), should be 4 years from the end of the year in which the amended order is passed and it should not be the date of the original order. This is for the reason that if the dispute in the foreign country takes more than 4 years to get resolved and if the limitation period is considered to be 4 years from the date of the original order, the taxpayer may not get credit for taxes which he has actually paid. Such may not be the intent of the proposed amendment.*

A similar provision is contained in S.155(16) which provides that where the compensation for compulsory acquisition is reduced by any Court or Tribunal, then the period of limitation shall be reckoned to be 4 years from the end of the year in which the order of the Court or Tribunal is passed.

(iii) *The time limit may be amended to provide for 6 months from date of settlement of dispute or date of effect of the amended order passed u/s. 155(14A), whichever is later.*

(iv) *Clarification may be provided on what is the documentation which shall constitute as sufficient evidence for justifying that the dispute has been settled. This may be done by specifying an illustrative set of documents, which shall constitute as evidence for settlement of dispute.*

Illustratively the following may be considered as evidence for settlement of dispute

- *Final assessment order/ final demand notice of the tax authority of the foreign country*
- *Judgment of the Court of Law along with the final demand notice of the tax authority based on the judgement*
- *Proof of payment of taxes*
- *Self-declaration*

22. Clause 63 – Section 194-IB – Requirement of tax deduction at source by individuals/HUFs paying monthly rent exceeding Rs.50,000 - Enabling measures to facilitate ease of compliance to be introduced & issue of clarification regarding the amount on which tax has to be deducted at source in a situation where monthly rent is increased during the previous year and the increased monthly rent exceeds Rs.50,000

The Finance Bill, 2017 proposes to insert new section 194-IB to provide that an Individual or a HUF (other than those covered under clause (a) & (b) of section 44AB of the Act), responsible for paying to a resident any income by way of rent exceeding fifty thousand rupees for a month or part of month during the previous year, shall deduct an amount equal to five per cent. ***of such income*** as income-tax thereon.

It is further proposed that tax shall be deducted on such income at the time of credit of rent, ***for the last month of the previous year*** or the last month of tenancy if the property is vacated during the year, as the case may be, to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Issues:

(1) The amount on which tax needs to be deducted in the last month of the previous year would generally be the total rent paid during the previous year. However, in a case when the monthly rent currently does not exceed Rs.50,000 but the same is increased, say, in the month of February and the increased rent amount exceeds Rs.50,000 per month, then it is not clear on what amount the tax needs to be deducted. Whether the tax needs to be deducted on the rent paid during that previous year although the rent per month for some of the months is less than Rs.50,000 p.m or the rent needs to be deducted on the aggregate amount of rent for the months where rent has exceeded Rs.50,000 pm.

(2) Since it is also proposed that the deductor shall be liable to deduct tax only once in a previous year, requisite measures for one time remittance of tax by such deductor may be implemented to facilitate easy compliance.

Suggestions:

It is suggested that:

(i) *a suitable clarification be issued clarifying the amount on which tax needs to be deducted under section 194-IB in case the monthly rent has been increased during the year and the amount of rent per month before such increment was less than Rs 50,000.*

(ii) *a simple challan-cum-statement for one-time remittance of tax by the lessee/rent payer be notified and a reasonable time period for remittance of rent may be prescribed in Rule 30 in line with sub-rule (2A).*

The PAN of the lessor/landlord and lessee/tenant may be required to be quoted in the challan so that the lessor/landlord can take credit of tax deducted and remitted.

The said suggestions are in line with provisions applicable for compliance of provisions of section 194-IA.

23. Clause 71 – Section 206C(1D) - Exclusion of specific reference to sale of jewellery, cash consideration exceeding Rs.5 lakhs - Consequent implication

Section 206C(1D) provides for TCS obligation on sale of jewellery, sale of bullion, and residuary limb being any other goods (other than bullion or jewellery) ,if the value of consideration received in cash exceeds specified limits as under:

For sale of jewellery, cash consideration exceeding Rs. 5 lakhs
For sale of bullion and any other goods in residuary category, cash consideration exceeding Rs. 2 lakhs .

The Finance Bill 2017 proposes to omit specific reference to 'jewellery' from section 206C(1D) such that post amendment, TCS obligation would be in respect of cash sale of "bullion" or "any other goods (other than bullion)" of an amount exceeding Rs. 2 lakhs. The proposed amended provision would read as under:

"(1D) Every person, being a seller, who receives any amount in cash as consideration for sale of bullion or jewellery [or any other goods (other than bullion or jewellery) or any other goods (other than bullion)or providing any service], shall, at the time of receipt of such amount in cash, collect from the buyer, a sum equal to one per cent of sale consideration as income-tax, if such consideration,—

(i) for bullion, exceeds two hundred thousand rupees; or
(ii) for jewellery, exceeds five hundred thousand rupees; [or]
(iii) for any goods, other than those referred to in clauses (i) and (ii), or any service, exceeds two hundred thousand rupees:"

An issue arises as to whether the proposed amendment intends to take out sale of jewellery completely from TCS levy or intends to retain the TCS levy on jewellery but with lower threshold of Rs. 2 lakhs.

A plain reading of the amended s. 206C(1D) (as reproduced above) would suggest that jewellery would now be covered under residuary clause "any other goods (other than bullion)" with lower threshold of Rs. 2 lakhs. The understanding, that the proposed amendment lowers the threshold of cash sale of jewellery from 5 lakhs to 2 lakhs, is also in line with the provisions of proposed 269ST restricting the amount of receipt in cash receipt by any person in excess of Rs. 3 lakhs. There seems to be no reason to exclude cash sales of jewellery beyond Rs. 2 lakhs from out of TCS levy- more particularly, jewellery is identified as source of investing black money.

However, the Explanatory Memorandum while dealing with the proposal in the Finance Bill, 2017 on introduction of section 269ST suggests as "It is also proposed to consequentially amend the provisions of section 206C to omit the provision relating to tax collection at source at the rate of one per cent of sale consideration on cash sale of jewellery exceeding five lakh rupees."

The Notes to Clauses also states as 'It is proposed to omit the said clause in view of restriction on cash transaction as proposed to be provided in section 269ST.

Therefore, there exists confusion as to whether the proposed amendment intends to take sale of jewellery completely out of the purview of TCS levy or jewellery would still be covered under the residuary clause with a threshold of Rs. 2 lakhs as applicable.

Suggestions:

It is suggested that:

i. *A suitable clarification on this issue (either by way of Circular or legislative amendment) may be issued.*

ii. *Since the value limit for bullion and the other goods both are at par (that is, Rs. 2 lakhs), the distinction is no longer relevant.*

The provision may be redrafted providing levy of TCS@1%on sale of any goods (including bullion and jewellery) or provision of services.

24. Clause 75 – Section 234F – Fee for delayed filing of return – Removal of provision levying fees to prevent undue hardship for the genuine assessees

The Finance Bill, 2017 proposes to levy fees of Rs.5,000 in case where return is furnished after the due date but on or before 31st December of the relevant assessment year and Rs.10,000, in other cases. However, it is also proposed to restrict the fees to Rs.1,000, where the total income does not exceed five lakh rupees.

Current provisions provide for penalty of Rs.5,000 under section 271F in case where return is furnished after end of relevant assessment year provided there is no reasonable cause for such delay.

The proposal is made with a view to ensure that returns are filed within the due dates specified in section 139(1). However, fees proposed under section 234F will be leviable on all assessees who have furnished return beyond the due date specified under section 139(1) irrespective of the reason for such delay and whether all the taxes have been paid through TDS or Advance Tax.

Also, the assessee cannot justify his cause for delay under any appeal against the same as there is no proposed provision to consider the reasonable cause for delay on the part of assessee.

Further, fee is generally levied in respect of services rendered. Whereas collection of tax by the Government is a sovereign function, as such, there is no rendering of services. Delay in filing of return is in contravention of law for which penalty should be attracted. The same can be waived if reasonable cause is proved.

Suggestion:

It is suggested that proposed fees under section 234F for delayed filing of return may be withdrawn and necessary amendments be made in section 271F.

25. Clause 83- Section 269ST- Restriction on cash transactions – Certain concerns to be addressed

In order to achieve the mission of the Government to move towards a less cash economy to reduce generation and circulation of black money, the Finance Bill 2017 proposes to insert section 269ST in the Act to provide that no person shall receive an amount of three lakh rupees or more,—

(a) in aggregate from a person in a day; or
(b) in respect of a single transaction; or

(c) in respect of transactions relating to one event or occasion from a person,

otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account.

Issues

(i) The phrase "transactions relating to one event or occasion" is very subjective and prone to multiple interpretations and may result in avoidable litigation. Receipts exceeding Rs. 3 lakhs in respect of transactions relating to one "event or occasion" from a person is prohibited. Say for example, if salary/ wages is paid in cash to supervisor/ consultant every month such that yearly aggregate exceeds threshold limit of Rs. 3 lakhs, tax authorities may argue that such receipt is covered by section 269ST since payment of salary constitutes one event or occasion even though payments might have been disbursed monthly and raise a demand notice. Hence, it may be suggested that third limb of "event or occasion" should be explicitly kept out of the scope to avoid any litigation and protect honest taxpayers. Similar controversy may also arise in case of second limb which covers receipt in respect of a "single transaction".

Suggestion:

It is suggested that suitable clarificatory guidelines may be issued to illustrate the intent of the phrase "transactions relating to one event or occasion from a person". In the alternative, clause (c) may be removed.

(ii) Some exceptions on the lines of Rule 6DD need to be provided. As per literal interpretation, even though receipt by banking company is permitted, withdrawal of cash from bank may be sought to be covered; payment of fund amongst relatives, say for household expenses or medical emergencies, is not exempted; money received may have been deposited into the bank the same day and yet it may be considered as a case of default, settlement of debt by book entry or conversion of loan into equity may also stand covered since it does not strictly fall within the specified modes mentioned above.

Suggestion

Exceptions on the lines of Rule 6DD may be provided.

(iii) The Finance Minister, in his budget speech has mentioned that promotion of a digital economy is an integral part of Government's strategy to clean the system and weed out corruption and black money. It has a transformative impact in terms of greater formalisation of the economy and mainstreaming of financial savings into the banking system.

Accordingly, the Finance Bill 2017 has, introduced provisions encouraging payment through electronic clearing system like, section 13A, section 35AD, section 40A etc. Further in section 269ST also, receipt in excess of Rs.3 lakh otherwise than by way of account payee cheque or account payee bank draft or use of electronic clearing system (ECS) through a bank account is not permissible and would attract penal provisions.

It is pertinent to note that debit cards, credit cards and e-wallets are being widely used to make payments and these instruments leave an audit trail. However, technically, they do not fall within the scope of "Electronic Clearing System" as per the meaning of the said term clarified by RBI through its FAQs given at https://www.rbi.org.in/Scripts/FAQView.aspx?Id=55 and reproduced below –

"Electronic Clearing Service (ECS) is an electronic mode of payment / receipt for transactions that are repetitive and periodic in nature. ECS is used by institutions for making bulk payment of amounts towards distribution of dividend, interest, salary, pension, etc., or for bulk collection of amounts towards telephone / electricity / water dues, cess / tax collections, loan instalment repayments, periodic investments in mutual funds, insurance premium etc. Essentially, ECS facilitates bulk transfer of monies from one bank account to many bank accounts or vice versa. ECS includes transactions processed under National

Automated Clearing House (NACH) operated by National Payments Corporation of India (NPCI)."

Suggestion:

It is suggested that payment made through banking channels, including debit cards, credit cards and e-wallets, may be permitted under the various provisions of the Income-tax Act, 1961. Alternatively, ECS may be specifically defined in the Income-tax Act, 1961 to include reference to these modes of payment.

(iv) The expression, 'amount' has been used u/s 269ST whereas the expression 'sum' has been used u/s 271DA, which may create confusion and result in avoidable litigation.

Suggestion:

It is suggested that a uniform expression, 'amount' or 'sum of money' may be used at both the places i.e. under section 269ST as well as under section 271DA.

(v) In Note no. 83 of notes on clauses, the following amounts/ nature of transactions are proposed to be excluded: -

"Any receipt from sale of agricultural produce by any person being an individual or Hindu Undivided family in whose hands such receipts constitutes agricultural income "

This transaction has been inadvertently omitted from the list of exclusions proposed in section 269ST.

Suggestion:

It is suggested that the above highlighted transaction as referred to in notes to clauses be excluded from the operation of section 269ST by suitably amending the proviso to section 269ST.

It is also suggested that the benefit of the above exclusion be not restricted only to individual and HUF but also to other assessee's also who are deriving agricultural income only.

26. Clause 86- Section 271J- Penalty imposable on chartered accountant for furnishing incorrect information in reports or certificates – Penalty may be removed

In order to ensure that the person furnishing report or certificate undertakes due diligence before making such certification, new section 271J is proposed to be inserted so as to provide that if an accountant or a merchant banker or a registered valuer, furnishes incorrect information in a report or certificate under any provisions of the Act or the rules made there under, the Assessing Officer or the Commissioner (Appeals) may direct him to pay a sum of ten thousand rupees for each such report or certificate by way of penalty.

a) **C&AG Report and Response of Ministry of Finance to the Observations of C&AG in its report No. 32 of 2014 : No requirement for additional penal provisions in the Income-tax Act, 1961 against CAs**

Observations of C&AG in its report No. 32 of 2014

(i) The observations of C&AG in its report No. 32 of 2014 have been viewed seriously by ICAI. Suitable steps have been taken by ICAI in respect of various observations of C&AG. The C&AG in its report had stated that it is the joint responsibility of ITD and ICAI to ensure the compliance of the Act. Assuming the said responsibility, the ICAI, on its part, has also suggested changes in the return format so as to plug the possibility of a chartered accountant exceeding the specified limit in respect of number of tax audit assignments but the same is yet to be given effect to by the CBDT.

It is pertinent to note that the C&AG has, in its report, also made a mention of cases where the report of chartered accountants was not fully utilized by the Assessing Officers despite audit objection of a CA, the deduction/exemption has been allowed by the Assessing Officer.

(ii) It is pertinent to mention that C&AG in its Report No.32 of 2014 had recommended incorporation of penal provisions against erring

CAs found indulging in gross professional misconduct. The response of the Ministry of Finance as stated in the aforesaid report is as under:

> ***"The Ministry stated (October 2014) that there is no need for any fresh provision in the Income-tax Act for taking penal action against CAs who signed incorrect reports as there were already sufficient provisions in sections 277, 277A and 278 of the Act."***

In light of the specific and pertinent observations of Ministry of Finance and without prejudice to the other suggestions given below, it is suggested that status quo be maintained and the proposed provision be dropped.

b) **Audit Opinion not to be construed as incorrect information thereby increasing litigation**

Auditors are required to follow Auditing and Assurance standards issued by ICAI for the conduct of audit and issue the audit report accordingly. It is pertinent to mention here that in normal circumstances, an auditor is not required to be investigative. The role of audit is derived from various assurance standards developed by the ICAI on the basis of global standards. Therefore, whether a member is responsible for the perceived incorrectness in the report or not requires the matters to be examined from the points of view of process of audit adopted by the Chartered Accountant and whether due process is followed by him in providing the report and/or certificate.

In a case where the accountant furnishes information on the basis of his opinion in respect of a particular transaction based on a court judgement, and the Assessing Officer is of a different view based on a contrary judgement, the same would not tantamount to furnishing of incorrect information. Different views taken on the basis of judicial decisions and sound judicial principles cannot be treated as non-compliance with the tax laws and auditors cannot be penalised. Such aspects have been dealt with by the ICAI in various guidance notes for e.g. Guidance Note in relation to tax audits u/s.44AB.

Therefore, whether the auditor has functioned diligently or not, whether he has provided incorrect information without a reasonable cause, etc. will have to be judged by taking into account various pronouncements on the role of an auditor. The proposed section 271J does not define "incorrect information", absence of which may give unbridled powers to the Assessing Officer to impose penalty thereunder. It is also pertinent to mention here that such pronouncements are made by the ICAI from time to time taking into consideration the provisions of related laws as also the international standards on the subject.

The consequential amendment proposed in section 273B that no penalty under section 271J would be imposable if it is proved that there is reasonable cause for failure may not be of much practical relevance.

c) **No right of appeal against order imposing penalty :**

It is possible that the income tax authority may find the chartered accountant guilty of providing incorrect information and the concerned chartered accountant may be aggrieved of such a decision. Levy of penalty in a case where a chartered accountant's opinion on any matter has been perceived as furnishing of incorrect information may have an adverse impact on the professional standing of the chartered accountant. Levy of penalty may also form the basis of initiation of the disciplinary proceedings against him, which may be unjust and also lead to endless litigation. Order imposing penalty under section 271J is also not appealable and hence there is no judicial remedy for unjust levy of penalty.

d) **Operational Issues:**

Another issue which may arise is regarding the jurisdiction of the Assessing Officer levying penalty under section 271J. There may be cases where accountant is belonging to some other city and the assessee is assessed in another city. If the Assessing Officer is of the opinion that information certified by the accountant is incorrect and he issues show cause notice to the accountant, then, the accountant has to appear before that Assessing Officer to prove reasonable cause for failure. This will create an unnecessary hardship for the accountant, since it would necessitate that the accountant travel to the other city for this purpose.

e) **Multiple Adjudicating Authorities:**

Cases of gross professional misconduct/gross negligence, are in the normal course reported by the Department to the ICAI, which is the regulatory body governing Chartered Accountants. On the basis of receipt of formal complaint from the Department, action is taken by ICAI within the regulatory framework provided in the Chartered Accountants Act and the Misconduct rules framed there under.

ICAI has sufficient regulatory, supervisory, organisational and budgetary independence as regards the audit profession although it is both a standard setter and a regulator. It is duty bound to continue to discharge its obligations to ensure the highest standards of audit quality as well as to protect public interest.

The ICAI disciplinary mechanism consists of an independent Discipline Directorate headed by Director Discipline. The Council constitutes Board of Discipline and Disciplinary Committee in terms of the provisions of the Chartered Accountants Act, 1949. The Government nominated member is also one of the members of Board of Discipline.

The Director Discipline initiates the disciplinary proceedings on receipt of any information or complaint and places it for adjudication before Board of Discipline and Disciplinary Committee. The decisions of Board of Discipline and Disciplinary Committee are subject to appeal before an Appellate Authority which is presided by a person who is or has been a Judge of the High Court.

Whenever the Income Tax Department has referred the matters to the ICAI for disciplinary actions, the ICAI has acted upon such references and taken them to the logical conclusion. The decisions of the ICAI in such cases are always available to the Department.

As per the provisions of section 21B of the Chartered Accountants Act, 1949, if disciplinary committee is of the opinion that a member is guilty of a professional or other misconduct, it may thereafter take any one or more of the following actions:

a) Reprimand the member;

b) Remove the name of the member from the register permanently or for such period, as it thinks fit;

c) Impose such fine as it may think fit, which may extend to Rs. 5 lakhs.

Therefore, the proposed provision will lead to a situation where there would be Multiple Adjudicating Authorities, which may not be appropriate.

Attention is hereby invited to the extracts of the Report no.32 of 2014 of C&AG reproduced below:

> *"The CAs are regarded as facilitators of the Income tax Department (ITD) for administrating the provisions of the Act correctly. The tax audit Reports(TARs)/ certificates issued by them serve as valuable reference guide to the Assessing Officers (AOs) while making assessments. The AO is expected to make his independent judgement while finalizing the assessment and can require the assessee to justify his claims with reference to records and references. The Delhi High Court has observed that the tax audit does not provide any immunity from scrutiny and investigation by ITD.*

Suggestions:

It is, thus, submitted that, as per the current practice, if it is felt that a chartered accountant who has furnished incorrect information in a report or certificate under any provision of the Act or the Rules made thereunder, is guilty of professional misconduct, the same be referred to the Institute of Chartered Accountants of India by the Income-tax authority.

Considering the robust disciplinary mechanism of ICAI and to avoid conflict of mandate with regard to the same, all the Disciplinary Cases should come to Disciplinary Committee of ICAI as constituted by Government which has two Government Nominees and three ICAI Council members (one being President ICAI and the other ICAI Council member) so that it does not create two parallel mechanisms, governing the same issue.

The need of the hour is to strengthen the system of exchange of information between Income Tax Department (ITD) and ICAI so as to enable timely action against the erring members by

ICAI. It is, thus, suggested that instead of imposing an additional penalty, the present relationship of ICAI and ITD be strengthened with better exchange of data.

Therefore, the proposed levy of penalty under section 271J on a chartered accountant may be withdrawn.

27. Other Suggestions

a) Relaxation from scrutiny provisions for assessees, having taxable income upto Rs.5 lakhs other than business income, filing return for the first time – Scope of relaxation to be extended

In the Budget Speech, the Hon'ble Finance Minister mentioned that the assessees, having taxable income upto Rs.5 lakhs other than business income, will not be subjected to scrutiny unless there is specific information available with the Department regarding his high value transaction:

"In order to expand tax net, I also plan to have a simple one-page form to be filed as Income Tax Return for the category of individuals having taxable income upto Rs.5 lakhs other than business income. Also, a person of this category who files income tax return for the first time would not be subjected to any scrutiny in the first year unless there is specific information available with the Department regarding his high value transaction. I appeal to all citizens of India to contribute to Nation Building by making a small payment of 5% tax if their income is falling in the lowest slab of Rs.2.5 lakhs to Rs.5 lakhs." (Para 176)

Suggestions:

It is a welcome move. However, in order to encourage more people to file income tax returns, necessary provisions may be introduced, such as:

- *Individuals having taxable income upto Rs.10 lakhs may not be subjected to scrutiny for 3 Assessment Years unless there is specific information available with the Department regarding his high value transaction.*

- *Individuals who pay 30% more taxes as compared to immediately preceding assessment year, may not be subjected to scrutiny for such Assessment Year unless there is specific information available with the Department regarding his high value transaction.*

b) Income Computation and Disclosure Standards introduced under section 145 vide Finance Act (No.2), 2014 – ICDSs may be withdrawn

Section 145 of the Income-tax Act, 1961 provides for the method of accounting. Section 145(1) requires income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" to be computed in accordance with either the cash or mercantile system of accounting regularly employed by the assessee, subject to the provisions of section 145(2). Under section 145(2), the Central ***Government is empowered to notify in the Official Gazette from time to time, income computation and disclosure standards (ICDSs) to be followed by any class of assessees*** or in respect of any class of income.

Accordingly, the Central Government had, vide Notification No.S.O.892(E) dated 31.3.2015, in exercise of the powers conferred by section 145(2), notified ten income computation and disclosure standards (ICDSs) to be followed by all assessees, following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit and gains of business or profession" or "Income from other sources". This notification was to come into force with effect from 1st April, 2015, to be applicable from A.Y. 2016-17.

However, the Central Government has, vide Notification No.S.O.3078(E) dated 29.9.2016, rescinded Notification No.S.O.892(E) dated 31.3.2015. Simultaneously, vide Notification No.S.O.3079(E) dated 29.9.2016, the Central Government has notified ten new ICDSs to be applicable from A.Y.2017-18.

The newly notified ICDSs have to be followed by all assessees (other than an individual or a Hindu undivided family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB) following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head “Profits and gains of business or profession” or “Income from other sources”, from A.Y.2017-18.

The Income Tax Simplification Committee has recommended deferral of ICDS considering that taxpayers are already grappling with regulatory changes like Companies Act, Ind-AS and GST; there is scope for litigation on many aspects of ICDS; ICDS merely results in multiplicity of accounting methods, increased compliance burden of multiple records, etc. which outweigh the benefits to be gained by application of ICDS. The Committee has also recognized that ICDS at best brings timing difference between accounting and taxable income.

Further, there is no international precedent on ICDS. The dual set of new standards for accounting under Ind-AS and tax computation under ICDS increases complexity, tax uncertainty and compliance burden for Ind-AS companies.

Suggestion:

It is suggested that the Income Computation Disclosure Standards may be withdrawn and necessary amendments be proposed under the Income Tax Act, 1961 itself.

Suggestions relating to International Taxation

28. Clause 4- Section 9(1)(i)- Benefit of non-applicability of indirect transfer provisions in case of Category I and II FPIs - Benefit to be extended to Category III FPIs and provisions for avoidance of double taxation in case of such indirect transfer provisions, where direct transfer has already been subject to tax

The Finance Act, 2012 amended Section 9(1)(i) of the Act with retrospective effect from 1st April 1962 to provide that any share or interest in an entity incorporated outside India shall be deemed to be situated in India if such share or interest derives, directly or indirectly, its value substantially from assets located in India.

The Finance Bill, 2017 proposes that the aforesaid deeming provisions shall not apply to an asset or capital asset mentioned in *Explanation 5* of section 9(1)(i), which is held by a non-resident by way of investment, directly or indirectly, in a Foreign Institutional Investor as referred to in clause (a) of the *Explanation* to section 115AD and registered as Category-I or Category-II foreign portfolio investor under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992.

The Finance Bill, 2017 proposes to exempt investors (direct / indirect) in category I (sovereign funds) and category II (broad-based funds) FPIs from the application of indirect transfer tax provisions.

Suggestions:

It is suggested that:

a. *This exemption may be extended to Category III (other than broad-based) FPIs as well as private equity funds too.*

b. *Further, while it is a welcome amendment for FPIs registered as Category -I or Category -II, in many other situations the indirect transfer provisions may lead to double taxation – first when the investments in India are* *sold by the offshore company or entity (by way of direct transfer) and second when such offshore company or entity passes on the consideration arising from such disposal to its investors either by way of redemption, buy-back, re-purchase, etc.*

Therefore, a suitable amendment should be brought in to the effect that once a transfer is taxable in India, the same shall not be taxed again pursuant to applicability of indirect transfer provisions.

29. Clauses 39 and 40 – Sections 90 & 90A – Clarification with regard to interpretation of 'terms' used in tax treaties under Section 90/90A but not defined in such treaties - Concern to be addressed

Under the existing provisions of Section 90 of the Act, power has been conferred upon the Central Government to enter into a tax treaty with the Government of any country outside India for granting relief in respect of income on which income-tax has been paid both under the said Act and Income-tax Act in that foreign country, avoidance of double taxation of income, exchange of information for the prevention of evasion or avoidance of income-tax or recovery of income-tax. Similar provisions are provided in section 90A of the Act in the case of a treaty entered into by any specified association in India with any specified association in the specified territory outside India.

It is further provided in section 90 and 90A of the Act that any 'term' used but not defined in this Act or in the tax treaty referred to in sub-section (1) of respective sections shall have the meaning assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf, unless the context otherwise requires, provided the same is not inconsistent with the provisions of this Act or the agreement.

The Finance Bill 2017 proposes to amend sections 90 and 90A of the Act, to provide that where any 'term' used in an agreement entered into under sub-section (1) of Section 90 and 90A of the Act, is defined under the said agreement, the said term shall be assigned the meaning as provided in the said agreement and where the term is not defined in the agreement, but is defined in the Act, it shall be assigned the meaning as per definition in the Act or any explanation issued by the Central Government.

A tax treaty is a bilateral agreement entered between two countries based on mutual negotiations by executives of respective countries. As per Article 31 of the Vienna Convention, a treaty shall be interpreted in good faith in accordance with the ordinary meaning given to the terms of the treaty in their context and in the light of its object and purpose.

In view of above, the Government cannot unilaterally introduce an amendment in the Act which would override a bilateral tax treaty. In several cases[1], the courts have also held the same.

Article 3(2) of the Indian tax treaties provides that if any term which has not been defined under the tax treaty, unless the context otherwise requires, the meaning defined under the Act shall apply. Therefore, the tax treaties already provide a mechanism in such a situation.

Suggestion:

> *It may therefore be suggested to withdraw the proposed amendments to Section 90 and 90A of the Act.*
> *Without prejudice to the above suggestion, the proposed amendment should be restricted to the terms defined under the Act and should not apply to 'Explanation to be issued by the Government'. In other words, reference to the 'Explanation to be issued by the Government' should be removed.*

30. Clause 42- Section 92CE- Introduction of secondary adjustment

The Finance Bill, 2017 has introduced the concept of secondary adjustment on Transfer Pricing (TP) adjustments. A taxpayer is required to make a secondary adjustment, where the primary adjustment to transfer price has been made in the following situations:-

[1]CIT v. Aktiongesellschaft Siemens [2009] 310 ITR 320 (Bom); Sanofi Pasteur Holding SA v Department of Revenue Minstry of Finance [2013] 30 taxmann.com 222 (AP), DIT v. Shin Satellite Public Co Ltd (Del) [ITA 500/2012]

- Suo moto by the taxpayer in the return of income;
- By the AO during assessment proceedings, and has been accepted by the taxpayer;
- Adjustment determined by an Advance Pricing Agreement (APA) entered into by the taxpayer;
- Adjustment made as per the safe harbour rules under section 92CB; or
- Adjustment arising as a result of resolution of an assessment by way of the mutual agreement procedure (MAP) under an agreement entered into under section 90 or section 90A for avoidance of double taxation.

Further, the proposed section 92CE(3)(v) defines 'Secondary adjustment' as an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price ***determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual p***rofit of the assessee.

The additional amount receivable from the AE as a result of the primary adjustment should be repatriated by the taxpayer into India within a prescribed time limit. If the same is not received by the taxpayer within the time-limit, then the primary adjustment will be deemed as an advance extended to the overseas AE and a secondary adjustment in the form of notional interest on the outstanding amount should also be offered to tax as an income of the taxpayer.

The above requirements for repatriating the adjustment amount into India and imputing a notional interest are triggered if the TP or primary adjustment exceeds rupees one crore. The manner of computation of interest on the amount deemed as advance made by the taxpayer to the AE would be prescribed.

The situation of excess payment treated as loan given to AE on which notional interest in computed and added to the income of the assessee till the excess amount is repatriated by AE.

It would be difficult for AE to repatriate the money to India on account of secondary adjustment as the income-tax laws and any other relevant laws pertaining to such country may not allow to repatriate money. Further the AE would have paid tax on such amount in its home country. This would lead to double taxation. This would lead to double taxation.

Further, the same cannot be treated as advance in the books of account maintained in India as the books of account are prepared as per the provisions of Companies Act, 2013 read with Indian Accounting Standards.

- Sub-section (1) of the proposed section 92CE provides for secondary adjustments to be made in respect of primary adjustments in certain situations. The phrase "secondary adjustment" has been defined in Clause (v) of Sub-section (3) to mean an adjustment in the books of account of the assesse and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price as determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee. Sub-section (2) lays down the requirement for excess monies to be repatriated to India and for interest to be levied thereon, if not repatriated within the prescribed time. However, Sub-section (2) does not refer to 'secondary adjustment' as envisaged under Sub-section (1) and defined in Clause (v) of Sub-section (3). The absence of references to Sub-section (1) and/or 'secondary adjustment' in Sub-section (2) results in an apparent disconnect between Sub-sections (1) and (2) which may have unintended consequences.

Suggestion

Sub-sections (1), (2) and (3) need to be revisited to streamline and appropriately link up the three sub-sections to provide adequate clarity as to the specific requirements from the taxpayers on this front.

- The section is unclear as to whether the interest levy is a one-time levy or will apply on a year to year basis until the amount related to the "primary adjustment" is brought into India. Further, in case any interest imputed is not paid in the year of imputation, it is unclear whether or not it will itself take the colour of a “primary adjustment” and interest will be levied on such unpaid interest of last year (treating it as an advance). This will lead to a cascading effect and unnecessary burden on the assessee.

Suggestion

The computation mechanism for levy of interest under Sub Section (2) should be clearly prescribed with detailed examples to obviate uncertainty including the trigger for such secondary adjustment or interest levy and the start date for levy of interest. Appropriate safeguards by way of clarificatory provisions / Rules should be brought in to obviate an interest on interest situation and cascading effect.

- In the case of Bilateral APAs or MAPs (relating to transfer pricing, the two Competent Authorities may agree on the amounts to be brought into India and may also agree on the cash remission schedule for the taxpayer. In absence of the requisite cash brought into the recipient country, the double tax relief may not be granted by the recipient country as per the Bilateral APA / MAP. Hence, including Bilateral APAs and MAPs under the provisions of the above section may not be appropriate since the terms of bringing money into India would already have been decided by the two countries and such terms should prevail over a domestic law.

Suggestion

It is suggested that Bilateral APAs and MAPs may be excluded from the purview of section 92CE.

- In respect of Unilateral APAs that have been entered till date, there was no provision relating to secondary adjustments in the statute. As a result, APAs have been concluded wherein terms that are not consistent with the proposed Section 92CE have been imposed on taxpayers. In view of a specific provision having been introduced, taxpayers should be entitled to follow the mandate of Section 92CE in respect of APAs signed till date.

Suggestion

A specific clarification should be issued under the APA Rules as well as in Section 92CE that the consequences for a delay in bringing money into India pursuant to a unilateral APA would be only under Section 92CE(2) and the APA would not be disqualified merely on this account.

- For better clarity and in order to avoid any confusion regarding the assessment year from which the secondary adjustment provisions would be applicable, it may be clarified that the section will be applicable from AY 2018-19, in relation to primary adjustments for fiscal years 2016-17 and thereafter.

Suggestion

The Government may issue a clarification that section 92CE will be applicable from A.Y.2018-19, in relation to primary adjustments for fiscal years 2016-17 and thereafter.

- Clause (ii) to sub-section (1) of the proposed section 92CE provides that a taxpayer is required to make a secondary adjustment where primary adjustment to transfer price has been made by the AO during assessment proceedings, and has been accepted by the taxpayer. There is lack of clarity on what exactly the term 'has been accepted by the taxpayer' means.

Suggestion

Government should clarify the term 'has been accepted by the taxpayer' in order to provide certainty on the applicability of these provisions in such situations. For e.g. if the taxpayer is in appeal against the assessment order to Tribunal, in such cases, will secondary adjustment provisions be applicable only after the Tribunal proceedings are completed or the same will be applicable after Court proceedings are completed i.e. if the taxpayer further appeals to High Court/ Supreme Court.

- Since a secondary adjustment is already an additional burden on a taxpayer, a high interest rate will exemplify that burden and put pressure on business of the assessee.

Suggestion

> *Considering the secondary and additional nature of the adjustment, a reasonable rate of interest may be notified.*

- Since adjustments are made subsequently when returns are taken up for scrutiny, any requirement to make secondary adjustment would depend upon whether the Associated Enterprise is willing to accept the secondary adjustments to be made in its books abroad. Non-acceptance of the same will lead to inter-company issues during consolidation. It could also require restatement of financial statements of an Indian entity if adjustments are material. This in turn might lead to filing of revised returns. Implication on shareholders value and lenders agreement (where there are borrowings) would need to be evaluated besides implications under the Companies Act, 2013. Further, FEMA requires money to be remitted within 6 months from the end of the accounting year. Also, if the Associated Enterprise (AE) located abroad does not pass entries in the books, inter-company adjustments/eliminations could be a challenge if the AE is a holding company.

Suggestion:

> *The said issues may be considered and appropriate remedial measures may be incorporated to avoid genuine hardship.*

- The proviso to the proposed section 92CE(1) states that nothing contained in this section shall apply, if;-

  (i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; and
  (ii) the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016.

From a bare reading of the proposed amendment, it appears that both conditions i.e. primary adjustment made before 1.4.2016 and it being less than 1 crore need to be complied, because the word "AND" is written between two conditions. It ought to be "OR". Else, in future years, there will be no threshold limit for secondary adjustment.

Suggestion:

It is suggested that the proviso may be restated as under:

(i) *the amount of primary adjustment made in any previous year does not exceed one crore rupees; ~~and~~* ***OR***

(ii) *the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016.*

- Applicability of section 92CE has to be restricted only to cases satisfying the base erosion test. The provisions, as presently worded, may give rise to an interpretation that even where the primary adjustment is made in the hands of non-resident, secondary adjustment follows. As a consequence, it may be interpreted as allowing repatriation of funds outside India, which may not be permitted even in terms of FEMA/ RBI regulations.

Suggestion

In order to remove this anomaly it is recommended that section 92CE(2) be amended to clarify that the section applies only in case where the primary adjustment is made in the hands of the Indian AE.

- Section 92CE provides for secondary adjustment in case where excess money (difference between transaction price and arm's length price), which remains outside India, due to the primary adjustment under TP is not repatriated to India.

  Taxable funds may remain outside India only in case where a foreign party is involved. In other words, there may be possible base erosion only in case where one of the parties to the transaction is foreign AE. A transaction between two domestic entities, will not lead to profits allocable to India, remaining outside India.

Suggestion

In order to avoid any unwarranted litigation, it may be clarified that section 92CE applies only to international transaction and not domestic transactions as covered under section 92BA.

- Section 92CE deems the difference between the transaction price and arm's length price as an advance (which is to be recorded in the books) and provides for imputation of interest on such advances.

  However, there is no specific provision to reverse the advances appearing in the books even in case where the AE relationship ceases to exist or in case where the excess money is repatriated.

Suggestion:

It may be specifically provided that the advances appearing in the books of the parties be reversed in following cases where AE relationship ceases to exist or excess money is repatriated.

31. *Clause* 43- Section 94B- Limitation of interest benefit provisions introduced – certain concerns to be addressed

The Finance Bill, 2017 proposes limitation of interest benefit (deduction) where an Indian company, or a permanent establishment of a foreign company in India, being the borrower, pays interest exceeding rupees one crore in respect of any debt issued/guaranteed (implicitly or explicitly) by a non-resident AE. The interest shall not be deductible in computing income chargeable under the head 'Profits and gains of business or profession' to the extent, it qualifies as excess interest.

Excess interest shall mean total interest paid/payable by the taxpayer in excess of thirty per cent of cash profits or earnings before interest, taxes, depreciation and amortisation (EBITDA) or interest paid or payable to AEs for that previous year, whichever is less.

There will be restriction on the deductibility of the interest in the hands of the taxpayer in a particular financial year to the extent it is excess as explained above. However, the same shall be allowed to be carried forward for a period of eight years and allowed as deduction in subsequent years. The above restrictions shall not be applicable to the taxpayer engaged in the business of banking or insurance. These provisions will be applicable for FY 2017-18 and subsequent years.

a. India is a developing country with a need for foreign investment to fund various initiatives, in particular, the development of India's infrastructure. The Government has given its support at a policy level, inter-alia, consistently reducing tax withholding rates on ECBs by Indian entities from non-residents, which indicates encouragement by the Government towards debt obtained by Indian entities by overseas parties. However, the restrictions imposed under the proposed Section 94B above in respect of interest of overseas loans is giving mixed signals to foreign as well as Indian parties at a policy level on overseas borrowings. This inconsistency may lead to further policy level uncertainty in the minds of the business community in India and may undermine the attempts at enhancing the "ease of doing business" by the Government. Under existing ECB guidelines, there is already a mechanism in place to limit the Borrower's Debt/Equity ratio, which effectively safeguards India's interests with regard to excessive debt. As such, there is no need for any additional measure to protect India's interests in this regard.

Suggestion:

In view of the above policy level issues, it is suggested that the restrictions proposed to be imposed on the interest benefits on overseas borrowings may be done away with entirely or at least deferred for 5-10 years to give India a chance to achieve high growth and achieve significant infrastructural development and maturity.

b. Without prejudice to the aforesaid, if at all it is considered necessary to have provisions to limit the deductibility of interest, the exclusions granted to banking and insurance companies may be extended to other sectors such as Infrastructure and Non-

Banking Finance Companies. Large capital intensive companies with long gestation periods, Non-Banking Finance Companies, companies in the real estate sector and companies in the infrastructure sector (requiring significant foreign capital which may not always come in the form of equity) are typically highly leveraged on account of the business requirements (either by way of external or related party debt) and might be negatively impacted by the interest restriction.

Suggestion:

It is recommended to carve out exceptions for inherently highly leveraged industries from the aforesaid restrictions. The Government may also consider allowing carry forward of excess interest for a longer period, say 15 years, instead of the prescribed 8 years to cushion the long gestation periods for such industries.

c. The proviso to sub-section (1) provides that where debt is issued by a non-associated lender but an AE either provides implicit or explicit guarantee to such lender, such debt shall be deemed to have been issued by an AE.

In respect of explicit guarantees, the transaction relating to associated enterprises is only towards a guarantee commission (in case charged by the overseas guarantor). The interest towards the borrowing is paid in this case only to a third party wherein the rate and terms are decided purely through negotiation. Hence, *restriction of benefit in relation to guarantees ought to be only to the extent of the guarantee commission (if any) claimed as a deduction by the Indian entity and not interest paid to the third party len*der.

Further, including implicit guarantees under the above restrictions would lead to significant hardship for the taxpayers and may result in protracted litigation in the coming years. It is pertinent to note that there is no clear definition of implicit guarantee and it would be an onerous task for the taxpayers and tax authorities to determine existence of an implicit guarantee. E.g. when a letter of comfort or simply an undertaking is provided by one AE to a lender or a bank, the tax authorities may contest that guarantee exists, without going into details whether the same has benefited the borrower and whether the AE has actually rendered any service or assumed any liability.

Suggestion:

The proposed section should be amended to specify limitation of benefits in guarantee cases only to the extent of the guarantee commission (if any) paid by the Indian entity to the overseas guarantor (being its AE) and not the interest. Further, the word implicit guarantee may be dropped from the provisions. The term 'explicit guarantee' may also be appropriately defined to obviate future litigation on this front.

d. Based on the definition of the term 'debt' as provided in clause (ii) of sub-section (5) of proposed section 94B, interest may include many other payments made on various kinds of financial arrangements and instruments. There may be an issue as to what payments made by the taxpayer needs to be included in the term interest e.g. which payments on account of finance lease and financial derivatives should be included in the term 'interest or similar consideration' etc. which may again lead to litigation.

Suggestion:

Appropriate guidelines may be issued to clarify what the term 'interest or similar consideration' should include or exclude as the definition provided in the existing Section 2(28A) of the Act may not be adequate for the purposes of thin-capitalisation rules based on the definition of the term 'debt'.

e. There is lack of clarity on the mechanism to calculate EBITDA i.e. say, on the basis of book profits calculated on the basis of accounting standards, Ind-AS or otherwise. This may result in unnecessary litigation.

Suggestion:

It is suggested that the mechanism to calculate EBITDA be clearly laid down.

f. The BEPS Action Plan 4 provides for a Group Ratio Rule wherein the Group's overall third party interest as a proportion of the Group's EBITDA is computed and that ratio is applied to the individual company's EBITDA to determine the interest restriction.

This would take into account the actual third party debt and leverage at global level vis-à-vis third parties. This also addresses the issue relating to inherently highly leveraged industries since the global leverage ratio would take into account the significant debt and would be commensurate to the leverage ratio required at individual country level. Given this, a relatively fair leverage requirement at India level would emerge.

Suggestion:

It is suggested in place of a fixed 30 per cent EBITDA restriction, a Group Ratio could be considered in order to apply the interest deduction restriction under the above provision.

g. Sub-section (1) of Section 94B specifically requires the lending to be from a non-resident AE for the section to trigger. However, branches or permanent establishments of foreign banks are also “non-residents” for the purposes of the Income-tax Act. Whilst branches or permanent establishments of foreign banks operate essentially as Indian companies and compete directly with Indian banks, debt by related Indian branches of banks or guarantees given by AEs towards borrowings by Indian companies from branches or permanent establishments of foreign banks would qualify for disallowance under the above provision. This places the Indian branches of foreign banks at a disadvantageous position vis-à-vis competing Indian banks.

Suggestion:

It is suggested that borrowings by Indian companies from Indian branches or permanent establishments of foreign banks may be wholly excluded from the purview of the aforesaid proposed Sec 94B (either by way of direct borrowing from or by way of guarantee by AE to such branches or permanent establishments of foreign banks).