# Budget 2010

## *Balanced despite constraints*

*The Finance Minister has presented a 'balanced' budget with a goodie bag for individuals with beneficial slab rates.*

In the backdrop of the global slowdown in 2009 and various expectations of multiple stakeholders regarding fiscal stimulus measures, , the Finance Minister has presented a 'balanced' budget for 2010-11 with a goodie bag for individuals with beneficial slab rates.

This benefit will also be available to expats paying taxes in India.

## Corporate tax

On the corporate front, there would be a saving in income-tax, due to decrease in the surcharge from 10 per cent to 7.5 per cent.

This reduction in surcharge would also marginally trim the dividend distribution tax rate from 16.995 per cent to 16.609 per cent.

Consequently, more profits will be available for distribution by Indian companies to their foreign parent. However, companies falling under Minimum Alternative Tax (MAT) would suffer due to hike in the MAT rate from 15 per cent to 18 per cent.

In the context of source-based taxation of income of non-residents on account of interest, royalty and fees for technical services, it has been reiterated that the such income shall be taxable in India irrespective of the fact that the non-resident has a residence or place of business or business connection in India; or whether the non-resident has rendered services in India.

This amendment has been proposed to overcome certain judicial rulings that have held that in order for such income to be taxable in India, there must be sufficient territorial nexus with India and the services must be rendered and utilised in India.

To encourage the corporate sector to invest in research and development, weighted deduction on expenditure incurred on in-house research and development has been increased form 150 per cent to 200 per cent.

This is likely to be an incentive for foreign MNCs to consider setting up in-house research and development facility in India.

## Transfer pricing

Transfer pricing in India has been high on the agenda of tax authorities as well as of the multinational corporations.

Even the Finance Minister, while inaugurating an international seminar on transfer pricing a few days back, had underlined and accentuated the importance of transfer pricing.

Owing to the administrative difficulties faced by the multinational corporations while undergoing transfer pricing audits, they had expressed their concerns regarding shortcomings in the current transfer pricing regime and were expecting certain corrective/ explanatory measures in this regard.

Also, it was widely expected that there would be some announcement relating to the operational part of the safe-harbour norms, which were already introduced in the previous Budget.

However, the Budget has failed to provide any guidance/respite as far as transfer pricing is concerned.

# Budget 2010

## *Taxation of non-residents' services*

*Budget 2010 states income in the nature of interest, royalty or technical services would be taxable in India under the main provision.*

S. P. SINGH, SENIOR DIRECTOR, DELOITTE HASKINS & SELLS.

S. P. Singh

In 1976 an amendment was made to clarify that dividend, interest, royalty and fees for technical services would be liable to taxation on source basis. In other words, it was desired by the Government that these types of income would be liable to taxation in India on the basis of payer irrespective of the place where the services were rendered or utilised. Of course, certain exceptions were built in.

### Territorial nexus

This concept was challenged in the Supreme Court in the Ishikawajima-Harima Heavy Industries Ltd case.

Here the court held that despite the deeming fiction in Section 9, for any such income to be taxable in India, there must be sufficient territorial nexus between such income and the territory of India and for establishing such territorial nexus, the services have to be rendered in India as well as utilised in India.

The Government felt that this interpretation was not in accordance with the legislative intent that the aforementioned types of income were taxable in India based on extended source principle. So far as services are concerned it was felt that these would be taxable in the hands of non-residents even if those are rendered outside India.

Accordingly, to remove doubts regarding the source rule, an Explanation was inserted in 2007 in the Section 9 to clarify that interest, royalty and fees for technical services of the non-resident would be taxable under Section 9, regardless of whether the non-resident has a residence or place of business or business connection in India.

However, this insertion failed to the serve the purpose. Recently, the Karnataka High Court, in the Jindal Thermal Power Company Ltd case, held that on a plain reading of the Explanation to Section 9, the criteria of rendering services in India and the utilisation of the service in India laid in the Ishikawajima-Harima case (supra) remains untouched and unaffected by this Explanation.

### Position clarified

Now, Budget 2010 proposes to clarify the position in more unambiguous manner by substituting the explanation to Section 9 inserted by the Finance Act 2007 by another Explanation.

It states clearly that even if services are rendered outside India or even if the non-resident does not have a residence or place of business or business connection in India, the income in the nature of interest, royalty or technical services would be taxable in India under the main provision.

Obviously, this position is in line with the one taken by India in the Organisation of Economic Cooperation and Development (OECD) and before various courts and also in many tax treaties that India has. However, this differs from the position taken by many countries and notably by the OECD.

Internationally, technical services are taxed in the hands of non-resident as business income and only if the services are rendered in the country or if there is permanent establishment. The approach is almost similar for royalty.

It will be interesting to see how the courts react to the amended provisions.

# Budget 2010

## *Harsh on realty*

*Apart from the 1 per cent interest rate subvention on housing loans, the Budget has no other incentives for the affordable housing sector.*

MAHESH JAISING, PARTNER, BMR ADVISORS.

In recent years, this is probably the only Budget that has impacted the real estate sector in such a big way. The proposals seek to mop-up significant amounts by way of taxes and duties from the real estate sector, be it residential or commercial projects.

While the Budget proposes to continue the 1 per cent interest rate subvention on housing loans granted for purchase of low-cost houses, it has no other incentive/policy announcements for the affordable housing sector.

### Service tax

In a move that would affect the affordable housing in particular and the residential real-estate sector in general, the Budget seeks to levy service tax on all transactions between the developers/builders and the buyers, irrespective of the method of contracting, unless the entire consideration for the property is paid after the completion of construction (that is, after issuance of completion certificate by the competent authority), by deeming such activities as taxable services.

This proposal has come as a surprise, as the Government had in January 2009 issued a Circular clarifying that no service tax is payable on the arrangements between the developer/builder and buyer.

For the industry which is faced with intense competition and challenge of declining affordability/reluctancy on the part of the end-users to spend high, the incremental tax costs could result in pricing pressures and could witness declining margins, especially where the builders/developers are not in a position to pass on the tax burden onto the end-customers.

### Commercial real estate

On the commercial real estate front, the Budget seeks to put to rest the debate on applicability of service tax on lease rentals.

In an effort to counter the Delhi High Court ruling in the Home Solution Retail India case, which strikes down the levy of service tax on commercial rentals holding that only services in relation to renting is taxable and renting per se is not taxed, the Budget proposes to treat the activity of ‘renting' itself as a taxable service, with retrospective effect from June 1, 2007.

This retrospective amendment is bound to create hardship to the developer community who have sought to take shelter under the Delhi High Court ruling and have not collected service tax from the tenants.

The other significant proposal in the Budget is that the land leases are now brought under the purview of service tax.

This could potentially be an important factor in business decisions of long-term leases versus outright purchases. Whether the levy would also cover pre-existing land leases is something for the legal pundits to decide and could be a potential litigation issue, unless the Government comes up with a clarification.

# Budget 2010

## *Budget 2010: Gainers all?*

*Some innovative steps such as adjusting the tax slabs to inflation could have been taken.*

Those in the lowest tax bracket could have got a better deal.

T. C. A. Ramanujam

The latest Budget has pleased both the middle and upper middle classes immensely. The upward revision of tax slabs has meant that a large body of taxpayers with incomes above Rs 3 lakh will gain substantially. In real terms it has been estimated, the tax savings can be over Rs 50,000. The slabs and rates proposed are welcome though they fall short of the proposal contained in the Direct Taxes Code (DTC) expected to be implemented next year.

## A disappointment

However, a sense of disappointment prevails among those who fall in the tax bracket Rs 1,60,000 to Rs 3,00,000. They will continue to pay tax at 10 per cent. No relief has been provided to them. Their number of such taxpayers exceeds one crore. Moreover, these small taxpayers feel the pinch of rising inflation more. In addition, the across the board levy of 2 per cent excise duty on all commodities will hit them further.

The real income of these taxpayers will go down. Some innovative steps could have been taken to adjust the slabs to inflation. The cost inflation index has been in operation since the 1992 Budget presented by Dr Manmohan Singh. But it applies only for computing capital gains tax and arriving at the cost of asset.

## Corporate Tax Rates

The Finance Minister has reduced the surcharge for domestic companies from 10 per cent to 7.5 per cent. The tax rate however remains the same. The new effective tax rate for companies will be 33.22 per cent, down from 33.99 per cent hitherto. The reduction in surcharge also applies to dividend distribution tax. There will be a small fall in the rate of DDT from 16.995 per cent to 16.609 per cent.

The Minimum Alternative Tax has been raised from 15 per cent to 18 per cent, including surcharge and cess MAT will now stand at 19.931 per cent for domestic company and 19.004 per cent for foreign companies. The small differential in favour of foreign companies in the matter of levy of MAT continues in this Budget too. The new rate will take effect from April 1, 2010, and applies in relation to the assessment year 2011-12 and subsequent years. The rise in MAT will more than offset the small reduction in surcharge.

## Tax-GDP ratio

In 2008-09, direct tax receipts amounted to 6 per cent of GDP. The next financial year they stand at 6.3 per cent of GDP. The Government has declared its commitment to take forward the reform process initiated in the direct tax regime and realise higher tax-GDP ratio with moderate tax rate structure. The present slabs and rate structure are considered a prelude to the introduction of the DTC during 2010-11. In 2010-11, direct taxes are projected to represent 6.2 per cent of GDP and then to 6.6 per cent. With more GDP growth, the tax-GDP ratio and tax buoyancy will all go up.

## TDS

The Budget has enhanced the threshold limit for tax reduction at source. About a third of the Budget collections comes from TDS. The enhancement in the threshold was long overdue. The proposal to dispense with furnishing of TDS certificates has been given up. Even after April 1, 2010, TDS and TCS certificates will have to be furnished to the deductee and the collectee.

Delay in the deposit of TDS will attract interest at 18 per cent per annum hereafter as against 12 per cent per annum at present. Delayed deposit of TDS will not attract disallowance of the relevant expenditure if the tax is deposited before the filing of the return of income.

These changes will help the Government and the taxpayer. Compliance cost will go down. Paperwork and administrative cost will go down.

The Finance Minister has said that tax reform is a process and not an event. He has promised to continue the process of reforming direct taxes next year and the year after. He has also declared that the process of initiating the amendments to our double tax avoidance treaties with foreign entities will continue so as to bring back unaccounted money secreted in foreign destinations.

The Finance Minister has assured the taxpaying public that the tax administration will be computerised so as to reduce the physical interface with taxpayers and speed up procedures and processes. A single window system for registration for all applications for redressal of grievances will be provided. Hopefully, taxpayers can look for better times.

(The author is a former Chief Commissioner of Income-Tax)

# Budget 2010

## *Uncertain effect on savings, consumption*

*The introduction of a the flat tax could be utilised to do away with all exemptions other than the minimum required.*

The liberal relaxation in income-tax slabs would mean additional purchasing power for individual households.

### A. Seshan

In analysing the impact of the Budget for 2010-11 on the economy, one can adopt both micro and macro approaches. The former is related to the effect on individual households, firms, industries and sectors. The second deals with the total impact on the economy — on variables such as savings, investment and growth.

### MICRO IMPACT

Effect of inflation: As far as the individual households are concerned — those who drive the demand for goods and services as final consumers — the liberal relaxation in income-tax slabs would mean additional purchasing power for them, especially those in the middle class, in nominal terms. But with rising inflation (for which there is no immediate respite, as admitted by the Government), the impact of the relaxation of income tax slabs on real consumption is less than clear.

Trying out a flat tax: One wonders why the Finance Minister is not able to take one more step and usher in a flat tax with a common rate, abolishing the slab system. There is a common misconception that it is not progressive. This is true only in the marginal sense, but not in the average sense.

If the exemption limit is fixed at, say, Rs 2 lakh, and the flat rate is, say, 20 per cent, then a person with an income of Rs 3 lakh would pay a tax of Rs 20,000. Assessees with incomes of Rs 5 lakh, Rs 10 lakh and Rs 20 lakh would be liable to pay taxes of Rs 60,000, Rs 1,60,000 and Rs 3,60,000, respectively. The average income tax rate, that is, tax divided by total income, in the above four cases would be 6.66 per cent, 12 per cent, 16 per cent, and 18 per cent, respectively. Thus it is progressive with higher incomes being subjected to higher average rates of tax. For a taxpayer it is the average rate that is indicative of the tax burden.

In any case, it is rather naïve to talk about progressive taxation when the super-rich are exempt from wealth taxation of financial assets worth billions of dollars, and earn dividends and capital gains amounting to millions of rupees. One hopes when the Direct Tax Code is finalised, this idea of flat tax is revisited, ignoring the perfunctory work done by one or two committees in the past which examined the matter.

Industry and the stimulus: The partial continuance of the stimulus provided since the onset of the Lehman crisis should be welcome news for export-oriented firms. Stimulus to such sectors yields dividends, as has been demonstrated in the case of automobiles. However, the partial rollback of relief in excise duty is not likely to endear the Finance Minister to the corporate sector. It could have adverse price implications, especially the duty on petrol and diesel.

## MACRO IMPACT

Market distortion: Savings have been encouraged by allowing a tax deduction on infrastructure bonds, over and above the Section 80C limit of Rs 1 lakh. While this move is a boon to individuals, it would have no impact on the total amount saved at the macro level.

There is enough evidence to show that savings depend on income and not on interest rate or yield. The latter determines the channels in which savings flow. Is it not time that the authorities recognise this fundamental fact? The incentives for savings distort the relative attraction of various sources and the final pattern may not be optimal, especially when there are administered rates.

The introduction of a flat tax could be utilised to do away with all exemptions other than the minimum required. In fact, the exemption limit and the rate can be so fixed as to make it revenue-neutral.

Investment in agriculture: The proposed investment outlay is a gross figure. One should know the net position after accounting for depreciation.

Achieving higher growth would require increasing the rate of investment as a proportion of national income. And in a country where monsoon plays a vital role in deciding the final outcome of GDP, no amount of investment is going to help unless it is in areas that can counteract the adverse effects of the monsoon.

It would call for augmenting irrigation facilities, developing drought-resistant crops, dry farming techniques, developing high-yielding varieties of seeds for crops like pulses, etc., supported by a competent and well-staffed and equipped extension service.

The proposals for agriculture are not indicative of any new attempts to rejuvenate agriculture, but are on routine lines. After the Green Revolution of the late 1960s we have not seen any breakthrough in crop productivity.

The Mahatma Gandhi National Rural Employment Guarantee Programme has only contributed to demand inflation in respect of the basic necessities of life. There is no assessment of the augmentation on the supply side due to the programme. Whatever evidence is available from even official sources indicates massive leakages and diversion of funds by intermediaries in the system.

(The author is a former Officer-in-Charge of the Department of Economic Analysis and Policy of the Reserve Bank of India.)

# Budget 2010

## *Realty cries foul on service tax*

*Developers claim that the Budget proposals on taxing additional services will hike construction costs.*

The provisions in the Budget for 2010-11 levying service tax on renting of commercial property and on residential sales transactions during the project construction phase hold major implications for developers and end-users.

Developers have strongly objected to the service tax provisions which will hike costs at a time when the sellers and the buyers had been hoping for measures to keep costs down, they say.

Nishith Desai Associates, international legal and tax counselling service providers, point to the clarification in the Budget on the applicability of service tax to renting of immovable property for commercial or business purposes. This amendment has been proposed to take effect retrospectively from June 1, 2007.

### Commercial Property

This clarification overrules the principle laid down by the Delhi High Court in Home Solution Retail India Ltd. V Union of India (UOI) and Ors., wherein it held that the ‘act of renting property could not be treated as service'. Pursuant to this judgment, renting of immovable property was considered to be out of the purview of service tax.

As the amendment takes effect from an earlier date, the occupants may now face interest levy or penalty. This will have a significant impact on a wide variety of sectors.

In addition, the Budget also seeks to impose service tax by expanding the scope of the term ‘renting'. This term will now include renting of vacant land where there is an agreement between the lessor and lessee for undertaking the construction of buildings for furtherance of business. This will impact the real estate sector, where such agreements are a common phenomenon.

## Healthcare

The Budget also proposes service tax on hospitals, nursing homes and multi-specialty clinics in relation to health check-ups or preventive care services rendered to employees of business entities. It has to be noted that service tax is applicable to such services irrespective of whether the payments are made by the recipient of such service or by an insurance company directly, according to Nishith Desai Associates.

## Residential units

According to developers, the Budget also clarifies that sales of residential property during the construction phase will attract service tax on the construction cost. Developers have expressed dismay over this move which they had thought had been resolved last year when the Central Board of Excise and Customs (CBEC) had clarified that it does not attract service tax.

In the clarification dated January 29, 2009, in the context of service tax of 12 per cent levied with effect from June 1, 2005, on construction of residential complex, the CBEC had said that the initial agreement between the developers and the ultimate owner is in the nature of ‘agreement to sell.' This, as per the provisions of the Transfer of Property Act, does not by itself create any interest in or charge on such property. The property remains under the ownership of the seller — the promoters, builders or developers.

It is only after the completion of the construction and full payment of the agreed sum that a sale deed is executed and the property gets transferred to the ultimate owner — the buyer of the residential unit. Therefore, till the execution of such a sale deed, any service provided by the seller in connection with the construction of residential complex would not attract service tax.

Mr K. Vaitheeswaran, an advocate and tax consultant, says the Finance Bill 2010 has introduced an amendment in the form explanation to the definition of taxable service of construction of complex services. The word ‘service' has been omitted from the definition and it says construction intended for sale by the builder before or during or after construction shall be deemed to be a service provided by the builder to the buyer. The concept of self-service has been legislatively nullified.

Service tax will not apply only if the buyer makes the entire payment for the property after the completion of the construction, including getting certification by the local authorities.

Typically, according to developers, this will mean an additional Rs 150-200 to the cost of a square feet of built-up space priced around Rs 3,000.

# Budget 2010

## *Finance Bill 2010: Hidden caves*

### Aseem Chawla

In the UPA Government's second Budget, the Finance Minister has continued the consistent trend by using the Budget as an alibi to overrule numerous landmark judicial precedents.

Leading the pack was the substitution of Explanation in section 9(1) which proposes to enlarge the scope of deeming provision of accrual of income of a non-resident tax payer in India, even if no services were rendered by such non-resident in India.

Through this one stroke, it has proposed to overrule the judgments in the case of Ishikawajima-Harima Heavy Industries Ltd. (288 ITR 408), Clifford Chance and Jindal Thermal Power Company Ltd, etc.

On one hand, it has been suggested that charitable organisations do have the ability of earning commercial income to the extent of Rs 10 lakh without compromising tax exemption, whilst on the other hand silently overruled another Supreme Court judgment rendered in the case of Surat City Gymkhana (300 ITR 214) wherein it was held that registration granted under Section 12A is a “fait accompli” and cannot be cancelled by the Commissioner under section 12A. This has now been proposed to be overruled by way of amending Section 12AA of the Act.

### Dana Corporation case

Recently, the Authority for Advance Ruling, notably, in the case of Dana Corporation (227 CTR 441) had held that if the shares of a private limited company are transferred without any consideration then no incidence of capital gains would arise.

Irrespective of the extant transfer provision, section 56 of the Act is proposed to be amended to contain such transfers and impute a fair market value of such shares to be the income in the hands of shareholders.

Besides this, in a run up to introduce the Direct Tax Code, the Finance Minister has proposed to increase the existing rate under section 115JB of the Act from 15 per cent to 18 per cent.

Recently, the Allahabad, Bombay and few other High Courts have dismissed various appeals preferred by the Revenue on the ground that these appeals were not filed within stipulated time period.

The Government has now proposed to amend section 260A to overcome the said obstacle and grant Courts to condone the delay in filing the appeal.

So, on the one hand Government is strengthening its information technology initiative to minimise the interface between the tax authorities and the tax payer, on the other hand it is finding it difficult to adhere to the procedure of allocating a Unique Document Identification Number to each of the notice, order or any other correspondence issued by any tax authority and hence extending the date of implementation to July 1, 2011.

As always the Budget Speech refers to the ‘divine' efforts being undertaken by the Government and does not whisper about the devil contained in the fine prints of the Finance Bill.

It can be at best termed as a mental exercise quietly left for the tax practitioners to mull over and analyse.

These amendments not only have far reaching impact but also yield uncertainty if not opportunities.

(The author is Partner, Amarchand Mangaldas, New Delhi.)

# Budget 2010

## *I-T relaxation to boost demand for retail loans*

*“The change in the income slabs for tax deduction will result in savings for a large section of people.”*

Welcoming the reduction in the income-tax slabs, bankers say the move will help salaried tax individuals and boost consumption

Demand for retail loans such as housing loans and personal loans is already on the rise and it will increase as sentiments will be positive due to higher disposable incomes, said Mr Neeraj Swaroop, Regional CEO, India and South Asia, Standard Chartered Bank. The recalibration in tax slabs will reduce the tax burden on personal taxes, thus, increasing disposable incomes, which in turn will help deposit mobilisation efforts of banks, said Mr O.P. Bhatt, Chairman, State Bank of India.

According to Mr M.D. Mallya, Chairman and Managing Director, Bank of Baroda, the change in the income slabs for tax deduction will result in savings to a large section of people.

Ms Chanda Kochhar, Managing Director and CEO, ICICI Bank, also said that the reduction in tax slabs for income taxes is expected to result in greater disposable incomes leading to greater consumer spending and demand. However, the Budget may not help contain inflation in the short-term and it will be left to the Reserve Bank of India to manage, Mr Swaroop pointed out.

“There is upward pressure on interest rates, but liquidity is excessive. So we have to watch the Reserve Bank of India's policy," he pointed out.

# Budget 2010

## *On taxes and being taxed*

**How the new tax slabs stack up**

| Present | | | | | Proposed | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Income (in lakhs) | Slabs | Tax | Cess | Total tax | Income (in lakhs) | Slabs | Tax | Cess | Total tax | Savings |
| 1.6 | Nil | | | | 1.6 | Nil | | | | |
| 1.6-3.0 | 10% | 14000 | 420 | 14420 | 1.6-5.0 | 10% | 34000 | 1020 | 35020 | |
| 3.0-5.0 | 20% | 40000 | 1200 | 41200 | 5.0-8.0 | 20% | 60000 | 1800 | 61800 | |
| 5.0-8.0 | 30% | 90000 | 2700 | 92700 | | | | | | |
| | | | | 148320 | | | | | 96820 | 51500 |

S. Murlidharan

The stock market is rejoicing in relief. It has got a breather; long-term capital gains from the bourses would continue to be immune to taxation while the gains of the short-term variety would be pampered as hitherto with a soft 15 per cent tax. But the salaried class too is rejoicing what with an employee earning Rs 5 lakh getting to pay Rs 20,000 less a year in taxes thanks to the liberal hiking of the first slab rate of 10 per cent from Rs 3 lakh to Rs 5 lakh, even though the basic exemption limits remain unchanged. Thus a working woman would continue to enjoy tax immunity on her income up to Rs 1.90 lakh whereas her male counterpart would continue to do so on his income up to Rs 1.60 lakh. Assuming both earn Rs 5 lakh, both would get a relief of Rs 20,000 - income from Rs 3 lakh to Rs 5 lakh suffering a 10 per cent tax as against the extant 20 per cent tax.

The one earning Rs 10 lakh would get a hefty reduction in tax liability of Rs 50,000 thanks to the second slab rate of 20 per cent applying to income up to Rs 8 lakh as against the current level of Rs 5 lakh — income from Rs 5 lakh to Rs 8 lakh getting taxed at 20 per cent as against the present 30 per cent thus giving him/her relief under both the first and second slabs.

The restoration of import duty of 5 per cent on crude coupled with increase in excise duty on petrol and diesel would give a fillip to the inflationary forces given the cascading effect of increase in petroleum products which is bound to happen sooner than later. It is a trifle curious that the Government has chosen to enrich itself from the same products whose marketers are called upon to bear a huge subsidy bill. Smokers have been the favourite whipping boys of successive finance ministers. While no tears would be shed for them and the diehard smokers would take the duty hike in their stride, paan masala chewers too are in for some tough times with excise duty both on the product and the machinery. The cost of travel could also become expensive not only due to hike in excise duty on diesel and petrol but also due to increase the rate of excise duty on utility vehicles from the present 20 per cent to 22 per cent.

(The writer is a Delhi-based chartered accountant.)