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INDIA UNION BUDGET 2017 – 18

DETAILED ANALYSIS OF KEY TAX PROPOSALS

FOREWORD

With the excitement and buzz of the Budget day fading, the focus shifts to a slower, more detailed, and decidedly less glamorous task of reading the legislative fine print and analyzing its full impact. This publication is an outcome of such an exercise.

Like every year, this year's Finance Bill too contains several far-reaching proposals. Many of them will have a significant effect on several taxpayers- both positive and negative. Although we provide a summary of virtually all the legislative changes in the last chapter, this publication focuses in detail on a few specific proposals. We believe that these proposals will require the close attention and engagement of tax directors and CFOs in the days ahead.

Specifically, we discuss the provisions relating to Minimum Alternate Tax, transfer pricing, capital gains and the scope of the 'other income' provisions. Although not strictly a part of the legislative proposals this year, we also discuss key issues that can arise under the General Anti-Avoidance Rule (GAAR). This is slated to come into force on 1 April 2017, and has not been deferred in the Budget.

We hope that you will find this a useful companion to the Budget proposals. For a more detailed discussion on the budget proposals, please feel free to reach out to us directly. As always, I look forward to your comments, suggestions and feedback.

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Transfer Pricing: A move towards global best practices

The year end review for 2016 released by the Central Board of Direct Taxes (CBDT) in January 2017 was an indicator for the changes in transfer pricing law that one could have anticipated. The CBDT mentioned that for the purposes of implementation of the Base Erosion and Profit Shifting (BEPS) Action Plans at a local level, a committee of officers was to be constituted to examine all the 15 reports and chalk out a clear-cut roadmap for implementing the recommendations contained in the Action Plans. Further, the CBDT also indicated that the implementation of the BEPS Action Plans would be through amendments to the Income-tax Act, 1961(the Act) or through framing Rules and Guidelines thereon.

Amendments based on some action points in the BEPS Reports such as equalisation levy, country-by-country reporting, lower rate of taxation for income from patents had been introduced in the statute through the Finance Act 2016.

This year, another set of amendments have been included in the proposals contained in the Union Budget 2017. Two important proposals which would have far reaching implications are the ones relating to a secondary adjustment in respect of a primary Transfer Pricing (TP) adjustment and introduction of thin capitalisation rules.

Thin capitalisation rules i.e. limit on interest deduction in certain cases

Genesis

To illustrate, A Co being a tax resident in Jurisdiction A borrows an amount from B Co being a tax resident of Jurisdiction B. The corporate tax rate in Jurisdiction A is 35% and corporate tax rate in Jurisdiction B is 10%. A Co is obliged to make interest payments to B Co. Such interest payment is deductible in the hands of A Co. B Co shall pay tax at the rate of 10% on the interest income. Hence, the group saves 25% on the interest income. Thus, shifting profits and eroding the base in the form of reduction of tax base.

The BEPS Action Plan 4 (Limiting Base Erosion involving Interest Deductions and Other Financial Payments) issued by the OECD made some recommendations and discussed key parameters to combat tax base erosion and cross border shifting of profits through excessive interest payments. Some of the best practices that were recommended include-

- A minimum monetary threshold to carve out entities which have low level of interest expense;
- Fixed ratio rule – which allows an entity to deduct net interest expense up to a benchmark net interest over the EBITDA ratio with a range of 10-30%;
- Group ratio rule – which allows an entity to deduct net interest expense up to its group net interest over the EBITDA ratio; and
- Carry forward or carry back of disallowed interest or unused interest capacity.

Amendments proposed

In line with the above recommendations of the OECD Action Plan 4, the Union Budget 2017 proposes to insert a new section 94B in the Act. The section provides that where an Indian company, or a permanent establishment of a foreign company in India, being the borrower pays **interest or similar consideration** exceeding one crore rupees, which is deductible under the head Profits or gains from business or profession, such interest expenses claimed by the entity shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid or payable to associated enterprise, whichever is less.

Further, the debt shall be deemed to be treated as issued by an associated enterprise where the related party provides an implicit or explicit guarantee to the lender or deposits a corresponding and matching amount of funds with the lender.

Interest expenditure not allowed as deduction in a previous year due to the limit specified, can be carried forward for subsequent 8 assessment years. This new provision is not applicable to entities engaged in the business of Banking and Insurance business.

Understanding the fine print

It is pertinent to note that the term 'similar consideration' has not been defined. Hence, the expenses that would get covered under the provisions is not clear. Further, from a plain reading, any payment of interest or similar consideration which is deductible under the head Profits and gains of business or profession shall be included for determining the interest claim. Hence, the question that arises is whether interest paid on moneys borrowed for capital expenditure shall be included in determining the fixed ratio, given that capital expenditure is not a deductible business expense (except depreciation).

Further, the provisions include both implicit and explicit guarantee within its ambit. Such inclusion of the term "implicit guarantee" within the ambit of the deeming definition would unfairly burden genuine business transactions of a Taxpayer.

In a scenario where the Assessing Officer has made a TP adjustment with respect to interest payments made by an Indian Taxpayer to its Associated Enterprise, it would merit consideration whether a corresponding benefit would be provided while computing the limits prescribed under section 94B.

To address the concerns of Taxpayers the Government could provide clarifications to reduce complexities and facilitate ease of compliance and implementation of the proposals made by the Government.

Secondary adjustments

Genesis

The second and an equally important change relates to 'secondary adjustments'. The OECD report on Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations had recommended corresponding adjustments in respect of secondary adjustments. Currently, where a transaction is not undertaken at arm's length, a primary adjustment is made to the taxable profits of the taxpayer to align the transfer price with the arm's length price.

Amendments proposed

In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, it is proposed to insert a new section 92CE providing that where a primary adjustment to the transfer price (i) has been made suo motu by the Taxpayer in his return of income; or (ii) made by the Assessing Officer has been accepted by the Taxpayer; or (iii) is determined by an advance pricing agreement entered into by the Taxpayer under section 92CC; or (iv) is made as per the safe harbour rules framed under section 92CB (v); or is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or 90A, the Taxpayer and its Associated Enterprise shall make a secondary adjustment.

Internationally some countries like UK, South Africa, Korea, etc. permit their Tax Authorities to resort to secondary adjustment in transfer pricing and the same is provided in their domestic tax laws. "Secondary adjustment" refers to an adjustment in the books of account of the Taxpayer and its related party to reflect that the actual allocation of profits between the Taxpayer 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 profit of the Taxpayer. This, ensures that the actual allocation of profits is consistent with the primary adjustment.

Further, the section also states that where as a result of primary adjustment, there is an increase in the total income or reduction in the loss of the Taxpayer, the excess money which is available with its associated enterprise, if not repatriated within the prescribed time limit, shall be deemed to be an advance made by the Taxpayer and interest on such advance shall be computed in such manner as may be prescribed. These provisions shall take effect from assessment year 2018-19 and would apply where the amount of primary adjustment exceeds one crore.

To illustrate, say a transfer pricing adjustment of 5% has been made on a service transaction provided by A Co (tax resident in India) to B Co (tax resident in US). This 5% constitutes primary adjustment. However, this adjustment is only a tax adjustment and no adjustment is made in the books of accounts. Basis the secondary adjustment, this primary adjustment of 5% will now be considered as a separate transaction to be treated as a deemed loan and interest on this will have to be computed.

Understanding the fine print

It is pertinent to note that though the Indian Government has characterised the secondary adjustment as a deemed loan, the European Union in its final report on secondary adjustments has recommended characterisation of secondary adjustments as constructive dividends or constructive capital contributions rather than constructive loans.

One of the primary concerns is that application of secondary adjustments may lead to double taxation, in the absence of specific provisions in a tax treaty or agreed adjustments under a MAP. Hence, the issue that needs to be addressed is whether the Associated enterprise of the Taxpayer would get a deduction for this secondary adjustment or alternatively could avail a tax credit.

Given that the books of accounts would be closed by the time such an adjustment is determined, would it be practically possible to record such adjustments in books of accounts. Further, whether a unilateral move by the Indian Government to enforce recording of such transactions in the books of the Associated enterprise would be within its jurisdiction. Thus, the requirement to record the adjustment in the books of accounts is quite burdensome. Repatriation of cash from the Associated enterprise after the close of the financial year may practically be impossible.

Further, given that a Tax Payer would have multiple associated enterprises, the Tax payer would be required to make adjustments in multiple books of accounts and thus adding to the complexities rather than simplifying the process.

Amendment to section 92BA of the Act

Currently, the domestic TP provisions are applicable to the transactions between two domestic related parties even in situations where transactions between them are tax neutral from base erosion of Indian tax base. As a matter of compliance and reporting, taxpayers are required to obtain chartered accountants certificate in Form 3CEB providing the details such as list of related parties, nature and value of specified domestic transactions, method used to determine the arm's length price etc. In order to reduce the compliance burden of the taxpayers, it is now proposed to restrict the scope of domestic TP provisions only to the transactions between domestic related parties where one of the parties is eligible for claiming profit linked deduction.

The exclusion of transactions between two domestic related parties from the purview of the domestic TP provisions and introduction of secondary adjustment is definitively a welcome move from taxpayer's perspective. However, as expected by many of the taxpayers, the Finance Bill 2017 has not provided any clarification regarding threshold for preparation and filing of Master and Local File. Also, no clarity has been provided for implementation aspects of the Master File and the CBC reporting.

MAT in an Ind AS Regime

An overview of changes relating to MAT

Introduction of Ind AS

With a view to converge with International Financial Reporting Standards (IFRS), the Ministry of Corporate affairs on 16 February 2015, had notified the roadmap for adoption of Indian Accounting Standards (Ind AS). Ind AS is applicable to companies with a net worth of more than INR 5000 million from FY 2016-17. All other listed companies and other companies with Net Worth of more than INR 2500 million would be covered from FY 2017-18 onwards followed by banks and NBFCs.

Transition to Ind AS

On transition to Ind AS, companies have an option to reinstate values of assets and liabilities *inter alia* through recognition of assets and liabilities at Fair Value through one-time adjustments. These one-time adjustments are allowed to ease the transition and are made in 'Other Equity'. Some of these adjustment items would subsequently not be reclassified to the Statement of Profit and Loss.

Similarly, in subsequent periods, there will be certain adjustments recorded in Other Comprehensive Income (OCI) on fair valuation, and some of these adjustment items will not be reclassified to the Statement of Profit and Loss.

Broadly, under the Ind AS regime, the Statement of Profit and Loss will have the following components:

Particulars	Amount (INR)	Amount (INR)
Profit for the year	XX	XX
Other Comprehensive Income (OCI)	XX	XX
• Items that will be reclassified to Profit and Loss	XX	XX
• Items that will not be reclassified to Profit and Loss	XX	XX
Total Comprehensive Income	**XX**	**XX**

MAT impact on Ind AS transition

Transition to an Ind AS regime would have an impact on computation of Minimum Alternate Tax (MAT) liability under section 115JB of the Income-tax Act, 1961 (the Act). Accordingly, the Central Board of Direct Taxes (CBDT) constituted a Committee for suggesting the framework for computation of MAT for Ind AS compliant companies in the year of adoption and thereafter.

Basis the recommendations provided by the Committee, detailed provisions have been proposed under section 115JB of the Act to compute MAT in case of companies converging to Ind AS. The key provisions are discussed below:

Proposed amendments in Finance Bill, 2017

The amendments are largely in line with the recommendations made by the Committee. Since Ind-AS is required to be adopted by certain companies for FY 2016-17 mandatorily, these amendments will take effect from AY 2017-18 and subsequent years. The key principles to be followed for computing book profits are summarized below:

- Starting point for computation of 'book profit' to be Profit before OCI as per the Statement of Profit and Loss which shall be subject to upward and downward adjustments specified under the existing provisions of section 115JB of the Act;
- On demerger, in case of a resulting company, where the assets and liabilities of the undertaking are recorded at fair value, any change in such value shall be ignored for computing book profits;
- Items recorded in OCI in the first year of adoption and in the subsequent periods, which shall be reclassified to the Statement of Profit and Loss - to be included in book profits in the year in which reclassification is made;
- Items recorded in OCI in the first year of adoption and in the subsequent periods, which shall not be reclassified to the Statement of Profit and Loss are as per the table below.

Items of adjustment	Treatment proposed under Finance Bill, 2017	
	On first time adoption of Ind AS	In subsequent periods
Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realization / disposal / retirement.	
PPE and Intangible assets at fair value as deemed cost (Ind AS 101)	• Adjustment to retained earnings to be ignored; • Depreciation to be computed ignoring the aforesaid retained earnings adjustment; • Gains/ loss on realization/ disposal / retirement of such assets to be computed ignoring the aforesaid retained earnings adjustment.	Not Applicable
Gains and losses from investments in equity instruments designated at fair value through OCI (Ind AS 109)	To be included in book profits at the time of realization / disposal / retirement.	
Investment in a subsidiary, joint venture or associate at fair value as deemed cost (Ind AS 101)		
Re-measurement of defined benefit plans (Ind AS 19)	To be included in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.	To be included in book profits every year as the re-measurement gains and losses arise.

Items of adjustment	Treatment proposed under Finance Bill, 2017	
	On first time adoption of Ind AS	In subsequent periods
Cumulative translation differences in relation to foreign operations at the time of transition to Ind AS	To be included in the book profits at the time of disposal of foreign operations.	Not Applicable
Deferred tax: adjustments recorded in Reserves and Surplus on account of transition to Ind AS	To be ignored.	Not Applicable
Any other item	To be included in book profits equally over a period of 5 years starting from the year of first time adoption of Ind AS.	To be included in book profits every year as the gains and losses arise

Key takeaways

- In the case of a demerger (not under common control), fair value accounting is applicable. The proposed amendment provides that such fair value accounting followed by the resulting company should be ignored for computing MAT. In such cases, for computing MAT, the resulting company will need to maintain and track assets/liabilities based on book value. Further, for a tax neutral demerger, assets and liabilities are required to be recorded at book value. This creates a contradiction between the Ind AS and tax provisions.

- Any other adjustments to retained earnings, not classified to Statement of Profit and loss is to be included in book profits over a period of 5 years. For instance, reversal of lease equalization liability on first time adoption of Ind AS will be subject to MAT over a period of 5 years. The specified period of 5 years may be short and lead to higher tax outflows in the initial years in a scenario where the lease agreement has been entered for a longer duration.

- Under Ind AS 109, preference shares are treated as a financial liability and classified as borrowings in the balance sheet. Dividend paid thereon is to be treated as interest cost and is debited to the Statement of Profit and Loss. Since dividend amount paid to the preference shareholders is charged to the Statement of Profit and Loss, an issue could arise whether the same should be considered as an allowable deduction while computing the book profits.

The transition to Ind AS by Indian Companies is an important step to be in line with global accounting standards. Rationalization of MAT provisions with Ind AS will clearly provide much needed clarity in taxation. However, some of the issues highlighted above, could impact MAT computation for the Companies which have converged to Ind AS and could lead to litigation. With the Government's commitment to provide clarity and certainty in administration of tax laws, one can expect that the Government will provide much needed clarity in the upcoming days.

Taxing a good bargain

An overview of the proposed amendments relating to section 56 and section 50CA

"Hon'ble Members are aware that I abolished the gift tax in 1997. That decision remains, but a loophole requires to be plugged to prevent money laundering. Accordingly, purported gifts from unrelated persons, above the threshold limit of Rs.25,000, will now be taxed as income. Gifts received from blood relations, lineal ascendants and lineal descendants, and gifts received on certain occasion like marriage will continue to be totally exempt".

- Budget Speech, 2004-05

The context

This brief paragraph set the stage for a series of provisions over several years (including sections 56(2)(vii), 56(2)(viia) as well as the proposed section 56(2)(x)), which have led to fundamental changes to the scope of 'income' that is taxable under the Act.

The original provision was contained in section 56(2)(v), which was introduced by the Finance (No. 2) Act, 2004 with the stated objective of preventing money laundering. The Memorandum to the Bill noted that receipts of amounts without consideration in excess of INR 25,000 by individuals and HUFs would be included within the definition of 'income' under section 2(24) of the Act, and that section 56 would also be amended to provide that such income would be taxed under the head 'Income from other sources'. Over time, the provisions of clause (v) of section 56(2) were superseded by clause (vi) in 2006 and eventually by clause (vii) in 2009, without any significant change to its basic structure.

The Finance Act, 2010 extended the scope of section 56 to the receipt of shares by companies in which the public were not substantially interested. This is now proposed to be further widened to cover receipt of money or property by any person without consideration or for inadequate consideration. The rationale behind the 2010 amendment and the 2017 proposals are reproduced in full below to better set the context for the ensuing analysis:

Memorandum to the Finance Bill, 2010	Memorandum to the Finance Bill, 2017
Under the existing provisions of section 56(2)(vii), any sum of money or any property in kind which is received without consideration or for inadequate consideration (in excess of the prescribed limit of Rs. 50,000/-) by an individual or an HUF is chargeable to income tax in the hands of recipient under the head 'income from other sources'. However, receipts from relatives or on the occasion of marriage or under a will are outside the scope of this provision. The existing definition of property for the purposes of section 56(2)(vii) includes immovable property being land or building or both, shares and securities, jewellery, archeological collection, drawings, paintings, sculpture or any work of art.	Under the existing provisions of section 56(2)(vii), any sum of money or any property which is received without consideration or for inadequate consideration (in excess of the specified limit of Rs. 50,000) by an individual or Hindu undivided family is chargeable to income-tax in the hands of the resident under the head "Income from other sources" subject to certain exceptions. Further, receipt of certain shares by a firm or a company in which the public are not substantially interested is also chargeable to income-tax in case such receipt is in excess of Rs. 50,000 and is received without consideration or for inadequate consideration.

Memorandum to the Finance Bill, 2010	Memorandum to the Finance Bill, 2017
These are anti-abuse provisions which are currently applicable only if an individual or an HUF is the recipient. Therefore, transfer of shares of a company to a firm or a company, instead of an individual or an HUF, without consideration or at a price lower than the fair market value does not attract the anti-abuse provision. In order to prevent the practice of transferring unlisted shares at prices much below their fair market value, it is proposed to amend section 56 to also include within its ambit transactions undertaken in shares of a company (not being a company in which public are substantially interested) either for inadequate consideration or without consideration where the recipient is a firm or a company (not being a company in which public are substantially interested). Section 2(18) provides the definition of a company in which the public are substantially interested. It is also proposed to exclude the transactions undertaken for business reorganization, amalgamation and demerger which are not regarded as transfer under clauses (via), (vic), (vicb), (vid) and (vii) of section 47 of the Act. Consequential amendments are proposed in— i. section 2(24), to include the value of such shares in the definition of income; ii. section 49, to provide that the cost of acquisition of such shares will be the value which has been taken into account and has been subjected to tax under the provisions of section 56 (2).	The existing definition of property for the purpose of this section includes immovable property, jewellery, shares, paintings, etc. These anti-abuse provisions are currently applicable only in case of individual or HUF and firm or company in certain cases. Therefore, receipt of sum of money or property without consideration or for inadequate consideration does not attract these anti-abuse provisions in cases of other assessees. In order to prevent the practice of receiving the sum of money or the property without consideration or for inadequate consideration, it is proposed 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". It is also proposed to widen the scope of existing exceptions by including the receipt by certain trusts or institutions and receipt by way of certain transfers not regarded as transfer under section 47. Consequential amendment is also proposed in section 49 for determination of cost of acquisition.

Analysis of the proposed Clause (x) to Section 56(2)

The proposed section 56(2)(x) is a comprehensive provision that incorporates:

i. the existing provisions of section 56(2)(vii) (which applied to individuals and HUFs);

ii. the existing provisions of section 56(2)(viia) (which applied to closely held companies and firms); and

iii. certain additional features

The key highlights of the new clause (x) are set out below:

a. Unlike the provisions of section 56(2)(vii) and section 56(2)(viia), which applied only to specified categories of persons referred to therein, the proposed clause (x) will apply to all persons. Thus, all individuals, HUFs, companies (regardless of whether they are companies in which the public are substantially interested or individuals and artificial judicial persons will be covered by this provision.

b. In the hands of closely held companies or firms, 56(2)(viia) applied only in case of receipt of shares of a company in which the public were not substantially interested. Hence, receipt of shares of listed companies, or the receipt of any other assets without consideration or without adequate consideration were not taxable. This changes under clause (x), which will bring to tax receipts of:

   i. Sums of money in excess of INR 50,000 without consideration

   ii. Immovable Property without consideration or for inadequate consideration; and

   iii. Property as defined in section 56(2)(vii) i.e. shares and securities, jewellery, archeological collections, drawings, paintings, sculptures, any work of art or bullion.

c. The exclusions contained in Clause (vii) such as receipts of money or property received from a relative, on the occasion of marriage, under a will or by way of inheritance etc. continue to apply in clause (x).

d. The scope of the exclusions from clause (x) has been widened. There are two changes in this regard:

   i. Receipts of money or any property *by* any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv), (v), (vi) or (via) are excluded;

   ii. Receipts of money or any property by way of a transfer covered under the following clauses of section 47 are excluded:

      - *Clause (i)* – distribution of capital assets on the total or partial partition of an HUF
      - *Clause (vi)* – a transfer in a scheme of amalgamation of a capital asset by the amalgamating company to an amalgamated Indian company
      - *Clause (via)* – a transfer in a scheme of amalgamation of a capital asset, being a share of an Indian company by an amalgamating foreign company to an amalgamated foreign company
      - *Clause (viaa)* - transfer of capital assets in a scheme of amalgamation of a banking company with a banking institution
      - *Clause (vib)* - transfer of capital asset in a demerger by the demerged company to a resulting Indian company
      - *Clause (vic)* - transfer of capital asset being a share in an Indian company by a demerged foreign company to a resulting foreign company
      - *Clause (vica) and (vicb)* - transfer of capital assets in a business reorganization of a cooperative bank
      - *Clause (vid)* - Issue of shares by a resulting company to the shareholders of the demerged company
      - *Clause (vii)* - transfer by a shareholder of shares held in an amalgamating company in consideration of allotment of shares in the amalgamated company.

   Of these, clauses (i), (vi), (viaa), (vib) and (vica) are newly introduced over and above what was originally excluded under clauses (vii) and (viia) of section 56. It is also interesting to note that clause (viab) and (vicc) of section 47, which exclude indirect transfers are not specifically excluded from the ambit of Clause (x). These clauses are similar to (vi), (via) and (vib), except to the limited extent that they deal with transfer of shares of foreign companies that derive value substantially from assets located in India. It will be interesting to see whether this omission can support the view that Clause (x) does not apply to the receipt by a foreign company of shares which derive value substantially from assets located in India.

e. Definitions of terms such as 'fair market value', 'relative', 'jewellery', 'property' etc. are to be borrowed from the existing provisions of Clause (vii).

f. At the time of introduction of tax on cash receipts in the hands of individuals and HUFs under section 56(2)(v), the Memorandum to the Finance Bill focused largely on the artificial inclusion of such receipts in the definition of 'income' under section 2(24). It implied that the introduction of clause (v) in section 56(2) was only to provide

that the newly defined 'income' in clause (xiii) of section 2(24) will be chargeable as 'income from other sources'. Over time, as more amendments came to be made to section 56(2), it was the amendments to section 2(24) that became 'consequential'. The current amendment, however, goes one step further, and makes no amendment to section 2(24). Although the definition of 'income' in this provision is inclusive, it will be interesting to see whether the absence of a specific clause in section 2(24) affects the operation of the new clause (x).

g. The provisions of section 56(2)(vii) and section 56(2)(viia) will not apply in respect of receipt of cash or property referred to therein after 1 April 2017. For receipt of cash or property after 1 April 2017, the provisions of clause (x) will apply.

Analysis of the proposed section 50CA

In addition to the overhaul of provisions that seek to tax a person who receives cash or property without consideration or for inadequate consideration, the Finance Bill also proposes a new section 50CA that applies to determine the full value of consideration for transfer of unquoted shares.

The general rule for computing capital gains involve reducing the cost of acquisition and improvement from the 'full value of consideration'. Section 50CA provides that where the consideration from the transfer of an unquoted share is less than the fair market value as determined in a prescribed manner, the fair value so determined shall be deemed to be the full value of consideration.

It is also provided that a quoted share is a share that is quoted with regularity from time to time and where the quotation is based on current transactions made in the ordinary course of business.

It is interesting to contrast the provisions of section 50CA with those of section 52(2), which were omitted by the Finance Act, 1987. This provision permitted the tax officer to adopt the fair value of an asset as the full value of consideration, if he was of the opinion that the fair value on the date of the transfer exceeded the full value of consideration declared by an amount of not less than 15% of the value declared.

This provision was interpreted by the Supreme Court in the case of K.P. Varghese v. ITO 1982 SCR (1) 619 as being applicable only when there was an element of understatement of consideration by the taxpayer, and not merely on account of a difference between the fair value and the consideration declared. In arriving at this conclusion, the Court noted that a strict literal reading of the provision was not warranted in the light of its objective, as set out in the speech of the Finance Minister. The Court also noted that Parliament could not tax as 'income' an amount which in no rational sense could be considered as 'income' or even 'receipt'.

The field of income-tax has seen radical change in the last several decades, including notably through the introduction of Transfer pricing. The case of K.P. Varghese related to AY 1966-67 and was decided by the Supreme Court in 1981. To what extent its ratio will apply to a provision that is broadly on the same lines as the erstwhile section 52(2) remains to be seen.

Key Takeaways

The biggest impact of these provisions will be on transactions involving shares and securities. As regards receipt of listed shares without consideration or for inadequate consideration, could trigger significant tax outflows, since, their 'fair market value' is based on the quoted price in the stock exchange, rather than on the book value. In the case of unlisted shares, the provisions of section 50CA could lead to a notional capital gains in the hands of the seller, as well as tax in the hands of the buyer if the price is lower than the value determined under Rule 11UA.

This will also significantly affect group restructurings, that do not involve amalgamations or demergers. There has been a long-standing demand that Income-tax law in India should move towards a full group consolidation. With the expansion in the scope of clause (x), the law has in fact moved further away from consolidation, by effectively requiring such restructurings to be done at fair market value.

Despite an overhaul of the entire gamut of provisions relating to receipt of money or other assets, several key issues arising from the original provisions remain unaddressed. For instance, the applicability of these provisions to rights issues, buybacks, conversions of preference shares and debt into shares, capital contribution of shares to firms and LLPs, applicability to foreign companies, etc. remain uncertain and could lead to litigation.

A real budget for the Real Estate Sector

Over the past few years, the real estate sector had been witnessing a deceleration and the Government's demonetization move affected it further. Promotion of affordable housing in the real estate sector were amongst the ten themes which formed part of this year's historical budget.

The Finance Minister (FM) has proposed that the affordable housing sector would be granted 'infrastructure' status. This has been a long-pending demand of the real estate industry. An infrastructure status will allow developers to access long-term funding at cheaper rates as well as institutional finance and other additional incentives which will attract developers towards affordable segment. This will also help in furthering the objective of providing housing to one and all by 2022.

Incentives for promoting investment in immovable property

On the tax front, a slew of new provisions have been introduced. Notable amongst them is the reduction of period of holding for land/building or both from 3 years to 2 years for claiming the beneficial tax rate applicable on transfer of long term capital assets. Further while calculating capital gains, the base year for indexation has been shifted to 1 April 2001 from 1 April 1981 for adopting the fair market value as the cost of acquisition of capital assets including immovable property. Consequently, the expenses incurred after such date can be considered towards cost of improvement. The shifting of base year from 1981 to 2001, which will provide higher cost by way of indexation benefit, coupled with the reduction of period of holding for land/building to 2 years will reduce the capital gains tax liability, thus promoting the real estate sector and making it more attractive for investment.

It has also been proposed that no withholding of tax shall be made where payment made on acquisition of immovable property (other than agricultural land) is made in respect of any award or agreement. The Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (LARR Act) provides that compensation received for compulsory acquisition of land under the said Act shall be exempt from the levy of income tax. Consequently, the Central Board of Direct Taxes also clarified that the said compensation which is exempt from tax under the LARR Act shall not be chargeable to tax under the Income-tax Act 1961 (Act). In order to rationalize the provisions of the Act, the Union Budget 2017 has now provided that no taxes shall be withheld on such payments.

Computation of capital gains for joint development arrangements

On taxation of gains arising under joint development agreement, hitherto the position commonly adopted was that the capital gains are taxable in the hands of the land owner in the year in which the possession of immovable property is handed over to the Developer. This effectively meant that the land owner would end up paying tax on notional gains even before actually receiving the sale consideration in cash or kind. It also caused severe cash flow issues for land owners who had no other source of income. The Karnataka High Court had upheld this position. The Union Budget 2017 proposes that these gains would now be taxable in the year in which the certificate of completion for the whole or part of the project is issued by the competent authority. These provisions are however applicable only to a taxpayer, being an individual or Hindu undivided family. It is also proposed that the stamp duty value of such property as on date of issuing of the certificate of completion, as increased by any monetary consideration, will be deemed to be the sale consideration.

Further, where the Taxpayer transfers his share to any person on or before the date of issue of the completion certificate then capital gains shall be taxable in the year in which the Taxpayer transfers his share.

This proposal has now put to rest the controversy on taxation of joint development agreements. However, the other Taxpayers like corporates and firms are not covered within the ambit of these provisions. Thus, the question still remains on the taxability of income from joint development arrangements in the case of

corporates and firms. Whether the same would be taxed as business income or capital gains and the date on which the transfer would be taxed would still be debatable.

Incentives for promoting Housing for all

The FM in the Finance Act 2016 had introduced profit linked deduction for affordable housing projects which provided a 100% deduction of the profits and gains derived from the business of developing and building housing projects. The FM in his budget speech said that the said same received a very good response and thus in furtherance of the goal of providing 'housing for all' and to promote development of affordable housing sector, certain other relaxations have been proposed. Relaxations like considering "carpet area" instead of "built-up area" while computing the size of residential unit, applying restriction of 30 sq. mts. on the size of residential units located within the municipal limits of metropolitan cities and increasing the time limit for completing the project from existing 3 years to 5 years have been proposed.

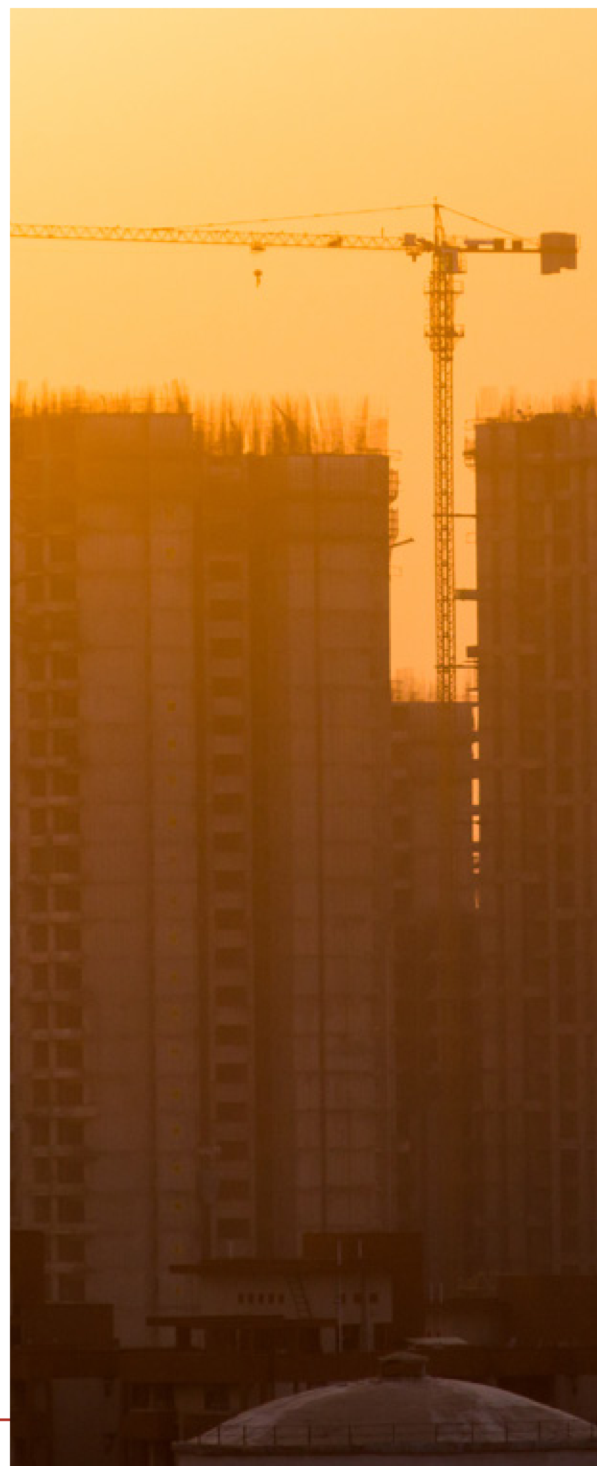
These relaxations will provide a stimulus to the developers of affordable housing sector and thus increase the supply of affordable houses. The extension for the term for completion will enable the developers to complete the project efficiently.

No notional income for house property held as stock-in-trade

In what appears to be a beneficial move to real estate developers, the budget proposes that where house property consisting of any building and land appurtenant thereto is held as stock-in-trade and such house property or part thereof is not let out during the whole/part of the previous year, then no notional rental income will be deemed for a period of one year from the year of receipt of completion certificate. Hitherto many real estate developers were not offering to tax notional rent on vacant unsold stock on the ground that when the stock was sold, it resulted in taxable Business income. Hence, real estate developers were taking a position that the provisions of income under the head house property were not attracted in their case. Whether this move confirms the taxability of the unsold stock of real estate developers under Income from House Property is to be seen.

Further, the Union Budget 2017 also restricts set off of losses under the head house property against under any other head of income to INR 2 lakhs. This could have an adverse impact given the restrictions on set off upto INR 2 lakhs.

On the whole, the changes proposed by the FM would be welcomed by the real estate sector and would provide the necessary impetus to the growth of the real estate sector.



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Dethroning the King

An analysis of proposals aimed at limiting the use of cash in the Indian economy

The promotion of a digital economy was one of the top focus areas of the Finance Minister in his Budget, which in turn were aimed at 'cleaning the system' and weeding out corruption and black money. It was also stated that this would have a transformative impact in terms of greater formalisation of the economy and mainstreaming of financial savings into the banking system, which in turn would energise private investment by lowering the cost of credit.

Multiple initiatives have been announced in this regard following the demonetisation exercise of last year, including the launching of new payment systems to increase digital transactions. On the tax front too, the Finance Bill contains several proposals aimed at giving an impetus to non-cash transactions through a combination of incentives, disincentives and even an outright prohibition of certain cash transactions. These proposals are based on a recognition that despite low levels of tax compliance in the economy, tax remains a powerful tool for modifying individual and corporate behaviour. It is expected that these tax proposals will augment the other non-fiscal measures of the Government aimed at reducing the use of cash.

Overview of the proposals

Incentives	Disincentives	Others
• Reduction of the existing rate of deemed total income from 8% to 6% (section 44AD of Income-tax Act, 1961 (Act))	• Restrictions on cash transactions in excess of INR 300,000 (new sections 269ST and 271DA) • Restrictions on cash donations (section 80G) • Disallowance of depreciation on assets acquired with cash (section 43) • Disallowance of capital expenditure in cash for specified businesses (section 35AD) • Reduction of the limit for permitted cash expenditure (sections 40A(3) and (3A))	• Electoral funding reforms (section 13A)

Analysis

Incentive Provisions

Section 44AD of the Act contains a presumptive income scheme for taxpayers engaged in eligible business (i.e. other than the business of plying, hiring or leasing goods carriages) who have a turnover of INR 20 million or less. Under this scheme, 8% of the total turnover or gross receipts is deemed to be the profits and gains from such business, and will be chargeable to tax under the Act.

With a view to encouraging the small disorganized sector to move away from cash transactions,

it is proposed that the 8% rate under this section will be reduced to 6% in respect of that part of the turnover or gross receipts that are received by:

a. Account payee cheque;

b. Account payee draft; or

c. Electronic Clearing System through a bank account

The 8% rate will continue to apply in respect of that part of the turnover or gross receipts that is realized in any other mode apart from the above.

This amendment is retrospective and will apply for the financial year 2016-17 (AY 2017-18).

Disincentives and Restrictions

Except for the one incentive under section 44AD, all the other provisions are aimed at limiting the use of cash through various disincentives. These are analysed below:

a. Restrictions on cash transactions in excess of INR 300,000:

The Memorandum to the Finance Bill notes that the quantum of undisclosed and untaxed incomes (black money) is very large, which in turn creates a resource crunch for various welfare programmes of the Government. Since this generally arises through cash transaction, a need was felt to impose restrictions on cash transactions beyond a monetary threshold.

Such a measure was also recommended by the Special Investigative Team (SIT) set up by the Government on black money. The SIT, in its report had noted that:

> *"The SIT has felt that large amount of unaccounted wealth is stored and used in form of cash. Having considered the provisions which exist in this regard in various countries and also having considered various reports and observations of courts regarding cash transactions the SIT felt that there is a need to put an upper limit to cash transactions. Thus, the SIT has recommended that there should be a total ban on cash transactions above Rs. 3, 00,000 and an Act be framed to declare such transactions as illegal and punishable under law"*

This restriction is proposed to be incorporated in a new section 269ST in the Act. This provision states that no person shall receive an amount of INR 300,000 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 an account payee bank draft or use of electronic clearing system through a bank account.

Certain categories of persons including the Government, banking companies, post office savings bank or co-operative banks are excluded from the scope of this restriction. The proposed law also empowers the Central Government to exclude other categories of persons or receipts from the scope of this provision by means of a notification.

A penalty for receiving a sum in contravention of this provision is also contemplated in the hands of the person receiving such sum. The penalty is proposed under a new section 271DA and will equal the amount of such receipt.

The restriction applies with effect from 1 April 2017.

A few important takeaways from these provisions:

- The restriction is very wide in its scope, in that it includes all payments from a person, a transaction and even multiple transactions that relate to a single event or occasion.
- Non-Banking Finance Companies are not excluded from the ambit of this restriction (unlike banks and cooperative banks). It remains to be seen whether these will be notified under Clause (iii) to the proviso to section 269ST.
- The penalty for contravention of this provision is on the person receiving any such sum, and not on the payer. This seems to reflect the Government's belief that cash transactions predominantly originate at the instance of the recipient, and that the penal provisions should therefore apply only in his hands.

It may be relevant here to note that the constitutional validity of section 269SS (which bars the acceptance of loans or deposits beyond a certain threshhold otherwise than through account payee cheques or drafts) was assailed before the Supreme Court in Asst. Director of Inspection v. Kumari A.B. Shanthi (2002) 255 ITR 258. One of the main grounds of challenge in this case was that the penal consequences under section 276DD (prosecution, which has since been omitted) and penalty under section 271D applied only to the recipient (i.e. the borrower), and that this amounted to discrimination, violative of Article 14 of the Constitution. The Supreme Court rejected this argument and upheld the validity of this provision.

- The SIT had noted that a ban on cash transactions would be successful only if it was accompanied by a limitation on cash holdings. The SIT had accordingly recommended an upper limit of INR 1.5 million on cash holdings. This recommendation does not form part of the legislative proposals in the Finance Bill, 2017.

b. Disallowance of depreciation / deduction in respect of assets acquired with cash

Although there is a disallowance for deductible revenue expenditure incurred in cash, there are no adverse tax implications that arise from acquisition of capital assets using cash. This is sought to addressed in this budget through an amendment to section 43.

With effect from financial year 2017-18 (AY 2018-19), depreciation will not be allowed under section 32 in respect of capital assets acquired otherwise than through an account payee cheque, draft or through electronic clearing system through a bank account. This restriction is proposed by the addition of a proviso to section 43 of the Act to the effect that the incurring of expenditure for acquisition of any asset or part thereof, in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account in excess of INR 10,000 shall be excluded for the purpose of determining the 'actual cost' of the asset.

A similar restriction is proposed under section 35AD which provides for investment linked deductions on capital expenditure incurred for certain specified businesses.

c. Reduction of limits under section 40A(3) and (3A)

Under section 40A(3), a deduction is not allowed in respect of expenditure in respect of which payments in excess of INR 20,000 are made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft. Similarly, under section 40A(3A), payments are deemed to be proits and gains of a business or profession, if the expenditure is incurred in a particular year, but the payment of an amount exceeding INR 20,000 is made in a subsequent year otherwise than by an account payee cheque or a bank draft.

The limit of INR 20,000 under these provisions is proposed to be reduced to INR 10,000 from financial year 2017-18 (AY 2018-19).

d. Restrictions on cash donations

Section 80G of the Act provides for deduction in respect of donations made to certain funds and charitable institutions. This provision was amended by the Finance Act, 2012 to exclude deductions for donations in excess of INR 10,000, unless such donation was paid by any mode other than cash.

This limit of INR 10,000 is proposed to be reduced to INR 2,000.

Interestingly, the Finance Act, 2012 had incorporated a similar restriction on cash donations in excess of INR 10,000 on donations for scientific research or rural development made to research associations, universities, etc. under section 80GGA. The limit on cash donations under this section, however remains unchanged at INR 10,000.

e. Electoral funding

The Finance Bill also proposes certain far reaching changes to bring about transparency in electoral funding. Specifically, it adds two additional conditions that need to be complied with for a party to be eligible for a tax exemption.

These are:

a. A bar on receipt of donations in excess of INR 2,000 otherwise than through an account payee cheque or an account payee bank draft or use of an electronic clearing system through a bank account or through electoral bonds;

b. A requirement for furnishing the return of income on or before the due date.

The concept of electoral bonds, in particular is a unique one, and could have far reaching implications. Under this scheme, a donor can purchase bonds from authorised banks (through cheques and digital payments). These bonds will be redeemable only in the designated account of a registered political party and will provide anonymity to the donor.

Key takeaways

The proposals discussed above reflect an interesting mix of policy choices. Though a carrot and stick approach has been followed, there are far more sticks than carrots. This is perhaps inevitable, considering India's fondness for cash, and the need for strong legislative measures to disincentivise cash transactions.

Although the objective of all of the provisions discussed above is to disincentivise cash payments, the approach adopted is not uniform. The reasons for this divergence are less clear.

For instance, in the context of section 80G, the law requires the donation to be made "by any mode other than cash". This can be contrasted with the provisions of sections 269ST, 35AD, 40A and 43 which apply to payments made "otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account".

In the context of section 80G, it is clear that the limitation applies to cash payments only. However, for the other provisions, questions could arise in cases where the consideration is in kind, or through a set-off of payables and receivables or through rendition of services. As long as these are properly reflected in the books, there is possibly no policy reason to discourage such modes of dishcharging consideration. Litigation on such issues has already arisen in the context of section 269SS and section 269T.

Law can almost never keep pace with technological advances. For instance, payments through electronic clearing systems through bank accounts are permitted in section 40A(3) only by an amendment in in this year's Finance Bill. Considering these challenges, and mindful of the overall objective, a proscriptive approach towards cash may be advantageous compared to a prescriptive approach requiring that payments be made only through specified means. This can help taxpayers avoid uncertainty and potential hardship.

Timely completion of assessment - First step in better administration

An analysis of proposals related to tax administration and dispute resolution

Tax policy and tax administration are inextricably linked aspects involved in Tax revenue yield of any country. Tax policy is the choice by a Government as to what taxes to levy, in what amounts, and on whom. It has both microeconomic and macroeconomic aspects. Tax administration is the machinery behind securing potential tax revenues effectively and efficiently. A reform in tax administration is as important as that in tax policy.

India recognized the importance of reforms in tax administration and a need for undertaking the same. One of the first steps taken in the recent years was constitution of the Tax Administration Reforms Committee. The Commission, constituted to recommend reform exclusively in tax administration, was specifically mandated "to review the application of tax policies and tax laws in the context of global best practices and to recommend measures for reforms required in tax administration to enhance its effectiveness and efficiency." The said Committee submitted it detailed report in 2014. Not all the recommendations of the committee were accepted or implemented by subsequent Governments. However, there has been some measures taken over the last few years towards improving the tax administration.

The Committee reported some "critical findings" in the report and the noteworthy ones included inordinate delay in processing refunds (resulting in interest payouts) and poor recovery of demands raised.

Leaving aside the usual reasons cited by the Committee, viz undue pressure on tax officers to meet a 'target' leading to unreasonable demands being raised, one possible reason for the above could be the time lag between the actual year in which the income is earned and the year when the income is assessed by the tax administration.

Importance of timely completion of assessment

Under the Indian tax laws, taxpayers (individuals, corporations, etc) are required to file income tax returns and pay income taxes due within time lines clearly set out. The taxes are to be paid in advance during the financial year in which the income is earned. The income-tax returns are to be filed anywhere between 4-8 months from the end of the financial year. If a taxpayer fails to meet the time lines set out by the Income-tax Act, harsh penalties and interest apply.

On the contrary, the tax administration has traditionally been granted time ranging between 2-3 years after the end of the financial year to assess the income of the tax payer. The time lag in assessing the income of the taxpayer leads to the following:

- Impact on recoverability – Many taxpayers, specifically small business taxpayers, operate in volatile business environments. Cash flow is key to their economic survival. A delay in assessment leads to the taxpayer's having to pay disputed taxes in respect of year in times when the economic scenario may not be the same. For instance, a tax liability of an year when a taxpayer had a booming business could possibly arise 3 years later when his business isn't doing as well. The tax administration would also not be able to recover the tax demand, even if legitimate, since the financial position of the tax payer could have undergone a sea change. An assessment made closer to the earning of income would lead to better recoverability.
- Additional interest on account of delay – Tax officers while determining the short fall of taxes at the time of assessing the income would need to compute interest for the time starting from end of the financial year in which the income was earned to the date of actual assessment. The more the delay in completion of assessment the greater the demand for recovery. An assessment made closer to the earning of income would lead to lower interest and lower burden on the taxpayers.
- Interest of refund – In situations where assessments result in refund of excess taxes, the income-tax department is liable to pay interest on such refunds. Hence, the longer the time to determine refunds due, the higher the interest to be paid by the income-tax department.

- Quality of the tax adjustments – A lot of times, the assessing officers are constrained to make adjustments to returned income due to lack of sufficient data/documentation to back taxpayers claims. These could arise due to the fact that taxpayers are routinely asked to defend positions taken or transactions completed after a time lag of nearly 3 years. The taxpayer for multiple reasons (including change in employees handling the tax functions, etc) would not be able to furnish sufficient documents to back their claims. And in most situations, tax adjustments carried out by the officer without examining underlying documentation are stuck down by tax courts.

For the above and variety of other reasons, it would be prudent for the tax administration to reduce the time lag between the earning of income and assessing the same. One of the proposals contained in Budget 2017 is aimed at this.

Proposal to reduce the time for completion of assessments

One of the proposals which would have a far-reaching consequence is reduction in the time limit for completion of assessment. Currently, income-tax authorities get twenty-one months from the end of the year in which the income was first assessable. It is now proposed to amend the provisions to provide that for the assessment year 2018-19, the time limit for making an assessment order shall be reduced from existing twenty-one months to eighteen months from the end of the assessment year, and for the assessment year 2019-20 and onwards, the said time limit shall be twelve months from the end of the assessment year in which the income was first assessable. To rationalize the time limits for other situations, it is also proposed to amend the time limit available for completion of reassessments and also assessment consequent to completion of a search or a survey.

The above changes could have far-reaching consequence on the overall efficiency of the tax administration. The Government has also spelt that in its effort to minimise human interface and move towards technology, massive computerisation has been carried out in the income-tax department, which has translated into overall enhanced efficiency in the functioning of the department. While at a first glance the amendments could only be indicative of change in dates for assessments, this particular amendment could lead to better recovery of demands, improving ability of the taxpayers to defend their tax positions and better quality of issues under disputes before the courts.

Functioning of the Authority for Advance Rulings

With a view to promote ease of doing business, the Government proposes to merge the Authority for Advance Ruling (AAR) for income-tax, central excise, customs duty and service tax. Accordingly, various amendments, have been proposed to all applicable statues to allow merger of these AARs.

In addition to the statutory provisions relating to the merging of AAR, the following other amendments are commendable:

- In order to improve the efficiency and efficacy of the AAR, and to increase the available pool for appointment as Chairman, AAR, it is proposed to amend the qualifications for appointment as Chairman and provide that a former Chief Justice of a High Court, or a person who has been a High Court Judge for at least seven years shall also be eligible to be Chairman of the AAR.
- It is also proposed to provide that the qualifications for appointment as revenue Member or law Member shall be considered as on the date of occurrence of the vacancy.
- It is also proposed that in the event the Chairman is unable to discharge his functions owing to absence, illness or any other reason, or in the event that the office of the Chairman falls vacant, the Vice-chairman shall discharge the functions of the Chairman until the new Chairman enters upon his office or until the incumbent Chairman resumes his duties.

It is a well-known fact that the applications filed before the AAR under Income-tax Act have taken more than 3 years for disposal. The reason for delay on many occassions has been on account of the vacancies at the AAR including that of the Chairman. The above changes (together with the earlier decision to set up multiple benches of AAR) should improve the efficiency of the AAR and reduce the time taken for disposal.

Key takeaways

While there are some proposals which lead to granting of powers of search, etc to junior officers, powers to seize materials during search, etc the changes proposed in Budget 2017 in the area of tax administration and dispute resolution should lead to a positive change in tax administration. There is a lot of ground to cover for making the tax administration efficient but reduction of time limit for completing assessments is a good start. The tax officers are driven toward efficiency by a statutory time limit.

Impact of Indirect Tax Changes

Overview of changes in the Indirect tax regime

The year 2016 was quite promising for Goods and Service Tax (GST), and the Government has achieved significant progress on its implementation; this fact was also acknowledged by the Finance minister during his speech. The year has witnessed the passing of the Constitution Amendment Bill for GST, and there have been several meetings of the GST Council which recently achieved consensus to resolve certain sticky issues pertaining to dual control, cross-empowerment and power of States to levy taxes in territorial waters.

The Finance minister also specifically mentioned that the GST Council has reached common ground on almost all the matters, and that the IT preparedness is on track. Further, extensive reach-out efforts to trade and industry would start from 1 April 2017 onwards, thus firmly establishing the start of the GST era.

However, the most awaited announcement of definite timelines for introduction of GST did not find a mention in the Budget Speech. It was also stated that the Government would try and implement GST as quickly as possible, keeping the spirit of cooperative federalism in mind.

With its stated intention of implementing GST in FY 2017-18, the Government did not make large-scale changes in the existing Indirect tax regime. Accordingly, most of the legislative amendments proposed in the Budget have been quite minimalistic.

No changes were made in the peak rates of Customs, Excise and Service tax. Some rate changes were made in Customs and Excise, which are in line with certain key priorities of the Government such as the Make in India initiative, the Digital India initiative, protecting the domestic industry, addressing the inverted duty structure on certain products, export promotion, anti-avoidance measure, etc.

On the legislative front, the primary focus was to address areas which could have led to a substantial revenue loss because of divergent views taken by the courts (e.g. deduction of value of land with retrospective effect, clarity on reversal of credit by banks, financial institutions and NBFCs, etc). Also, the doubt was cleared on applicability of Service tax on one-time premium paid to State Industrial Corpotrations towards lease of industrial plots over 30 years, as exemption from service tax is now granted with retrospective effect with a provision to claim refund of tax paid for the past years. Further, the proposal for abolishment of Research & Development Cess with effect from 1 April 2017 is a welcome move as this will substantially reduce the cost of technology.

In addition to the above, two key amendments have been made to check any kind of tax evasion/ avoidance, but which could also lead to uncertainty for taxpayers and litigation.

Transfer of credit in case of mergers, amalgamation, shifting etc.

Rule 10 of the CENVAT Credit Rules deals with the transfer of CENVAT credit in cases where a manufacturer or provider of output service shifts his factory/ premises to another site or transfers his business, on account of sale, merger, amalgamation, lease etc. The transfer of credit in such cases has been allowed on the condition that the stock of inputs and capital goods is transferred as well. Further, the said inputs or capital goods, on which credit has been availed, needed to be duly accounted for 'to the satisfaction of the authorities'.

Historically this clause led to several disputes, as the departmental authorities insisted that permission was required for transfer of CENVAT credit while the tax payers took a position that mere intimation was sufficient to transfer the credit. In fact, in a judgement by Delhi Tribunal in the case of M/s. S.C. Johnson Products (P) Ltd., the Hon'ble Tribunal held that no permission is required to transfer the CENVAT credit in terms of Rule 10.

Against this backdrop, a new sub-rule 4 has been inserted in Rule 10, stating that transfer of CENVAT Credit shall be allowed by the jurisdictional authorities within 3 months (to be further extended by 6 months on sufficient cause being shown) from the date of receipt of application by the manufacturer or service provider.

As per the wording of this newly introduced clause, it appears that the credit cannot be utilised by the new entity/ unit unless express written approval is received from the authorities. This will pose the following issues from a practical and financial standpoint:

- It may increase the compliance procedures for tax payers who have multiple premises/ factories and consequently multiple registrations under Excise & Service tax, as an application must be made with each jurisdictional officer. This may lead to an overall delay in the entire process, with the various jurisdictions disposing of the applications at different times.
- Pending approval from the authorities or in a case where the application is rejected by the authorities, there could arise a situation where the new entity/ unit has to discharge the output liability of both the current operations and new operations. Thus, the liability may have to be paid in cash without being able to utilize credit of the transferor entity/ factory. This may pose huge working capital issues and could also lead to additional costs for acquiring funds. In this regard, it would be welcome if the Government allowed transfer and utilisation of credit on provisional basis, with suitable recovery mechanism in case of ineligibility.
- Further, there could be a scenario where the authorities may not be able to issue the formal approval within the prescribed timeline, for whatever reason. In such a case, the amendment is silent as to whether deemed transfer of credit would be permitted after the lapse of the prescribed time period.
- It remains to be seen whether the Government will issue a clarification on such practical issues that are likely to be faced by the industry.

Beneficial owner – Importer and Exporter is proposed to include beneficial owner

The Customs Act, 1962 ('Customs') fastens the liability to pay duty on the importer of goods. The term 'importer' is defined to mean an owner or any person who holds himself out to be the importer. Consequently, in case of an allegation relating to evasion of duty, the Customs Authorities could raise demand notices only on an importer on record; a notice on any other person could be raised only in his or her capacity as an abettor, and that too only for penalty.

There have been multiple instances where the actual defaulter was not the importer on record e.g. where an intermediary was appointed only for customs clearance purposes, and he imported the goods at a lower price and subsequent sold the goods to the actual importer at a higher price. This led to a lower payment of Customs duty.

The said definition of importer has now been amended to include a beneficial owner. The term 'beneficial owner' has been defined to mean any person on whose behalf the goods are being imported or exported, or who exercises effective control over the goods being imported or exported.

The aforesaid amendment has wide ramifications, as it will enable the Customs authorities to issue notices for recovery, penalty and prosecution on any person who they believe is a beneficiary. But while this is a positive move in the context of imports involving intentional duty evasion, it is likely to lead to harassment of tax payers even in bona fide cases. The ultimate buyer, who is buying locally, may not always be aware of the source of procurement when he is buying, and may not have any means to determine whether the goods are imported appropriately or not. While this would be a clear case of the non-applicability of the 'beneficial owner' definition, it would not stop the Customs Authorities from issuing notices, considering that the definition of beneficial owner is very subjective.

What constitutes 'effective control' or how it can be proved that the goods are not imported on behalf of the beneficiary, could become a matter of dispute. This would also give rise to duplicity of litigation, as the same Show Cause Notice is likely to be issued to the importer on record as well as the beneficiary.

Though there were a few amendments in the Indirect tax law, the most awaited economic reform - the introduction of the GST law, is under process. As mentioned earlier, there have been some significant progress towards GST in the financial year 2016-17, but as the Revenue Secretary indicated in the recent press release on 3 February 2017, the introduction of final laws is likely to be announced by March-end and the rates by May-June 2017.

The Finance Minister has suggested July 2017 as the go-live month, but it's natural to be sceptical about when GST will become a reality. If the implementation indeed sees the light of day in July, the industry will barely have any time to prepare. Thus, it would be imperative for the Government to revisit the timelines for the introduction of the biggest tax reform in India.

Nevertheless, considering the eagerness of the Government to introduce GST from 1 July 2017, the industry has no option but to gear up adequately. After all, GST would not only impact the indirect taxes of a company, but would require re-tooling of practically all the functions in every business.

The debut of GAAR

An overview of Chapter XA, which comes into force from FY 2017-18 (AY 2018-19)

Traditionally, a taxpayer was permitted to arrange his affairs within the four corners of law with a view to minimizing his tax liability. This was based on the premise that there is no legal, patriotic or even a moral duty to pay more taxes than what the law explicitly requires. This principle ruled the roost in India over several decades, albeit with some minor tweaks to exclude sham transactions and subterfuges designed to avoid paying tax.

GAAR fundamentally alters this position. Under GAAR, tax authorities are empowered to re-determine the tax consequences of arrangements that are entered with the main purpose of obtaining a tax benefit. Thus, transactions can be scrutinized to determine whether they are driven mainly by tax considerations, and the tax benefits arising from them can thereafter be potentially denied.

A brief overview of the structure of the GAAR and some of the key issues that could arise from its implementation are discussed below.

Structure of GAAR

Chapter XA of the Income-tax Act 1961 (Act) comprises of four distinct parts:

The *first part* (comprising of sections 95 and 100) is the operative portion of the Chapter. It states that notwithstanding anything contained in the Act, an arrangement entered into by an assessee may be declared to be an 'impermissible avoidance arrangement', and the consequence in relation to tax arising therefrom may be determined subject to the provisions of Chapter XA.

The *second part* (comprising of sections 96, 97 and 102) deal with the meanings of key concepts including 'impermissible avoidance arrangement', commercial substance, tax benefit, arrangement etc.

The *third part* (comprising of sections 98 and 99) sets out the consequences that can flow if an arrangement is declared to be an impermissible avoidance arrangement.

The *fourth part* (comprising of section 144BA) sets out the procedure to be followed for invoking Chapter XA and the safeguards in this regard.

Analysis

Part 1 – Section 95

The first and more important feature of this Part is that GAAR will prevail over all other provisions of the Act. To reinforce this, a new sub-section (2A) has also been included in section 90 of the Act to provide that GAAR will prevail over tax treaties, even if it is not beneficial to him.

Another pre-condition for invoking GAAR is that the arrangement in question must have been *entered into by* an assessee. Although the law does not explicitly state when an assessee can be said to have *entered into an* arrangement, given the wide definition of arrangement, the threshold for this may be quite low.

If an arrangement is declared to be an 'impermissible avoidance arrangement', the consequences in relation to tax can be determined under Chapter XA. Since the word 'tax' is defined in section 2(43) as referring to income-tax chargeable under the provisions of the Income-tax Act, it follows that any consequence under GAAR can only be limited to the liability of a taxpayer under this Act. Consequences under other statutes cannot be determined in proceedings under GAAR.

It is also provided in section 100 that the provisions of this Chapter shall apply in addition to, or in lieu of any other basis for the determination of tax liability.

Part 2 – Sections 96, 97 and 102

Much of the attention (and possible litigation) surrounding GAAR will revolve around these three provisions.

The first and the most important definition is that of 'impermissible avoidance arrangement'. The law provides that an impermissible avoidance arrangement is an ***arrangement,*** the ***main purpose*** of which is to obtain a ***tax benefit,*** and it—

a. creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;

b. results, directly or indirectly, in the misuse, or abuse, of the provisions of this Act;

c. lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or

d. is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for bona fide purposes.

It is also provided that an arrangement shall be presumed, unless it is proved to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit.

The term arrangement is defined in section 102 to include any step in, or a part of any transaction, operation, scheme, agreement or understanding, whether enforceable or not, and to include the alienation of any property in such transaction, operation, scheme, agreement or understanding. Though this definition is very wide, some questions may yet arise as to its scope. Particularly, unilateral actions such as a declaration of a dividend, or voting by a shareholder, are not considered 'arrangements' in an ordinary commercial sense, and it will be interesting to see whether these are sought to be covered within the ambit of 'arrangement' for invoking GAAR.

The second issue relates to the meaning of 'main purpose'. This term is not defined and several issues may arise as to its determination. For instance, if there are multiple parties to an arrangement with different (and possibly conflicting) motives, whose 'purpose' is to be looked at? Similarly, there could also be some debate as to whether the determination of 'main purpose' is a subjective test or whether the tax authorities can invoke a more objective evaluation of the 'main purpose' of the arrangement. It is also relevant in this regard to note that the law refers to the main purpose of the arrangement, and not of the assessee.

The term 'tax benefit' is also widely defined in section 102 to include a reduction, avoidance or deferral of tax, increase in refund or loss etc. This suggests that transactions that lead to a savings in indirect tax costs, or overseas tax costs may not be covered under GAAR. Another factor that is relevant in this context is that the Income-tax Rules have clarified that GAAR will not be invoked if the tax benefit in the relevant year does not exceed INR 30 million. In this regard, questions were raised as to whether the tax benefit has to be viewed qua the arrangement, or a specific taxpayer. This assumes significance as a benefit to one party to a transaction may often lead to a tax disadvantage to another (e.g. a sale of an asset at a lower value will save capital gains tax in the hands of the seller, but will lead to lower depreciation in the hands of the buyer) In such a case, if an arrangement centric view is adopted, the 'tax benefit' may be lower, or even non-existent.

The CBDT in its Clarification 7/2017 dated 27 January 2017 noted that GAAR is with respect with an arrangement and hence the limit of INR 30 million could not be read in respect of a single taxpayer only. It also noted that since the application of tax law was jurisdiction specific, the tax benefit enjoyed in India would be examined.

Once it is established that there is an arrangement, and that the main purpose of that arrangement is to obtain a tax benefit, it is additionally necessary to show that the arrangement falls foul of one of the four tainted elements tests set out in section 96. These tests are again fairly wide in their scope. One interesting point that emerges is the reference to 'substantial commercial purpose' in section 97 in the context of location of an asset or a transaction or the place of residence of a party. Any assessment of GAAR inevitably leads to a discussion on 'substance', which in the context of several structures and transactions is seen as referring to the number of employees, qualification of directors, availability of office premises etc. While these are not unimportant, the fact is that a distinction may have to be drawn between 'substance' and 'substantial commercial purpose', the latter referring to the rationale behind locating an asset or transaction or a person in jurisdiction, rather than the number of people, assets etc. in that jurisdiction.

Part 3- Consequences under GAAR

Section 98 confers wide powers on the tax authorities to determine the consequences under GAAR. Specific powers in this regard include:

- Denial of treaty benefits,
- Disregarding, combining, recharacterizing the arrangement,
- Treating the arrangement as if it had not been entered into,
- Disregarding accommodating parties,

- Reallocating income, expenditure, deduction, reliefs or rebates,
- Re-determining place of residence/location/situs of parties or assets,
- Looking through any arrangement by disregarding corporate structures,
- Recharacterizing debt as equity or vice-versa.

There is no specific guidance on how the consequences will be determined and what consequences will flow in specific situations. However, Circular 7/2017 specifically notes that corresponding adjustments may not be made as it would undermine the deterrent effect of GAAR.

The need for the consequences to correspond to the changed economic positions of the parties may also need to be specifically dealt with. (for e.g. if a merger or other form of corporate restructuring is disregarded for tax purposes under GAAR, how will that reconcile with the fact that, in law, the merger or restructuring has actually taken place?).

Part 4- Procedural safeguards

Procedural safeguards are also provided for in the law to allay taxpayer concerns over the implementation of GAAR. Most importantly, the law envisages an Approving Panel comprising of a retired High Court Judge, a revenue official and an outside expert, whose sanction will be required before GAAR can be applied in a particular case.

Grandfathering and other issues

The rules relating to GAAR provide that:

- GAAR shall not be applicable to any arrangement where the tax benefit arising to all parties to the arrangement do not exceed a sum of INR 30 million in the relevant financial year.
- GAAR will not be applicable in respect of income from transfer of investments made before 1 April 2017. In this regard, it has been clarified that this grandfathering will be available to investments made before 1 April 2017 in respect of instruments that are compulsorily convertible into another instrument. Similarly, bonus shares, consolidation and stock splits in respect of shares acquired prior to 1 April 2017 in the hands of the same investor will also be eligible for grandfathering.
- GAAR shall not apply to a Foreign Institutional Investor (FII) which have not taken tax treaty benefits.
- GAAR would not be applicable to any investment made by a non-resident that directly or indirectly invests in offshore derivative instruments or otherwise through an FII.

GAAR and SAAR / LOB

Circular 7/2017 suggests that the provisions of GAAR and SAAR can co-exist and will be applicable as may be necessary, depending upon the facts and circumstances of each case. Similarly, with respect to GAAR vs LOB, the Circular provides that anti-abuse rules (such as LoB conditions) contained in tax treaties may not be sufficient to address all tax avoidance strategies, and hence these may need to be tackled through GAAR. However, if avoidance is sufficiently addressed by LoB in the treaty, then there may be no occasion to invoke GAAR.

In contrast, the Shome Committee had in its report on GAAR discussed the concerns arising out of interplay between GAAR and SAAR. It recommended that where SAAR is applicable to a particular aspect/ element, then GAAR should not be invoked to look into that aspect / element.

In this context, it would be interesting to see the interplay of GAAR with the Multilateral Instrument (MLI). The MLI which was recently released by the OECD as part of its Base Erosion and Profit Shifting (BEPS) project provides that as a minimum standard, countries should implement at least one of the following measures in its treaties

- Providing only for a principal purpose test (PPT), which is a general anti-abuse rule based on the principal purpose of transactions or arrangements
- A PPT supplemented with either a simplified or a detailed LOB provision, or
- A detailed LOB provision, supplemented by a mechanism to deal with conduit arrangements not already dealt with in tax treaties.

Given that the signatories to the convention may elect to opt in any of these alternatives in respect of their tax treaties, it would be interesting to see if such PPT 'sufficiently addresses' the abuse as envisaged by GAAR, and whether GAAR would still be applicable to the transaction.

Applicability of GAAR to Court approved Scheme of Arrangements

The Circular states that where the Court/National ompany Law Tribunal has explicitly and adequately considered the tax implications while sanctioning any arrangement, the provisions of GAAR will not be invoked. In contrast, the Shome Committee had recommended that amalgamations and demergers approved by the High Court should form part of the 'negative list' to which GAAR would not apply.

What next?

Section 101 of the Act provides that the provisions of GAAR will be applied in accordance with prescribed guidelines. Although this Circular deals with several issues that one would have expected to be covered in the guidelines, it is not clear whether any further guidelines under section 101 will be released. Having said that, unlike in the case of the draft report issued by a Departmental Committee and the Shome Committee in 2012, no examples relating to the applicability of GAAR have been released yet. A further clarification from the government will be of much help in understanding the scope of the legal provisions, particularly on issues such as the 'misuse or abuse' test, the 'commercial substance' test, etc. More clarity on how the consequences of GAAR will be determined and applied in specific instances will also be useful.

All in all, considering the recent Circular and with no further deferral being announced by the FM in the Budget of 2017-18, it is now evident that GAAR will make its debut starting 1 April 2017. This will require the taxpayers to make significant changes in the way they manage their tax affairs and also devise a plan to cope with the uncertainties that are likely to follow in the initial years.

Summary of Tax Proposals in the Budget
A. Direct Tax

Tax rates

Individuals

- For Individuals, Hindu Undivided Families (HUFs) and Association of Persons (AOP), the tax rate is reduced from 10% to 5% in respect of income between INR 250,000 and INR 500,000.
- For senior citizens (60 years to 80 years) tax rate reduced from 10% to 5% in respect of incomes between INR 300,000 and INR 500,000.
- Surcharge of 10% of tax introduced for incomes between INR 5 million to INR 10 million in case of Individuals, HUFs and AOP.

Companies

- Corporate tax rate reduced to 25% for companies with a turnover of less than INR 500 million in FY 2015-16. No other change in corporate tax rates.
- No change in Minimum Alternate Tax (MAT) rate.

Deductions and rebates for individuals

- The limit of deduction by way of contribution to the National Pension Scheme (NPS) for individuals (other than salaried individuals) increased to 20% of gross total income from the existing limit of 10%.
- Exemption provided in respect of partial withdrawal from NPS upto 25% of the contribution made.
- Taxpayers having gross total income of less than INR 1.2 million were entitiled to a deduction of upto INR 25,000 for three consecutive assessment years for investments in an equity savings scheme subject to fulfilment of certain conditions. This deduction has been discontinued going forward and will be phased out from Financial Year (FY) 2019-20.
- Tax rebate available to eligible resident individuals reduced from INR 5,000 to INR 2,500 in respect of incomes below INR 350,000.
- Interest income received by individuals from Non-Resident External (NRE) Accounts is exempt. The definition of 'a person resident outside India' for the purposes of this exemption is now aligned with the Foreign Exchange Management Act, 1999.

Taxation of House Property

- Annual Letting Value of building or land appurtenent thereto held as stock in trade (and not let out) will be taxed after a period of one year from the end of the financial year in which the completion certificate for the same is received.
- Set-off of loss under the head 'Income from House Property' against income from other heads is restricted to INR 200,000.

Taxation of Business income

- Tax deduction in respect of profit of units operating in a Special Economic Zone (SEZ) to be restricted to the total income of the taxpayer.

Disincentivising cash payments

- Any expenditure incurred in cash exceeding INR 10,000 for the acquisition of any asset to be ignored for the purposes of determination of actual cost of such asset.
- Any payment in cash above INR 10,000 to a person in a day to be denied deduction.
- Rate of 'presumptive income' reduced from 8% to 6% in respect of receipts through banking channels.
- Cash donations above INR 2,000 will not be allowed as deduction under section 80G.
- Cash transactions of INR 300,000 or more are prohibited. Person receiving cash of INR 300,000 or more is subject to penalty of an equal amount.

Banking sector

- Tax deduction in respect of provision for bad and doubtful debts increased from 7.5% to 8.5% for banks.
- Interest on loan from a co-operative bank to be allowed as a deduction only on payment basis. The payment should be made on or before the due date of furnishing the return of income.

Depreciation on excess consideration over book value

- Where a deduction claimed under section 35AD in respect of certain capital spends is subsequently withdrawn, depreciation will be allowable on the the actual cost of the capital asset as reduced by the notional depreciation calculated from the date of its acquisition.
- Currently, eligible start-ups have an option to claim 100% tax holiday for any three consecutive years out of five assessment years since incorporation. This time limit of five years has been increased to seven years.
- To promote development of the affordable housing sector, following relaxations are proposed:
  - While computing the size of residential unit "carpet area" to be considered instead of "built-up area"
  - The restriction of 30 square meters on the size of residential units to apply only to projects located within the municipal limits of Chennai, Delhi, Kolkata or Mumbai.
  - The time limit for completing the project increased from existing three years to five years.

Carry forward and set-off of loss in case of eligible start-ups

- Accumulated losses of closely held companies lapse in case of a change in shareholding beyond 51%. This provision has been relaxed in the case of start-ups. This is subject to the condition that the original shareholders continue to hold their shares from the year in which loss is incurred, to the year in which the loss is proposed to be set-off. Thus, any change in shareholding of start-ups due to capital infusions by new investors will not affect accumulated losses.
- This relaxation applies only to losses incurred during the period of seven years from the date of incorporation.

Maintenance of books of accounts and tax audits

- Individuals and HUFs carrying on business or profession no longer required to maintain books of account if their income is below INR 250,000 and sales / turnover / gross receipts is below INR 2.5 million.
- Any person opting for the presumptive taxation scheme for specified businesses is not required to get his books of accounts audited if his total sales, turnover or gross receipts in business for the previous year does not exceed INR 20 million.

Minimum Alternate Tax (MAT)

- Book profits for MAT to be computed in line with Indian Accounting Standards (Ind AS) with effect from AY 2017-18 for companies to which Ind AS applies.
- Starting point for computation of book profit to be Net profit before Other Comprehensive Income (OCI).
- Items in OCI not be reclassified to P&L for items such as Revaluation of Property, Plant, Equipment, Intangible assets, Financial Instruments etc. to be included in book profits at the time of disposal / retirement / transferred.
- On first time adoption, 'transition amount' to be included in book profit over a period of 5 years.
- In case of demerger, impact of fair value accounting under Ind AS to be ignored.
- MAT / AMT credit allowed to be carried forward for 15 years (from the existing 10 years)
- FTC in excess of MAT to be ignored for MAT / AMT carry forward purposes

Foreign Portfolio Investors (FPIs)

- The provisions of indirect transfer will not be applicable to Category-I or Category-II FPIs (with retrospective effect from AY 2012-13).
- The Finance Minister in his budget speech mentioned that a clarification will be issued that the indirect transfer provisions will not apply in case of redemption of shares or interest arising out of redemption or sale of underlying investments in India which are chargeable to tax in India.
- Concessional withholding tax rate of 5% on interest payment in case of rupee denominated bonds issued to FPIs will now be available for interest payable upto 1 July 2020.

International Taxation

- In respect of double tax avoidance agreements entered into with countries or specified association in certain territories, if any term is not defined under the agreement, it shall be assigned the meaning as definition in the Act or any explanation issued by the Central Government.

Transfer pricing

- Transactions between two domestic related parties outside the scope of Specified Domestic Transaction provisions, except where one of the parties is claiming a profit-linked deduction.
- In order to align the transfer pricing provisions in line with OECD transfer pricing guidelines and international best practices, the assessee shall be required to carry out secondary adjustments where a primary adjustment to the transfer price has been made in certain circumstances.
- Where primary adjustment exceeds INR 10 million and funds have not been brought into India, such amount will be treated as an advance made and interest will be imputed thereon in the prescribed manner.
- Thin capitalization rules are proposed to be introduced in respect of interest (and other similar) payments exceeding INR 10 million paid to associated enterprises (not applicable to banking and insurance companies). Key aspects are as under:
  - Deduction of such interest is restricted to actual interest paid / payable or 30% of EBITDA, whichever is lower; and
  - Excess interest paid will be allowed to be carried forward for 8 years.

Capital Gains

Preventing abuse of the long-term capital gains exemption regime

- Exemption for long term capital gains on sale of listed shares will not be available for shares acquired on or after 1 October 2004 without payment of Securities Transaction Tax (STT). However, to protect the exemption in genuine cases where STT could not have been paid, such as acquisition of shares in an IPO, FPO, bonus, rights issue, preferential allotment to foreign investors, etc., appropriate exceptions will be notified.

Joint Development Agreement (JDAs)

- A relaxation has been provided from capital gains on deemed transfer of immovable property in JDAs in the hands of individuals and HUFs. The incidence of capital gains in such cases is deferred to the year in which the certificate of completion is issued for the whole or part of the project. It is also provided that the cash consideration (if any) received along with stamp duty value of the share in the project (land / building) as on the date of completion shall be the full value of consideration for computing the gains.
- However, in case the share in the project is transferred before completion, capital gains taxation will apply on such sale.

Transfer of unquoted equity shares

- In case of transfer of unquoted equity shares, gains will be calculated based on Fair Market Value (FMV) if the consideration received is lower than the FMV. The manner of determining FMV will be prescribed.

Tax incentive for development of the new capital city of Andhra Pradesh

- Andhra Pradesh government has come up with a land pooling scheme for the development of a new capital in Amaravati. The landowners are provided reconstituted plots or land as compensation for pooling of their land in this scheme.
- Capital gains earned by individuals or HUFs from the following transfers pursuant to the land pooling scheme is exempted with retrospective effect from 1 April 2015:
  - Transfer of land or building or both;
  - Sale of Land Pooling Ownership Certificates by Landowners (received in lieu of land transferred); and
  - Sale of reconstituted plot or land by landowners (within two years from end of the financial year in the possession of such plot or land was handed over to them).

Conversion of preference shares to equity shares

- Conversion of preference shares into equity shares will not trigger capital gains tax. In such cases, the cost of acquisition and the period of holding of such equity shares shall be the same as that of the original preference shares.

Others

- Land and buildings will qualify as long term capital assets if held for two years.
- The base year for imputing fair value as the cost of acquisition for computing capital gains changed from 1 April 1981 to 1 April 2001.
- An exemption from transfer of mutual fund units on account of consolidation of mutual fund schemes was provided in the Finance Act, 2016. As a consequent amendment, it is now proposed that the cost of the units received consequent to consolidation (regarded as an exempt transfer) will be the same as the cost of the mutual fund unit which was transferred on consolidation.
- Transfer of rupee denominated bonds by one non-resident to another will not trigger capital gains. The benefit of exclusion of rupee appreciation on redemption of rupee denominated bonds has been extended to secondary holders (this was earlier available only to subscribers of such bonds).
- Long term capital gains to the extent of INR 5 million are exempt, if the taxpayer invests the whole or any part of capital gains in certain specified bonds of the National Highways Authority of India / Rural Electrificiation Corporation. It is proposed to widen the scope of this provision to also cover other bonds (having redemption period greater than three years) as may be notified by the Central Government.

Widening scope of 'income from other sources'

- The provisions of section 56(2)(vii) – relating to receipt of cash and other specified property without adequate consideration by indviduals / HUFs and provisions of section 56(2)(vii)(a) - relating to receipt of shares of closely held companies willl not apply from FY 17-18 onwards.
- Going forward, any specified property (including immovable property, listed / unlisted shares), received without adequate consideration by any assessee, will now be taxed under the head 'income from other sources'.
- Business reorganizations and other specified exclusions are carved out from the above provision.

Trusts and Political parties

Application for fresh registration of trusts in case of change of objects

- If a registered trust has adopted or undertaken modifications of its objects which are not in conformity with the conditions of registration, such trust must now obtain a fresh registration by making an application within a period of thirty days from the date of such adoption or modifications.

Tax return

- Exemption to income of trusts / political parties will not be available unless the trust/political party has furnished its return of income for the previous year under consideration, within the specified time limit.

Cash donations to Political Parties

- Political parties cannot accept cash donations exceeding INR 2,000

Exemption of income of certain Relief Funds

- Income of the Chief Minister's Relief Fund and the Lieutenant Governor's Relief Fund will be exempt from tax with retrospective effect from 1 April 1998.

Corpus donations

- Voluntary contribution towards corpus by any fund or trust or institution or university or educational institution or any hospital or other medical institution to any registered trust or institution shall not be treated as application of income to the objects of such donors.

Withholding tax

- Individuals or HUF (other than those liable to tax audit) shall be liable to withhold tax of 5% in case of rent payments exceeding INR 50,000 per month paid to a resident.
- Payment of money under a JDA to individuals or HUF liable to withholding tax at the rate of 10%.
- Taxes shall be withheld at the rate of 2% on the payment for professional or technical services, made to a payee engaged only in the business of operation of call centre.
- Any payment made in respect of award or agreement which has been exempt from levy of income-tax by virtue of the provisions of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, shall be exempt from withholding tax provisions.

- Concessional withholding tax rate of 5% on interest payment in case of moneys borrowed in foreign currency from non-residents will now be available for borrowings made before 1 July 2020. Similar benefit has been extended to interest payable to a non-resident on 'masala bonds' with retrospective effect from AY 2016-17.
- No withholding tax in case of payments in the nature of insurance commission where the payee furnishes a declaration in the prescribed form (with effect from 1 June 2017).

Compliance and Procedures

- Time limit to file revised returns reduced to 12 months from the end of the relevant financial year.
- Filing of belated return of income to attract a late filing fee. Maximum late filing fee of INR 10,000 proposed.
- Interest at 0.5% per month payable on TDS refunds due to a deductor.
- Penalty of INR 10,000 (per report / certificate) to be imposed on merchant bankers / registered valuers / accountants for furnishing incorrect information in any report or certificate

Jationalisation of Tax Collection at Source and Interest on Advance Tax

- Sale of jewellery in cash will not be subject to tax collection at source.
- Specified buyers such as Central and State Governments, Embassy, High Commission, local authority, public sector company engaged in business of carrying passengers etc. exempted from provision of tax collection at source on purchase of motor vehicle.
- Buyers (other than non-residents not having permanent establishment) subject to tax collection at source shall furnish Permanent Account Number, failing which, tax to be collected at source shall be higher of, twice the rate specified or 5%.
- No interest on deferment of advance tax payable,

  if shortfall is on account of dividend income which is subject to additional tax of 10%.

Procedures

- Time limit for completion of regular assessment proceedings to be reduced in a phased manner from AY 2018-19 onwards:
  - AY 2018-19: 18 months from the end of the relevant AY (from existing 21 months)
  - AY 2019-20: 12 months from the end of the relevant AY (from existing 21 months)
- Return of income has to be processed within the prescribed time-limit (and refunds are to be issued) unless prior approval of higher authorities is sought by the Assessing Officer. This is effective in respect of the return of income filed for AY 2017-18 and onwards.
- Credit for foreign taxes not granted earlier (on the basis that such tax payment was in dispute) will be granted by way of rectification of the relevant intimation/ assessment order upon settlement of dispute subject to furnishing of evidence of tax payment/ settlement of dispute within the prescribed time frame.
- Charitable Trusts to be included within the purview of a survey.
- During the course of a search, Authorized Officer empowered to:
  - Provisionally attach property belonging to the Assessee for a period of 6 months subject to approval from the higher authorities
  - Make reference to a Valuation Officer for estimation of FMV.
- Scope of initiation of assessment / reassessment proceedings pursuant to a search extended to ten years from the existing six years subject to prescribed conditions.
- Reason to believe / reason to suspect not to be disclosed to any person / authority or Appellate Tribunal in cases of search proceedings to ensure confidentiality of such cases.
- The Central Board of Direct Taxes empowered to issue necessary directions in respect of levy of penalty for non-compliance with provisions relating to deduction / collection of taxes at source

- The Authority for Advance Ruling for income-tax, central excise, customs and service tax will be merged.
- Order passed by Commissioner of Income-tax (Exemption) in case of Charitable Funds / Institutions or any trust or institution set up wholly for public religious purposes and / or charitable purposes will be appealable before the Income Tax Appellate Tribunal.

Miscellaneous

- It is proposed to tax all categories of taxpayers who receive income by way of dividend in excess of INR 1 million at the rate of 10%. The provisions of this section will not be applicable to domestic companies and certain funds, trusts, institutions, etc.
- Gross income received from transfer of carbon credits proposed to be taxed at 10%. No expenditure or allowance can be claimed against such income under the Act.
- The amendment made in the Finance Act, 2016 extending the concessional rate of 10% on long term capital gains arising to non-residents from the sale of private company shares has been made retrospectively applicable from FY 2012-13 onwards

B. Indirect Tax

Goods & Services Tax (GST)

With the focus on implementing GST in FY 2017-18, the Government has made minimal legislative changes in existing indirect tax laws. Although the Finance Minister referred to the consensus on GST and the readiness of the IT infrastructure in his Budget Speech, he did not lay down any concrete timetable in this regard. He has however, in the past, stated that 1 July 2017 will be the likely date for introduction of GST.

Tariff Rate

- No change in peak rate of Customs, Excise & Service Tax
- Changes in Customs Duty / Excise duty rates on account of the following:
  - To incentivize domestic value addition - 'Make in India' (e.g. LNG, parts of LED)
  - To address problems of inverted duty structure (e.g. solar tempered glass)
  - To provide protection to the domestic industry (e.g. PCBs for mobile)
  - To promote cashless transactions and domestic manufacturing of device (POS card reader, micro ATM, Scanner & components)
  - To improve ease of doing business and export promotion (e.g. increase in limit of duty free import of inputs for leather / synthetic footwear)
  - Anti-avoidance measures (e.g. silver coins)

Customs – Key legislative changes

- Meaning of 'importer' and 'exporter' amended to include a beneficial owner. 'Beneficial owner' is defined to mean any person on whose behalf the goods are being imported or exported or who exercises effective control over the goods being imported or exported
- Meaning of 'Customs station' is amended to include international courier terminal and foreign post office.

- Bill of entry needs to be filed within the next working day of arrival of vessel / aircraft / vehicles. Delay in filing would attract charges as may be prescribed.

- Payment of Customs duty is to be made at the time of presentation of Bill of Entry in case of self-assessment and within one working day (currently - 2 days) from the day of return of bill of entry by the Customs officer in case of assessment, reassessment or provisional assessment

- The facility of storing dutiable goods (pending clearance) in a public warehouse now stands extended to goods meant for warehousing. Further, for goods meant for home consumption (pending clearance), the facility of storing such goods in private warehouse stands withdrawn.

Service Tax – Key legislative changes

- Retrospective exemption from 1 June 2007 to 21 September 2016 for upfront lease payment for services by way of leasing of industrial plots for a period of 30 years or more by State Government corporations / undertakings to industrial units. For Service tax collected, refund applications can be made within 6 months from the date of Finance Bill receiving presidential assent.

- Rule 2A of the Service Tax (Determination of Value) Rules, 2006 has been amended to exclude value of land while calculating value of works contract service. In case where value of land is not identifiable, the value shall be considered as 25% / 30% of the total consideration as applicable.

Common legislative changes

- Amendment in Advance Ruling provisions (Customs, Central Excise & Service Tax)
  - Common Authority for Advance Rulings for Income Tax, Customs, Central Excise, Service tax. Pending cases on the date of assent of Finance Bill, 2017 would be transferred to the common authority,
  - Time limit for pronouncement of advance ruling increased from 90 days to 6 months.
- Application for Settlement has also been extended to co-noticees.
- Settlement Commission can amend its order within three months to rectify any error apparent on record.
- Research & Development Cess repealed effective 1 April 2017.

CENVAT Credit

- A proviso has been inserted to Explanation-I(e) of the Rule 6(3D) of the CENVAT Credit Rules, 2004 (CCR) to exclude banks, financial institutions (including NBFCs). The said amendment requires value of interest or discount to be considered for the purpose of reversal of CENVAT Credit under Rule 6(3) and Rule 6(3A) of the CCR. The amendment would be effective 2 February 2017.
- Rule 10 of the CCR has been amended requiring an assessee to make an application for transfer of credit in case of sale, merger, demerger, amalgamation etc. The said application shall be allowed within a period of 3 months from date of receipt of application. Further, an extension may be sought by Deputy/Assistant Commissioner for further period of six months from Principal Commissioner on providing sufficient cause/reasons.

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