BUDGET SUBMISSION REPORT

UK INDIA BUSINESS COUNCIL

CBI THE VOICE OF BUSINESS

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INTRODUCTION

This submission is the outcome of extensive business consultation conducted by the UK India Business Council (UKIBC) and Confederation of British Industry (CBI), in advance of the India Budget which is due to be presented on 1st February 2017.

The UK is the largest G20 investor and job creator in India. There are some 535 UK businesses in India with estimated combined annual revenues of more than $54bn. UK businesses employ 691,000 people and have an aggregate annual Indian wage bill in of excess $6bn. In total, these companies have invested US$22.2 billion in the form of equity FDI between April 2000 and September 2015. UK businesses make an important contribution to the Indian economy and society through job creation, training and CSR activities[1].

Critically, UK businesses represent a significant percentage of the formal corporate sector in India as shown by analysing the employment generated by British companies by sector in India as a % of all foreign employment.

Industry		British companies's % share
All industries		7%
Services sector		7%
Food processing industry		52%
Chemicals		58%
Drugs & Pharmaceuticals		27%
Petroleum & natural gas		38%

Source: Sterling Assets India, 2015

As such, the policies of the Indian Government and the announcements in the Indian budget are an increasingly important factor in the decision-making process of UK businesses and not just those already in India, but the many others considering international investments and weighing the options to enter the Indian market.

BUILDING MOMENTUM THROUGH 2016

UK industry in India saw several positive developments in the Indian economy during 2016. These developments have led to a growth in headline GDP and in the earnings experienced by many companies in the UKIBC and CBI memberships.

The pro-growth budget of February 2016 was supplemented by FDI reforms in defence, insurance, railways, and retail. Another key feature was increased transparency in key sectors such as power generation and natural resources.

Signature programmes such as Make in India, Digital India, and Smart Cities have started to gain traction and attract foreign investment. Competitive federalism and policy initiatives to improve the ease of doing business are beginning to pay dividends in moving India up the World Bank's Ease of Doing Business rankings.

[1] Sterling Assets India: UK Investment Creating Indian Jobs. September 2015 CBI/ UKIBC/ PwC

Many respondents felt that the actual rankings understate the tangible improvements already felt on the ground and pointed to specific issues such as the first ever National IPR Policy improving India's IP regime and stimulating creativity and innovation in the economy, the passage of the *Insolvency and Bankruptcy Code 2016,* the passage of the GST Bill and the demonetisation announcement of 8th November 2016.

LOOKING AT 2017 AND BEYOND

Respondents believe that there is much to be positive about in 2017 and beyond.

While it is accepted that the decision to demonetise high denomination currency notes may result in a short term drop in India's growth rates, the medium and long term benefits of greater transparency in the economy, higher tax collections and higher growth outweigh such near-term issues.

Indeed, of equal, and perhaps greater, significance are the direct and indirect benefits which are expected to flow from GST, once rolled out. An incremental increase of 1.0 – 1.9% pa in GDP growth that a "single market" catalyses will bring a double-digit growth closer to reality. The computerisation and consequent transparency of commercial transactions will significantly enhance the Ease of Doing Business.

Another important positive for respondents is that GST will result in the levelling of the playing field between the formal and informal sectors.

THE SUBMISSION

The UKIBC and the CBI have gathered the views of some 85 UK companies in advance of the 2017 Budget on 1 February.

The respondents came from a wide range of sectors including defence, pharmaceuticals, telecommunications, IT hardware, life insurance, oil and gas, beverages, healthcare, manufacturing, chemicals, infrastructure, banking and financial services.

The submission is in three parts:

1. **the second annual UKIBC survey on Ease of Doing Business in India**;
2. **consolidated issues from the respondents**, which are grouped thematically in the Summary Findings section; and
3. detailed responses by sector, which are presented in the annexes.

SURVEY FINDINGS

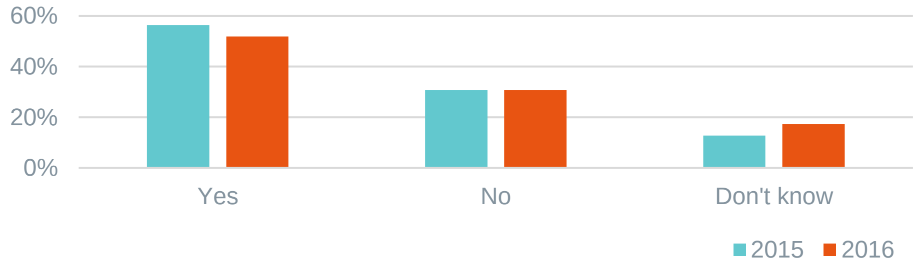
Set out below is the second annual UKIBC survey on the Ease of Doing Business. The first survey was conducted amongst UK businesses operating in India in November 2015 immediately in advance of the visit to the UK by Prime Minister Modi. The second survey was conducted, asking the same questions, in November/December 2016. A selection of the comparative results are included in this submission to set the scene for a more detailed discussion.

The survey respondents were from across sectors and were split almost equally between SMEs and larger businesses.

Our analysis revealed that the results of the second survey closely mirrored those of the first.

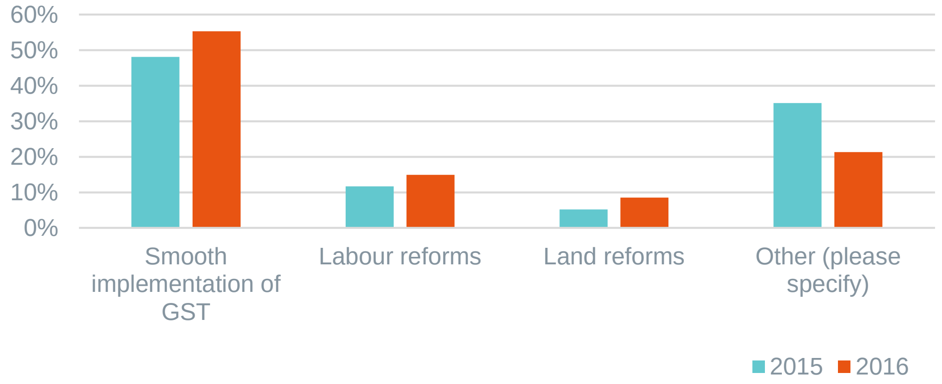
ON THE WHOLE, DO YOU THINK IT IS GETTING EASIER TO DO BUSINESS IN INDIA?

The majority of respondents have noticed an improvement in India's business environment – this was the case both in 2015 and 2016. The 2015 survey found that 56% of respondents were optimistic that India's ease of doing business was improving, while the number was 52% in 2016.



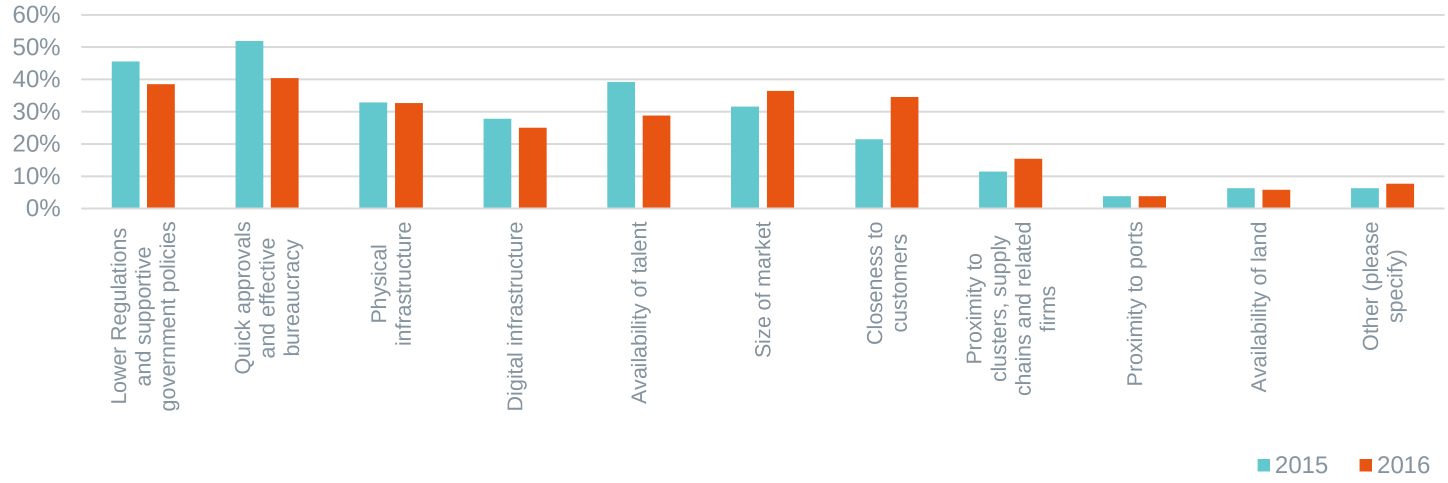
WHICH OF THE FOLLOWING REFORMS IN YOUR OPINION WILL SIGNIFICANTLY IMPROVE INDIA'S BUSINESS ENVIRONMENT?

Implementation of GST was found to be the most effective reform to significantly improve India's business environment with 55% opting for this in 2016 and 48% choosing it in 2015.



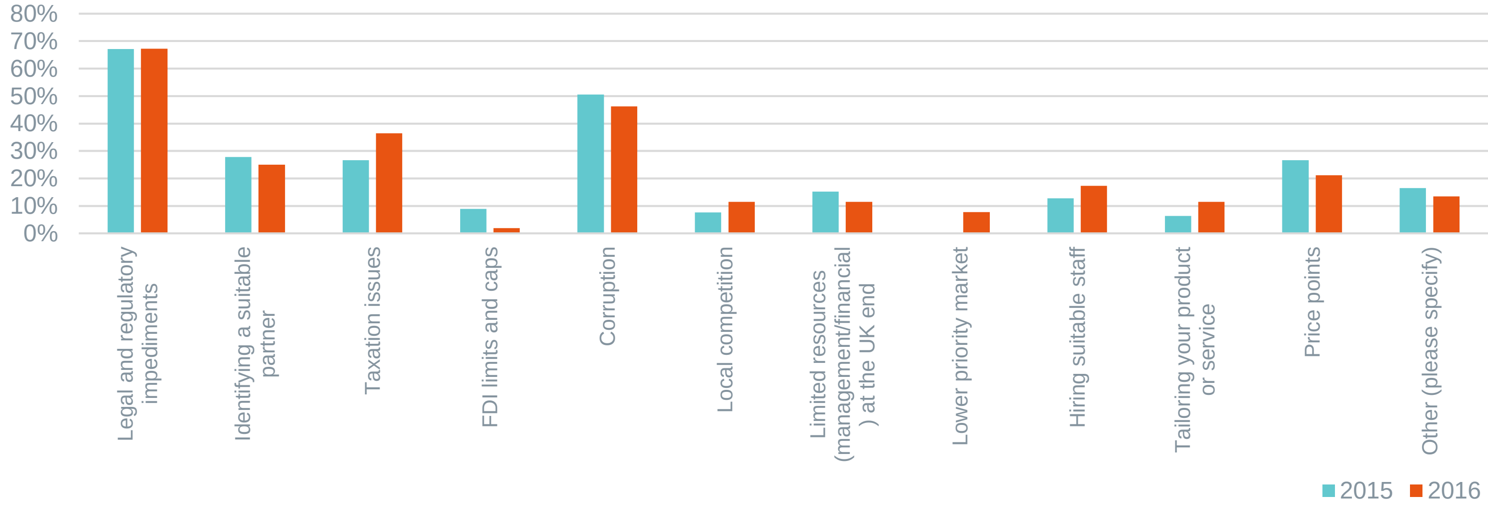
WHICH FACTORS ARE MOST IMPORTANT WHEN CHOOSING WHERE IN INDIA TO INVEST?

When asked which factors were most important when choosing which states to invest in, 'quick approvals and effective bureaucracy' was deemed most important by respondents with 52% in 2015 and 40% in 2016 choosing this factor. 'Lower regulations and supportive government policies' followed closely behind in both surveys with 46% choosing it in 2015 and 38% in 2016.



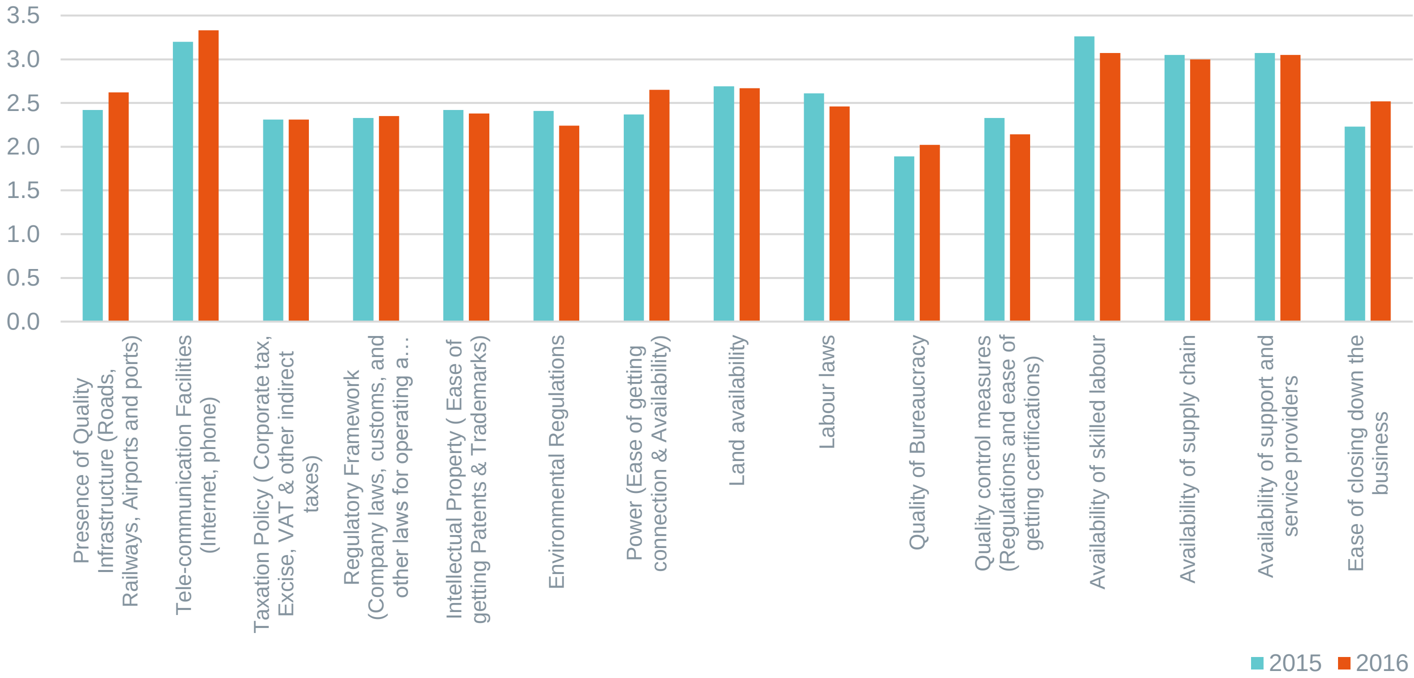
WHICH OF THE FOLLOWING BARRIERS TO DOING BUSINESS DO YOU PERCEIVE TO EXIST IN INDIA?

Legal and regulatory impediments were found to be the biggest barrier in both years (voted by 67% in 2016 and by 67% in 2015), followed closely by corruption, which came second in both surveys (at 46% in 2016 and 51% in 2015). The only difference was that taxation ranked higher as a barrier to doing business in 2016 (at 37%) than identifying a suitable partner, which ranked third in 2015 at 28%.



HOW DO YOU RATE THE DIFFERENT COMPONENTS OF INDIA'S BUSINESS ENVIRONMENT MENTIONED BELOW?

In both years, the ‘availability of skilled labour’ and ‘telecoms facilities’ were rated most highly followed by the ‘availability of supply chain’, the ‘availability of support and service providers’ and ‘power (ease of getting connection)’.



UK INDIA BUSINESS COUNCIL

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SUMMARY RESPONSES

ECONOMIC OVERVIEW FY 2018

The World Bank and other agencies have pared-down the expected Indian GDP growth rate for 2016-17 from 7.6% to around 7%, due to the recent demonetisation and slightly weak private investments in the economy.

The World Bank is optimistic about the resilience of the Indian economy and expects the country to return to its growth rate within 2017-18 as reforms loosen domestic supply bottlenecks. Growth in 2016 -17 will further be boosted by the good monsoon after two consecutive bad years, resulting in improved agricultural production and consequent increase in rural income and employment.

In the next fiscal year, inflation will not be the chief worry for the economy, and the government is expected to meets its target of reining in the fiscal deficit at 3.5%. Consumer inflation is likely to remain moderate – below 5%, and a civil service pay rise will continue to support real incomes and consumption.

However, certain intrinsic challenges will remain. In the last two and a half years, the economy has been running primarily on government expenditure and private consumption which are only two out of the four engines of the economy. This has led to a pressure build up on the external finances of the economy. Weak global demand has led to a lacklustre export performance – a trend which started from December 2014. The government may also face a significantly higher oil import bill as there are predictions that 2017 will see a rise in oil prices to $52 a barrel, up from around $40 in 2016. Announcements made by the Prime Minister on New Year's Eve on welfare measures add another Rs 3,500 crore of expenditure.

Private investments, the fourth wheel of the engine, have contracted over the last three quarters. However, in 2017-18, this is expected to recover as banks and firms de-leverage and the effects of important structural reforms like GST and the Insolvency and Bankruptcy Code start to make an impact.

Following the global slowdown and demonetisation at home, it is recommended that the government should:

- Increase budgetary outlay for infrastructure by creating an environment of attracting investment from the private sector and the FPIs. An action plan for the National Investment and Infrastructure Fund is expected;
- It is expected that an enhanced capital outlay could be nearly Rs 2.8 lakh crore which is more than 12% of the previous year;
- Tax breaks for economic zones and revamping public-private projects to make them attractive to FPIs; and
- A higher outlay for affordable housing, shipping, ports and roads.

THEMATIC OBSERVATIONS

A very wide range of issues have been covered in this submission, many of them specific to each sector. The detailed sector specific submissions are in annexes A to I.

The recommendations that the UKIBC and CBI believe would bring most benefit to the Indian economy and wider society, and would therefore like to see implemented, are set out below.

1. **Highlight the opportunities.** The majority of respondents want to increase investments in India, but there is a lack of medium-term clarity on areas of major Government expenditure, for example defence, and on plans for infrastructure development. This deters investment decisions.

   Overall it was felt that a revamping of the Fiscal Responsibility and Budget Management (FRBM) Act would give much greater clarity and guidance to financial planning and hence to investment decisions.

   Defence

   Defence respondents observed that the defence budget for FY17 was 1.71 % of the GDP, and including defence pay and pensions it amounted to 2.26 % of India's GDP. This 2.26% expenditure is lower than the 3% of GDP recommended by the parliamentary standing committee.

   Investors would welcome a statement from the Finance Minister setting-out projected defence budget levels for the next 5 years. Further, a split between spending plans for land, sea, air and cyber would be welcome. As would a split between legacy, new and emerging equipment programmes.

   As well as accelerating the modernisation of India's armed forces through the procurement of state-of-the-art equipment, higher defence expenditure and greater clarity on the Government's defence priorities and procurement plans would incentivise existing UK investors to invest more and it would encourage new investment.

   Infrastructure

   At the same time, the Government of India's focus on infrastructure development is important and welcome as it will support the transformation of the Indian economy and society. To achieve value for money and effective delivery of projects, integrated infrastructure planning is required which necessitates excellent coordination and cooperation among the various transport ministries and departments.

   In addition, the Government has identified the need for foreign expertise for initiatives such as smart solutions for cities and the modernisation of the Indian railways. It is therefore important to incentivise foreign firms to participate in such programmes through various tax and non-tax benefits.

   The lead taken by the Ministry of Railways in proposing a National Integrated Transport Plan should be adopted and followed more widely. Such a plan would inform future transport development and ensure that money is spent wisely releasing maximum benefit. This would allow India to manage its financial resources efficiently.

2. **Make the operating environment more competitive.** India is an attractive environment in terms of the economic growth and skilled workforce. However, the operating environment remains challenging from an absolute and a relative tax and regulatory point of view.

Numerous respondents across sectors highlighted the need to focus on the corporate tax environment. In the 2015 Budget, the Finance Minister stated that the corporate tax rate will be reduced from 30% to 25% in a phased manner over four years. So far, it has been lowered to 29%. At the same time, respondents also called for the reduction of Dividend Distributive Tax, which pushes-up the effective tax rate to around 45.67%, thereby undermining India's competitiveness as an investment destination.

A reduction in corporate and effective tax levels will encourage more businesses to invest more in India, thus generating a virtuous cycle of job creation, increased consumption and savings, and tax revenues.

At the same time, the residual issues of retrospective tax still drive external perceptions. The high-profile cases, started by the previous government, are ongoing to the detriment of India's image among global investors, the companies involved, and their clients/customers, staff, and wider local communities. The companies involved have had to sell assets, postpone major investments, and substantially reduce their workforces.

While the Government of India's approach of allowing the current arbitration to play-out may reflect political realities, it gives the impression that the Union Government is being dragged to a solution rather than taking a bold and welcome initiative.

Respondents continue to believe that the most positive step the Government of India could take would be to repeal the 2012 legislation on retrospective taxation, drop the outstanding cases, and adopt international norms.

3. **A smooth and fair implementation of GST.** Overall, the benefits of GST are recognised and the Government of India is to be congratulated on the successful passage of the Constitutional Amendment.

   Annex M of this submission identifies several issues associated with the introduction of the GST, including the treatment of sectors such as alcohol, petroleum products, and services (such as insurance, healthcare and senior living) that are delivered pan-India.

   Such issues relate to either the level at which GST might be levied and/ or whether the compliance/ reporting/ monitoring is conducted either at State or at the Centre. At the same time, concerns have been expressed that sectors such as healthcare services which are exempt from service tax are not subject to GST.

   Industry would also welcome clarity on the scope of the draft law, commencement date, and on the transition processes for what will necessarily be a complex technical operation in how government departments – centrally and in States – and businesses operate. It is hoped that the transition period will allow flexibility to enable all parties to adapt to the new regime.

4. **A simpler, fairer and more predictable tax regime that encourages investment in important sectors.** India is a fast-developing economy. A more certain and equitable tax regime improves the ease of doing business and will attract more FDI and domestic investment in the Indian economy, particularly in those sectors which are vital to economic

growth. The respondents' individual comments and recommendations are set out in the next section. For instance, inter alia, respondents highlighted the following issues:-

- Finance: the extension of sunset clausing under Section 194LC and 194LD of the Income Tax Act 1961 and extension of benefits to External Commercial Borrowings (ECBs); the reinstatement of "Export" as a PSL eligible asset class by bringing it at par with international banks (less than 20 branches norms);
- Spirits: respondents request a phased reduction in BCD to 75% in Year 1 and then to 30% over the next 2-4 years to provide a boost to the growing domestic BII segment;
- Investment Services: allow netting of underlying losses with underlying gains on equity disposals, meaning Indian-based funds are subject to tax at a level which aligns with the economic returns actually received;
- Insurance: "zero-rating" should be applied to the life and healthcare insurance sectors to mitigate against the capital-intensive nature of the industries during the set up phase.
- Defence: a greater liberalisation in the defence FDI regime to allow more of the US$20bn worth of offset investment to be realised.

CONCLUSION

As the budget recommendations (above) and the survey results illustrate, UK business remains positive about India. They welcome the reforms being introduced by the Government of India, and have made clear the areas that would make most difference in improving the ease of doing business.

The Annexes below provide more detail on: sector specific and cross-cutting issues; GST on alcohol and petroleum products; and lists the businesses that have contributed to this submission.

ANNEX A – AEROSPACE / DEFENCE

DEFENCE BUDGET

Issue 1

Businesses want to increase investments in India, but the lack of medium term clarity on defence expenditure in the UK defence sector. This deters them from making investment decisions in the short term.

Businesses observed that the defence budget for FY17 was 1.71 % of the GDP, and including defence pay and pensions it amounted to 2.26 % of India's GDP. This expenditure is lower than the 3% of GDP recommended by the parliamentary standing committee, which obviously affects the overall allocation of funds towards modernisation of India’s defences, particularly its ability to procure new equipment.

Recommendation

To set out projected defence budget levels for next 5 years both in real and percentage terms. Further, a split between spending plans for land, sea, air and cyber would be welcome. As would a split between legacy, new and emerging equipment programmes.

Industry would very much welcome incentives for defence-related research and development in India.

Benefit to the Indian economies

As well as accelerating the modernisation of India’s armed forces through the procurement of state-of-the-art equipment, higher defence expenditure and greater clarity on the Government’s defence priorities and procurement plans would incentivise existing UK investors to invest more and it would encourage new investment. It would also boost the defence sector as a whole, particularly for domestic manufacturers seeking international partners and new growth opportunities.

Issue 2

The government increased the FDI limit to 49 per cent in 2014 (and up to 100% in certain cases), but this has largely been ineffective in achieving India’s objective of technology enhancement. Around $20bn worth of offset investment is yet to be realised in India.

Recommendation

Given the scale of this investment, a more liberalised FDI regime would encourage more companies to transfer technology and provide more confidence around issues of ownership.

Benefit to the Indian economies

Greater transfer of technology will unleash several benefits - it will enable India to attain global manufacturing standards, and help achieve PM Modi’s ‘Make in India’ objectives. It will also allow the Indian advanced engineering sector to develop its supply chain, cater to its domestic market more effectively as well as export globally.

INDIRECT TAX

Issue 3

The definition of the “Intermediary clause” is wide enough to cover services of primary and basic facilitation into its ambit. The intent of laws was never to tax services that are business auxiliary and preparatory in nature. The generic nature of the definition makes the tax authorities challenge every support function as an intermediary function and hence levy tax. This results in prolonged litigation and unnecessary hardship to the tax payer. Also it increases the cost by the service tax rate of 14%.

Recommendation

It is strongly suggested that the definition of “intermediary” should be made applicable to only those functions that are directly related and impact the revenue generating activities. The changes should not seek to tax support or preparatory functions for businesses.

Benefit to the Indian economies

Implementing the aforementioned changes will ensure that India is not viewed negatively from an investment perspective. It will also ensure that there are no impediments to Government of India’s ‘Make in India’ objective particularly from a tax barrier point of view. Reduction of tax uncertainty will improve the ease of doing business.

DIRECT & INDIRECT TAX

Issue 4

Withholding tax on reimbursement of assignee charges. The issue around withholding tax on reimbursements of assignee charges to the overseas entity has been a subject matter of debate over the past many years. The tax authorities have been contending that the reimbursed constitutes fee for technical services and hence should be subject to withholding tax. There have been recent judgments professing the same.

Recommendation

It is strongly recommended that since these charges are purely in the nature of costs of the employee benefits borne by the overseas entity these should not be taxable. The employment of assignees that have been transferred to India under secondments do not constitute as a provision of services to the Indian entity. Therefore, these should be treated as a cost-to cost reimbursement and not subject to withholding. Further taking a contrary view will create further hardships for the overseas entity to apply for a PAN in India and also get into the compliances of filing the tax returns in India etc. Not getting a PAN will further impose a higher rate of tax on the overseas reimbursement. Such a treatment reduces investors’ confidence in India as an investment destination and downgrading India’s ranking on ease of doing business.

Benefit to the Indian economies

Removing this clause would increase investors’ confidence in India as an investment destination and will enable the country to move higher up the ease of doing business ladder.

Issue 5

Direct Tax Exemption for Domestic companies under section 10(6C) at par with foreign companies

Currently the tax exemption is available only for foreign companies engaged in defence and earning fee for technical Services while working with the government on projects connected with the security of India. This not only discriminates but also does not provide a level playing field to the domestic companies.

Recommendation

It is strongly recommended that such or a similar exemption should be provided to Indian companies including Indian subsidiaries of foreign companies.

Benefit to the Indian economies

Equal treatment for both domestic and foreign companies will create a level playing field and promote further participation in the defence sector which is in line with the PMO's vision.

ANNEX B – BEVERAGES

Issue 1

Basic Customs Duty

India currently imposes Basic Customs Duty (BCD) of 150 percent on all distilled spirits (bottled or bulk) that are imported into the country. As the country's economy progressively integrates into the global trading system, while customs duty rates have reduced for most other goods – peak rate of 30% - this has not been the case with beverage alcohol.

India's BCD (150%) is very high when compared with other Asia-Pacific countries: Thailand – 60%; Vietnam – 45%; Philippines – 15%; China – 10%.

In addition, Alcohol is out of the scope of GST, though the tax would still apply to the inputs of goods and services acquired by the industry for use in production and distribution of alcohol with no mechanism to set off GST on inputs. The industry faces significant non-recoverable GST costs with up to 80% increase in procurement taxes. Letters sent to the Minister of Finance are included in Annex N.

Recommendation

1. Businesses therefore request a phased reduction in BCD to 75% in Year 1 and then to 30% over the next 2-4 years. Such reform has widespread industry backing - the Confederation of Indian Alcoholic Beverage Companies (CIABC), the association of primarily Indian producers, has recommended reduction of BCD to 30% to the Commerce Ministry in its pre-budget recommendation both in 2015-16 and 2016-17.

2. Where possible, new import duties to include a minimum bench mark, customs-duty payable, to ensure some ongoing protection for lower-value domestic spirits.

Benefit to the Indian economies

As Indian market dynamics have changed, the time is now right to change the BCD structure. Growth in demand for higher quality products is being met by international brands that are being Bottled in India (BII). The growth of BII products has led to increased international investment as well as the creation of jobs. A lower BCD for bulk spirits will significantly boost the growth of this segment.

Local producers have expanded their business through significant foreign direct investment aligning India's domestic spirits industry more closely with global distilled spirits production. Reducing the BCD would encourage greater foreign direct investment and contribute to the growth of the Indian domestic spirits industry.

Indian companies are increasingly entering into distribution agreements with international producers to market and distribute international products.

There are significant revenue growth opportunities for the Government through BCD reduction:

1. Increasing tax revenues by reducing the incentive for non-tax paid activity. In countries and states with robust regulatory systems and practical tax policies to govern the sale of alcohol, the illicit sector is small or non-existent. Illicit represents a substantial foregone tax revenue and is an important driver of social cost. As per the FICCI – Cascade Report of 2015, the total loss to the Government due to counterfeit attributed to 7 industries is Rs. 39,239 crores - 16% of which is from the alcohol beverage sector. Reduced BCD would reduce the incentive for inflows from grey markets, unlicensed and counterfeit channels.

2. Volumes shift from Duty Free to Domestic Market. Currently the liquor sales from duty free shops are approximately double the sales from the domestic market. As the revenues from the duty-free shops do not come to the government, rationalising the BCD would ensure an increase in the legitimate volumes of duty-paid liquor.

3. India has an opportunity to become a value-added production hub. Both due to the large domestic market but also due to the export potential to North Africa and the Middle East. Thailand, Vietnam, Philippines, and China have become hubs of production as they have lowered BCD.

ANNEX C – FINANCIAL SERVICES

Below are a wide range of issues and recommendations covering the financial services industry. Contributors are from the banking, investment services, and insurance industries, and the issues they raise include: external commercial borrowings; common reporting standards, payment card services; service tax on bank charges; GST; and priority sector lending.

BANKING

DIRECT TAX

Issue 1

Extension of sunset clause under Section 194LC and 194LD of the income tax, 1961 Act and extension of benefits to External Commercial Borrowings (ECBs) in INR.

The existing provisions of Section 194LD of the Act, provide for lower withholding tax at the rate of 5 percent in case of interest payable at any time on or after 1st June, 2013 but before 1st July, 2017 to Foreign Portfolio Investors ('FPIs') on their investments in government securities and rupee denominated corporate bonds subject to fulfilment of certain conditions. The benefit of the concessional withholding tax has been appreciated by the foreign investing community who has invested heavily into government debt thereby exhausting the aggregate government debt investment limit for foreign portfolio investors.

Similarly, Section 194LC of the Act provides for concessional withholding tax rate of 5% on interest earned on issue of long-term bond at any time on or after 1 October 2014 but before 1st July 2017 in foreign currency subject to fulfilment of certain conditions.

Both the above sections providing concessional rate have a sunset clause as of 30 June 2017. Accordingly, in respect of Section 194LD - interest payable to FPIs with effect from 1 July 2017, a general withholding tax rate on interest at 20% will apply. For investors other than FPIs, the withholding tax on interest on investments on specified security/loan made on or after 1 July 2017 will be 20%.

Additionally, RBI has allowed rupee denominated ECB primarily to help address the concern of borrowers carrying the foreign currency risk.

Currently, Section 194LC only covers money borrowed in foreign currency from a source outside India under a loan agreement or by way of issue of long-term bonds. Accordingly, it appears that withholding rate of 5% does not apply to ECBs denominated in INR.

The key difference between foreign currency ECB and INR ECB is that in case of the INR ECB, liability of the borrower is crystallised in INR and exchange rate risk is borne by the lenders/investors. While in case of foreign currency ECB, liability of the borrower is crystallised in foreign currency and exchange rate risk is borne by the borrower instead of the lenders/investors.

Recommendation

Extension of sunset clause Under Section 194LC and 194LD of the Act and extension of benefits to External Commercial Borrowings (ECBs) in INR.

The intention of introduction of Section 194LC and 194LD was to provide long term low cost funds to Indian entities from abroad. To retain the attractiveness of Indian bonds for foreign investors and align consistency in interest payments to foreign investors irrespective of the currency of loan or interest payments i.e. Indian Rupees or Foreign Currency, we request your consideration for the following points:

Keeping in mind the spirit of these sections, the sunset date for both Sections 194LC and 194LD should be extended for further 5 years (i.e. from 1 July 2017 to 1 July 2022). This would incentivise the investors to invest for a longer period and build market for this segment and therefore as a corollary would broaden the investor base. This will provide a much needed boost to the Indian bond market which is yet to achieve its full potential. The recommended extension period is at-least 5 years considering the aspect of promoting long term investments and also ties into the prevalent rule of allowing FPIs to invest in bonds with a minimal residual maturity of 3 years. Keeping in mind the intention behind the introduction of section 194LC of the Act (i.e. augmentation of long-term low cost funds from abroad) and long term nature of ECBs denominated in INR, the benefit of the concessional tax rate should also be extended to ECBs in INR.

Issue 2

FATCA and Common Reporting Standard

1. List of jurisdiction referred to the definition of Passive Non-Financial Entity ("Passive NFE") to be notified by the Central Board of Direct Taxes ("CBDT")

    i. As per Rule 114G of the Income-tax Rules, 1962 ("the Rules"), the Reporting Financial Institutions ("RFI") in India are required to report information about financial accounts maintained by them that are identified as 'reportable accounts' pursuant to due diligence procedures specified in Rule 114H of the Rules.

    ii. As per Rule 114F(6) of the Rules, the definition of 'reportable account' includes account held by a Passive NFE with one or more controlling persons resident in a country/territory outside India.

    iii. The Passive NFE among other includes an investment entity described in sub-clause (B) of clause (c) of the Explanation to clause (3) of Rule 114F, which is not located in any of the jurisdictions specified by the Central Board of Direct Taxes in this behalf.

    iv. So far, list of such jurisdiction has not been notified. In the absence of list of specified jurisdiction, it may lead to an absurd interpretation that investment entity in every jurisdiction including the United States of America are covered in scope. This is resulting the financial institutions being unable to determine the reportable status of Passive NFE.

2. Aligning the definition of Reportable Account with definition provided in the Standard for Automatic Exchange of Financial Account Information (Standard) issued by Organisation for Economic Co-operation and Development ("OECD")

As per Rule 114G of the Rules, RFI in India are required to report information about the financial accounts maintained by them that are identified as 'reportable accounts' pursuant to due diligence procedures specified in Rule 114H of the Rules.

As per Rule 114F(6) of the Rules, 'Reportable Account' among other includes "financial account" which has been identified, pursuant to the due diligence procedures provided in rule 114H, as held by, a passive non-financial entity with one or more controlling persons that is a person described in sub-clause (b) of clause (8) of this rule."

Persons described in sub-clause (b) of clause (8) of this rule are as follows:

"(8) "reportable person" means,-

one or more persons other than,-

i. a corporation, the stock of which is regularly traded on one or more established securities markets;

ii. any corporation that is a related entity of a corporation mentioned in item (i);

iii. a Governmental entity;

iv. an International organisation;

v. a Central bank; or

vi. a financial institution,

That is a resident of any country or territory outside India (except the United States of America) under the tax laws of such country or territory or an estate of a decedent who was a resident of any country or territory outside India (except the United States of America) under the tax laws of such country or territory;"

It can be observed that if the entity account holder is a Passive NFE then the Financial Institution must "look-through" the entity to identify its controlling persons. If the controlling persons are "reportable persons" then information in relation to the Financial Account must be reported, including details of the account holder and each reportable controlling person.

It is submitted that the definition of "reportable account" as provided in the rules is not in alignment with the definition provided in the Standard issued by OECD. The definition of reportable account as per the OECD Standard is as follows:

"The term "[Jurisdiction A] Reportable Account" means a Financial Account that is maintained by a [Jurisdiction B] Reporting Financial Institution and held by one or more [Jurisdiction A] persons that are Reportable Persons or by a Passive NFE with one or more Controlling Persons that is a [Jurisdiction A] Reportable Person."

On comparing the definition of reportable account in the Rules as well as in the Standard issued by OECD and considering the changes introduced in the amended definition of Passive NFE in the Rules, it can be observed that Rules require a financial institution to treat only those Passive NFE as "reportable person" which are not located in the jurisdiction to be specified by the CBDT, but the controlling persons of such entity are tax resident of any country other than India (including jurisdictions specified by CBDT).

This is in clear contrast with the requirement as per the Standard issued by OECD wherein only those Passive NFE are treated as "reportable person" which are not located in the participating jurisdiction, but the controlling person of such entity are tax resident of participating jurisdiction.

Recommendation

FATCA and Common Reporting Standard

1. List of jurisdiction referred to the definition of Passive Non-Financial Entity ("Passive NFE") to be notified by the Central Board of Direct Taxes ("CBDT"): It is submitted that the list of jurisdictions be notified by CBDT.

2. Aligning the definition of Reportable Account with definition provided in the Standard for Automatic Exchange of Financial Account Information (Standard) issued by Organisation for Economic Co-operation and Development ("OECD"): Recommend to amend the definition of "Reportable Account" to align the same with the definition provided in the OECD Standard.

INDIRECT TAX

Issue 3

Credit card, debit card, charge card or other payment card service

Effective 1 May 2006, a new taxing head "credit card, debit card, charge card or other payment card services" has been introduced in the Finance Act, 1994. Section 65(33a) of that Act defines such service to include, among others, any service provided by any person, including an *'issuing bank'* and an *'acquiring bank'*, to any other person in relation to settlement of any amount transacted through such card.

Therefore, effective 1 May 2006, the services collectively rendered by the issuing bank, acquiring bank and the Card Associations (for example Master Card, Visa) in relation to the settlement of the amount transacted through the use of such card by the card holder is liable to service tax.

In this connection, we enclose as an illustration a typical credit card transaction showing the various steps involved in flow of money between the various parties—please refer **Exhibit 1**. Explained below briefly is the role of each person in relation to the settlement of the amount transacted through the card:

Merchant: Merchant is the supplier of goods or services who accepts the payment from his customers by way of Card. To achieve this, electronic equipment (POS terminal) is provided to the Merchant by the Acquiring Bank to enable validation and acceptance of such Card payment.

Acquiring Bank: This is the Bank that pays the Merchant for all valid transactions carried out through the use of the Card by the cardholders. This Bank pays to the Merchant the aggregate amount representing credit card transactions, net of applicable discount.

Card Association: Card Associations (for example, MasterCard, Visa) facilitate the validation and settlement of transaction and also acts as a settlement intermediary between various *Acquiring banks* and *Issuing banks*.

Issuing Bank: This is the Bank that issues the Card (carrying its name) to its customer (card holder). Typically, this Bank periodically issues bill/statement to its cardholder for the transactions carried out by such holder through the use of Card.

The *Acquiring Bank* typically earns the gross Discount income from its Merchant (Rs. 4 shown in step no. 3 of the enclosed illustration). The *Acquiring Bank* shares a portion of such Discount (through the Card Association) with the Issuing Bank (such share is referred to as "*Interchange*"—shown in step no. 5 of the enclosed illustration as Rs. 2). In result, the *Acquiring Bank* makes a net income of Re. 2 (gross Discount of Rs. 4 minus Interchange paid of Rs.2). The *Issuing* Bank earns income of Rs. 2 as its share thereof.

In a theoretical situation, the *Acquiring Bank* should be liable to pay service tax on its share of net income — Re 2 in the above illustration and the *Issuing Bank* should be liable to pay service tax on its share of income – Re 2 in the above illustration. In aggregate, the Government will receive service tax on total gross income of Rs. 4 arising from the card transaction i.e., on Re. 2 (Discount less *Interchange*) from the *Acquiring Bank* and on Rs. 2 (*Interchange*) from the *Issuing Bank.*

Recommendation

The *Acquiring Bank* and the *Issuing Bank* do not deal or settle the card transactions inter-se directly—the *Card Associations* are the interface to facilitate the settlement of card transactions. The sheer volume of credit card transactions poses significant administrative difficulty, if not impossibility, in creating documents that will allow the *Acquiring Bank* to claim credit for service tax payable by the *Issuing Bank* on the interchange (in the above example Rs. 2). This is further compounded by the fact that the *Card Associations* are non-residents providing similar settlement platform globally that makes it difficult to meet with India specific documentation requirements. In the circumstances, levying single-point service tax on the gross Discount earned by the *Acquiring Bank* (i.e., Rs. 4 in the above example) should fully overcome the practical difficulties faced by the banking industry in general. At the same time, it will be service tax revenue-neutral from the perspective of the Government of India since the total service tax revenue will remain receivable on the total income of Rs. 4. The company therefore kindly requests the Central Board of Direct Taxes to issue appropriate clarification to the effect that service tax is payable by the *Acquiring Bank* on its gross Discount income and therefore no further service tax has to be paid by the *Issuing Bank* on its Interchange income being the share of such Discount.

Issue 4

Service tax - Service Tax on bank charges paid by foreign banks

As part of trade related services, a bank in India liaises with an overseas correspondent bank for collection of export proceeds/remittance of import proceeds on the request of its customers. During this process, the overseas bank acts on behalf of overseas trade counterparty and may levy its charges /

fees, which may be deducted from export proceeds of Indian customer / additionally charged to Indian importer.

Banks in India separately charge their customers for trade related services rendered, on which they levy and recover service tax from the customers. However, since banks in India are acting in their capacity as "authorised dealer" while dealing with the overseas correspondent banks, they have taken a position that they are not liable to service tax by way of reverse charge on charges levied by the overseas correspondent banks. This is a unanimous position adopted by all the banks including foreign banks, Indian private sector banks and public sector banks.

Office of the Commissioner of Service Tax - I, Mumbai has issued a Trade Notice, contending that it's the banks in India and not their customers who obtain and utilise the services of overseas correspondent banks. Hence, the banks in India are liable to pay service tax by way of reverse charge. Accordingly, notices have been issued to all Banks to provide data for last five years.

The actual service recipient is the Indian customer. The India Banks merely facilitates the payments in the capacity as Authorised Dealer. Hence, the Indian Banks cannot be considered as service recipients.

Recommendation

It is recommended to withdraw the Trade Notice bearing No. 20/13-14-ST-I dated 10 February, 2014 and clarify that the Indian Banks are not service recipients.

Issue 5

Goods and Service Tax

Issue 5a

Services between branches in India
Unlike goods, rendering of services cannot be physically tracked, measured or monitored. Under current regime of service tax, intra-entity services are not subject to any tax due to inherent nature of "services".

Recommendation

The principle should also be expressly extended that the services rendered between two establishments in India within the same legal entity and the same should not be subject to any separate tax. This provision should be expressly enacted within both CGST and SGST laws.

Issue 5b

Compliance and Audit

Due to interconnected and seamless nature of services provided within banking and financial services industry, multiple audits under each state jurisdiction will create complete chaos and uncertainty in taxability of services. In view of this a single India-wide GST registration number should be granted with state prefix for the purposes of tracking and administrative convenience.

Recommendation

It is recommended that the assessment of tax return should be the responsibility of the Central Govt only. Alternatively, single body representing both the Centre and the States could conduct audit of banks at one location centrally. To ensure seamless implementation of GST and full compliance including documentation, all invoices, returns, forms, challans, accounting codes, rules, procedures, etc. must be uniform across the country. The Select committee in its report under para 3.44 has also recommended, relevant extract is as below:

"Further, single registration coupled with IGST provision should be made available to enable CenVAT credit for consumers of banking services."

Issue 5c

Coverage of services

Currently, service tax is applicable on all categories of services provided in the taxable territory by one person to another for a consideration other than services specified in the negative list of services.

The interest component on loans has never been charged to service tax thus far. An exemption has also been provided for the interest component in relation to overdraft facility and cash credit facilities. Likewise, a special dispensation has been provided in respect of inter-bank transactions in relation to foreign currency. Accordingly, interest, and inter-bank transactions in relation to foreign currency should not be liable to GST.

Recommendation

It is recommended that the current regime for taxation of services should continue under the GST law, ensuring consistency in taxation of services by incorporating appropriate provisions in GST law.

PRIORITY SECTOR LENDING (PSL)

Issue 6

International banks face a significant challenge in meeting priority sector lending targets. International banks (with more than 20 branches) are required to lend towards Agriculture and Low income group (weaker section) segments at par with local banks. It requires a wider network and a different set of capabilities to serve this segment and assess risk. The International banks are required to obtain specific branch license for each branch from the regulator. This requirement has significantly constrained the branch network of International banks in India and thereby impacting their ability to achieve PSL targets. It is noteworthy that in the event of shortfall, the banks are required to place funds with notified Govt. agencies at extremely low yield, resulting in adverse P&L impact for the banks. It is estimated that annual cost of PSL for SCB India will go up to ~USD 100Mn by year 2020. It has a dual impact for international banks as they are not only restricted from expanding their presence (which can compensate for the priority sector burden) but also have to comply with stringent PSL norms/ related costs.

Up until March 2013, international banks in India could comply with PSL norms mainly through export finance. Export / trade finance has been a core strategy of most international banking operations and it blended well with the prevailing PSL norms till March 2013. RBI revised the PSL guidelines effective

From April 2013, wherein international banks with 20 or more branches are required to follow PSL norms as applicable to domestic banks. Three banks got impacted (SCB, Citi, HSBC) with the revised norms, which included Agriculture/ Weaker section lending targets and excluded export finance from eligible categories.

Detailed challenges are as follows:

1. Limited branch network due to restricted branch licensing regime: Achievement of PSL norms have been a challenge even for large Indian banks with vast branch networks. Significant amount of local level engagement with customers is required (from loan disbursement through to repayment/ recovery). The International banks are required to obtain specific branch license for each branch from the regulator. This requirement has significantly a constrained the roll-out of branch networks of International banks in India thereby impacting their ability to achieve PSL targets.

2. Limited capabilities, in terms of product, processes and credit assessment, to serve Agriculture/ weaker section segment which involves small value & high volume business. The loan size can be as small as USD 1000-2000 per borrower with non-uniform cash flow cycle linked to agriculture crop cycle.

3. The cross border global structure of International banks makes it economically challenging business proposition to target the segments (Agri/ Weaker section) on standalone basis

4. These regulations are unique to India and SCB has no precedence of doing such business elsewhere. In some of the other markets, even though there are directed lending targets (e.g. Bangladesh has less than 5% target) they are relatively low, whereas in India the requirement at 40% is significantly steep.

Recommendation

We believe that international banks should be allowed to achieve PSL targets through export finance and other partnerships models between financial institutions. Also, the regulator should consider removing the restrictions for international banks to open branches at par with local banks.

Our recommendation is to reinstate1 ‘Export’ as a PSL eligible asset class by bringing it at par with International banks (less than 20 branches) norms. Please note that for these banks, Agri, Micro or Weaker section targets are not applicable under current PSL guidelines.

Benefit to the Indian economies

This would help establishing level playing field for all International banks. This will provide the necessary impetus to export sector of the economy which has been declining over last few years. This would also tie in well with the global network strengths of international banks in terms of cross border trade flows.

KEY ASKS

1. Usher in FRBM Version 2.0 to revamp fiscal responsibility. In order to revamp the previous fiscal responsibility guidelines in accordance with the changing economic and financial order, the FY18 Budget can consider:

i. Adhering to a point target for fiscal deficit (instead of a range target) to avoid policy ambiguity and uncertainty for financial markets

ii. Fixing medium-term consolidated fiscal deficit target (for Centre & States) at 6% of GDP & placing a ceiling on Govt debt at 60% of GDP (to be achieved over the next 3 years)

iii. Framing detailed Expenditure Rules in favour of capital spending & set up a Fiscal Council to ensure adoption of rule-based fiscal policy

2. Enhance Savings in the Economy for Investment Revival:

The implementation of the 7th Central Pay Commission and the ongoing demonetisation exercise will boost financial savings. Adoption of a GEAR (Growth – Efficiency – Attractiveness - Reach) approach will further augment domestic financial savings:

i. Enhance economic GROWTH to increase per capita incomes: Income Tax slabs can be carved out as per recommendations of the Direct Tax Code (DTC) Committee to provide immediate thrust to household incomes & financial savings

ii. Focus on EFFICIENCY in financial transactions: Increased use of technology will improve ease of transactions, enhance saving propensity, monetise the economy and help bring down demand for floating currency. The Government. and RBI can consider appropriate incentives for wider spread of POS terminals

iii. Make financial savings ATTRACTIVE: Increase inflation adjusted post tax returns & introduce product innovation.

3. E-Gold: Grant exemption from reserve requirements for Gold Monetisation Scheme to reduce costs for banks by 50-100 bps. For high net worth entities such as religious trusts, the Govt. can make participation in GMS mandatory, with relaxed declaration norms.

4. Tax Incentives: Critical for newly generated savings of the working youth and also to boost spending:

i. 80C limit can be increased to INR 3 lakhs from current INR 1.5 lakhs to help deepen the Mutual Fund industry & Capital Markets (large pool of savings can be incentivised from Pay Commission roll out).

ii. Encourage bank deposits by reducing lock in for tax rebates to 1 year (from 5 years) & enhance threshold for mandatory TDS on interest income to INR 50,000 a year (from INR 10,000 currently).

5. Financial Diversification & Safety Net: Household savings in pension instruments in India is restricted to just 1.2% of GDP.

i. Address disparity in post-tax returns of EPF/ PPF/ NPS by moving towards uniform tax treatment

ii. Reintroduce inflation indexed bonds to promote financial savings & significantly lower reinvestment risks for pension/ provident/gratuity funds.

iii. Expand financial REACH: Aided by better digital & communications infra in rural areas, Indian Post Payment Bank (IPPB) can be a game changer to financialise a large base of the economy at low costs & boost rural savings.

iv. Activate the Post Offices in India, by getting Banks to open extension counters in their premises.

6. Create & Incentivise cash-less transactions

   i. Equip debit cards with smart chips for public transport payment (on lines of T-money in South Korea). The chip should be modified to fit credit/debit/SIM cards (which means people can tap their mobile phones to take the bus/ metro).

   ii. Develop mechanism for change for payments at retail outlets not in cash/coins but through e- wallets.

   iii. Create progressive, enabling regulatory and licensing framework for the vital, high growth Fintech sector.

   iv. Safeguard all stakeholders, ensure cost and time-efficient remittances. Enable creation of Regulatory Sand-box for quicker turn around as well as limiting risks.

7. Lower Cost of Funding for Transformational Growth

   i. A vibrant Corporate Bond Market is essential for infra growth - a new Trading Platform for Corporate Bonds (on lines of Govt Bonds) can be institutionalised; further, Banks should be allowed to hold 0.5-1.0% excess SLR in high quality corporate bonds (AAA/ AA+).

   ii. Progressively enable lower cost of funds by 100-150 basis points for both corporate & retail borrowers.

   iii. Calibration of sectoral risk weights in select sectors such as Affordable Housing, Renewable Energy, to drive credit appetite.

   iv. Guidelines for end use of ECBs can be relaxed, with relevant risk mitigants – this will reduce cost of funds, allow IBUs wider ambit, include lending for refinance of ECBs (currently not permitted). Tax holiday for IBUs can be extended from 5 years to 20-25 years (similar to Dubai).

   v. Building on success of GIFT City, set up new IFCs in Mumbai and Noida/ Gurgaon, along with enabling regulatory environment.

   vi. A Refinance window at RBI can be opened up (under SIDBI) at prevailing repo rate to help SMEs tide over short term liquidity crunch (likely stress due to demonetisation). Will also cushion the sector during transition to a new ‘less cash’ norm.

   vii. Create a Centralised Portal/ Repository for updated bank account details of all MSMEs - ~90% MSMEs are partnerships/ proprietorships - such a portal, with Udyog Adhaar linkage, will increase transparency of MSME financial data, enable automating financial assessment real time, reducing decision making time & leading to further reduction in interest costs by ~1%.

Recommendation

For 'High Output, Growth Multiplier' Sectors:

1. De-risking Infra & Energy Financing Sectors

   i. Enhance Take-out Financing Schemes for Renewable Energy Sector.

   ii. Encourage setting up of domestic Warehousing Facility by structuring a large number of small projects together to attract Institutional investors.

   iii. Set up Credit Enhancement schemes to facilitate investment from institutional investors in infra.

   iv. projects.

2. Integrated growth through Smart Cities & Affordable Housing

   i. Akin to recently unveiled Municipal bonds, allow Smart City Bonds (within infra bonds category)

   ii. Award incremental F.A.R. if projects are completed on time

3. Unlocking India's Soft Power through Tourism

   i. Lower tax rate for tourism & hospitality Industry in GST to minimum bracket, preferably less than 10%

   ii. Special incentives like tax-free bonds & income tax exemptions on profits invested back

   iii. Permit LTA every year (vs. current restriction of 2 times in 4 years) – in addition to transportation, also include lodging related expenses

4. Develop India as a food-processing powerhouse

   i. Widen ambit of PSL to reduce cost of funds - qualify loans to units as PSL (Agriculture) without any upper cap on lending (currently Rs. 100 Cr) (will reduce cost of funds by 1-2% p.a.).

   ii. Increase access to low cost institutional credit - Credit Guarantee Scheme, with 75% risk coverage (up to Rs 20 Cr for each unit) & corpus of INR 5,000 Cr for Greenfield units.

INVESTMENT SERVICES

Issue 1

Netting of losses and gains on realisation of equity investments

Typically when a company invests, in conjunction with other investors, in India - focussed funds ("Funds") incorporated in the form of a limited liability partnership ("LLP"), registered as an Alternative Investment Fund ("AIF") with tax pass-through status for Indian tax purposes.

The tax pass-through status of the Fund means that the company (as an investor), rather than the Fund, is liable for Indian tax on gains realised on the disposal of underlying Indian equity portfolio investments in an assessable period, as if the company had made such investment directly.

However, where disposals of the underlying equity investment result in a loss, and the investor has a tax registration in India, these losses are only available for offset against gains of future periods and are not available for carry back against historic gains.

In circumstances where an investor does not have a tax registration, such losses cannot be passed through to the investors and is instead retained at the Fund level.

Therefore, over the life of a Fund, (say 10 years) the level of profits to which the company is subject to taxation in India may not reflect the economic return achieved on its overall investment in the Fund, given the restricted manner in which these losses can be utilised by an investor.

In the most severe situations, the company could actually end up paying tax on individual gains whilst generating an overall loss on its entire commitment to a Fund.

Recommendation

The Ministry of Finance is therefore requested to consider:

- facilitate the netting of underlying losses with underlying gains on equity disposals so that investors in India - focussed funds are subject to tax on a level of income that aligns with the economic returns actually achieved; and
- to allow the pass-through of losses on underlying equity disposals to investors in India - focussed funds, irrespective of their tax registration status in India, such that these losses could be utilised against other income subject to tax in India.

Issue 2

Management fees

Management fees to Fund managers are paid in line with usual commercial private equity practice, typically structured to be a proportion of the overall value of capital committed to such a fund. The value of the management fees materially impact the economics of the returns achieved on investments, however no account is taken for such cost in the calculation of profits to which the investor is subject to Indian tax.

Recommendation

Businesses should be allowed to deduct management feed when calculating underlying gains on equity disposals to align the basis for taxation with the actual economic returns achieved on investing into India. It should also be noted that the recipient of the management fee income in India would be taxable on such income, so the allowance of a deduction would achieve equitable treatment for the fees.

Benefit on the Indian Economies

Amending this legislation as outlined above will encourage greater foreign investment in India - focussed funds, thus stimulating investment into India's private sector, particularly high growth businesses with the potential to employ large numbers of people.

Issue 3

Offshore fund managed from India

The existing provisions of section 9A of Act provides that in the case of an eligible investment fund, the fund management activity carried out through an eligible fund manager acting on behalf of such fund shall not constitute business connection in India of the said fund.

An eligible investment fund means a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefits and fulfils certain condition prescribed in sub-section 3 of section 9A of the Act. It is submitted that some of the conditions prescribed are not feasible to satisfy. Hence, in order to enable fund management activity, such conditions should be relaxed as follows:

Section 9A(3)(c) provides that the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed five per cent. of the corpus of the fund; We wish to highlight that in case of public market funds, it is practically impossible to verify whether indirect investment in the fund by persons resident in India does not exceed 5% of the corpus of the fund. In this regard, the fund can rely on declaration from the direct investor regarding the participation of Indian tax residents. However, practically it may be difficult to obtain such declaration in respect of upward investor participation.

Recommendation

Offshore fund managed from India

It is recommended to amend the said condition of Section 9A(3)(c) as follows: "the aggregate direct participation or investment in the fund by persons resident in India does not exceed five per cent. of the corpus of the fund;"

Issue 4

Sub-section (e) to (g) of Section 9A(3) provides as follows:

- (e) the fund has a minimum of twenty-five members who are, directly or indirectly, not connected persons;
- (f) any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding ten per cent;
- (g) the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than fifty per cent

It may be noted that government related investors such as central banks, sovereign wealth funds, pension funds, etc., may not satisfy this condition given their ownership structure. Further, given the language of the aforesaid clauses, the following categories of funds may get excluded:

- Offshore funds investing into India via intermediate holding companies; and
- funds which have less than 10 institutional investors comprising the total corpus.

Further, the conditions are a significant constraint. Hence, it is recommended that the diversification related conditions be aligned to the requirements prescribed under SEBI (FPI Investors) Regulations, 2014.

Recommendation

Sub-section (e) to (g) of Section 9A(3) amendments have been suggested substituting all three clauses as follows:

"the fund shall either be a broad based fund or a fund with investors, directly or indirectly, being Government and Government related investors such as Central Banks, Governmental agencies, sovereign wealth funds, international or multilateral organisations or agencies, insurance / reinsurance companies, university funds and pension funds" Explanation: For the purpose of the above clause, broad based fund shall have the same meaning assigned to it under Explanation 2 to clause (b) of Regulation 5 of Securities Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

Issue 5

Sub-section (h) and (i) of Section 9A(3) provides as follows:

- (3)(h) the fund shall not invest more than twenty per cent of its corpus in any entity;

- (3)(i) the fund shall not make any investment in its associate entity;

It is submitted that in case of offshore fund which is not an India focused fund i.e. the fund invests in entities in India as well as outside India, there could be situations where the fund invests more than 20% of its corpus in an entity outside India in a country where it is permitted to do so. Hence, it is submitted that the above condition of sub section (3)(h) could be restricted to investments in India. Similarly there could be situations where the offshore fund invests in an associate entity outside India in a country where it is permitted to do so. Hence, the condition mentioned in sub section (3)(i) should be restricted to investments in India.

Recommendation

It is recommended to amend the above clauses as follows:

- "(*3)(h*) the fund shall not invest more than twenty per cent of its corpus in any entity which is established or incorporated in India;"

- *"(3)(i)* the fund shall not make any investment in its associate entity which is established or incorporated in India;"

Issue 6

Sub-section (j) of Section 9A(3) provides as follows:

“the monthly average of the corpus of the fund shall not be less than one hundred crore rupees: Provided that if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of such previous year;”

It is submitted that in case of a newly set up offshore fund, (particularly, if the fund is set up closer to March 31) it may be difficult to have a monthly average corpus of more than Rs 100 crores. Hence, a 12-month period could be provided to newly set-up funds, for satisfying this condition.

Recommendation

It is recommended to amend sub-section (j) of Section 9A (3) as follows:

“(3)(j) the monthly average of the corpus of the fund shall not be less than one hundred crore rupees: Provided that if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of such previous year or 12 months from the date of establishment or incorporation of the fund, whichever is later;”

Issue 7

Sub-section (m) of Section 9A(3) provides as follows:

“the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken by him on its behalf is not less than the arm’s length price of the said activity.”
Fund manager and the fund may not be a related entity in all cases, and hence, where they are not related, the transaction would be inherently at arm’s length. Where they are related parties, the transaction will be subject to transfer pricing provisions, irrespective of this condition.

The eligibility of the fund will be impacted only if the remuneration paid or payable by the fund to the fund manager has been determined to be not at arm’s length price for a period of three previous years in succession; or for any three out of the preceding four previous years. However, considering that transfer pricing assessments happen 3 years in arrears and the precedents are usually followed in subsequent years, practically this relaxation may not achieve any result.

Recommendation

It is recommended that the condition of sub section 3(m) should be dropped.

Issue 8

Clause (a) of Sub-section (4) of section 9A of the Act provides that the eligible fund manager, in respect of an eligible investment fund, means any person who is engaged in the activity of fund management and fulfils the following conditions, namely: (4)(a) the person is not an employee of the eligible investment fund or a connected person of the fund.

Recommendation

It is submitted that "connected person" condition should be deleted. New clause should read as under: "the person is not an employee of the eligible investment fund"

Issue 9

Clause (b) of Sub-section (4) of section 9A of the Act provides that the person is registered as a fund manager or an investment advisor in accordance with the specified regulations; The definition of specified regulations only includes "SEBI (Portfolio Managers) Regulations, 1993" and "SEBI (Investment Advisors) Regulations, 2013. Thus, this may not cover certain intermediaries such as mutual fund managers.

Recommendation

CBDT should also notify Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, for the purposes of specified regulations under this clause.

Issue 10

Clause (d) of Sub-section (4) of section 9A of the Act provides that the person along with his connected persons shall not be entitled, directly or indirectly, to more than twenty per cent of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through the fund manager.

There is an ambiguity around the period to be considered for ascertaining profits, particularly in case of open ended funds and in the event of a loss or marginal profit situation which will be known only at the end of the period, the fund manager cannot charge any fee, and if it does charge the fee might exceed the limit imposed in this clause. This may pose serious business challenges in remuneration model.

Recommendation

It is recommended to delete condition of clause 4(d).

Issue 11

Sub-section (5) of section 9A of the Act provides that every eligible investment fund shall, in respect of its activities in a financial year, furnish within ninety days from the end of the financial year, a statement in the prescribed form, to the prescribed income-tax authority containing information relating to the fulfilment of the conditions specified in this section and also provide such other relevant information or documents as may be prescribed. It is not clear whether non-compliance with this section (i.e. if the statement is not furnished within 90 days) will result in denial of the beneficial provisions to the offshore fund. Section 271FB already penalises the Fund for not furnishing the statement at INR 500,000.

Recommendation

Considering it's an administrative lapse, it should be expressly clarified that non-furnishing of statement should not result in denial of tax benefit under section 9A.

ANNEX D – INSURANCE

The insurance industry has proposed, below, issues and recommendations from the perspectives of both the customer and the industry.

ISSUES FROM THE CUSTOMER'S PERSPECTIVE

Issue 1

Tax benefit should not be the deciding factor for an individual contributing to a pension scheme under the National Pension Scheme (NPS) or buying a pension policy issued by a life insurance company. Life insurance companies should also have a level playing field as compared to the NPS as the product issued i.e. pension fund is similar and these companies also contribute towards the growth of the economy through majority investments in government securities and the infrastructure and housing sectors.

Issue 2

In India, it is expected that by 2050 between 25-30% of population will be above the age of sixty years. In the absence of an active social security framework, it is important that people are encouraged to buy annuities to provide for retirement. Under the current laws, an individual can commute up to one third of policy proceeds, which is received tax-free. The balance two third of the fund is converted to an annuity policy and the annuity is taxable.

Recommendations

Deductions to be allowed under the Income Tax Act, to contributions in the NPS, should also be extended to pension policies issued by life insurers.

The annuities received should be tax free under Section 10 (10A) of the Income Tax Act.

To give impetus for investment in life insurance policies, returns on policies, which do not qualify for exemption under Section 10 (10 D), should be treated at par with normal investments such as bank fixed deposits, investments in mutual funds and equities, wherein only accretion of income is taxable and which provide for indexation benefits on such investments. This view is in line with the view taken by the tax department in the past wherein it has been clarified that that tax should be levied on accretion and not the premium paid.

To ensure parity, so that the customer decides on an investments based on the value proposition rather than discriminatory tax treatment. Investments in policies (not qualifying under Section 10 (10 D)) be treated at par with bank fixed deposits, mutual funds and equities, and the exemption under section 10 (38), indexation under section 48, lower rates under Section 115 BBB should also be accorded to the aforesaid insurance policies.

ISSUES FROM A BUSINESS PERSPECTIVE

These fall into two categorites - challenges under the GST Law and Carry Forward of Losses

Issue 1

GST: The Model GST Law necessitates life insurance companies to obtain State-level registrations and comply with the requirement of GST law for each State distinctly. As against this, the extant service tax regime does not cast the burden of registration in multiple states.

The Model GST law appears to have been drafted with the supply of "goods", rather than “services” in mind. Services in general and life insurance services in particular are rendered on pan India basis as life insurance companies operate across India to provide policies, while other aspects contributing to of issuance of policy, eg, underwriting may happen from other states.

Therefore, subjecting the life insurers to registrations (and tax liability) in different states could create several fundamental ambiguities.

Additionally, life insurers would be required to undertaking state-level compliances at each state across India resulting in filing multiple returns, and subjecting the insurers to audit and assessment in each state by central and state tax authorities.

All this works against the ease of doing business and exposes the life insurers to administrative difficulties, ambiguity, potential tax disputes and corruption, which we are sure is not the intention of Government.

The Model GST law envisages a concept of ‘zero-rated supply’ which has been extended to only to exports.

Issue 2

Carry Forward Losses: The life insurance industry is capital intensive. Due to high distribution expenses in the first year - including expenses towards setting up operations, training costs for developing the agency force, creating a niche market for products, achieving reasonable levels of persistency, providing for policy liabilities, and maintaining the solvency margin - it has proved to be difficult for the insurers to earn profits in the initial seven to ten years of their operations.

Statistics shows that the life insurance companies have incurred losses for a period in excess of 7-10 years. Under the present law life insurance, companies will lose the benefit of carry forward and off-set the initial losses.

Recommendation

The concept of “zero-rating” should be extended to the life insurance sector as well. Many countries follow the practice of exempting life insurance services.

The time limit under Section 72 of the Income Tax Act should be relaxed for life insurance industry and a longer period of at least 15 years should be available for carry forward of losses of the preceding years since most of the insurers have failed to break even after eight years of operations. IRDA has also increased the limit from 5 years to 10 years in respect of cases where actual expense exceeds the allowable limit.

Benefits to the Indian economies

Making annuities tax-free will go a long way in creating a desired pensionable society, which is the stated objective of the Government.

Treating investment in insurance products similar to normal investments such as bank deposits will give investors an option to participate in the capital market either directly or through mutual funds or through insurance products.

Making the insurance sector a “zero-rating” sector will ensure that life insurance products are available to public at a reasonable cost without burdening the industry with the cascading effect of taxes.

While this may arguably result in a loss of tax base (approximately INR 8400 crores as per our estimates), but this will go a long way in deepening the penetration of life insurance in India, especially when the social security measures provided by the Government are negligible and the majority of the population falls below the lower/average income group. As a measure of public welfare and social security, zero-rating of life insurance would benefit the population as a whole. This would also help in reducing the cost of the life insurance services and will act as a catalyst for increasing life insurance cover.

Besides the social benefits of increasing life insurance penetration, another advantage is that it will increase exponentially the contribution of life insurers as the major purchases of Government Bonds and investments in the infrastructure sector, which is a top priority for the Government. Currently the Government provides a huge impetus for investments in infrastructure through tax-free bonds, which are usually subscribed by the higher income groups.

Comparatively, the life insurance sector (which attracts subscriptions from across all parts of society) also invests in the range of INR 15 Lakh Crores in the infrastructure sector. Should the zero tax regime be encouraged in the life insurance sector, this will significantly deepen insurance penetration in India and in turn significantly enhance the contribution of life insurers in the infrastructure sector.

LIFE INSURANCE

DIRECT TAX (FOR LIFE INSURANCE)

Issue 1

Direct Tax - Section 10 (10D) of Income Tax Act, 1961: Currently any sum received under a Life Insurance Policy, including sum allocated by way of bonus is exempt from tax if premium payable in any of the years is not greater than 10% of sum insured.

Recommendation

Exemptions under section 10(10D) should be allowed on the basis of term of policy. We recommend increasing the cap of 10%.

Revise Section 10(10D) to bring it in line with the minimum assured death benefit guidelines prescribed by IRDA. Policies which do not qualify for exemption under section 10(10D) could be treated as normal investments and at par with Mutual Funds for the purpose of computing Income.

Benefits to the Indian economies

Life insurance policy terms are more important than the mode of payment. Policies taken by those of higher age or with deteriorated health will not qualify for 10(10D) due to the stringent 10% cap guidelines. These are cases that need life insurance cover and associated tax benefits more than others. This will iron out the disparity pertaining to the minimum death benefit criteria on a life insurance policy as prescribed under the IRDA and Income Tax provisions respectively. The receipts of policies, which do not qualify for tax exemption under section 10(10D) should be considered under the heading "Capital gains" with the benefit of indexation.

Issue 2

80C - Deduction from the total taxable income: Over time, various investments such as mutual fund and bank deposits have been included within the overall limit of Rs. 1.50 lakh. Additionally, expenditures such as tuition fees are also allowed as deduction within the stated limit. There is therefore limited room for deductions on investments under the life insurance category.

Recommendation

Allow deduction under Section 80C on the basis of the term of policy and create a separate deduction limit of Rs. 1.50 lakh for life insurance.

Benefit to the Indian economies

Implementing this recommendation will incentivise more people to take up life insurance policies to protect themselves.

Issue 3

Contribution to superannuation fund and limits to commutation: Most employees/members of the superannuation scheme would like to consider contributions greater than Rs. 1 lakh to meet their retirement needs. Several employers have discontinued the existing superannuation schemes as the limit of Rs. 1 lakh made the scheme less attractive to the employees.

Recommendation

Remove the limit of Rs.1 lakh and make the entire contribution towards superannuation tax free. Alternatively, at least adjust it for inflation since 2005, the year when the limit was prescribed. Also enhance commutation limits prescribed for superannuation/pension products by the regulator so that higher tax exemption can be claimed on commutation.

Benefit to the Indian economies

In the absence of any social security benefits in India, such a measure would encourage retirement savings. It would also create parity with the NPS (National Pension Scheme) with respect to limits on contribution as well as commutation.

Issue 4

Taxation of Pension and Annuity Schemes: Currently the entire annuity income is subjected to tax in the hands of the recipients. This amounts to taxing even the principal amount.

Recommendation

Exempt the pension in the hands of policyholders by introducing a new sub section under Section 10. Alternatively, avoid double taxation of the principal amount invested by levying the tax only on the Interest component and not the entire Annuity.

Benefit to the Indian economies

This will incentivise greater retirement saving and enable senior citizens to live a better quality of life.

Issue 5

Section 80CCC – of the Income Tax Act 1961 deduction allowed for the Contribution:

Recommendation

Enhance limit for the premium paid on Pension Policy under the section 80CCC (read with Section 80CCE). Make provisions for additional limit of Rs 0.50 lakh for contribution to Pension Scheme issued by life insurance company.

Benefit to the Indian economies

Implementing this recommendation will bring about parity with NPS (as provided in 80CCD(1B) of the Act) given that both the schemes aim to serve the same purpose.

Issue 6

TDS on Policy holders (Section 194D) introduced by Finance Act, 2014:

As per the section 194DA, tax needs to be deducted on the payment, other than the amount not included in the income under section 10(10D) of the Income Tax Act, 1961.

On analysing this, the life insurance policy qualifies for exemption if we compare Premium/SA on a yearly basis. However, if we compare the premium with the minimum sum assured across the policy term, it will not qualify for exemption. We understand that this is not the intention of law.

Recommendation

The section should be further widened to include section 10(10A), 10(13) and 10(10AA). In addition, clarification is needed regarding the applicability of 194DA to certain insurance products. Policies should be indexed by the variable sum assured and the premium. It should be clarified that in case of payments under a pension policy, annuity policy or group superannuation, gratuity and leave encashment policy, the provisions of section 194DA shall not be applicable.

Over the years, the tax legislature has recognised life insurance products separately and included appropriate provisions in the Act giving different tax treatment of these products. Section 194 D should also take cognisance of different types of insurance products and give appropriate tax treatments.

Life insurers have indexed products under which companies allow their customers to increase their sum assured and, accordingly, the corresponding premium also increases. These are approved products from IRDA.

Benefit to the Indian economies

All these abovementioned changes will encourage greater retirement related savings/investments.

Issue 7

Corporate Tax:

Non-applicability of transfer pricing provisions for life insurance companies.

Recommendation

It should be specifically provided that the provisions of Chapter X of the Income Tax Act are not applicable for life insurance companies.

Benefit to the Indian economies

This is supported by the overriding provisions of Sec 44 and the fact that the method of computation of profits for income tax purposes is based on the surplus / deficit arising from the actuarial valuation, which could not be subject to any other adjustments. This will help settle the dispute between the tax authorities and the life insurance companies.

INDIRECT TAX (FOR LIFE INSURANCE)

Issue 8

GST Rates:

The penetration of life insurance cover in India over last decade has declined and at 3.1% of GDP is significantly below the global average.

Recommendation

Lower the standard (12%) rates for risk products. The investment component of ULIP and traditional life insurance plans should continue be kept out of the ambit of GST coverage (as currently it is included in the definition of the term 'Securities and Actionable Claims' which is a service as per the model GST law).

Benefit to the Indian economies

Lowering tax rates will help boost penetration of the life insurance cover in the country.

Issue 9

Reduction in Interest Rate on delayed payment of Service Tax applicable from October 2014. Most of the demands outstanding are due to disputes with the Service department which are appealed before different Appellate authorities. It takes a long time to settle the disputes at the stage of Appeals. The interest charged at 24/30 percent far exceeds the demand itself, which is a burden for the Assesses.

Recommendation

Rate of interest should be reduced to the reasonable level of 12% on par with interest charged on Income tax demands.

Benefit to the Indian economies

This high rate of interest should be reserved for as a deterrent for malpractices – e.g., where tax has been collected and not deposited with the Government. The rate of Interest levied on the defaults under Income Tax Act is capped at 12% p.a (except Sec. 201(1A)(ii)) w.e.f. September 2003 onwards and there has been no change in rate of interest till date.

Issue 10

Reduction of Service tax rate on Single Premium Policies and endowment policies: Risk premium as a proportion to total premium is less and hence even 1.75% is on the higher side w.r.t. first year premium. Since there is no difference between the service rendered in first and subsequent years there is no justification for doubling the service tax rates in first year. The internationally accepted weightage for single premium with regular premium is 10% (i.e. 10% of tax rate of 12% =1.2%)

Recommendation

Retain Service tax level at 1.75% for first year premium. And, charge single Premium policies at 1.75%

Benefit to the Indian economies

This will encourage more uptake of these policies.

Issue 11

Service tax on ‘Surrender Charges’:

Recommendation

Amend the provisions so as to clarify that Service tax is not leviable on ‘Surrender Charges’ up to June 2012.

The insurance companies do not receive Surrender Charges for the services provided. Rather, it is a penal charge that the Policy Holder needs to pay when such Policy Holder makes a premature termination of the Insurance Policy. As such charges are essentially penal in nature and therefore do not qualify as a ‘service’.

Benefit to the Indian economies

Amending this legislation will make India a more attractive investment market to global insurance companies.

Issue 12

CENVAT credit:

Recommendation

The investment component and resultant income should not warrant any reversal of Cenvat Credit.

In order to reduce the cascading impact of taxes, Cenvat Credit for Swachh Bharat Cess should be allowed to life insurance companies.

Benefit to the Indian economies

Life Insurance premium comprises of two components i.e. the charges on which service tax liability is levied and the investible portion invested for and on behalf of policyholders. The component invested on behalf of policyholders is akin to an investment in a fixed deposit in a bank or an investment in a mutual fund, which is not subjected to service tax and is also not considered as an exempted receipt for service tax. Considering it as exempted service will imply proportional reversal of Cenvat Credit claim. Doing so will result in wiping out substantial Cenvat Credit for the life insurance companies, which we believe is not the intent of the law.

Issue 13

Service tax on annuity products.

Recommendation

Annuity products purchased after the maturity of a pension scheme of life Insurers should be exempt from Service Tax.

Benefit to the Indian economies

This will create parity with NPS scheme and incentivise retirement related saving.

ANNEX E – HEALTHCARE

HEALTH INSURANCE

Issue 14.

Long-term saving-linked health products.

Recommendation

Health insurers should be allowed to offer long-term saving-linked health insurance products. A specific portion of the premium could be invested in unit-linked products, and the income from these can be utilised to fund the health insurance premiums beyond a certain age and also cover any specific ailments not covered under normal health insurance.

Benefit to the Indian economies

Increase health insurance penetration since the product has a better value proposition from a customer standpoint. Better affordability – since renewal premiums shall reduce direct tax

Issue 15.

Carry forward of losses.

Recommendation

For specialised health insurance companies, the period of carry forward of business loss and depreciation should be extended to at least 12 years.

Currently, business loss and depreciation can be carried forward for 8 years whereas specialised health insurance companies require about 10 years to break-even and another 3-4 years to have sufficient profits. Due to this mismatch, they tend to lose credit of initial years' losses.

Benefit to the Indian economies

Extending this to 12 years will incentivise specialised health insurance companies to invest more in India.

DIRECT TAX (FOR HEALTH INSURANCE)

Issue 16.

Tax exemption under Sec 80D for two-year policies of the income Tax Act 1961.

Recommendation

In the case of multi-year policies, tax deduction for insurance premium should be linked to the tenure of the policy.

Currently the tax exemption is available only in the year of payment. For of two-year policies, the tax deduction is only available in the year of payment. Given that the two-year premium could be higher than the current prescribed maximum deduction limit, it is recommended that in case of multi-year policies, the deduction for insurance premium should be linked to the tenure of the policy.

Benefit to the Indian economies

This will provide a greater incentive to buy health insurance for a longer term, which is good for the customer from a protection perspective and will increase health insurance penetration across the country.

Issue 4:

Tax exemption limit under Sec 80D of the Income Tax Act 1961

Recommendation

In order to promote large value insurance covers, the deduction limit for health insurance premiums should be increased from the current limit of Rs. 25,000 to Rs. 50,000.

Benefit to the Indian economies

Health costs are increasing with medical inflation so people should be incentivised to take larger insurance covers. This will also help increase health insurance penetration.

INDIRECT TAX (FOR HEALTH INSURANCE)

Issue 5

GST

The likely rate for GST will be higher than the current rate of service tax applicable to health insurers.

Recommendation

Health insurance being a critical and social need should have a preferential rate (12%) of tax under the GST regime.

ANNEX F – HEALTHCARE MANUFACTURING

MANUFACTURING OF SPECIALITY (BOPP) FILMS

INDIRECT TAX

Issue 2

Indirect Tax: MEIS rate is too low at 2%

Recommendation

Increase the rate from 2% to 5% on BOPP and Thermal Films.

Benefit to the Indian economies

This will boost export sales, and support Make in India, employment growth and India's balance of payments.

Issue 3

Duty drawback rate at 1.9% is too low.

Recommendation

Increase it from 1.9% to 4-5% on BOPP and thermal films.

Benefit to the Indian economies

The current rates are very low. As a result, manufacturers of BOPP and thermal films never avail this and make all exports and imports against advance authorisations. A decent rate of duty drawback (4-5%) will incentivise usage of duty draw back and remove lengthy process of advance authorisations.

Issue 4:

CENVAT credit

Recommendation

Amend CENVAT credit rules, 2004 to allow for credit on:

- Execution of works contracts for building or a civil structure or a part thereof;
- Renting of motor vehicles, general insurance, health insurance; and
- 100% credit on capital goods instead of 50% in the first year.

Benefit to the Indian economies

The world incentivise expansion and make exports from India more competitive.

Issue 5:

Rebate/refund of duty on exports as per Rule 18 of Central Excise Rules, 2002.

Recommendation

Simplify the procedure such that the refund is received within 30 days instead of 90 days without any litigation. Only duty verification should be done.

Benefit to the Indian economies

This will help reduce the cost of doing business by reducing the working capital requirement.

GENERAL HEALTHCARE MANUFACTURING

DIRECT TAX

Issue 1

Direct Tax

Corporate Tax rate is too high. The budget last year or 2 2 years ago said rate would drop to 25%.

Recommendation

Reduction in rates to 25%

Benefit to the Indian economies

The corporate tax rate at 34.61% (inclusive of surcharge and education cess) is considerably above the global average corporate tax rate of 22.5%.

HEALTHCARE SERVICES INCLUDING SENIOR LIVING

From the Draft National Health Policy 2015, it is understood that the Government of India plans to increase its expenditure on public healthcare provision to 2.5% of GDP. It is also understood that the Government is working to stimulate private healthcare provision, including through insurance.
While it is important to recognise the growth and potential of a rapidly expanding private sector, international experience shows that health outcomes and financial protection are closely related to absolute and relative levels of public health expenditure.

Two changes that would help grow private sector provision are:

- increase the medical reimbursement exemption limit for salaried employees to Rs. 1 lakh per annum from the current limit of Rs. 15,000. The present limit of Rs 15,000 was fixed in 1999. Given the significant cost inflation index in general and medical inflation in particular, the limit needs to be enhanced to not less than Rs 1 lakh; and

- increase from Rs. 5,000 to Rs.20,000 the limit on permissible deductions for employers for preventative health checks from their employees. Given the rising advent of lifestyle diseases in India and the need to prevent loss of productivity, it is imperative that employers get a separate annual deduction of upto Rs 20,000 per employee annually, towards expenses incurred for sponsoring the health check expenses of their employees. This should be over and above the existing deduction available in respect of medical reimbursement for salaried employees.

The rest of this section of the submission sets-out further recommendations that would protect existing private investment into the sector and encourage more.

FINANCIAL BENEFITS

Issue 1

The current financial incentives are insufficient to attract enough private investment into India's healthcare services sectors.

Recommendation

There are a number of recommendations to rectify this situation:

- provide the healthcare sector with the same financial benefits as the Infrastructure sector;
- extend the tax holiday to 10 years, or grant an option to accommodate any 5 years within 10 years of commencing operations;
- provide loans / financial assistance to the healthcare sectors on a 'priority' basis, at concessional rates, as provided to the infrastructure sector;
- Any new capital expenditure towards replacement of old machinery / equipment, at any time, to be entitled to 100% deduction.

Benefit to the Indian economies

The financial incentives outlined above would encourage much needed investment to set up healthcare operations and sustain them in the long run. Given healthcare's wider social benefits and employment generation capability, its financial needs should be catered to on a priority basis.

Issue 2

The reward rate in the Services Exports from India Scheme (SEIS) scrip is too low.

Recommendation

Revise reward rate of SEIS scrip from 5% to its previous level of to 10% of Net Foreign Exchange.

Benefit to the Indian economies

This move will provide a boost to the Medical Value Travel sector

DIRECT TAX

Issue 3

150% weighted deduction scheme under section 35 AD of the income tax ACT, 1961.

Recommendation

Extend it to another 5 years upto 2022. Based on the existing dispensation which allows for the weighted deduction scheme, several hospital groups had begun setting up green field capacities and given the long gestation period in identifying suitable land parcels, getting government approvals etc, there are several projects which have taken off but will get completed /commenced only in the next 3-4 years.

Benefit to the Indian economies

A sudden withdrawal from 1st April 2017 would lead to a huge setback to the initiatives that have already commenced on these fronts. This would remove the only benefit available to the healthcare sector which is already confronted with various other challenges such as spiralling cost of real estate for setting up hospitals, high rate of medical technology obsolescence, shortage of skilled medical resources and long gestation period.

Issue 4

Review Dividend Distribution Tax (DDT).

Recommendation

Convert DDT paid by the foreign shareholder into traditional withholding tax to avoid double taxation at the hands of foreign shareholders.

Benefit to the Indian economies

This will attract greater FDI into the Healthcare sector. Given that the Government is able to fund only 1% of the Healthcare spend and there is an acute demand-supply mismatch of quality beds and human resources, attracting FDI into Healthcare space is an imperative.

Issue 5

Review Minimum Alternate Tax (MAT) requirement and refine current rule.

Recommendation

Phase out MAT over a period of 2-3 years and revise MAT calculations to include both business loss and depreciation.

Benefit to the Indian economies

The underlying idea behind MAT when originally envisaged was to levy a “minimum tax” on companies that had book profits but no or negligible taxable profits owing to the availability of tax incentives, by charging a certain percentage (7.5% then to 18.5% now) of book profits. However, in the emerging scenario, when the tax incentives are being phased out, MAT has lost its relevance. There is lot of confusion on adjusting carry forward book "business loss or depreciation" while computing MAT. It is suggested here that for the purposes of MAT, the accumulated book losses (both business loss and depreciation) should be considered. This principle shall augur well with the main premise on which Tax on Book Profits was levied.

SENIOR LIVING

Issue 6

Section 54 & 54F

Recommendation

For the purpose of exemption from long term capital gains under this section, extend the definition of "purchase" of residential property to include a purchase made through a long-term lease as well. The long-term lease of a residential house has substantial attributes of 'purchase'. For example, the resident pays the capital value, has a choice of exiting at any time, and gets capital appreciation benefits.

Benefit to the Indian economies

Implementing this benefit will increase the attractiveness of private sector investments in this sub-sector.

Issue 10

Service Tax for senior citizens

Recommendation

Services provided to senior citizens by senior living communities should be exempted by the government from service tax levy. Senior citizens have worked hard all their lives and paid all due taxes during their work life so should not be liable to pay service tax especially when they don't have a source of income. The government already provides various income tax benefits and tax exemptions to senior citizens.

Benefit to the Indian economies

This measure would make senior living services more affordable, increasing demand which will incentivise investment and create jobs and investment. It will also increase the level of high quality care for the elderly.

INDIRECT TAX

Issue 7

GST

Recommendation

Continue to exempt the final sale of patient care/diagnostic services by the hospitals/clinics to their patients from GST as is the case with respect to service tax under the current regime. GST rate on the earlier part of the healthcare supply chain (ie supply of healthcare equipment/services to the hospital/clinical establishments) should be kept at merit rate of 5%. This would bring parity of duty/taxes between public and private sector healthcare service providers as the former, as per schedule IV of Revised GST model law, is stated to be exempt from GST.

Benefit to the Indian economies

This measure would sustain an expansion of healthcare provision in India. It would:

- avoid any increase in the cost of healthcare being provided by the private sector in India
- eradicate any possibility of disincentivising future investments; and
- combat inflation by reducing the cost of healthcare services, which are otherwise exempt from duty/taxes.

INFRASTRUCTURE & CONSULTANCY

Issue 8

The Government of India's focus on infrastructure development is important and welcome as it will support the transformation of the Indian economy and society.

To achieve value for money and effective delivery of projects, integrated infrastructure planning is required which necessitates excellent coordination and cooperation among the various transport ministries and departments.

In addition, the Government has identified the need for foreign expertise for initiatives such as smart solutions for cities and the modernisation of the Indian railways. It is therefore important to incentivise foreign firms to participate in such programmes through various tax and non-tax benefits.

Recommendations

The lead taken by the Ministry of Railways in proposing a National Integrated Transport Plan should be adopted and followed more widely.

Such a plan would inform future transport development and ensure that money is spent wisely releasing maximum benefit. This would allow India to manage its financial resources efficiently by establishing economically justified, nationwide, priorities for infrastructure development.

A further recommendation is a waiver on certain taxes or lower withholding taxes to incentivise greater participation from foreign firms in India's infrastructure sector.

Benefit to the Indian economies

The company believes that implementing such suggestions will ensure accelerated development in India, particularly in the infrastructure development sector.

ANNEX G – IT PRODUCTS AND SERVICES

Issue 1

Harmonisation of IT Product Lists across central and states. Harmonisation of IT Product Lists across central and state indirect tax jurisdictions is necessary to ensure that the industry is able to claim their entitled benefits on IT goods and avoid unnecessary litigation.

Recommendation

A detailed list issued by the Central Government can be used as a reference guide by states to re-tune/re-determine their lists of products covered under the IT goods list, under the relevant VAT laws.

Issue 2

Exemption from customs duty and CVD of spares used for servicing ITA products. ITA products such as computers, tablets, hand phones, and POS machines play a significant role in promoting digital transactions and the idea of Digital India in general. Whilst the products per se are exempted from Customs Duty, some of the spares used to service such products attract customs duty.

Recommendation

It is recommended that customs duty and CVD on all spares imported for service of ITA products be exempted to enable seamless service of ITA goods and thereby promote the dream of Digital India.

Issue 3

Extension of exemption from excise duty / CVD to all types of POS machines. In keeping with the Government's stated objective of promoting digital / transactions, excise duty / CVD on POS machines were exempted w.e.f 28th November, 2016. However, the exemption was restricted to POS machines falling under 8470. This restriction does not serve the objectives of the Government. in full measure as the vast majority of the new age POS machines are classifiable under 8471, 8473 and 8528 – being attached to or are ADP machines themselves.

Recommendation

It is recommended that POS machines falling under all tariff headings or at the very least those falling under 8471 and 8473 too, be exempted from CVD / excise duty / IGST.

Issue 4

Technology to bridge rural barriers and promote Digital India in rural areas. The state of rural education has been a major point of concern for educational policy-makers in India. A study by the government in 2014 revealed that 67% of India's population belongs to rural areas. The ratio of rural-urban enrolment of students is a massive 7:5. Despite such a high rate of enrolment, nearly 60% of students in rural areas up to the age of 10 do not possess basic reading skills nor can they solve simple mathematical problems. Under the e-Kranti (revolution), the Government plans to launch ambitious initiatives to bridge the urban rural education divide. e-Kranti has plans to offer Wi-Fi to 2.5 lakh schools within the next five years. Devices such as tablets, as provided to students in central universities, are to be distributed among rural students. There has to be a clear goal of "One PC per Family", which is ultimately most critical for India to become a technologically equipped nation.

Recommendation

Towards achieving this following to be considered;

- 100 % depreciation provision. Tax rebate / 100% depreciation on computer and printer for all sole proprietor or small businesses. This will get them ready for GST and digital economy.
- Subsidising loans. Easy EMI / Interest-free or subsidised loans from banks for notebooks/desktops and printers to make it affordable for students, home office start-ups and small retailers.
- Considering lowest slab. Classify PCs/printers under lowest slab of GST, which will make these devices affordable
- The Government should offer fiscal as well as policy stimulus to IT hardware manufacturers to efficiently supply quality equipment to schools.

Issue 5

Support and incentives to attract value - added manufacturing. The government aims to achieve Digital India, where every area is digitally empowered and all information is digitally available.

Recommendation

To promote Digital India in rural areas, the government should offer rebates on laptops and desktops to students.

The scheme should provide financial support and incentives to manufacturers in the electronics sector to attract value added manufacturing involving medium and high technologies.

Issue 6

Single brand retail. The Government has launched a bold demonetisation initiative to push India towards a cashless economy. The role e-commerce and retail play becomes immensely critical. However mandatory local sourcing norms in single brand retail continue to hamper the full potential of foreign participation.

Recommendation

Relaxation of the local scouring criteria to level the playing field between online and offline retail. Indian consumers can now already purchase online from single brand e-commerce stores globally. The lines between online and offline are blurring and there should not be a distinction. India is already pushing to be an e-commerce powerhouse, so there has to be a push towards having a vibrant offline retail sector too.

Issue 7

Taxability of service portion in the execution of works contracts. This law impacts largely MNCs/ foreign shareholders. It reduces the confidence of foreign investors in India and acts as a significant hindrance from free movement of capital and earnings.

Currently VAT is charged at 60% to 80% of the contract value and service tax is charged on 70% of contract value creating a situation of double taxation where 130%-150% of the contract value is being taxed under both VAT as well as Service Tax laws.

This “double taxation” will apply where the value of goods versus services is not known at the time of entering into the works contract. Under the VAT Law, if the value of spares is not known at the time of billing, VAT is applicable on 60% to 80% of the contract value (depending upon the abatement available in the State VAT law).

However, under the service tax law, Service Tax is payable on 70% of the contract value if VAT is not paid on actual value of spares consumed. This double taxation increases the end price to customers and creates disputes with customers who question the validity of such double taxation.

Recommendation

Amending the service tax law to:

- Either the balance contract value after deducting the prescribed percentages under the respective state VAT laws; or
- 40% of the contract value to service tax would help eliminate or at least reduce this instance of double taxation.

Issue 8

Address dual taxation on sale of packaged or canned software. Being a copyrighted article, the license to use software is given to customer. The customer can get the software on media or electronically (download). The normal practice today is to supply software electronically and in which case both VAT and Service Tax become applicable. This results in one transaction being taxed both as a good and a service. Given the Supreme Court Ruling in the case of TCS in 2004, there is no ambiguity on the applicability of VAT on the sale of software. The introduction of the negative list regime of Service Tax from 1st July 2012 also saw the inclusion of software licenses as a service liable to Service Tax.

Recommendation

Issuing a clarification exempting Service Tax where CST/VAT is paid on the sale of packaged software (even with a license to use such software), whether delivered on media or electronically, would ensure that this instance of double taxation is eliminated. Unfortunately, this ambiguity seems to continue in the provisions of the Revised Model GST Law as well.

ANNEX H – OIL & GAS

Issue 1

Goods and Services Tax (GST)

- Exclusion of the sales of crude oil, natural gas and petroleum products in the (goods and services tax) GST roll-out will impact the industry significantly. The Ministry of Petroleum as well as Industry Associations like CII (Confederation of Indian Industry) have made representations to the Ministry of Finance on this including a stop-gap offsetting solution (i.e. a marginal GST) to reduce the impact to both the industry and the key states.

- The key issue with the roll-out is that the oil and gas industry's input costs will be taxed as per GST, while the sales of crude oil, natural gas and petroleum products will still be under the VAT and Sales Tax system. This inconsistency in fiscal application increases the financial burden for the industry by over 10% per transaction.

- Specific to the upstream side of the oil and gas business, this will increase cost of capital projects by 10% from the additional burden of GST. The industry is looking to spend close to US$20 billion in the next 5 years in the deep water projects, this will increase by US$2 billion if the industry cannot offset these costs.

Recommendation

Petroleum products should be included under GST

Benefit to the Indian economies

The inclusion of petroleum products under GST will eliminate stranding of taxes paid by suppliers and the industry at different stages in the value chain. This would plug tax leakages, bring in operational efficiencies, and enable States and the Centre to capture full revenue potential.

There is a further, more detailed submission on GST and petroleum at annex M.

Issue 2

Service Tax on royalties and profits on petroleum

Recommendation

Royalties and profits on petroleum are not payments for services provided so should not be taxed as services. Royalties and profits on petroleum are part of the fiscal mechanism for profit sharing as described in the Production Sharing Contract (PSC), for which the Government is a partner and party.

TDS DETAILS AS PER CLAUSE 34 OF FORM 3CD OF THE TAX AUDIT REPORT

Proposal

It is requested that necessary instructions be given to ICAI to immediately revise the Guidance Note to exclude the "Reconciliation Clause" which is not stipulated in the prescribed Form 3CD.

INDIRECT TAXES

1. Time limit for adjudication of Show Cause Notices issued by department

   a) We therefore request you to kindly prescribe some time limit for adjudication of the Show Cause Notices by the department so that the issues are not kept open indefinitely. It is requested that a suitable amendment should be made in law to provide that if the Show Cause Notices issued by the department are not disposed in a time bound manner, the issue shall be deemed to be settled in the favour of assessee.

2. Clarity required on the interpretation of the term "Food Stuff"

   a) We request your good self to kindly issue some clarification explaining the scope of expression 'food stuff' so that tax payers may get rid of unnecessary litigations.

3. Extension in period for finalisation of Provisional assessment

   a) It is therefore requested to amend Rule 7 of the Central Excise Rules, 2002 to provide that once the permission has been granted by the Commissioner for extension of the period of finalisation of provisional assessment, the same would be applicable for the subsequent periods as well unless there is any change in the facts based on which the permission was obtained.

4. Due date for payment of service tax

   a) It is requested that the payment date may be extended to 15th of the next month so that Assessee gets sufficient time for reconciling and deposit of correct amount. This will avoid deposit of any short or excess service tax amount which necessitates filing of refund or adjustments in subsequent returns.

   b) Further, for deposit of service tax for March, no interest should be charged from the assessee in case at least 80% of the total monthly service tax is deposited basis the estimated value of services.

5. Utilisation of VKGUY Scrips

   a) The process simplification can be done by allowing the holder of the scrip to endorse the scrip in the name of supplier/ service provider and allowing the facility of one time debit in the scrip by the customs authorities based on the anticipated volume of transactions during the year. Based on such endorsement & debit in the scrip, the manufacturer/ service provider should be granted the exemption from excise duty/ service tax without any undertaking from the holder of the scrip.

b) Further, in order to provide more flexibility to the scrip holder, the scrip should be allowed to be utilised for payment of excise duty on the final products manufactured by the scrip holder himself.

c) Also, the scrip should be allowed for payment of service tax on any output service being provided by the holder of the scrip himself or for discharging the service tax liability under the reverse charge mechanism.

6. Adjustment of excess paid service tax

a) It is requested that once the factum of excess payment by the assessee is established, the adjustment of excess paid service tax should be allowed to the assessee without any monetary limit and without restricting it to the subsequent month or quarter only.

b) Alternately, Rule 6(3) of the Service Tax Rules should be amended to allow the assessee to take self credit in all the situations involving excess payment of service tax.

7. Service Tax on facilities provided by Employer to Employees

a) We request your good self to please look into the matter and make suitable amendment in the definition of 'service' under Section 65 B(44) of the Finance Act, 1994 to exclude the services provided by the employer to the employee.

b) Alternatively, a simple procedure may be prescribed for collection & payment of service tax on such amounts recovered by the employer from the employees.

ANNEX I – TELECOMMUNICATION

The Indian telecommunication industry is playing a pivotal role in the 'Digital India' initiative introduced by the Indian Government under the leadership of PM Modi. The cumulative investment made by the telecommunication industry towards the telecommunication infrastructure of India, stands at INR 8.5 lakh crores. This has catapulted the growth of the economy.

Telecommunication Industry has emerged as a key driver of economic and social development in India over the last two decades. India is the world's second-largest telecommunications market with more than a billion subscribers. The role of telecommunication sector as an effective tool to extend e-governance and internet broadband cannot be ignored.

However, this effectiveness is substantially reduced due to numerous challenges which the industry is facing today, including inter-alia on account of tax controversies and challenges. While the Indian telecommunication market is the second largest in the world in terms of subscriber base, its position is almost insignificant in terms of revenues.

The Average Revenue Per User ('ARPU') in India is abysmally low as compared to other major telecommunication markets in the world. It is currently in the range of INR 120 to 125 (approximately USD 2). The ARPU of the Chinese telecommunication industry is nearly 5 times higher at approximately USD 10 while US is in the range of USD 45 to 50. Even Singapore's ARPU is in the range of approximately USD 60 to 70.

On the other hand, a massive debt burden (in excess INR 3.50 lakh crores) on the telecommunication industry means that the interest costs remain on the higher side and the bottom lines are under enormous strain.

While India ranks well in the affordability of telecom services based on global benchmarks, the tax and levies structure applicable to the telecom operators can impact the affordability of the services thus creating supply side bottleneck for driving the Digital agenda.

As we are aware, the direct tax rate in India works out to nearly 32% (inclusive of surcharge and cess), as against a tax rate of 25% in China. ASEAN countries such as Indonesia and Singapore have tax rates `of 25% and 17% respectively.

In the telecom context, the issue is further compounded when other levies such as the License fees of 8% (including the USO levy of 5% on the Adjusted Gross Revenue ('AGR')) and the Spectrum Usage Charges ('SUC') (both initial and recurring) are factored in.

Furthermore, the numerous tax disputes with the Income Tax Department which the industry is presently grappling with only increase the hardships faced by the Industry. These include withholding tax dispute on distributor's margin on sale of SIM cards and recharge coupons, and retrospective amendments to the Royalty definition.

The consideration and support on the recommendations made below will be a significant step to take this very important industry to the next level of contribution to the national telecom and broadband objectives, and to achieving the Government's vision of a Digital India and inviting further significant investments.

GST

The telecoms sector welcomes the introduction of GST, noting that it is the biggest Indirect Tax reform post-independence. It is essential that GST law is drafted through a consultative process so that the practical challenges of the industry are factored in. It would also be very critical that adequate time be allowed to industry to be ready for GST once the Final GST law along with all the Rules and Regulations are enacted given the magnitude of change involved.

It is an apprehension that tax compliance, assessments, audits and investigations would increase multi-fold in GST if the pan-India service providers are required to take registrations, undertake compliance and get assessed in each state. Hence, Single Centralised Registration would greatly achieve the objective of 'Ease of doing business' for pan-India service providers like telecoms comapanies. It would also not compromise State's tax revenue as tax would be paid on the basis of the consumption location irrespective of registration taken.

Telecom is an essential service and has penetration to the lowest economic strata. So a high GST rate would increase the cost for common man. It is a service which provides stimulation to economic development and growth. Telecom merits the lower rate of GST to maintain the affordability. Further higher rate of tax would go against the Government's objective of 'Digital India'.

The telecoms industry have made a number of further points for consideration by the Finance Ministry, as set out below.

<u>Issue 1</u>

Reduction of USO Fund. As per Indian Telegraph Act 1885, as amended in 2003, the Universal Services Obligation" means the obligation to provide access to basic telegraph services to people in rural and remote areas at affordable and reasonable prices."

The Industry has been constantly investing in rural areas, surpassing critical milestones. As per the TRAI data, since 1999 till May 2015: the Rural Density has increased from 0.52% to 48.6%; the rural subscribers have gone up to 421mn from 3.6mn in 1999; and there were 290,000 villages unconnected in 1999, while now there are only 55,000 left to be connected.

The industry has invested significantly in rural areas helping meet tele-density targets well before the timelines, while contributing to USOF – a costly additional burden

As of 30 September 2016, the total funds collected under USOF amount to around US$ 11.75 Bn with only around US$ 5 Bn being disbursed, leaving a remainder of around US$ 7.74 Bn unutilised.

As per a study performed by GSMA in 2013, the levy of 5 per cent in India is on the higher side when benchmarked against other countries. For example, it is 1% in Malaysia, 0% in China, and applies only to ISD calls in Sri Lanka.

<u>Recommendation</u>

It is requested that the USO levy is reduced to 3% to start-with, with ultimate objective of ending this subsidy in next 3-5 years.

DIRECT TAX ISSUES

Issue 2

Non-characterisation of telecom charges as 'royalty' and non-application of Explanation 5 and 6 to section 9(1)(vi) to DTAAs and tax treaties

Domestic as well as cross-border payments in respect of a wide array of telecommunication services are under litigation on account of retrospective amendment in the definition of 'Royalty' vide Finance Act, 2012.

The said amendment brings within the purview of Royalty, transmission by satellite, cable, optic fibre, or similar technology. Also, use of equipment irrespective of any actual possession or control of rights, properties or information has been termed as Royalty by virtue of the said amendments.

The traditional jurisprudence has been that telecommunication services were standard services and hence the fee for the same cannot be taxed as Royalty under the provisions of the Act and Double Taxation Avoidance Agreements ('DTAA') signed by India with other countries.

The tax authorities have now started taking a position that payments made by telecom companies, even for standard telecom services, are in the nature of a Royalty, resulting in protracted litigation not only on characterisation but also on withholding taxes.

This has resulted in an increase in the cost of telecommunication services for the end customers since taxes are typically borne by service recipients.

Recommendation

To avoid an increase in the cost of telecom services for Indian consumers, the definition of the term 'Royalty' may be amended with retrospective effect to exclude standard service arrangements for rendition of telecommunication services.

Further, the Government should clarify that the amended provisions should be applicable prospectively and should not be applicable on the transactions which were entered into before the amendment.

Clarification should also be issued that amendments made to the definition of Royalty under the Act [vide insertion of Explanation 5 and 6 to section 9(1)(vi)] shall not be read into the DTAAs, as has also been held in numerous judgments by the Indian judiciary.

Issue 3

Restriction of disallowance under section 40(a)(i) to 30% of sum payable

Section 40(a)(i) of the Act provides for disallowance of any sum payable to a non-resident on which tax is required to be deducted and the same has not been deducted.

The corresponding section 40(a)(ia) of the Act, dealing with the disallowance of any sum paid to a resident on which tax is not deducted, provides for only 30% disallowance of the sum payable.

There is no rationale or justification for making a 100% disallowance in case of non–resident when for the same default disallowance is restricted to 30% in relation to a sum payable to a resident

Recommendation

An amendment should be made in section 40(a)(i) of the Act to restrict disallowance to 30% of the sum payable to a non-resident.

Issue 4

Lower TDS rate of 2% on discount extended to pre-paid distributors. Telecom companies transfer prepaid vouchers and SIM cards (representing 'right to receive prepaid services') to independent distributors at a discount, who further sell to retailers and/ or subscribers.

Telecom companies do not withhold tax on the discount offered to distributors, since distributors are not agents of telecom companies and hence the discount offered to them cannot be termed as commission. Further, since no payment/ credit towards the discount allowed to the distributors is made by the Telecom companies, section 194H of the Act is not applicable

However, the tax authorities have adopted a contrary position that withholding tax under section 194H of the Act is required on margins earned by distributors as they are in the nature of 'commission'. Also, there are divergent rulings of the Courts on the above issue.

Recommendation

This issue is resulting in severe litigation and a clarity on this aspect is urgently required.

While the Industry firmly believes that the provisions of Section 194H of the Act are not applicable to discounts extended to pre-paid distributors, in order to put an end to litigation, a position of applicability of TDS provisions on pre-paid discount may be acceptable to the Industry on a go forward basis.

However, considering the low margins, it is suggested that a lower withholding rate of say, 2%, may be prescribed since a rate of 5% results in a drastic reduction in the margins of small scale distributors causing hardship to them.

Issue 5

Order under section 201 to be made a condition precedent for invoking provisions of section 40(a)(i)/40(a)(ia). Section 40(a)(i)/ 40(a)(ia) of the Act provides for disallowance of any sum payable to a resident/ non-resident on which tax is deductible at source under Chapter VIIB and the same has not been deducted.

The above provisions are in the nature of penal provisions, triggering harsh consequence of disallowance of expenditure.

The Assessing Officers are disallowing the expenditure under section 40(a)(i)/ 40(a)(ia) of the Act even in cases where:

- proceeding under Section 201(1) of the Act has not been initiated or
- proceeding having been initiated but the assessee is not treated as an assessee in default

Recommendation

Amendment should be brought in section 40(a)(i)/ 40(a)(ia) of the Act to provide that holding an assessee as ‘assessee in default’ shall be a condition precedent for invoking the provisions of 40(a)(i)/ 40(a)(ia) of the Act.

INDIRECT TAX ISSUES

Balance of CENVAT Credit of ‘Education Cess’ and ‘Secondary and Higher Education Cess’. With the increase in service tax rate from 12 percent to 14 percent, ‘Education Cess’ and ‘Secondary and Higher Education Cess’ (“Cess”) have been subsumed in the revised service tax. Upon subsuming of such Cess, there is an unutilised balance of CENVAT Credit of Cess in books of assessees which is not allowed to be used against duty / tax payable.

Recommendation

The Government issue a Notification to enable service providers to utilise CENVAT credit of Cess paid on inputs/capital goods received by an output service provider on or after 1 June 2015 (receipt of invoices post 1 June 2015 in case of input services)

Issue 6

Applicability on service tax on partial allocation of spectrum. In certain cases, spectrum is made available by the government at a later date even after spectrum is allocated pursuant to an auction, on account of such spectrum not being available for use in telecom business.

The present issue is with respect to determining applicability of service tax on spectrum allocations in cases where spectrum has been allocated to telecom operators on or before 31 March 2016 but actual frequency is made available on or after 1 April 2016, i.e. the date from which service tax on spectrum allocation is made applicable

Recommendation

Since auction and spectrum allocation is concluded on or before 31 March 2016, service tax should not be applicable considering the fact that making available requisite frequency at a later date is only a procedural subsequent to assignment.

Issue 7

Imposition of service tax on Right of Way/ access charges levied by local authorities .For obtaining permission to lay optical fibre cables within municipal limits, telecom operators are required to pay Right of Way (RoW)/ access charges to local authorities/ municipalities.

In view of the definition of Renting of Immovable Property under service tax law, such services could be treated as renting services provided by Government. In view of provisions of Notification No. 30/2012–ST dated 20 June 2012, the Government/local bodies are liable to pay tax on such RoW/ access charges.

As a matter of practice, no tax is being discharged by local bodies/ state governments since they consider that this tax is related to land and buildings on which they have exclusive taxation powers and that income of state government/ local bodies cannot be subjected to Union taxes.

Further there is an exemption notification which exempts such services provided by local bodies under Entry 39 of Mega Exemption Notification considering it as a function covered by Article 243W of the Constitution.

However, where service tax demands are raised by the authorities, local bodies are trying to make recoveries of both - the tax amounts as well as interest and penalties from the business entities.

Recommendation

Clarification should be issued as to the applicability of Entry 39 of Mega Exemption Notification to RoW charges considering it as a function covered by Article 243W of the Constitution.

If a view is taken that the above exemption is not applicable, then retrospective exemption should be issued exempting government and local bodies from payment of service tax on such charges recovered by w.e.f. 1 April 2011.

Alternatively, Rule 9(1)(bb) of the Credit Rules should be amended allowing credit on the strength of supplementary invoices issued by Government/ local authorities seeking reimbursement of service tax for past periods.

Issue 8

Exclusion of Interest in the value of service provided by the Government. Vide Notification Number 23/2016-ST dated 13 April 2016, it had been clarified that service tax would be applicable even on the interest payable to Government as deferred payments against service received from them.

Telecom companies are paying huge charges to government for acquiring spectrum, and to make up its already strained cash flow are generally opting to pay in instalment with interest.

Payment of interest cannot be regarded as a service and therefore service tax should not be levied on this interest component

Recommendation

Interest should not form part of the value of services in respect of services provided by the Government, and proviso to Rule 6(2)(iv) of the Service Tax (Determination of Value) Rules, 2006 should be deleted.

ANNEX J – CONTRIBUTING COMPANIES

1. Tata Steel
2. Rolls Royce
3. Diageo
4. Unilever
5. GSK
6. Finmeccanica India (Leonardo Company)
7. Croda
8. Mott MacDonald
9. The Hongkong and Shanghai Banking Corporation Limited
10. Vodafone
11. Aviva
12. EY
13. HP
14. Dassault Systems India Pvt. Ltd.
15. BP
16. Cairn Energy
17. Smith & Nephew
18. Renishaw
19. Vodafone
20. GKN
21. BAE Systems
22. Pearson Engineering
23. WFEL (although we didn’t use their contribution)
24. Standard Chartered
25. YES Bank
26. MAX Group
27. Unilever
28. CDC

ANNEX K – EY

COMPANY: EY
SECTOR: Services
SUB-SECTOR: Financial Services (Audit, Accounting, Consultancy, Advisory)
CURRENT CHALLENGES:
CORPORATE TAXATION

1.1. Reduction in tax rates

In the 2015 Budget Speech, the Hon'ble Finance Minister had announced a roadmap for reduction of corporate tax rates from 30 percent to 25 percent over the next 4 years.

In the other Asian countries, the prevailing maximum tax rate in case of companies ranges from 16%-25%. Also, average effective corporate tax rate across industry sectors in India is about 22-23%.

1.2. Surcharge on corporate tax rate for domestic companies

The prevailing tax rate for companies is already very high (30%). Moreover, vide Finance Act, 2015 the rate of surcharge for domestic companies with income exceeding Rs 10 crores was further increased from 10% to 12%, resulting in additional tax burden on domestic companies.

1.3. Abolition of DDT

DDT levy leads to double taxation on corporate sector and hence, should be done away with. Further, introduction of super rich dividend levy u/s 115BBDA leads to additional hardship for the taxpayers.

1.4. Rationalisation of section 14A and Rule 8D provisions

Section 14A of the Act provides for disallowance of expenses incurred in connection with earning of exempt income. As per the current provisions, direct as well as indirect expenses are subject to this disallowance. However, indirect expenses are generally overhead expenses that are required to be incurred irrespective of whether the income is taxable or not or irrespective of the level of income.

The modified Rule 8D provides for a new method for computation of disallowance of expenditure which, in addition to amount of expenditure directly relating to exempt income, also includes an amount equal to 1% of annual average of monthly averages of the opening and closing balance of the value of investment which gives rise or may give rise to exempt income.

The expenses are not allowed even in respect of partnership profits on which taxes are paid by the Firm or LLP and in the real sense full tax is collected.

1.5. Amortisation of capital expenditure

Presently, there is no provision in the act for amortisation of capital expenditure such as fees paid for increase in authorised share capital and payment made towards elimination of competition or premium paid on acquisition of leasehold rights in land etc. Such expenditure being capital in nature cannot be charged to revenue as there is no provision for claiming these expenses in computing the income.

1.6. Deduction for Corporate Social Responsibility (CSR) expenditure

Finance Act 2014 has amended provisions of section 37 of the Act to provide that any expenditure incurred on activities relating to corporate social responsibility (CSR) referred to in section 135 of the Companies Act 2013 shall not be deemed to be an expenditure incurred for the purposes of business.

On the other hand, the Companies Act, 2013 has mandated every company fulfilling certain criteria to spend at least 2% of its average net profit for the immediately preceding three financial years on CSR activities. Since there is statutory obligation of companies to spend specified sum on CSR activities, such expenditure represents an integral part of conducting business operations of the tax payer company. Furthermore, allowing tax deduction may encourage corporates to incur expenditure in excess of the prescribed sums. While donation for specified purposes entitles the payer to deduction under section 80G provisions, where CSR expenditure deduction is not allowed, this shall be discriminatory for corporates who may be carrying out CSR activities for their own defined purposes.

1.7. Section 28(iv) – Income Chargeable under the head Profits and Gains of Business or Profession

Clause (iv) of Section 28 seeks to tax income in the nature of any benefit or perquisite, whether convertible into money or not, under the head 'Profits and Gains of Business or Profession'. Section 28(iv) only refers to the 'income' which can be charged under the head 'profits and gains of business or profession' and therefore, when a particular advantage, perquisite or receipt is not in the nature of income, there cannot be any occasion to bring the same to tax under section 28(iv). Further it settled law that a capital receipt, in principle, is outside the scope of income chargeable to tax.

It has been seen that Revenue is widely interpreting this Section so as to charge to tax even the receipts which are purely of capital nature and which does not arise in the regular business dealings of the assessee.

1.8. Amortisation of mining expenses under section 35E

Presently, the expenditure incurred wholly and exclusively on prospecting, extraction or production of any mineral during 4 years prior to the start of commercial production is eligible for amortisation over a period of 10 years starting from the year of the commercial production. Any expense incurred prior to 4 years gets lapsed and no deduction for the same can be claimed as per section 35E.

The Income Tax Act provides a special mechanism for taxation of income of entities, which enter into a contract with the Government of India for exploration and production of oil and gas in India. Section 42 of the IT Act provides that the taxable profits of a person, who has entered into an agreement (i.e. a Production Sharing Contract- PSC) with the Government for its association/ participation in the business of prospecting, exploration or production of mineral oil, will be determined in accordance with the special provisions contained in the PSC (and the provisions of the Act are deemed to be modified to the extent these agreements provide for certain deductions/ allowances in excess of those provided under the Act).

Exploration and drilling expenditure (as defined in the Model PSC), both capital and revenue in nature, is 100% tax deductible. All such allowable expenditure is required to be aggregated till year of commencement of commercial production and is allowed to be carried forward and set off for a future period of 8 years. Alternatively, such expenditure may be amortised equally over a 10 year period. All unsuccessful exploration costs from other PSCs are permitted to be set off against income arising under the relevant PSC.

Thus, the oil and gas sector has been greatly benefited by the specific provision in the IT Act, which allows deduction for all expenses incurred prior to commercial production, including capital expenditure.

1.9. Section 35D - Amortisation of certain preliminary expenses

Section 35D provides deduction to Indian Companies for certain expenditure incurred before the commencement of business or after the commencement in connection with the extension of the undertaking or in connection with setting up a new unit. The benefit of deduction under Section 35D is limited to the expenditure in the nature of legal charges and registration fees etc. incurred for incorporating the Company.

Further, the deduction of this expenditure is restricted to 5 percent of the cost of project or capital employed at the option of the company.

However, legitimate expenditure incurred post incorporation for and until setting up of business, which are neither covered within Section 35D nor can be capitalised to the actual cost of fixed assets, gets permanently disallowed under any of the provisions of the Act even though they are incurred for the setting up the business and becomes sunk cost. Some of this expenditure could be office / sales employees' salary, audit fees, advertisement and business promotion expenditure incurred prior to setting up of business, etc.

This is more particularly in the case of companies having longer gestation period for setting up their business such as manufacturing entities, insurance business requiring multiple licenses, etc. This affects the cash flow and the spending capacity of the company.

1.10. Balance 50% of additional depreciation u/s 32(1)(iia)

In the Finance Act, 2015 a proviso was inserted after the second proviso to sub section (1) of section 32 so as to provide that where an asset referred to in clause (iia) or the first proviso to clause (iia), as the case may be, is acquired by the assessee during the previous year and is put to use for the purposes of business for a period of less than one hundred and eighty days in that previous year and the deduction under sub-section (1) in respect of such asset is restricted to fifty per cent of the amount calculated at the percentage prescribed for an asset under clause (iia) for that previous year, then, the deduction for the balance fifty per cent of the amount calculated at the percentage prescribed for such asset under clause (iia) shall be allowed under sub-section (1) in the immediately succeeding previous year in respect of such asset. However, the amendment was made effective from F.Y. 2015-16 i.e. A.Y. 2016-17 and subsequent assessment years.

1.11. Investment Allowance u/s 32AC

Finance Act 2016 proposed an amendment under section 32AC(1A). It provides that acquisition and installation of machinery or plant in excess of value of Rs 25 crores need not be in the same year i.e., the twin conditions of “acquisition” and “installation” of assets in the same year has been dispensed with.

Subsection (1) of Sec 32AC introduced vide Finance Act 2013, provides for deduction for investment allowance, if the cost of new assets exceeds Rs 100 Crores and the same is acquired and installed in stipulated time between 31st March 2013 and 1st April 2015. The limit of investment of Rs 100 Crores suggests that the investment is expected to be made in large capital intensive projects. In such a case stipulation of acquiring and installing plant and machinery within a time frame of two years defeats the efficacy of the beneficial provision. Large capital intensive project normally take at least 3 to 4 years to get installed.

1.12. Investment allowance and enhanced depreciation to Defence Companies

Currently, there is no provision under the Act for tax incentives for Company engaged in the defence sector. Defence sector is a ‘Make in India’ initiative and involves high cost and long gestation period. Thus, it is imperative that some tax incentive is given to such companies to attract private sector participation.

1.13. Deduction under section 80IB on profits and gains from certain industrial undertakings other than infrastructure development undertakings

The Government of India has identified electronics manufacturing as a focus sector to boost exports, import substitution, increasing manufacturing output and provide employment opportunities.

1.14. Weighted deduction for in-house scientific research

The phased out reduction of R&D weighted deductions may have impact on innovation and could de-incentivise the industry from spending more on R&D.

1.15. R&D tax breaks

Companies engaging in in-house R&D facilities are provided weighted deduction @ 200% of the capital and revenue expenditure incurred by them. One of the key conditions is that the R&D activity should be carried out in-house. This effectively means that each and every kind of research activity, and really speaking every stage of the entire research activity, has to be conducted in-house and necessary capital and labour has to be deployed. However, there will always be cases of one-time or sporadic use in which scenario it will not be effective to create capacity and deploy labour since it will lead to a waste of scarce and critical labour and capital.

1.16. Certain R&D expenditure not eligible for Weighted deduction

Presently, only expenditure, which are directly identifiable with approved R&D facility, shall be eligible for the weighted tax deduction. However, several types of expenditure such as the following are not allowable for weighted deduction:

- Expenditure purely related to market research, sales promotion, quality control, testing, commercial production, style changes, routine data collection etc.;
- Capitalised expenditure of intangible nature;
- Foreign patent filing expenditure, foreign consultancy expenditure, REACH compliance expenditure;
- Consultancy expenditure, retainership, contract manpower/ labour;
- Expenditure in the nature of cost of any land or building etc.

1.17. IT and ITES sectors to be entitled to weighted deduction under Section 35(2AB)

Currently, there is no clarity whether a company engaged in the business of development and sale of software or providing IT / Information Technology Enabled Services (ITES) services, is eligible for weighted deduction on the R&D expenditure incurred by it.

1.18. Weighted deduction on internally developed intangible assets

The DSIR guidelines provide that eligible capital expenditure on R&D will include expenditure on plant, equipment or any other tangible item only. It also provides that capital expenditure of intangible nature is not eligible for weighted deduction.

1.19. Benefit under Section 35(1)(iia) to be increased to 200 per cent

Section 35(2AB) of the Act has been gradually amended to provide increased tax benefits on expenditure incurred towards in-house R&D facilities i.e. from 125 per cent to 200 per cent. However, Section 35(1)(iia) of the Act, which provides tax incentives in respect of payments made to R&D company, has remained same at 125 per cent. The conditions specified by the DSIR for grant of approval for a recognised R&D facility/ company under Section 35(2AB) and Section 35(1)(iia) are the same and hence, the tax benefits provided under Section 35(1)(iia) should be at par with the tax benefits provided under Section 35(2AB) of the Act.

1.20. Deduction for employment generation under section 80JJAA

Deduction for employment generation shall be available in respect of cost incurred on any employee whose total emolument is less than or equal to Rs. 25000/- per month under section 80JJAA. The capping of salary limit will make the claim ineffective especially in case of Software Industry. The industry is absorbing the fresh talent from colleges/IIT/IIM's with attractive salaries as part of hiring process. Also one of the agenda of the Government is job creation; this capping will discourage the Industry from creating more jobs for the unemployed youth.

1.21. Exchange differences on money borrowed in foreign currency for acquisition of assets within India

Section 43A allows an assessee to make adjustment in "actual cost" of the asset after the acquisition of assets from a country outside India on account of exchange rate fluctuation arising either on liability payable towards such foreign asset or on account of money repayable in foreign currency utilised for acquiring such foreign asset. The adjusted "actual cost" becomes the base for claiming depreciation.

Section 43A allows adjustment in actual cost under Section 43(1) with respect to exchange differences on account of loan taken from outside India but utilised for the acquisition of assets outside India. However, the section does not specifically provide for such adjustment where the asset is acquired in India out of funds borrowed in foreign currency.

1.22. Section 36(1)(va) –Employees' contribution to Provident Fund

Section 43B of the Act allows deduction towards employer contribution to PF/ any other fund for the welfare of the employees if the same is deposited upto the date of filing the return of income. However, deduction for employees' contribution to PF/ ESI or any other fund is governed by Section 36(1)(va) of the Act which mandates that the employees' contribution should be credited to the relevant fund by the due date specified under the relevant Act, rule, order or notification governing that fund.

1.23. Disallowance of expenditure for non-deduction of tax

Presently, in case of non-deduction or non-payment of tax deducted at source (TDS) from certain payments made to residents as specified in section 40(a)(ia) of the Act, 30% of the entire amount on which tax is deductible is disallowed under section 40(a)(ia) of the Act. Similar provision has not been introduced in section 40(a)(i) of the Act which governs the non-deduction of TDS on payments to non-residents. As the intention is removal of undue hardship, similar amendment should also be made in section 40(a)(i) of the Act governing the non-deduction of TDS on payments to non-residents.

1.24. Disallowance under section 40(a)(ia)

Section 40(a)(ia) of the Act provides for disallowance to the extent of 30% of any sum payable to a resident on which tax is deductible at source under Chapter VIIB and same has not been deducted.

The Assessing Officer during the course of assessment proceedings is disallowing the expenditure under section 40(a)(ia) even in cases where the proceeding under

Section 201(1) has not been initiated or proceeding having been initiated but the assessee is not treated as an assessee in default under Chapter VIIB.

1.25. Carry forward of business losses on merger under section 72A of the Act

Carry forward of business losses on merger is limited to companies owning 'Industrial undertakings". The definition of Industrial Undertaking is extremely narrow and restricted; thus a number of sectors are impacted as their ability to carry forward losses is significantly compromised.

Further, the section also prescribes for stringent conditions such as continuity of holding of the assets by the amalgamating company pre transfer (2 years) and by the amalgamated company post transfer (5 years), etc.

2. Withholding tax (TDS)

2.1. Concessional rate of tax for Rupee denominated Overseas Bond (Masala Bond)

Concessional rate of tax @ 5% has been currently extended to Rupee denominated Overseas Bond vide CBDT Press Release but without incorporating under section 194LD in the Statute. Additionally, certain tax issues in relation to Masala Bonds to non-resident investors are required to be addressed.

2.2. Extension of concessional tax rate regime under sections 194LC and 194LD

The eligibility period for benefit of reduced tax rate of 5% available under sections 194LC and 194LD in respect of external commercial borrowings (ECB) and corporate bonds respectively is till 30 June, 2017.

2.3. Time limit for TDS assessment in case of payments to non-residents

As per sub section (3) of section 201 of the Act, in respect of default in TDS on payment to a resident, no order u/s 201 shall be made after the expiry of 7 years from the end of the financial year. The same limitation does not apply in case TDS default on payment to a non-resident and the assessment can be done for any financial year. However, the court has held 4 years to be a reasonable period.

2.4. Generation of TDS certificates in case TDS is deducted @20% u/s 206AA

As per current instruction and configuration at TIN system, entries without PAN cannot be filed in the TDS return. For companies, it is now mandatory to generate TDS Certificate online. For deductees in the absence of PAN, TDS is deducted as per the provisions of Section 206AA of the Act. For these entries TDS certificate is not generated online through TIN system.

2.5. Applicability of TDS on Monthly Provision

Provisions for monthly expenses debited in the company's books of account only for the purpose of monthly MIS which are reversed in the beginning of subsequent month are in respect to-

i. Expenses which are booked on account of identified payee and known amount but invoice copy from the party is to be received.

ii. Expenses which are booked on ad-hoc basis.

2.6. TDS on International Interconnect Charge (IIC) paid to foreign operators

Finance Act 2012 brought in a retrospective amendment by introducing Explanation 5 and Explanation 6 to Section 9(1)(vi).

Royalty is defined in Explanation 2 which connotes exclusivity & the exclusive right in relation to an asset which should be with the grantor (be it physical or intellectual property) for which royalty is paid. In case of an intellectual property, it is generally associated with some discovery, invention, creation, specialised knowledge etc. emanating from human mind and is payable to the inventor/ grantor for allowing the usage of his invention or creation and having an exclusive right over it. "Process" needs to have an IPR.

Payment made for anything which is widely available (as standard product/ off the shelf product) in the open market to all those willing to pay may not constitute 'royalty' and is essentially in the nature of business income.

Further, when a service provider is using its own equipment/ process to render services to service recipient, it cannot be said that service recipient or any other person is using such equipment/ process at same point in time. The two situations are mutually exclusive.

The law has provided two separate provisions relating to 'royalty' [under section 9(1)(vi)] and 'fees for technical services (u/s 9(1)(vii)) under the Act and the said provisions are mutually exclusive and do not overlap. The distinction which has been made by legislature between aforesaid concepts has to be maintained and given the intended effect. It is but obvious that even where services are not 'technical', the distinction between a service contract and royalty contract is still required to be maintained.

The amended provisions under the Act (including Explanations 5 & 6 to section 9(1)(vi)) shall have no relevance in so far as the definition of 'royalties' as contained in the Treaties is concerned. Under treaty, the process has to be a 'secret process' in form of Intellectual Property Right in order to fall within purview of royalty and there has to a direct usage of such 'secret process' by payer in order to qualify the payment as 'royalty' under Treaty. The term 'royalty' is already defined in all treaties.

There is no dispute on the fact that provisions of DTAA will prevail over Act to the extent they are more beneficial to the assessee. The treaties are binding on both countries and have to be interpreted in good faith.

2.7. Certificate for tax deducted at source

Vide section 203 of the Income Tax Act, the deductor has to furnish Form 16A/ Form 16 generated from TRACES, to the deductee within the prescribed time. Earlier deductor had to furnish the certificate in the prescribed form. Now deductor has to generate the certificates from TRACES website and the same should be issued to the deductee.

2.8. TDS Credit

The E-TDS system is undergoing issues and there is mismatch of data between TDS certificates issued by deductors, TDS statements uploaded on TIN system and bank payment details, PAN of the deductees. As a result, deductees do not get the full credit for tax deducted. Further, based on the mismatch the tax authority is issuing orders upon the deductor thereby causing unnecessary adversity to the deductor/ taxpayer.

The E-TDS system mandates all the deductors of taxes to process TDS Certificates in Form 16A's only through TIN- NSDL website. The software of the tax department automatically picks up the address of the deductee from the address appearing in the PAN database maintained by the tax department. As a result, all the TDS certificates are getting issued at the address declared in the PAN application made by the deductee. This has resulted into severe hardship for the companies which have a multi locational set up, since all the TDS certificates get accumulated at the Registered office of the company (being PAN based address) and such accumulation makes it difficult to co-relate/ reconcile them with the accounts which are maintained at different locations and also the units are not able to identify whether the TDS certificate is received from the party or not.

2.9. TDS on payments to Universities and research institutions

Income earned by universities and research institutions is exempt under section 10(21) and section 10(23C) of the Act. However, while making payments to such research institutions and universities, taxpayers are required to deduct taxes even though such income is exempt in the hands of universities and research institutions. The research institutions and universities are required to claim the taxes deducted as refund while filing their income-tax returns. This leads to the creation of a time-consuming process in the form of additional compliances to claim the refund and deferment of cash inflow for such research institutions and universities.

2.10. Statutory Refund mechanism for excess paid / wrongly paid TDS amounts
Currently there is no specific provision in the statute which governs the procedure to be followed for application of refund for excess paid/ wrong paid TDS amount.

2.11. Timelines for grant of lower/ nil withholding Tax certificate
There is no timeline under the Act obligating the tax officer to give lower/ nil withholding tax certificates under section 195/ 197 of the Act.

2.12. Penalty for failure to furnish information or furnishing inaccurate information under Section 195
The Finance Act, 2015 has introduced penalty under Section 271-I of the Act in case of failure to furnish information or furnishing of inaccurate information as required to be furnished under Section 195(6) of the Act, to the extent of INR one lakh. It is not clear whether the penalty is qua the payment made or qua the transaction or qua the contractual obligations for a specific financial year.

2.13. Penalty imposed on deductors for quoting invalid PAN in e-TDS Returns
As per the section 139A(5B) of the Income Tax Act, deductor has to quote the PAN of the deductee in the electronic TDS Return filed and TDS Certificate issued by it. As per section 272B, penalty will be levied on the deductor for failure to comply with the provisions of section 139A.

2.14. Threshold limit in concessional TDS Certificate issued u/s 197
Generally there is a threshold limit specified in concessional TDS Certificates issued u/s 197. In case of large organisations, it is very difficult to keep a track/check of the amount of payments on which concessional TDS rate has been applied for each of the various deductees so that the concessional rate is not applied beyond the threshold limit.

3. **Return/Assessment /Penalty procedures**

3.1. Filing of tax returns by non-residents having income from Royalty or Fees for Technical Services (FTS) in India
As per section 206AA, TDS from payment of Royalty & FTS to a non-resident will be as per rates in force i.e. 10%, on fulfilling the prescribed conditions, even if the non-resident does not PAN in India, if the deductee furnishes the details and the documents as prescribed under Rule 37BC. However, section 139 required a foreign company to file tax returns in India. There is no exemption to foreign company from filing the returns, if their income from India is only of Royalty / FTS. This makes the foreign companies to mandatorily have the Pan in India and do tax compliance of returns filing, though the full tax has been paid by way of TDS.

3.2. Carry forward of losses in case of belated returns
Currently, losses cannot be carried forward in case of a belated return.

3.3. Claim made during the assessment proceedings
The tax officers reject the claims made by the taxpayers during the course of the assessment proceedings which are inadvertently omitted to be claimed by the latter in their return of income.

3.4. Adjustment of Outstanding Demands

Once the demand is raised by the Income Tax Department, Assessing Officer starts pressuring the tax payer for payment of the same, inspite of pending order giving effect giving rise to pending refunds from other orders or rectification applications filed by the tax payer under section 154 of the Act. Section 245 provides that AO should provide intimation in writing before adjusting refund arising out of earlier orders. However this process is not followed by the Revenue Authorities.

3.5. Demand of Income Tax where Assessee has applied for Stay of demand

Currently, in cases where assessments are completed pursuant to direction of DRP and demand is raised, the same is generally payable within 30 days of receipt of demand notice. However, the period available to the tax payer for filing the appeal before the appellate authority is 60 days.

3.6. Interest under section 244A

The rate of interest payable to the assessee by the Income Tax Department is only 6% while the interest charged by the department is 12%. Interest is compensatory in nature and not penal. The loss of interest for the Income Tax Department as well as the assessee is same due to non-payment of dues in time. There is a need for equity.

Further the computation of interest on amount due to the assessee is an area of litigation. The assessee is not given the interest on “total amount due” (Tax plus interest thereon) to the assessee as per the last order.

3.7. Delay in remitting refund even after issue of Assessment Order

As per the Act, scrutiny assessments can be completed within 24 months (now 21 months) from the end of the assessment year. When a Company’s Return is selected for scrutiny, ideally the excess remitted tax amount will not be remitted to the assessee until the assessment is completed. This results in undue hardship to the assessees due to the blockage of working capital in the name of pending assessment. When scrutiny assessment results into demand, the Department issues assessment order along with notice of demand with a specific due date for remittance to exchequer.

3.8. Time Limit for completion of Appeals

Currently there is no provision for providing time limits for disposal of Appeals at CIT(A) level and by other appellate authorities above it.

3.9. Authority for Advance Rulings

The Authority for Advance rulings (“AAR”) has a significant backlog of cases; therefore getting an advance ruling within a reasonable time has become extremely difficult.

Certain contrary recent judicial precedents (including of AAR rulings) has created an ambiguity on maintainability of AAR in case of return of income has been filed.

3.10. Section 68 – Scrutiny examination of funds infused by non–residents

Section 68 of the Act provides that if any sum is found credited in the books of an assessee and the assessee fails to offer an explanation about the nature and source of money or explanation offered is found not to be satisfactory, then such income can be taxed as (unexplained) income in the hands of the assessee. Vide Finance Act 2012, section 68 was amended to provide that the nature and source of any sum credited, as share capital, share premium etc., in the books of a closely held company shall be treated as explained only if the source of funds is also explained by the assessee company in the hands of resident shareholder/ investo.

But the Assessing Officers have been utilising the amended provision for non – resident investors (of International Repute) also, which have not been covered by the amendment. The non-resident investors are compelled to submit even such information to the AO's during the course of scrutiny assessment proceedings of Investee Companies, over which AO has no jurisdiction or is totally irrelevant from the assessment perspective.

Additionally, section 56(2)(viib) of the Act provides that share premium received by an unlisted company upon issue of shares in excess of the fair market value shall be treated as income in the hands of such company and subject to tax accordingly. This law is applicable w.e.f. AY 2013-14.

Section 68 can be invoked in a situation wherein nature and source of funds remain unexplained by the recipient and the contributor. If the nature and source of funds stands explained, tax department could then have recourse under section 56(2)(viib) only in situations where difference in technical aspect of valuation exist. However, the converse may not be true i.e. if Section 56(2)(viib) is invoked to tax the difference in technical aspect of valuation, the test of nature and source of funds stand automatically satisfied. The rigours of Section 68 should stop with the investigation into nature and source of funds and not extend to cater to the technical aspect of valuation dealt specifically under section 56(2)(viib) as the Legislature may not have intended to provide two sections i.e. Section 56(2)(viib) and Section 68 to be used interchangeably. Section 68 also cannot be invoked in cases of genuine issue of shares by a company to joint venture partners or financial investors, i.e., private equity, venture capital funds etc.

3.11. Clarity on section 271G penalty

The said section has extended the power to the TPO to levy penalty. As the provision exists today, after the TPO's order the AO has to pass the final assessment order. The AO is also vested with power to levy Penalty on the Final Order. With this the TPOs Authority to levy penalty can be dropped. This will help in reducing multiple appeals arising on account of parallel proceedings carried out by the AO & the TPO Separately.

4. Capital gains

4.1. Amendment requirement in section 47(xiiib) of the Income-tax Act

Many companies are now converting themselves to LLP. There is a need to popularise the concept of LLP and also in view of the fact that such provision should apply to all cases of revenue neutral conversions from one form of entity to another form of entity.

4.2. Cost of acquisition with reference to assets acquired under demerger

Section 49(1) refers to certain modes of acquisition wherein the cost would be substituted by the cost of the previous owner. Section 49(1)(iii)(e) covers corporate restructurings such as amalgamations, but does not include a reference to a demerger which is exempt u/s 47(vic).

4.3. Business Reorganisation

There are issues on the regulations relating to Buyback Tax under section 115QA.

In numerous M&A deals a part of consideration is deferred and may be contingent on future factors such as the future revenues of the target company. The deferred amount (in part or full) may in reality never be received by the seller owing to milestones not being met. There is no provision in the Act for the tax payer to claim back the excess capital gains tax paid upfront on the higher amount.

In case where the amalgamated foreign company is a parent company of the amalgamating foreign company, the first condition of section 47(via) of the IT Act cannot be complied with, as 25% of the shareholders of amalgamating foreign company (being amalgamated foreign company) will not become shareholders of amalgamated foreign company since the amalgamated foreign company cannot become its own shareholder.

5. Minimum Alternate Tax ('MAT')

5.1. Removal of MAT/ realignment of MAT rates

With the removal of incentives, the scope for taxable income being lower than the book profits has considerably reduced. The only major difference between the book profits and normal taxable income arises on account of depreciation rates. The difference in depreciation also gets reduced if the company is not expanding and a stage is reached when the tax depreciation is lower than the book depreciation.

On the other hand, the MAT rate has gone up to as high as 21.34%, which can even be considered as closer to the corporate tax rate of 34.61% on taxable profits.

5.2. Recommendation on MAT- IndAS Committee Report

The Government has constituted Accounting Standards Committee, a Committee to suggest amendments to MAT provisions under section 115JB in view of transition to Ind-AS as notified by Ministry of Corporate Affairs (MCA). The Committee is yet to bring out its final report.

In its first interim report dated 18 March 2016, the Committee had inter alia recommended that items which are directly transferred to Retained Earnings on first time adoption (FTA) of Ind-AS and are not reclassified to Profit & Loss Account (P&L) in future should be picked up for MAT in the first year of Ind-AS adoption.

To address concerns raised by stakeholders that upfront MAT levy on FTA adjustments recorded in Retained Earnings may cause significant hardship resulting in MAT levy on unrealised gains/losses, the Committee issued second interim report dated 23 July 2016 which recommends the following along with other recommendations:

1. The FTA adjustments in Retained Earnings in respect of Property, Plant & Equipment (PPE) and Intangible Assets be ignored for MAT computation in first year but picked up in year of realisation/disposal/retirement of such assets ; and

2. The FTA adjustments in Retained Earnings in respect of other items like lease equalisation reserve, financial instruments fair valued through P&L, etc. be spread over three years for MAT computation, starting from the first year of Ind-AS adoption.

5.3. MAT on exempt income

MAT is payable even on those incomes that are exempt such as sale of listed equity shares under section 10(38) and incomes that are not taxable under regular provisions such as Capital Receipts. This results into accumulation of MAT credit and blockage of funds for businesses.

5.4. MAT on foreign dividend

The Finance Act 2011 introduced a new Section 115BBD in the Act which provided that dividend paid by a foreign company to an Indian company, in which the Indian company holds 26% or more of the equity share capital, would be taxed in the hands of the Indian company at the rate of 15% (plus applicable surcharge and cess).

Further, in order to remove the cascading effect in respect of dividend received by an Indian company from a foreign company, an amendment was introduced in Section 115-O of the Act. As per the said amendment, where an Indian company pays tax on dividend received from a foreign company under Section 115BBD and thereafter, such Indian company distributes dividend to its shareholder, then the dividend on which tax has already been paid by the Indian company (i.e. under Section 115BBD) shall be reduced from the amount of dividend on which Dividend Distribution Tax ('DDT') is payable by the Indian company.

Domestic dividend is specifically exempt from the applicability of MAT provisions under Section 115JB. However, similar exemption is not available under Section 115JB in case of foreign dividend which suffers tax under section 115BBD.

The consequence of this would be that Indian companies will end up paying an effective tax of 21.34% on foreign dividend due to applicability of MAT provisions as against the effective rate of 17.30% stipulated under the provisions of section 115BBD. Further, since the Indian companies have made outbound investments through investment companies which generally do not have any other source of income, the companies would not be able to utilise the MAT credit.

The higher rate of tax under MAT provisions would remain a disincentive for repatriating the funds to India and partially defeats the very purpose for which section 115BBD was introduced.

5.5. Exemption of SEZ profits from MAT calculation

Finance Act, 2011 has widened the scope of MAT by bringing SEZ units under the ambit of MAT, thereby significantly diluting benefits offered under the popular SEZ Scheme. Now, tax is also required to be paid on profits of SEZ units, though these were envisaged to be tax free when the provision was enacted.

5.6. Carry forward of MAT credit by amalgamated company

There is no clarity under the Act, whether on amalgamation/merger of companies, MAT credit available to amalgamating company can be availed by amalgamated company post amalgamation.

5.7. Reduction of unabsorbed depreciation / business loss for MAT computation

Section 115JB of the Income-tax Act provides for reduction of loss brought forward or unabsorbed depreciation, whichever is less as per books as a reduction from net profits while computing book profits. The Explanation further states that if loss brought forward or unabsorbed depreciation is nil, no amount shall be reduced.

Tax on book profits is a tax on notional income and was introduced to levy tax in case of companies which though earning net profits and declaring handsome dividends do not pay taxes under normal provisions of the Act on account of various incentives / deductions.

The Act does not specify the method of computing the unabsorbed depreciation or business loss for set off against the book profits. In the absence of prescribed methodology for the computation of unabsorbed depreciation and business loss, there exists high uncertainty of interpretation and consequential litigation.

Furthermore, it may be noted that a company is said to make profits only if it has wiped off all the past losses, both book loss and unabsorbed depreciation and earned net profits during a particular year. To consider set-off of only one element i.e. either book loss or unabsorbed depreciation while computing book profits, usually the latter, would only be a half-hearted relief while taxing a company notionally on its net profits.

The provisions of Companies Act also allow a company to freely distribute profits to shareholders post set-off of all past losses. In such a situation, taxing a company on its net profits for a year, that too notional, without reduction of past book losses would not be fair. The very intent behind introduction of MAT which is to tax companies earning net profits and declaring dividends but not paying taxes seems to be defeated in the instant case.

5.8. Rationalisation of MAT provisions for infrastructure companies

The benefit available to the infrastructure companies and other entities eligible for deduction under Chapter VI-A of the Act, gets neutralied since the companies are required to pay MAT on their book profits.

In order to promote investments in the infrastructure sector, the Government has provided tax holiday u/s 80-IA. However, this benefit is substantially diluted due to the MAT to be paid by the Companies. Though MAT credit can be accumulated, there is a restriction on the quantum & period of its utilisation.

6. Provisions in respect of Units established in Special Economic Zones

Under section 10AA of the Income tax Act, 1961, an SEZ Unit is eligible for a deduction (for a period of 5 consecutive assessment years) of 50% of SEZ Reinvestment Reserve, created by the assessee after expiration of 10 year tax holiday period. Creation of a re-investment reserve hampers the ability of an SEZ unit, especially ones in the manufacturing process. Presently, SEZ Units need to commence operations/ manufacturing on or before 31st March 2020 to claim tax benefit.

Further, Companies operating in capital goods, infrastructure / manufacturing industries have made huge investments to create local job opportunities as well as to boost domestic industry. Tax holiday period has been provided to, inter alia, enable them to recover their investments faster. Due to subdued market performance, they have not been able to recover their investments due to lower than anticipated profits and most of the companies have either exhausted the period of 5 years or are close to exhausting the said period.

7. Transfer Pricing / International Tax

7.1. Transfer Pricing requirement for Non-resident

At present non-resident assessee are required to obtain a Transfer Pricing Audit report U/S 92E of the Income Tax Act. The non-resident assessees are also required to maintain and justify the arm's length value of transactions for all transactions taken with resident (Indian) assessee.

When transaction is once assessed under transfer pricing regulations, reported and assessed for resident assessee, it is duplication of work to assess the same transaction under transfer pricing regulations for non-resident assessee.

7.2. Narrow interpretation of Rule 10B(1)(e)(iii)

If the Transactional Net Margin Method (TNMM) is adopted then under Rule 10B(1)(e)(iii) an assessee is eligible for adjustments to be made to the profit margins so as to enable the assessee to make comparison with the comparable margins of the comparable companies.

Rule 10B(1)(e) states as under:

"e) transactional net margin method, by which,—

(i) the net profit margin realised by the enterprise from an international transaction or a specified domestic transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;

(ii) the net profit margin realised by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;

(iii) the net profit margin referred to in sub-clause (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction or the specified domestic transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market"

Practically adjustment in the comparable uncontrolled transaction is not possible as the details of the comparable entities available in the public domain are less. The TPO takes stricter interpretation and no adjustment is granted if the assessee wants to adjust its own margins to make the comparison more meaning full.

7.3. Contradiction between Customs and Transfer Pricing

Customs and Transfer Pricing are based on arm's length principle, whose objective is to ensure that taxable values of imports are correct and taxes are paid appropriately on arm's length value. However, intention under both the regulations drives in opposite directions i.e. the Customs Cell would prefer to increase the import value of goods to increase tax while the tax department would prefer to reduce purchase price of goods to increase taxable profits. The diverse end-results create ambiguity and uncertainty in pricing.

7.4. Intra-group services

Intra-group services (also referred to as management services) are collection of services provided by any company of a MNC group to other affiliates (on a centralised basis) for a service fee, in its endeavour to improve synergies and leverage experience, knowledge and in-depth understanding of the company in relation to the industry best practices, market perception, vendor expectation, etc. However, the Indian transfer pricing regulations do not provide any explicit guidance on the transfer pricing treatment of intra-group services.

It is increasingly becoming a matter of concern as to how these services are audited for transfer pricing purposes. Most cases suffer with the extreme views taken by the tax office holding that such services have not resulted in any benefit to the taxpayer, and therefore, the arm's length price is determined to be nil.

7.5. Comparison of tested transactions with controlled transactions

In many instances, the tax authorities have taken an approach of determining the arm's length price by comparing the tested transaction with another controlled transaction (i.e. transaction undertaken between 2 entities of the same MNC). This is clearly against the basic principles of determining the arm's length price. The Indian judicial precedents also do not give a clear view on the issue.

7.6. Transfer Pricing - Safe Harbour Rules

Safe Harbour Rules provide for circumstances in which a certain category of taxpayers can follow a simple set of rules under which transfer prices are automatically accepted by the revenue authorities. Essentially, safe harbour provisions offer benefits to taxpayers and tax administrators in the form of compliance relief, administrative simplicity and certainty. However, these rules have not been extended to banking transactions.

7.7. Penalty for non-furnishing of Country by Country report

Section 271GB of the Act prescribes stringent penalty for non-furnishing of Country by Country (CbC) report as prescribed in section 286 by the due date. The deadline for filing the CbC report in India is 30 November 2017 for first covered FY 2016-17 i.e. only 8 months post the end of FY 2016-17 have been provided to the taxpayers to prepare and furnish the CbC report.

7.8. Introduction of Master File requirement but no clarity on its threshold

Though the Memorandum to Finance Bill mentions about Master File requirements and provides that detailed nature of information would be required to be furnished in the Master File, detailed provisions or rules for Master File have not been prescribed. Further no threshold for preparation and filing of Master File has been prescribed.

It would be an additional burden on the taxpayers requiring investment of lot of time, efforts and resources to compile the information required in Master File (as detailed in OECD BEPS guidelines). Further without any knowledge about what would be the threshold of master file requirement, taxpayers are unable to plan their affairs in advance.

7.9. Clarity on adoption of Local File

There is no clarity on whether the OECD recommendations on Local file would be adopted as is in the Indian TP regulations or not and whether there would be any threshold for the same. This would create uncertainty for taxpayers.

7.10. Indirect Transfer of assets

The Income Tax Act, 1961 through the Finance Act, 2012, provides that share or interest in a foreign company or entity that derives its value 'substantially' from assets located in India would be deemed to be situated in India. As such, a completely offshore transfer of such foreign shares would be brought within the Indian tax net.

In this regard, additional measures are required to ensure that the law is not adversely contrary to the global practices.

7.11. Interest payment by India branch to Head Office

Finance Act 2015 amended the law that the payment of interest by the India branch to the Head Office or any branch outside India shall be chargeable to tax in India and liable withholding tax in India. As Head Office and branch(es) are part of the same legal entity, the taxability of the intra-group interest income would be against the principle of mutuality.

7.12. Indian branch of foreign company

As per Section 115A, income (royalty and fees for technical services) earned by foreign person gets taxed at concessional rate when the payment is made by an Indian concern.

7.13. Rollback of APA

The CBDT introduced the rollback rules under the APA program on 14 March 2015. There were some ambiguities about the implementation of the rollback rules, and therefore, CBDT issued Frequently Asked Questions (FAQs) clarifying certain issues.

The international transaction proposed to be covered under the rollback is to be the same as covered under the main APA. The term ‘same international transaction’ implies that the transaction in the rollback year has to be of the same nature and undertaken with the same AEs, as proposed to be undertaken in the future years and in respect of which APA has been reached.

7.14. Requirement for non-residents having no place of business in India to comply with TDS obligations

The Finance Act, 2012 extended the obligation to withhold taxes to non-residents irrespective of whether the non-resident has— (i) a residence or place of business or business connection in India; or (ii) any other presence in any manner whatsoever in India.” The aforesaid amendment was introduced with retrospective effect from 1st April 1962.

The amendment has resulted in a significant expansion in the scope of withholding provisions under the Act and covers all non-residents, regardless of their presence/connection with India resulting into extra-territorial taxation.

7.15. TDS from payments to Non-residents having Indian branch/ fixed place PE

The corporate tax rate for non-resident companies being 40% (plus surcharge and education cess) results in requiring a non-resident company to file return of income to claim refund of excess taxes deducted. This creates cash flow issues for the non-resident company having operations through an Indian branch unviable, when compared with its Indian counterparts.

7.16. Removal of cascading effect of Dividend Distribution Tax (DDT) in a multi-tier structure

Vide Finance Act 2012 the benefit of removal of cascading effect of DDT was extended to a multi-tier corporate structure where multiple corporate entities are involved. This was sought to be done by simultaneous amendments in sub-section (1A) of Section 115O at two places – firstly, by removing the restrictive condition in clause (c) of sub-section (1A) that the domestic company should not be a subsidiary of any other company and secondly, by providing that the tax base for DDT is to be reduced by the amount of dividend received from its subsidiary if such subsidiary has paid the tax which is payable on such dividend.

This was introduced in contradistinction to the expression which existed in the pre-amended section i.e. ‘the subsidiary has paid the tax under this section on such dividend. Thus, while the pre-amended clause mandated the actual payment of DDT by the subsidiary but the amended clause only mandates that the subsidiary should have paid the tax which is payable. Thus, it is evident that the intent of bringing in simultaneous amendments in sub-section (1A) was to extend the benefit of DDT paid by the bottom most subsidiary company, to the top most holding company, in a multi-tier holding structure and avoid the cascading of DDT.

While the amendments brought about by Finance Act, 2012 aims and intends to remove the cascading effect of DDT in a multi-tier corporate structure on absolute basis i.e. at every tier but the Revenue may raise doubts and may attempt to restrict the benefit in a multi-tier corporate structure effectively upto two-levels only by placing reliance on the Proviso to sub-section (1A).

Further, it is evident that the principle applied for removing the cascading effect of DDT is ‘tax should be paid once on the same income’. But this has been applied in a limited context as when a company which holds less than 50% shares in another company, receives and pays dividend has to pay DDT on both the receipt and payment separately, though to the extent of receipt it is same dividend (income) only.

7.17. Section 9(1)(i) – Transfer of minority stake within the same group

The Finance Act 2012, amended Section 9(1)(i) of the Act, retrospectively w.e.f. 01 April 1962 to insert an explanation that seeks to clarify that the situs of capital assets being shares / interests in foreign entity, directly or indirectly deriving value substantially from the assets located in India shall be deemed to be in India. Further vide amendments by Finance Act 2015, an Explanation 7 was inserted which provides that if the transferor does not hold the right of management or control of such company; nor holds the share capital or voting power in excess of 50% of the total capital or voting power of the foreign company, the deeming provision shall not apply.

Presently under Section 47 of the Act, the transactions of transfer of capital assets between holding and subsidiary company are not regarded as transfer and consequently no capital gains tax is levied. Further in recent rulings, High Courts have held in context of section 79 that it will not be triggered where there is a change in shareholding and where 51% of the shares or voting power is beneficially held by the same group of shareholders.

In both the above scenarios, it can be seen that in case the control of the asset ultimately lies in the hands of same controlling group then the same is not regarded as a transfer.

7.18. Deputation of employees

Increasing globalisation has resulted in fast growing mobilisation of labour across various countries. Typically, the company deputing the personnel (home employer) initially pays the salary and other costs on behalf of the company to which such personnel are deputed (host company), which are thereafter reimbursed by the host company. The issue which had cropped up before the Indian tax authorities and courts due to the increasing deputation agreements being entered cross border was whether such reimbursements made by the host company in India to an overseas entity (home employer) towards salary and other costs in relation to the deputed employees should be taxable in India as being payment in the nature of fees for technical services. Further, the main issue in such arrangements is whether the deputed employee is rendering services in India on behalf of the home employer resulting in FTS taxation or a taxable presence for home employer in India.

7.19. Tax Residency Certificate (TRC)

The Finance Act, 2012 had provided that in order to be eligible to claim relief under the tax treaty, a taxpayer is required to produce a Tax Residency Certificate (TRC) issued by the Government of the respective country or the specified territory in which such taxpayer is resident, containing certain prescribed particulars. Obtaining a TRC certificate may also be a time consuming/difficult process. TRC requirement increases the administrative difficulty for non-residents, especially from the perspective of non-residents having very few/limited transactions connected to India.

As per the new Rule an Indian resident who wishes to obtain TRC from Indian income tax authorities, is required to make an application in Form No. 10FA to the tax officer, containing prescribed details. However, no time limit for issue of TRC is specified from the date of application by the assessee. Furthermore, the issue of TRC in Form No. 10FB has been left to the discretion of satisfaction of the tax officer, without providing a substantive definition for satisfaction in this regard.

Also, it has not been specified as to who shall sign Form 10F.

7.20. Foreign tax credit

As per section 40(a)(ii) taxes paid are not deductible. This section defines taxes to include sum eligible for relief u/s 90 or 91. Further, section 91(1) provides that the relief shall be equal to Indian taxes payable on the income that has suffered taxation. Similarly, most of the DTAAs restrict the relief in India, to the extent of Indian taxes payable on such doubly taxed income. Reading both sections together, if the taxes paid in foreign country are in excess of the relief available u/s 91(1), the deductibility of the surplus is not clear in the law.

As per recent FTC Rules, FTC shall be the aggregate of amounts of credit computed separately for each source of income arising from a particular country or specified territory.

7.21. Concessional rate of tax for Rupee denominated External Commercial Borrowings (ECBs)

The concessional rate of 5% under Section 194LC of the Income Tax Act only covers borrowings in foreign currency. In the absence of clarity, the withholding tax for INR ECBs could be lower of either the domestic rate of 40% or the applicable treaty rate between India and the jurisdiction of the non-resident lender but may be still without the benefit of concessional rate of 5%. The impact is quite pronounced as higher WHT is applied on the equivalent INR coupon which is higher than a FCY coupon thereby making the product less competitive. As a consequence, the eligible borrowers would prefer achieving the same at a lower cost through a FCY ECB as compared to INR ECB.

8. Other provisions

8.1. Income Computation and Disclosure Standards (ICDS)

ICDS is effective from F.Y. 2016-17. These standards are applicable to the computation of income under the heads “Profits and gains of business or profession” and “Income from other sources”. The preamble states that if there is any conflict between the provisions of the Act and the ICDS, the latter will prevail. It is pertinent to note that taxpayers are already grappling with regulatory changes of the Companies Act, 2013, Ind-AS, BEPS Action Plans and the proposed GST.

8.2. Place of Effective Management (PoEM)

Finance Act 2016 deferred the implementation of POEM based on the residence test by one year and to apply from the Financial Year 2016-17. Transaction pertaining to period starting from 01-04-2016 will be evaluated as per the provisions of PoEM. The government is to notify the income computation mechanism in case of a foreign company having a POEM in India.

8.3. General Anti Avoidance Rules (GAAR)

The Government has received inputs from the stakeholders on GAAR and is yet to come out with the final guidelines.

9. Personal Taxation

9.1. Revision of basic exemption limit for individual Tax Payers

Considering the steep rise in cost of living due to inflation it is suggested that basic limit for exemption and other income slabs should be enhanced to give benefit to low income group. The income trigger for peak rate in other countries is significantly higher.

The Parliamentary Standing Committee on Finance (PSC) in its Report on the Direct Taxes Code Bill 2010 (DTC Bill) has appropriately recommended the following revised tax slabs for individual taxpayers.

Income Slab (Amount in INR)	Tax Rate
0-3 Lakhs	NIL
3-10 Lakhs	10%

10-20 Lakhs 20%
Beyond 20 Lakhs 30%

9.2. Revival of Standard Deduction

A standard deduction was earlier available to the salaried individuals from their taxable salary income. However, the same was abolished with effect from

AY 2006-07. On the other hand, business expenses continued to remain as permissible deductions from taxable business income. It has to be appreciated that standard deduction is not a personal allowance and used to be given as a lump sum for meeting employment related expenses.

9.3. Deduction under section 80C

Currently, deduction under section 80C of the Act is restricted to Rs 150,000. Further, contribution to provident fund has been included in the deduction under section 80C limit.

Equity Linked Savings Scheme (ELSS) which is an open-ended equity mutual fund is qualified for deduction under section 80C with lock-in period of three years. Further, dividend and capital gain are tax exempt.

To make the term deposits at par with ELSS, the lock in period for 80C should be reduced from present five years to three years. To induce long term savings through fixed deposits it is essential to remove the tax arbitrage. Further, this would be revenue neutral as there will be no loss to the Revenue.

9.4. Deduction of Principal Repayment of Housing Loan Borrowed by an assessee from his employer being a Private Company

Currently the assessee is restricted to claim deduction U/s 80C(xviii) of the principal amount for amount borrowed for purchase etc. of a House Property. It is common that the employees in private sector are provided loans at concessional rates by employer. The employees are also charged to income tax on the concessional part of the loan provided under perquisites.

9.5. Consideration of FTC while computing TDS to be deducted from salary payments

With globalisation, most companies have internationally mobile employees. These employees may be subject to tax in overseas countries and taxes are withheld on behalf of such employees and deposited as per the local provisions of the overseas jurisdiction.

When the employees are deputed back in India or any payment is made by the Indian employer of such employees, presently there is no mechanism to extend foreign tax credit to such employees while deducting their taxes in India. The new tax return forms have facility to consider foreign tax credit, which supports that income tax authorities recognise granting of foreign tax credit. However, as no mechanism exists for allowing credit while deducting tax, such employees have to claim the credit for taxes withheld in foreign jurisdictions only in their return of income and claim refund for excess tax withheld which creates undue hassle for such employees.

9.6. Deduction in respect of health insurance premia under Section 80D

Currently, a deduction up to Rs.55,000 (25,000 for self/ family and 30,000 for senior citizen parents) is available to an individual under Section 80D of the Act from taxable income, towards health insurance premium paid by him. The limit for parents is increased to INR 30,000 if the parents are senior citizens. Unlike many other countries, India does not have a comprehensive health-care system for its citizens. There are Government hospitals but the facilities available are woefully inadequate while the private hospitals are very expensive. Also, the penetration and awareness of health insurance in India is very slow. Most individuals buy insurance only to save taxes.

9.7. Restoration of section 80CCF of the Income Tax Act

Section 80CCF was introduced in 2010, providing Income Tax deduction for two assessment years viz. A.Y. 2011-12 and A.Y. 2012-13 for subscription to long term infrastructure bonds issued by LIC, IFCI, IDFC and NBFCs classified as Infrastructure Finance Companies (IFCs) on investments upto Rs.20,000, over and above the Rs.100,000 deductions available under other sections. The investor would have a minimum lock-in period of 5 years in the long term bonds. The objective was to promote savings of retail investors in bonds and raise funds for infrastructure.

9.8. Revision of minimum exemption limit for allowances

- The transport allowance granted by the employer to the employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty is currently tax exempt up to Rs 1,600 per month in terms of Section 10(14) of the Act read with Rule 2BB of the Rules. This exemption limit seems quite nominal considering the ever rising fuel costs and resultant conveyance costs.
- The education allowance granted by the employer to the employee to meet the cost of education expenditure upto two children is currently tax exempt up to Rs 100 per month per child in terms of Section 10(14) of the Act read with Rule 2BB of the Rules. This exemption limit was fixed in 2000 with retrospective effect from 1 August 1997 and seems quite nominal considering the ever rising cost of education.

9.9. Leave Travel Concession

At present the leave travel concessions for employees are based on calendar year.

Further, Section 10(5) allows exemption for assistance or concession received from employer for employee and his family on leave to any place in India. There is no provision in the Act which covers the travel outside India.

9.10. Reimbursement of Medical Expenditure - Section 10

Any sum paid by the employer in respect of any expenditure incurred by the employee on the medical treatment of self/ family is currently exempt from tax, to the extent of Rs 15,000 per annum.

9.11. Rent Free Accommodation

There is no beneficial perquisite of rent free accommodation provided in a campus accommodation where factory is located in remote areas.

9.12. Meals and meal vouchers provided by employers

Para (iii) of sub-rule 7 of Rule 3 prescribes the valuation norms for free food and non-alcoholic beverages provided by the employer to an employee during working hours. A limit of Rs 50 per meal has been prescribed up to which the said benefit is not taxable in the hands of the employee. This limit of Rs 50 was introduced in 2001.

Further, it may be noted that provision of electronic meal card to employees is not specifically included in Rule 3(7)(iii), however, the same was mentioned during the FBT regime. Accordingly, confusion arises whether or not electronic meal cards are covered by Rule 3(7)(iii).

9.13. Gifts provided by employers

Para (iv) of sub-rule 7 of Rule 3 prescribes the valuation norms for gifts given by employers to employees or members of their household on ceremonial occasions or otherwise. The value of perquisite is taken as nil where the aggregate value of such gifts during the previous year is below Rs 5,000.

Indirect Taxes:

A. Service Tax

1. Service of transportation of goods by sea from an overseas port to an Indian port to be zero rated

Prior to 1st June 2016, services of transportation of goods by a vessel from a place outside India up to a customs station of clearance in India (i.e. import cargo transportation) were in the negative list of services. Effective from 1st June 2016, these services are removed from the negative list of services. In view of the above stated amendment, domestic shipping lines registered in India are liable to pay service tax on import cargo transportation as a service provider (either engaged by Indian or foreign consignor). Further, import cargo transportation services received by Indian customers from foreign shipping lines are liable to service tax under reverse mechanism in the hands of the Indian customer. If the Indian consignee is engaged in trading of goods or in manufacture of excise exempted goods, the Indian consignee is not eligible for service tax paid on import cargo transportation.

However, if the shipping company is an overseas company engaged by foreign consignor, not having any place of business in India, services are exempt from service tax (Vide serial no 34 of the Service tax Mega exemption Notification No 25/2012 dated 20th June 2012).

Thus, it is clear that, the amendment to levy service tax on import cargo transportation results in a disadvantage for an Indian shipping company vis-à-vis a foreign shipping company. This could be due to the fact that foreign vendor / consignor (at the instance of Indian customer) could prefer to have a contract with foreign shipping companies over Indian shipping companies. This has a serious impact on the Indian shipping industry.

Accordingly, it is suggested that services of transportation of goods from an overseas port to a customs station in India should be exempted from service tax. In addition to the above, allowing the shipping companies to claim CENVAT credit on the above would help in reducing the costs relating to transportation of goods by sea and help the Indian shipping companies to be competitive vis-à-vis foreign shipping companies.

Further, this would also provide a boost to the shipping industry and promote the transportation by sea which is a more eco-friendly option and results in less pollution as compared to road transportation. Further, export cargo transportation services have been zero rated from service tax with full CENVAT credit on input and services, the same service tax treatment should also be extended to import cargo transportation services.

Globally, major maritime jurisdictions like Canada, UK, Singapore, Netherlands, Greece etc, give full credit of taxes paid on inputs used for export and import cargo and have a zero rated tax treatment for import cargo as well as export cargo transportation services.

2. Restoration of Service tax exemption on construction of ports / airports

Service tax exemption on services of construction, erection, commissioning, installation etc. of original works pertaining to airport and port under Entry 14 of Notification no. 25/2012-ST, was withdrawn w.e.f. 1st April 2015.

The exemption is restored for the above services provided under a contract entered into before 1 March 2015, and on which stamp duty has been paid prior to that date vide introduction of Entry 14A in Notificaiton No. 25/2012-ST. There is a further requirement that certificate has to be obtained from Ministry of Civil Aviation or the Ministry of Shipping, certifying that the contract has been entered into before 1st March 2015.

This exemption will be applicable till 31st March 2020.

With this amendment, the Government had sought to restore exemption to such public welfare projects upto 31st March 2020, with respect to contracts entered into prior to 1st March 2015. However, the additional requirement of procuring certificate from the Ministry of Civil Aviation or the Ministry of Shipping is quite cumbersome and would cause hardships to the companies. Payment of stamp duty prior to 1st March 2015 would be sufficient to prove that the contract has been entered into prior to that date. The requirement of additional documents would not be in line with the policy of “Ease of doing business”.

Further, it is not clear whether the exemption can also be extended to a sub-contractor engaged in providing services other than works contract like erection, installation, commissioning etc. where the main contract is entered into before 1st March 2015, but the sub-contract is entered into after 1st March 2015.

3. Increase of interest rate on refunds in case of delay in passing order

Currently, as per section 11BB of The Central Excise Act, 1944, interest at the rate of 6% p.a. is paid in case excise duty is not refunded within the prescribed time limit. Rate of 6% p.a. is fixed vide Notification No. 67/2003-C.E. (N.T.), dated 12th September 2003.

Section 27A of The Customs Act, 1962 has similar provisions with regard to refund on delayed refunds.

Also, section 83 of the Finance Act, 1994 has adopted provisions of section 11BB of the Central Excise Act, 1944 and accordingly, interest at the rate of 6% p.a. is paid in case service tax is not refunded within the prescribed time limit.

However, on the other hand interest on delayed payment of indirect taxes is 15%. Thus, there is a wide gap which needs to be narrowed down. It is high time that the Government revisits interest rate which was prescribed way back in 2003.

Accordingly, it is suggested that interest rate on refunds be increased from 6% p.a. to at least 9% p.a. as proposed in Income tax. This will also safeguard the interest of the assessees who are entitled to refund and they shall be compensated appropriately.

B. Central Excise

4. Infrastructure Cess not to be levied on importation of motor vehicles

The Finance Minister in his budget speech announced the levy of an Infrastructure Cess, of 1% on small petrol, LPG and CNG cars, 2.5% on diesel cars of certain capacity and 4% on other higher engine capacity vehicles and SUVs. Section 162 of Chapter VII of the Finance Act 2016 provides for the said levy.

As per the Eleventh Schedule to the Finance Act 2016, such Infrastructure Cess shall be levied on all goods falling under Chapter 8703 of the First Schedule to the Central Excise Tariff Act, 1985. It is relevant to note that no corresponding amendment has been proposed in the CENVAT Credit Rules, 2004 ('CCR') to allow credit of the said levy even against any output Infrastructure Cess liability. Accordingly, no CENVAT credit is available for input Infrastructure Cess nor can any other input CENVAT credit be used to offset the output liability of Infrastructure Cess, resulting in direct cash outflow for automobile manufacturers.

Given the complex nature of the automotive industry in terms of the various forms in which motor vehicles, parts and components are imported in India, there is much speculation amongst industry players on the levy of such Cess in different scenarios. More particularly, clarity is required on applicability of Infrastructure Cess on import of motor vehicle parts and components in Completely Knocked Down (CKD) or Semi-Knocked Down (SKD) form.

Eleventh Schedule to the Finance Act, 2016 refers to all goods covered by Chapter heading 8703. Thus, where the imports are classified under the said heading for Customs purposes, the appraising authorities may automatically levy the Infrastructure Cess as part of Additional Duty of Customs in lieu of Excise (CVD). If Infrastructure Cess is levied on import of motor vehicles parts and components in CKD/ SKD form, and then again on manufactured vehicles at the time of clearance from the factory, it would lead to double taxation and increase in cost of manufacture. Infrastructure Cess is already leading to an increase in cost of manufacturing motor vehicles. Ultimately, this will lead to inflation in the sector as manufacturers will pass on the extra duty element to the consumer. Further, imposition of Infrastructure Cess on CKD/ SKD imports will be against the 'Make in India' agenda of the Government.

Additionally, this would also lead to an anomaly wherein the import of completely built up motor vehicles (CBUs) will attract the Infrastructure Cess only once, whereas motor vehicles manufactured in India out of CKD/ SKD imports would attract the levy twice, i.e., once on import of CKD/ SKD kits and then again on finished goods.

Clearly, this does not seem to be the intention of the Government. However, the statutory provisions create an ambiguity and hence, a suitable clarification/ amendment in law is required to avoid such a situation where import of vehicles get a more preferential treatment compared to vehicles manufactured in India.

With regard to CENVAT credit, it is observed that for other special purpose levies, CENVAT credit of input duty/ cess has been allowed against output liability of the same duty/ cess. However, by not providing for any CENVAT credit in case of Infrastructure Cess, it has been put on a differential footing compared to other special levies such as the NCCD or the Krishi Kalyan Cess, where credit of input NCCD / KKC has been permitted or proposed to be permitted against the output NCCD / KKC.

5. Excise duty exemption on ready mix concrete to be given retrospective effect

Vide Notification No. 4/1997-CE dated 1st March 1997 substituted by Notification No 12/2012 dated 17th March 2012, concrete mix ('CM') manufactured at the site of construction for use in construction work at such site was exempted from excise duty. However, many manufacturers did not pay excise duty even on ready mix concrete (RMC) by taking shelter under the said Notification. The exemption on RMC was denied on the ground that the assessee manufactured RMC and not the conventional site mixed concrete and that the exemption is available only to CM and not RMC. This debate was resolved by SC recently and it was held that both the products are different and hence exemption granted to one cannot be extended to the other.

Having regard to the consequences of Apex Court ruling and the representation from the industry, Government exempted RMC manufactured at site of construction w.e.f 1st March 2016 vide Notification No 12/2016 dated 1st March 2016 amending Notification No 12/2012 dated 17th March 2012. An explanation has also been inserted to define the expression 'site'.

Since, the amendment will take effect from 1st March 2016, revenue authorities raise demands in cases where exemption was sought, given the fact that the amendment in exemption notification has not been made retrospectively effective.

C. CENVAT Credit

6. Credit of Krishi Kalyan Cess to be available to manufacturers

Chapter VI of the Finance Act, 2016 levies Krishi Kalyan Cess ('KKC') at the rate of 0.5% on the value of service with effect from 1 June 2016. Finance Minister in his Budget Speech has stated that tax credit of KKC will be available for payment of KKC. Also, Circular D.O.F. No.334/8/2016-TRU dated 29th February 2016, clarified that credit of KKC paid on input services shall be allowed to be used for payment of the proposed Cess on the service provided by a service provider.

From the TRU it is understood that credit of KKC shall be utilised for payment of KKC only.
While manufacturers (not providing any services) avail various services for manufacturing finished products, and suffer KKC on such input services procured, they cannot utilise CENVAT credit of KKC since they would not have any output services on which KKC is payable. Thus, while manufacturers can avail credit of KKC, they cannot utilise the same. This will only add thup to the product cost of the manufacturers.

7. Definition of exempted services for CENVAT Credit reversal

Explanation 3 to Rule 6(1) of CCR inserted w.e.f 1st April 2016, provides that for the purposes of Rule 6, exempted services shall include an activity, which is not a service as defined in section 65B(44) of the Finance Act, 1944. Rule 6 is in relation to apportionment of credits between exempted and non-exempted final products/services and subsequent reversal of credits w.r.t exempted goods/services. Explanation 3 to Rule 6 reads as under:

"Explanation 3. – For the purposes of this rule, exempted services as defined in clause (e) of rule 2 shall include an activity, which is not a service' as defined in section 65B(44) of the Finance Act, 1994.

Explanation 4. – Value of such an activity as specified above in Explanation 3, shall be the invoice/agreement/contract value and where such value is not available, such value shall be determined by using reasonable means consistent with the principles of valuation contained in the Finance Act, 1994 and the rules made thereunder."

With this amendment, it appears that activities not constituting as service and ones excluded from the definition of service under section 65B (44) of the Finance Act, 1944 such as:

- transfer of title in goods or immovable property, by way of sale, gift or in any other manner;
- transaction in money or actionable claim;

- service by an employee to the employer in the course of or in relation to his employment;
- fees taken in any Court or tribunal established under any law for the time being in force,

shall be included in the definition of exempted service for the purpose of Rule 6 of CCR. Also, it is not clear if an activity without consideration will also be included in the above definition of exempt service.

Due to such a broad definition of exempted service, while computing the reversal amount in case of ineligible common CENVAT credit, the amount of reversal shall be substantially high which would result into loss of credit to manufacturers / service providers.

Further, it would be extremely cumbersome process to identity and value activities which shall not constitute a service and which are to be included in the definition of exempt services for the purpose of reversal.

Also, the intent of the Government may not be to bring the above activities within the purview of the definition of exempted service for Cenvat credit reversal.

8. Input service definition in CCR to be expanded

In the last Union budget 2016-17, definition of capital goods has been expanded to include Wagons (sub-heading 8606 92), Equipment & Appliance used in an office and capital goods used for pumping water to a factory (that are installed outside the factory). Also, definition of 'Inputs' has been expanded to include goods used outside a factory for pumping water to a factory and capital goods with value per piece being up to INR 10,000. Thus, the scope of capital goods and inputs has been expanded.

But, the scope of input services has not widened. It is suggested that the Government should re-instate the old definition of input service (prior to 2011) to include activities relating to business in order to broad base it and to align it with upcoming GST. Also, the exclusions in the definition of input service should be curtailed so that manufacturers and service providers can avail higher credits.

Even State Governments are allowing credit of goods procured except items falling in the negative list.

9. Distribution of CENVAT credit by an Input Service Distributor to contract manufacturers

ISD facility is extended to outsourced manufacturers also i.e. credit of input services can be distributed by an ISD to Job worker (covered under Rule 10A) and to Contract manufacturer (goods bearing brand name of the Input Service Distributor and covered under MRP based valuation).

ISD definition under Rule 2(m) of CCR has been amended to facilitate distribution even to the Job workers and Contract manufacturers. In terms of the definition, only "an office of manufacturer or producer of final products or a provider of output service" can get registered as ISD.

While there is absolutely no ambiguity on distribution of input credit to Contract manufacturer in cases where the ISD also has its own manufacturing unit or is engaged in provision of output service, the issue arises in case where the manufacturing activity is entirely outsourced by an entity on P2P basis without any manufacturing set-up of its own. For ease of reference, such entities are referred to as "Principal traders".

Given that a Principal trader is neither a manufacturer nor a service provider, there is a doubt whether such Principal Traders would be allowed to distribute credit to outsourced manufacturing units engaged by them. Such doubt has arisen since no change has been made in the definition of "input services" or in the definition of ISD which defines the person eligible to receive and distribute input service credit.

The eligibility criteria should not be different for an entity having a manufacturing set-up of its own or otherwise considering the fact that there is no revenue leakage, since duty is collected on the maximum value - based on MRP (Sec 4A) valuation.

If Rule 7 had to be literally interpreted so as to deny the benefit of credit distribution by carving out one scenario, the very purpose of the amendment would be defeated.

10. CENVAT credit of Swachh Bharat Cess paid on taxable services should be allowed
Swachh Bharat Cess ('SBC') is levied at the rate of 0.5% on the value of taxable services with effect from 15 November 2015. Proviso to rule 3(4) has also been inserted in CCR to specify that the CENVAT credit of duty / tax paid as specified in rule 3(1) shall not be utilised for payment of SBC (vide Notification No. 2/2016 – CX (NT) dated 3rd February 2016).

Further, no amendment is made in Rule 3(1) of CCR to specify that credit of SBC paid shall be available. Thus, currently credit of SBC is not available. This SBC paid on procurement of any taxable service is a cost to service providers and manufacturers and will have cascading effect which will ultimately add to the burden of the end consumers.

Suggestions/recommendations to the government

1. Corporate Taxation
1.1. Reduction in tax rates

Recommendations

- It is suggested that the corporate tax rate should be reduced to an all-inclusive rate of 22-23%.
- Further, reduction in tax rates should be extended to other forms of unincorporated bodies/ business entities like partnerships, LLPs, AOPs and co-operative societies to ensure horizontal equity between different legal forms in which business is carried on.

1.2. Surcharge on corporate tax rate for domestic companies

Recommendations

- The rate of surcharge for domestic companies with income exceeding Rs 10 crores should be rolled back to 10%.
- Further, to ensure horizontal equity between different legal forms in which business is carried on, the rate of surcharge even for other unincorporated entities (LLP, Partnership, etc.) should be restored back to 10%.

1.3. Abolition of DDT

Recommendations

- It is suggested that it is high time to do away with the additional income tax in the form of DDT under section 115-O the Income-tax Act, 1961.

- Alternatively, DDT rate is recommended to be reduced to 10% from the current effective rate of 20% (after including education cess, surcharge and grossing up of DDT).
- Alternatively, a basic exemption limit, say 10% of profits/capital, may be provided where the company distributing dividend is not made liable to DDT upto such specified limit.

1.4. Rationalisation of section 14A and Rule 8D provisions

Recommendations

- It is requested that indirect expenses should be excluded in the computation of expenses incurred in relation to exempt income.
- Disallowance @ 1% of average monthly value of investment is too high, and hence, it should be limited to 0.5%.
- Further, the disallowance is linked to the value of assets and not to the income, hence the disallowance should be 1% of the exempt income and that too, the exempt income which is derived from the assets acquired out of the borrowed funds.
- The deduction for expenses for earning partnership profits and dividend income should be allowed.

1.5. Amortisation of capital expenditure

Recommendation

It is suggested that provisions may be incorporated in the Act to allow amortisation of such capital expenditures which are essential to run the business.

1.6. Deduction for Corporate Social Responsibility (CSR) expenditure

Recommendation

- A deduction of the expenditure on community/ social development (both capital and revenue) be introduced, covering critical focus areas for CSR such as education, health, women empowerment, etc.
- Even in cases where the company has its own trust or foundation, the deduction in respect of expenditure incurred for CSR activities should be allowed.
- Such expenses however may be subject to a limit of say 5% of total income.

1.7. Section 28(iv) – Income Chargeable under the head Profits and Gains of Business or Profession

Recommendation

It is recommended that Government should suitably clarify as to the scope of section 28(iv) specifying absolute exclusion to capital receipts (arising out of the transfer of capital assets) which are covered under charging section 45.

1.8. Amortisation of mining expenses under section 35E

Recommendation

It is suggested that all pre-mining costs of all years prior to commercial production including acquisition of deposits, site or rights should be allowed for amortisation over minimum lease period or lesser period at the option of the lessee.

1.9. Section 35D - Amortisation of certain preliminary expenses

Recommendation

Section 35D of the Act should be suitably amended to include all the expenses incurred by Companies post-incorporation but during the course of setting up of its business as eligible for deduction.

1.10. Balance 50% of additional depreciation u/s 32(1)(iia)

Recommendation

In order to dispose of the pending litigations in various stages of appellate authorities w.e.f. AY 2006-07 on the same issue, the proviso introduced in Finance Act, 2015 needs to be made applicable from AY 2006-07 retrospectively.

1.11. Investment Allowance u/s 32AC

Recommendation

The amendment made in sub section (1A) should be extended to sub section (1) retaining the threshold of Rs 100 Crores i.e. assets acquired even before 1st April 2013 but installed within stipulated two year period will qualify for benefit of investment allowance.

1.12. Investment allowance and enhanced depreciation to Defence Companies

Recommendation

Special tax incentive in the form of additional investment allowance and enhanced depreciation should be given for defence companies.

1.13. Deduction under section 80IB on profits and gains from certain industrial undertakings other than infrastructure development undertakings

Recommendation

It is proposed to amend section 80IB of the Act to provide 50% deduction on profits and gains derived from business of an Electronics System and Design Manufacture ('ESDM') facility for a period of 10 consecutive assessment years.

1.14. Weighted deduction for in-house scientific research

Recommendation

Government should consider rolling back the phase out plan for weighted benefits available on the R&D expenditure.

1.15. R&D tax breaks

Recommendation

An exception may be provided that where the external R&D is only a small component of the entire R&D and is non-critical in nature, the same will continue to be considered for weighted deduction, provided the principal company continuously monitors and directs the program.

1.16. Certain R&D expenditure not eligible for Weighted deduction

Recommendation

An amendment should be brought in to the effect that entire expenditure incurred in connection with R&D should be eligible for a weighted deduction to reduce complexity and make it a more attractive commercial proposition to invest in setting up R&D facilities in India.

1.17. IT and ITES sectors to be entitled to weighted deduction under Section 35(2AB)

Recommendation

It is suggested to amend provisions of Section 35(2AB) of the Act to specifically include R&D with respect to the development and sale of software.

1.18. Weighted deduction on internally developed intangible assets

Recommendations

- It is recommended to provide weighted deduction for expenditure incurred on internally developed intangible assets under Section 35(2AB) of the Act.
- It is also recommended that any initial cost paid for acquiring R&D related intangible assets, which are used in the R&D unit should also be allowed for weighted deduction under Section 35(2AB) of the Act.

1.19. Benefit under Section 35(1)(iia) to be increased to 200 per cent

Recommendation

It is recommended that the tax benefits under Section 35(1)(iia) should be increased to 200 per cent from the present level of 125 per cent.

1.20. Deduction for employment generation under section 80JJAA

Recommendation

Government should either roll back the capping of salary limit to Rs 25,000 per month or increase the limit to a minimum of Rs 50,000 per month.

1.21. Exchange differences on money borrowed in foreign currency for acquisition of assets within India

Recommendation

It is recommended that provisions of section 43A should be extended to allow for adjustment of foreign exchange fluctuation in "actual cost" even where the asset is acquired in India from foreign currency. This will bring parity between assets acquired from outside India and assets acquired within India and will also be in sync with "Make in India" concept.

1.22. Section 36(1)(va) –Employees' contribution to Provident Fund

Recommendation

It is recommended that suitable amendment should be made in the Act so as to bring the provisions relating to the Employees' contribution towards employee welfare funds in line with the employer's contribution towards such funds.

1.23. Disallowance of expenditure for non-deduction of tax

Recommendation

In line with section 40(a)(ia) of the Act, it is recommended that section 40(a)(i) of the Act should also be amended restricting the disallowance to 30% of the amount of expenditure paid/ payable to non-residents on which no taxes have been withheld at source.

1.24. Disallowance under section 40(a)(ia)

Recommendation

It is recommended that suitable amendment should be made in section 40(a)(ia) to restrict disallowance of expenditure in cases where no TDS assessment has been initiated or proceeding having been initiated but the assessee is not treated as an assessee in default under Chapter VIIB. The order under section 201 holding an assessee as 'assessee in default' should be made a condition precedent before invoking the penal provisions of disallowing the expenditure section 40(a)(ia)

1.25. Carry forward of business losses on merger under section 72A of the Act

Recommendations

- It is recommended that the definition of 'Industrial Undertaking' should be either done away with, so that all mergers are eligible for carry forward of losses.
- The section should be amended to replace the stringent conditions to liberal ones such as reducing the period of holding assets and carrying on of business from 5 years to 3 years.

2. Withholding tax (TDS)

2.1. Concessional rate of tax for Rupee denominated Overseas Bond (Masala Bond)

Recommendations

- It is recommended that for the sake of clarity and certainty, concessional rate of 5% for rupee denominated bonds be incorporated in the statute itself by way of amendment to section 194LD.
- In addition, suitable amendments need to be made (a) Extension of exemption on forex gains even to the secondary subscribers and (b) provide capital gains exemption on trading gains.

2.2. Extension of concessional tax rate regime under sections 194LC and 194LD

Recommendation

With a view to boost the economy by way of continued interest from Indian borrowers for availing loans under ECB route or issuer of bonds, it is recommended to extend the date of concessional rate regime under section 194LC and 194LD by 3 years, to 30 June 2020

2.3. Time limit for TDS assessment in case of payments to non-residents

Recommendation

It is recommended that amendment should be made in sub section 3 to section 201 to include similar time limit of 7 years for assessment with respect to payments made to non-residents as in the case of payments to residents to bring in parity.

2.4. Generation of TDS certificates in case TDS is deducted @20% u/s 206AA

Recommendations

- A clarification regarding the procedure for providing TDS Certificate to make the process easy and smooth and better compliance of the Act may be provided.
- Additionally, procedure for issuing TDS certificate should also be clarified in cases where non-residents do not furnish PAN and comply with requirements of Section 206AA(7).

2.5. Applicability of TDS on Monthly Provision

Recommendation

It is recommended that TDS should not be applicable on monthly provision which are mainly for MIS purpose and reversed on first day of next month.

2.6. TDS on International Interconnect Charge (IIC) paid to foreign operators

Recommendations

- It is recommended that government should clarify by way of appropriate amendment to Explanation 5 & 6, that these Explanations would not have any bearing on standard services agreements by way of giving some examples which cannot fall within purview of royalty even after insertion of Explanation 5 & 6.
- Further, in any case, the Government should clarify that the retrospective amendment is not applicable on the transactions which were entered into before the amendment.
- It is recommended that government should clarify by way an amendment to Explanation 5 & 6 that these explanations would not have any bearing on the interpretation of treaty and the definition of “process” as defined in domestic tax law should not be imported into treaty. This

view is acknowledged by various Indian Courts also and the same may be clarified in the statutory provision to avoid further disputes/ litigation.

2.7. Certificate for tax deducted at source

Recommendation

Considering the volume of transactions and in order to reduce the compliance burden, Form 16A/Form 16 should be made available directly to the deductees. This can be done in either of the following ways:

- Sending Form 16/Form 16A directly by TDS Processing Centre (TRACES) to the deductees' mail id registered under his PAN; or
- Making a provision and facilitating downloading of these forms by deductee himself from e-filing site/TRACES site similar to Form 26AS.

2.8. TDS Credit

Recommendations

- It is suggested that TDS certificates issued by the deductors, which are furnished by the deductees in the tax assessment, should be given due cognisance and refund claims based on such TDS certificates should be processed. Further, the tax officer can suitably issue proper notice for the clarification rather than hurriedly issuing orders to the taxpayer concerned.
- It is recommended that suitable instructions be issued by the lawmakers providing an option to the deductee to indicate their TAN in the invoice and further a column/ field may be added in the TDS returns asking the payers to furnish the TAN against each deductee (this should however be an optional column), wherever TAN has been provided by the deductee, at the time of submission/ filing of TDS returns by the payers.
- It is recommended that E-TDS software of the tax department may be amended so that when the TDS returns are processed to generate the TDS certificates, the address should first be automatically picked from the TAN database in respect of the deductee maintained by the tax department and in case no TAN is mentioned in the TDS return, then the address should be picked from the PAN database. This would facilitate generation of the TDS certificate at the TAN address, wherever TAN is provided by the deductee.
- It is recommended that credit for TDS should be allowed to the taxpayer in the year in which such TDS certificate is issued to the taxpayer/ payee or in the year in which TDS credit appears on the online database of the payee without having the requirement to claim tax credit in the year in which corresponding income has been offered to tax. This would address the various problems being faced by the payees today in claiming due credit for TDS.

2.9. TDS on payments to Universities and research institutions

Recommendation

An amendment should be brought into effect to introduce a proviso/ clause in respective sections which exempts the requirement to deduct taxes while making payments to research institutions and universities.

2.10. Statutory Refund mechanism for excess paid / wrongly paid TDS amounts

Recommendation

Under Chapter XVII of the Income tax Act, 1961 (dealing with TDS) proper provisions & procedures may be made for refund of excess paid TDS / wrongly paid TDS.

2.11. Timelines for grant of lower/ nil withholding Tax certificate

Recommendation

It is suggested to introduce timelines within which a lower/nil withholding tax certificate under Section 195/197 must be granted/denied by a tax officer.

2.12. Penalty for failure to furnish information or furnishing inaccurate information under Section 195

Recommendation

The same should be clarified in a suitable manner.

2.13. Penalty imposed on deductors for quoting invalid PAN in e-TDS Returns

Recommendations

- It is suggested to make suitable amendments in the Income Tax provisions so that deductors are not penalised under circumstances when the deductees provide wrong/invalid PAN to the deductors
- It is suggested to take a liberal view in levying penalty in case of those deductors who have inadvertently quoted invalid PAN only in very few cases as compared to the total number of deductees and total TDS deposited.

2.14. Threshold limit in concessional TDS Certificate issued u/s 197

Recommendation

In avoid the complexities, it is requested to look into the possibility of not to keep any threshold limit for the said concessional certificates under section 197 of the Act.

3. Return/Assessment /Penalty procedures

3.1. Filing of tax returns by non-residents having income from Royalty or Fees for Technical Services (FTS) in India

Recommendation

It is recommended to amend section 115A(5)(a) to have an impact that a foreign company having only Royalty / FTS income in India, is not required to file tax returns in India.

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3.2. Carry forward of losses in case of belated returns

Recommendation

It is suggested that to address the genuine hardship faced by assessees, loss declared in returns filed late under section 139(4) may be allowed to be carry forward.

3.3. Claim made during the assessment proceedings

Recommendation

It should be suitably clarified in the Act that the tax officer is duty bound to allow the legitimate claim of the taxpayer made before him during the course of the assessment proceedings and assess the total income/ loss after allowing the said claim.

3.4. Adjustment of Outstanding Demands

Recommendation

It is recommended that before collecting outstanding demand, AO should pass the pending Order Giving Effects and the rectification orders for earlier years.

3.5. Demand of Income Tax where Assessee has applied for Stay of demand

Recommendation

It is suggested to align the period for payment of demand to 60 days instead of 30 Days. This will lead to parity in the number of days for appeal and the demand payment.

3.6. Interest under section 244A

Recommendations

- The rate of interest charged on the assessee as well as the rate of interest payable to the assessee should be the same.
- Interest should be granted to the assessee on amount of refund due (tax plus interest) which is due to the assessee on each order date but not granted by the department in full.

3.7. Delay in remitting refund even after issue of Assessment Order

Recommendation

In line with notice of demand with specific due date, there should be specific time frame in the Act for processing refund arising out of assessment.

3.8. Time Limit for completion of Appeals

Recommendations

- The Act should provide clear time lines for disposal of appeal proceedings at all levels.
- Further internal time limits need to be provided for appointment of councils from the department side (wherever required).
- Application for adjournment on the ground that council needs to be appointed should be curtailed.
- The Government should direct the Appellate authorities / forums to adhere to the suggested timeline without attaching any importance to the value of the demand.

3.9. Authority for Advance Rulings

Recommendations

- It should be ensured that the time limit prescribed for passing orders should be adhered to by the AAR.
- Considering that the objective behind AAR is to provide faster dispute resolution mechanics, therefore, a specifc provision be made in law to the effect that mere filing of income tax return should not debar the taxpayer in approaching the AAR.

3.10. Section 68 – Scrutiny examination of funds infused by non–residents

Recommendations

- It is recommended that the scope and depth of examination / scrutiny with respect to financial affairs of the non-resident investors needs to be restricted. Especially considering that vast reporting requirements are prescribed for non-residents such as Section 195(6) reporting, CbCR, TRC, Liaison Office reporting, requirement to quote PAN u/s. 206AA, reporting u/s. 285BA under FATCA etc.
- Moreover the Government can also clarify that before the Assessing officer can get into further in-depth examination of financial affairs relating to source of funds of a non – resident investor, the same should be allowed only with the pre-approval of CIT / Pr. CIT on the basis of tangible material / evidence brought on record by the AO.
- Provisions of section 56(2)(viib) and section 68 should be suitably amended to provide safeguards against its invocation interchangeably. Only if the tests laid down in section 68 do not stand to be fulfilled, section 68 can be invoked. Furthermore, once section 56(2)(viib) has been invoked, then the test of section 68 should be considered as automatically satisfied.

3.11. Clarity on section 271G penalty

Recommendation

Clarity should be given as to whether TPO is required to only give a direction to levy penalty to the AO or a parallel penalty proceedings need to be initiated by the TPO.

4. Capital gains

4.1. Amendment requirement in section 47(xiiib) of the Income-tax Act

Recommendations

- There should be no threshold on turnover or on value of assets, to avail the benefit under section 47(xiiib)
- Alternatively, the turnover limit of Rs 60 lacs and limit on asset value of Rs 5 Crores should be substantially enhanced

4.2. Cost of acquisition with reference to assets acquired under demerger

Recommendation

It is suggested that Section 49(1)(iii)(e) should be amended to include reference to demerger which is exempt under Section 47(vic).

4.3. Business Reorganisation

Recommendations

- In case of non-residents, the Buyback Tax may result in double taxation of income, hence, appropriate mechanism for availability of credit to shareholders should be introduced.
- In case of shares issued to employees under an ESOP scheme, the fair market value considered for the purpose of perquisite taxation should be considered as amount received by the company for issue of shares.
- It is recommended that capital gains tax payment should be triggered as and when the contingent consideration is received by the sellers and not on the date of transfer itself.
- It is suggested that such amalgamation, where the amalgamated foreign company is a parent/ holding company of the amalgamating company, should be specifically brought within the purview by section 47(via) of the Income Tax Act.

5. Minimum Alternate Tax ('MAT')

5.1. Removal of MAT/ realignment of MAT rates

Recommendations:

- At the outset, there is a need for a fundamental rethink on MAT at a conceptual level. MAT appears to be inconsistent with the current tax policy of low corporate tax rate of 25% and withdrawal of corporate tax incentives. MAT may therefore be withdrawn or significantly modified at the earliest.
- Even where it is decided to continue the MAT levy, following may be considered:

  - A roadmap may be announced for reduction in MAT rates to 7.5% of book profit (from current rate of 18.5%) over a period of five years.
  - MAT may be made applicable to only those entities which avail specified tax incentives in the normal computation (similar to section 115BA introduced by Finance Bill, 2016 which provides for 25% corporate tax rate to new domestic manufacturing companies who are willing to sacrifice specified tax incentives).
  - Alternatively, MAT may be levied in the form of Alternate Minimum Tax (AMT) currently applicable in case of non-corporates which is a simple basis involving add-back of tax incentives in the computation of total income and allowance of depreciation at normal rates.
  - MAT credit should be allowed to be carried forward indefinitely as against the current law where the MAT credit is allowed to be carried forward for 10 years.

5.2. Recommendation on MAT- IndAS Committee Report

Recommendations

- In regard to the Committee's recommendation to spread over MAT impact of FTA adjustment in respect of lease equalisation over 3 years, we submit that three year period is very short considering that the lease is usually for long term. In these cases, higher MAT credit will arise due to upfront levy of taxes on notional gains and the companies may be unable to utilise MAT credit to set off against normal tax liability. Hence it should to be included in the book profits over the unexpired lease period.
- In line with the recommendation for Fair Valuation of investments in equity instruments through Other Comprehensive Income (OCI), it should be included in the book profits at the time of realisation.

5.3. MAT on exempt income

Recommendations

It is submitted that levy of MAT should be restricted to those incomes that are taxable under regular provisions and incomes that are exempt under normal provisions such as LTCG on sale of listed equity shares or incomes that are not taxable such as Capital Receipts, should be kept out of the ambit of MAT.

5.4. MAT on foreign dividend

Recommendation

It is recommended that just like domestic dividend, foreign dividend should also be exempt from MAT.

5.5. Exemption of SEZ profits from MAT calculation

Recommendation

It is recommended to remove SEZ profit from MAT calculation, thereby, reducing taxation impact on the Companies and leaving profits with the Companies for further investment. This will provide a significant relief to exporters who are already finding it difficult to sell their products in the wake of a struggling global economy.

5.6. Carry forward of MAT credit by amalgamated company

Recommendation

- Specific provisions should be introduced for carry forward of MAT credit by the amalgamated company.

5.7. Reduction of unabsorbed depreciation / business loss for MAT computation

Recommendations

- The above clause should be suitably amended to provide that aggregate of book loss and unabsorbed depreciation shall be allowed as a reduction from net profits even if one of the elements is nil.
- Alternately, an amendment should be brought into effect which specifies the mode of computing business loss or unabsorbed depreciation to be allowed as a deduction for MAT computation.

5.8. Rationalisation of MAT provisions for infrastructure companies

Recommendations

- To attract more and more investment in power and infrastructure sector, such infrastructure companies should be kept outside levy of MAT.

6. Provisions in respect of Units established in Special Economic Zones

Recommendations

- Sunset clause for units in SEZ should be removed. Time limit for commencement of operations for SEZ units should be extended beyond 2020 to encourage exports and generate employment.
- In line with the Government of India's 'Make in India' initiative, it is recommended that the provision of creation of SEZ Reinvestment Reserve be done away with for SEZ Units engaged in manufacturing activities.
- It is recommended to enhance the 100% holiday limit to 10 years (from 5 years) so that the Companies can recover the investment faster and also provide additional funds for expansion / modernisation as well as job creation, thereby contributing to the welfare of the country.

7. Transfer Pricing / International Tax

7.1. Transfer Pricing requirement for Non-resident

Recommendation

The non-resident assessee should be exempted from Transfer Pricing provisions, if the same transactions are declared by resident (Indian) assessees.

7.2. Narrow interpretation of Rule 10B(1)(e)(iii)

Recommendation

Considering the intention and spirit of the law, it is suggested that under sub-clause (iii) of Rule 10B(1)(e) the adjustment should also include a reference to the net profit margin referred to in sub clause (i) to clear the ambiguity in interpretation of the law.

7.3. Contradiction between Customs and Transfer Pricing

Recommendation

There is a need for harmonisation between these two conflicting regulations. Guidance may be provided for acceptability of transfer prices by one arm of the Government, in case the other arm had accepted the price at arm's length.

7.4. Intra-group services

Recommendations

- The Government should provide examples of services that could be considered as deemed to be shareholder services and therefore, should not be charged for by the group.
- It is suggested to provide a definition of cost base that may be allocated for common group services.
- It is suggested to provide guidance as well as detailed list of acceptable allocation keys for common group services.
- It is recommended to prescribe a format of third party certification that should be acceptable by the tax office to establish the appropriateness of the cost base and appropriateness of allocation for common group services.
- It is suggested to provide an acceptable range of mark-ups on costs vis-à-vis support services availed from group companies.
- It is suggested to provide an exhaustive list of documents acceptable to substantiate receipt of services by the Indian affiliate.
- It is recommended to provide guidance towards documents to be maintained for substantiation/ quantification of benefits received in India from the intra-Group services, as most of these services are in the nature of support services.

7.5. Comparison of tested transactions with controlled transactions

Recommendation

There needs to be guidance not to do a comparison with controlled transaction which will avoid needless litigation on this issue and would also be in line with the Indian transfer pricing legislation as well as the OECD principles.

7.6. Transfer Pricing - Safe Harbour Rules

Recommendations

- Banking related transactions like FCY loans, and FX transactions are quite voluminous and homogeneous across Banks. Considering its voluminous data, the Banking sector requires safe Harbour Rules which will provide them certainty and at the same time do away with the need to maintain contemporaneous documentation.
- Further, the Rules give the benefit of safe harbour only to the 'eligible assessee' which has opted to be governed by the Rules for its 'eligible transaction'. As the 'eligible transactions' have corresponding tax impact on the associated enterprises, it is recommended that such safe

harbour rules should also be accepted by the income-tax authorities for such associated enterprises as otherwise it will result into double taxation of the same income in hands of two enterprises and will not meet the intended objective.

7.7. Penalty for non-furnishing of Country by Country report

Recommendation

There is a need to rationalise penalty for the filing requirements in the first year at least as even OECD's guidelines under BEPS Action Plan 13 provide for a 12 month period in the first year of filing. Accordingly, partial relief from the stringent penalties should be provided for the first year of CbC report filing, such that penalty is applicable for CbC report filed on or after 1 April 2018.

7.8. Introduction of Master File requirement but no clarity on its threshold

Recommendation

Draft rules should be released for public consultation (giving adequate time) detailing Master File requirements and applicable threshold, which should be considerably higher.

7.9. Clarity on adoption of Local File

Recommendation

Draft rules should be released for public consultation (giving adequate time) detailing Local File requirements and applicable threshold, which should be higher than the currently prescribed threshold for TP documentation i.e. INR 1 crore.

7.10. Indirect Transfer of assets

Recommendations

In addition to small shareholder exemption, exemption should also be provided for (a) transfer of shares listed outside India (b) income on Offshore Derivative Instruments/ Participatory notes (c) all forms of intra-group restructuring outside India (presently the provisions cover only amalgamation an

- It is recommended that suitable exemption should be provided to avoid multi taxation that may arise in case of multi-tier structure.
- The acquisition of rights/control and management is by virtue of additional issue of shares to either existing or new shareholders (could be rights shares issuance, or fresh shares issued to a new shareholder, etc.). It is recommended that such cases should not be covered under the definition of 'capital asset' and 'property' (see the discussion under Para 3.3 of the Expert Committee Report).
- The valuation rules also remain silent on what criteria should be used when determining whether a particular methodology is internationally accepted or whether an accountant. This may leave otherwise accurate FMV determinations, open to litigation.
- In view of the impracticality of tracking and reporting of all transactions, it should be clarified that the reporting be restricted to those transactions (a) whose income is covered within the ambit of indirect transfers which are deemed to accrue or arise in India. (b) reporting entity would be the foreign transferor entity.

- Further, the Indian concerns are required to furnish information or documents under section 285A of the Income Tax Act r.w. Rule 114DB and the same is too onerous for the Indian counterparts. Accordingly, the requirement of reporting of transactions by the Indian concerns should be relaxed, since the Indian concern may not even be aware of a change in shareholding coupled with various other impossibilities.
- To address the aforesaid issues, it is suggested that the clarificatory circular be rolled out for public consultation.

7.11. Interest payment by India branch to Head Office

Recommendation

It is recommended that the amendment regarding taxability of interest paid by India branch to Head Office should be withdrawn.

7.12. Indian branch of foreign company

Recommendation

In order to provide level playing field, Indian branch of foreign company should be considered as "Indian concern" for the purposes of this section.

7.13. Rollback of APA

Recommendations

- It is recommended that this provision should be relaxed to the extent that the taxpayers with similar transactions with no substantial changes in the functional, asset and risk profile should be allowed to take benefit of this provision. Further, if the same/ similar transaction is undertaken with another AE, the benefit of rollback should be provided. The provision should be made applicable to similar nature of transactions and with different AEs.
- Further, the rules provide that if the applicant does not carry out any actions prescribed for any of the rollback years, the entire APA shall be cancelled. It is recommended that this provision should be relaxed and should not result in the cancellation of the entire APA.

7.14. Requirement for non-residents having no place of business in India to comply with TDS obligations

Recommendation

It is recommended that applicable rules of statutory interpretation read with Section 1(2) of the Act, which indicate Section 195 of the Act as currently in force, should not apply to non-residents unless there is some territorial nexus with India as explained by Hon'ble Supreme Court in the case of GVK Industries [2011] 332 ITR 30 (SC).

7.15. TDS from payments to Non-residents having Indian branch/ fixed place PE

Recommendation

It is recommended that payments which are in the nature of business income of non-residents having an India branch office or 'a place of business within India' should be subject to similar TDS requirements as in case of payments to domestic companies.

7.16. Removal of cascading effect of Dividend Distribution Tax (DDT) in a multi-tier structure

Recommendation

It is recommended that an appropriate explanation be inserted clarifying that the benefit of DDT paid by a subsidiary company is available at each company level in a multi-tier corporate structure so as to avoid the cascading impact of DDT.

It is recommended that the existing provision should be amended to provide uniform and simplified taxation regime so as to provide for the DDT credit irrespective of the stipulating condition that one company should hold more than 50% of the share capital of the company declaring, distributing or paying the dividend.

7.17. Section 9(1)(i) – Transfer of minority stake within the same group

Recommendation

It is recommended that Explanation 6 to Section 9(1)(i) should provide relaxation in case of transfer of minority stakes which does not result into transfer of control of underlying indian asset and also the transfer of stake within the same group thereby permitting group reorganisation.

7.18. Deputation of employees

Recommendation

In order to put an end to this uncertainity and litigation, it is recommended that guidance should be provided on factors relevant to determine whether deputation of employees results into provision of services by the employee on behalf of the home employer. Tax administrations in various jurisdictions have provided similar guidelines e.g. Guidelines of Canada Revenue Agency on Employment, Denmark's revenue authority (SKAT) guide on "international hiring out of labour" dated 24 October 2013, China SAT's Announcement No.19, 2013 etc.

7.19. Tax Residency Certificate (TRC)

Recommendations

Despite being an additional compliance, TRC is useful in many cases to claim treaty benefits and avoid unnecessary rejection from tax authorities. Significance of TRC is upheld by the Hon'ble SC in the case of Azadi Bachao Andolan (263 ITR 706) and various Courts have upheld granting of treaty benefits e.g. under the India-Mauritius treaty, based on the TRC.

- Without prejudice, even if the requirement to obtain TRC must stay, it is recommended that the TRC shall be made mandatory only for cases where the total payment to a non-resident exceeds Rs. 1 crore in a financial year and it should be clarified that in other cases, treaty benefits will not be denied based on residency alone.
- Further, it should be clarified who is authorised to sign the form 10F.

7.20. Foreign tax credit

Recommendations

- It is suggested to add explanation to section 40(a)(ii) that the surplus of foreign taxes paid, over the relief available u/s 90 or 91, shall be allowed as deduction while computing taxable income.
- It is suggested to specify procedure for income calculation based on Profit/Sales ratio as per financials.

7.21. Concessional rate of tax for Rupee denominated External Commercial Borrowings (ECBs)

Recommendation

It is recommended that the concessional rate of tax under section 194LC be extended to Rupee denominated ECBs.

8. Other provisions

8.1. Income Computation and Disclosure Standards (ICDS)

Recommendations

- At the outset, ICDS should be scrapped.
- Subject to the above, it should be clarified that test of 'reasonable certainty of ultimate collection' applies not only to revenue from sale of goods but also to interest and royalty income to avoid any ambiguity. There should be no compulsion to recognise interest income which is doubtful of recovery.
- It is recommended to clarify that ICDS will not override the existing jurisprudence and accordingly, interest income will be recognised on accrual basis.
- Further, clarity is required on application of ICDS in cases falling under the DTAA, where interest/ royalty is taxable on "receipt basis".
- Since the Act does not recognise the concept of Deferred Revenue Expenditure, it is recommended to clarify that the post-trial run expenditure should be written off in full in year of incurrence.
- ICDS should align with judicially settled position under the Act and recognise differences on MTM basis.
- It is recommended to clarify that exchange fluctuation loss on borrowings for acquisition of local assets (from India) is allowable as revenue expenditure.
- Since there is material departure from methodology of capitalisation as per ICAI AS-16, CBDT should provide guidance with the help of illustrations on how general borrowing cost should be capitalised under ICDS IX.

8.2. Place of Effective Management (PoEM)

Recommendations

- It should be clarified that decisions which affect the fundamental existence of the Company itself or the rights of the shareholders and which are to be taken by shareholders should not be relevant in determining PoEM. Non-binding guidance provided by shareholder / Parent company for providing guidance to group entities should not be a conclusive factor for determining PoEM.
- Income in the nature of royalty, interest or similar income should not be considered as passive income if it is arising out of active conduct of trade or business of the assessee.
- For the purpose of determining the characterisation of income, regard should be had to the characterisation of such income in the books of account of the company and not to the income tax definition.
- Clarification should be provided that gross income as per books of accounts is to be considered for determining the total income and passive income under the 50% criteria.
- Income from the transactions of purchase and sale of goods even with associated enterprise should not be considered as passive income.
- Alternatively, for avoidance of doubt, it should be clarified that if either purchase or sale of goods is from / to unrelated entities, then it will not be considered as passive income. The clarification will make it abundantly clear that income earned by companies which may be purchasing from third party and selling to group companies or vice versa is not passive income.
- Holding companies having investment in “Active Companies” in the same jurisdiction should also be considered as “Active Companies”. Accordingly, dividend or capital gains derived by such holding companies from active companies should not be considered as passive income.
- It is recommended that meaning of term “management and commercial decisions” should be clarified to aid the understanding of both the taxpayers and the tax authority.
- PoEM should not be considered to be in India in case the foreign company is incorporated in a jurisdiction which is not a ‘low tax jurisdiction’. Low tax jurisdiction may be defined as per the Controlled Foreign Company provisions under draft Direct Taxes Code Bill, 2010 or a jurisdiction which has a base tax rate of less than 15% or 20%.
- The Guidelines should further provide a safe harbour provision for companies listed outside India on any of the recognised stock exchanges.
- The Guidelines on PoEM should clearly provide a mechanism for claiming FTC in case a foreign company creates a PoEM in India.
- A mechanism should be provided to avoid double taxation of the same income in the hands of different companies creating PoEM in India in a multi-layer structure. Further, dividends from companies whose PoEM is held to be in India may also be subject to dividend taxation under section 115BBD of the ITA.

- The transactions between the foreign company (PoEM in India) and the Indian company should not be considered to be within the ambit of Specified Domestic Transactions under Indian transfer pricing regulations. Transactions between the foreign company (PoEM in India) and its group companies outside India should also not be considered within the ambit of International
- Transactions under Indian transfer pricing regulations. In any case, if the Transfer pricing compliances are to be undertaken for transactions between the foreign company (PoEM in India) and its group companies (within or outside India), it should be applicable only once the status of the foreign company is established as having PoEM in India.
- In the absence of guidelines, the implementation of POEM should be deferred to next financial year in order to facilitate a smooth implementation and compliance with the POEM provisions.

8.3. General Anti Avoidance Rules (GAAR)

Recommendations

- The tax administration may identify prominent methodologies of tax abuse which are the areas of concern for tax administration. A specific anti-avoidance rule may be introduced to control such abuse instead of open ended GAAR.
- Arrangements covered under existing rules should be assessed as per such specific provisions and there should not be overlapping with the provisions of GAAR. Balance Impermissible Avoidance Arrangements (IAA) may be assessed under GAAR.
- It is submitted that primacy of Tax Treaty over GAAR should be maintained and the arrangement entered after compliance of the conditions spelt out in treaty should be kept out of the provisions of the GAAR.
- All arrangements entered into prior to the date of introduction of GAAR should be grandfathered.
- The term “tax benefit” should be explained by giving illustrations.
- Also it needs to clarified that grandfathering will protect the allotment of bonus shares/right share, dividend etc. from grandfathered investment. Also shares received upon tax neutral merger/demerger/re-organisation in lieu of grandfathered investment should enjoy the same immunity.
- It is submitted that a specific and explicit clarification may be provided that the onus should be on the tax authorities to demonstrate that the main purpose of an arrangement is to obtain tax benefit.
- To avoid frivolous cases and reduce the administrative burden on taxpayers and the Income Tax Department and to avoid large scale litigation, a reasonable threshold of about Rs.50 Crores should be provided in the Act itself (as against currently provided threshold of Rs. 3 crores in Rules).
- If the above recommendation is not accepted, it is submitted that threshold should be provided at participant level instead of arrangement level, comprising of all the parties. The invocation of GAAR for a particular year per se should not lead to the reopening of cases that belong to the earlier years.
- If there is a case of reopening of assessment, such reopening will be guided by existing statutory provisions and judicial precedents.
- Specific provision should be provided to the effect that where an arrangement is treated as an impermissible avoidance arrangement, to ensure that the same income is not taxed twice in the hands of the same taxpayer in the same year or in different assessment years.
- When any transaction/arrangement is disregarded in full or part then consequential adjustment should be allowed in case of other parties to the said transaction so that there is no double taxation on the “disregarded component”.

- Section 144BA(1&7) provides that the term of the approving panel shall ordinarily be for one year and may be extended upto a period of 3 years. This is unjustified as one cannot expect an Approving Panel to change every year and to do justice in one year. In fact, considering the complexities involved, the minimum term for such Approving Panel should be 3 Years and it should be extendable upto 5 Years.

9. Personal Taxation

9.1. Revision of basic exemption limit for individual Tax Payers

Recommendations

- There is need to revise the tax slabs as appropriate.
- Further, the highest tax rate should be reduced to 25%.

9.2. Revival of Standard Deduction

Recommendation

The standard deduction for salaried employees should be reinstated to at least Rs 1,00,000 to ease the tax burden of the employees and keeping in mind the rate of inflation and purchasing power of the salaried individual, which is dependent on salary available for disbursement.

9.3. Deduction under section 80C

Recommendations

- Limit of deduction under section 80C may be increased from Rs.150,000. A new section should be inserted under Chapter VI-A which provides for deduction of contribution to provident fund from the gross total income in addition to deduction under section 80C. This would encourage investments in other schemes provided in section 80C and increase the liquidity and investments in the country.
- Lock-in period for term deposits should be reduced from five years to three years.

9.4. Deduction of Principal Repayment of Housing Loan Borrowed by an assessee from his employer being a Private Company

Recommendation

It is suggested to include the repayment of loan by the employee in private sector to the employer for deduction under section 80C (xviii) of the Income Tax Act.

9.5. Consideration of FTC while computing TDS to be deducted from salary payments

Recommendation

It is recommended that suitable amendment should be made to section 192 to explicitly clarify the employer to consider foreign tax credit while deducting tax at source from salary income of the employee.

9.6. Deduction in respect of Health Insurance Premia under Section 80D

Recommendation

There is a need to raise the above limit to achieve two-fold objective of giving a tax incentive while also encouraging people to obtain larger healthcare cover in wake of the rising costs.

9.7. Restoration of section 80CCF of the Income Tax Act

Recommendation

This exemption is justifiable with a limit of Rs.50,000 inspite of a minimal loss (of tax) to government given that this would support infrastructure projects. At the same time, it would enable raising of lower cost long term funding as well as participation of retail investors.

9.8. Revision of minimum exemption limit for allowances

Recommendations

- The exemption limit of Rs 1,600 per month needs to be considerably raised upwards, say to minimum of Rs 5,000 per month to bring it in line with the rising conveyance costs.
- The exemption limit of Rs 100 per month needs to be considerably raised upwards, say to minimum of Rs 2,000 per month to bring it in line with the rising inflation and cost of education.

9.9. Leave Travel Concession

Recommendation

To be in line with the concept of “financial year” adopted by other provisions of the Income tax Act, it is suggested that the concept of calendar year should be replaced with financial year.
Section 10(5) should be amended to exempt the concession/assistance received from the employer for foreign travel as in case of domestic travel.

9.10. Reimbursement of Medical Expenditure - Section 10

Recommendation

The current tax exemption limit of Rs 15,000 per annum needs to be increased to at least Rs 50,000 per annum. This could to some extent help to bring the exemption up to speed with the rising medical costs.

9.11. Rent Free Accommodation

Recommendation:

It is suggested that due consideration should be given to the facts where accommodation is provided by the employer in factory campus and staying there is a need of employment. In such cases, accommodation should be valued at NIL / or lower rate of 5% of Salary.

9.12. Meals and meal vouchers provided by employers

Recommendation

- Keeping in mind that the original limit was set over 15 years ago and the significant increase in food prices in the past 15 years, it is suggested that the limit should be increased to a minimum of Rs.200 per meal in line with the inflation since 2001.
- It may be specifically clarified that benefit of Rs 50 per meal shall be extended even to electronic meal cards as was extended in the FBT regime.

9.13. Gifts provided by employers

Recommendation

Keeping in mind that this limit has been constant for quite many years and the impact of inflation on prices, it is suggested to revise the limit to Rs 18,000.

A. Service Tax

1. Service of transportation of goods by sea from an overseas port to an Indian port to be zero rated

Recommendations

It is suggested that:

- Services of transportation of goods from an overseas port to a customs station in India should be brought under the mega exemption notification, similar to the service tax exemption granted in the Union Budget 2016 to transportation of goods by air from an overseas port to an Indian port; and suitable amendments be made in CENVAT Credit Rules, 2004 ('CCR') to allow credit; or
- An amendment should be made in Rule 10 of the Place of Provision of Services Rules, 2012 stating that for services of transportation of goods, the place of provision of services would be considered as outside India if either the origin or destination of goods is outside India and suitable amendments be made in CCR to allow credit; or
- Abatement for import cargo transportation services should be increased to 100% and suitable amendments should be made in CCR to allow credit.

2. Restoration of Service tax exemption on construction of ports / airports

Recommendations

- The requirement of obtaining a certificate from Ministry of Civil Aviation or the Ministry of Shipping for certifying that the contract has been entered into before 1st March 2015, under Entry 14A of Notification no. 25/2012-ST, should be withdrawn.
- Also, a clarification or an amendment should be brought about to extend the exemption to a sub-contractor providing erection, installation, commissioning services where the sub-contract is entered into after 1st March 2015, though the main contract is entered into before 1st March 2015 and stamp duty has been paid before that date, in order to avoid ambiguity.

3. Increase of interest rate on refunds in case of delay in passing order

Recommendation

It is recommended that interest rate in case of delay in paying refunds within the prescribed time limit should be enhanced from 6% p.a. to 9% p.a. (across all indirect tax levies).

B. Central Excise

4. Infrastructure Cess not to be levied on importation of motor vehicles

Recommendations

- A suitable clarification is issued by way of an appropriate amendment to the provisions governing Infrastructure Cess under the Finance Act, 2016 to exclude import of motor vehicles in CKD/ SKD kits, from the levy of Infrastructure Cess; and/or
- Allow set-off of input Infrastructure Cess against output Infrastructure Cess to avoid cascading and resultant increase in manufacturing costs.

5. Excise duty exemption on ready mix concrete to be given retrospective effect

Recommendation

It is recommended that excise duty exemption on RMC, manufactured at the site of construction for use in construction work at such site should be made available retrospectively.

C. CENVAT Credit

6. Credit of Krishi Kalyan Cess to be available to manufacturers

Recommendation

It is suggested that credit of KKC should be allowed by suitably incorporating the provisions under Rule 3 of the CCR to allow utilisation of KKC against other duties or taxes payable so as to bring manufacturers at par with service providers.

7. Definition of exempted services for CENVAT Credit reversal

Recommendation

It is suggested that the proposed explanation defining exempt service should be deleted.

8. Input service definition in CCR to be expanded

Recommendation

It is recommended that input service definition be expanded to include “activities in relation to business” in order to widen its scope.

9. Distribution of CENVAT credit by an Input Service Distributor to contract manufacturers

Recommendations

- Definition of input service distributor under Rule 2(m) of CCR should be amended to include even a “Principal trader” within its ambit i.e. the first part of the definition of ISD should be amended to mean “an office of the manufacturer or producer of final products or provider of output service or the person who engages an outsourced manufacturing unit”.
- An amendment should also be made in the definition of “input service” given under Rule 2(l) of the CCR, in the “means” part, to include “any service used by a person who engages an outsourced manufacturing unit, whether directly or indirectly, in or in relation to the manufacture of final products and clearance of final products upto the place of removal”.

10. CENVAT credit of Swachh Bharat Cess paid on taxable services should be allowed

Recommendation

It is suggested that suitable amendment is made in Rule 3 of CCR to allow credit of SBC paid on taxable services.

ANNEX L – PHARMACEUTICALS (GSK)

DIRECT TAXES

1. Signing of Income Tax Returns/Appeals

Existing Provision

The company's Income Tax Returns and Appeal before ITAT and CIT-A are required to be signed by the Managing Director or any other director (only in case Managing Director is not available for unavoidable reasons) as per Rule 45(2) and rule 47(1) of the Income Tax Rules read with section 140 (c) of the Income Tax Act. [Infact in case of electronic filing of Returns under digital signature of the MD, the digital signature USB Token in the name of the MD under actual scenario is used by the person authorised by the Board of the company to file the elctronic Return without the physical intervention of the MD]

Recommendation

Amend the Income Tax Rules to enable any signatory who is authorised by way of a Resolution passed by the Board of Directors of the company to sign the Appeals, Returns and all other documents under the Income Tax Act so as to align with the rules prescribed under Excise, Service Tax, etc. by the CBEC. This will reduce the complexity/constraints of getting all the documents signed/verified by the Managing Director and the procedure will be at par with the persons authorised to appear before the Department Officers during hearings/assessment proceedings.

2. Modification of return forms to include some remarks / disclosures

Existing Practice

The current format of electronic Income Tax Return and electronic Form 3CEB (TP Certifcate) do not provide any scope for the tax payer/TP Auditor to include separate disclosures / remarks.

Recommendation

It is requested to modify the formats of electronic Income Tax Return and electronic Form 3CEB (TP Certifcate) to enable the tax payer/TP Auditor to include separate disclosures / remarks

3. Education Cess / Secondary & Higher Education Cess

Existing Provision

As per the existing practice, apart from the normal tax and surcharge (wherever applicable), a tax payer has to also pay Education Cess as well as Secondary & Higher Education Cess

Recommendation

For simplification it is requested to have a consolidated tax rate instead of having separate Education Cess and Secondary & Higher Education Cess

4. Scheme for Out of Court settlement

Existing Provision

Presently there are numerous old litigations pending before High Courts / Suprreme Court.

Recommendation

It is requested to look into the possibility of coming out with some schemes of "Out of the Court Settlement" to put an end to the number of old litigations pending before High Courts / Suprreme Court

5. Double Taxation with regard to contribution to Superannuation Fund.

Existing Provision

According to Section 17(2) (vii) any contribution to an approved superannuation fund by an employer in excess of Rs. 1 Lac is treated as perquisite and accordingly taxed in the hands of the employee. At the time of retirement when the employee gets the superannuation amount back in cash from the fund, the whole or 2/3 amount (by way of pension) is once again taxable in the hands of employee.

Proposal

The current provisions relating to contribution of superannuation funds results in double taxation of same amount in the hands of employee and accordingly the provisions of section 17(2) (vii) may kindly be withdrawn from the statue to avoid unnecessary hardship of double taxation to the employee.

6. Specified Domestic Transactions (SDT) covered under Transfer Pricing (TP) Provisions

Existing Provision

As per the existing provisions of Section 92BA, Transfer Pricing provisions have been extended to cover all Specified Domestic Transactions (SDT) with domestic related parties (having aggregate value of transaction exceeding Rs. 5 crores p.a.) w.e.f. AY 2013-14 even if the assessee and the domestic related party are not availing/claiming any tax exemption and also paying tax at maximum marginal rates making the transaction as revenue neutral.

Proposal

It is requested to amend the provisions accordingly so that two domestic related parties are not covered by the said provisions of the Specified Domestic Transactions (SDT) if both of them are not availing/claiming any tax exemption and also paying tax at maximum marginal rates making the transaction as revenue neutral.

7. Special Audit u/s 142(2A) of the Income Tax Act

Existing Provision

Prior to introduction of Finance Bill 2013, the existing provisions contained in subsection-section (2A) of section 142 of the Income Tax Act, inter alia, provide that at any stage of the proceedings, the Assessing Officer having regard to the nature and complexity of the accounts of a tax payer and the interests of the revenue, can after obtaining specified approval from the Chief Commissioner or Commissioner, direct the tax payer to get his accounts audited by an accountant and furnish a report of such audit.

It has been held by the Courts that

- The complexity of intricacy in accounts, or, in other words, the manner of accounting/recording transactions, is a condition precedent for directing special audit

- The accounts cannot be regarded as 'complex' simply because the same are difficult to understand by one officer, since what is difficult to understand for one may be simple to understand for another [Refer Sahara India (Firm) vs CIT : 300 ITR 403 (SC)]

- The assessing officer cannot direct special audit on the ground of verification of voluminous nature of transactions or voluminous records of the assessee and pass the buck to the special auditor [Pls. refer DDA & Anr. Vs UOI: WPC No. 356/2011]

In order to overrule the aforesaid judgments that have interpreted the expression "nature and complexity of the accounts" in a restrictive way, it has been enacted vide the Finance Bill 2013 that the following factors can also be considered by the AO for directing the tax payer to get his accounts audited:-

- Volume of the accounts
- Doubts about correctness of the accounts
- Multiplicity of transactions in the accounts
- Specialised nature of business activity of the tax payer

The proposed amendment has enlarged the scope of section 142(2A) of the Act and gives sweeping powers to the assessing officer to direct special audit for specified reasons, not confined to complexity in accounts alone.

Having regard to the wording of the provisions, it would not be difficult for the assessing officer to recommend special audit in most of the cases, adding to the compliance burden of the tax payer.

<u>Proposal</u>

Accordingly it is requested to look into the possibility of amending the provision so that the special audit may not be mandated for the tax payers who have already got their accounts audited u/s 44AB and filed the same with the assessing officer.

8. Section 145A – Revenue neutrality

<u>Existing Provision</u>

As per section 145A, the valuation of purchase and sale of goods and inventory for the purposes of determining the income chargeable under the head "Profits and gains of business or profession" shall include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation.

Whereas as per AS 2 "Valuation of Inventories" issued by the ICAI, "cost of inventories" and "cost of purchases" cannot include duties and the taxes which are subsequently recoverable from the taxing authorities. Hence the input tax which is refundable should not be included in the "cost of inventories" and "cost of purchases"

Section 145A of the Income Tax Act requires valuation of purchase and sale of goods and inventory for the purposes of computation of income from business or profession, in case of any deviation on the method of accounting as required by section 145A, assessee needs to prepare reconciliation or adjustment statement for its effect thereof on the profit or loss as required under clause 12 (b) of form

3CD. Accordingly as per the Guidance note on Tax Audit issued by ICAI, the adjustment envisaged by section 145A will not have any on the "Trading, Profit & Loss Account" of the assessee.

The same can be elucidated with the following example:-

Trading, Profit and Loss account on "Exclusive method"

Particulars	Qty	Rate	Amt		Particulars	Qty	Rate	Amt
Opening Stock	10	1000	10,000		Sales	40	1600	64,000
Purchases	50	1200	60,000		Closing Stock	20	1200	24,000
Gross Profit			18,000					
			88,000					**88,000**
Other Expenses			6,000		Gross Profit			18,000
Net Profit			12,000					
			18,000					**18,000**

Trading, Profit and Loss account on "Inclusive method"

Particulars	Qty	Rate	Amt		Particulars	Qty	Rate	Amt
Opening Stock	10	1050	10,500		Sales	40	1680	67,200
Purchases	50	1260	63,000					
Less: VAT Credit availed on Cost of Goods sold			2,300					
			71,200					
					Closing Stock	20	1260	25,200
Gross Profit			21,200					

			92,400					**92,400**
Other Expenses			6,000		Gross Profit			21,200
VAT paid on sales			3,200					
Net Profit			12,000					
			18,000					**18,000**

The statutory adjustments required under section 145A in the aforesaid illustration can be explained as below :

Sl No.	Particulars	Increase in Profit (Rs.)	Decrease in Profit (Rs.)
1	Increase in Opening Stock on inclusion of VAT		500
2	Increase in Purchase on inclusion of VAT		3000
3	Increase in Sales on inclusion of VAT	3200	
4	Increase in Closing Stock on inclusion of VAT	1200	
5	VAT Credit availed on cost of goods sold	2300	
6	VAT paid on Sales		3200
	TOTAL	**6700**	**6700**

Based on the above working it can be seen that irrespective of the method of accounting followed by the assessee there is no impact on the “Trading, Profit & Loss Account” of the assessee.

Proposal

Since the entire computation of 145A adjustment in case of large assesses is very cumbersome/complicated and the same is revenue neutral as well, it is requested to modify the provisions so that if the tax auditor during audit finds the entire exercise as “revenue neutral”, they may be allowed to mention in Form 3CB/3CD that the same is revenue neutral and hence the amounts are not computed.

9. Once an Expense is offered/surrendered for taxation in one year not to be disallowed again in subsequent year

Existing Provision

Section 41(1) has been incorporated in the Act to cover a particular fact/situation. This Section applies where a trading liability was allowed as a deduction in earlier years in computing the business income of the assessee and the assessee has obtained a benefit in respect of such trading liability in later year by way of remission or cessation of the liability. In such a case, the section says that whatever benefit has arisen to the assessee in the later year by way of remission of the liability will be brought to tax in that year. The principle behind the section is to ensure that the assessee (doesn't ?) get way with a double benefit once by way of deduction in an earlier assessment year and again by not being taxed on the benefit received by him in a later year with reference to the liability earlier allowed as a deduction. The tax auditor has to mention in Clause 20 of Form 3CD all such profits chargeable to tax u/s 41 irrespective of the fact whether the relevant amounts have been credited to Profit & Loss Account or not.

Proposal

By the same logic it is requested to

- incorporate separate sections so that the expenses (mainly provisions made in books) which have been disallowed/offered/surrendered for taxation in one year should be allowed in the subsequent year when such provisions are actually utilised or written back and credited to Profit & Loss Account

- to incorporate specific clause in Form 3CD for the tax auditors to specify such amounts which have been actually utilised or written back and credited to Profit & Loss Account

The principle behind the aforesaid proposal is to ensure that the assessees are not subjected to double taxation.

10.TDS on amounts credited to provisions/suspense A/c.

Existing Practice

As per the TDS provisions under Chapter XVII of the Income Tax Act, TDS is required to be deducted on any amounts credited in the books of accounts whether in any Suspense account or party account.

These provisions create lot of practical problems as each company provides some estimated liabilities on monthly basis for management information purposes only and these provisions are reversed in the next month. No deduction for these provisions are claimed in the tax returns as the same are reversed in the next month except for the provisions lying in books as on 31st March of each year

Proposal

In order to avoid hardship of deduction of tax at source on monthly provisions, it is suggested that the provisions relating to tax deduction at source on provisions should be restricted to the provisions lying in books as on 31 March for which the deduction of expenses is claimed in the return of income. TDS provisions should not be applied on the provisions made during the year which are reversed before 31 March of the year. Accordingly the existing provisions, say under section 194C may be modified as under:- “Where any sum referred to any sub section 1 is lying to the credit of any account as on the last day of the financial year i.e; 31 March, whether called Suspense Account or by any other name in the books of accounts the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of payee and the provisions of these section shall apply accordingly. Similar amendments may be made in other sections relating to tax deduction at source.

11.TDS Deposit by 7th of the following month

Existing Practice

As per the current provisions TDS amount needs to be deposited in the Government Treasury by 7th day of the following month. It becomes difficult for the assessees to reconcile their Accounts for the entire month and deposit correct TDS Amounts within only 7 days of the end of the month.

Proposal

Kindly consider extending the date to 15th day of the following month to enable the tax payers to reconcile their account and deposit correct amount in the Government Treasury to avoid filing of revised return and refund on excess TDS deposited inadvertently

12.Filing of Return, TP Certificate, TP Study Report by Foreign tax payers in case of TDS u/s 195

Existing Provision

If tax is deducted at source u/s 195 towards any payment, foreign tax payers, [even if they do not have Permanent establishment (PE) in India] are supposed to file Income Tax Return in India and also comply with the requirement of Transfer Pricing (TP) provisions by filing TP Certificate in Form 3CEB as well TP Study Report.

Proposal

It is requested to look into the possibility of giving relief to the foreign tax payers from the burden of filing Income Tax Return in India and also from the burden of complying with the requirement of Transfer Pricing (TP) provisions by way of filing TP Certificate in Form 3CEB as well TP Study Report in case they do not have a PE in India even if payments are made to them by the Indian tax authorities after deducting tax at source u/s 195

13. Disallowance of expense for non-deduction of tax at source

Existing Practice

As per the Finance Act 2014, Section 40(a) (ia) has been amended to provide that in case of non-deduction of tax at source (TDS) towards payment to resident assessees, 30% of the expense will be disallowed. However as per Section 40(a)(i), still 100% of the expense is disallowed in case of non-deduction of tax at source (TDS) towards payment to non-resident assessees.

Proposal

Similar provision of 30% disallowance instead of 100% disallowance may also be made w.r.t. Section 40(a)(i) towards payments to non-residents in order to align the said two sub-sections w.r.t. payments to both residents and non-residents.

14.Rationalisation of the TDS Provisions

Existing Provision

- For Tax Deducted at Source (TDS), Sections 192 to 197 of the Income Tax Act specify the various payments from which the taxpayer needs to deduct tax at the prescribed rates in force. The rates and threshold of exemption limits are different for Sections 194A, 194C, 194I and 194j. It is an accepted fact that the provisions relating to TDS are very cumbersome, ambiguous and irrational. No amount of input can give an assurance that the compliances are flawless. There would hardly be any organisation that can claim perfection in compliance with these provisions.

- There are lot of interpretational issues with respect to the sections 194C and 194J leading to numerous litigations.

Proposal

- There is need to consolidate/improve the various TDS sections like stipulations, rates for TDS, exemption limits, etc. thereby rationalise the same under one section.

- While the existing TDS rates is 2% u/s 194C and 10% u/s 194J, it requested to have one rate (say 5%) both u/s 194C and 194J to put an end to all unnecessary litigations/ambiguities w.r.t. the interpretational issues of 194C and 194J

15.Penalty imposed on deductors for quoting invalid PAN Nos. in e-TDS Returns

Existing Provision

Penalties imposed on the deductors for quoting invaild/wrong PAN Nos. of the deductees/employees in the electronic TDS Return.

Proposal

As per the section 139A(5B) of the Income Tax Act, TDS deducting authority has to quote the PAN No. of the tax payer in the electronic TDS Return filed and TDS Certificate issued by it.

As per section 272B, penalty will be levied on the tax deducting authority for failure to comply with the provisions of section 139A.

It is therefore requested that

- Suitable amendments in the Income Tax provisions are made so that TDS deducting authority are not penalised under such circumstances when the tax payers provide wrong/invalid PAN Nos.

16.Threshold limit in concessional TDS Certificate issued u/s 197

Existing Provision

Generally there is a threshold limit specified in concessional TDS Certificates issued u/s 197. In case of large organisations, it is very difficult to keep a track/check of the amount of payments on which concessional TDS rate has been applied for each of the various deductees so that the concessional rate is not applied beyond the threshold limit.

Proposal

In avoid the complexities, it is requested to look into the possibility of either not to keep any threshold limit for the said concessional certificates u/s 197 or not to give any concessional certificates u/s 197.

17.TDS Details as per clause 34 of Form 3CD of the Tax Audit Report

Existing Provision

1. Prior to amendment in Tax Audit Report made by CBDT vide notification 33/2014 dated 25-07-2014., the following TDS/TCS details were required to be reported in Form 3CD by the Tax Auditor till AY 2013-14 :
2. Clause 27(a): Whether the assessee has complied with the provisions of Chapter XVII-B regarding deduction of Tax at Source and regarding the payment thereof to the credit of the Central Govt.
3. Clause 27(b): If the provisions of Chapter XVII-B have not been complied with, please give the following details, namely :
4. Tax deductible and not deducted at all
5. Name of party
6. PAN
7. Section under which tax was deductible
8. Amount
9. Shortfall on account of lesser deduction than required to be deducted
10. Name of party
11. PAN
12. Section under which tax was deductible
13. Amount
14. Tax deducted late
15. Name of party
16. PAN
17. Section under which tax was deductible
18. Due date of deduction
19. Actual date of deduction
20. Amount
21. Tax deducted but not paid to the credit of the Central Govt.
22. Name of party
23. PAN
24. Section under which tax was deductible

25. Date of deduction
26. Amount deducted
27. Reason for not making payment to the credit of Central Government
28. Post amendment in Tax Audit Report made by CBDT vide notification 33/2014 dated 25-07-2014., the following TDS/TCS details were required to be reported in Form 3CD by the Tax Auditor w.e.f. AY 2014-15 :-
29. Clause 34(a): Whether the assessee is required to deduct or collect tax as per the provisions of Chapter XVII-B or Chapter XVII-BB, if yes please furnish :
30. Column 1: TAN No.
31. Column 2: Section
32. Column 3: Nature of payment
33. Column 4: Total amount of payment or receipt of the nature specified in
34. Column 3
35. Column 5: Total amount on which tax was required to be deducted or collected out of Column 4
36. Column 6: Total amount on which tax was deducted or collected at specified
37. Rate out of Column 5
38. Column 7: Amount of tax deducted or collected out of Column 6
39. Column 8: Total amount on which tax was deducted or collected at less than specified rate out of Column 7
40. Column 9: Amount of tax deducted or collected out of Column 8
41. Column 10: Amount of tax deducted or collected not deposited to the credit of the Central Government
42. Clause 34(b): Whether the assessee has furnished the statement of tax deducted or tax collected within the prescribed time. If not, please furnish the details:
43. TAN
44. Type of Form
45. Due date for furnishing
46. Date of furnishing, if furnished
47. Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported
48. Clause 34(c): Whether the assessee is liable to pay interest under section 201(1A) or section 206C(7). If yes, please furnish:
49. TAN
50. Amount of Interest under section 201(1A)/206C(7) is payable
51. Amount paid out of above along with date of payment
52. A plain reading of the prescribed Form 3CD prior and post amendment dated 25-07-2015, there has not been much changes and the basic requirement of the Tax auditor remains the same i.e to report
53. The cases of non-deduction/non-collection of tax at source
54. The cases of non-deposit and late deposit of TDS/TCS
55. The cases of non-filing and late-filing of TDS/TCS Returns
56. The cases of interest of TDS/TCS non-compliance
57. However immediately after the said amendment on 25-07-2015, the ICAI has suddenly issued a revised Guidance Note on 09-09-2014 wherein some of the important portions of the said guidance note relating to TDS/TCS details are as follows :-
58. The auditor should obtain a copy of the TDS/TCS returns filed by the assessee which shall form the basis of reporting under this clause, to the extent possible.
59. Further, in view of the voluminous nature of the transactions, the tax auditor can apply test checks and compliance tests on the transactions reported in the TDS return.

60. The details of column 4 may be drawn from the TDS/TCS statements along with the books of accounts and other relevant documents.
61. Auditor may maintain working paper giving reconciliation of amount as per books of accounts and amount on which is TDS/TCS is required to be deducted / collected.
62. It is essential to note that it is the primary responsibility of the assessee to prepare the information in such a manner that the tax auditor can verify the compliance as required in the new clause.
63. Based on the said guidance note, the tax auditors w.e.f. AY 2014-15, have started asking the assessees to provide reconciliation of the payment amounts as per TDS Returns with the expenses appearing in the books of accounts. This has created a lot of doubts/discomforts/disagreements between the assessees and Tax Auditors.
64. Therefore it has become necessary to appreciate/consider the following very relevant points in this regard :-
65. In view of the voluminous nature and complexities of the transactions in case of big organisations and different nature of the accounting heads applicable to each payment / credit on which tax is deductible, it is not feasible to maintain working papers giving reconciliation of amount as per books of accounts and amount on which TDS/TCS is required to be deducted/collected as mentioned in the ICAI Guidance Note
66. This sort of reconciliation mat not be feasible or possible because
67. In case of Salary TDS Return, each employee will have separate tax computations based on slab rates, different exemptions (viz. HRA, House Property Loss, 80G, LTA, etc, etc.), different perquisities, etc., etc.
68. In case of non-Salary TDS Return, with each expense head in Books of Accounts there can be various nature of transactions and parties which may attract TDS or may not attract TDS
69. Nowhere in the Form 3CD, such reconciliation has been stipulated by CBDT
70. The Guidance Note in this regard is also contradictory since on one hand it is mentioning that the TDS/TCS returns filed by the assessee shall form the basis of reporting and the tax auditor can apply test checks and compliance tests, however on the other hand it is mentioning that the tax auditor may maintain working paper giving reconciliation of amount as per books of accounts and amount on which is TDS/TCS is required to be deducted / collected
71. However the Guidance Note has never mentioned that it is mandatory for the Tax Auditor to have the said reconciliation; instead it has mentioned that the Tax Auditor “may maintain working paper giving reconciliation ………………..”
72. Also the Guidance Note has not specified that the assessees shall have to provide such reconciliation. As per the Guidance Note, the onus is on the Tax Auditors to maintain such reconciliation, if they wish, based on the books of accounts and TDS Returns to be provided by the assessees
73. However, since such reconciliation is neither feasible nor possible to maintain due to shortage/paucity of the span of tax audit time, the Tax Auditors have started giving adverse qualification in the Tax Audit Report viz. “The Company has represented that in view of the voluminous nature of transactions, it is not feasible to prepare a reconciliation of the amounts as per the books of accounts and the amounts on which TDS/TCS is required to be deducted/collected and accordingly, we are unable to verify the information furnished in clause 34 with the books of account”, etc. etc., etc. inspite of the fact that the entire books of Accounts and TDS Returns are duly provided to Tax Auditors by the assessees
74. The Tax Auditors themselves does the audit of the Books of Accounts
75. These sort of adverse reporting/remarks by the Tax Auditors in the Tax Audit Report gives a wrong impression to the assessing officers with regard to the reputation/image of the assessee company and always creates an element of doubt/concern in the minds of the assessing officers.

ANNEX M – GST

GST IMPACT ON THE ALCOHOLIC BEVERAGES SECTOR

1. The UK India Business Council warmly welcomes the passage of the GST law through Parliament. We congratulate the Finance Minister, Shri Arun Jaitley, and the Finance Ministers of the State Governments for the rapid and substantial progress that has been made on the roadmap for implementation.

2. There is, however, one important issue that we wish to bring to the attention of the Empowered Committee of State Finance Ministers. Although "Alcohol for Human Consumption" does not attract GST when sold to the consumer, the production of alcoholic beverages is directly affected by GST in a way that will damage consumers, State Government revenues and the industry.

3. This situation will arise because GST will be charged on the input goods and services required for the production of alcoholic beverages - but because no output GST will arise on the finished products, producers will not be able to offset their input taxes against their output taxes. The total burden of 'input GST' will fall upon the industry, which will inevitably have to put up prices to consumers.

4. The following Table illustrates the expected impact of 'input GST' compared with present duties.

TABLE 1: CURRENT AND EXPECTED DUTIES ON INPUT GOODS AND SERVICES

	DRY GOODS	WET GOODS	INPUT SERVICES

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The rates are expected to be higher on inputs in GST regime	New Bottles	Recycled Bottles	Packing Materials	Molasses/ Malt	Neutral Spirits	Agri Inputs	Freight Services	Intellectual Property	Other Services
Current Average Rates (Incl. Excise Duty, VAT, CST etc)	15.0%	4.0%	12.0%	14.5%	5.0%	4.0%	4.5%	4.0%	15.0%
GST Rate (assuming it to 20%)	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
GST Impact	5.0%	16.0%	8.0%	5.5%	15.0%	16.0%	15.5%	16.0%	5.0%

5. We estimate that there will be an 80% increase in the level of taxes and duties currently paid by the industry on procurement of goods and services, with no ability to offset this new cost against 'output GST'. At least four damaging consequences would follow:

- Suppliers of alcoholic beverages would be forced either to increase their prices - thus increasing inflation - or to abandon the business.
- The combination of higher consumer prices and fewer producers of legitimate alcoholic beverages would increase the incentive to manufacture and sell liquor outside legitimate channels (un-declared, un-taxed producers, including counterfeits.)
- Higher consumption of counterfeit and unregulated products will damage public health and increase the risk to public safety (eg from drink-driving.)
- Lower consumption of legitimate, regulated alcoholic beverages - and higher consumption of unregulated, often counterfeit products - will reduce State Government revenues.

TABLE 2.1: ESTIMATED PAN-INDIA IMPACT (SPIRITS)

(INR MILLION)

SPIRITS BUSINESS – INDIAN MADE FOREIGN LIQUOR							
INPUT TAXES		ASIS		TOBE		IMPACT	
Inputs	Base Values	Taxes	Tax rate	Taxes	GST rate	Avg. incremental tax % (∆%)	Avg. Incremental tax burden
Wet Goods	42,500	1,550	3.6%	8,500	20.0%	16.4%	6,950
Dry Goods	56,250	6,250	11.1%	11,250	20.0%	8.9%	5,000
Employee expenses related to Salaries, Wages & Bonus etc. incl. contract wages	16,850	315	1.9%	378	2.2%	0.4%	63
Expenses related to repairs. Power, fuel, rent, legal & professional services	9,850	920	9.0%	1,970	20.0%	10.7%	1,051
Freight Outwards	4,400	198	4.5%	880	20.0%	15.5%	662
Advertisement and Sales Promotion, commission, cash discount, royalty etc.	24,100	1,975	8.2%	4,820	20.0%	11.8%	2,845
Other Administrative. Distribution & Miscellaneous expenses	4,850	728	15.0%	970	20.0%	5.0%	243
Service Tax on Govt. Levies	22,000	0	0.0%	4,400	20.0%	20.0%	4,400
TOTAL	**1,80,800**	**11,935**	**6.6%**	**33,168**	**18.3%**	**11.7%**	**21,233**

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TABLE 2.2: ESTIMATED PAN-INDIA IMPACT (BEER)
(INR MILLION)

MALT BUSINESS – BEER							
INPUT TAXES		ASIS		TOBE		IMPACT	
Inputs	Base Values	Taxes	Tax rate	Taxes	GST rate	Avg. incremental tax % (∆%)	Avg. Incremental tax burden
Malt	8,164	1,021	12.5%	1,633	20.0%	7.5%	612
Other Agricultural Inputs	5,178	385	7.4%	1,036	20.0%	12.6%	651
Other Wet Goods	1,546	159	10.3%	309	20.0%	9.7%	150
Used Bottles	9,924	496	5.0%	1,985	20.0%	15.0%	1,489
New Bottles	6,044	946	15.7%	1,209	20.0%	4.3%	263
Other Input Dry Goods	9,962	1,430	14.4%	1,992	20.0%	5.6%	562
Employee expenses related to Salaries, Wages & Bonus etc. Incl. contract wages	6,400	120	1.9%	160	2.5%	0.6%	40
Expenses related to repairs. Power, fuel, rent, legal & professional services	10,968	1,236	11.3%	1,974	18.0%	6.7%	738
Freight Outwards	7,100	320	4.5%	1,420	20.0%	15.5%	1,100
Advertisement and Sales Promotion, commission, cash discount, royalty etc.	11,062	974	8.8%	2,216	20.0%	11.2%	1,242
Other Administrative. Distribution & Miscellaneous expenses	3,207	0	0.0%	641	20.0%	20.0%	641
Service Tax on Govt. Levies	3,800	481	12.7%	760	20.0%	7.3%	279
TOTAL	**83,375**	**7,568**	**7.5%**	**15,336**	**18.4%**	**10.9%**	**7,768**

In total, we estimate the impact would be about INR 3000+ crore on Beer (800) & IMFL (2,200) industry. INR 500+ crore additional impact if Country Liquor is included.

STATEWISE IMPACT – STATE REVENUES FROM LIQUOR

1. As explained earlier, because input taxes on goods & services will be stranded at levels higher than earlier, with total pass-through tax on procurements increasing by some 80% under GST, producers' margins will be seriously eroded.

2. Companies will be forced to pass on the incremental taxes to consumers, which would lead to

   a. Multiplier impact on consumer prices (MRP)
   b. Consequential adverse impact on volumes
      i. Volumes would slip down the value chain
      ii. Lower segments could well slip into illicit / spurious alcohol
      iii. Negative impact on revenues, both for Governments and the Industry

3. Impact on stakeholders:

   a. Increase in cost per case for IMFL, Beer & CL products
   b. Increase in taxes related to services for Suppliers, Wholesalers, Retailers

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4. Based on the incidence of additional taxes that will need to be passed on to the trade chain, the consequential impact on consumer prices and the estimates of demand elasticity in a price increase scenario, the industry estimates the impact on government revenues to be (in INR crore):

WEST BENGAL

Product Type	Estimated % Increase in MRP	Estimated % Impact on Volumes	Present Excise Duty Estimates	Present Sales Tax Estimates	Decrease in Revenues	Excise Duty Estimates in GST	Sales Tax Estimates in GST	Estimated Impact on Excise Revenues from Alcohol
IMFL	9-10%	8-15%	16,500	11,200	8-15%	14,520	9,856	3,324
Beer	10-12%	12-14%	3,200	3,400	12-14%	2,752	2,924	924
CL	12-15%	7-10%	14,000	4,500	7-10%	12,600	4,050	1,850
TOTAL IMPACT ON GOVERNMENT REVENUES FROM ALCOHOL			**33,700**	**19,100**	**8-10%**	**29,872**	**16,830**	**6,098**

PUNJAB

Product Type	Estimated % Increase in MRP	Estimated % Impact on Volumes	Present Excise Revenue Estimates	Estimated % Decrease in Revenues	Estimated % Revenue in GST	Estimated Impact on Excise Revenues from Alcohol
IMFL	15-20%	14-18%	17,970	14-18%	14,735	3,235
Beer	18-20%	20-25%	4,360	20-25%	3,270	1,090
PML	15-20%	14-18%	31,640	14-18%	25,945	5,695
TOTAL IMPACT ON GOVERNMENT REVENUES FROM ALCOHOL			**53,970**	**16-20%**	**43,950**	**10,020**

MAHARASHTRA

Product Type	Estimated % Increase in MRP	Estimated % Impact on Volumes	Present Excise Duty Estimates	Present Sales Tax Estimates (Incl. cess)	Decrease in Revenues	Excise Duty Estimates in GST	Sales Tax Estimates in GST	Estimated Impact on Excise Revenues from Alcohol
IMFL	10-15%	8-10%	49,700	24,850	8-10%	44,730	22,365	7,455
Beer	10-12%	12-14%	22,500	14,300	12-14%	19,350	12,298	5,152
CL	9-10%	4-5%	28,280	19,100	4-5%	26,866	18,145	2,369
TOTAL IMPACT ON GOVERNMENT REVENUES FROM ALCOHOL			**1,00,480**	**58,250**	**8-10%**	**90,946**	**52,808**	**14,976**

KARNATAKA

Product Type	Estimated % Increase in MRP	Estimated % Impact on Volumes	Present Excise Revenue Estimates	Estimated % Decrease in Revenues	Estimated % Revenue in GST	Estimated Impact on Excise Revenues from Alcohol
IMFL	20-40%	15-30%	1,34,850	15-30%	1,14,623	20,228
Beer	6-10%	8-12%	23,140	8-12%	21,289	1,851
TOTAL IMPACT ON GOVERNMENT REVENUES FROM ALCOHOL			**1,57,990**	**12-18%**	**1,35,911**	**22,079**

KERALA

Product Type	Estimated % Increase in MRP	Estimated % Impact on Volumes	Present Excise Revenue Estimates	Present Sales Tax Estimates (Incl. cess)	Estimated % Decrease in Revenues	Excise Duty Estimates in GST	Sales Tax Estimates (Incl. cess) in GST	Impact on Revenues from Alcohol
IMFL	12-20%	15-20%	19,650	61,520	15-20%	16,703	52,292	12,176
Beer	6-10%	8-12%	23,140	5,560	10-15%	540	5,004	616
TOTAL IMPACT ON GOVERNMENT REVENUES FROM ALCOHOL			**1,57,990**	**67,080**	**12-16%**	**17,243**	**57,296**	**12,792**

CONCLUSION

Although the members of the UK India Business Council with an interest in both countries have drawn this situation to our attention, we believe this is an issue of general concern to businesses in the alcoholic beverage sector, whether Indian-owned or foreign-owned. More important, we believe it is a matter that has potentially far-reaching public policy implications for Indian consumers, inflation rates, public health and State Government revenues. It is in that spirit that we provide this briefing to the Empowered Committee of State Finance Ministers.

October 2016

GST IMPACT ON THE PETROLEUM PRODUCTS SECTOR

1. The UK India Business Council warmly welcomes the passage of the GST law through Parliament. We congratulate the Finance Minister, Shri Arun Jaitley, and the Finance Ministers of the State Governments for the rapid and substantial progress that has been made on the roadmap for implementation.

2. There is, however, an important issue that we wish to bring to the attention of the Empowered Committee of State Finance Ministers. 5 key products under the oil and gas sector – petrol, diesel, natural gas, crude oil and aviation fuel have, for the time being, been excluded from the ambit of GST. Although these products do not attract GST when sold, the industry is directly affected by GST in a way that will damage consumers, State Government revenues and the industry.

3. This situation will arise because GST will be charged on the input goods and services required for the production of the petroleum products - but because no output GST will arise on the finished products, producers will not be able to offset their input taxes against their output taxes. The total burden of 'input GST' will fall upon the industry, which will inevitably have to put up prices to customers.

4. Further, certain oil industry products like lubricants have been included under GST which means the industry would have to manage with a complex dual tax regime, which complicates rather than eases doing business.

THE NEGATIVE IMPACT OF EXCLUDING PETROLEUM PRODUCTS FROM GST

1. There is an industry consensus that exclusion of petroleum products from GST would have an adverse impact on the economy. For example, there will be an increase in inflation due to the increase in cost of production, increased compliances, and the non-availability of credit. This will affect investment and growth in the long term.

2. Under the proposed regime, GST would be applicable on most of the input of goods and services for oil and gas companies while the end-products (petroleum products and natural gas) would continue to be levied under existing Excise, CST/ VAT regime. Hence the sector would end up with a hybrid regime which will restrict set-off of input taxes against the output taxes.

3. There will be a break in the credit chain between the input and output taxes of oil and gas companies resulting in input taxes becoming a cost to be borne either by the industry or the end consumers. With the proposed tax rates under GST being higher than the tax rates under the current regime, this hybrid regime is likely to lead to an inflationary impact on the economy.

PARTIAL GST ON THE EXCLUDED PETROLEUM PRODUCTS

1. As an interim solution, the Government of India is considering a proposal to include the excluded petroleum sector products under the GST regime to the extent of addressing the incremental input tax costs under GST. The proposal is to levy a very low rate of GST (up to

5%) on the 5 excluded products. This would give the industry the ability to off-set the input GST against the output GST, and address the issue of cascading taxes.

2. This means that along with the taxes under the current regime - excise duty and VAT - a GST would also be levied on the sale of these products. There is a concern within the industry that this tax regime would be highly complex, and the impact may not be uniform in the upstream, midstream and downstream businesses. Hence this solution is not fully supported by the entire industry.

ALTERNATIVE APPRAOCHES

1. The Industry advocates two alternative approaches:

(i) **Inclusion of petroleum products under GST**

All petroleum products such as petrol, diesel and natural gas should be immediately brought under the ambit of the proposed GST regime. Non-inclusion would result in a significant cascading impact and increased cost of production, placing the domestic industry at a competitive disadvantage.

This will have an adverse impact on investment in India, which is critical for energy self-sufficiency and import substitution.

On the other hand, the inclusion of petroleum products under GST will eliminate stranding of taxes paid by suppliers and the industry at different stages in the value chain. This would plug tax leakages, bring in operational efficiencies, and enable States and the Centre to capture full revenue potential.

In order to address any revenue concerns, the states could consider levying a tax on the final sale of these products which would not be creditable.

(ii) **Zero rating**

If it is decided to exclude petroleum products, including natural gas, from GST in the initial phase, the sale of these products should be zero-rated. This means that on the output side no tax under the GST regime would be levied on these products (existing excise duty and VAT would continue). But, critically, all the input GST would be refunded. If this approach is adopted, it would be imperative that a time bound refund mechanism is legislated to address impact on working capital.

THE GST RATE STRUCTURE FOR LUBRICANTS

1. The Central Government has proposed a four-tier rate structure with a lower rate of 6%, two standard rates of 12% and 18% respectively, and a higher rate of 26%. It has been proposed to include lubricants under the 26% tier, which means that lubricants are being clubbed with the Fast Moving Consumer Goods sector which caters mainly to the final consumer.

2. Lubricants, on the other hand, cater more to the business sector which uses them as inputs in their businesses. Hence any burden of higher tax which is passed on to the industry will be ultimately passed on to the consumer.

3. Further a higher tax rate for lubricants could result in increased fares for public transport, impacting the public at large. Therefore, we would advocate that lubricants be placed under the 18% tier, with other items which cater to business segment.

CONCLUSION

Although the members of the UK India Business Council with an interest in both countries have drawn this situation to our attention, we believe this is an issue of general concern to businesses in the petroleum products sector, whether Indian-owned or foreign-owned. More important, we believe it is a matter that has potentially far-reaching public policy implications for Indian consumers, inflation rates, and State Government revenues. It is in that spirit that we provide this briefing to the Empowered Committee of State Finance Ministers.

November 2016