

Budget 2016 – Direct tax proposals

Key direct tax proposals in the
Finance Bill 2016

- ▶ Dividend distribution tax, buyback of shares
- ▶ Equalisation levy
- ▶ Tax collection at source
- ▶ MAT on foreign companies
- ▶ Income Declaration Scheme 2016
- ▶ Royalty from licensing patents
- ▶ Infrastructure companies
- ▶ Incentives for startups
- ▶ Other amendments

Taxation of dividends & distributed income

- Dividend distribution tax – s. 115-0
- Taxation of distributed income for buyback – s. 115-QA

Dividend distribution tax

- ▶ Section 115-O taxes @ 15% (+ surcharge + cess)
- ▶ Vertical inequity in the hands of top-bracket taxpayers (30% vs 15%)

Thus

- ▶ Dividend received, if in excess of Rs. 10 lakhs, to be taxed – section 115BBDA
- ▶ Individuals, HUFs, and firms
- ▶ Taxation to be on a gross basis

AY 2017-18 onwards

Issues

- ▶ Why companies have been excluded from the levy?
- ▶ 10% is to be computed on what value?
- ▶ How would section 14A apply in such instance?
- ▶ Whether s 194 will apply?
- ▶ If the dividend recipient is a non-resident, will the treaty apply?

Buyback of shares – s 115QA

- ▶ Section 115QA – tax on distributed income to shareholder
 - ▶ “buy back” means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956
- ▶ Other instances, than s 77A – amalgamation, demerger, issuance of shares in tranches, for different considerations

Thus

- ▶ Scope enlarged from Sec 77A to any law relating to companies
- ▶ Rules to be framed to determine taxable amount

Equalisation levy

- **Introduction**
- **Constitutional validity**
- **Unanswered questions**

Attempts to tax online advertisements

- ▶ No income accrues as activity carried out in India
- ▶ No income deemed to accrue as “no business connection” in India (Right Florists – ITAT, Kolkata) nor can they be regarded as royalty or FTS (Yahoo India – ITAT, Mumbai).
- ▶ In any case, in the absence of PE, in case of treaty countries, advertisement receipts cannot be subject to tax in India (Pubmatic India - ITAT, Mumbai)
- ▶ An enterprise cannot be said to have performed services without any physical presence (Piedras Negras Broadcasting Co. v Commissioner)

Equalisation levy – Introduction

- ▶ Introduced as a separate levy in Finance Act , 2016 – not forming part of Income-tax Act
- ▶ Subject of levy - Any consideration received from a resident or a NR having a PE, for
 - ▶ Online advertisement, provision for digital advertising space or any other facility or service for online advertisement, any other service as may be notified by Central Government
- ▶ All income of payee non-residents subject to levy @ 6%
- ▶ Permanent establishment defined
- ▶ Exemption u/s 10(50) provided

▶ State List

- ▶ Entry 55 – Taxes on advertisements other than advertisements published in the newspapers _and advertisements broadcast by radio or television

▶ Union List

- ▶ Entry 82 - Taxes on income other than agricultural income
- ▶ Entry 92 C – Tax on services
- ▶ Entry 92 – Taxes on the sale or purchase of newspapers and on advertisements published therein
- ▶ Entry 97- Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.

- ▶ Taxes on income need not be imposed by Income-tax Act alone. It can be through a Finance Act also
- ▶ Can be tax on service collected by Income-tax Authorities?
 - ▶ On the same transaction, based on “aspect theory”, income aspect and service tax aspect can be subjected to two different levies
- ▶ Challenge to constitutionality not possible

Questions

- ▶ Nomenclature of tax [‘equalisation levy’] is not relevant
- ▶ DTAA applicable?
 - ▶ New tax of similar nature?
 - ▶ Meaning of PE to be governed by IT Act definition or Treaty definition?
- ▶ Can assessee choose to be governed by provisions of IT Act?
- ▶ Is the levy extra-territorial in nature?
- ▶ Will service tax be included in the computation of levy?
 - ▶ Service tax does not form part of ‘consideration’ for the service

TCS

- **History and constitutional validity**
- **New amendments**
- **Unanswered questions**

- ▶ Inserted in 1988, faced many challenges of its validity as “no income accrues or arises” when tax is collected at source
- ▶ Validity upheld in Sanyasi Rao, relying on Anglo French – income is embedded in purchases as well
- ▶ Section expanded over a period of time to include non business purchases

Amendments

- ▶ TCS @1% on purchase of motor vehicle valued > Rs 10 Lacs
- ▶ Any cash purchase of goods (other than gold bullion which were already covered) or services of > Rs 2 Lacs
- ▶ Tax @ 1% to be additionally paid by the buyer

Unanswered questions

- ▶ Constitutionally valid even after Sanyasi Rao?
- ▶ Rule 37 provides for credit in the year in which corresponding income offered to tax. How would credit mechanism work
 - ▶ Motor vehicle purchased by individual as capital asset
 - ▶ Purchases made for consumption

MAT on foreign companies

MAT on foreign companies

- ▶ **Circular 794 of 2000**
 - ▶ The new provisions provide that all companies having book profits under the Companies Act, prepared in accordance with Part II and Part III of Schedule VI to the Companies Act, shall be liable to pay a minimum alternate tax at a lower rate of 7.5%, as against the existing effective rate of 10.5%, of the book profits. These provisions will be applicable to all corporate entities without any exception.
- ▶ **MAT not applicable: Praxair, Timken (AAR)**
- ▶ **MAT applicable: Castleton, ZD (AAR)**
- ▶ **Justice AP Shah Committee report (2015)**

MAT on foreign companies ... *contd*

- ▶ Shah Committee report accepted by the Government
 - ▶ Press Release 24/9/15 and **Instruction 18/2015** were justified

Thus

- ▶ Foreign company not having a PE India or
- ▶ not registered in India

are not subjected to MAT in India

Income Declaration Scheme 2016

Provisions of the scheme

- ▶ Declaration in respect of undisclosed income to be made after the commencement of the scheme but before the date to be notified
 - ▶ As per budget speech before 30-Sep-2016
- ▶ Tax on undisclosed income – 45% - non-refundable
 - ▶ Tax Rate=30 per cent of undisclosed income
 - ▶ Krishi Kalyan Cess @ 7.5 per cent of undisclosed income
 - ▶ Penalty @ 7.5 per cent of undisclosed income
- ▶ Wealth Tax shall not be charged on the undisclosed investments
- ▶ Provisions not to apply in certain cases e.g. pending proceedings, criminal offences

▶ All India Federation of Tax Practitioners v UOI

▶ **Bombay High Court:**

“Keeping the aforesaid well-settled law in mind, it would be difficult to arrive at a conclusion that, as more benefits are given to tax-evaders, the provisions of the Scheme are arbitrary and violative of article 14. It is adopted by the Parliament after taking into consideration the economic and social conditions prevailing in the society.”

▶ **Supreme Court:**

Attorney General’s statement – Government is committed to make VDIS 1997 a success and is going to pursue its objective behind such scheme

Royalty from licensing patents

Income from licensing patents – S. 115BBF

Budget proposal

- ▶ Tax rate of 10% on royalty income on gross basis
- ▶ Eligible assessee:
 - ▶ Patentee being resident of India
 - ▶ True and first inventor whose name is entered on patent register
- ▶ Patent should be developed and registered in India
- ▶ Developed in India means – expense is incurred in India
- ▶ Proposal applies to existing patents and licensing arrangements as well !!
- ▶ *Does not cover knowhow*

Disadvantage

- ▶ Assessee would be in dis-advantageous position if
 - ▶ Gross total income is a loss, in which case, gross basis of tax would be payable
 - ▶ Holding research outcomes as a business secret
 - ▶ Royalty free licensing already entered into

Advantage

- ▶ Can be used as a good tax saving tool

Illustration

Particulars	AB Ltd	A Ltd.	B Ltd.
Gross Sales	1,00,00,000	1,00,00,000	
Royalty Income			25,00,000
Less: Business Exp	55,00,000	55,00,000	
Less: Royalty Exp		25,00,000	
Net Income	45,00,000	20,00,000	
Tax @ 30% / 10%	13,50,000	6,00,000	2,50,000
Total tax of A & B		8,50,000	
Tax arbitrage		20% of 25,00,000	

Infrastructure companies

Roads, bridges, highway on BOT basis

Position as of now

- ▶ Road etc is owned by construction company in economic sense hence depreciation as intangible asset
 - ▶ Noida Toll Bridge [2013] 213 Taxmann 333 (All) – Explanation 1 to sec. 32 applied
 - ▶ Swarna Tollway [2014] 30 ITR (Trib) 171 (Hyd)

- ▶ Road etc does not legally belong to construction company hence no depreciation allowable
 - ▶ North Karnataka Expressway Ltd. [2014] 372 ITR 145 (Bom)

Roads etc. on BOT basis.....

Position as of now

- ▶ No legal ownership with company – amortise cost over tenure of right to collect toll – CBDT Cir. 9 of 2014 – following MIIC (SC)
- ▶ Assessee cannot be forced to amortise a revenue expense – Taparia Tools (SC)

Budget proposal

- ▶ Section 35AD amended to cover infrastructure as new eligible business
- ▶ Infrastructure means:
 - ▶ Road including a toll road, a bridge or rail system;
 - ▶ A highway project
 - ▶ A water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system
 - ▶ A port, airport, inland waterways, inland port or navigational channel in the sea

Roads etc. on BOT basis.....

Budget proposal - coverage

- ▶ Business should be owned by a Company registered in India or a consortium of such companies or an authority/board/body
- ▶ Such entity shall have agreement with CG , SG, LA, Oth. St. Body for
 - ▶ ‘Developing’ or ‘operating and maintaining’ or ‘developing, operating and maintaining’ infrastructure facility
- ▶ 100% of expense incurred is deductible

Taxation of startups

- **Startup India Action Plan, and the proposed amendments**
- **Issues**

Taxation of startups

- ▶ Providing impetus to startups
- ▶ Startup India Action Plan: threefold promises in income-tax
 - ▶ Capital gains exemption
 - ▶ Incubator investments
 - ▶ Three year tax **exemption**

Thus

- ▶ Section 54EE inserted, sec 54GB amended – capital gains exemption
- ▶ Section 80-IAC inserted – 3 year deduction

Issues

- ▶ Incubator investments– section 56 **not amended**
- ▶ Exemption vs. deduction – funding problems would continue, and determination of FMV of shares would be problematic

Other amendments

- ▶ Section 32AC as introduced required an assessee to “acquired and install” new asset within specified date
- ▶ Practical difficulties existed
 - ▶ Where assets “acquired” in one year and “installed” in subsequent years
 - ▶ Where assets took more than a year to install
- ▶ Position now clarified that deduction would be available for assets purchased in any block period as long as it is installed during any previous year

Exemption from 206AA

- ▶ Higher rate of TDS provided for if NR did not provide PAN
- ▶ Caused significant hurdle as NR in some cases not required to obtain PAN
- ▶ Amended clarifies that higher TDS rate would not apply subject to conditions that may be prescribed, which might include
 - ▶ Tax identification number from foreign tax authorities
 - ▶ Other identification forms

Resolving disparities– S. 112

- ▶ LTCG tax for transfer of unlisted securities by non-residents is 10%
- ▶ S. 112 defines ‘unlisted securities’ and refers to ‘securities’ definition of SCRA
- ▶ Memorandum states that Courts held that ‘securities’ definition does not include Pvt Companies
- ▶ Thereby, a view is possible that the term ‘unlisted securities’ does not cover in its ambit Pvt. Companies
- ▶ Now amended prospectively that the beneficial LTCG tax rate of 10% is applicable to transfer of shares of companies in which public are not substantially interested

Benefit of lower corporate tax – S. 115BA

- ▶ An option of choosing lower corporate tax @ 25% for companies newly set-up or registered on or after 1/4/2016
- ▶ This option to be exercised at the time of filing of return of income
- ▶ Other conditions:
 - ▶ No deductions u/s. 10AA, 32(1)(iia), 32AC, 32AD, 33AB, 33ABA, 35, 35AC, 35AD, etc.,
 - ▶ No set-off of brought forward losses
 - ▶ Depreciation to be claimed in the manner prescribed
 - ▶ Loss is deemed to have been already given full effect and no further deduction in future

Other amendments to PGBP

- ▶ Section 44ADA introduced to provide for presumptive income of 50% for professionals receipts upto Rs 50 Lacs
- ▶ Section 44AB – threshold limit for audit of persons having professional income increased to Rs 50 Lacs
- ▶ Section 44AD –threshold limit for presumptive taxation scheme for persons having income from business increased to Rs 2 Crores

Gradual phasing out!

- ▶ In Sections 10AA, 35AC, 35CCD, 80IA, 80IAB, 80IB, 32, 35(1)(ii), 35(1)(iia), 35(1)(iii), 35(2AA), 35(2AB), 35AD, 35CCC – benefit and tax incentives will be phased out gradually
- ▶ Aims at reducing the effective tax rate @ 25% eventually

Amendment to Section 28(va) and 55

- ▶ Section 28 (va) amended to cover ‘profession’ also
- ▶ Delhi ITAT ruling in *Satya Kant Khosla v. ITO [2015] 63 taxmann.com 293* – Overruled!
- ▶ Section 55 – Cost of acquisition and cost of improvement for *right to carry on business or ‘profession’* shall be Nil.

Dispute Resolution Scheme 2016

- ▶ Covers 'tax arrears'
 - ▶ amount of tax, interest or penalty determined under the I.T. Act or the Wealth-tax Act, 1957 in respect of which appeal is pending before the CIT(A).
- ▶ Scheme not to apply in certain cases
- ▶ Coverage:
 - ▶ Where disputed tax < 10 Lakh: Whole of the disputed tax and the interest thereto till the date of assessment or reassessment; or
 - ▶ Where disputed tax > 10 Lakh: Whole of disputed tax plus 25% of the minimum penalty leviable plus the interest on disputed tax till the date of assessment or reassessment;
 - ▶ Penalty Appeal: the penalty plus 25% of the minimum penalty leviable and the tax and interest.

THANK YOU!

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