FICCI

Economy
Taxes
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PRE-BUDGET MEMORANDUM 2016-17

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PREAMBLE

The last 12 months have been extremely eventful, both for the global as well as the Indian economy. While external factors have highlighted the attractiveness of India as an investment destination, there are still several reform measures that are necessary to ensure that our economy is placed firmly on a double digit growth trajectory. On the tax front as well, there have been several positive steps over the course of the year; however, much still needs to be done to restore taxpayer confidence in the system and to ensure that the tax challenges do not undermine India's growth opportunity. We believe that the coming budget offers an important opportunity for the government to initiate meaningful long-term reforms in the tax system. This will help set the tone for boosting investor sentiment- both foreign as well as domestic- and pave the way for ushering in a new era of growth.

Specific recommendations on various key aspects of our direct and indirect tax laws are set out in this Memorandum. At a conceptual level, we believe that the following key areas warrant the close attention of the Government:

Growth Friendly Tax Policies

Tax is now widely acknowledged as a key component of economic policy. Hence, there is a need to ensure that our tax policies are geared not only towards the collection of the revenue, but also towards boosting our economic growth. The proposal to reduce corporate tax rates announced as part of last year's budget is undoubtedly a step in the right direction. However, there are several other factors that warrant a closer look in this regard:

First, there is a need to give greater weightage to business and economic factors in the framing of tax policy. For instance, important provisions such as the levy of tax on subsidies should have been subject to a wider public debate and examination prior to enactment. Such provisions have the direct ability to affect the economic viability of projects around the country and therefore require detailed and careful consideration.

Second, there is a need to ensure stability in tax policy in the medium term. For instance, in an income-tax context, this involves eliminating frequent policy reversals, both directly (for e.g. through the removal of MAT exemption to SEZ units) as well as indirectly (for e.g. through levy of buyback tax to overcome capital gains exemptions in treaties, or widening the scope of section 56).

Third, adequate care must be taken to ensure that the fine-print of various provisions are in sync with the larger policy objectives sought to be achieved. There are several beneficial provisions that fail to achieve their intended results, due to complex and often unviable pre-conditions and requirements being prescribed. These must be urgently addressed.

Lastly, while revenue and enforcement considerations are undoubtedly important, proposals in this regard must be balanced with their overall economic impact, as well as the potential compliance burden that these could pose to taxpayers.

Greater Clarity in Law

There is an urgent need to ensure greater clarity in tax laws. This is very often the primary reason for the proliferation of tax disputes in the country. There are several provisions in the law, which need urgent rationalisation, so that they can keep place with rapid changes in the business world. There is also a need for greater sophistication in the law so that complex and often contentious issues emerging from new business models are proactively addressed through legislative action, rather than evolving through prolonged litigation through our already overburdened judiciary.

Proactive steps are also needed from the government to ensure that contentious issues are identified and addressed through circulars, instructions, position papers etc. from time to time. Additionally, it must be ensured that the issues so addressed, are followed in letter as well as spirit by tax authorities around the country.

Consistency in Interpretation and Implementation

The implementation of tax laws across the country is often inconsistent, with officers taking different views on similar topics. As mentioned above, there are several areas where the law is unclear, and the lack of guidance often contributes to extremely subjective and divergent approaches by tax officers. Even in cases where circulars are issued, one often finds that their provisions too are applied inconsistently by officers.

While factual questions undoubtedly need to be addressed by individual officers, the divergence in the positions taken by the authorities on legal issues needs to be urgently addressed. Measures need to be taken to ensure that there is strict adherence to the legal positions and circulars issued by the government.

Overhauling the Administrative and Dispute Resolution Machinery

A single-minded focus within the tax department on meeting revenue targets risks undermining the goal of an impartial and objective implementation of tax law. The presence of a large hidden economy in India undoubtedly necessitates a strong response from the tax authorities to seek out and bring to tax hidden incomes. However, a focus on meeting numerical targets as an end in itself without adequately acknowledging the various causes / sources of the revenue shortfall, often results in the authorities seeking to maximize tax collections at all costs, rather than ensuring that all taxpayers are paying the correct amount of tax.

A shortfall in collections often arises due to multiple factors, not all of them within the control of the tax authorities (including tax rates, economic cycles etc.). Hence, a single source-agnostic approach to tax collections should be ended so as to ensure that resources of the department are not unduly focused on maximizing tax collections. Eliminating the relevance of revenue targets in the performance appraisals of officers will also go a long way in improving the taxpayer experience. Taxpayer feedback could also be made part of the overall performance appraisal process.

On the dispute resolution front as well, there is a need for radical overhaul. Issuance of notices on frivolous grounds, routine adjustments accompanied by a failure to follow binding precedents leads to much wonted litigation. This coupled with the practice of routine filing of further appeals by the tax authorities, clogs up precious judicial time, and risks undermining our entire tax system. Despite several instructions, there is little change at the ground level. It is not uncommon to see SLPs being filed before the Supreme Court by the tax authorities on pure questions of fact, even in cases where the High Court, ITAT and the Commissioner (Appeals) have consistently ruled in favour of the taxpayer.

FICCI's paper on Dispute resolution in tax matters could provide a useful reference point for the initiation of meaningful reform in this regard.

To sum up, the relevance of tax policy in determining the overall economic climate cannot be underestimated. If India is to fully leverage the benefits of the prevailing fortuitous external environment, serious reform initiatives will need to be launched at a domestic level. The forthcoming budget could be an appropriate platform for kick-starting this process, particularly as regards reforming the tax system.

We, at FICCI, would be delighted to work with the Government to provide all possible support in this regard.

ECONOMIC OVERVIEW

2.1. Current State of Economy

The global economic landscape is undergoing a significant metamorphosis. The year 2015 has not been without challenges and some recent developments have weighed heavy on global economic prospects. First, Greece missed its repayment deadline to IMF in June this year posing significant risk to stability in the European Union. Alongside, a break in China's unprecedented year long bull run caused ripples in the global stock market. This was further followed by China's unanticipated move to devalue yuan on August 11, 2015 raising fears of a greater than anticipated slowdown in world's biggest growth engine.

Amidst this situation of persisting uncertainty, India's growth outlook has remained intact. There has been some volatility in exchange rates and stock markets given the contagion effect; but India's macro fundamentals have gained substantial strength over the past year and the ongoing policy initiatives have placed us on a stronger footing.

India's GDP growth was reported at 7.3% in 2014-15 (vis-à-vis 6.9% growth in 2013-14) and the growth estimate for the fiscal year 2015-16 has been put marginally higher at 7.4% by the Reserve Bank of India. Further, estimates by agencies like IMF and World Bank also place India's growth to be in a similar range.

In the latest Global Competitiveness Report, 2015-16, World Economic Forum, India was ranked 55 among 140 countries. This marked an improvement by 16 positions from the rank in 2014 and ended five consecutive years of fall in India's ranking. Further, according to latest Financial Times ranking of destinations for greenfield investments in the first half of the year 2015, India emerged as a top ranker performing better than China and United States.

India has once again successfully placed itself on the investment radar and the slew of reforms undertaken over the past year has provided a perfect dose of optimism.

The key pressure points on the domestic front until about two years ago - inflation, current account deficit and fiscal deficit- remain largely under control. The Consumer Price Index has softened significantly over the past year and the Wholesale Price Index has been in the negative terrain for eleven consecutive months ending September 2015. The decline has been broad based reflecting subdued global commodity prices. Though pressure on food prices can emerge going ahead, the Government is fully geared to handle the situation. The Government has committed to address structural challenges in the food supply chain and is also working towards improving overall agri-productivity levels.

On the fiscal front, the Government is making an earnest effort to ensure fiscal prudence by bringing greater efficacy in expenditure management system and pruning down unnecessary expenses.

However, India's external performance remains a concern and the prolonged weak demand conditions globally make recovery difficult. Exports have been in the negative terrain and can take some more time to recuperate.

Given the current state of affairs, it remains imperative to give a greater push to domestic consumption and investments. While the existing stalled projects are being debottlenecked and some pick up in implementation has been noted; there is still a sense of apprehension with regard to undertaking new projects amongst members of corporate India.

The Reserve Bank of India has cut the repo rate by 125 bps between January and September 2015. The Banks have also responded by revising down their base rates. Industry looks forward to an effective transmission of rates to revitalize domestic demand and investment. Amid the prevailing global headwinds, these two will be the most critical factors for realizing our growth aspirations.

2.2. Government Stays Committed to Reforms

The Government has displayed a strong commitment to meet the overall objective of taking India to a higher growth

trajectory. The central focus of policy measures being undertaken has been generating job opportunities for India's youth. The previous Union Budget for 2015-16 was also in line with Government's broader vision.

The Government has laid emphasis on pushing the growth of industrial sector and is consistently working towards creating a conducive environment for doing businesses. Several measures have been undertaken to cut down red tape and diminish human interface to make the system efficient. There has been considerable action on administrative and procedural reforms.

With respect to taxation, we have seen Government's resolve to simplify the tax structure. The announcement of rationalizing the corporate tax structure, including reduction in corporate tax rate from 30 per cent to 25 per cent over the next four years has been much appreciated by Industry.

Various campaigns initiated by the Government including the 'Make in India', 'Digital India', 'Skill India' are clearly directed towards creating productive jobs and a skilled workforce. It has been nearly a year since these campaigns were announced and the response received has been very encouraging. Several foreign and domestic investors, belonging to a wide array of sectors, have indicated interest to invest in India.

Promoting entrepreneurship has also been the top agenda for the Government. The announcement to set up Self Employment and Talent Utilization (SETU) Fund and the Micro Units Development Refinance Agency (MUDRA) in the last Union Budget are very positive steps. In addition to this Hon'ble Prime Minister announced the 'Start up India Stand up India' initiative on August 15, 2015. This initiative is expected to boost entrepreneurship by promoting bank financing and offering incentives for job creation.

The biggest drag on India's competitiveness has been the infrastructure sector and there remains a huge lacuna between our growth aspirations and the concurrent logistics support available. Financing need of infrastructure projects is huge and remains a major challenge. The setting of the National Investment and Infrastructure Fund announced in Union Budget 2015-16 is a welcome move. The operational framework for the fund has been already approved and the fund is expected to be launched soon.

In addition, tax-free infrastructure bonds for rail, road and irrigation projects were reintroduced. Government also indicated adoption of 'plug and play' approach in case of UMPPs, plan for corporatization of ports and steps towards revitalizing Public Private Partnerships.

On the agriculture front, the announcement to create a Unified National Agriculture Market was significant. Move towards a single national market for agri-produce will help rein in the inflationary pressure in case of food commodities.

India's banking sector is also set for a turnaround on the back of various efforts and reforms of the Government. The government has recently announced 'Indradhanush' reforms for revamping the Public sector banks – these encompass reforms in 7 key areas namely Appointments, Bank Board Bureau, Capitalisation, Destressing PSBs, Empowerment, Framework of Accountability and Governance. These reforms pave way for a far more robust financial sector. Moreover, action on several other important announcements including gold monetization, black money and setting up of a bank board bureau is already underway.

Besides the focus on strengthening economic forces, the Government has laid an equal emphasis on social and inclusive development. In the Union Budget 2015-16, several steps were announced towards creating a universal social security system for all Indians. The Government is also working towards provision of housing for all, availability of basic amenities like water, electricity and medical facilities, wider coverage under pension and insurance schemes – all to be achieved by 2022 – marking 75 years of India's independence.

The government has exhibited continued action with regard to reforms both during the announcement of the Union Budgets and outside of it. It will be most apt to further build on this momentum. There is a need to keep nurturing the emerging signs of a turnaround and make them more sustainable.

2.3. Focus areas for Union Budget 2016-17

The forthcoming Union Budget provides an opportunity to mend the gaps in the existing system and strengthen the demand conditions to boost overall economic output. While the following sections of this Pre-budget memorandum provide specific suggestions for various sectors, some of the key areas that require special focus to facilitate transition to high growth trajectory are detailed below:-

(a) Give further thrust to 'Make-in-India' Program: Stimulate Demand and Investments

'Make in India' is a laudable initiative which has generated much interest amongst the domestic as well as global investors. Several global companies have made plans for investments in India. However, domestic investments are yet to pick up pace as capacity utilization levels across sectors continue to remain low due to weak demand. There is an urgent need to prop up demand to impart momentum to the capex cycle and put GDP on a high growth track. Following measures may be considered in the forthcoming Union Budget.

One, lower lending rates will give a much needed boost to demand for housing, durables and also encourage greater investments by industry. Following the reduction in policy rate by the Reserve Bank by 125 basis points, many banks have initiated reduction in lending rates. However, greater efforts are required to facilitate an effective and equivalent transmission. The Government should consider fast tracking the recapitalization plans of public sector banks and also initiate the review of small savings framework to enable banks to lower their cost of capital. In addition, the Government should also address the issue of stressed assets of public sector banks. While Asset Reconstruction Companies are being strengthened, the Government should consider setting up a National Asset Management Company (NAMCO) that can take over large NPAs from the balance sheets of banks. This would release capital, provide banks with lendable resources and also help in lowering interest cost.

Two, the forthcoming Union Budget should lay out an appropriate personal tax framework that can put greater disposable income in the hands of consumers. This will give a strong boost to consumer demand and facilitate expansion of economic activities.

Three, the Government should work towards an early implementation of GST. Once implemented, GST will facilitate seamless and efficient movement of goods across country, lower the production costs, ease the tax burden and increase the overall output in the economy.

Four, there is a need to bring about a level playing field for domestic industry vis-à-vis imports. While the Government has taken steps to correct the inverted duty structure in the past, the Government should correct all remaining anomalies in the duty structure.

Five, specific measures are required to push the exports, which have been reeling under stress for a long time. The Government should create a mechanism for early refund of the duty drawback amounts, introduce interest subvention scheme, enhance incentives under the Merchandise Exports from India Scheme (MEIS), add more items under the MEIS, and promote exports of specific items as a part of the trade agreements.

Six, we look forward to the reduction in corporate tax rate in the forthcoming Union Budget, as announced by Hon'ble Finance Minister while presenting the last Budget.

Seven, we need to create a strong supply eco-system for the key sectors as identified under the 'Make in India' program. The Government could consider special fiscal incentives for attracting investments in new / relatively new sectors that are critical for integration into the global value chains such as manufacturing of electronic components. This may include tax holidays, incentives for adoption of new technology etc.

(b) Give boost to MSMEs and Start-ups

As a part of the Start-up India initiative, the Government may consider following specific measures.

One, a rebated income-tax for small start-up businesses called START (Startup Rebated Tax) can be introduced to encourage small Start-ups and thus boost job-creation. The Government should also introduce employment linked tax rebates to entrepreneurs.

Two, ease of doing business is extremely important for MSMEs, who face time and capability constraints in adhering to complex procedures and compliances. There is a need to have a single window mechanism for MSMEs that serves as one-stop shop service for all business related compliances, with in-built provisions for time bound and deemed clearances.

(c) Continue thrust on Infrastructure

The Government has remained committed to accelerating infrastructure activities in the country. Given the huge fund requirements, the Government may consider launching funds similar to the National Investment and Infrastructure Fund, perhaps, with other countries as co-investors. Such funds can be managed by professional fund managers and leveraged multiple times by providing equity for large projects across sectors.

While massive impetus has been given to public investment, government may also consider initiating privatization of public sector ports for imparting greater efficiency in port operations.

(d) Continue with Fiscal Consolidation

In addition to the above, it remains critical that we continue to move on the path of fiscal consolidation. It is important that the government continues its endeavor to garner higher revenues and attempts to move towards a more efficient expenditure management system.

With respect to the revenues, the Government should aim at widening the tax base – incomes above a certain threshold need to be taxed irrespective of the source.

On the expenditure side, an effort has been made by the government to get the focus back on productive outlays. Productive investments should continue even as steps are taken to rein in consumptive expenditure.

We also look forward to the report of the Expenditure Management Commission (EMC) in identifying areas for better management and expenditure control. The forthcoming budget should implement the key recommendations of the EMC in this regard.

SECTORAL ISSUES

AGRICULTURE

3.1.1. Agriculture Marketing

Government has announced the creation of a National Agricultural Market. Small Farmers' Agribusiness Consortium (SFAC) has been designated as the nodal agency which has appointed E&Y as the transaction advisor. It appears that Government would like to have a Government promoted single entity for setting up the National Agricultural Market. Few suggestions in regard to lack of common market and poor linkage of agriculture market information are as under:

(a) As Agricultural commodities are very large and diverse in nature it would be impossible for a single entity to deal with the complexities and the scale involved e.g. fruits & vegetables, grains, oilseeds and pulses, would each require different marketing channels and infrastructure. Similarly, cotton, spices, edible nuts, copra and rubber would require having different structures.

(b) Modern and efficient Agricultural Marketing structures would require well capitalized entities that understand and are active in these markets. Government should therefore create an enabling environment to promote not a single but multiple players who may specialize in one or more Agricultural crops for setting up Pan India markets. Government of India policy should therefore set Net Worth and Governance criteria for recognizing such entities analogous to the policy adopted for National Commodity Exchanges

(c) Government promoted entities such as APMCs / Marketing Boards have not provided the farm community adequate and transparent marketing and distribution channels.

(d) Implementation of this reform would require concurrence of State Governments as Agriculture is a state subject which could delay its implementation. It is therefore proposed that in the initial phase entities may be enabled to set up markets for mandi fee paid produce which would not require any approval of the State Government. Several transactions could then be enabled to even bypass the mandis which have in any case become dysfunctional and inefficient.

3.1.2. Procurement and Stock Management of Food Grains by Private Sector Entities

To promote efficiency in procurement operations the Government of India has recently announced a new policy of engaging private sector players for Eastern states. The same should be extended to other regions and states. In respect of Pulses and Oil seeds while FCI / Nafed may continue to be the nodal agency, all procurement operations should be allowed with the participation of the private sector organized entities. Along with procurement under MSP, credible private sector entities should also be outsourced for stock management services to improve efficiencies and ensure improved quality of preservation of food grains.

3.1.3. Agriculture Storage

Approximately 15 MMT of Agro warehousing has been built or contracted under FCI 7/10 year guaranteed scheme. However, still there is estimated gap of 15 MMT in agro warehousing in the country. In this context the policy recommendations are as follows:-

(a) The interest subvention scheme for farmers who store their produce should be extended to all farmers and all warehouse receipts rather than being restricted to only negotiable receipts and to only small and marginal farmers.

(b) The capital subsidy under the Grameen Bhandaran Yojana should be restored. The Capital subsidy of 15 %, which was announced in the 2014 budget, has been suspended and no budgets have been provided. In the interim the projects where the loans have been sanctioned should be restored.

(c) Government should extend Capital subsidy for construction of vertical silos by organized private sector entities to give an impetus to modern and efficient storage structures. While no Government guarantee needs to be given for such structures all such silos should automatically be treated on par with CWC godowns for use by the FCI on need basis and the rentals fixed at 10% above the CWC rates to encourage establishment of modern structures (storage and grain handling) which would provide better quality of preservation and food safety.

(d) Under Priority sector lending guidelines – WHR (Warehouse Receipt Funding) should get differential treatment as part of the larger agro credit budget. It is also suggested that Subsidy/Viability Gap funding should be provided to warehouse service providers for working with small and marginal Farmers.

(e) Service tax on warehouse rent, warehouse management services, laboratory services for agro produce, agro commodity care services should be taken off.

(f) The tenure of Warehousing construction lending is low and ROI is high. It is suggested that the terms from NABARD to fund agro warehouses should be revisited. It is suggested that repayment period should be increased to 10 years and the ROI should be in the range of 8-8.50%.

(g) Multiple regulations/registration requirements make agro warehousing an unviable business. There should be single regulator in WDRA (Warehouse Development and Regulatory Authority) to bring much needed transparency and hence, better regulations and investments in the sector.

(h) The pace of adoption of Negotiability of Warehouse Receipts and hence expansion of post-harvest credit is slow. Therefore, target should be set for banks to lend against Negotiable Warehouse Receipts within the Agro lending budget. Secondly, lending against negotiable Warehouse Receipts should be qualified under Agro Credit

(i) Capital subsidy for cold stores should be enhanced and also extended to all capital investments in back end supply chain logistics to reduce the losses in fruits and vegetables.

(j) Investment in Solar Technology Applications for Cold Chain to Reduce Dependence on Electricity in Rural Areas should be increased.

3.1.4. Agricultural Income

(a) Contract Farming

The Government is promoting consolidation of farms/farming through physical pooling, collective farming by FPOs (Farmer Producer Organizations) or such other entities. All of these help in transfer of technology, HYV (High Yielding variety) of seeds, quality inputs and modern agronomy practices/equipment to small farmers by such organisations to help farmers improve yields and income. Corporates are working with farmers for contract multiplication of high yielding varieties of seed of which there is an acute shortage in country, encouraging organic farming and cultivation of high value crops.

However, in such Contract / Joint farming land belongs to the farmer but other vital inputs (such as agricultural expertise, seeds and/or other inputs, etc.) are provided by the corporate. Further risk of failure of the crop impacts both the farmer and the corporate. Hence for all practical purpose there is a partnership. Till recently such interventions by way of contract farming were considered to be an agricultural activity and the income there from was considered as Agricultural income. However, many Income Tax Officers are disallowing such income as agricultural income without appreciating the true nature of the activity and the intent of the Government leading to unnecessary litigation and harassment. This is being done in spite of various judgements in favour of such contract farming causing uncertainty and harassment to such agricultural partnership process. This is one amongst many reasons why contract farming/ consolidation models are not taking off.

In order to promote agricultural partnership between farmers and corporate, it is suggested that a clarification be issued stating collaborative / joint / contract farming as agricultural operations and the income there as Agricultural income tax. Such joint / contract farming should include (a) growing of seed under contract / joint farming where the risk and reward of the crop is shared between the corporate and the farmer (b) contract / joint farming of crops where some of the critical elements such as seeds, inputs along with agronomy expertise are provided by the contractor.

Merely, purchase of crops under a contract price declared in advance is not sought to be covered under agricultural income but where the contractor has a stake and active involvement in the crop it should be covered.

(b) Modern Farming via Hydroponics etc.

Government is encouraging modern farming techniques which includes Aeroponics, Aquaponics, Hydroponics, Nutrient Film Technique (NFT) etc. These technology driven agriculture solutions are also critical for the Smart City concept to feed the local citizens. "Agricultural income" is defined under section 2(1A) of the Income Tax Act, 1961. However, Income Tax Officers are claiming that crops grown by using the above techniques i.e. Aeroponics, Aquaponics, Hydroponics, Nutrient Film Technique (NFT) etc. are not covered under section 2(1A) as the crop is grown in water or air or on rooftops/buildings and not on land. This is vitiating the whole concept of modern agriculture.

This is an incorrect interpretation as what is produced in nurseries / greenhouses through modern / innovative techniques is an agricultural crop and such actions will only deter modern cultivation. Suggested solution is that a clarification be issued that " Income derived from crops grown by using farming techniques like Aeroponics, Aquaponics, Hydroponics, Nutrient Film Technique (NFT), in net houses and green houses and such other modern techniques shall be deemed to be agricultural income.' or a broader definition could be that "income derived from crops grown either on land, water or air shall be deemed to be agricultural income".

3.1.5. Farm Machinery

All types of Crop Harvesters / Cotton Pickers are exempted from Excise, hence levying of 4% SAD in respect of any parts (e.g. mechanical, electric, plastic component etc.) covered under any Customs Tariff Heading, imported for use in manufacture of these products be exempted from 4% SAD, as it has cascading effect on price when no cenvat credit of SAD is available.

3.1.6. Crop Insurance

Since service tax is not levied on crop insurance forming part of a government notified scheme, it may well be worth considering waiver of service tax on crop insurance taken by corporations where the beneficiary is the farmer. The major advantage of this proposal is that it may result in innovative products which can be replicated.

Secondly, allowing corporations credit on crop insurance premium under CSR will lead to better products and timely payment of claims. Through this, subsidy burden of the government will also come down. Crops not notified under the Government schemes can also be covered under the CSR initiatives.

3.1.7. Dairy

India is the largest producer of milk in the world, but to meet the growing demand for milk and acute shortage of supply, formation of commercial dairies should be promoted. Two concerns in running such dairies are (a) easy availability of silage that is prepared from Maize (Corn) (b) secondly, easy availability of credit. It is suggested that

(a) Government should remove Import duty on a Self-propelled Forage Harvesters for a period of 5 - 10 years to promote entrepreneurs who can prepare and sell silage commercially.

(b) Such commercial dairies face the reluctance of banks to lend in absence of 100% collateral guarantee. Government should catalyse flow of bank credit to such first generation entrepreneurs for setting up dairies without the hassles of arranging collateral. This can be done by providing back up guarantee to Banks on behalf of Commercial dairy owners / promoters.

Other Proposals

3.1.8. Exemption for Services related to Agricultural Produce

As per extant Service Tax laws the agro-sector has been supported by keeping a bulk of services relating to agriculture or agricultural produce in the Negative List or in the list of exempted services. However, there are some services like Warehouse Management Services, Security Services, and Laboratory Testing Services etc. which are essential to secure storage of agri-produce and to determine quality of the agri-produce but which are subjected to Service Tax.

It is recommended that all services provided for agricultural produce be exempted from service tax.

3.1.9. Service Tax on Processing of Whole Pulses to Split Pulses

Negative List of Services includes processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but makes it only marketable for the primary market. In case of processing of whole pulses to split pulses, such activity is carried out in factories. The prices of the pulses are showing an upward trend in last few years owing to lower production, impact of weather, etc. Levy of service tax on such processing activities adds to the higher prices of pulses, which is a staple diet for the common man. On a similar corollary, Finance Ministry has exempted levy of service tax on processing of paddy into rice.

It is recommended that the processing of whole pulses into split pulses should be covered under negative list of service tax.

3.1.10. Expansion of the Scope of Definition of "Board" under Section 65B

As per Section 66D of the Finance Act, 1994 the Negative List of Services includes:

> *"(d)(vii) Services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce;"*

Under clause (6) of Section 65B, "Agricultural Produce Marketing Committee or Board" has been defined to mean any committee or board constituted under a State law for the time being in force for the purpose of regulating the marketing of agricultural produce.

In this connection it would be pertinent to note that by virtue of it being expedient in public interest, the Union Government has taken under its control several agri industries and has set up Boards for such industries. The duties and objectives of such Boards include, inter-alia, regulating the relevant agri commodity and promoting its sale – both within the country as well as exports, having due regard to the interests of all the stakeholders like the farmers / growers, manufacturers, dealers and the government. Examples of such Boards include Spices Board of India, Tobacco Board, Coffee Board of India, Coir Board and Tea Board of India.

In line with the inclusion in the Negative List of services provided by Agricultural Produce Marketing Committees or Boards, it is recommended that the services provided by Boards set up under Central enactments for similar purposes are also included under the definition of "Board" under Section 65B of the Finance Act, 1994. This will ensure that the tax cost of the services are not embedded in the export cost of the agri-products or in the cost of the agri-products sold in the domestic market, as is the case today.

CHEMICALS AND PETROCHEMICALS

3.2.1. Background

The Indian Chemical Industry is an integral part of Indian economy. The industry has key linkages with several other downstream industries such as agriculture, infrastructure, textiles, food processing etc. Over the last few decades, the chemical industry has seen an increasing shift towards Asia. Indian chemical industry stands out to be the 3rd largest producer in Asia and 12th in the world in terms of volume. The chemical industry in India stands at ~USD 144 Billion* FY14 and is expected to grow at ~9 % p.a. over the next five years. It currently accounts for ~3.4% of the global chemicals industry (~USD 4 Trillion) The industry which includes basic chemicals & its products, petrochemicals, paints and varnishes, gases, soaps, perfumes and toiletries is one of the most diversified of all industrial sectors covering ~80,000 products.

The growth of this sector will be primarily driven by domestic consumption because per capita consumption of most of the chemicals is much lower than global averages. The government has been taking initiatives to address challenges in infrastructure, feedstock availability, complex tax and duty structure and overcome other system intricacies. One of the initiatives is 'Make in India' campaign, which aims to facilitate investment, foster innovation, enhance skill development and build best-in-class manufacturing infrastructure. GOI is focusing to raise the share of manufacturing in GDP from 16% in FY14 to 25% by 2022.

To meet this increasing demand either the local production will have to ramp up or the imports will have to go up. As import duties have fallen across South and Southeast Asia, large global manufacturers have set up transnational supply chains in countries with better infrastructure, ports and friendly regulatory regimes. This has led to global players shifting from manufacturing to assembly and, subsequently, to outright imports into India. Our view is that sustained growth is more likely to stem from the rise of domestic manufacturing, rather than relying on international companies. Besides simplifying regulatory processes and compliance related issues, the government will have to look at policies specific to the chemical manufacturing sector to generate sizable impact. Industry feels Free Trade Agreements (FTAs) are having a negative impact on business. FTAs create an 'inverted duty structure' making it cheaper to import a finished product rather than manufacturing or assembling it in India.

3.2.2. Feedstock for Chemical Industry

(a) Reduction of Customs Duty on Feedstock Ethyl Alcohol

Presently, India is net deficit of ethanol with estimated production around 245 crore litres against consumption of total 325 crore litres (in 2014-15). Launch of 5% Ethanol Blending Programme with the requirement of 105 crore litres of ethanol has raised the demand. This has further increased price of ethanol available to chemical industries. Due to the inadequate supplies of ethanol in the domestic market, Indian Chemical industry is forced to import ethanol. The chemical industry would be dependent on ethanol imports for the next few years to meet its requirements.

Products manufactured by Ethanol based chemical industry compete with products made from petroleum route where feedstock is derived from crude oil. Currently import duty on industrial ethanol is 5% whereas it is nil for crude oil and 2.5% for ethylene. Hence, there has to be a level playing field to make this industry competitive. On application side, the downstream applications of ethanol are fuel blending, potable liquor, Pyridine, Mono Ethyl Glycol (MEG- further used for Polyester Fibre and Films, Packaging Films and Pet bottles etc.). Ethyl Alcohol is also used for making Acetic Acid, Ethyl Acetate and Acetic Anhydride. Most of these products (Pyridine, Ethyl Acetate etc.) are exported out of country and are major building blocks for various agro chemicals and pharmaceuticals products. Removal of Duty will further boost the export of such products and will increase the forex revenue for the country.

In view of the above, it is requested that basic customs duty on feedstock ethyl alcohol should be reduced to nil as this will promote growth of downstream chemical industry products. It will align the duty rates with other feedstock to make ethanol based chemical industry compete in global market with the finished products obtained from the petroleum route.

(b) Reduction of Customs Duty on Feedstock Methyl Alcohol

Methanol consumption in the country is estimated at 1.8 - 2.0 million tonnes and is expected to reach 2.5 million tons by the end of the 12th five-year plan. The current production capacity in the country is 0.385 million tonnes/annum thereby creating a significant gap which would primarily be met through imports from Middle East and China.

On application side, the downstream products of methanol are Acetic Acid, Formaldehyde, Di Methyl Ether, Methyl Tertiary Butyl Ether, Gasoline etc. which are major basic building blocks for majority of chemicals in India. The removal of duty on methanol will boost the downstream industry and will reduce outgo of foreign exchange from country also the resultant lower cost of production will increase the profitability of end products exported out of country. There exists strong opportunity in investment in methanol capacity in the country, but these are limited by feedstock (naphtha and natural gas) availability. In such a scenario, the government can incentivize the development downstream industry by removing custom duty on methanol.

It is requested that basic customs duty on feedstock Methyl alcohol should be reduced to nil as this will promote growth of downstream chemical industry products.

(c) Increase of Customs Duty rates of Ethyl Acetate

India is among the top 5 global producers and is a net exporter of ethyl acetate. India is dependent on Singapore for acetic acid imports which are used as input in the manufacture of Ethyl Acetate. In view of the lopsided FTA, the company which supplies the acetic acid as well ethyl acetate has a cost and logistic advantage. India is not able to compete with them.

Under the Singapore FTA, import of Ethyl acetate suffers 0% duty whereas Acetic acid is subject to 5.56% duty. Hence, there is an inverted duty structure which needs rectification. It is suggested that customs duty be imposed on Ethyl acetate at par with acetic acid.

3.2.3. Alkali Industry

The alkali industry in the country produces mainly Caustic Soda, Chlorine and Soda Ash. These products are the basic building blocks and find various applications as given below:-

Caustic Soda is used in the Soaps and Detergent Industry, Pulp and Paper Industry, Textile Processing Industry, Aluminium Smelting, Dyes and Dyestuff Industry, Plastic Polymers, Rayon Grade Pulp, Pharmaceuticals, Electroplating and Adhesives/Additives.

Chlorine, joint-product of Caustic Soda Industry, is very important for manufacturing PVC, one of the five major thermoplastic commodity plastics. Besides this, it is used in disinfection of drinking water, in pharmaceutical industry and various other chemical industries. Because of the strong oxidizing properties of Chlorine, it is effectively used to control growth of bacteria and viruses in drinking water thereby preventing the spread of water-borne diseases such as Cholera. Use of Chlorine is very important for countries like India especially in case of floods. Over 85% of the pharmaceuticals rely on Chlorine chemistry including medicines that treat heart disease, cancer, AIDS and many other life threatening diseases. Chlorine tablets are also used by public health workers in rural areas.

Soda Ash is used in Glass Industry, Soaps & Detergents, Silicates and various other Chemical Industries.

The present global capacity of Caustic Soda is estimated at 94 million MTPA while India's capacity is only 3.3 million tonnes i.e. a mere 3.5% of the world capacity, while China has a capacity of 44 million tonnes i.e. 47% of the world

capacity. Similarly the global Soda Ash capacity is 60 million MTPA. China has the largest capacity at 25 million MTPA or 41.5% of total global capacity, while India's capacity is only 3.1 million tonnes i.e. 5.2%.

The Indian industry is facing challenges due to high power cost, cheaper imports and impact of cascading duties and taxes.

These challenges affect the capacity utilization which is sub-optimal at less than 80%.

Following recommendations are made in this background:-

(a) Membrane Cell Plant / Electrolysers, Membranes & their parts for manufacturing Caustic Soda

None of these items are manufactured in India as manufacturing is cost intensive and the low demand does not justify investments in manufacturing. An exemption to these items from the current rate of 2.5% will improve the cost competitiveness of the industry who have invested nearly Rs.5000 crores in the past ten years to convert to energy-efficient and eco-friendly membrane cell technology for caustic soda production

It is requested that full exemption from the levy of Customs duty may be granted on imports of membrane cell plant / electrolysers, membranes & their parts for manufacturing caustic soda. This will have a revenue impact of Rs.1.2 crores per annum for spares and Rs.0.6 crores per annum for membranes The resulting higher production and duties paid thereon will offset this amount substantially.

(b) Caustic Soda and Soda Ash

India is facing challenges due to cheap imports from low power cost countries in South, SE Asia & Middle East. In terms of technology, India is second only to Japan in adoption of latest technology by investing substantially. However, the high cost of power renders Indian manufacturing at a comparative disadvantage.

It is suggested that basic customs duties on imports of caustic soda and soda ash may be increased from 7.5% to 15%

(c) Poly Vinyl Chloride (PVC)

Poly Vinyl Chloride (PVC) is probably the most important plastic. It is a basic product that goes into serving the basic needs of Indian people. Today unfortunately more than 1.4 million tons of PVC, representing more than 50% of the local demand, is imported into the country due to lack of local investment. The lack of incentive for creating local capacity in India has meant that, while PVC demand in India is growing at a rapid rate, unfortunately it is being serviced by imports – by companies who are serving the Indian market from their overseas locations, rather than by setting up capacities in India. The demand for PVC in India is growing at over 10% every year, and domestic manufacture is disadvantaged due to non-availability of ethylene and the high cost of power. This is resulting in very poor margins for domestic manufacturers, leading to a complete disinterest in capacity additions.

To redress this situation, it is recommended that duty on PVC be raised to 10% from the present level of 7.5%. This move will result in a positive revenue impact of around Rs. 190 crores. Increasing the duty will give an impetus to the domestic PVC industry and provide the incentive for further expansions and investment within India.

(d) Ethylene di-Chloride (EDC) and Vinyl Chloride Monomer (VCM)

EDC and VCM are key inputs in the manufacture of PVC. There is no local manufacture of these products for merchant sale in the Indian market; hence no Indian manufacturer will be affected by bringing down customs duty to nil. Facilities to manufacture these intermediates are usually set up only for captive use. This proposal will therefore not impact setting up of such facilities. In countries with developed petrochemical infrastructure, these are sourced off pipeline; in India, VCM is shipped under highly specialized conditions involving huge logistics cost, making domestic manufacturers uncompetitive compared to their international counterparts.

It is recommended that import duty on these, which is currently at 2.5%, be brought down to 0%. The revenue impact is reasonably small at around Rs. 90 crores, which is more than made up by the increased revenue that can accrue from an increase in Basic Customs Duty (BCD) on PVC resin.

3.2.4. Agrochemicals

Agrochemicals / Pesticides are an important ingredient for the agriculture sector along with good seeds and fertilizers. They need similar treatment for the purposes of levy of excise duty, as the fertilizer sector. Excise duty on pesticides (heading 3808 50 00 and 3808 91 11 to 3808 99 90) needs to be brought on par with the duty on fertilizers. Excise duty on technical grade pesticide and formulations is 12.50%. If this duty is reduced to 8% it will bring down the cost of pesticides to farmers and encourage country wide production leading to lower logistics costs.

3.2.5. Oleo Chemicals

The imports from ASEAN under ASEAN-India FTA incur a preferential tariff which has a slight negative impact on the domestic business. Under ASEAN FTA, in general import duty on most Oleo chemicals has been reduced, whereas the reduction in duty on input raw materials is much less thus rendering domestic chemical manufacturing industry uncompetitive. Following suggestions may be considered to revive the industry:

(a) Since ASEAN FTA is under review, duty structure hurting Oleo chemicals, Surfactants, Home and Personal Care Products needs to be reviewed by imposing reasonable import duties to protect domestic manufacturing industry. This is important as even after having very low or zero import duty on their finished products as per FTA, Indonesia / Malaysia continue to give economic advantage to their domestic manufacturers by imposing Export Duty on the raw materials like Palm Oil, Palm Kernel Oil and its fractions.

(b) Chapter 3401 and 3402 which cover all the surfactant, Soap Noodle, Personal and Home Care Products that use raw materials imported from Indonesia / Malaysia should be removed from ASEAN FTA and should be listed under normal track and an import duty of 15%, both under FTA and under General Tariff area (as it was applicable prior to its inclusion in ASEAN FTA) should be imposed immediately to save extinction of this industry segment.

(c) Fatty Alcohols covered under Chapter 382370 and Chapter 290517, which also depends on the raw materials from Malaysia / Indonesia, should also be removed from the ASEAN FTA and be listed under normal track and an import duty of 15%, both from FTA and from General Tariff area, be imposed on its import in to India. This will save the domestic industry from closure as it already has surplus manufacturing.

(d) Crude Glycerine is one of the key by-products of Oleo chemicals Industry and its pricing very much affects the economics of the main products manufactured from the oils. Currently there is an inverted duty structure for Crude and Refined Glycerine. Since India has sufficient glycerine refining capacity, it is recommended that import duty (both FTA and General Tariff) on Crude Glycerine (HS Code 15200000) should be reduced to zero and import duty (Both FTA and General Tariff) on refined Glycerine which is covered under HS Code 29054500 be increased to 15%.

(e) South East Asian manufacturers use Natural quality raw materials like Crude Palm Oil (HS Code 1511), Palm Kernel Oil (HS code 1513) for manufacturing high quality finished products. Indian manufacturers should also be allowed to import similar quality raw materials without a condition of minimum 20% FFA content at NIL rate of duty only for the manufacture of Soaps and Oleo chemicals on actual user conditions. For this purpose recent Notification No. 12/2014-Cus dated 11-07-2014 should be suitably amended.

3.2.6. Chemical Clusters

The Chemical Industry has special requirement of dealing with effluent discharge. This sector is important and there is a huge unrealised potential of growth as indicated by the present very low per capita consumption levels in the country

as also for export. Most of Indian Chemical industry is in small and medium sector and same restricts the capability of investment of entrepreneurs for adoption of newer technologies. The provision of common facilities in the form of good quality power/water supply, effluent treatment/incineration, testing and other logistic facilities such as chemical storage tanks, telecom/firefighting and rail/road connectivity can facilitate the sector. Further if related industries are set up in close proximity in an industrial estate, they could be vertically integrated resulting in a saving on the transfer cost of feedstock and finished goods. This, coupled with lower investment on infrastructure as a result of sharing, would tremendously improve their cost competitiveness. This will also help in containing the environmental load linked to the chemical industry. Existing hubs (brown field) will need slightly different approach. About 3-4 such chemical clusters based on the best models, could be set up in different regions of the country and these could become the role model for replication. Department of Chemicals and Petrochemicals is already facilitating cluster approach in plastics sector.

3.2.7. Technology Up-gradation Fund for Chemicals Industry

To remain globally competitive and comply with requirements of international conventions, Indian chemical industry needs to upgrade its technology to meet world standards and show improved performance in global trade. A number of chemical plants are of smaller capacities and operating at uneconomic scales of production with obsolete technologies. The industry, especially the micro, small and medium enterprise sector, does not have access to capital to upgrade technology on its own. Also, non-availability of technology leads to imports in some technology-intensive sub-segments.

To address these issues, the government may establish a "Technology Up-gradation & Innovation Fund" (TUIF) that can address specific technology issues, faced by the industry. The fund should also support setting up of common chemicals infrastructure (e.g. effluent treatment plants, chemical waste disposal plants, etc.), which would benefit industries and the environment. From this fund support may be extended to the chemical industry for technology up-gradation at lower rate of interest. This will help industry in improving quality of output and become more competitive.

3.2.8. Petrochemicals

Petrochemicals constitute a very important segment of world chemicals market, with a share of nearly 40 per cent. The industry is important as it has several linkages with other sectors of the economy. Petrochemicals have backward linkages with other industries in petroleum refining, natural gas processing and forward linkages with industries that deal in a variety of downstream products. Also, the industry offers alternatives, which serve as substitutes for natural products and hence, has the capacity to meet the constantly growing demand that would otherwise strain the natural resources. The petrochemical industry is facing financial difficulty with pressure on prices and margins, this has discouraged capacity expansion, investment in the sector is severely lagging demand growth. This is making the "Make in India" campaign infructuous. There are already large imports and huge outflow of foreign exchange. The situation would get aggravated with burgeoning trade gap. In the above back-drop, FICCI would like to make the following submissions for the Government's consideration.

(a) Feedstock and Inputs

(i) Feedstock is the major component of cost in petrochemicals. While in the Budget 2014-15, partial relief was given by reducing the import duty from 5% to 2% on feedstock like Ethane, Propane and Butane, duty on the largest feedstock for the industry - Naphtha, remained unchanged, Naphtha is also used for power and fertilizer production, wherein for fertilizer production it is exempt from import duty. This anomalous situation needs to be corrected.

(ii) Import duty on key petrochemical feedstocks Naphtha (HS code: 27101290) may therefore be reduced to 2.5% to bring it at par with other petrochemical feedstock. This in turn would increase the duty spread between the feedstock and end-product (polymers) and incentivize domestic manufacturing. Currently, the duty spread in India is one of the lowest in the world.

(iii) Liquefied Natural Gas (LNG) is a basic input to the chemical and petrochemical industry. In order to enhance the cost competitiveness of the industry, import duty on Mixed petroleum Gases / LNG (HS code: 27i12900) be brought down from 5% to 2.5%.

(iv) Import tariff on key petrochemical inputs EDC (HS code: 29031500), VCM (HS code: 29032100) and Styrene (HS code: 29025000) may be brought down from 2% to zero. There is very little production of many of these for merchant sale within the country and whatever capacity exists is essentially for captive use. There is no domestic production of Styrene and the entire Styrene requirement of the country is imported.

(b) Polyethylene (PET)

Polyethylene (PET) is one of the important raw materials extensively used by textile and the packaging industry. With the growth of retail, demand for PET is expected to rise rapidly, Most of the major plastics raw-materials attract 7.5% duty. India is having significant investment in its production and the country is a net exporter of this material, import duty on PET (HS code: 390760) may therefore be raised from the existing level of 5% to 7.5% thus bringing this at par with other major commodity plastics, The 3 tariff lines covered under the PET tariff subheading 390760 are 39076010, 39076020 and 39076090 of which 39076010 finds wide applications in the textiles sector.

(c) Engineering Plastics

India has a nascent engineering plastic production capacity. These are advanced materials with superior properties mainly used in critical applications in automotive, appliances, electrical, lighting and electronic sectors. India has reasonable investment for production of ABS and SAN. However, import duty on the materials continue to be at 5%. It is proposed that import duty on ABS (HS code: 39033000) and SAN (HS code: 39032000) be increased from 5% to 7.5% aligning this with other major plastic raw-materials.

(d) Synthetic Rubber

India has a growing automotive industry and associated tyre and rubber goods industry. The industry uses both synthetic and natural rubbers wherein import duty on the major synthetic rubber like SBR and PBR are at 10% level. The objective is to protect the natural rubber sector from large scale import of synthetic rubber. However, Butyl rubber or IIR has an import duty of 5%, much below the level applicable for other major synthetic rubbers. In view of this import duty on Isobutylene Isoprene Rubber (IIR) (HS code: 40023100) and Halo Butyl Rubber (Hilo lsobutene lsoprene Rubber-HIIR; HS code: 40023900) be raised from the existing 5% to 10% to rationalize the duty structure in the synthetic elastomers sector.

(e) Man-made Fibres and Yarns

The whole of textile industry has been demanding reduction in the excise duty on man-made fibre (MMF) and yarns to increase the domestic consumption. The present rate of 12.5% is very high and discriminates MMF with Cotton which has zero excise duty. This makes man-made textiles, used by masses, expensive. It may be noted the all spun yarns of cotton were given an optional route in 2004 and spun yarns of man-made fibres too given the optional route in 2006. A reduction in excise duty from existing 12.5% to 8% may be considered.

3.2.9. Indian Plastics Processing Industry

This is an important segment of Indian industry with usage in packaging, agriculture as also auto, medical and other segments as they replace items such as wood, metal etc. The sector has huge unrealized potential, going by the present very low levels of consumption in the country. Per capita usage is only about 10 kg in India as compared to about 100 kg in USA and 40 kg in China. Central Excise Duty on Plastic Polymers and Articles of Plastics Plastic products have replaced wooden products substantially:-

- 6000 MT of plastic furniture saves 140,000 cubic meter of wood or 32000 hectares of forest.

- Plastic crates have substituted almost 95% of wooden crates used in the soft drink industry.
- The only viable alternative to the wooden furniture is plastic moulded furniture. Plastics have been coming up as replacement of wood in furniture in a major way.
- Only PVC doors and windows, plastics crates, plastics furniture can save at least 17.5 million trees from cutting. Plastic based wood substitutes are amenable to recycling. To conserve wood, the Government of India in 1988 had issued a directive to promote wood substitutes, including plastics in all Government and institutional purchases for furniture, door and window frame and shutters.

The organized Plastic Industry is today hamstrung by the grey market – estimated to be as high as 40% -- on the one hand and under-invoiced, smuggled imports from China on the other. Reducing the central excise duty to 8% will bring down the cost spreads between organized segment and the grey market and correspondingly boost Government revenues both through better compliance and increased turnover. It is requested that Central Excise duty on plastic polymers and articles of plastics be reduced from 12.5% to 8%.

Imports of articles of plastic are taking place at low and unjustified prices. Articles of plastics are also imported under CChapters 42, 56, 63, 67, 90, 94, 95 and 96, the volumes whereof are also growing. It has been recommended by the subgroup on the Plastic Processing Industry constituted by the Department of Chemicals and Petrochemicals that Customs Duty on differential between Plastic Polymers and Processed Plastics Goods should be 10%. Keeping these factors in view, it is essential that import duty structure on imports of articles of plastics is re-calibrated to increase import duty on plastic goods from current 10 % to 15%. It may be noted that import duties in many of countries in the region are in the range of 15-20%.

3.2.10. Technology Up-gradation Fund for Plastics sector

Existing units need up-gradation/installation of new plant and machinery in place of old plant and machinery. Technology up-gradation fund scheme (TUFS) for Plastics industry is needed badly. This will provide loan to units at subsidized rates to Plastics Processors for the purchase of new machinery for up-gradation. The Indian plastics processing and converting industry has large population of older technology machinery and thus does not have the same technological edge to remain competitive in costs and quality compared to our global competitors. The proposed Scheme aims at making available funds to the domestic plastics processing and converting industry for technology up-gradation of existing units as well as to set up new units with state-of-the-art technology so that its viability and competitiveness in the domestic as well as international markets may enhance. There is increasing competition from China and other countries not only in the international market, but also in the domestic market. To meet the challenges the industry is required to become competitive, cost effective and quality oriented. This will make the industry competitive.

3.2.11. Setting up of Centres of Excellence

Centres of Excellence (COE) are needed for dealing with specific issues/segments in the chemical industry as follows:-

(a) Indian Bureau of Corrosion Control - India loses a colossal figure of over Rs 2 lakh crores every year due to the menace of corrosion. The annual cost of corrosion worldwide is estimated to be $2.2 trillion. Corrosion has a huge economic and environmental impact on virtually all facets of the world's infrastructure, from highways, bridges, and buildings to oil and gas, chemical processing, water and wastewater systems and particularly industrial structures. A Centre of Excellence (COE) jointly with industry can help identify the causes and measures to deal with corrosion including awareness generation.

(b) Agrochemicals, Dyes/Colourants and Pesticides - This segment of industry has huge potential and needs to be encouraged. More than 60% of production from these sectors in India is getting exported, indicating the potential of the sector from a global perspective. A COE for this segment will be helpful.

(c) Fire-Retardant Chemicals - Accidental fires are causing huge losses. (Estimated loss of lives is 25000 persons per annum, besides huge economic cost). In modern homes where rooms contain upholstered furniture, varied electrical and electronic equipment, (made mainly of plastic components) and other consumer goods, fires can develop rapidly and violently. The focus so far has been on fighting fires, after they have taken place. There have been recent developments in the sector in relation to chemicals which retard/prevent fire. There is need to encourage and create awareness about these developments in the chemical industry. The focus of flame retardants is on fire prevention rather than fire mitigation. It is important to bring out issues related to the safety aspects and also the potential of chemicals for fire safety in a preventive mode as also in an environment friendly manner. We propose setting up a Centre of Excellence for the Fire Safety aspect.

3.2.12. Reverse SEZs - Setting up of Chemical Complexes in Resource Rich Countries

The concept envisages Indian Companies to invest into such a zone established in resource rich countries, to use the cheap gas/resources available to make chemical building blocks and bring them to India for the country's needs. Both countries will be benefited as investments flow to that country as also jobs get created. India receives assured supply of intermediates/chemicals for final value addition in the country

The country is deficit in cheap energy sources particularly natural gas and needs to depend more and more on fuels such as LNG. The local availability of gas is very limited and unable to meet total needs and the country needs to depend on imported LNG. On the international scenario with new discovery of shale gas in the USA and recent discoveries in Africa, the local gas prices in these countries are now between $2 to 3/MMBTU. Learning from other countries, such as China where energy and mineral needs have pushed the country to source these inputs in far flung regions, such as Brazil, Africa etc., India needs to similarly progress in order to secure its needs in energy and building blocks. The closest energy/gas availability in abundance in countries around India is as those in Africa, Middle East and on the eastern border of India. However, since these countries are politically unstable, it is always a high risk for an individual Company to set up gas based manufacture of basic building blocks in these countries. It is therefore, proposed that the Indian Government help create a Special Economic Zone (SEZ) in these countries and maintain a politically stable relationship with the local Government. Various Indian Companies would be interested to invest into such an SEZ to use the cheap gas available to make chemical building blocks and bring them to India for the country's needs. The Reverse SEZ would be blessed with political stability due to the Indian Government and economic attractiveness due to cheap availability of gas in these countries.

The biggest beneficiary would first be the Fertilizer industry which would be able to get gas, its major input at a price which would be 1/4th of its current price. It is expected that every fertilizer plant with an individual capacity of 1500 tons/day would be able to save about a thousand crores every year, thereby contributing to reduce subsidies permanently. The Petrochemical industry could look at making basic building blocks along with the Fertilizer industries in these Reverse SEZ areas such as Ammonia, Methanol and other C1 chemistry products. Cheap availability of C1 building blocks from the Reverse SEZ area will help assure large investments on downstream products in India (home market) India could also explore opportunities to make power based on crude/cheap Methanol being imported instead of LNG. Some countries so identified include Mozambique, Iran, Oman and Myanmar.

CIGARETTES

3.3.1. No Increase in Excise Duties

As a result of a taxation policy targeting the cigarette segment, the share of cigarettes has been declining over the last 30 years. With the last hike in excise duty affected in Union Budget 2015, the increase over the last 4 years aggregates to a 98%. The issue is compounded by arbitrary increase in State Taxes on cigarettes – with rates as high as 42%. Consequently, India is amongst the countries where cigarettes are least affordable.

The illegal cigarette segment comprising both contraband (customs duty evaded) and excise duty evaded domestic cigarettes, continued to grow and at 23 billion sticks currently accounts for nearly 20% of the total cigarettes sold in India.

Declining volumes of legitimate duty-paid cigarettes in the national market has not only resulted in reduced domestic off-take of tobacco but, coupled with withdrawal of export incentives under the new Foreign Trade Policy exposed Indian farmers to exploitation by foreign buyers. Besides loss of revenue to the Government, millions of persons in the cigarette value chain - whose livelihoods are supported by the cigarette Industry like farmers who grow cigarette type tobaccos, small retailers running cigarette vending kiosks, distributors, salesmen etc. - would also be adversely impacted.

It is a well-established principle of fiscal policy that moderation and stability in rates is not only one of the most effective means of increasing tax revenue, but also of widening the tax base. In order to enable the legitimate industry to effectively combat the menace of illegal cigarettes, facilitate shift in tobacco consumption into revenue-efficient cigarette form and to provide impetus to revenue buoyancy it is strongly recommended that current excise duty rates for cigarettes be maintained to enable recovery and optimisation of Government revenue.

3.3.2. Continuation of Length Based Specific Duty Structure of Excise for Cigarettes

Length based specific excise duty structure is a simple, transparent method of taxation which is easy to administer and which has no potential for valuation disputes. It has enabled manufacturers to position their products at various price points, across different socio economic strata of the Indian society. It has also facilitated introduction of high quality products – benchmarked to international brands - resulting in increased demand for high quality Indian tobaccos leading to improved farmer earnings. Retention of this structure has been recommended repeatedly by eminent economists like Dr. Raja Chelliah and Dr. Vijay Kelkar.

Therefore, it is recommended that length based specific excise duty structure on cigarettes be retained.

3.3.3. Review of Length based Segments in the Cigarette Duty Structure

The existing excise duty structure where different length based segments are subjected to different rates of excise duty was designed keeping in mind the diverse socio economic profile of the Indian populace and the need to offer products at different price points in line with their affordability-profile. Accordingly the Industry has been offering a 'laddered' portfolio of products at multiple price points catering to the needs of all sections of the Society.

However, the Union Budget 2014 has deleted the 'greater than 75mm but less than or equal to 85mm' category and combined this with 'Others' segment presumably to simplify the excise duty structure. Given the diversity in the socio economic profile of the Indian populace, it is important to have multiple length based tax points. This facilitates the industry to make offers tailored to meet the requirements of each section of the society.

Secondly, in the 'less than 65 mm segment', the cumulative increase in excise duty rate has been a steep 109% in the last 2 Union Budgets. This segment had enabled the legitimate industry to hold on to Rs. 2 price point thus helping partial retention of volumes, which would have otherwise gone into illegal segment, within its fold. The recent increase has forced the industry to vacate the crucial Rs. 2 price point. This puts the legal industry at a severe disadvantage.

In order to effectively combat the menace of illegal cigarettes, there is a need for a new segment of 'less than 60mm length' with an excise duty of Rs. 200 per thousand cigarettes. Therefore it is recommended that -

(i) The existing length based segments should be continued

(ii) A new length segment of 'less than 60mm length' be introduced with an excise duty of Rs. 200 per thousand cigarettes

(iii) In addition, the rate of Central Excise duty on the 65 mm filter cigarette slab be reduced from the existing level of Rs.1440 per thousand cigarettes to the earlier level of Rs.689 per thousand cigarettes

3.3.4. Standardise Tobacco Taxation across all types of Tobacco Products

Unlike most countries in the world, cigarettes account for less than 11% of the total tobacco consumption. In fact, with 17% of the global population India accounts for only 1.8% of global cigarette consumption. On the other hand, India accounts for about 84% of the global Non-smoking Tobacco consumption. Besides, biri and smokeless tobacco forms are known to be potentially more dangerous than cigarettes since most manufacturers produce inferior quality, cheap products with higher tar, nicotine deliveries which are more harmful for consumers. Smokeless tobacco is popular amongst women and children as the fear of detection is less and it does not attract social sanction like smoking.

In order to ensure sustainable tax buoyancy from tobacco it is recommended that the tax base is widened by bringing in the large unorganised segment of the tobacco sector into the tax net, and the large differential in central excise rates between cigarettes and other tobacco products reduced gradually. Registration of all manufacturers of tobacco products must be made compulsory.

3.3.5. Exempt Excise Duty on Cigarettes used Captively for Testing

Currently excise duty is applicable on all cigarettes which are used in non-destructive quality testing. Innumerable disputes have arisen with the Department on what machine tests are destructive. Further, costs have also increased by way of duty paid on cigarettes used in non-destructive quality tests. It is recommended that full duty exemption to cigarettes used for quality testing purposes should be provided.

3.3.6. Paper Rolled Biris

In order to evade high excise duty that is payable on cigarettes, certain smoking products masquerading as “Paper Rolled Biri” have mushroomed in the market. These products are claimed to be hand-made and are sold at about Rs 0.25 paise per stick. They look and smoke like regular cigarettes and are sold in packages which are also very similar to cigarette packages and yet they are claimed to be Biris and therefore escape all taxes that are payable on Cigarettes. Currently Paper Rolled Biris are classified under 2403 19 29 as “Biris – Others”.

A Chapter Note in Chapter 24 of the Central Excise Tariff should be inserted to clarify what constitutes a Biri and how the so called “Paper Rolled Biri” is to be classified. It is suggested that for this purpose reliance is placed on the definition of biri as stated in the Indian Standards (IS) 1925:1992. The Chapter Note must also clarify that a product comprising of tobacco wrapped in paper must be classified as “cigarettes”. A suggested draft of the Chapter Note is given below.

“Biris shall be either conical or cylindrical in shape and only consist of biri tobacco mixture and the wrapper leaves to hold the contents. Any smoking product comprising of tobacco wrapped in paper, with or without filter, will be classifiable as cigarette.”

It is recommended that paper rolled biris be classified as cigarettes and appropriate excise duty based on length be imposed.

CIVIL AVIATION

3.4.1. Issuance of Tax Free Infrastructure Bonds

To facilitate the private airport operators to raise funds, it is recommended that they should also be allowed to issue tax free infrastructure bonds to the public. Further, the investments in these bonds should be notified for the purpose of claiming deduction under Section 80CCF of the Act and the applicability of Section 80CCF should be extended to cover the investments made from financial year (FY) 2016-2017 onwards.

3.4.2. Support Services of Airport to be termed as Infrastructure

In the airport sector, there are many ancillary/support services and facilities required which are essential for smooth functioning of airports. These include fuel facility, parking, cargo facilities etc. No airport can function in the absence of these facilities as these are life line for airport.

In the absence of clear definition of 'Airport' under the current Section 80-IA of the Act, it leaves an ambiguity whether these facilities are entitled to benefit of Section 80-IA of the Act or not. FICCI recommends that benefit under Section 80-IA of the Act be extended to cover these facilities as well.

3.4.3. Other Tax Issues

(a) Section 72A of the Act be amended to extend the benefits therein to the entire airline industry and not only to public sector companies with a view to provide the private airline operators a level playing field as well as sustaining the current growth of the civil aviation sector.

(b) To provide impetus to manufacturers of critical components of an aircraft, the period for 100% deduction under section 10AA(1)(i) of the Act may be extended to 8 years from existing 5 years for new units which are engaged into manufacture of critical components to Aerospace Industry.

(c) Tax incentives for development of Maintenance, Repair and Overhaul ('MRO') facility in India be provided. It will help airlines to reduce cost of repairs presently carried overseas and will also develop India as a hub for such facility.

E-COMMERCE

3.5.1. Provide Exemption from TDS on Payment to E-Commerce Service Providers

Currently, the provisions of section 194H, 194-I and 194C of the Act mandate deduction of tax at source on accrual or payment of commission, warehouse rent or service charges to a service provider by the principal. However, in the e-commerce business, the e-commerce service provider collects the entire sales consideration from the end customer and pays the amount (net of commission, service charges) to the actual seller of goods or services; similar to the credit card industry.

In order to comply with the stringent TDS compliance requirements, the principal sellers of goods and services have to await computation of commission/service charges and remittance of sales consideration from e-commerce service provider and then deposit applicable TDS thereon. Presently, the e-commerce sector serves several thousands of small and medium enterprises and it is practically very difficult for the latter to comply with TDS provisions.

It may be worth-while to note here that a similar situation was faced by credit card issuers who retain their share of commission and remit sales consideration (net of commission) to the sellers of goods and services. To ease the burden of TDS compliance on such sellers of goods and services, CBDT issued a notification no.56/2012 dated 31.12.2012 as per which the commission paid to banks on credit card and several other services was exempted from the purview of TDS. It is accordingly recommended that the requirement to deduct tax at source by manufacturers or traders on retention or deduction of commission or service charges or rental etc. by the e-commerce companies be dispensed with. Alternatively, the e-commerce companies may be required to deposit a prescribed sum (say 1% of commission, service charge etc.) to the Government at the time when sales consideration becomes payable to the actual seller of goods or services or at the time of actual payment of such sales consideration.

3.5.2. Restriction on Carry Forward and Set-off of Losses

Currently, as per the provisions of section 72 of the Act, business loss can be carried forward and set-off for a period of 8 years subject to certain restrictions prescribed under section 79 of the Act. Given the capital intensive nature of

the e-commerce industry and huge gestation period typically experienced by e-commerce companies, the time-limit of 8 years may not be sufficient for absorption of the losses. Further, section 79 restricts the e-commerce companies from carry forward and set off losses in case shareholding varies by 51 percent or more in the year in which the loss is considered to be set off vis-a-vis the year in which the loss is incurred. While the Securities Exchange Board of India has also approved enabling provisions for technology based start-ups and other companies to raise capital by leveraging institutional platforms, the provision in the Act as it stands today, actually discourages an investor to invest in start-up (where the natural window of setting off of losses for the legal entity is narrowed down or restricted even for genuine cases where the reason of change in shareholding is capital infusion and not really change of management and control of the entity).

There is a need for a clarification/circular to be issued by the Government stating that restriction prescribed under section 79 of the Act will not apply to start ups where change in shareholding pattern is due to infusion of funding by investors without change in the management of the company run by original founders and the rigours of section 79 of the Act should be restricted to cases where the change in shareholding is effected with a view to avoid or reduce tax liability by way of a restructuring exercise. A timely clarification to resolve this anomaly for the benefit of entire start-up ecosystem will help in promoting research and innovation in new areas, creating business and start-up culture which will lead in employment generation for millennial generation and in making the Digital India dream come true.

It is further recommended that the time-limit for carry forward and set-off of business loss be extended from the current period of 8 years to 12 years under section 72 of the IT Act to enterprises operating in the field of e-commerce.

3.5.3. Allow carry forward of losses under Section 72A

A large number of investments are made in start-ups in technology oriented sector like e-commerce. A large number of companies make substantial losses in their initial stages but the said losses are not available for carry forward and set off in the hands of the acquiring companies. There is a need to widen the scope of Section 72A to include technology enabled e-commerce companies so as to encourage consolidations through mergers, acquisitions and internal restructurings.

It is recommended that the definition of the term “industrial undertaking” under section 72A of the Act should be broadened to include all kinds of information technology oriented service companies.

3.5.4. Allow Weighted Deduction under Section 35(2AB)

Section 35(2AB) of the Act provides 200% weighted deduction on scientific research expenditure incurred by companies who are engaged in the business of bio-technology or in any business of manufacture or production of any article or thing or computer software. Several e-commerce companies invest heavily in developing and designing warehousing and logistics processes to handle millions of products situated in multiple locations through robotic or other processes. It is recommended that the provisions of section 35(2AB) of the Act should be widened to extend the tax benefits of the research and development to e-commerce service providers who use technology to develop various tools in the course of/for rendering service. This would also be in line with many foreign countries where the R&D incentive provisions are liberal and not restricted to a brick and mortar setup.

3.5.5. Concurrent demand of CST from Origin State and local VAT from the Destination State

The provisions of section 9 deal with the levy and collection of tax and penalties under the Central Sales Tax Act, 1956. It explicitly states that tax shall be collected by the state from which the movement of goods commences. However, due to revenue collection pressures and lack of awareness, the VAT authorities of states to which the goods are consigned also demand VAT with respect to sales made to the consumers in their respective states. In other words, there is a double claim of tax -from the origin state from which the movement of the goods occasioned and the destination state where the consumers are located.

The current appeal and fast track dispute resolution mechanism provided u/s 18A of CST Act, 1956 prescribe that if a dealer receives a tax demand u/s 6A(2) or (3) from a state on stock transfer of goods and on whose sales he has already paid tax in another state , he can directly appeal to VAT tribunal of the origin state. However, no such appeal procedure has been prescribed for a vice-versa situation i.e. where the Central Sales Tax has already been paid in one state on inter-state sales of goods and where the other state also demands VAT on the same, alleging the same to be local sales in its state. In most of the states, a tax payer is even compelled to make a substantial pre-deposit to even file an appeal before the first appellate authority. Further, in an eventuality of such inter-state transaction being held as local sale, there is no recourse to claiming refund of CST paid to the Origin state; or for the settlement of the tax paid amongst the States.

In wake of the above, it is recommended that expeditious appellate mechanism prescribed under section 18A of the CST Act, be extended to disputes entailing whether transaction qualifies to be inter-state sale under section 3 of the CST Act, involving two States seeking to tax the same transaction (i.e., the origin State seeking to tax the transaction as an interstate sale and the destination State seeking to treat the transaction as a local sale).

3.5.6. Scope of the Authority for Advance Rulings

It is requested that Advance Ruling Authority constituted under the CST Act may be empowered to issue clarification in respect of the following amongst others:

- CST liability on transactions entailing interstate movement of goods
- CST liability on transaction in the course of export or import

This mechanism should aid in reducing litigation and in providing certainty of tax position to dealers.

EDUCATION

3.6.1. School Education

Education is one of the most important sectors of any growing economy like India. Education and skill development are crucial for reaping the demographic dividend. India is expected to have one of the youngest populations in the world with the median age being 32. Considering the importance of education and skill development, the Government of India has set itself an aggressive target of achieving 30% gross enrolment ratio ('GER') in higher education by 2020, which translates into substantially increasing the GER in the next eight years from the current GER at 22.5% (2013-14E) .In school education, the current GER of 69.3% is expected to grow to 95% by 2022.

Under the current regime, pre-school and school education has been excluded from the service tax net. Further, education recognized by law and vocational educational courses have also been excluded. Thus, most of the education services are not taxed currently.

Educational institutions procure a variety of input services in order to run the institutions and provide educational services. Prior to amendments made in the Union Budget 2014-15, 'auxiliary educational services' procured by educational institutions were not liable to service tax. The term 'auxiliary educational services' was quite broad and included within its ambit outsourced services procured by educational institutions. In the Union Budget 2014-15, the list of input services eligible for exemption was pruned down to just four services, namely transportation, catering, security / cleaning / housekeeping and any service relating to admission to, or conduct of examination.

Post the amendment in Union Budget 2014-15, the scope of exemptions available to the education sector have been curtailed by excluding services such as renting of immovable property, development of course content, services pertaining to training of teachers, courseware development etc. This has hampered the education sector, since the cost of educational services provided by the institutions has increased on account of service tax on these input services which cannot be claimed back by the educational institutions.

In addition, the educational institutions also pay Value Added Tax (VAT) on the purchase of goods which are used for imparting education such as computers, classroom furniture and stationery etc. This VAT is also a cost for educational institutions since there is no output VAT liability.

Based on the data of educational companies, the total cost of running an educational institute includes the cost of input tax in the range of 6% to 8% which is ultimately passed on to the customer i.e. the student.

It is recommended that the tax treatment of the education sector prevailing prior to the changes in the Union Budget 2014-15 may be restored.

3.6.2. Higher Education

Following incentives/exemptions may be provided in the context of higher education:-

A. To address the shortage of faculty in the country, the Government should expedite the launch of National Mission for Faculty Development and provide a tax relief to the tune of 50% to Universities / Higher Educational Institutions that spend on the capacity development and training of their staff.

B. Given the priority of Skill Development in the national agenda , Government should make the following provision-

- Any person enrolling for a Skills Certification course be eligible for a 20% tax rebate (only applicable for the tuition fee amount)
- Any Educational Service Provider opening a Skills Centre in a backward area should be given an exemption from income tax for the first 3 years.

C. All donations (and not just restricted only to research funding) to qualified Higher Educational Institutions should be eligible for 200% tax deduction

D. New or existing educational institutions making a fresh investment of Rs. 75 crores or above should be eligible for a preferred and long term Loan facility with interest rates at par with Base Rates or Prime Lending Rates of the commercial banks or financial institutions and for a tenure of up to 15 years with step up repayment plan

E. Higher Educational Institutions should be free to set up campuses overseas freely and a line of credit of at least $500m should be set up by the Exim Bank, as a part of India's diplomatic efforts and use of soft power

F. Tax break to corporates which nominate their employees for higher education either through the continuing education model or a full time program. The fees paid by corporate for employees' education should qualify for investment in human resources and hence exempted for tax purposes.

G. As colleges fees have increased tremendously income taxpayers should be allowed a deduction against gross total income up to a minimum of Rs 1,00,000 per child for fees paid to a higher educational institution recognized by Government. This will mitigate the cost of Higher education.

H. Industries setting up higher education research institutes at an investment of 20 crores or more with respect to National Security Advisory Board, Government of India document on " Strategic Industries and Emerging Technologies for a Future-Ready India" in key identified areas of Micro and nano-electronics, Advanced Materials, Photonics should be eligible for a preferred and long term Loan facility with interest rates at par with Base Rates or Prime Lending Rates of the commercial banks or financial institutions and for a tenure of up to 10 years with step up repayment

I. Industries investing to the tune of Rs.20 crores or more in product focussed research institution similar to the Fraunhofer Institutes in Germany should be eligible for a preferred and long term Loan facility with interest rates at par with Base Rates or Prime Lending Rates of the commercial banks or financial institutions and for a tenure of up to 10 years with step up repayment

J. Manufacturing industries investing in technical skill development institutes to the tune of 5 crores or more similar to University of Applied Sciences or Hochschule (primarily vocational or technical on par with University) should be eligible for a preferred and long term Loan facility with interest rates at par with Base Rates or Prime Lending Rates of the commercial banks or financial institutions and for a tenure of up to 5 years with step up repayment.

FINANCIAL SERVICES

I - INSURANCE

3.7.1. Period of Carry Forward and Set-off of Losses in Case of Insurance Business

The insurance industry has a long gestation period and it takes a long time to achieve a break-even. Accordingly, the limit of 8 years for carry forward and set off of business losses is not sufficient. Considering the importance of Insurance Sector for the Indian economy, it should be allowed to carry forward and set-off unabsorbed business losses for an indefinite period.

3.7.2. Sum Assured to Premium Ratio for Life Insurance Policies

Tax benefits under Section 10(10D) and Section 80C of the Act in respect of life insurance policies are available only in case where premium payable for any of the years during the term of the policy does not exceed 10% of Actual Capital Sum Assured. This makes the Life Insurance policies unattractive for middle and higher age groups given that there is an exponential rise in the cost of mortality after age 45. Given uncertain macro-economic circumstances, customers are unwilling to enter into very long premium payment commitments.

It is suggested that the sum assured multiple be lowered to 5 times of the premium paid or the tax benefits should be linked with the tenure of the policy rather than the sum assured and accordingly, the tax benefit should be given only on policies with a minimum tenure of 10 years.

3.7.3. Enhanced Deduction of Life Insurance Premium under Section 80C of the Act

Section 80C of the Act basically provides for a deduction up to Rs 150,000 for investments made in various savings instruments such as mutual funds, bank deposits along with long term savings in life insurance plans, pension plans, etc. In order to encourage growth in the life insurance segment it is recommended that the Government should increase the limit of deduction for life insurance premium/ by creating a separate limit for deductibility of life insurance premium along with an overall enhancement in the investment limit under section 80C of the Act to at least Rs 200,000.

3.7.4. Deduction in Respect of Insurance Premium

Presently, deduction under Section 80C of the Act is available for payments made for life insurance premium and deduction under Section 80D is available for payments for medical insurance premium. On similar lines, it is suggested that premium paid for personal accident policy, home insurance and travel policy should be allowed as deduction to the policy holders.

3.7.5. Discrimination in Taxation of Pension Products vis-a-vis Non-Pension Products

There is discrimination in tax treatment of pension products vis-a-vis non-pension products under the Act to the extent that any amount received from the pension fund (including interest or bonus) [on surrender or on receipt of pension under the annuity plan] is entirely taxable, however, in case of life insurance policy/ Unit Linked Insurance Policy (ULIP), the entire maturity proceeds are tax exempt, if the conditions prescribed in Section 10(10D) of the Act are satisfied. Even if the conditions prescribed under Section 10(10D) of the Act are not fulfilled; only income portion in the surrender value (i.e. surrender value – premiums paid) is taxed. Thus, there is discrimination in the taxability of pension vis-a-vis

non-pension products under the Act. This also leads to taxation of return of capital in case of pension products which is highly unjustified.

Considering the importance of pension products in India due to lack of any other Social Security measures, taxability of Pension products should be treated at par with traditional and ULIP products. It is further recommended that similar provisions of reversal of deduction in case of surrender of Non-Pension products can be made applicable to the Pension products as well and only the income portion in the surrender value should be considered for taxability.

3.7.6. Taxability of Re-insurance Premiums earned by Foreign Re-insurers

It should be explicitly clarified that the re insurance premium earned by foreign re insurers from Indian insurance companies wherein no part of the operations of the reinsurer are carried out in India is not liable to tax in India. Further, in order to allay the apprehension of foreign re insurers, it is recommended that clarity be provided on the aspect of taxability of re insurance premium paid by Indian insurance companies by clarifying that the withholding tax provisions shall not apply to payment made by Indian insurance companies to foreign re insurers.

3.7.7. Adjustment of TDS in case of Free Look Cancellations

Insurance Regulatory and Development Authority (IRDA) allows policyholders to cancel the policy during the free look period (currently set to 15 days). In case of cancellations during free look period, the commission income accrued/ paid to agents needs to be reversed/ recovered. It should be provided that taxes that were already deducted under Section 194D of the Act and paid to the Government Treasury on the commission amounts, which no longer would be payable on account of free look cancellations, should be allowed to be adjusted in meeting the subsequent TDS liability of the insurers or alternatively, a mechanism should be laid down for claiming refund of such excess TDS deposited.

3.7.8. TDS on Policy Holders' Pay-out

Section 194DA of the Act was introduced vide the Finance Act (No 2), 2014, for applying TDS on policyholders pay-out where amount exceeds Rs 1 Lakh. This Section should be repealed as it is detrimental to the insurance business. The low threshold of Rs 100,000 not only increases the compliance burden for insurers but also causes small taxpayers and persons not requiring to otherwise file the tax returns to do so for claiming of refunds. This is ideally not desirable. The threshold limit of Rs 1 Lakh under Section 194DA should be enhanced in line with the basic exemption limit applicable to individuals. Also, clarity is required on the following issues:

a) Whether Section 194DA of the Act would apply to other products issued by insurance companies as permitted by IRDS such as health insurance policy, pension plan, group insurance policy like gratuity, superannuation etc.?

b) Whether Section 194DA of the Act would apply to reversionary bonus and terminal bonus, where bonus gets converted into premium?

c) What would be treatment in case of partial surrender of policy?

3.7.9. Enhance Threshold Limit for TDS on Insurance Commission

The threshold limit for deduction of tax at source under section 194D of the Act may be increased to Rs. 50,000/-. Further, the requirement of issuance of TDS certificate under section 194D of the Act on a quarterly basis may be dispensed with and may be allowed to be issued on yearly basis as done under section 192 of the Act.

3.7.10. Extend the Deduction under Section 80CCD to Approved Pensions Plans of IRDAI

There are specific tax benefits available for contributions to the NPS under section 80CCD of the Act. It is recommended that the same benefit be also extended to the Insurance Regulatory Development Authority of India ('IRDAI') approved pension plans offered by life insurance companies.

3.7.11. Taxation of Income Distributed by Securitization Trusts to Insurance Companies

Given the peculiar nature of life insurance business, the profits of life insurance companies are taxable at the rate of 12.5% as per Section 115B of the Act. Insurance law permits life insurance companies to invest in the securities issued by the securitization trust. A levy of additional-tax @30% on income distributed by securitization trust to life insurance companies can have the impact of reducing the return in their hands on such investments and consequently, reducing the returns that can be distributed to its policyholders. It is recommended that the income distributed by securitization trusts to life insurance companies should also be provided a special tax treatment whereby income so distributed shall be subject to additional tax @12.5% and not @30%.

The income of a fund set up by the life insurance company under a pension scheme, which is approved by IRDA, is exempt from tax under Section 10(23AAB) of the Act. It should be clarified that no additional tax would be payable in respect of income distributed by the securitization trust on investments made from IRDA approved pension fund set up by a life insurance company.

3.7.12. Tax Treatment on Assignment of Keyman Insurance Policies

The Finance Act, 2013 has made an amendment to Section 10(10D) of the Act to provide that a keyman insurance policy which has been assigned to any person during its term, with or without consideration, shall continue to be treated as a keyman insurance policy. Accordingly, the maturity proceeds received under such a policy is not exempt under Section 10(10D) of the Act. It may be noted that CBDT vide Circular no. 762 dated 18th February, 1998 has clarified that the surrender value of the policy, endorsed in favour of the employee and in case of other persons having no employer-employee relationship, be treated as “profits in lieu of salary” or “income from other sources” respectively and to be taxed accordingly. The situation would trigger double taxation since the surrender value of the policy at the time of assignment would get taxed in the hands of the assignee and further, the maturity proceeds will be also be taxed after the amendment made to the provisions of Section 10(10D) of the Act.

It is requested that, CBDT should issue a clarification to provide that the maturity proceeds under a keyman insurance policy should be reduced by the amount on which tax has already been paid at the time of assignment of such policy.

II - NON BANKING FINANCIAL COMPANIES (NBFCs)

3.7.13. Exclusion of Interest paid to NBFC from the Provisions of Section 194A of the Act

NBFC’s have to face severe hardship in terms of collection of TDS certificates from its customers whose numbers run in thousands. Therefore, payment of interest to NBFC’s should be excluded from the purview of provisions of Section 194A of the Act and tax collections through NBFC’s should be made by way of advance tax. This will provide level playing field to NBFCs similar to banking companies, LIC, UTI, public financial institution etc., which are also exempted from the purview of this Section.

3.7.14. Deduction for Provision for NPAs for NBFCs and Treatment of Recognition of Income

As per the provisions of Section 36(1)(viia) of the Act, provisions for bad and doubtful debts (if made as per RBI directions) made by banks are allowed as a deduction to the extent of 7.5% from the gross total income and 10% of aggregate average rural advances made by them. NBFCs are now subject to directions of RBI as regards income recognition and provisioning norms. Accordingly, NBFCs are also compulsorily required to make provisions for NPAs. However, the deduction under Section 36(1)(viia) of the Act is not available to NBFC. This discrimination severely impedes functioning of NBFCs. NBFCs are vital channel for credit delivery especially to the under-privileged segments of the society, it is essential that such discriminations between NBFCs and banks be eliminated. This inconsistency may be resolved by including NBFCs/NBFC-MFIs also in Section 36(1)(viia) of the Act.

Section 43D of the Act recognises the principle of taxing income on sticky advances only in the year in which they are received. This benefit is already available to Banks, Financial Institutions and State Financial Corporations. In accordance with the directions issued by the RBI, NBFCs follow prudential norms and like the above institutions are mandatorily required to defer income in respect of their non-performing accounts. It is accordingly recommended that the provisions of Section 43D of the Act should also be made applicable to NBFCs registered with RBI.

3.7.15. Deduction for Reserves to NBFC-MFIs (Micro Finance Institutions)

Section 36(1)(viii) of the Act provides deduction in respect of special reserve created and maintained by a specified entity, to the extent of 20% of the profits derived from eligible business. The deduction is available to a reserve created by a financial corporation engaged in the business of providing long-term finance for industrial or agricultural development in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes. NBFC-MFIs also provide long-term finance for agricultural and industry in the form of micro-credit/small loans but are not eligible for deduction under Section 36(1)(viii) of the Act. It is, therefore, suggested that NBFC-MFIs should also be included as specified entity eligible for claiming deduction under Section 36(1)(viii) of the Act.

III - BANKING

3.7.16. Extend Provisions of Section 43D to 'Non-Performing Securities'

Section 43D of the Act provides that in the case of a scheduled bank, income by way of interest in relation to prescribed categories of bad or doubtful debts, shall be chargeable to tax in the previous year in which it is credited by the scheduled bank to its profit and loss account; or in which it is actually received by the bank, whichever is earlier. A suitable amendment may be brought into the law to provide that the provision is applicable to non-performing investments as well.

RBI guidelines require interest on non-performing securities to be reckoned as income on realisation basis, whereas for tax purpose it is to be reckoned on accrual basis. The benefit of section 43D may be extended to taxation of non-performing securities as well which would be in line with RBI guidelines.

Further, Rule 6EA of the Rules provides the criteria for determining the prescribed categories of bad and doubtful debts for the purpose of section 43D, which continues to recognize bad and doubtful debts on the basis of 6 month overdue delinquency norms. Rule 6EA should be amended in line with current RBI guidelines which provide for a period of 90 days of overdue delinquency norms to recognise bad and doubtful debts. Section 43D of the Act provides for taxation of interest on bad or doubtful debts having regard to the guidelines issued by the RBI in relation to such debts. Rule 6EA has however not kept pace with the changes with RBI guidelines which creates an issue in the assessment of banks.

3.7.17. Provide Exemption on Deduction of Tax at Source on Income of Banks

TDS on the income of banks cause considerable inconvenience in view of huge volumes of TDS certificates to be collected by banks for commission received on cross selling etc. Since TDS is only a means of advance collection of tax and banks pay advance tax, it is recommended that banks be granted exemption from TDS under section 196 of the Act.

3.7.18. Definition of Rural Branch

As per section 36(1)(viia) of the Act, banks are eligible to avail deduction in respect of provision made for bad and doubtful debts as under:

(A) 7.5% of total income; and

(B) 10% of the aggregate average advances made by the rural branches of the bank.

Clause (ia) of Explanation to section 36(1)(viia) defines "rural branch" situated in a place which has a population of not more than ten thousand according to the last preceding census. It is recommended that in the definition of rural branches the limit for population should be increased to at least one lakh instead of ten thousand.

3.7.19. Period for Maintenance of Special Reserve under Section 36(1)(viii) of the Act

The existing provisions of Section 36(1)(viii) of the Act provide for a deduction to the banking company in respect of any special reserve created and maintained for providing long-term finance for industrial or agricultural development or development of infrastructure facility in India; or for development of housing in India. The deduction is hence available to special reserve "created and maintained" by the taxpayer. Thus, any amount withdrawn from such special reserve is subject to tax as per Section 41(4A) of the Act in the year of withdrawal. Section 41(4A) of the Act seems to have had an un-intended consequence of retaining the amounts in special reserve account in perpetuity, even long after the purpose of granting the loans has been fulfilled. It is recommended that Section 41(4A) of the Act should be suitably amended to specify a period, say 5 years, for retaining the transferred amounts in special reserve as such a period would be adequate to fulfil the purpose of granting long-term finance.

3.7.20. Threshold Limit for Applicability of TDS on Interest

At present, banks are required to deduct TDS @ 10% in case interest payable on deposits exceeds Rs. 10,000 per year. The limit of Rs. 10,000 was set in FY 2007-08 and since then tax slabs have been substantially rationalized. Therefore, it is essential that the TDS provisions be also rationalized. It is recommended that the threshold limit for deduction of TDS on interest other than interest on securities be increased from Rs. 10,000 to Rs. 100,000 where the payer is a banking company.

Rule 31(3) requires quarterly issuance of TDS certificates in Form 16A. It is recommended that TDS certificate in Form 16A should be allowed to be issued on annual basis as in the case of Form 16.

3.7.21. Conversion of Indian Branch of a Foreign Bank into a Subsidiary Company

The Finance Act, 2013 inserted Section 115JG in the Act to provide tax neutral conversion of an Indian branch of a foreign bank to a subsidiary company. Section 115JG of the Act provides that where a foreign bank branch situated in India is converted into an Indian subsidiary company, in accordance with a scheme framed by the Reserve Bank of India and subject to the conditions as may be notified by the Central Government in this behalf, then the capital gains arising from such conversion shall not be chargeable to tax.

Also, there should be no gain on conversion recorded in the books of the Indian branch. The gain, if any, could arise only to the Head office/ foreign parent company to be recorded in the books of the foreign parent. The MAT provisions should not be applicable to the income from the transfer of the India branch, being income earned by the Head office / foreign parent company. However, there is no specific exemption from the Minimum Alternate Tax (MAT) provisions for a foreign company.

Further, the amendment made by the Finance Act 2015, would have no impact on the proposed transfer, as the case of conversion envisages a transfer of the Indian branch to the subsidiary company and not a transaction in securities giving rise to capital gains, as contemplated by the amended MAT provisions.

Considering, the fact that conversion of an Indian branch into a subsidiary company would be only pursuant to the Guidelines of the Reserve Bank of India and would not result in any commercial profits/real income, we recommend that specific exemption be granted from the applicability of MAT provision on conversion by foreign banks of their branches into Indian subsidiary companies.

Further, the provisions of Section 115JG of the Act do not provide any clarity on certain transitional issues such as value at which closing 'block of assets' are to be transferred to subsidiary and treatment of allowability of expenses to subsidiary earlier disallowed under Section 43B in the hands of branch. It is requested that clarity may be provided on tax treatment of these issues to achieve the intended objective of conversion of branch into subsidiary.

3.7.22. Implementation of ICDS for Banks to be made in sync with RBI and SEBI Requirements

ICDS aims to bring consistency in computation of income and reduce potential litigation. The preamble in the Notification issued by CBDT for releasing Income Computation and Disclosure Standards (ICDS) specifically clarifies that no separate books of accounts are required to be maintained for the purpose of complying with the ICDS. The overall crux of the ICDS seems to be more applicable to Industry / sectors which rely on various conflicting judicial precedents for deferment of income and hence, payment of tax. Banks and NBFCs are governed by Reserve Bank of India ('RBI') Regulations / and or Securities and Exchange Board of India ('SEBI') Regulations and its overall accounting including accounting on Investments, accounting on derivatives and forward contracts, exchange rate for conversion are all governed by RBI/ SEBI Guidelines. Practically, the Banks and NBFCs will pose a serious challenge given significant differences between its accounting treatment governed by RBI/SEBI guidelines and ICDS and these will create adjustment between accounting treatment and computation of income. Hence, Exceptions need to be carved out for Banking / Financial Sector from the applicability of all the ICDS.

3.7.23. Restoration of Deduction under Section 80P to Co-operative Banks

Withdrawal of deduction under Section 80P of the Act has given a heavy blow to the co-operative banks which helped small and medium enterprises. It is recommended that the deduction in respect of income of co-operative banks under Section 80P of the Act be reinstated.

3.7.24. Other suggestions

- It is recommended that electronic filing of Form No. 15G, 15H, 60 and 61 should be introduced so that accountability is maintained and there is a check on frivolous filing and false declaration of such forms. Further, this will also reduce unnecessary paper work.
- It is recommended that Section 72AA of the Act should be amended to allow carry forward and set-off of accumulated business losses and unabsorbed depreciation allowance in case of all types of banking consolidation.
- It is recommended that Section 163 of the Act, should be amended to provide that in the following scenarios banks should not be regarded as 'representative assessee:'
    - o Provision of mere custodial services, under license issued by SEBI.
    - o Provision of services as Authorized Dealer ("AD") for facilitating the remittance of funds, in the course its ordinary banking business.

HEALTHCARE, MEDICAL EQUIPMENTS AND DEVICES

I - HEALTHCARE AND INSURANCE

3.8.1. Measures to Improve Healthcare of Citizens

India's healthcare infrastructure is lagging behind when compared with other developing countries. There exists a huge gap between demand and supply of healthcare infrastructure facilities available in the country. Therefore, it is imperative to create an inductive environment for facilitating investments into the sector. Following measures are suggested to improve the healthcare of citizens:-

(a) Increase budget share to the healthcare sector with greater provision for the National Rural Health Mission and National Urban Health Mission.

(b) Plan for a Universal Screening Programme for the entire country, for age group (maybe 35 – 60 years) which is at risk. The Programme can be implemented in stages under a 10 to 15 year health target. Programme should include massive awareness campaign through print and electronic media in local language, capacity building for ASHA workers & Auxiliary Nurses/Midwives and screening programmes taken up in selected Blocks (Aadarsh Gaon) in stages.

3.8.2. Incentives for Voluntary Organ Donors

India needs to do 2,00,000 solid organ transplants each year to meet the recipient target, which is grossly undersupplied due to the shortage of donor pool. In order to incentivize and promote voluntary donors to meet the organ shortage, donors may be provided lifetime health coverage through insurance benefits through funding.

3.8.3. Compulsory Health Insurance for Employees

To promote Health insurance penetration in the country, it should be mandated that organizations insure every employee for a minimum amount of Rs.1 Lakh. The employer should be allowed tax deduction on the premium paid. Moreover, the employee should have the flexibility to increase this cover; the additional premium so paid should also be made tax exempt. This should be over and above the cover extended under the ESI, CGHS and other government health insurance schemes.

3.8.4. Health Insurance Coverage for Senior Citizens

Medical Insurance Premium for senior citizen should be subsidized or the limit increased to Rs.50,000 per annum. Also, there is a need for restructuring the premium, so that the monetary burden on the end user reduces as his / her age increases and the ability to contribute decreases. This innovative premium structuring will help increasing affordability amongst the masses.

3.8.5. Tax Incentives

(a) Service Tax Exemption

(i) There is a pressing need to increase the safety net of health insurance in India. One measure that could help is withdrawal of service tax on health insurance premiums, thereby leading to a lowering of cost/ premium for the consumer. Mediclaim insurance Premium may be exempted from levy of Service Tax.

(ii) Service tax on Service and Maintenance Contracts for medical equipment be exempted fully.

(iii) All input services, in cancer treatment, should be considered for service tax exemption to reduce the cost of health care providers.

(iv) All Healthcare Education and Training services, especially life-saving ones, should be exempted from service tax.

(v) CENVAT credit should be made eligible to be availed in respect of inputs for the Rashtriya Swasthya Beema Yojana (RSBY) policies to keep the cost of servicing these policies low.

(b) Direct Taxes Relief

(i) Tax exemption on Preventive Health check-up should be raised from the current Rs. 5000 to Rs. 20000 under section 80D of the Act.

(ii) Considering the increased cost of medical treatments, health insurance is necessary for every individual. The same can be promoted by offering tax incentives. In order to encourage investment in health insurance policies, it is suggested that the current limit of Rs 25,000 prescribed under section 80D of the Act be enhanced to Rs 50,000.

(iii) Increase in Tax holiday from current five year to ten year time frame under section 80-IB for private healthcare providers in non-metros for minimum of 50 bedded hospitals instead of current 100 beds.

(iv) Income Tax/ MAT exemption for at least 15 years for domestically Manufactured Medical Technology products to promote "Make in India".

(v) To incentivize hospitals and diagnostic laboratories to undergo accreditation, there should be 100 % deduction on approved expenditure incurred for securing accreditation from National Accreditation Board for Hospitals and Healthcare Providers (NABH) and National Accreditation Board for Testing and Calibration of Laboratories (NABL) respectively.

(vi) To encourage move towards maintenance of Electronic Health Record (EHR), financial incentives/grants should be provided to willing institutions. 250% deduction on investment made for the implementation of EHR should be extended.

(vii) 250% deduction for approved expenditure incurred on operating technology enabled healthcare services like telemedicine, remote radiology etc. should be allowed for improving accessibility, affordability & quality healthcare in remote areas.

(viii) For an insurance company, claims expense includes reserve towards claim which is Incurred But Not Reported ("IBNR"). Currently, IBNR reserves are computed based on appointed actuary basis IRDA guidelines. Schedule 1 of Income Tax act is silent about admissibility of IBNR reserve as allowable expense. In the absence of any guidelines, there are instances wherein Tax authorities contest this expense. This reserve should be included as allowable expense.

(ix) Due to anomaly in the current income tax law, the self-insured market (otherwise known as "Administrative Services Only" or ASO (which is a combination of healthcare administration and stop loss insurance) have not evolved. As a result, in India, small employers (having less than 100 employees) who do not usually buy insurance (because they do not want to incur an annual outflow of premium) do not have an option to join a ASO group to provide healthcare benefits to the employees. Therefore, most employees borrow on an ad-hoc basis to fund healthcare costs and remain in debt to their employer. It is therefore recommended that the law be amended to provide that any sum paid by the employer for medical treatment of the employee or a member of his family is exempt from tax in the hands of the employee if the treatment is in any hospital or nursing home which is empanelled with any registered health insurance company in India as a provider of health insurance.

(x) Healthcare sector should be exempt from Minimum Alternate Tax.

II - MEDICAL ELECTRONICS AND MEDICAL DEVICES

3.8.6. Encouraging Complete or Partial in-house Manufacturing

India is a very small manufacturing hub for Medical Equipment (~2% of the USD 66B Indian Healthcare Market). To provide cost effective healthcare in India, Government should encourage complete or partial in-house manufacturing set up. In this process the following benefits are expected to attract more investment:-

(i) 150% depreciation on infrastructure investment U/S 35 of IT Act

(ii) Exemption from Excise Duty on equipment manufactured or assembled in India, wherein the value of imported raw material content does not exceed 50% of complete equipment cost. In any case excise duty on medical equipment be reduced significantly and may be prescribed at the lowest slab to enable the domestic industry to find a foothold

(iii) Zero custom duty on all imported raw materials by manufacturers, wherein the imported raw material content is limited up to 50% of complete equipment cost

(iv) R&D Cess to be Cenvatable with Excise duty

3.8.7. Other Tax Incentives

(a) Any new capital expenditure towards replacement of old machinery/equipment in hospitals, at any time, be entitled to 100% deduction.

(b) Manufacturers of indigenous medical technological products be granted complete tax exemption from MAT.

(c) 250% deduction of approved expenditure incurred on R&D activities related to indigenous development of medical technology should be provided.

3.8.8. Exemption for Medical / Dental / Surgical Equipment

a) Nil Basic Customs Duty be specified for Medical Equipment, Medical or Surgical Implants, Medical Devices falling under headings 9018, 9019, 9020, 9022 and 9027.

b) Blood Glucose Monitoring Strips of heading 3822, Medical, Surgical or Laboratory Sterilisers of heading 8419 and sterile surgical catgut and similar sterile suture materials and sterile tissue adhesives for wound closure of heading 3006 should also be exempted from customs duties.

c) Medical products classifiable under headings 9018 to 9022 and parts and accessories thereof presently levied to 5% basic duty in terms of S.No. 474 of Notification No. 12/12-Cus dated 17.03.2012, be totally exempted from import duties. The exemption may also be extended to parts, accessories, consumables or assembly components, whether required for manufacturing or to be assembled at site of use. This will remove classification disputes and allow the industry to get the desired exemption. Specifically parts and components of hearing aids should be exempted from customs duties to provide a level playing field for domestic manufacturers.

d) To ensure that the spare parts imported to be used for maintenance of critical care devices, are used for the same purpose, importer may be asked to furnish “End Use Certificate” within a period of 12 months. Procedure for Consumption Certificate for materials imported as per Customs Notification 21/2010 to be amended to read as “Importer to submit Self Declaration for having consumed the materials in the process of manufacture of Medical Equipment”.

e) Prior to 2012, Medical Cyclotrons were classified separately and eligible for concessional duty as applicable for medical equipment. Presently Cyclotrons (whether used for Industrial or Medical purpose) are listed under one heading in CTH 8543 and Cyclotrons for Medical use do not qualify for the concessional duty benefit which is normally available for Medical Equipment. The Medical grade cyclotrons support production of Radio isotopic drugs which are used either for treatment or detection of Cancer cells at an early stage. The Atomic Energy commission which is the nodal agency for certification of cyclotrons also has different approval standards for Industrial and Medical Grade cyclotrons. Medical grade Cyclotron should be considered for concessional duty benefit similar to CTH 9018 or 9022 as these will be used for medical purpose only.

3.8.9. Other Customs Exemptions/Concessions

1. All medical devices used in critical care, consumables used with devices in the specific critical care treatment procedure and their spare parts should be exempted from Customs Duty. It is recommended that the following be included in the list of critical care products:-

    - Patient monitoring systems and image guidance systems

- Pacemakers and their leads for cardiac therapy
- External Defibrillators
- NT and ENT Surgery Products including electrical/pneumatic drills and the consumables
- Deep Brain Stimulation Implanters, drug pumps, leads used in neurosurgery etc.
- Heart Lung Machine and Oxygenators, cannula, accessories used in vascular therapy and during cardiopulmonary
- Heart valves, Annuloplasty Rings and various Cardiac catheters
- Respirators and Masks (industrial and healthcare)
- Dialysis Machines equipment, dialyzers, dialysis pump consumables and Devices (Hemo and Peritoneal Dialysis)
- Peripheral Vascular Stents
- Reveal Diagnostic devices
- External loop recorders

2. The duty levied on spare parts of the Radiotherapy equipment (currently charged at 31%) be reduced to 11% at par with the rate for the main equipment.

3. Sterilizers of Heading 8419 20 90 which are presently levied to import duty at 25.85%, may be levied a reduced customs duty to 0-5%. Sterilisers are used for sterilizing medical devices such as implants, sutures etc. They play a critical role as critical care equipment

4. Topical Skin Adhesive like steristrip of Heading 3006 which is presently levied to basic customs duty of 10% (in addition to Additional duty, cesses and SAD) may be given an exemption by levying basic custom duty in the range of 0-5% and provided exemption from CVD and SAD This duty exemption would enable millions to have an affordability as these adhesives are used for skin closure by replacing conventional sutures.

5. Full Custom Duty waiver for essentially required radiopharmaceuticals used in Diagnostics like Imaging and Scanning (PET-and SPECT) and Therapy some of which are not manufactured in India like Iodine 131, MIBG 131, Lutetium 177, Yttrium 90, Ge-68-Ga 68 generator, Cold Kits for Tc 99m, Rubidium 82, Ir-192.

6. Cardiovascular, cancer and neurological surgeries involve Iodophor impregnated drapes (HS 3005) for prevention of wound infection and Fibrin sealants (HS 300620) for achieving immediate sealing of blood vessels which are critical for life of the patients. These products currently are levied duties under headings 3005 and 3006 at basic of 10% and a total import duty of 21.78%. It is submitted that these may be included in the critical care category (List 4) and subjected to concessional 5% basic duty and Nil CVD.

7. Medical grade PVC (Heading 3921 90 99), Polypropylene, HDPE required for the manufacture of dialysis products, Dextrose Anhydrous USP, for use in manufacture of Intravenous fluids be levied custom duties in the range of 0-5%.

8. Power tools/ drills, surgical blades and burs used in various neurological, orthopaedic, spinal, by-pass surgery and other skeletal surgeries, Endoscopy Camera, accessories and parts should be levied custom duty in the range of 0- 5%.

9. Integrated Operation Theatre (Consisting of Routers, Booms, Pendants, Lights, Monitors, Camera, and Connectors etc.) should be charged to a reduced duty of 5% basic and Nil CVD.

10. Sterilization Gas Cartridges used by Hospitals to sterilize surgical instruments including sutures, catheters etc. before critical care surgeries currently attract an import duty of 7.5% +12.5%+3%+4% . In order to provide an affordable health care to millions of people zero or minimum basic customs duty of 5% may be imposed and CVD and other duties may be exempted.

11. PDS plates (3920.69.99) - PDS plate is a scaffolding support for "nasal reconstructive surgery" especially used for Septoplasty and Rhinoplasty. Most of the cases wherein these plates will be used are the ones in which there are trauma cases and there is severe damage to the nasal cavity and septum. Effective duty of 26.85% makes it really unaffordable for the patients as it increases the basic surgery cost of nasal reconstruction. This product which can help a lot of patients recover from the trauma of nasal reconstructive surgery will only be accessible to a selected section of the society in case such heavy duty rates are imposed.

12. Customs duty on most of Diagnostic reagents is 28% except EIA, CLIA, HIV and HBsAG etc. Custom duty on high-end specialised testing like tumour marker, Molecular diagnostic product should be brought down to NIL to enable these tests to become more affordable to people.

III - IN-VITRO DIAGNOSTICS (IVD) SECTOR

3.8.10. Duty Exemption for Antigens / Antibodies used in Diagnostic Kits

- The import of raw materials such as antigens/antibodies or any other ingredient corresponding to the manufacture of diagnostic test kits specified in list 4 put the local manufacturer at disadvantage in comparison to imported finished diagnostic test kit specified in list 4 which is imported at nil duty. The notification should therefore include: "Bulk drugs / antigens / antibodies (monoclonal / polyclonal) / raw materials / components used in the manufacture of critical care drugs / medicines including their salts and esters and diagnostic test kits".
- The following items which were a part of the now abolished List 37 need to be included in List 4 under notification No.12/2012-Customs, dated 17/03/2012 to allow for a level playing field for both Indian manufacturers and importers:
    - AIDS (Acquired Immune Deficiency Syndrome) test kits
    - T.P.H.A kits and AIDS diagnostic kits.
    - Rapid diagnostic kit for detecting infection with malaria parasite / Tuberculosis (TB)
    - Australia antigen/ HBsAg kit.
    - HCV (Hepatitis C Virus) by any technology.
    - Dengue detection systems/kits.
- Exemptions for components for Elisa Kits to be expanded: The list that provides the benefit of lower duty may be extended to include antigen or antibody on the solid phase for coating. The other key component is the enzyme conjugate and their stabilizing buffer / solutions. It is important to put the local ELISA kit manufacturers at par with the importers because all finished ELISA kits are imported at nil duty as per item no. 36 of List 4.
- Cases of duty rationalization: With abolishing of List 37, all diagnostic devices are now covered under Chapter 90 (9027). They therefore attract high duty rates and it is recommended that they be charged to NIL duty to encourage access to newer technologies. Further duty on manufacture or import of diagnostic reagents to be reduced to encourage manufacturing in India. That apart duty structure of following items should be rationalized.
- Excise duty for manufacturing of Diagnostics Reagents may be made NIL from existing 10% to allow cost benefit to indigenous manufacturer.

- Diagnostics Reagents may be subjected to same levels of duty as Medical Equipment/Devices under Chapter 9018 as against the existing rate of 26.75%.
- Duty on PCR kits may be made NIL as given for ELISA, CLIA Diagnostics kits, etc. from existing 26.75% in order to quantify the load of deadly viruses/bacteria such as Hepatitis C, CMV, H1N1, TB, etc. in patients for subsequent treatment and monitoring.
- All diagnostics equipments including Fully Automated Biochemical Analyzers may be assessed at NIL duty or with a total duty of 9.63% as sudden reversal and imposing duty of 14.72% makes the cost of these Hi Tech Instruments significantly expensive.
- Imported automated pre-analytical and post analytical equipment for IVD devices and their accessories are currently being charged to duty at 29% approximately. These should be considered for NIL or lower duty so as to promote affordability of lab automation and to manage high throughput labs and Govt. sites to give high quality results.
- Spares for medical equipment under chapter 9027, may be subjected to same levels of duty as corresponding Medical Equipment/Devices under heading 9018, as against the existing rates for spares at 26-29% to extend the productive life of purchased Medical Equipment by Government Hospitals and Labs.
- Customs duties for Diagnostics kits may be based on criticality of the test rather than the technology.

3.8.11. Duty Exemption be based on Test rather than Analyte for Critical Tests

Customs Tariff for Diagnostics kits is based on technology rather than the Analyte causing anomalies e.g.: ELISA &CLIA kits are exempt from customs duty whereas IFA (Immuno Florescence) and Bio-chemistry kits are liable for duty under heading 3822 @ 26.75%. It is recommended that duty exemption be based on Test rather than Analyte for the following critical tests:

(a) Blood Banking Panel

(b) HIV

(c) HBSAG

(d) HCV

(e) Sepsis Marker

(f) Procalcitonin (PCT)

(g) Tests of Auto immune diseases (ANA and ds DNA)

(h) Diabetes –Glucose, HbA1C, microalbumin, etc.

(i) Cardiac – Triglycerides, Cholesterol, LDL, HDL, lipids, CRP, hs-CRP, etc.

(j) Therapeutic Drug monitoring – Tacrolimus, Sirolimus, etc.

(k) Kidney function tests –Creatinine, Total Protein, Albumin, Urea, Uric acid, etc.

(l) Liver Function tests – Alkaline Phosphatase, Bilirubin, Gamma GTP, SGPT, SGOT, etc.

(m) Electrolyte balance – Sodium, Potassium, Chloride, Calcium, Phosphorus, etc.

IV - PHARMACEUTICAL INDUSTRY

3.8.12. Exemption for Oncology and Critical care/ICU drugs

Oncology and Critical care/ICU drugs being lifesaving drugs should be exempted from Excise duties. Some molecules are already exempted, however, following molecules are also suggested for exemption:-

Oncology Drugs - Aprepitant, Fosaprepitant Dimeglumine, Abirateroneacetate, Bortezomib, Erlotinib, Fulvestrant, Gefitinib, Oxaliplatin, Palonosetron, Pemetrexed, PaclitaxelIP, Docetaxel.

ICU/CriticalcareDrugs – Sulbactam Sodium, Colistimethate, Tigecycline, Voriconazole, Doripenem, Cefepime, Imipenem, Meropenem, PolymyxinBSulphate, Tazobactam, Cilastatin, Meropenem+Sodium Carbonate, Cefepime+Tazobactam, Imipenem+Cilastatin.

3.8.13. Correction of Inverted Duty Structure in Pharmaceutical Industry

The pharma products classifiable under Chapter 30 of the Central Excise Tariff are exigible to excise duty at a concessional rate of 6% keeping in mind the essential nature of the medicines. The said fiscal advantage has been provided as a welfare perquisite considering the essential nature of these products.

The principal raw material required for manufacturing the pharma products is API (Active Pharmaceutical Ingredient) classifiable under Chapter 29 of the Tariff. Ironically, APIs are taxed at 12.5%. This creates an 'inverted duty structure' where the rate of duty on the principal raw material is twice the rate of duty of the final product, resulting in huge accumulated unutilized Cenvat credit which finally culminates into higher price of pharma products.

Thus, the objectives of Government to provision fiscal advantages to pharmaceutical products by reducing the rate of excise duty does not achieve fruition owing to a relatively higher rate of APIs. The reduction in the duty for APIs should follow as a logical sequence to avoid an inverted duty structure.

It is suggested that the excise duty on APIs be reduced to 6%.

3.8.14. Medical Services provided by Clinical establishments

Medical services provided by Clinical establishments are exempt from Service tax. The Hospital provides services to patient and they engage doctors for providing such services. Hospital raises their memo of fees by specifying Operation Charges, Doctor Fees and medical Consumables. The Department is taking a view that Hospital provides infrastructure to Doctor and intends to recover the Service tax on such charges. There is a need to clarify that such services are also in the nature of medical services and exempt from Service tax.

3.8.15. Excise Duty Exemption for Essential Medicines

Drugs listed in the National List of Essential Medicines considered by Department of Pharmaceuticals for Price Control should also be exempted from the levy of Excise duties with a view to reduce their prices.

3.8.16. Weighted Deduction under Section 35(2AB) for computing Book Profits

Presently, while computing the 'book profit' under Section 115JB, the amount of weighted deduction under Section 35(2AB) is not deducted. In order to promote in-house R&D in India, the amount of weighted deduction under section 35(2AB) of the Act should be deducted while computing book profit for the purpose of MAT.

3.8.17. Safe Harbour Rule for Contract Manufacturing

The Central Board of Direct Taxes has recently notified Safe Harbour Rule covering sector like IT/ITES, KPO and Auto Component manufacturer prescribing desirable margins so that it avoids litigation under transfer pricing regulation.

It is requested to provide similar guidelines for pharma companies that are manufacturing and exporting the product as contract manufacturer.

3.8.18. Clinical Trials - Weighted Deduction under Section 35(2AB)

Weighted Deduction u/s 35(2AB) should be enhanced from existing 200% to 250% for a period of next 10 years i.e. up to 31st March, 2024. The current provisions for deduction u/s 35(2AB) covers only expenditure incidental to research carried on at the in-house R&D facility. As clinical trials are specialized and expensive most R & D facilities outsource these trials. Hence, In order to successfully launch any new drug, the innovator has to get the clinical trial done outside approved facilities within India & abroad. Therefore all expenditure related to research i.e. clinical trials, bioequivalence studies, regulatory and patent approvals should be eligible for weighted deduction, even if these activities are carried outside the approved R&D facility. Presently, as per DSIR guidelines amount spent by a recognized in -house R&D towards foreign consultancy, building maintenance, foreign patent filing are not eligible for weighted deduction u/s 35(2AB). DSIR guidelines need to be modified accordingly to allow the above said expenses for weighted deduction u/s 35 (2AB).

INFORMATION TECHNOLOGY (IT) AND IT ENABLED SERVICES (ITES)

3.9.1. Extend Deduction under Section 35(2AB) of the Income Tax Act to Computer Software

Currently, weighted deduction of 200% is available for expenditure incurred on scientific research on in-house research and development facility as approved by Department of Scientific & Industrial Research. The deduction is available to a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing. There is an ambiguity whether in-house Research & Development facility for computer software is covered within the ambit of section 35(2AB) and whether the software product should be eventually owned by the company.

It should be provided explicitly in the Act that the benefits of weighted deduction under section 35(2AB) of the Act are also available to companies engaged in the manufacture of 'computer software'. The definition of computer software for the purpose of this section should be the same as provided under Explanation 2 to section 10A of the Act.

3.9.2. Allow Weighted Deduction on Skill Development Expenditure

To promote skill development in the IT sector, weighted deduction on skill development expenditure incurred by IT companies should also be made eligible for deduction under section 35CCD of the Act.

3.9.3. Parity in the Treatment of Export Turnover and Total Turnover

The term 'total turnover' has not been defined in the Act. The tax authorities do not provide parity in the treatment of the term 'Export Turnover' ('ET') and 'Total Turnover' ('TT') for the purpose of computation of deduction under sections 10A/10AA/10B of the Act. Hence, certain items which are excluded while computing the ET are not excluded from the TT, thereby distorting the figure of ET/TT. It is recommended that definition of total turnover should be clearly provided in the Act and which should be in parity with the definition of export turnover (in relation to exclusion of certain items).

3.9.4. Clear Guidelines on Attribution of Profits to Permanent Establishment

Many a times, a Permanent Establishment ('PE') of foreign enterprises is alleged by the tax authorities on account of mere procurement of orders for sale of goods or provision of services or answering sales related queries, etc. These are routine services outsourced to Indian enterprises. Provision of these services is the backbone of IT/ITeS sector in India for which they get remunerated at Arm's Length Price ('ALP'). Foreign investors/companies are losing interest to invest in India since there is a tendency of the tax authorities to allege that the Indian entity is a PE of the foreign entity. They also fear attribution of profits of the foreign entity to such an alleged PE. This is in-spite of the fact that Indian entity is remunerated at ALP by the foreign company and such ALP is accepted during transfer pricing audit of the Indian entity.

It is recommended that the Act should categorically provide that no further profits can be attributed to PE, if PE is remunerated on arm's length basis.

INFRASTRUCTURE

3.10.1. Amendment of Section 80-IA Regarding Upgrading Existing Infrastructure

Infrastructure development is a pre requisite for the growth and development of any country. Infrastructure development is available in two ways i.e. to build altogether new infrastructure or to convert the existing structure by upgrading it and also enhancing the existing capacity. Both activities entail huge investment and human efforts.

It is recommended that a suitable amendment may be made in the Act to clarify that the up-gradation/extension of the existing infrastructure facility would also be eligible for the benefit of Section 80-IA of the Act.

3.10.2 MAT on Infrastructure Companies

Infrastructure Industry in India has been experiencing a rapid growth with the development of urbanization and increasing involvement of foreign investments. Government has offered various tax incentives under Section 80-IA of the Act to the infrastructure companies to boost infrastructure. The benefit available to the infrastructure companies under the normal provision of the Act get neutralized since the companies are required to pay MAT on their book profit.

To attract more investment in infrastructure sector, MAT on infrastructure companies should be abolished.

MICRO, SMALL AND MEDIUM ENTERPRISES

3.11.1. Improve Access to Finance

Banks are not forthcoming to lend under various schemes like the CGTSME due to it being non- collateralized and their risk perception. Therefore, SIDBI should be converted into a full-fledged Commercial Bank for MSMEs. The prime object of setting up SIDBI was to fulfill credit needs of MSMEs, but even after 25 years of its existence, non-availability of adequate credit continues to be a major concern for MSMEs due to the reason that SIDBI has not expanded its operations beyond 100 branches and primarily confining to be a refinancing agency. SIDBI'S refinancing role is no more relevant now.

3.11.2. Service Tax for Rentals on Immovable Property for Units in MSME Sector

Rental on immovable property, used for industrial purpose for manufacturing activities by micro and small sector, casts a huge burden on the units in the MSME Sector. Large manufacturing units do not experience the burden of the Service tax on rent as they are eligible to claim CENVAT of the tax paid. MSME units are not able to set off the burden of the service tax paid on rent as most of them are not required to pay excise duty, their value of clearances being within the exemption limit.

It may appear that service tax is payable only if the annual rent is Rs 10 lakhs or more. Fact is that small units may be taking a part of premises on rent for Rs.5,000 per month but the owner may be liable to pay service tax because his total rental income from the premises crosses the exemption limit of Rs. 10 Lakhs.

MSMEs who take premises on rent mostly are beginners or young entrepreneurs who don't have finances to start their new enterprise in their own premises. They put all their available resources and energy to risk in starting a new enterprise. Micro & Small Sectors should be exempted from the purview of Service Tax for rental for their office / factory / warehouse premises for their own use.

3.11.3. Date of Payment of Service Tax

Rule 6 of the Service Tax Rules 1994 prescribes the dates and the manner in which the service tax shall be paid to the credit of the Central Government. In the said Rule certain relaxations have been provided in cases where the assesse is an individual or proprietary firm or a partnership firm. It is requested that private limited MSMEs should also be extended similar relaxations in payment of service tax.

Payment of Service Tax by the 5th of next month is too early for MSMEs to comply with. This may be extended to at least till 20th of the month.

3.11.4. Payment of Service Tax by MSMEs on Realization of Proceeds

As per the Point of Taxation Rules, the Point of Taxation shall be the time when the invoice for the service provided is issued. These provisions are adversely affecting units in the MSME sector since in many cases especially manufacturing and auto component industry, payments are received after 60 days in the normal course and sometime after 90 days of the issue of invoice. Any tax which is paid to the Government is from the resources of the MSME unit itself. Given that the finances of MSME units are already stretched they find this a huge strain on their business since liquidity is an issue and MSME units operate on very tight margins.

It is requested that a special relaxation for payment of service tax for MSMEs may be provided so that they do not have to pay taxes in advance from their resources but the payment is affected on realization of their dues from the buyers.

3.11.5. Allow investment in Plant and Machinery for Rs. 25 crores or more in span of three years

Deduction for investment allowance as per section 32AC(1A) of the Income Tax Act at the rate of 15% for 3 years is allowed to a manufacturing company which invest at least Rs 25 crores or more in plant and machinery in a financial year starting from April 1, 2014, as announced in the Union Budget 2014-15. However, the provision will benefit MSMEs only if the revision in the limit of defining MSMEs will match the above investment limits. It is recommended that in order to allow MSMEs to take the benefit of the said deduction the acquisition and installation in plant and machinery of Rs. 25 crores or more should be allowed to be made within a span of three years i.e. April 1, 2014 to March 31, 2017.

3.11.6. Provisions of Section 56(2)(viib) of the Act not to Apply on Investments by Angel Investors

It is recommended that the investments made by an investor who is part of a recognised, formal angel group, should not be considered for the purpose of invoking the provisions of section 56(2)(viib) of the Act.

NON FERROUS METALS

I - COPPER

3.12.1. Exemption from the Levy of Import Duty on Copper Concentrate

Copper is a critical input for various industries, including infrastructure indicators. The critical raw material for this industry, i.e. copper concentrate, is available very scarcely in India, making it imperative for the country to import either refined copper or copper concentrate. Given the structural constraint of non-availability of copper concentrate, Indian producers set up custom copper smelters (similar to the business models of China, Japan and Korea) based on imported concentrate. Nearly 90% of the requirement for copper concentrates is met through imports.

The customized copper smelters operate on a conversion business model with very thin margins. Copper prices on London Metals Exchange (LME) are a pass-through for the industry since they also import concentrate at ruling LME prices less the internationally negotiated Treatment and Refining Charges (TCRC). In recent years, TCRCs have faced a downward pressure due to: (a) Delays in implementation of mining projects after the financial meltdown, (b) Falling copper ore grades across the world and (c) Increased requirement for concentrates from emerging markets, especially China. The sharp reduction in TCRCs – the key value driver of the industry – along with the continued cost pressures, have affected the viability of the copper smelting industry. Over the years, the duty differential between refined copper and copper concentrate has been compressed from 30% at the turn of the century to just 2.5%. This tiny differential, in a conversion business where TCRCs are less than 5% of the turnover, is hardly adequate.

To sustain the viability of the smelting model in Indian refined copper industry, it is recommended that copper concentrate be exempted from basic customs duty. This proposal is likely to result in a revenue loss of Rs 200 crore which can be offset by an increase in custom duty on copper products to 10% (likely revenue gain of Rs 350 crores).

3.12.2. Increase in Customs Duty on Copper products from 5% to 10%

Indian primary copper producers had set up global-scale capacities to maintain their cost competitiveness with state-of-the-art technology. However, this resulted in Indian refined copper capacity (close to a million tonnes) that is significantly higher than the domestic market size (nearly 0.6 million tonnes). Despite such excess capacity in India, imports of refined copper products are steadily going up. Imports have zoomed nearly 100% from around 85,000 tonnes in 2012-13 to over 170,000 tonnes in 2014-15. This is eroding the market size available for the domestic players and the imports have a share of 35% of the total market. The Free Trade Agreements with Japan, Malaysia and other countries are causing a surge in the imports.

In view of the rising imports and considering the excess capacity in Indian refined copper industry, it is recommended that the basic customs duty on copper products be increased from 5% to 10%

3.12.3. Technical Correction in the Notification Exempting Gold and Silver Content in Copper Concentrate

In the Union Budget 2011-12, Government had exempted gold and silver content in imported copper concentrate (CH 2603) from basic customs duty to encourage production of precious metals through the copper concentrate route (Notification No. 24/2011-Customs dated 1.3.2011). While this was a welcome move, the exemption is subject to the condition that the importer produces an assay certificate from the mining company specifying separately, the value of gold and silver content in such copper concentrate. In this context, it is pointed out that a significant quantity of copper concentrate is procured from traders or from trading companies of the miners. This trade route has been inadvertently left out of the notification – which needs to be corrected. It is therefore, recommended that the notification be amended so as to make the assay certificate from the supplier of concentrate as an adequate condition rather than assay certificate from the mining company.

II - ALUMINIUM

3.12.4. Imposition of Export Duty on Alumina

Around 80-85% of total alumina exports from India in 2013-14 were destined for Middle East countries. At the same time, imports from Middle East have surged from 308kT in FY11 to 528kT in FY15 with a CAGR of 14%. This means that the Indian companies are helping Middle East smelters run and export back value added product to India. In India, Aluminium smelters of 1.5 million tons capacity are ready but have not been commissioned due to non-availability of alumina. In case the indigenous requirement of alumina is fulfilled from domestic sources (instead of exporting the same to Middle East), India will be able to export aluminium which will fetch more value. This will also save outflow of foreign exchange and reduce load on infrastructure. It is accordingly suggested that export duty of 5% be imposed on export of alumina.

3.12.5. Reducing Import Duty on Aluminium Fluoride

India is net importer of Aluminium fluoride. Aluminium industry is importing 100% of its requirement of AlF3. Contribution of Aluminium fluoride in cost of production of aluminium metal is around 1.5%. The demand for AlF3 will increase with the operationalization of expansion projects. Duty correction on AlF3 will not have any impact on any other industry. Hence, it is recommended to reduce import duty on Aluminium Fluoride from 7.5% to 2.5%.

3.12.6. Reducing Import Duty on Coal Tar Pitch

Coal Tar Pitch is a crucial raw material for aluminium to be used as binding material for manufacturing anodes for the electrolysis process with the aluminium industry using a substantial quantity of total production / imports of CT Pitch.

Its contribution in the total cost of production of aluminium is around 3.5-4%. It is suggested to reduce import duty on CT Pitch from 5% to 2.5%.

3.12.7. Increasing of Export Duty on Bauxite

India's alumina production capacity is 6.1 million tonnes per annum. The requirement for bauxite is around 18 million tonnes per annum. Since no new major bauxite mines could be started in the last 20 years, Alumina refineries in India are finding it difficult to source indigenous bauxite and are forced to import. On the other hand merchant miners are exporting huge quantities of bauxite.

Even though the government has increased the export duty to 20% on bauxite in Union Budget 2014-15, it has failed to stem the outflow of bauxite. Bauxite exports in FY14 and FY15 were 3.3 and 6.4 million tonnes respectively.

To ensure domestic value addition within India, export of bauxite must be discouraged. It is therefore suggested to increase export duty on bauxite from 20% to 30%.

3.12.8. Increase in Basic Customs Duty on Aluminium Products from 5% to 10%

Indian Aluminium industry has seen a huge surge in imports in recent years. The market share of domestic manufacturers has dropped to 44% in 2014-15 with imports nearly doubling to 15.63 lakh tonne from 8.81 lakh tonne in 2010-11. The threat of imports is primarily from two locations: Middle East and China. Both these locations have a huge capacity surplus. Further, the domestic capacity of 41 lakh tonnes per annum is currently operating at 50%.

The consumption of aluminium in India is expected to grow at 10-11% CAGR over the next decade. To cater to such huge demand potential, Indian primary aluminium industry has announced ambitious growth plans involving massive capital outlay for increasing the capacity to 5 million TPA by 2020. The rising imports are, however, endangering the very basis of these large investments and their viability. The surge in imports is happening at a time when the industry has been already squeezed by subdued realizations and incessant increase in cost of production.

With such adversities it is recommended that the import of aluminium products into India should be controlled by increasing the basic customs duty on aluminium products (HS codes 7601, 7603, 7607) from 5% to 10%.

3.12.9. Customs duty on Aluminium Scrap at par with the duty on the Metal Products

For all base metals other than Aluminium, import duty on scrap in India is the same as the duty on the metal. It is only in case of Aluminium that the duty on scrap is 2.5%, while duty on aluminium products is at 5%. In most of the Aluminium downstream products, scrap and primary aluminium can be used almost interchangeably. The differential duty structure seems to be, therefore, leading to a substitution of primary aluminium by scrap – reflected in a sharp rise in imports of scrap (CH 7602). Scrap imports are causing an immense harm to the Indian aluminium industry due to market diversion.

It is recommended that the basic customs duty on Aluminium Scrap (CH 7602) be raised and brought on par with the duty on Aluminium products

3.12.10. Inclusion of Aluminium Ingots under Interest Subvention Scheme

In order to encourage exports, Government has widened the Interest Subvention Scheme by including 134 engineering products vide a circular dated January 14, 2013 issued by RBI. While this list includes Aluminium wire rods and Aluminium sheets, it does not include the primary product, i.e. Aluminium Ingots (HS 7601). Exports of aluminium ingots from India have been nearly stagnant over the last three years at around 200 tonnes per annum. These exports may get some leverage if ingots are included under the above scheme. It is, therefore, recommended that Aluminium Ingots (HS 7601) be included under the Interest Subvention Scheme.

III – ZINC AND LEAD

3.12.11. Increase in Basic Custom duty on Zinc and Lead Ingots, Alloys, Scrap etc.

Heavy investments have been made by domestic industry in non-ferrous metal sector, but low domestic demand is leading to excess supplies. Despite the availability of metals in the country imports are increasing in the market. There has been a 123% increase in Zinc imports in FY 15 over FY 14 & 96% increase in Zinc Alloys for the same period leading to an oversupplied market.

The import trend of lead has recorded a 17% increase from last year. Import volume of Zinc alloys has doubled compared to previous year. Import of Zinc scrap has significantly increased by more than 72% since FY2010-11, and rendered the manufacture of high quality downstream products of Zinc uncompetitive.

Quality of zinc/lead produced by Indian industry compares with the best in the world and there is no incentive for domestic consumers (of zinc/lead) to go in for imports except for the cheaper price of material. Cheaper imports under Free trade agreements like from South Korea under India – Korea CEPA trade agreement where import duties on zinc, lead and value added products like alloys are now nil, result in oversupply in market and disturb balance of trade. Production capacity is underutilized resulting in loss of jobs especially in SME sector of alloying sector. Likewise cheaper imports of Zinc Oxide, is a great cause of concern for the domestic downstream industry.

It is recommended that basic Custom duty on Zinc Ingots (HS code 790111, 790112), Lead Ingots (HS code 780110), Zinc Alloys (HS code 790120), Zinc scrap (HS code 790200) and Lead Scrap (HS code 780200), may be increased from existing 5% to 7.5% and on Zinc oxide (HS code 281700) from existing 7.5% to 10%

3.12.12. Customs Duty on Lead Concentrates

Limited availability of ore in country and restrictions on new mining are leading to shortage of lead ore and concentrates and idle capacity. High import duties on concentrate make production of lead ingots costlier and face stiff competition from international players both in the domestic as well as international market.

It is suggested that basic Customs duty on Lead concentrates (HS code 260700), be reduced from 2.5% to Nil.

OIL AND GAS

3.13.1. Service Tax Exemption to Services used in Exploration & Production (E&P) Sector

Services in relation to Survey and exploration of mineral, Oil & Gas service were brought in the service tax net in September 2004. As the operators and their associates in E&P sector do not provide any taxable output service or do not manufactures any excisable goods, they are not able to set off the service tax paid and have to absorb the cost. Further, the risks and uncertainty associated with capital intensive E&P sector underlines the need of providing supportive environment for sustaining the business. After advent of the concept of negative list, the burden of input stage tax has further increased on E&P sector. This underlines the need of providing supportive environment for sustaining the business. Services related to core infrastructure sector activities like highways, airports, sea ports, metro, railways etc. are already exempted from service tax on economic considerations. It is therefore suggested that the services required for E&P sector may be included in the negative list of services so as to reduce their cost in line with consideration given to services required for infrastructure development like roads, airport, railways, ports etc. It will incentivize investment in E&P sector by way of reduction in capital cost

3.13.2. Abolish National Calamity Contingency Duty

National Calamity Contingent Duty of Excise (NCCD) was introduced @ Rs. 50 per metric tonne on indigenous crude oil and simultaneously an additional duty of customs at the rate of Rs 50 per metric tonne on imported crude oil was also introduced effective from 1st March 2003. This duty was to be valid for one year i.e. up to 29th February 2004 so as to replenish the National Calamity Contingency Fund, but it is still continuing.

It is recommended that NCCD on Crude Oil should be abolished.

3.13.3. Oil Industries Development Cess

Oil Industry Development (OID) Cess is levied on Crude Oil produced as a duty of excise under the Oil Industries (Development) Act 1974. OID Cess on crude oil produced from Nomination blocks and pre-NELP Exploratory blocks is presently leviable at Rs. 4,500/MT. However, in case of pre-NELP discovered blocks (e.g. PMT and Ravva), OID Cess is payable as mentioned in respective PSC i.e. Rs. 900/MT whereas OID Cess is exempted in case of NELP blocks.

OID Cess was last revised from Rs. 2,500/MT to Rs. 4,500/MT with effect from 17 March, 2012, when the price of Indian basket of crude was in the range of US$ 110/bbl. Subsequently, crude prices have reduced considerably. During current year 2015-16, the average price of Indian basket of crude is US$ 57.83/bbl (till 28 Aug'15) and presently it is hovering around US$ 47/bbl.

Existing rate of OID Cess of Rs. 4,500/MT works out to the order of US$ 9.52/bbl (considering exchange rate of Rs. 63/$ and BMT factor of 7.5 bbl/MT). It is also pertinent to mention that at current level of crude prices and cost of production, the economic viability of many of the schemes/projects already approved by ONGC is in jeopardy. Therefore, at current level of crude prices, there is an urgent need for review of present applicable rate of OID Cess of Rs. 4,500/ MT (equivalent to US$ 9.52/bbl).

It is recommended that at the present level of crude price, upstream oil companies are not in a position to absorb the applicable OID Cess and there is an urgent need for review of the existing rate of OID Cess. It is suggested that keeping in view the volatility in crude prices, it would be prudent that OID Cess may be levied at ad-valorem basis, say @ 8% to 10% on realized price.

3.13.4. Reduction of Customs Duty on LNG import

Last two decades have seen substantial economic growth in India coupled with increased energy consumption to drive a fast growing economy. Given India's future growth aspirations, it is clear that access to abundant energy will be critical to sustaining the momentum of this growth. Thus, energy security has assumed strategic importance for a country like India. On the other hand, India has few indigenous energy resources, which are not environment friendly. Under this energy condition necessarily the country has to diversify its fuel mix and look to global energy markets for its energy needs. In the Indian context, imported LNG can only be a long term solution.

Despite the few domestic discoveries adding marginally the natural gas production, but the demand for natural gas has continuously outstripped the supply. Therefore imported LNG will be critical to overcome the wide gap between gas demand and domestic production. LNG being a cleanest fossil fuel compared to traditional fuels like oil and coal which are not environment friendly, it must be promoted and at the same time deserves more fiscal concession. The Hydrocarbon Vision also envisages increased usage of natural gas/LNG as a clean and efficient energy source.

It is recommended that customs duty on imported LNG may be reduced to 2.5% if it cannot be exempted altogether in one go.

3.13.5. Anomaly in Excise and Customs Notifications for Exemption of Duty on Furnace Oil

As per Notification No. 12/2012- Customs dated 17.03.2012, customs duty in case of import of Furnace Oil is exempt provided such import of Furnace Oil is for the purpose of manufacture of fertilizers. However, Notification No.12/2012-

Excise dated 17.03.2012, exempts excise duty on the furnace oil provided the following two conditions are satisfied:

(i) Such furnace oil is intended for use as feedstock in the manufacture of fertilizers.

(ii) The exemption shall be allowed if it has been proved to the satisfaction of an officer not below the rank of the Deputy Commissioner of Central Excise or the Assistant Commissioner of Central Excise, as the case may be, having jurisdiction that such goods are cleared for the intended use specified in column (3) of the Table.

On account of the variance in the notification under customs & excise, the sale of this product indigenously has been affected as the customers are able to import the product free of duty even if the product is not intended for use as feedstock in the manufacture of fertilizer. This results in higher imports and drain in foreign exchange even though the product is available locally.

Consider aligning the import duties (BCD and CVD) on import of FO and excise duty on manufacture of FO for use in fertilizers by allowing same exemption to domestic manufacture as has been allowed in case of imports, or impose levy of BCD and CVD on import of FO for use other than in the feedstock in the manufacture of fertilizer so as to bring in price parity between imported and indigenously manufactured FO.

3.13.6. Tax Holiday for Exploration and Production Activities Relating to Natural Gas and CBM

To avoid uncertainty, it is important that the Government should clarify that for the eligibility to avail tax holiday under Section 80-IB of the Act, the definition of 'mineral oil' would include natural gas retrospectively irrespective of NELP round and that the benefit should also be available to Coal Bed Methane ("CBM"). In other words, it should be explicitly provided that the term 'mineral oil' will include natural gas and CBM for all past and future rounds of NELP for the purposes of Section 80-IB of the Act.

3.13.7. Treatment of Losses and Depreciation Allowance in Amalgamation or Demerger

Section 72A of the Act needs to be amended so that accumulated loss and unabsorbed depreciation allowance from specified business of laying and operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network is allowed to be carried forward and set off in the hands of the resulting company in case of demerger or amalgamated company in case of amalgamation, provided the loss is directly relatable to the undertakings transferred.

3.13.8. Scope of 'Undertaking' for the Purposes of Tax Holiday

The limitation of the tax holiday for oil and gas to a single undertaking based on a single PSC is regressive and inconsistent with the construct of tax holidays for other sectors. This should be amended to define an 'undertaking' (consistent with the judicial decisions) that each distinct field development evidenced by a separate development plan should be an undertaking eligible for the tax holiday. This is all the more important as the amendment has been made retrospectively and declaring each block as a single undertaking, that too with retrospective effect, will adversely affect the profitability of operators.

3.13.9. Extension of benefit under Section 80-IB(9) from 7 years to 10 years

It is suggested that the benefit under Section 80-IB(9) of the Act may be extended from 7 years to 10 years to companies engaged in production of mineral oil and natural gas. It may further be provided that the benefit under Section 80-IB(9) of the Act shall not be restricted only to blocks licensed under a contract awarded till 31st March, 2011 and the period be extended till 31st March, 2017.

3.13.10. Amend Definition of 'Infrastructure Facility' to include Exploration and Refining Activities

Definition of 'infrastructure facility' as per Section 80-IA of the Act should be amended to include exploration and refining activities.

3.13.11. Extension of Section 42 to investment in Foreign E&P blocks

Section 42 of the Act is a special provision for computing the profits or gains of any business consisting of prospecting for or extraction or production of mineral oils. It provides for specific deduction subject to the satisfaction of following cumulative conditions:-

- Expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee;
- Companies have entered into an agreement with the Central Government for extraction or production of mineral oils; and
- Such agreement has been laid on the table of each house of Parliament.

The word "surrendered" in the section precludes allowability of deduction for expenditure incurred in an area which cannot be surrendered due to practical constraints. It is therefore suggested that the word "surrendered" may be deleted from section 42(1)(a) of the Act or the word "surrendered" may be replaced with the term "relinquished in full or in part".

Accordingly, as per Section 42 of the Act, deduction is not allowed for expenditure incurred by Indian companies for prospecting or extraction or production of mineral oils from oil and gas blocks situated abroad.

It is suggested that Section 42 of the Act be amended to remove the aforesaid conditions so as to enable Indian companies to claim specific deduction of expenditure incurred on oil and gas blocks situated outside India.

Exploration of hydrocarbons is a high risk business. By its very nature, the outcome of such expenditure is quite uncertain. However, to ensure energy security of the country it is very essential that all efforts are made to explore all prospective areas available in the country. Therefore, it is recommended that weighted deduction of 200% in respect of exploration expenditure under section 42 of the Income-tax Act, 1961 be provided.

3.13.12. Taxation of Non-Residents on Presumptive Basis under Sections 44B, 44BB, 44BBA and 44BBB

A. Application of Section 44BB where Section 44DA applies

Finance Act, 2010 made an amendment in the proviso to Section 44BB of the Act which provided that Section 44BB shall not apply to a non-resident taxpayer in case the provisions of Section 44DA of the Act are applicable. A corresponding amendment was also made in Section 44DA of the Act. These amendments were made effective from April 1, 2011. However, there has been a controversy on the aforesaid amendment wherein Revenue authorities contend that the amendment has a retrospective impact. On this basis, revenue authorities have been reopening completed assessments under Section 147 of the Act even though judicial authorities have held that the amendment is prospective in nature [BJ Services Company Middle East Limited vs. DDIT (Special Appeal No 316 and 317 of 2012, Uttarakhand High Court)]. The prospective application of the amendment is also evident from of the intention of the legislature as per the notes to clauses to the Finance Act, 2010 explaining the said amendments.

It is suggested that a clarification be issued to clarify that the amendment is prospective in nature. This will help avoid unwarranted litigation.

B. Scope of 'FTS'

The term 'FTS' has been defined in Explanation 2 to Section 9(1)(vii) of the Act. The consideration received for 'mining or like project' has been specifically excluded from the definition of FTS. The services rendered by the non-resident oilfield services providers (such as seismic data acquisition and processing, provision for hire of vessel etc.) are integral to exploration of mineral oil and fundamental to the drilling operations.

The CBDT, vide instruction no 1862 dated October 22, 1990, also clarified that the services rendered in connection with prospecting etc. of mineral oil can be termed as 'mining' operations. However, it has been seen that the Revenue Authorities have not been abiding to the above instruction in holding that services rendered by the non-resident oilfield services providers are in the nature of FTS. Thus, the benefit of deemed profit regime under Section 44BB of the Act is being denied to such non-resident oilfield service providers.

In order to avoid unwarranted litigation in India on applicability of provisions of Section 44BB of the Act, it is suggested that amendment be made in Section 9(1)(vii) of the Act to specifically exclude the services rendered by oilfield service providers from the ambit of the term FTS.

C. Statutory Taxes not to form part of Gross Receipts

Certain Sections of the Act provide for taxation of non-residents on a presumptive basis, such as Sections 44B, 44BB, 44BBA and 44BBB of the Act. These Sections deem a specified percentage of the amounts received by the non-residents for the activities covered by the provisions as income under the Act. In the past there has been considerable litigation on whether Government dues, such as service tax, recovered by the non-residents from the Indian parties would constitute part of gross receipts [such as DIT vs Schlumberger Asia Services Ltd (317 ITR 156) (Uttarakhand HC), Siem Offshore Inc vs DIT (337 ITR 207) (AAR)]. As these statutory dues are to be paid over by the non-resident taxpayers to the Government, there is no income element therein.

In view of the above, these Sections of the Act should be amended to provide that statutory taxes and dues (such as service tax) recovered by the non-resident service provider from the Indian residents would not form part of gross receipts for computing deemed income under the Section. This will be fair and will eliminate unnecessary litigation on the issue.

3.13.13. Exemption from MAT

Oil exploration and production companies should be exempted from the purview of Section 115JB of the Act to promote the domestic exploration and production. This will reduce import dependence of the nation.

3.13.14. Clarification on Depreciation on Premium paid to Acquire E&P Assets Abroad

It should be explicitly provided that the premium paid to acquire any Exploration and Production asset abroad is intangible asset eligible for depreciation under Section 32 of the Act @ 25%.

3.13.15. Weighted Deduction for Cross Country Natural Gas/ Crude/ Petroleum Oil Pipeline Network

Under Section 35AD of Act, 100% deduction in respect of capital expenditure incurred (other than land, goodwill and financial instrument) prior to commencement of operation of specified businesses carried on by a taxpayer including laying and operating a cross-country natural gas/ crude / petroleum pipeline network for distribution is allowed. The Finance Act, 2012 further increased the weighted deduction to 150% of the expenditure in respect of certain specified businesses as per Section 35AD (1A) of the Act. It is recommended that similar weighted deduction should be allowed to specified business of laying and operating a cross country natural gas / crude / petroleum oil pipeline network for distribution.

3.13.16. Allow 100% Depreciation on Equipment used for Upgradation of Fuel Quality

Under the Auto Fuel policy, the Govt. has directed oil companies to supply High Speed Diesel with minimum prescribed Sulphur content. As per the proposed Auto Fuel Policy of Government oil companies are required to provide the HSD with maximum sulphur content of 0.005% (BS-IV) with effect from 01.04.2017 throughout the country. Huge capital investment is required to be undertaken so that they can comply with the Directives of the Government and to remove the Sulphur from crude oil which is in excess of prescribed limits. Such reduction of Sulphur content also helps to reduce

the Air Pollution. It is recommended that plant and machinery and equipments used for the purposes of upgrading auto fuel quality in accordance with the Auto Fuel Policy of Government of India through reduction of sulphur content or octane improvement be made eligible for depreciation @ 100%.

PAPER AND PAPER BOARD

3.14.1. Customs Duty on Paper/Paperboards

The Indian Paper/Paperboard industry has made significant capital investments to ramp-up capacities for meeting domestic requirements. The Industry has strong backward linkages with the farming community, from whom wood, which is a raw material, is sourced. A large part of this wood is grown in backward marginal/sub-marginal land, which is potentially unfit for other use. This industry, being mainly based in backward areas, has transformed the socio economic conditions of the population residing there. It is therefore strategically important and also necessary to keep Paper/ Paperboard industry, outside the ambit of FTA's (ASEAN etc.) and recognise this Industry as "sensitive" deserving special treatment. Increased imports from foreign countries are severely impacting the economic viability of many paper mills in India.

In order to provide a level playing field to the domestic industry it is recommended that:

(a) Customs duty for import of Paper and Paperboards should be increased and brought in line with agricultural products as currently industry is sourcing majority of its raw materials from Agro-forestry – supporting millions of farmers in creating value on their marginal lands.

(b) This category to be kept in the 'sensitive' List (i.e., no preferential treatment) in bi-lateral and multi-lateral trade treaties and agreements.

3.14.2. Reduction of Excise Duty on Poly-coated Paper and Paperboards

The market size in India for disposable cups is close to 40 billion cups per year out of which 10 billion cups are paper cups. The balance 30 billion is plastic cups - here too there are two varieties viz., HIP (High Impact Polystyrene) and PP (Polypropylene). Among plastic cups, 60% of the market is for PP, 30% is for Recycled HIPS and 10% is for Virgin HIPS.

Poly coated paperboard is used for manufacture of paper cups, which contains more than 90% by weight of bio-degradable food grade paperboard and is an eco-friendly substitute for plastics. The global trend is to actively discourage the use of plastics (which do not conform to requisite hygiene and environmental standards) and to replace it with poly coated paper / paperboard.

In India major consumers of this type of paper / paperboards are SSI / SME units engaged in manufacture of paper cups that are increasingly being supplied to institutional customers like the Railways, the FMCG sector and the household sector. Paper cups are used for mass consumption items such as tea, coffee, fruit juices, soft drinks, ice cream etc.

Paper and paperboard that is coated / impregnated / covered with poly coating are classified under Central Excise Tariffs 4811 51 90 (Bleached, weighing more than 150 g/m2 - Other) and 4811 59 90 (Other - Other) with an excise levy of 12.5% ad valorem – even as a large number of paper / paperboard items covered by Central Excise Tariff 4802, 4804, 4805, 4807, 4808 and 4810 are excisable to excise duty only at 6% ad valorem.

Further SSI/SME Units are not able to avail Cenvat credit for the excise duty paid on the base board used for manufacture of poly coated paper cups.

It is recommended that excise duty on poly coated paper / paperboards, classifiable under Central Excise Tariffs 4811 51 90 (Bleached, weighing more than 150 g/m2 - Other) and 4811 59 90 (Other - Other) be reduced to 6% from 12.5% - in line with most other paper / paperboards classifiable under Chapter 48. Such a move will also be a "green" initiative in line with global trends.

3.14.3. Customs Duty on Wood Logs / Chips

India is a wood fibre deficient country, with the domestic demand-supply gap in wood widening every year. Raw materials constitute 35-40% of cost of paper production. Currently, the wood and bamboo demand of the country's Pulp & Paper Industry is around 11 million tonnes against availability of 9 million tonnes per annum. The demand is expected to increase to 15 million tonnes by 2024-25.

India being a fibre deficient country, indigenous paper manufacturers are forced to use a variety of raw material such as wood, agro-residues, waste paper, etc. Because of this reason the domestic paper producers import substantial quantities of wood pulp and waste paper to meet the raw material deficit.

On account of the significant demand-supply gap in respect of the primary raw material for the industry, the cost of wood has gone up exponentially over the last few years. Shortage of supply with exponential rise in prices of wood is adversely impacting the competitive edge of the industry and the domestic manufacturers are ceding ground to cheaper imports. It is therefore, important to bring down the cost of domestic as well as imported raw material.

In India, the total import duty presently on the primary raw material - wood logs / chips - is 9.27%, with the basic customs duty at 5%. It is important to mention here that under the India-ASEAN Free Trade Agreement (FTA), wood logs / chips imports attract 'nil' rate of basic customs duty.

In order to reduce input cost of wood, the Government should introduce 'zero' rate of customs duty for all heads on import of wood logs / chips (HS No. 44011010, 44012100, 44012200).

3.14.4. Customs Duty on Import of Pulp

In May 2012 the Government reduced the import duty on pulp from 5% to "Nil". More than 1.25 million MT of pulp, valued at approximately USD 820 million is imported in to the country every year. The customs duty for these imports is estimated to be about Rs. 245 crore p.a.

The break-up of the pulp imports is as under:

Type of Pulp	Quantity ('000 MT)	Value (Rs. Crore)
Hard Wood Chemical Pulp	900	3,420
Soft Wood Chemical Pulp	200	900
Bleached Chemi Thermo Mechanical Pulp (BCTM Pulp)	160	580
Total	**1,260**	**4,580**

In view of the fact that Soft Wood cannot be grown in the country, requirement of Soft Wood Pulp will have to be met through the import route only. However, in so far as Hard Wood Pulp is concerned, it would be pertinent to note that the domestic industry is working closely with the farming community for creating sustainable supply of wood – a key raw material for hard wood pulp – through re-development of waste-lands.

In so far as Bleached Chemi Thermo Mechanical Pulp (BCTMP) is concerned, the technology for manufacturing BCTMP has not been available in India. In line with the vision "Make in India", for the first time, the industry is setting up a state of art BCTMP manufacturing facility in India, which is expected to be operational by June 2016. The project involves huge capital investments and will continuously save forex outflows that would otherwise be spent for import of BCTM pulp.

In an era of increasing global competition it is necessary for governments and industry to work in partnership to ensure creation of economic wealth for the nation. Accordingly, for creation of sustainable sources of fibre required by the pulp and paper industry it is recommended that:

(i) policy measures be put in place to facilitate private sector participation in plantation development programmes, and

(ii) 10% customs duty on pulp be imposed only for Hard Wood Chemical Pulp and Bleached Chemi Thermo Mechanical Pulp (BCTMP)

3.14.5. Incentives for Investments in "Clean" Technologies by Paper Industry

Today technology stands out as the most critical factor in achieving sustained competitiveness and industry performance. Indian Paper Industry is a signatory to the Government of India's Charter on Corporate Responsibility for Environmental Protection (CREP). This calls for substantial investments in green technologies such as introduction of ECF (Elemental Chlorine Free) pulp manufacture, Ozone bleaching etc. to ensure a positive environmental footprint. The indigenous mills are consciously focusing on clean technologies which are cost effective with quality benefits. The Government should encourage such initiatives of the industry. But Indian Paper Industry being a traditional industry suffers from inadequate economy of scale and obsolescence of process technology.

In order to encourage manufacturers within the industry to adopt environment friendly "clean" technologies that ensure, inter-alia, reduced carbon footprints, better emission norms, better effluent treatment norms, usage of renewable sources of raw material and energy, improved waste recycling, etc., appropriate fiscal benefits should be provided.

It is recommended that-

(a) Entitlement for import of all raw materials at a 50% concessional rate of duty.

(b) Exports by manufactures who have adopted environmentally friendly technology should be granted additional incentives in the form of cash incentive of 5% of FOB.

(c) Full exemption from excise and VAT taxes for paper and paperboard produced using clean technology.

(d) Accelerated tax depreciation @ 150% of the normal depreciation rates under income tax laws for investments on environment friendly technology, should be provided to the industry.

These measures will not only promote preservation of ecology, it will also incentivize all players in the Indian Paper Industry to adopt 'green' technologies, thus aligning domestic industry to international eco-friendly norms.

3.14.6. Clean Energy Cess

Clean Energy Cess on purchase of coal was imposed in the Union Budget 2010. No doubt, the Cess was introduced on the principle of "polluter pays". Whilst this principle may be justifiable for industries causing environmental pollution, it is to be recognized that within the industry there are players who have invested considerable sums of money on state of the art technology like elemental chlorine free paper manufacture, ozone bleaching processes, waste water management, solid waste recycling, usage of energy from renewable sources etc. to ensure environment friendly manufacture.

In view of the above, levy of a clean energy cess on coal – which impacts adversely on the cost competitiveness of manufacturers – should be restricted to only those manufacturers who do not adopt clean technologies. Manufacturers who have already adopted internationally recognized clean technologies, at considerable investment, should be incentivized and encouraged by way of being exempted from levy of any clean energy cess.

It is further recommended that the 'Clean Energy cess' on coal, if used for power generation, should be made cenvatable.

REAL ESTATE

3.15.1. Service Tax – Value of Construction Contract liable to tax

For construction contracts where service provider does not maintain separate books of accounts and services, the current Service Tax law provides for taxation @ 40% of the total amount charged for such contract [Rule 2 A (ii) of Service Tax (Determination of Value) Rules 2006]. On the other hand, in most of the States for such contracts services portion is assumed as 30% or less, and remaining value is subject to VAT. Some representative States standard deduction towards services is as follows:

State	Standard deduction for Services
Andhra Pradesh	30%
Delhi	20%
Maharashtra	30%
Haryana	25%
Gujrat	30%
Tamil Nadu	30%

Therefore, there is a double taxation happening for the difference in the value.

It is recommended that the said Rule 2A (ii) percentage chargeable to service tax be brought down to a maximum of 30% from the current 40% of the total amount charged under such contracts. This would act as a stimulus to the much desired growth of Real Estate sector.

3.15.2. Real Estate Investment Trusts (REIT's)

Union Budget 2014-15 had introduced a tax regime for REITs and Budget 2015-16 made further amendments to the taxation of REITs. However, REITs have not really taken off and the following further amendments will help in making REITs a reality:-

(a) Removal of Dividend Distribution Tax ('DDT') on distribution of dividend by Special Purpose Vehicle ('SPV') to REIT

As per the current legislation, dividend received by a business trust shall be subject to DDT at the level of SPV but the same is exempt in the hands of the business trust. DDT at the SPV level may lead to multiple levels of tax. This makes the business tax structure tax inefficient. It is suggested that incidence of DDT be removed on distribution of dividend by SPV to REIT. This is also in-line with global REIT taxation regimes where there are no distribution taxes

(b) Extension of capital gains exemption on interest or assets in a firm to business trust

Under the current legislation exemption of taxes has been provided only in case of transfer of shares of a SPV by sponsor. SEBI regulations in relation to Business Trusts permit the Business Trust to hold assets directly as well as hold interest in a firm. Therefore, the same tax treatment should be extended to the sponsor on transfer of assets or interest in firm to the Business Trust against issuance of units. Provision of exemption on transfer of assets directly would encourage the sponsors/ investors to transfer assets. Where an asset is directly transferred or interest in a firm is transferred to the Business Trust, there would not be any dividend distribution tax in the chain and therefore, the investors would benefit from higher distributions. Business Trust is a new product and hence requires tax incentives to make it attractive for investors from various classes.

(c) Clarity on exemption on transfer of shares of SPV to REIT

Based on the combined reading of Section 47(xvii) and explanation to Section 10(23FC) of the Act, in order to be eligible for exemption of taxes under Section 47(xvii) the SPV whose shares are transferred should be an Indian company in which the Business Trust already has controlling interest. Practically, once a Trust is registered, the sponsor/ investor would transfer shares of SPVs to the Business Trust against issue of units. However, as per the definition of SPVs, the exemption as provided under Section 47(xvii) would not be available to the sponsor/ investor in such a situation as Business Trust will get the controlling stake only after such transfer takes place. Therefore the exemption contemplated in Section 47(xvii) may be theoretical. Based on the reading of memorandum explaining provisions of Finance Bill, 2014, we understand that the intention of the legislature is to provide exemption to sponsor/ investor on sale of shares of SPV. However, a literal interpretation of the provision seems to suggest a different view. Accordingly, it needs to be amended.

(d) Expenses of Business Trust and allocation of Business Trust expenses to income distributed to unit holders

The new tax regime in relation to Business Trusts does not clarify deductibility of the expenses in the hands of business trust. Further, section 115UA (1) of the Act provides that 'any income distributed by a business trust to its unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder as it had been received by, or accrued to, the business trust'. Since distribution of income to unit holders is proposed to be taxed in the proportion in which income is earned by the Business Trust, it is imperative that provisions be introduced prescribing the method of allocation of expenses of Trust on distribution to unit holders. New tax regime for Business Trust does not provide a clear road map in relation to deductibility of expenses and allocation of the same in the hands of unit holders. In absence of clarity, such deductibility and allocation would be left open for interpretation by tax authorities. Business Trust structure may not be considered as a tax efficient structure. It is recommended that an allocation methodology should be put in place in relation to expenses incurred at the REIT level.

(e) Period of holding of units of a business trust to qualify as long term capital asset should be 12 months

It is mentioned in the memorandum that listed units of Business Trust would be given same tax benefits in respect of taxability of capital gains as equity shares of a company. Business Trusts should be accorded same treatment provided for listed equity shares. Accordingly, period of holding for the purpose of capital gains should be 12 months and not 36 months. In absence of the same, intention of the legislature to grant same tax benefits is not achieved.

3.15.3. Deduction of Interest paid on Borrowed Capital

The deduction available under section 24 of the Act is to a maximum limit of Rs. 2,00,000/- for interest on loan taken for acquisition/construction of self-occupied house property. Given the rising interest rates and the increase in property prices and also to spur the demand for housing, it is recommended the exemption should be increased to at least Rs. 3,00,000/- per annum.

3.15.4. Taxability of Unsold Flats in the Hands of Real Estate Developers

The issue relates to the addition on account of annual letting value (ALV) of flats, constructed but lying unsold, assessed on notional basis under the head "Income from head House Property" in the hands of real estate developers. Such unsold construed flats as per the specific exclusion provided in Section 22 of the Act would not attract tax under the head 'income from house property' which comes within the purview of exception provided in Section 22 of the Act, in as much as, it exclude the property that an owner occupy for the purpose of his business.

However, the tax authorities have made additions to the income of the real estate developers on account of annual letting value (ALV) of flats, constructed but lying unsold, assessed on notional basis under the head "Income from head House Property". It has not been appreciated that the real estate developers are not in the business of renting out of

flats and letting out vacant or other properties. Thus, such real estate developers cannot be taxed in respect of ALV of flats notionally because they (as owners) are occupants of the flats, and such occupation is limited for the purpose of business, as a builder.

It is recommended that a clarification may be issued by the CBDT to provide that property held as stock-in-trade by the real estate developer for the purposes of its business would not to be assessed to income tax on a notional ALV basis under the head "Income from House Property".

3.15.5. Clarity on Taxability of Joint Development Agreement ('JDA')

Section 45 of the Income Tax Act provides that any profits or gains arising from the transfer of a capital asset in the previous year shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place. Further, section 2(47) of the Act defines transfer to include allowing possession of immovable property under a contract referred to in section 53A of the Transfer of Property Act 1882. Given the above there has been considerable litigation between the tax authorities and taxpayers around (i) timing of taxation and (ii) method of arriving at sale consideration. Appropriate clarifications/ amendments should be made to provide that in case of a JDA between land owner and developer, the profit or gain from the transfer of land will arise only on completion of the development project or when share of revenue from the sale of the property or share of built-up area, on completion of the project, is received by the land owner.

Similarly, it should be clarified in the Service Tax law as to the person liable to pay tax, point of taxation and valuation aspects covering revenue split, where consideration is not in money etc.

3.15.6. Characterization of Rental Income

There is an ambiguity prevailing around characterization of rental income as house property or business income. Such characterization should be clarified so as to ensure that uniform practices are followed across industry and litigation arising in this regard is removed.

3.15.7. Raise the Limit for Deduction for Principal Repayment

In the case of home loan repayments, the ceiling under tax benefits is capped at Rs. 1,50,000/- for principal paid, which is very less, particularly when home loan principal repayments are clubbed with other tax saving instruments. Therefore, the deduction for principal repayment of housing loan under Section 80C of the Act should be either increased from the overall existing limit of Rs 1,50,000 or the principal repayments should be considered for a separate / standalone tax exemption (rather been clubbed under Section 80C of the Act).

3.15.8. Infrastructure Status to Development of Integrated Townships

An integrated township involves development of residential, institutional, educational, medical, community and commercial buildings etc. In the process of development of an integrated township, apart from development and construction of above establishments, various facilities such as roads, water supply, sewerage system, sanitation, water treatment, electrification, land scaping, solid waste treatment, horticulture and other civic services are required to be created/provided. While according approval, the State Government specifically directs that these development projects including all facilities / services created/ provided therein will ultimately be handed over to respective State Governments / Local Bodies and shall not remain with the developer. These integrated township projects are, therefore, in a way at par with the BOT (Built, Operate & Transfer) projects.

In the light of above facts and in order to motivate the genuine Real Estate Companies to come forward and step into promotion and development of large integrated townships in line with above arrangements to mitigate the huge shortage of housing to all class of society and development of robust infrastructure for the Indian economy, it is requested that Integrated township development projects be brought within the definition of infrastructure or at least

various facilities such as roads, water supply system etc. created after obtaining Government approvals be considered as infrastructure facility for the purpose of Section 80-IA of the Act and deduction under Section 80-IA of the Act be granted to the developers in respect of such infrastructure development.

3.15.9. Deduction for Ground Rent

Deduction for ground rent should be restored while computing the income under the head 'House Property'. Considering the rising value of land and proportionate ground rent in metros and other big cities, it is recommended that the deduction for ground rent be separately provided i.e. in addition to the overall statutory deduction of 30% available within the ambit and scope of Section 24 of the Act.

RENEWABLE ENERGY

3.16.1. Solar Manufacturing

(a) To modify the subsidy scheme for roof top solar and extend the same to all the adopters instead of restricting the same only to government buildings and PSU. Government of India has set a target of 40 GW for the rooftop segment. Such target will not be met if it is restricted only to small user segment. The subsidy can be a fixed price on approved capex for a definite period and reviewed thereafter.

(b) Till last year, exports of PV cells from India were eligible for 2% export incentive and also for deliveries to SEZ within India. From this year the incentives are restricted to only Category B countries which are not active in the solar sector. Such a restriction needs to be removed to open up exports from India.

(c) Income tax benefit for Renewable SEZ – Instead of MAT applicability now, the renewable units in SEZ should enjoy the IT benefit as before for a period of 5 years from start up.

(d) VAT exemption is available in few states and hence may be extended nation-wide to avoid anomaly of CST and VAT on solar products

(e) There is an excise duty exemption for Solar products manufactured within a SEZ / DTA for DTA sale. This should be extended for all components that are to be sold in DTA which may not directly be a solar product but a component used in the manufacturing of a solar product.

3.16.2. Solar Power Generation

(a) Allocation for sovereign fund to support dollar based tariff / competitive bidding in solar power generation procurement

(b) Removal of cap for margins and maturity under the ECB guidelines for solar power generation projects

(c) Allow uncapped capital lending from Holdcos as part of the Yieldco arrangement to enable higher ECB fund availability

(d) The possibility of Green Bonds for Solar Sector may be considered for projects once they achieve CoD and rated at AA or above. These should be tax free bonds (as allowed to NTPC recently). This will reduce the cost of borrowing to 7% - 7.5%

(e) Solar parks should be treated on par with SEZs and MAT exemption may be provided to power projects within Solar Parks.

(f) Section 80 IA benefits should be available to an entity that is merged or amalgamated with its parent or subsidiary or sister company. Extension of 80 IA for projects having CoD after Mar 2017 by 3 years. Generally for any new

project, an SPV is made to facilitate project development. Given that investment is done by Parent in that SPV, post development if Parent wants to merge that subsidiary with other similar SPVs or with Parent itself for better management or other operational considerations, it should not stand to lose 80IA benefits. The intention of 80IA is to promote investment and that is achieved at CoD of the project.

(g) Include standalone storage solution under the definition of the renewable generation. Waiver of customs and excise duties on Energy Storage Batteries and their ancillaries associated with Solar Roof top and Utility scale renewable power plants

(h) Exemption of service tax for companies providing power backup services

3.16.3. Exemption to Income from Sale of Carbon Credit Entitlements

Carbon credit is an incentive available to the industries reducing CO2 emission by investing in energy efficient technology. Considering the 'global warming' impacts, it is a very important initiative on the part of industries. Energy efficient and carbon emission reduction technologies are substantially costly and results in additional investment for industries. It is very much likely that the income generated from sale of Carbon Credits may or may not compensate additional outflow laid out for earning the same.

Section 10 of the Income Tax Act should be amended to provide exemption to income from sale of Carbon Credit entitlements. In addition, in order to provide impetus to generation of power through renewable energy sources, a specific tax holiday for the same may be provided in the Section 80-IA of the Act.

RETAIL

3.17.1. Allow Carry Forward of Losses under Section 72A

In order to enable mergers and amalgamations in loss making retail companies, so that the amalgamated entity is able to carry forward the predecessor losses, section 72A of the Act should be extended to retail companies, as currently there is an ambiguity prevailing as to whether retail companies come under the definition of industrial undertaking or not, which is one of the mandatory conditions for carrying forward of losses under section 72A for any merger and acquisition.

3.17.2. Allow Weighted Deduction under Section 35(2AB)

Currently 200% weighted deduction is permissible for in-house approved R&D under section 35 (2AB), however the same is restricted to manufacturing organization. Retail is not considered as manufacturing, however retail companies also incur substantial R&D expenditure, which is very much required for growth and survival of the industry. Hence this benefit should be extended to retail companies.

3.17.3. Extend deduction under Section 35AD

Investment linked incentives provided to the specified businesses under section 35AD of the Act should be extended to the retail sector as well.

STEEL AND OTHER FERROUS PRODUCTS

3.18.1. Increase in Import Duty on Steel Long and Flat products

Customs duty on imports of Iron & Steel at present is 10% on Long Products and 12.5% on Flat Products. In view of the continued economic slowdown in the country which had an adverse impact on the steel sector as also keeping in view

the investments undertaken by domestic steel producers in anticipation of an increase in consumption in the country, there is an urgent need to provide protection to the domestic industry. This becomes all the more imperative in view of oversupply in the global market which has led to increased protectionism being resorted to by almost all the countries to protect their local industry.

During April-August 2015, India imported 4.5 million tonnes steel as compared to 2.9 million tons during April-August 2014 registering a whopping 51% growth. Exports, on the other hand, fell by 28%, and were 1.76 million tons against 2.4 million tons in April-August 2015.

It is recommended that the basic customs duty on all steel imports may be raised to 25%.

3.18.2. Import duty on Manganese ore, Chrome ore etc.

Customs duty on Manganese ore, Chrome ore, Molybdenum ore, Vanadium oxides, Hydroxides and other salts of Oxo metallic Acids (Vanadium Oxides Concentrates and Ammonium Meta Vanadate) may be reduced to nil from the existing 2.5%.

3.18.3. Reduction in Customs Duty on Coking Coal

Import duty of coking coal has been increased to 2.5% in the Union Budget 2014-15. Coking coal is used largely by the steel industry. Negligible quantity of coking coal is available domestically, and thus the need is met mainly from imports.

The zero duty on coking coal is in place since 1978. The increase in import duty from zero to 2.5% on coking coal has increased the cost of steel making substantially, leading to domestic steel being uncompetitive vis-à-vis imports. It will also contribute to inflation.

It is therefore recommended that the duty on coking coal be exempted as was the case prior to the Budget 2014-15.

3.18.4. Reduction of Basic Custom Duty on Metallurgical Coke

Basic Custom Duty on metallurgical coke has been placed at 5%. Coking coal, Steam coal and Met coke are key inputs in steel making and account for substantial portion of cost of production for Steel. Historically coal used for metallurgical purposes has enjoyed exemption as steel is critical in fuelling India's growth. Subsequently, due to scarce availability of coking coal technology has been developed to use other coal (non-coking coal including what could be termed as steam coal) for metallurgical purposes through technologies such as COREX. During the period 2012-2013 such coal was exempt (Sl. No. 123 of Notification No. 12/12-Cus dated 17.03.2012) but this exemption was subsequently withdrawn. It is suggested that basic custom duty on metallurgical coke may be reduced to NIL.

3.18.5. Increase of Basic Custom Duty on LAM Coke

Basic Custom duty on LAM Coke be increased from 5% to 10% ad-valorem. LAM Coke is a value added product and made from Coking Coal at various captive and merchant Coke Oven Plants for onward usage for metallurgical purposes mostly in Blast Furnaces for Steel making. Devaluation of its currency by China has made its imports very cheap and Indian Coke Oven Plants are incurring losses.

3.18.6. Reduction of Custom Duty on Natural Gas used for Production of Steel

India has a gas based steel manufacturing capacity of 10 MTPA accounting for almost 9% of the total steel manufacturing capacity in the country. The gas based units in western coast of the country were the earliest gas users and have contributed in a big way in nurturing the gas and steel industries during their nascent years. However, the units today are facing unprecedented challenges for their sustainability due to non-availability of affordable natural gas.

These units also represent more than 45% of sponge iron production in the country and are critically dependent on natural gas as feedstock. Although these units have an allocation of more than 7 MMSCMD domestic gas from APM and RIL KG D6 but are currently receiving less than 0.60 MMSCMD gas. Due to the non-operations of these units, it has to

face holistic adverse effects such as stranded investment and unemployment. It is recommended that customs duty on LNG is made NIL without any user condition so that user industries including Gas Based Steel Plants are able to import LNG for usage in manufacture of steel.

3.18.7. Reduction in Import Duty of Iron Ore

India is currently faced with a shortage in the production of iron ore, the primary raw material for steel making. The iron ore production in the country has fallen from 218 million tons in 2009-10 to 144 million tons in 2013-14 and 125 million tons in 2014-15. As a result, several Indian steel producers are importing the iron ore. But with the import duty of 2.5% on the imported ore, it is adding onto the financial costs for the domestic producers and is thus further eroding their shrinking margins.

Thus, till such time that the domestic production of iron ore increases and the supply gap is bridged, import duty on iron ore may be brought down to zero, from the currently levied 2.5%.

3.18.8. Import duty on Steel Grade Limestone and Dolomite

For Indian steel industry, the cement grade limestone reserves are adequate but the reserves of SMS, BF and Chemical grade limestone are not adequate and are also available in selective areas. Increase in steel production in the country, has led to rising demand for SMS and BF grade limestone. Therefore the limestone imports have been increasing consistently. It is imperative that Customs Duty on steel grade limestone (sub heading 2521 00 10) and dolomite (sub heading 2518 10 00) be reduced from 2.5% to NIL.

3.18.9. Reduction in Customs Duty on Ferro Nickel, Pure Nickel and Ferro Moly

Stainless steel is made of combination of iron, chromium, silicon, nickel, carbon, nitrogen, and manganese. Properties of the final alloy are tailored by varying the amounts of these elements. It is a highly raw material intensive industry with over 70% of the cost being accounted for by raw material and therefore adequate raw material availability is critical for this industry.

The key ingredients for production of stainless steel include Ferro chrome, Ferro Nickel, Pure Nickel, Ferro Moly etc. These are not available in India and need to be necessarily imported for production of stainless steel.

It is recommended that the basic Customs Duty on all key raw materials like Ferro Nickel, Pure Nickel, Ferro Niobium, Ferro Vanadium, Ferro Titanium and Ferro Moly be reduced to zero to ensure that domestic industry remains competitive globally. It would also help the Indian stainless steel manufacturers to pursue a more aggressive export strategy since they would be cost competitive in the international markets.

3.18.10. Import Duty on Electrodes, Refractory Material

Currently there is import duty of 7.5% on electrodes (sizes 30” and 16”) and 5% for refractory materials. As there is no sufficient domestic capacity for manufacture of these items and need to be imported, the cost of domestic producers is increased; therefore the import duty on electrodes and refractory material may be reduced to Nil.

3.18.11. Import Duty on Stainless Steel Scrap

The Domestic Stainless Steel Industry uses Electric Arc Furnace (EAF) route for manufacture of stainless steel and is, therefore, constrained to use Stainless Steel (SS) Scrap instead of Iron Ore. The bulk of the Scrap requirements of the Domestic stainless Steel producers are met through imports which is procured mainly from countries like Europe, Korea, South East Asia, Central Asia etc.

Despite the dependence of domestic industry on imported scrap, the Ministry of Finance, vide Notification No. 25/2013-Customs dated 8th May’2013, had announced increase in Basic Custom Duty on Stainless Steel Scrap (HS Code720421) and Steel Scrap (HS Code 720449) from NIL to 2.5%.

It is suggested that the duty on Stainless Steel scrap be restored to the original rate of "NIL". It may be pointed out that China maintains its scrap duty at zero.

3.18.12. Customs Duty on Seconds and Defective Goods falling under Chapter 72

Prime quality of major finished steel products are liable to customs duty @ 12.5%. However, seconds and defective goods falling under Chapter 72 of the Customs Tariff are liable to customs duty @ 15%. In view of the narrow margin of difference between the rates of import duties of prime quality and seconds / defective goods, there has been a surge of imports of 'seconds' and 'defective' steel products in the country. This is putting further pressure on the industry already grappling with the challenge of subdued demand and rising cost of production; alongside raising the quality concerns for long-term infrastructure and construction projects using steel. In order to suppress the imports of defective steel into the country, the rate of seconds / defective goods needs to be increased. It is suggested that Customs duty on seconds and defective goods falling under Chapter 72 be raised to 40%.

3.18.13. Reduction of Excise Duty on Pre-fabricated Steel Structures

Pre-engineered building / pre-fabricated structurals have emerged in India for last few years owing to fast track steel based construction and to incorporate the latest innovative designs requiring special profiles developed by structural engineers and architects in the field of construction.

It has been an anomaly that while the site based pre-fabrication of structurals are permitted to be used in the building / structure without payment of Excise Duty as these are not taken out of the site, the pre-fabrication activities conducted on structurals at outside premises of the pre-fabricated manufacturers are excisable @ 12.5%. This has led to mass fabrication of structurals at the site which do not follow the quality norms as required in structural fabrication and generally done by fabricators having little knowledge of good quality fabrication. On the other hand, the steel structurals fabricated at the premises of fabricators follow state-of-the-art technology and standard operating practices of good fabrication, are priced much higher (after loading Excise Duty of 12.5%) and hence lack orders.

It is, therefore, recommended that the Excise Duty on fabricated steel structure undertaken by PEB/Pre-fabricators at their own premises be reduced from the current 12% to 8%. This would reduce the price gap between steel fabrication at sites and at fabricators premises and would prompt the consumers to go in for quality fabrication

3.18.14. Classification of COREX under Central Excise Tariff

Existing tariff entry 2705 of Central Excise schedule covers: "2705: Coal gas, water gas, producer gas and similar gases other than petroleum gases and other gaseous hydrocarbons." Certain doubts have been expressed about classification of Corex Gas under the aforesaid entry of heading 2705. Blast Furnace gas is specifically mentioned in the Explanatory Notes of heading 2705. Blast furnace gas and corex gas both emerge as by-products in the process of manufacture of molten hot iron using, respectively, Blast furnace and Corex. The manufacturing process involved in the blast furnace technology and corex technology is similar. The by-product Corex gas is very similar in composition and use to coal gas and blast furnace gas covered under the tariff heading 2705. However, in the absence of specific mention of these gases under tariff entry 2705, a doubt is being created about coverage of corex gas as 'similar gases' under the said tariff entry. For removal of this doubt, either a clarification may be issued or the aforesaid entry in heading 2705 may be amended to specifically include Corex Gas.

3.18.15. Review of Exemptions (CVD and Excise Duty) on Grain Silos Kits

Domestic Grain Silo Kit Manufacturers who are largely in MSME sector have to pay 12.5% as Excise duty which is non-cenvatable. This is a significant cost impact particularly for a small sector player. Moreover, manufacturing sector in India faces domestic disparities viz. under-developed infrastructure and high finance cost which translate into 11-12% of additional costs.

Major material used in Grain Silo Kit is galvanized steel. India with a coated capacity of approximately 10 million tonnes compulsorily exports 30% of its production of 6 million tonnes, fetching lower margins due to shortage of domestic demand.

Hence 50% reduction in the payment of 12.5% of excise duty for domestic manufactures and bringing the import duty on Grain Silo kits at par with this new reduced excise duty, would partially compensate the domestic disparities, encourage domestic production, thus creating employment opportunities and demand for domestic steel.

3.18.16. Removal of Clean Energy Cess

The hike in clean energy Cess from Rs 100 per Tonne to Rs 200 per Tonne should be rolled back to the old level or be removed altogether. Steel Plants having ISO 14001 accreditation and or Clean Development Mechanism (CDM) under the Kyoto Protocol should be exempted from the payment of Clean Energy Cess.

3.18.17. Warehousing Facility for Steel Products

In the steel industry, it is a practice that most of the materials are sold from stockyards / depots which are situated across the country and there is a time lag between dispatch of material from the manufacturing plant and sale from the stockyard / depot. As such, there is possibility of a difference in price prevailing at the time of dispatch of materials from the plant and the price prevailing at the time of final sale of material from stockyard.

As per Warehousing provisions of Rule 20 of Central Excise Rules 2002, the Central Government may by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty subject to such conditions etc. as may be specified.

It is requested that Iron and Steel products should be included in the warehousing provisions under the said rule 20. Such change will not only simplify the procedures, but will also eliminate disputes relating to valuation at the time of dispatch from plant while, at the same time, achieving the purpose of levy of duty on final selling price.

3.18.18. Process of Cutting/Slitting of Sheet Metals should be deemed to be "Manufacture"

It is suggested that the process of cutting/slitting of sheet metals be considered as amounting to "manufacture" and hence leviable to excise duty.

Presently this is causing enormous confusion & administrative hurdles where service centres operate for cutting & slitting of sheets and supply to the industry. This is in view of the fact that in some cases (like profile cutting) it is considered as manufacture and in other cases it is not considered as "manufacturing" leading to complexities/litigation.

3.18.19. Weighted Deduction under Section 35AD of the Act

The steel industry is a highly capital-intensive industry. To improve the return on investment in the steel industry and to attract fresh investments, capital expenditure in steel business should be allowed weighted deduction of 150% of the expenditure under Section 35AD of the Act.

TEXTILES

3.19.1. Excise Duty on Man-made Fibres (MMF)

The value chain in textile and apparel sector has differential tax treatment. The levy of different rates has created needless distortions. In India, while excise duty on natural fibres like cotton, wool and flax is nil, man-made fibres and yarns attract duty as high as 12.5%. China, Pakistan, Sri Lanka, Indonesia and Thailand follow fibre neutral policy i.e. the duty on cotton/cotton yarn and MMF/MMF yarn textiles are imposed at the same level.

Globally MMF textiles constitute 66% of total production. However, in India it is only 34%; whereas cotton constitutes

66%. The global fibre consumption trend in future is likely to further tilt in favour of man-made fibres. One of the concerns raised by industry is that MMF being a high technology and high investment area requires an enabling and better fiscal environment At present, India also does not have the complete value chain in MMF i.e. fabric, processing and apparel making. Reduction in excise duty on MMF will stimulate the growth of the industry by attracting investments leading to completing the value chain and higher production and exports and thereby generate additional employment.

It is therefore suggested that excise duty on man-made fibres/yarns should be reduced to 8% to reduce the huge gap between the duties on man-made fibres and cotton. The revenue loss on this account would be made up with increased consumption as witnessed in 2008-09 when the excise duty on man-made fibres was 4%. This measure will further help the downstream industry especially weavers.

3.19.2. Removal of Import Duty on Dissolving Grade Pulp

Soft Wood Dissolving Grade Pulp is not available in India due to tropical weather conditions and per se has to be imported from temperate countries in Europe, North America, South Africa, etc. Soft Wood Pulp is highly essential to produce high quality Viscose Rayon. Further, the current domestic capacity of Hard Wood Pulp is approximately 2,11,000 MT as against a requirement of approximately 4,50,000 MT thus resulting in more than 50% shortage of RGWP. To overcome this shortfall, the domestic industry is compelled to import. VSF imports from ASEAN have NIL duly while pulp has 2.5% duty making it a case of Inverted duty structure. It is therefore recommended that the Import Duty on RGWP be brought down to NIL.

3.19.3. Textile Upgradation Fund Scheme (TUFS)

This Scheme has been operating since 1999 and has been prevalent over the period with various amendments and currently valid up to March, 2017. During last 3-4 years, there have been problems in implementation of this Scheme and many of the eligible beneficiaries have not been provided benefits. The present provision under the Scheme is not sufficient to take care of the arrears payable to various claimants.

Exports incentives are being rationalized due to multilateral commitments under WTO. Hence, TUFS is perhaps the only non-actionable support possible for Indian textiles industry. Current year budget allocation was reduced from Rs 1864 Crore to Rs 1520 Crore. Allocation needs to be increased to Rs 5000 Crore given new investments done by exporters and last year's pending applications for the scheme.

For the restructured TUFS, It is suggested that term loans sanctioned by banks should be considered under the existing TUFS scheme. Also, Capping under the scheme will discourage large investments in the domestic industry and derail competitiveness of Indian manufacturer.

TOURISM

3.20.1. Service Tax on Room Rent and on Sale of Food and Beverages

In Finance Act 2011 the scope of Service Tax was expanded to levy Service Tax on renting of Rooms and Food and Beverages sales by Air Conditioned Restaurants having liquor license (subsequently the coverage was extended to all restaurants) despite the fact that in hotels Luxury Tax is charged on renting of Rooms and VAT is charged by all hotels and restaurants on Sale of Food and Beverages.

Whilst the current abatement in respect of service tax has been provided @ 40% for Rooms and @ 60% for Food and Beverage, on the balance portion there is an element of double taxation – Service Tax and Luxury Tax in the case of Rooms and Service Tax and VAT in the case of Food and Beverages.

The total tax outflow for the Guest works out to more than 20% on an average. Consequently, this tax levy is a significant

deterrent to the Hospitality Industry which is already impacted adversely by the general slowdown of the global economy. It is recommended that the levy of Service Tax on renting of Rooms and sale of Food and Beverages be discontinued to provide some relief to the industry.

3.20.2. Infrastructure Status for all Hotels

To promote Tourism and the Hospitality Industry, it is most important that hotels irrespective of project cost and star rating are given infrastructure status. This has been a long standing demand of the industry and if in this budget this can be incorporated, the Industry will get a huge boost which in turn will generate more employment.

The following benefits will accrue to the Hospitality Industry:-

(i) Higher Debt Equity Ratio.

(ii) Relatively lower Rate of Interest on Term Loans.

(iii) Longer tenure of Term Loans up to 20 years.

(iv) Financial Assistance including take out financing from specialized agencies such as IIFCL, IDFC and Infrastructure Debt Funds.

(v) Deductions in respect of profits under section 80-IA of the Income Tax Act.

This would give a major boost to the development of small and mid-segment hotels which is the need of the hour. It will also propel the further development of large, upscale and luxury hotels.

MEDIA AND ENTERTAINMENT INDUSTRY

3.21.1. Overview

The Indian media and entertainment industry grew from INR 918 billion in 2013 to INR 1026 billion in 2014, registering an overall growth of 11.7 percent. The industry is estimated to achieve a growth rate of 13 percent in 2015 to touch INR 1159 billion. The sector is projected to grow at a healthy CAGR of 13.9 percent to reach INR 1964 billion by 2019.

Television clearly continues to be the dominant segment, however we have seen strong growth posted by new media sectors. Gaming and digital advertising recorded a strong growth of 22.4 percent and 44.5 percent compared to the previous year, however, film sector has shown a minimal growth of 0.9 per cent in 2014 over 2013.

Radio is anticipated to see a spurt in growth post rollout of Phase 3 licensing. The benefits of Phase 1 & 2 of cable digital access system (DAS) rollout, and continued Phase 3 rollout are expected to contribute significantly to strong continued growth in the TV sector revenues and its ability to invest in and monetize content. The sector is expected to grow at a CAGR of 15.5 percent over the period 2015-2019.

I - TELEVISION BROADCASTING

3.21.2. Deduction of tax at source under Section 194H on the "15% agency commission"

One of the main sources of income of Television Broadcasting Companies ('Broadcasters') is through sale of advertisement airtime. Broadcasters sell advertisement airtime either to Advertisement agency or Advertisers. Below is the flow of advertisement air time sale transaction:

– Advertisers appoints Advertisement agency for providing various services in respect to any ad campaign including procurement of air time from broadcasters to telecast the advertisements on the television channel.

– Advertisement agency procures air time on television channels, on behalf of advertisers, from Broadcasters.

– Transaction between Advertisement agency and Broadcasters is on principal to principal basis.

- Post entering into a contract with Broadcasters, Advertisement agency releases order confirming the advertisement airtime purchase.
- Broadcasters telecast the advertisement as per the instruction of Advertisement agency and raise invoice for sale of ad airtime.
- Broadcasters mention "15% agency commission" on the invoice raised by it, which is an age old industry and customary practice.
- Advertisement agency makes the payment to Broadcasters of the invoice raised, after deducting appropriate taxes on net amount of invoice (i.e. after reducing the 15% agency commission).
- Advertisement agency in turn raises the invoice on advertisers for recovering the cost of airtime plus their own service charges.
- Advertisers make payment to Advertisement agency after deduction of appropriate taxes on the entire invoice raised by Advertisement agency including on cost of airtime.
- The two transaction namely between Broadcasters and Advertisement agency and Advertisement agency and Advertisers are separate and distinct.

Further, "15% Agency commission" mentioned by Broadcasters in its invoices for ad airtime sale raised on Advertisement Agency/Advertisers is merely a presentation in the invoices and not a real transaction. Neither the Broadcasters nor Advertisement agency recognizes the same as revenue/expense. It is customary in nature, as is also evident from the fact that even on the invoices raised directly on advertisers; the said "15% agency commission" is appearing.

Further, Broadcasters are not supposed to make any payments towards "15% agency commission" mentioned in the invoice, as there is no agreement or arrangement to pay such 15% agency commission with Advertisement agency/ Advertisers. In fact, Broadcasters do not make any payment to Advertisement agency/Advertisers in respect of the said "15% agency commission" mentioned on the invoices.

Considering, the nature of the transaction, FICCI recommends a clarification/ instruction, that no taxes need to be deducted at source by the Broadcasters on the "15% agency commission" as mentioned in the invoice raised by Broadcasters to Advertisement agency/ Advertisers, should be issued.

3.21.3. Payment for Content Production

There is an ambiguity being faced since the tax authorities have been adopting a view that the payment towards production of content is in the nature of fees for technical services and subject to tax at the rate of 10% under section 194J of the Act whereas Explanation III to section 194C of the Act clarifies that payments made towards a contract, concerning broadcasting and telecasting including production of programmes for such broadcasting or telecasting, would fall under the definition of 'work' for the purpose of section 194C of the Act.

In order to avoid difference in positions adopted by the tax payer and tax department on applicability of relevant section and to mitigate resultant litigation and hardship, a clarification may be issued regarding appropriate classification of content production services and applicability of relevant section for withholding of taxes.

3.21.4. Carriage Fees/Placement Charges

Broadcasters pay placement/carriage fee to the cable operators/DTH operators to place their channel in prime bands which in turn enhances the viewership of the channel. Such charges are paid under a contract merely for placing the channel on agreed frequency bands.

The tax department is contending that since the cable operators are providing technical services, the payments made towards placement of channels is subject to TDS under section 194J of the Act.

The Government should provide a clarification that the payments made towards carriage fees are not in the nature of royalty or fees for technical services and TDS is required to be made on such payments as per section 194C of the Act.

3.21.5. Parity with Manufacturing Industry under Section 72A of the Act

The disparity between the service and the manufacturing sector is very adversely affecting the growth and consolidation of Service sector.

The tax benefits under Section 72A of the Act in respect of amalgamation or demerger (carry forward and set off of accumulated loss and unabsorbed depreciation allowances) are currently limited to industrial undertakings or a ship, hotel, aircraft or banking. The definition of industrial undertaking should be widened to include service industry, broadcasters and content production companies.

3.21.6. Infrastructure Status

The Broadcast, Cable and DTH sector should be treated as infrastructure industry and all the benefits and incentives available for infrastructure industry should be extended to Cable and DTH sector including the availability of finance at a concessional rate. The sector should be allowed tax concessions as per Section 80-IA of the Act.

The digitization process and the deployment of STB's are heavy capital oriented and thus require huge investments which may force various amalgamations and thus they should be allowed to set off accumulated losses and unabsorbed depreciation allowances to be carried forward as per Section 72 A of the Act.

3.21.7. Rationalization of Indirect taxes

The rate of taxes which range from 30% to 70%, especially the entertainment tax imposed by the states, over and above the service tax, are punitive in nature. State Entertainment tax legislations levy high taxes on the subscription earned by cable operators and DTH Operators. The non-availability of credit of central taxes against the state taxes and vice versa increases the tax burden on the entertainment industry. In addition to this, the Central Government has levied service tax at 14% on the transfer of copyrights which is already being taxed as 'goods' under the various state VAT legislations. Such punitive level of taxation incentivizes unhealthy practices, such as piracy, revenue leakage on account of under reporting of revenues, etc. It is important that the overall taxation level is brought down for the sector as a whole.

II - RADIO BROADCASTING

3.21.8. Tax Exemptions for Radio Broadcasting

Government should consider the following suggestions:

- Phase III of Digitization: Provide tax holiday of 5 years for new capital investment in Phase III.
- Custom Duty: Reduce customs duty on capital equipment for Radio broadcasting to 4%.
- Service tax exemption for billings to service recipients covered in the negative list.

III - FILM SECTOR

3.21.9. Tax Holiday for 5 years for setting up of New Screens

There has been an increase in piracy, since the number of screens for viewing films has not increased in proportion to the increase in number of films and the number of people viewing these films.

It is essential to extend benefit to cinema owners in terms of 80-IB of the Act to multiplexes constructed after March 2005 to encourage the set-up of multiplexes and thereby improve the density of cinema houses in the country. This will encourage setting up of new screens in India and help in improving screen density.

3.21.10. Reduction of prescribed Time Limit under Rule 9A and 9B

As per Rule 9A of the Income Tax Rules, if a film producer sells all rights of exhibition of his feature film, the entire cost of production is allowed as a deduction in computing the profits and gains of such previous year. However, if the film producer does not sell all rights of exhibition of his feature film, the following two scenarios arise in terms of deduction of cost of production:

Scenario 1: Feature Film is released for exhibition on a commercial basis at least 90 days before end of the financial year. In this scenario, the film producer is eligible to claim deduction of the entire cost of production; or

Scenario 2: Feature Film is released for exhibition on a commercial basis within a period 90 days before end of the financial year. In this scenario, the film producer is eligible to claim deduction of cost of production only up to a ceiling limit and any excess cost of production is carried forward to the next financial year. This ceiling limit is the amount of revenues generated by the feature film in the financial year.

In certain cases where not all rights of exhibition of a feature film are sold and it is released for exhibition on a commercial basis within 90 days before end of the financial year, the feature film performs poorly and it is exhibited only for a short duration. Consequently, the film producer may not recover costs. In such cases in view of the prevailing IT Rules, the film producers are unable to claim a deduction of entire production cost and, the loss is to be carried forward to the next financial year. Accordingly, such film producers are unable to claim losses in the year the feature film is released for exhibition despite no further scope of income. A similar situation exists in the case of expenditure of distribution rights in view of Rule 9B of IT Rules.

FICCI suggests that the existing period of 90 days before end of the financial year (under Rule 9A and 9B of IT Rules) is suitably reduced to grant relief to assessees whose feature films have incurred losses and have been released for exhibition in the last quarter of the financial year.

3.21.11. Exemption of Service Tax on major Inputs/Input Services

It is recommended that major inputs/ input services that are used in relation to theatrical rights in movies, be exempted from service tax

Since the major inputs/input services used in relation to revenue earned from theatrical rights are taxable, the CENVAT credit of service tax paid on such inputs/input services is blocked in the supply chain due to applicability of CCR. Eventually such taxes result in increase of the cost of production thereby defeating the purpose of providing an exemption on the output service.

3.21.12. Re-instatement of the Service Tax exemption on Transmission of Digital Cinema

Service tax on transmission of digital cinema is a direct cost to the Producers since the same is in relation to theatrical exhibition of cinematograph film (which is an exempt service with effect from 1 April 2013) and hence no credit can be availed of such service tax.

It is recommended to re-instate the exemption to digital cinema service distributors, as it existed earlier vide notification 12/2007 ST dated 1 March 2007 which has been rescinded with the introduction of the negative list.2.12.13.

3.21.13. Clarity on export status of Post-production Services

Given the various technological advances in the Indian Film Industry, many Indian entities are hired by foreign producers for carrying post production activity. For such activities, the content is temporarily imported into India (either physically or electronically) and re-exported after completion of service. Post-production activities which may be performed in India, do not find explicit mention in the proviso that carves out exceptions to the performance based rule in POPS Rules.

Clarity may be bought as to the inclusion of post- production activities in the exclusion to this Rule. Alternatively, the second proviso to the Rule 4(a) of the POPS Rules be reworded.

3.21.14. Service Tax exemption to On-screen Advertising in Cinemas

Since 1st October 2014, the negative list of services has been amended whereby on-screen advertising within cinemas shall be liable to service tax. On screen advertising in cinemas and multiplexes should be exempted from levy of service tax.

The on-screen advertising within cinemas caters to advertisers with small businesses, with limited resources. For large advertisers, on-screen advertising is a secondary medium of advertising at best and they have a small contribution to on-screen advertising within cinemas. The on-screen advertising forms an important source of revenue for the exhibitors, which are already reeling under the pressure of multiple taxes. Re-instatement of service tax on such revenue will only increase their tax burden.

3.21.15. Applicability of Service Tax on Food and Beverages sold within Cinemas

The food and beverages sold in theatres during movies are subject to VAT under local state laws and the same is paid by the exhibitors. With effect from 1st April, 2011 Restaurant Services became taxable whereby services rendered by any air-conditioned restaurant serving alcohol were made liable to service tax and later with effect from 2013 the condition of serving alcohol was withdrawn. However the wordings of the proposed amendment were not clear whereby there is ambiguity as to whether the sale of food and beverages by cinema halls and multiplexes is covered in this service.

Unlike restaurants, there is no seating arrangement, no cutlery is provided and no waiter is there to serve food and beverages and hence there is no element of service involved in any meaningful manner.

It may be clarified that levy of service tax is intended on “restaurants” rendering certain services and is not intended on sale of food, beverage and snacks from candy counters in cinema theatres.

3.21.16. Service Tax exemption on entry to Award Functions, Musical Performance etc.

The Union Budget of 2015 had amended the negative list of services and effectively withdrawn the unconditional service tax exemption which was granted to tickets for award functions, music events, sports events etc. With effect from June 2015, service tax is payable when the consideration for admission to entertainment events such as award function, concert, pageant, sporting event etc. is more than Rs. 500 per person.

Payment for admission to any event is already liable to a high state entertainment tax. Levying of a service tax of 14% over and above the high rates of entertainment imposes a high burden on the entertainment sector.

A clarification should be issued to specify that the value of ticket for the purpose of levy of service tax on such admission (where the ticket price is more than Rs. 500) should be the value excluding Entertainment tax. Further, it should also be clarified that if service tax is payable, the same should be computed on a value exclusive of Entertainment tax and accordingly no service tax should apply on entertainment tax amount.

3.21.17. Customs Duty exemption on film equipment under the ATA Carnet

The ATA Carnet permits duty free temporary admission of goods into a member country. The list of exempted products covers filming equipment too. However, there is no Customs Notification in order to exempt the import of filming equipment from the levy of Customs Duty, on the lines of the ATA Carnet.

It is recommended that Customs Duty should be exempted on film equipment under ATA Carnet. The film production equipment is very expensive and not easily available in all countries because of which the film producers are compelled to temporarily import the same on lease for the purpose of producing the film. In absence of a customs notification to exempt filming equipment, the ATA carnet duty exemption benefit cannot be extended to import of filming equipment. These imports significantly increase the burden of tax on the film producers.

IV - ANIMATION, VFX & GAMING (AVG) INDUSTRY

3.21.18. Proposals for Animation, Gaming and VFX Industry

For Animation, Gaming & VFX Industry the following suggestions are for consideration:

- 10 Years Tax Holiday for Animation, Gaming, and Visual Effects Industry.
- Removal of withholding tax: There should be removal of withholding tax on revenues accruing from sales of mobile games in non-India markets as well as removal of withholding tax on the development contracts given to mobile game developers outside India. Also, there should be removal of withholding tax paid by expats working in India for Indian mobile game development companies.
- The Minimum Alternate Tax (MAT) applicability for units undertaking animation work in SEZ should be withdrawn to encourage export of animated contents.
- Restoration of STPI advantage scheme for AVGC or ITES for another 10 to 20 years and cover/encourage exports as well as IP creation.
- Excise duty reduction: To promote domestic gaming market, excise Duty on local manufacture should be brought down to nil (similar to film and music industry). This will enable CVD to be brought to zero also. The effective reduction in taxes would be around 15%. Import duty on consoles (Gaming hardware) to be brought down to 0% to increase the installed base to enable the local developer ecosystem to flourish.
- Market Development Assistance: There should be a provision of 50% reimbursable MDA (Market Development Assistance) for travel and registration fees to international market events. Government to extend support under Market Development Assistance (MDA) activity for Indian companies to exhibit by setting Indian Pavilions in the world markets. What is needed is to help bringing local production companies to international markets, collect and disseminate information and support creating the infrastructure needed for a healthy media market to develop.

INCOME TAX

4.1. Tax Rates – Companies/Firms/Limited Liability Partnership

Issues

- The tax rate on domestic companies is currently being levied at 30%, which is quiet high in comparison with the global standards. Further, the Finance Act 2015 has increased the rate of surcharge levied on domestic companies by 2%. The effective tax rate (including surcharge and cess) for a domestic company having total income above INR 10 crore is 34.608% which is quiet high.

  The Hon'ble Finance Minister in his Budget Speech for Union Budget 2015-2016, has proposed to reduce the corporate tax rate from 30% to 25% in the next four years. The reduction in the tax rate would be accompanied by rationalisation and removal of various kinds of tax exemptions and incentives for corporate taxpayers. Our recommendations in regard to the said proposal are given below.

- In addition to high tax rate, enhanced DDT and lowered depreciation rates, impose a further strain on companies, leading to increased pay-out of taxes thus leaving inadequate funds for generation of internal resources for ploughing back for expansion, modernization, technology up-gradation, etc.

- The rate of tax for firms and limited liability partnership is considerably high and needs to be reduced to 25%.

Recommendations

- The process of phasing out of exemptions and deductions should not be on a lock stock barrel basis across sectors. There are various sectors where the turnaround time for the companies to reach a break even and start earning profits takes longer than some other industries. For e.g. infrastructure sector would take long for the completion of projects. The Government and health care sectors as well have long gestation periods. There would be certain entities which would have recently commenced commercial operations, will have to tackle phasing out much faster than anticipated and planned. Thus, the phase out of deductions and exemptions should be applicable in a selective manner and beyond that which would consider the sensitivity of various industries.

- It is recommended that the Corporate Tax rate of 25% should be after inclusion of surcharge and education cess.

- The Government should consult the industry and stakeholders at large before phasing out the various exemptions and incentives available to a corporate taxpayer and the manner in which they would be phased out in a span of four years so that the businesses are not affected adversely.

- There may also be a need to re-look at a number of disallowances as a result of which the chargeable income is found to be in excess of commercial income. An ideal situation is one where there is no mismatch between commercial and statutory income.

- Basic purpose of introducing MAT was to bring all zero tax companies within the tax net. It was introduced to neutralize the impact of incentives. We would welcome an announcement that, with the phasing out of incentives, the burden of MAT will be gradually reduced and that MAT will be eventually phased out.

- Consistent with the reduction of rates of tax, the rate of Dividend Distribution Tax may also be reduced suitably so as to be competitive in terms of the comprehensive tax burden.

- Similarly, the income tax rates for unincorporated bodies i.e. Firm, Limited Liability Partnership (LLPs), etc., should also be reduced to 25% from the current 30%.

- It would be appropriate to remove the levy of surcharge and education cess on corporate and non-corporate taxpayers.

4.2. Tax Rates - Individual Taxpayers

The Finance Act (No. 2), 2014 had marginally increased the basic exemption limit to Rs. 2.5 lakhs. Currently, the peak tax rate of 30% is made applicable over an income of Rs. 10 lakhs for individual taxpayers. However, the income level on which peak rate is applied in other countries is significantly higher. Hence, there is a need for further raising the income level on which the peak tax rate would trigger, to make the same compatible with the international standards.

FICCI recommends the following revised tax slabs for individual taxpayers. FICCI would, therefore, like to urge that the aforesaid recommendation be implemented during FY 2016-2017.

Slab (Rs. lakhs)	Tax Rate
0-3	Nil
3-10	10%
10-20	20%
Beyond 20	30%

The Finance Act, 2015 has levied surcharge @ 12% on individuals having total income exceeding Rs. 1 crore. The increased surcharge on certain category of individuals distorts equity and tends to discourage entrepreneurship and incentivizes people to relocate to other locations. It is suggested that the Union Budget 2016-17 should withdraw the levy of surcharge on individuals having income above Rs. 1 crore.

4.3. Minimum Alternate Tax and Alternate Minimum Tax - Section 115JB/115JC

Issues

- Current rate of MAT of 18.5% is quiet high and has impacted significantly cash flow of companies who otherwise have low taxable income or have incurred tax losses. Further, this has also diluted significantly the tax incentives offered under Chapter VI-A of the Act to eligible businesses and industrial undertakings as the difference between the corporate tax rate of 30% and MAT of 18.5 % is not very high.
- Further, an Alternate Minimum Tax (AMT) was also introduced on LLPs, individuals, HUF, AOP etc. which is to be computed on adjusted total income. Adjusted total income is total income as increased by deduction claimed under Chapter VI-A and Section 10AA of the Act and under section 35AD of the Act (net of depreciation).
- Pursuant to above, the Companies/LLP's who have invested large sums in eligible businesses/industrial units in the backward areas are also getting penalized as the benefit of such incentive gets reduced due to the narrow difference between the basic MAT/ AMT rate of 18.5% and the basic corporate tax rate/LLP tax rate of 30%.
- Presently, the amount of loss brought forward or unabsorbed depreciation which is less as per books of account is allowed as a deduction while computing book profits under section 115JB of Act. A company having huge book losses and meagre unabsorbed depreciation or vice versa would be adversely affected and would end up paying MAT despite having accumulated losses. This causes undue hardship to revive companies and hampers the revival process substantially.
- The MAT/AMT credit is allowed to be carried forward for 10 years for set-off but this period is generally not always sufficient. Many companies, particularly investment companies whose core business is investments are not able to utilize MAT credit efficiently and within due time-limits provided.

- The MAT Credit allowable under the Act is difference of income tax payable under normal provision of the Act and MAT which would have been payable. Due to the said restriction, the taxpayers are not able to utilize the credit efficiently in time and therefore, in most of the case the credit is either not available or is lapsed.
- Currently, the companies licensed under Section 8 of the Companies Act, 2013 are levied MAT. These companies are formed primarily for undertaking charitable objects. Such companies have a statutory mandate to apply their surplus for promoting their objects. There is also a prohibition from payment of any dividend to its members. MAT levied on surplus of these section 8 companies, will never be available for set-off as MAT credit as these companies will never have to pay tax under the normal provisions of the Act. There is no justifiable reason to levy MAT on any presumptive book profits of these companies, especially when these companies were never intended to be taxed.
- Income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund is exempt under Section 10(38) of the Act. The objective of giving such exemption was that Indian residents should invest in the capital market for long term, however, by including such income in the book profit the benefit is taken back from the Companies. Taking back such benefit from the Companies is not equitable.
- The Finance Act, 2011 broadened the scope of MAT by bringing SEZ developers and units under the ambit of MAT thereby significantly diluting benefits offered under the popular SEZ Scheme. In this regard, the Finance Minister in his Budget speech for 2014-15, stated that manufacturing is of paramount importance for the growth of the economy. He further stated that the Government is committed to revive the SEZs and make them effective instruments of industrial production, economic growth, export promotion and employment generation.
- Exemption from AMT is provided to certain specified persons if the adjusted total income of such person does not exceed Rs. 20 lakhs. The limit of Rs. 20 lakhs is inadequate considering especially the huge amount of investments made by the businesses in relation to export of goods and services.

Recommendations

- The basic rate of MAT/ AMT should be reduced to make it equivalent to 50% of the basic corporate tax rate (i.e. 15%).
- Companies should be allowed to set-off entire past book losses including unabsorbed depreciation before they are subjected to MAT.
- The MAT/ AMT credit should be allowed to be carried forward and set-off without any time limit.
- Currently, sale of listed securities is free from levy of Capital Gains Tax. This has resulted in buoyancy of Capital Markets, promoted substantial FII inflows and ensured transparency. However, there is one lacuna here. If the seller of the listed shares is a company, there is no taxability of the gains but the book profits are subject to the levy of Minimum Alternate Tax (MAT). The levy of MAT at 20 per cent + defeats the very exemption from levy of capital gains tax. It is therefore suggested that profits which are exempt from levy of capital gains tax be also not taken as part of book profits for the purposes of MAT.
- MAT on SEZ developers and units should be abolished.
- The threshold limit from exemption of AMT should be increased from Rs. 20 lakhs to Rs. 50 lakhs.
- The amount of weighted deduction under Section 35(2AB) of the Act should be deducted while computing MAT/ AMT. The benefit of investment linked deductions is getting diluted as MAT/ AMT at 18.5% applies on book profits. Therefore, these deductions should also be allowed while computing the book profit/adjusted total income under the provisions of Section 115JB/Section 115JC of the Act respectively.

- In computing the adjusted total income for AMT, investment linked deductions on capital expenditure for specified business (net of depreciation) should not be added back under Section 115JC of the Act.
- To attract more industrial and infrastructural investments, MAT/AMT on eligible businesses/industrial undertaking should be abolished.
- Set off of MAT credit should be allowed in full.
- It is suggested that the companies licenced under Section 8 of the Companies Act, 2013 be excluded from the purview of MAT.

4.4. Dividend Distribution Tax - Section 115-O

Issues

- As per the provisions of Section 115-O of the Act, the domestic holding company will not have to pay DDT on dividends paid to its shareholders to the extent it received dividends from its subsidiary company on which DDT has been paid by the subsidiary. However, the provision as it stands on today, gives relief in respect of dividend received from only those companies in which the recipient companies are holding more than half of the nominal value of equity capital.
- Further, the Finance Act, 2011 has also burdened the SEZ developers by including them in the scope of DDT.
- DDT currently is payable at the basic rate of 15%. Further, dividends distributed by domestic companies will be grossed up for the purpose of computing DDT, translating into an effective tax rate of about 20% (after the levy of surcharge of 12% and cess of 3%). Since DDT is a sort of surrogate tax on behalf of the shareholders, and if the shareholders were to pay tax on their dividend receipts, the tax impact thereon is likely to be lesser in most of the cases in comparison to the DDT tax burden.
- It is still also unclear whether the rate of surcharge (and even cess) has to be considered while grossing up the amount of distributable profits. The Government should specifically clarify this aspect to avoid litigation.
- The Memorandum explaining the provision of the Finance (No.2) Bill, 2014 states that prior to introduction of DDT, the dividends were taxable in the hands of the shareholder. However, after the introduction of the DDT, a lower rate of 15% is currently applicable but this rate is being applied on the amount paid as dividend after reduction of tax distributed by the company. Therefore, the tax is computed with reference to the net amount. In order to ensure that tax is levied on proper base, the amount of distributable income and the dividends which are actually received by the shareholder of the domestic company need to be grossed up for the purpose of computing the additional tax.

  The above memorandum appears contrary when compared with the speech of the Finance Minister who while introducing the DDT in the Budget of 1997-98 stated as follows: “Some companies distribute exorbitant dividends. Ideally, they should retain the bulk of their profits and plough them into fresh investments. I intend to reward companies who invest in future growth. Hence, I propose to levy a tax on distributed profits at the moderate rate of 10% on the amount so distributed. This tax shall be an incidence on the company and shall not be passed on to the shareholder’. Thus, the then moderate rate of 10% has almost doubled with an effective rate of DDT resulting to about 20%.
- The earlier DDT rate of 10% was lower in line with the rate of TDS on dividends in most Indian and international tax treaties. The increased basic DDT rate of 15% (effective rate of about 20%) reduces the dividend distribution ability of domestic companies and the uncertainty with respect to its credit in overseas jurisdictions impacts the non-resident shareholders adversely.

- Currently, DDT is also levied on undertakings engaged in infrastructure development which are eligible for tax benefit under Section 80-IA of the Act. This is detrimental to the growth of the Indian Economy.

Recommendations

- All dividends on which DDT has been paid, be allowed to be reduced from dividends irrespective of the percentage of equity holding keeping in mind that investment companies which do not necessarily own/have subsidiaries as they invest in various companies in the open market, be also made eligible for such benefit.
- The proviso to Section 115-O(1A) of the Act provides that the same amount of dividend shall not be taken into account for reduction more than once. The levy of Dividend Distribution Tax (DDT) at multiple levels has been a subject matter of grievance by corporates. A part of this issue has been resolved by providing in the Act that if a holding company receives dividend from its subsidiary, a further distribution of dividend by the parent will not attract levy of DDT. As it happens, promoter holdings in operating companies are not necessarily in a single parent. Also, irrespective of whether there exists a parent-subsidiary relationship, a tax on dividends which have already suffered levy of DDT amounts to multiple taxation and needs to be avoided. It is therefore suggested that dividends which have suffered DDT be treated as pass through and be not subjected to levy of DDT.
- The Ministry of Commerce and Industry (Department of Commerce) has recommended the restoration of original exemption from MAT and DDT to SEZ developers and units. In line with these intentions of the Government and to attract more investment in the SEZs, DDT on SEZ developers and units should be abolished.
- The tax rate of DDT is recommended to be reduced to 10% from the current effective rate of about 20% (after including the education cess, surcharge and grossing-up of the dividend).
- To incentivise the investment in infrastructure sector, it is recommended that DDT on industrial undertakings or enterprises engaged in infrastructure development, eligible for deduction under Section 80-IA of the Act, should be abolished. It is also recommended that further exemption from DDT be granted to the 'infrastructure capital company/fund' with the condition that it invests the dividend received from its subsidiary in the infrastructure projects.

4.5. Deemed Dividend - Section 2(22)(e)

Section 2(22) of the Act defines the term 'dividend' and sub-clause (e) thereof includes, within the meaning of this term, even an advance or loan, to a shareholder having at least a 10% voting-power in a company in which the public are not substantially interested, to the extent that the company possesses accumulated profits. Thus, a payment, which is clearly not a dividend as commercially understood, is, by a fiction of law, deemed to be one. Apart from payment to the shareholder himself, a loan or advance to any concern in which he is a partner or a member, with a beneficial interest of not less than 20% is also considered, to be deemed dividend, and is taxed accordingly. The object clearly is to prevent tax-avoidance by deeming an advance or loan (which would not be taxable) as dividends which is subject to income tax.

4.5.1. Taxability of genuine inter-corporate Loans and Advances as Deemed Dividend

Issues

The provision suffers from many inequities:

- It taxes a loan, though it may be quite a genuine one, which is duly repaid within its scheduled short time. Moreover, there is no corresponding tax-relieving provision at the time of recovery of the loan.
- The tax is attracted, notwithstanding that the loan may be advanced at a fair commercial rate of interest and notwithstanding that preponderant majority of persons owning the concern which received the loan are not even shareholders of the lending company.

Recommendations

- At present, no tax is payable by the shareholder on dividend received from companies and only the company pays DDT. Therefore, levy of tax on deemed dividend in the hands of shareholder at the normal rate is unjustifiable especially when all other deemed dividends are also subjected to DDT. If this suggestion is not accepted, then adequate provisions should be made to exclude genuine transactions from the consequences of these provisions.
- Illustratively, genuine loans and advances, given on current market rate of interest and which are re-paid during the year, should be excluded from the scope of deemed dividend as these are not a subterfuge for payment of dividend.
- Loan given as part of business transaction and Inter-corporate deposits should specifically be excluded from the application of Section 2(22)(e) of the Act to avoid unnecessary litigation.

4.5.2. Accumulated Profits not to include Capital Reserves - Section 2(22)(e)

Issue

- As per the Companies Act, capital reserves cannot be utilized for distribution of dividend by a company. This leads to controversies as to whether capital reserves should form part of accumulated reserves for the purpose of Section 2(22)(e) of the Act.

Recommendation

- An amendment should be brought in Section 2(22) of the Act to exclude capital reserves from the ambit of "accumulated profits".

4.5.3. Taxability of Deemed Dividend in the hands of recipient not being a shareholder

Recommendation

- The object of sub-clause (e) of Section 2(22) of the Act is to prevent tax-avoidance by making an advance or loan (which would not be taxable), as a deemed dividend to the shareholder, which is subject to income tax. It is recommended that the threshold for substantial interest of the shareholder in the recipient concern should be increased to 51%.

4.6. Place of Effective Management

The Finance Act, 2015 has modified the condition of determining residential status of a company. A company will now be resident in India if it is an Indian company; or place of effective management in that year, is in India. Place of effective management ('POEM') is defined to mean a place where the key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

Issues

- Inspite of the explanation to section 6(3) of the Act there is still insufficient clarity on what would constitute 'the place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made'.
- Instances where Indian multinational companies to have a common group policy, for instance human resources policy, finance policy, risk management , common code of conduct, etc. for the purpose of uniformity, mobility, consistency and endurance. These policies are, by custom, formulated at headquarters and circulated to the group companies for ensuring compliance. In the context of outbound investment, these policies are likely to be formulated and circulated by Indian company. It should not happen that the presence of such common policies

may lead to allegation of group companies being considered a resident in India.

- Issue may arise as to at which point of time in the previous year, the residential status has to be determined viz. at the beginning of the year or the end of the previous year. The section does not specify timing of such examination. This is a critical point and has many implications. For example, the tax deduction provisions applicable to resident and non-resident are different. If the residential status determination is done at the end of the year, then how such tax deduction provisions operate where obligation for deduction would depend on the residential status?
- The term 'commercial' as contained in the POEM definition is very wide; therefore, the same should be replaced in line with the internationally accepted principles.
- There should be clarification in relation to terms used in the definition of POEM like 'in substance made', etc.
- In this global scenario, managers working and residing in multiple jurisdictions can communicate through the use of technology rather than physically meeting in one location to take decisions. Therefore, if technology is used as the key medium for making management and commercial decisions, each jurisdiction in which a manager is located at the time of decision making can be regarded as a place of management. Therefore, it is recommended that a detailed guideline with respect to such scenarios should be issued.
- It would be unfair to apply the POEM provisions on a foreign company in such scenarios – a foreign company having manufacturing base outside India only, whose majority of the employees and assets employed for the business are outside India or where income of the foreign company is derived from assets and resources located outside India only.
- Whether overseas board members of a foreign company visiting India and possibly taking some important decision could create an exposure that the foreign company be treated as resident?

Recommendations

- CBDT should issue a set of guiding principles for determination of POEM. POEM is an internationally accepted concept and is fact dependent exercised, as witnessed by several Indian and foreign court rulings.
- Since the amended provision is likely to have a bearing on foreign companies and many other stakeholders, it is recommended that a draft of the guidelines may be released to the public for discussion and comments be invited on the same. After considering the representations and suggestions made by industry groups and various stakeholders, the final guidelines should be notified.
- Defer applicability of the provision to A.Y. 2017-18, such that taxpayers have reasonable time to study the guidelines and have law compliant implementation. This is in line with the Government's commitment to avoid sudden surprises and instability in tax policy. Hence, it is recommended that this provision is made effective only from A.Y. 2017-18, after the guidelines and principles for determination of POEM are finalized.
- Guidelines should clarify the meaning of the following terms to avoid any ambiguity with regards to its interpretation:
  - Key
  - Commercial
  - Management

  - Substance
  - Effective
  - As a whole

- Additionally, guidelines should contain illustrative examples to interpret the following issues:-
  - Whether the term 'key management' needs to be read along with 'commercial', as both of them are joined by the conjunction 'and'
  - Decisions necessary for conduct of business, as the same may vary from case to case.
  - Shareholder functions versus key management and commercial decisions in scenario, where shareholders holding majority may have larger say in conduct of business of entity.
  - Hardships of variation in tax residency status - Amongst multiple consequences, dual residence may and often does result in liability for double taxation, with concern on ability to be able to absorb full tax credit when taxes are demanded by both the countries by claiming residence. In such a scenario, having a domestic law provision which is ambiguous could easily aggravate the chances of dual residency and its adverse effects. Also, where taxes are paid in two countries, claiming foreign Tax Credit in respect of the same will pose a substantial challenge.
- It is suggested that the Government should carefully calibrate POEM intent and draft guidelines to ensure that POEM is indeed an anti-avoidance rule and that there is clarity in computing income under such rules.

4.7. Rationalization of provisions of Section 14A and Rule 8D

As per Section 14A of the Act, no deduction shall be allowed in respect of expenditure incurred in relation to income not includible in the total income. Section 14A(2) of the Act provides that the amount of expenditure incurred in relation to income not includible in the total income shall be determined by the tax officer if he is not satisfied with the correctness of the claim of the taxpayer in respect of such expenditure in relation to income not includible in the total income. This satisfaction is to be arrived at by the tax officer having regard to the accounts of the taxpayer. The determination of the amount of expenditure incurred in relation to the income which is not includible in the total income of the taxpayer is to be done in accordance with the method prescribed, i.e. Rule 8D of the Rules.

Issue

- Disallowance is made on the basis of the formula prescribed in Rule 8D without having regard the amount of exempt income earned.

Recommendations

- The way in which the Rule 8D stands drafted leads to a situation where the quantum of disallowance may far exceed the exempt income. This could be absurd at times and runs contrary to the intention of Section 14A of the Act.
- It should be clarified that the disallowance as per the deeming provisions of Rule 8D of the Rules should not exceed the amount of exempt income earned in the relevant FY.

Issue

- A deeming provision of the administrative expenditure @0.5% of the average investments, results in ad hoc and excessive disallowance.

Recommendations

- This Rule is very harsh and by applying the formula under the said Rule, expenditure that has no connection with the earning of exempt income gets disallowed. A deeming provision of the administrative expenditure @ 0.5% of the average investments, results in ad hoc and excessive disallowance. There is even more hardship when the investments are made only at the end of the year (say 31 March) which are also subject to disallowance at 0.5% as per the deeming provisions.
- It is suggested that Rule 8D of the Rules should be amended such that the arbitrary clause i.e. clause (iii) of Rule 8D(2) of the Rules on disallowance of 0.5% of the average investments be deleted. Alternatively, the disallowance for administrative expenses should be made by estimating the time of the personnel and the resources involved for undertaking the activities which would earn exempt income. The aforesaid estimation to be done on reasonable basis after considering the facts of each case and the frequency of such activities.

Issue

- It has been noticed that even if exempt income is not earned during a particular year, the tax officers disallow the expenditure in relation to the investments which have the potential to earn tax exempt income.

Recommendations

- Section 14A(1) of the Act reads as:

  "no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act"

- Based on the provisions of said Section, it is recommended that if there is no income in a particular year, which does not form part of the total income under this Act, then the disallowance under Section 14(A) should not be triggered. A clarification to this effect through the amendment in the Act, notification, etc. would be helpful in reducing unwarranted litigation on this issue.

Issue

- It has been noticed that for the purpose of computing disallowance under clause (ii) of Rule 8D(2) of the Rules total interest expenditure debited to the profit and loss account is considered by the tax officers, even if the interest expenditure has no nexus with earning of exempt income.

Recommendation

- It should be explicitly clarified that the interest expenditure which is not directly relatable to exempt income or receipt is to be excluded from the interest expenditure considered for the purpose of computing disallowance under Section 14A of the Act read with Rule 8D of the Rules.

Issue

- The disallowance under Section 14A of the Act is required to be made in respect of expenses incurred for earning exempt income. The provisions are harsh in respect of the investments held as stock-in-trade or strategic investments made purely for acquiring controlling interest or as per the specific requirement under a statute or contract with government.

Recommendations

- The strategic investments are generally made with the intention of acquiring controlling interest for the purpose of enhancing the business objective of the group. The investment idea is therefore business driven and not with the intention of earning dividend income. In such cases, dividend income, if any, is purely incidental in nature.

- Further, in respect of certain businesses like power, infrastructure development etc., the statute/government requires the taxpayer to execute the project only through a SPV Company. Accordingly, making an investment in a Company is a pre-requisite business model for such businesses. In such cases also, dividend income, if any, is purely incidental in nature.
- It should be specifically clarified that aforesaid investments would not be included for computing disallowance under Section 14A of the Act.

Issue

- As per clause (f) of Explanation 1 to Section 115JB of the Act, expenditure relatable to exempt income which is debited to the profit and loss account needs to be added back for the purpose of computation of book profits under Section 115JB of the Act. However, it has been observed that the deeming provisions of Section 14A of the Act read with Rule 8D of the Rules are applied by the tax officers to disallow the expenditure incurred in relation to exempt income for the purpose of computing the book profits under Section 115JB of the Act. This is against the provisions of Section 115JB of the Act and result into disallowance of expenditure in excess of the expenditure actually incurred and debited to the profit and loss account.

Recommendation

- A specific clarification should be issued to provide that the provisions of Section 14A of the Act read with Rule 8D of the Rules cannot be applied for the purpose of computation of disallowance of expenditure under clause (f) to Explanation 1 to Section 115JB of the Act. It further needs to be clarified that it is only the actual expenditure incurred to earn exempt income and debited to the profit and loss account which has to be added to compute the book profits under Section 115JB of the Act.

4.8. Taxation of Subsidies

The issue of whether subsidies received by a taxpayer are 'income' under the Income-tax Act, 1961 has been the subject matter of some litigation historically. However, based on judicial pronouncements over the years, the law had evolved such that only subsidies granted to meet revenue expenditure or losses were considered as 'income'. Subsidies granted for incentivising the setting up of new units in backward areas or otherwise were considered to be of a capital nature.

This longstanding position was overturned by the amendment to section 2(24) introduced as part of this year's Finance Act. A new clause (xviii) has been inserted as a result of which any assistance in the form of subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement by the Central or State Government or any authority or body or agency will be considered 'income' and liable to tax.

This amendment was not part of the Finance Bill, 2015 as originally introduced and accordingly many taxpayers did not have a suitable opportunity to assess the impact of this proposal and make representations in this regard. Nonetheless, the impact of this amendment is extremely far reaching and could have serious economic consequences.

The impact that such an amendment will have on the various initiatives launched by state governments over the years to incentivise investments in backward regions of their respective States cannot be understated. It goes without saying that such incentives whether in the form of concessional land, sales tax incentives, reduced stamp duties etc. act as a powerful stimulus to investments in such regions. A levy of income-tax on the value of such benefits will result many projects becoming unviable, thus affecting the success of the 'Make in India' initiative. It will also mean that State governments will be required to effectively gross-up the quantum of incentives if their existing schemes are to retain their attractiveness.

Such a provision runs contrary to the Government's stated principle of empowering states. The levy of tax by the Centre on incentives given by States in essence amounts to a reverse resource transfer from the States to the Centre which runs counter to the objective of cooperative federalism advocated by the Government and the NITI Aayog.

It is therefore submitted that this provision be dropped and the position prevailing before the amendment be restored.

4.9. Recommendations to Widen the Tax Base

The issue of widening of tax base of the country has been a subject matter which has received considerable attention of the successive Governments over the years. There has been intense debate on the subject in the recent past also. FICCI has come up with an analysis in the form of a paper titled 'Widening of tax base and tackling black money'. The document identifies the root causes of generation of black money in India, sectors where black money generation is prevalent and suggestions to uncover the generation, accumulation and distribution of black money within the Indian economy. A copy of the aforesaid study has been submitted to the Revenue Secretary and other officials of the Ministry of Finance.

Some of the important suggestions forming part of the document are as follows:-

1. Incentivize transactions through credit/debit cards and other banking instruments

It is recommended that Government may provide some incentives so that dealers (particularly of high valued items like jewellery, FMCG etc.) are encouraged to accept payments through credit card / debit card and other banking instruments. These incentives could take the form of an additional deduction from income relatable to the transaction value for calculating the tax liability or a reduced Value Added Tax (VAT).

2. Set-up central database to store invoices

It is suggested that a central database be established, to facilitate storing of invoices issued by Fast Moving Consumer Goods (FMCG) companies to small businesses across the country. The database can be then used to effectively monitor the purchases made by these small businesses from FMCGs stores and the corresponding sales reported by them. This will help in detecting any discrepancy in sales reported by small businesses and probable chain of generation of black money.

3. Expand the scope of Presumptive Taxation

The Government can consider bringing a presumptive profit estimation scheme by incorporating provisions in the income tax law to capture professionals who operate through transactions in cash and stay out of the tax net.

4. Tax on Agricultural Income

State Governments be encouraged to usher suitable mechanism (while providing reasonably high level of thresholds to avoid small farmers being burdened) for increasing the scope and quantum of agricultural income tax.

5. Reforms in real estate

As the registration charges and taxes are dependent on the value of the transaction, buyers under-report the value to avoid paying higher taxes and charges (by making a portion of the payment in cash). This enables the parties involved to declare lower transaction values.

Taxes and charges at the time of registration can be split into two parts — a fixed component and a variable component. Irrespective of the reported value of the property a fixed component be paid to civic authorities, while the variable component may be dependent on the current market prices of the property. The market price of a property may be determined by an independent government approved agency. The value of the property reported by the agency may form the basis for calculating the taxes and charges to be paid by the buyer.

6. Create IT infrastructure to track tax evasion

It is imperative to deploy and use robust IT Infrastructure to consolidate and exchange information pertaining to different streams of taxes i.e., Income tax, Service tax, Sales tax, Excise duty, etc. by using common means such as PAN of an assessee. This will facilitate in tracking cases pertaining to tax evasion resulting in accumulation of black money.

7. Expand the provisions of Tax Deduction at Source/Tax Collection at Source

It is suggested that the provisions of the Income Tax Act, 1961 be amended to expand the scope of TDS and TCS by including uncovered sectors where black money gets generated.

8. Enhance tax base by detecting non-filers of income tax returns

To enhance the tax base and augment tax collection, it is pivotal for the government to focus on non-filers and uncover black money in the economy. The Income-Tax (IT) department should implement stronger mechanisms to identify persons who resorted to tax evasion and bring them under the tax net.

9. Simplify the tax structure

The Government should simplify the tax structure, and possibly reduce tax rates. This would deter tax evasion by leading to reporting of full transaction value. The step would be instrumental to discourage black money generation.

The Study "Widening of Tax Base and Tackling Black Money" can be accessed from

http://www.ficci.com/publication-page.asp?spid=20548

4.10. Issues related to allowability of certain Expenditures, Deductions and Disallowances

4.10.1. Depreciation – Section 32

Issues

- Whether depreciation allowable on Goodwill.
- Oil wells are classified as buildings and therefore, depreciation at a less rate of 10% is allowed on the same.
- Need for Higher depreciation for plant and machinery.
- Whether 'non-compete fee' can be regarded as 'any other business or commercial right of similar nature', to be eligible for depreciation as 'intangible asset' under Section 32 of the Act.
- The ambiguity revolves round whether the unabsorbed depreciation relating to AY 1997-98 up to AY 2001-02 can be carried forward for set off without any time limit after the amendment made by the Finance Act, 2001.

Recommendations

- In line with the recent Supreme Court decision in the case of CIT v. Smifs Securities Ltd. (2012) 24 Taxmann.com 222, a clarificatory amendment should be brought for specific inclusion of Goodwill in the definition of block of intangible assets. Further, it would be appropriate to provide clarity on allowability of depreciation on self-generated/ purchased goodwill.
- Oil/Gas well should be classified as 'Plant and Machinery' for mineral oil concerns eligible for special rate of 60% depreciation. However, tax officers consider oil well as building and allow depreciation @10% as against eligible rate of 60% applicable to such plant & machinery relying on the definition given in notes forming part of Appendix – I "Table of rates at which depreciation is admissible'' wherein 'building' has been defined to include roads, bridges, culverts, wells and tube wells. Tax officers consider that oil well is also covered as building since it is an inclusive definition.

Oil wells are not normal well and require special equipment, knowledge and skill which go into developing oil well. Therefore, one cannot consider oil well as same as any water well. Oil well is made up of various machineries and 'cementing' is just one process to strengthen the structure of such well and therefore by no means oil wells can be considered as building. It is recommended that a necessary clarification by way of circular may be issued by the Government to the effect that oil/ gas well be classified as 'Plant and Machinery' for mineral oil concerns eligible for special rate of 60% depreciation.

- It would be in fitness of things to restore the rate of depreciation on general plant and machinery to 25% from 15% to encourage investment in new plant and machinery entailing up-gradation of obsolete technologies.
- Moreover, the Government should extend the initial depreciation under Section 32(1)(iia) of the Act to service industries as well which is currently available to only manufacturing sector.
- There is a lack of clarity as to whether payment made for non-compete fees shall be eligible for depreciation under Section 32 of the Act as 'intangible assets', which has given rise to unintended litigation. However, various judicial precedents [Pentasoft Technologies Limited vs. DCIT (264 CTR 187) (Madras HC) and ITO vs Medicorp Technologies India Ltd (122 TTJ 394) (Chennai Tribunal)] have held that non-compete fees shall fall within the meaning of 'any other business or commercial right of similar nature'. It is therefore, suggested that a clarificatory amendment should be made in Section 32(1)(ii) of the Act to include non-compete fee within the definition of 'intangible asset'.
- The Government should clarify that the unabsorbed depreciation relating to AY 1997-98 to AY 2001-02 can be carried forward for set-off without any time limit.

4.10.2. Investment Allowance - Section 32AC

The Finance Act (No. 2), 2014 has amended Section 32AC of the Act, wherein the taxpayer shall be allowed a deduction of 15% of cost of new plant and machinery, for investment made up to 31 March 2017, if such investments are more than Rs. 25 crore in a FY. Further, the taxpayer eligible to claim deduction under the earlier combined threshold limit of Rs.100 crore for investment made in FYs 2013-14 and 2014-15 shall continue to be eligible to claim deduction even if its investment in the year 2014-15 is below the new threshold limit.

Issues

- The phrase 'manufacture or production of an article or thing' has not been defined in Section 32AC of the Act which can entail litigation.
- The Memorandum explaining the provisions of the Finance Bill, 2013 states that the proposed investment allowance is meant for a company engaged in the business of manufacture of an article or a thing. However, other sectors like developing and building an infrastructure facility, telecom infrastructure service providers, processing/ assembling activities, creation of broadband facility are equally important for the growth of the Indian economy. Similarly, the investment allowance should be allowed for the other sectors for the overall growth of the economy.
- New asset for the purpose of Section 32AC of the Act would not include any office appliance including computers and computer software. It may be noted that the computers and computer software such as servers, ERP systems etc. are intended to enhance overall operational efficiency. Hence, it is ironical that modern technologies tools such as computer and computer software are excluded though they bring about efficiency in manufacture and production of goods.

- The benefit intended to be provided by way of grant of investment allowance under Section 32AC of the Act would get diluted on levy of MAT under Section 115JB of the Act.
- There is ambiguity as to whether the unutilized investment allowance (in case there is no sufficient income to absorb the investment allowance) would be carried forward to the next year or not.
- One of the eligibility criteria for grant of investment allowance is that the taxpayer must 'acquire and install' the new plant and machinery in the year of claim. The terms 'acquired' and 'installed' for the purpose of Section 32AC of the Act are not defined which will lead to doubts on interpretation and may entail litigation. Further, it is possible that 'acquisition and installation' may not be completed in the same year; installation of asset specifically for big projects may spill over to the subsequent year of acquisition. In such cases, the benefit is lost which is not the objective behind the introduction of the investment allowance.
- The cumulative condition of acquisition and installation of new assets in the same financial year cast by sub-section (1A) of section 32AC of the Act for an amount exceeding Rs. 25 crores may simply forfeit the incentive irrespective of the objective of the section. The taxpayer making investment in each of the three qualifying years may still not get any relief if the acquisition of assets is towards the end of the financial year while the installation happens in the subsequent financial year.

Recommendations

- The allowance under Section 32AC of the Act should also be extended to other sectors of the economy like those in operating developing and building an infrastructure facility, telecom infrastructure service providers, processing/assembling activities, creation of broadband facility, and conversion of LNG into RLNG etc. This will truly provide a fillip to the economy and will meet the true intent of the provisions.
- Further, it is not clear if deduction under this Section is applicable to IT (Information Technology)/ITES (IT Enabled Services) companies using various kinds of computers/ data processing machines to manufacture/develop software. Therefore, it is suggested that an explanation be inserted under Section 32AC to extend such benefit to IT/ITES companies engaged in 'manufacturing' or 'developing' of software. Also, the definition of "new assets" under Section 32AC of the Act should be amended to cover 'computers or computer software used by IT/ITES companies for manufacturing/development of software'.
- The investment allowance eligible for deduction under Section 32AC of the Act should be reduced while computing book profit of the company under the provisions of Section 115JB of the Act. Otherwise a taxpayer may have to pay MAT though being eligible for the deduction under normal provisions of the Act. Such reduction of book profit by the deduction amount will give taxpayers the investment benefit in real terms and thereby attract more industrial and infrastructural investments.
- Specific provisions for carry forward and set off of investment allowance for an indefinite period should be brought in the Act.
- The scope of 'manufacture or production of any article or thing' and terms 'acquired', 'installed' be clearly defined to avoid any potential litigation on interpretation and implementation of the provision.
- It may be clarified that the deduction under section 32AC(1A) of the Act will be granted as long as new plant and machinery exceeding Rs. 25 crores is acquired and installed within the block of specified years (3 years) irrespective of the fact that acquisition and installation of new assets falls in different financial years. The threshold for acquisition and installation of assets exceeding at least Rs. 25 crores in single financial year may be removed.

4.10.3. Investment in new Plant and Machinery in notified backward areas – Section 32AD

Issues

- The benefit under section 32AD of the Act is granted to the Taxpayer who sets up an undertaking or enterprise for manufacture or production of any article or thing in specified area on or after 1 April 2015. This would mean that existing Taxpayers who have already set up an undertaking in said areas will not be entitled to avail benefit of section 32AD of the Act.
- The benefit should be extended to assets where 100% depreciation is claimed in a financial year. Such benefit would encourage investment in priority sector which earn higher depreciation because of the significance of their industry. For example, the amendment will deny benefit to the Industry which employs fuel efficient machinery eligible for deprecation @ 100%.
- The benefit intended to be provided by way of grant of higher additional depreciation and additional investment allowance on acquisition and installation of new assets/plant and machinery in the notified backward areas will get diluted on levy of MAT.

Recommendations

- Since the intention is to encourage investment in notified backward areas, it is recommended that benefit be granted even to existing Taxpayer who undertakes substantial expansion.
- To avoid dilution of incentive benefit, the investment allowance should be deductible even in the computation of 'book profit' under MAT provisions.

4.10.4. Amortization of certain Preliminary Expenses - Section 35D

Issues

- Section 35D of the Act provides deduction to resident taxpayers 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 of the Act is limited to the specified expenditure such as legal charges, registration fees etc. incurred for incorporating the Company.
- Further, the deduction of this expenditure is restricted to 5% 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 capitalized to the actual cost of fixed assets, gets permanently disallowed under the provisions of the Act and becomes a dead cost for the taxpayers even though they are incurred for the setting up of the business. 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.

Recommendations

- There is no plausible reason for not allowing these expenses as deduction either as revenue or on a deferred basis in five equal instalments. Therefore, 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.

- Even the ceiling of 5% should be removed as there is no rationale behind having such ceiling when the actual expenditure is far higher.

4.10.5. Tax treatment of Corporate Social Responsibility expenditure – Section 37

Issues

- One of the highlights of the Companies Act, 2013 is that every company meeting the specified threshold would need to mandatorily spend 2% of their 'average net profits' on Corporate Social Responsibility (CSR).
- As per the Finance (No. 2) Act, 2014, the expenses incurred by the taxpayer on the activities relating to CSR referred to in Section 135 of the Companies Act, 2013 shall not be deemed to be incurred for the purpose of business and hence, shall not be allowed as a deduction under Section 37(1) of the Act.

Recommendation

- It is recommended that the Explanation 2 to Section 37 should be omitted and a deduction of CSR expenses incurred by the taxpayers pursuant to provisions of the Companies Act should be allowed under Section 37 in computing business income.

4.10.6. Deductibility of discount on issue of ESOP

Issue

- The deductibility of discount on issue of ESOP as allowable business expenditure under the Act has been a matter of litigation. Recently, the Special Bench of Bangalore Income-tax Appellate Tribunal (Tribunal) in the case of Biocon Ltd. vs. DCIT (155 TTJ 649) held that ESOP is one of modes of compensating the employees for their services and is part of their remuneration. Further, by undertaking to issue shares at a discount, the company does not pay anything to its employees but incurs obligation of issuing shares at a discounted price on a future date in lieu of their services, which is expenditure covered under Section 37 of the Act. However, in absence of clear guidelines on tax treatment of such discount laid down under the Act, the issue has led to unwarranted litigation.

Recommendation

- It should be explicitly provided in the Act that discount on issue of ESOP is a deductible business expenditure. Further, the principles regarding the determination of ESOP discount and its timing for claiming expense while computing taxable income under the Act should be clearly laid down to avoid any ambiguity.

4.10.7. Disallowance - Section 40(a)

Issues

- The Finance Act (No 2), 2014 amended Section 40(a)(ia) of the Act to provide that if specified payments to residents are made without TDS, it will result in disallowance of only 30% of the such payments and the payer is considered as an assessee in default. Prior to FY 2014-15, entire amount (instead of 30%) of the specified payments on which tax was not deducted was disallowed under Section 40(a)(ia) of the Act. In addition, no disallowance shall be made and the taxpayer shall not be treated as an assessee in default, where the resident payee has paid the taxes due on such receipt and furnished evidence in support of this such as return of income for that year, a certificate from accountant to this effect etc. This benefit is only available in case of resident payees.

- There is an interpretation issue whether an expenditure which suffered 100% disallowance prior to this amendment for default in TDS in earlier financial year will now be allowed only to the extent of 30% in the year of payment of TDS on account of strict reading of proviso to section 40(a)(ia) of the Act.
- There has been a recent debate regarding disallowance of expenses under Section 40(a)(ia) of the Act whether it would cover the amounts which were 'paid' during the FY or only the amounts which remained 'payable' at the end of the FY. In this regard, there are conflicting decisions by various Courts [such as CIT vs. Vector Shipping Services (P) Ltd (357 ITR 642), Merilyn Shipping & Transports v ACIT (146 TTJ 1), ITO vs. Pratibhuti Viniyog Limited (ITA No 1689/Mum/2011)].
- In view of widespread litigation on this issue, the CBDT has clarified (vide Circular No 10 of 2013 dated December 16, 2013) that disallowance under Section 40(a)(ia) of the Act for non-compliance of TDS provisions is applicable both to amounts paid as well as remaining payable at the end of the FY.

Recommendations

- It is recommended that 30% disallowance should be restricted on the part of the payment on which the tax was not deducted/ deposited at source and not of the entire payment.
- It is recommended that the provisions of Section 40(a)(ia) should clarify that if, in earlier years, the disallowance of 100% was made, then 100% of the amount should be allowed as deduction on payment of such taxes to the Government Treasury during the subsequent years (instead of 30%).
- Due to ambiguity in the provisions of Section 40(a)(ia) of the Act and contrary decisions on the issue whether such provision would be attracted on both 'paid and payable', it is recommended that amendment should be made in Section 40(a)(ia) of the Act to specifically clarify the applicability of such provisions.
- In order to align the two sub section (i) and (ia) of Section 40(a), it is also suggested that Section 40(a)(i) of the Act should be amended to provide the following:
  - 30% disallowance, instead of 100% disallowance for amount paid/ payable to non-residents,
  - no disallowance in cases where the due taxes have been paid by the non-resident payees subject to conditions as applicable in case of resident payees.

4.10.8. Deduction of employees' contribution to Provident Fund etc. – Section 43B

Issue

- 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 up to 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. Differential tax treatment for employees' contribution and employer contribution to the same fund is discriminatory.

Recommendation

- It is therefore recommended that suitable amendment 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.

4.11. General Anti Avoidance Rule - Chapter X-A

The General Anti Avoidance Rules (GAAR) had first been introduced in the Direct Tax Code in 2009 to curb 'Impermissible Avoidance Agreement' (IAA) entered into by a person to avoid taxes. The GAAR had been introduced to deal with aggressive tax planning involving use of sophisticated structures. The Finance Act, 2012 had inserted Chapter X-A, dealing with the provisions of GAAR to be effective from 1 April 2014. Subsequently, Finance Act 2013, amended provisions of Chapter X-A and the current GAAR provisions would come into force with effect from 1st April 2016. The CBDT has also notified certain rules relating to application of GAAR.

The Finance Act, 2015 deferred implementation of General Anti Avoidance Rules (GAAR) by two years so as to introduce provisions of GAAR with effect from financial year 2017-18. It has been proposed that GAAR will apply to investments made on or after 1 April 2017, when GAAR is implemented. Certain recommendations related to GAAR are given as below:-

- In order to maintain investment momentum in the country, the deferral of GAAR provisions to financial year 2017-18 was indeed a welcome move. As stated in the Explanatory Memorandum to the Finance Bill, 2015, GAAR provisions would be implemented as part of a comprehensive regime to deal with Base Erosion and Profit Shifting (BEPS) and aggressive tax avoidance.
- Considering the current economic environment and efforts of the Government to attract FDI, GAAR should be further deferred. This will provide certainty to the investors and help accomplish the efforts of the Government to bring tax certainty.

If Government decides not to defer GAAR, then following needs to be addressed on immediate basis:-

4.11.1. Factors relevant for determining Impermissible Arrangements

- Section 97(4) of the Act provides that factors like, period or time for which the arrangement exists, the fact of payment of taxes and the fact that an exit route is provided by the arrangement, may be relevant but shall not be sufficient for determining whether an arrangement lacks commercial substance or not.

Recommendations

- Apart from the circumstances provided for clarifying whether the arrangement lacks commercial substance, the following additional points may also be considered relevant for determining whether the arrangement is an impermissible avoidance arrangement:
  - the form and substance of the transaction in which the scheme was entered into or carried out;
  - whether the transaction is a single isolated transaction or a series of transactions;
  - the change in the financial position of the taxpayer that has resulted or will result from the transaction; and
  - the change in the financial position of the party connected to the relevant taxpayer that has resulted or will result from transaction.

4.11.2. Scope of the term 'Significant' in Section 97(1)

Section 97(1) provides for a condition that an arrangement shall also be considered to be lacking commercial substance, if it does not have a significant effect upon business risks, or net cash flows apart from the tax benefit.

Issues

- It is a fact that any prudent businessman would undertake a transaction with a third-party which will definitely have a bearing on the business risks/ net cash flows of him/ other party. The intent behind the insertion of this provision is to go behind the taxpayers who undertake a transaction which does not have an effect on their business risks/ net cash flows.

- The terms 'significant' is not defined under the section to quantify the actual risk/ net cash flow in order to conclude that the arrangement lacks commercial substance.

Recommendation

- The term "significant" needs to be defined appropriately to avoid potential litigation.

4.11.3. DTAA vis-a-vis Domestic Tax Laws

Section 90(2A) of the Act provides that the provisions of newly inserted Chapter X-A i.e. GAAR should apply, the same would override DTAA provision, even if such provisions are not beneficial to the taxpayer.

Issues

- Insertion of this provision would nullify the international & global principle on "treaty overriding domestic tax laws".
- A Double Taxation Avoidance Agreement (DTAA) is a bilateral agreement entered between two sovereign governments. As per Article 26 and 31 of the Vienna Convention, a DTAA should be implemented in good faith. Further as per Article 27 of the Vienna Convention, a Government cannot invoke its internal law as a justification for its failure to perform the DTAA. Therefore, a unilateral amendment in the domestic law of any particular country cannot override a DTAA which has been signed with full knowledge, understanding and consent of both of the Governments.

Recommendation

- This amendment should be withdrawn since the same is against the internationally accepted principles. Given the resultant implications on the non-resident taxpayers, this amendment should be rolled back.

4.11.4. Appeals against directions of Approving Panel

Section 144BA provides that the directions, issued by the Approving Panel shall be binding on the taxpayer and the Commissioner, and no appeal under the Act shall lie against such directions.

Issues

- The direction issued by the Approving Panel is as per the provisions of the Act. Therefore, taxpayer should be provided with a right to appeal against such directions with the Tribunal.
- In the absence of any right to appeal under the Act, the taxpayer will only have an option to file a writ to challenge the directions of the Approving Panel.

Recommendation

- The provisions need to be amended to state that the directions issued by the Approving Panel can be appealed with the Tribunal and higher forums.

4.11.5. Other recommendations

The Committee under the Chairmanship of Dr. Parthasarathi Shome, after considering the suggestions of various stakeholders, submitted its final report on GAAR to the Government. The Government considered the report of the Committee and accepted some of the recommendations with a few modifications. However, some of the recommendations do not find any reference in the Finance Act 2013. Some of the critical suggestions in relation to GAAR are given below:

- From a foreign investor's standpoint, it is critical to have certainty on whether or not offshore foreign investors investing into India would be entitled to treaty benefits, as may be applicable. If GAAR is invoked, treaty benefits could be denied. Moreover, the language of the conditions triggering GAAR including 'misuse or abuse of

provisions of tax laws', 'lacks commercial substance', 'not for bona fide purposes' and 'substantial commercial purpose' etc. are very widely worded and subjective. This could be amenable to various differing interpretations even among the Revenue Authorities. This would result in significant uncertainty on whether or not offshore India investment structures set up by foreign investors would be respected and treaty benefits granted. These provisions could also impact transaction closure/ costs owing to uncertainty on TDS/ representative assessee related liabilities etc.

It is suggested that certain objective criteria/ conditions should be laid down, which if fulfilled would not result in the triggering of GAAR provisions and its consequential implications on any offshore entity including denial of treaty benefits.

Further, it is recommended that the language clarifying the objective criteria/ conditions should also include examples (like incurrence of minimum specified expenditure by the overseas entity) where GAAR provisions would not be triggered.

- As per the recently notified Rules, the provisions of GAAR shall not apply to an arrangement where the tax benefit arising to all the parties to the arrangement in the relevant AY (AY) does not exceed Rs. 3 crore in aggregate. This threshold limit should be further enhanced so as to capture only highly sophisticated structures.
- Many countries do not apply GAAR where SAAR is applicable. It is a settled principle that, where a specific rule is available, a general rule will not apply. SAAR normally covers a specific aspect or situation of tax avoidance and provides a specific rule to deal with specific tax avoidance schemes.

  As per the recommendations of the Expert Committee on GAAR, where the treaty itself has anti abuse provisions in the form of an Limitation of benefit clause (LOB) (as in the case of India Singapore tax treaty), the GAAR provisions shall not apply overriding the treaty.

  Thus, GAAR should not be a substitute for SAAR. It should be invoked only as a residual, to fortify the SAARs, and only in the case of abusive transactions. Therefore, clear examples should be provided confirming that where LOB exists in a tax treaty, GAAR will not be invoked. Also it may be clarified that where SAAR provisions are provided under the tax treaties and/ or domestic tax laws the same should prevail over GAAR.
- A distinction between tax mitigation and tax avoidance should be made to ensure that legitimate business choices do not result in the invocation of GAAR. To ensure clarity, as recommended by the Shome Committee, an illustrative negative list of such instances where GAAR cannot be invoked should be issued.
- Detailed illustrations must be given through Guidelines/Circulars to appropriately clarify the provisions of GAAR. Illustrative examples of situations where GAAR can and cannot apply should also be formulated in order to provide clarity to the taxpayers.
- In alignment with the intent of the Government as mentioned by the Hon'ble Finance Minister in his Union Budget Speech for 2015-16, in order to ensure complete clarity, the law should be amended to clarify unequivocally that all investments made up to 31 March 2017 should be grandfathered to make GAAR truly prospective.
- Provisions for avoiding the taxation of the same income in the hands of the same taxpayer across tax years, if the GAAR provisions are invoked are missing in the amendments brought in so far.

  It is recommended that provisions should be enacted in a manner which would ensure that the same income is not taxed twice in the hands of the same taxpayer in the same year or in different AYs.

4.12. Tax Incentives and Benefits -¬ Section 35AD

4.12.1. Profit Linked Incentives for specified industries vis-a-vis Investment-Linked Incentives

Section 35AD of the Act, extends investment linked incentives to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses. Further, once investment linked incentive for the capital expenditure is availed under this section, no benefit shall be allowed in respect of such specified business under Chapter VI-A (Deductions in respect of certain incomes) and section 10AA of the Act.

Issue

- Deduction under Section 35AD is an alternate form of accelerated deduction for the capital expenditure in the specified business. However, the cash flows of these capital intensive industries suffer on account of levy of MAT. This is because book profits continue to be higher than taxable profits (given that deduction for capital expenditure is not taken to the profit and loss account other than in the form of depreciation) and hence, MAT is paid by the industry during the incentive period. While MAT is creditable against normal taxes in future, the period for recovery of MAT paid could result in being longer than under profit linked incentives. Further, given the restriction on the years for carry forward of MAT, it is possible that MAT paid in initial years may not be recovered, especially for those taxpayers who have a longer period before reaching break-even.

Recommendations

- The profit-linked incentives currently given for infrastructure and crucial sectors should be continued till the end of 12th Five Year Plan i.e. till 2017 to encourage investment and growth of India's infrastructure sector.
- With the governments 'Make in India' campaign, there would be a need to bring under the ambit of deduction of Section 35AD more sectors to further strengthen the industrial base of the country, for e.g. the steel industry being a high capital intensive industry, capital expenditure should be allowed as a deduction on the amount of expenditure incurred.
- It should be considered to do away with MAT for the infrastructure industry as levy of the same defeats the very purpose of extending tax incentives to the industry, especially given the high rate of MAT now.

4.12.2. Dilution of Tax Incentive under Section 35AD by insertion of Section 73A of the Act

Issue

- The underlying idea behind allowing the investment linked incentive granted under Section 35AD of the Act is to enable the taxpayer to set-off the business losses incurred by this write-off against the taxable profits from their existing businesses and reduce their tax liability in the year of deduction and thereby to provide part of the resources of investment required for setting up of the businesses. However, the incentive so intended cannot be achieved owing to the insertion of Section 73A of the Act, which restricts the set-off/ carry forward of losses by specified business only against the profits and gains, if any, of any other specified business carried on by the taxpayer in that AY and the amount of loss not so set-off can only be carried forward and set-off against profits from specified business in the subsequent AYs.

Recommendation

- The losses from the specified business under Section 35AD of the Act ought to be made eligible for set-off against profits from other businesses of the taxpayer, and not restricted to be set-off against only the specified businesses, as it is not always the case that the taxpayer would only be carrying on the 'specified business'. In light of the above, section 73A of the Act should therefore be deleted.

4.12.3. Clarification on amendment to Section 35AD(3) of the Act

Issues

- It appears that the above amendment to Section 35AD(3) of the Act carried by the Finance Act, 2010, seeks to prevent a taxpayer from claiming dual deduction in respect of the same business.
- Accordingly, it appears that if a taxpayer carrying on a specified business does not claim deduction under section 35AD, he may opt for deduction under the relevant provisions of Chapter VI-A or Section 10AA, if the same exist for such business and it is more beneficial.

Recommendations

- A clarification should be issued that the taxpayer may exercise an option (where available to the taxpayer) to avail tax incentive under section 35AD or Chapter VI-A/ Section 10AA of the Act, depending upon which is more beneficial to the taxpayer.
- Further, it is suggested that a clarification may also be issued that in the event the taxpayer opts for the investment linked incentive under Section 35AD of the Act and the same is denied/rejected at time of assessment proceedings (could be on account of non-satisfaction of prescribed conditions), in such case the taxpayer is eligible to make an alternative claim under Chapter VI-A or Section 10AA, on satisfaction of the conditions provided therein, notwithstanding the requirement stipulated in Section 80A (5) of the Act or 10AA of the Act. This is because, a taxpayer who is otherwise entitled to deduction in respect of qualifying profits of the specified business would lose such deduction on account of Section 80A(5) of the Act that mandates a claim for deduction under chapter VI-A be made in its return of income. As the taxpayer would not have claimed deduction under provisions of Chapter VI-A/ Section 10AA of the Act in its return of income since claim was made under Section 35AD of the Act, such taxpayer would be precluded from claiming deduction in view of Section 80-A(5)/ Section 10AA of the Act.

4.12.4. Investment Linked Tax Incentive under Section 35AD is a Restrictive Tax Incentive

Issues

- Section 35AD of the Act extended investment linked tax incentive to a taxpayer engaged in building and operating anywhere in India a 2-star or above category hotel. The same is a restrictive tax incentive to the industry as only such taxpayers are eligible which are engaged in both building and operating the hotel. Similar restriction exists for the hospitals, wherein the tax incentive is available for 'building and operating' anywhere in India a hospital with at least 100 beds for patients.'
- Thereafter, vide Finance Act, 2012 w.e.f. 1st April 2011, a new section 35AD(6A) of the Act was inserted, which extended investment linked tax incentive to a taxpayer engaged only in 'building' hotel (and transferring the operation to another person). However, similar benefit was not extended for taxpayer engaged in building hospital.
- As can be seen from a plain reading of Section 35AD of the Act, it appears that the benefit under the section would not be available in case the person building the hospital is different from the person operating it. This does not seem to be in harmony with the objective, specifically given the typical operating structure of the industry wherein very often the developer or builder of the hospital is different from the taxpayer who is operating and managing the hotel/hospital. Considering, the said anomaly was removed by the Finance Act, 2012, vide Section 35AD (6A) for hotel industry by granting investment incentive to a builder (though not operating the hotel), similar benefit ought to be extended to a hospital industry.

- Further, if a person does not build the hotel/hospital, but acquires the same by purchase or rent or otherwise for purposes of operation and management thereafter, such taxpayer would not be entitled to the benefits of this section.
- If any asset for which such deduction is allowed, is used for other than the specified business, before the period of eight years after the asset acquisition, then such deduction allowed, as reduced by the amount of depreciation allowable as if no deduction under this Section was allowed, shall be deemed to be the business income of the taxpayer of the FY in which the asset is so used.
- Currently, there are no benefits available for rural/ semi-urban healthcare infrastructure (other than for building and operating hospitals with at least 100 beds under section 35AD).

Recommendations

- In view of the above discrepancy, a clarification is required and it is suggested that the relevant clause be amended to read as under:

  *"(aa) on or after 1st day of A*pril, 2010, where the specified business is in the nature of building or operating or building and operating a new hotel of two-star or above category as classified by the Central Government."

  Similar amendment is also recommended for the hospital sector and the relevant clause be amended to read as under:

  "(ab) on or after 1st day of April 2*010, where the specified business is in the nature of building or operating or building and operating a new hospital with at least one hundred beds for patients"*
- Consequential amendments should also be considered in clause (iv) and (v) of sub-Section (8)(c)of Section 35AD of the Act.
- The condition of non-transferability of the asset should be reduced to at least four years since even usage of the asset for four years indicate that the taxpayer intended to use the asset for the specified business. Higher period of non-transferability puts restriction on the transfer of independence of the taxpayer's business decision and therefore, will prove to be counter-productive to the business growth.
- It should be clarified that if an asset is not used for the specified business due to obsolescence, etc. and at the same time not used in any other business, then the deduction allowed under this Section shall not be reversed.
- It is recommended that the weighted deduction of 150% be extended and made generally applicable to the entire list of business covered in the Section 35AD since all the said businesses are extremely important for the Indian economy like natural gas/ crude pipe line distribution, hotels etc. This would help to remove the discriminatory tax treatment between various specified businesses.
- It is suggested that a weighted deduction for healthcare infrastructure expenditure (other than hospitals) incurred in rural/ semi urban areas should be also provided.

4.12.5. Tax Incentives - Weighted Deduction under Section 35(2AB) and 35(1)(iia)

Issues

- No deduction under section 35(2AB) of the Act will be allowed for expenditure incurred towards scientific research after March 31, 2017. In order to encourage research initiatives by Indian corporates, the benefit for deduction under section 35(2AB) of the Act should be extended beyond March 2017.

- Section 35(2AB) of the Act extends deduction of a sum equal to twice the expenditure incurred towards scientific research on in-house research and development facility as approved by the prescribed authority to companies engaged in the business of
  - bio-technology; or
  - manufacture or production of any article or thing (other than those specifically excluded for purposes of this tax incentive).
- The aforesaid Section extends the weighted deduction of expenditure incurred only in respect of "in-house research and development facility". India is globally recognised as an attractive jurisdiction for outsourcing owing to its affordable, skilled and English-speaking manpower. Outsourced R&D work is becoming a key area of growth for the Indian services sector however there are no specific tax benefits available to units engaged in the business of R&D or contract manufacturing. There certainly exists a need to provide impetus to such activities in the form of tax and fiscal benefits.
- Further, specifically in the pharma sector, pharmaceutical discovery is a lengthy, risky and expensive proposition. In this business environment, necessitated by the current business needs, sometimes companies incur expenses towards scientific research outside their R&D facility.
- Another anomaly existing in the current provisions is that any expenditure incurred outside the approved R&D facility by pharma companies' i.e. towards clinical trials (including those carried out in approved hospitals and institutions by non-manufacturing firms), bioequivalence studies conducted in overseas CROs and regulatory and patent approvals, overseas trials, preparations of dossiers, consulting/ legal fees for filings in USA for new chemicals entities (NCE) and abbreviated new drug applications (ANDA) as approved by the Department of Scientific and Industrial Research (DSIR) which are directly related to the R&D, etc. are currently not covered. Furthermore, Indian companies incur substantial costs in defending their patent rights and applications in and outside India and these sums are not eligible for deduction.

Recommendations

- It is recommended that the benefit of deduction under section 35(2AB) of the Act may be extended beyond March 31, 2017.
- It is suggested to extend tax benefits to units engaged in the business of R&D or contract manufacturing to provide impetus to R&D in India.
- Presently, there are no specific provisions which enable carry forward of R&D benefits separately. Considering the time taken in R&D activity, and its benefit available after a very long gap, it is suggested that it should be clarified that the unutilized R&D deduction should be available for carry forward and set off indefinitely (as in the case of unabsorbed depreciation).
- Benefits should be provided for units engaged in the business of R&D and contract manufacturing by way of deduction from profits linked to investments. Benefits in the form of research tax credits which can be used to offset future tax liability, similar to those given in developed economies can also be introduced.
- It is further suggested that the existing provisions should specifically allow weighted deduction in respect of expenses incurred outside the R&D facility which are sometimes necessitated by the industry's business needs. Additionally, it could be clarified that where the risk of doing research is assumed by a company, the entire cost of R&D activities (whether outsourced or undertaken in-house) is eligible for weighted deduction in the hands of company undertaking the risk.

Issues

- Currently, there seems to be an ambiguity with respect to whether a company engaged in the business of development and sale of software or providing IT services or ITES is eligible for weighted deduction on the R&D expenditure incurred by it.
- Currently, as per DSIR guidelines amount spent by a recognized in-house R&D towards foreign consultancy, building maintenance, foreign patent filing etc. are not eligible for weighted deduction under Section 35(2AB) of the Act. Such expenses are essential in carrying out research at the approved R&D centres.

Recommendations

- Explicit provisions should be introduced in the Act, to provide that DSIR can approve the R&D facilities of the companies engaged in development and sale of software. It is further recommended that weighted deduction for R &D expenditure be extended to service sector as well.
- It is further suggested that DSIR guidelines need to be modified accordingly to specifically include expenses (such as foreign consultancy, building maintenance, foreign patent filing etc.) for claiming weighted deduction under Section 35(2AB) of the Act.

Issue

- 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.

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.

Issue

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

Recommendation

- In order to be fair between an R&D company recognized by DSIR under Section 35(1)(iia) and an in-house R&D facility under Section 35(2AB), the tax benefits under Section 35(1)(iia) should be increased to 200% from the present level of 125%.

4.13. Carry back of Losses - Section 72

Issue and Recommendation

- It is has been observed that provisions relating to carry-back of business losses are prevalent in many developed countries like United States of America, Singapore, United Kingdom etc. In case of carry back of losses, losses are allowed to be offset with the profits of the previous years.

Such provisions should also be introduced in the Act and carry back of losses up to 3 to 5 years should be allowed.

4.14. Deduction under Section 80JJAA of the Act

The Finance Act, 2015 has extended the deduction under section 80JJAA of the Act to all assessees deriving profits from manufacturing of goods in factory which was erstwhile restricted only to Indian companies.

"Additional wages" to mean the wages paid to the new regular workmen in excess of 50 (erstwhile it was 100) workmen employed during the previous year.

Issues

- The deduction under section 80JJAA of the Act is not available to companies engaged in the service sector irrespective of the same being major contributor of employment in the Indian economy.
- Wages are not defined under this section.
- One of the conditions stipulated by the section is that new workman should be employed for a period of three hundred days or more during the previous year of employment. In a situation, where workman joined in July and worked till March of the relevant previous year of employment i.e. worked for less than 300 days in Year 1 but for full year in Year 2 and Year 3 and assuming all other conditions prescribed in Section 80JJAA of the Act are complied with, the company is still not eligible to claim deduction in any of the years.
- In case of an existing undertaking the 10 per cent increase in the number of regular workmen is calculated as a percentage of existing number of 'workmen' and not 'regular workmen' as on the last day of the preceding year, which minimizes the chances of falling within the eligibility criteria of 10%.

Recommendations

- It is recommended that the benefit of deduction under Section 80JJAA should be extended to assessees engaged in providing services. It will provide impetus to the growth of the service industry in India and will also generate employment opportunities.
- The components of wages to be considered for the purpose of computation of deduction under this section should be clearly defined.
- It is recommended that appropriate clarification should be introduced with respect to grandfathering of allowability of deduction in case of amalgamation/merger/demerger.
- Workmen in respect of whom the period of continuous employment of 300 days or more is attained in the previous year succeeding the previous year in which the workmen is employed, the deduction under section 80JJAA of the Act should be granted from the succeeding previous year.
- For the purpose of calculating the percentage increase in the new regular workmen employed during a year - as per proviso to clause (i) of Explanation to Section 80JJAA - parity should be maintained i.e. only the existing number of ''regular workmen" as against all 'workmen' employed as on the last day of the previous year should be considered as a base.

4.15. Definition of Association of Persons (AOP) to be modified - Section 2(31)

Issues

- The term Association of Persons (AOP) has not been defined in the Act. As per Section 2(31) of the Act, 'person' includes, inter-alia, association of persons or body of individuals, whether incorporated or not. Explanation to

Section 2(31) of the Act further provides that an AOP shall be deemed to be a person, whether or not such person or body was formed or established or incorporated with the object of deriving income, profits or gains.

- Since the definition is not provided by the statute itself, one has to refer to the legal jurisprudence for understanding the meaning of term 'AOP' which results in unwarrantedd litigation and subjectivity. Recently, the Delhi HC in the case of Linde AG, Linde Engineering Division and Anr vs DDIT (W.P. no 3914/2012) held that apart from presenting a 'common face' as members of a consortium, high level of common management, element of mutual agency and joint action for mutual purpose is also necessary to form an AOP. The essential characteristics of an AOP flowing from the various judicial precedents including this recent decision can be illustrated as follows:-
  - Two or more persons join together or associate together;
  - The parties should come together out of their own free will (out of volition);
  - The association should be for common purpose or common action;
  - Mutual rights and obligations;
  - Incurrence of common expenditure;
  - There should be joint execution and/ or supervision of the work;
  - Possibility of reassignment of work amongst members;
  - Some kind of scheme for common management.
- Whether an AOP is constituted or not would have to be decided on a conjoint reading and analysis of the above factors to the facts and circumstances of the case. No one factor can be said to be decisive for determining AOP and the priority of the factors is also not laid down in law.

Recommendation

- It is suggested that the term AOP may be appropriately defined to lay down the essential aspects for constituting an AOP. This would provide some certainty and help to reduce litigation for the consortiums formed by non-residents to execute contracts in India.

Issues

- A large number of big infrastructure contracts are awarded by Public Sector Undertakings/ Government companies to non-residents. Many developers also require contractors to bid in a consortium with a view to ensure that specific components of the project get executed by an earmarked contractor who has requisite capabilities in this regard and yet, derive the comfort that the entire project (comprising of several parts) will be successfully commissioned by the consortium of contractors, although each contractor will be executing its specific part only. The consortium members/ contractors undertake their respective scope of work separately/ independent of each other and do not share profits/losses with each other. Further, there is a separate consideration earmarked for each contractor and the payment is made directly to respective contractor by the customer. Thus, contractors enter into consortium and agree to jointly undertake the work for better co-operation in their relationship with the developer/ provide comfort to developer and for no other purpose.

  Consequently, the intention behind consortium/contract split arrangements is never to constitute a partnership/ AOP but to meet the business requirements of the developer.

- With a view to provide clarification in this regard, CBDT had issued instruction no 1829 dated September 21, 1989, wherein, it was clarified that companies forming the consortium for execution of power projects on turnkey basis will not constitute an AOP under the Act and offshore supply of goods by non-resident contractors engaged in execution of turnkey projects shall not be liable to tax in India, if the title to the goods is transferred outside India. However, in the year 2009, the said instruction was withdrawn on account of misuse of such instruction by various non-residents.
- The principles outlined in the aforesaid instruction have also been accepted by the Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd and Hyundai Heavy Industries Co. Ltd. (2007) 161 Taxman 191 (SC). Further, Delhi HC in the case of Linde AG, Linde Engineering Division and Anr vs DDIT (supra) has also followed the aforementioned principles and held that offshore supply of goods by non-resident contractors are not taxable in India, if the title of such goods is transferred outside India. The HC further held that if the offshore services are inextricably linked to such offshore supplies, then such services are not taxable in India.
- However, the Revenue Authorities are taxing such non-residents as AOP at the withholding tax/assessment procedure stage on the basis of a few favourable AAR rulings and withdrawal of the abovementioned circular. Further in this regard, there are various tax complexities that are associated with assessments of AOP, including double taxation of non-residents in India and their country of residence (with no possibility of double taxation being avoided). The said position of the Revenue Authorities is causing hardship to the industry and is also resulting in pessimism as regards the uncertain tax environment in India. Large amount of working capital is also getting blocked up in TDS/ payment of tax demands consequent to completion of assessments.

Recommendation

- In light of the above, it is strongly recommended that the aforementioned instruction should be reissued and the clarification be made applicable to the infrastructure sector and EPC contracts. The reissuance of the "1989 clarification" would go a long way in instilling confidence amongst the non-resident contractors as regards the stability/ fairness of the Indian tax regime, which, in turn, would also encourage non-resident contractors to set up their manufacturing hubs in India and thereby result in a multiplier effect on the Indian economy.

4.16. Non-resident related provisions

4.16.1 Provisions regarding Indirect Transfer of Capital Asset situated in India

Explanation 5 to Section 9(1)(i) of the Act, which was introduced by the Finance Act, 2012 provides that a share or an interest in a company or entity registered or incorporated outside India shall be deemed to be situated in India, if the share or interest derives its value substantially from the assets located in India.

The Finance Act, 2015 has amended provisions dealing with indirect transfer of capital asset situated in India. The amendment provides clarity on certain contentious aspects with regards to taxation of income arising or accruing from such indirect transfers. The following amendments have been introduced in the Act.

- Share or interest in a foreign company or entity shall be deemed to derive its value substantially from Indian assets only if the value of Indian assets (whether tangible or intangible) as on the specified date exceeds the amount of INR 10 crores and represents at least 50% of the value of all the assets owned by the foreign company or entity.
- The value of an asset shall be its Fair Market Value (FMV).
- The date of valuation of assets (without reducing the liabilities) shall be as at the end of the accounting period preceding the date of transfer. However, in case the valuation of assets as on the date of transfer exceeds by at least 15% of book value of the assets as on the date on which the accounting period of the company/entity ends preceding the date of transfer, then the specified date shall be the date of transfer.

- Exemption from applicability of the aforesaid provision has been provided in the following situations:-
  - Where the transferor along with its related parties does not hold (i) the right of control or management; (ii) the voting power or share capital or interest exceeding 5% of the total voting power or total share capital in the foreign company or total interest in the entity directly holding the Indian assets (Holding Co).
  - In case where the Indian assets are not directly held, then if the transferor along with related parties does not hold (i) the right of management or control in relation to such foreign company or the entity; and (ii) any rights in such foreign company which would entitle it to either exercise control or management of the holding company or entitle it to voting power exceeding 5% in the holding company.
- The Finance Act, 2015 has introduced Section 47 (vicc) in the Act which, subject to fulfillment of certain conditions provides that transfer of shares of a foreign company (which directly or indirectly derives its value substantially from shares of an Indian company) by the demerged foreign company to the resulting foreign company under a scheme of demerger will not be regarded as transfer.
- The Indian entity will be required to furnish information relating to indirect transfers. In case of any failure, the Indian company will be liable for a penalty of INR 500,000 or 2% of the value of the transaction as specified.

Issues and Recommendations

- Retrospective amendments having major impact have been introduced in 2012 in the name of clarificatory amendments. In reality, they are substantive amendments and it was unfair that the amendments were made retrospective effective from 1 April, 1962.

  FICCI is of the view that the Government should make the amendment prospective or at least may announce that the following default consequences will operate prospectively:-
  - Interest levy on demand arising as a result of amendment should be restricted to prospective period.
  - No penalty proceedings may be initiated in respect of alleged understatement of income.
  - Tax withholding obligation should be applied prospectively.
  - Payer of income should be considered as a representative assesse, on a prospective basis.
- By way of amendment, 50% of the value has been fixed to interpret "substantial value" derived from India which accords with the international understanding. This amendment is made applicable from 1 April 2016. There appears to be no reason why the parameter for "substantial value" should not be made applicable to pending proceedings, so that at least the taxpayers may not have to struggle on the interpretation as may be adopted in assessments as may pertain to past years. Hence, it is recommended that the said amendment should also apply retrospectively.
- "Explanation 5 to Section 9(1)(i) clarifies that an asset or a capital asset being any share or interest in a company……". Whether all and any type of asset will be covered by this Explanation or whether it will be restricted to only capital asset in the nature of share or interest in an entity. Therefore, clarity is required on interpretation of this phrase.
- There is no clarity on the phrase 'assets located in India' mentioned in Explanation 5 to Section 9(1)(i) of the Act, given that the following interpretations are possible:
  - Whether the section refers to shares of an Indian company as assets located in India; or
  - Whether it is referring to the assets owned and held by the Indian company whether in India or outside India.

Clarification should be provided for the phrase 'assets located in India' mentioned in Explanation 5 to Section 9(1)(i) of the Act.

- Value comparison yardstick recommended by Shome Committee is pragmatic and may be adopted.
- As per the recommendations made in the report released by the Committee headed by Dr. Shome to examine the provisions relating to taxation of indirect transfer of assets, the comparison between India asset value and value of target entity which is transferred, should be based on commercial principles after taking into consideration the liabilities which may have been incurred by all companies. If this recommendation is accepted, the value comparison will become logical.
- The intent of the law is to capture this gain if it is enclosed within an indirect transfer (instead of a direct transfer) and the India asset value is substantial at more than 50%. For this comparison, the fair value of the subject matter of indirect transfer should also be determined after taking liabilities into account. The commercial deal is unlikely to ignore the liabilities.
- Given its language, Explanation 6 to section 9(1)(i) of the Act is prone to serious tax litigation on its interpretation. Ignoring liabilities can lead to distortion of values - Explanation 6 to section 9(1)(i) of the Act, as proposed, requires that the fair value should be determined without reducing the liabilities. It is submitted that ignoring liabilities which are incurred in the conduct of business may distort the comparison of values substantially.
- Valuation Methodology – Guiding Principles

  The valuation of shares in the context of the indirect transfer provisions poses several practical as well as legal challenges which should be appropriately addressed in the Rules. The suggestions in this regard are based on three fundamental principles:

  (i) The identified methodology must be objective and should minimise the possibility of disputes on valuation.

  (ii) The methodology must be such that the valuation can be easily undertaken based on information that is either readily available with or easily ascertainable by the taxpayer.

  (iii) The need for taxpayers to obtain information necessary for the valuation must be appropriately balanced by the need for foreign companies to comply with applicable securities laws and their need to maintain the confidentiality of competitive business information.
- Valuation of assets located in India

  If the assets located in India comprise of shares of an Indian company, their valuation be undertaken on the following basis so as to ensure certainty and minimise litigation:

  (i) In cases where the shares of the Indian company are listed, the closing market price of such shares on the specified date must be taken as their value for the purposes of Explanation 6.

  (ii) In cases where the shares of the Indian company are not listed, we submit that the Discounted Cash Flow (DCF) Method should be adopted as the sole basis for determining the value of Indian shares. This will be in line with internationally accepted norms of valuation.

  Valuation of all assets owned by the foreign company

  Under Section 9(1)(i) read with Explanation 6, shares of a foreign company are deemed to be situated in India if the value of assets located in India represents at least 50 per cent of the value of all assets owned by the foreign company or entity.

A literal reading of this provision suggests that the fair value of all assets owned by the foreign company/entity would have to be undertaken in order to determine whether the 50 per cent test is satisfied. It is submitted that such a reading will cause serious practical difficulties. Given that most companies own a large number of diverse assets, a valuation exercise that requires all assets to be identified and individually valued could prove to be highly impractical, if not impossible.

Therefore, the Rules should provide that the value of all assets of the foreign company for the purposes Explanation 6 should be taken as the value of the company based on the price at which the shares are transferred (i.e. the transaction value). This will ensure objectivity in the computation and minimise the potential for disputes.

Alternatively, in the case of listed foreign companies, the market capitalisation could be considered as the value of the foreign company. This too will provide a non-contentious and objective basis of valuation.

- Since the objective of the amendment is to tax indirect transfer through shell companies, a listed company should not be considered as a shell or conduit company. The same was also suggested by the Shome Committee.

  The non-exclusion of listed company shares from the ambit of the indirect transfer provisions will cause serious hardship to shareholders in several listed companies as well as pose several computational and practical challenges in cases where frequent trading of shares takes place on a daily basis.

  Such cases also pose significant challenges from the point of view of withholding, given that the very identify of the seller is not ascertainable. Further challenges exist in respect of ascertaining whether the seller holds more than 5% or not, whether he qualifies for treaty benefits, his cost of acquisition etc.

  Even if one were to take the view that withholding is merely a tentative determination of tax, and is subject to the correct determination at the time of assessment, the practical challenges in requiring millions of investors in stock markets around the world to obtain a TAN in India, deduct tax, and deposit the same with the government, and issue TDS certificates without even knowing the identity of the person on whose behalf such tax is deposited are simply mind-boggling. Further, there would be no basis on which such buyers could even issue TDS certificates since the identity of the seller would not be known.

  The Expert Committee under the Chairmanship of Dr. Shome as well as the Parliamentary Standing Committee on Finance (in the context of the Direct Taxes Code Bill, 2010) have also recommended exclusions for listed company shares.

  In view of the above, indirect transfer provisions must be suitably modified to provide for an additional exclusion from capital gains liability in cases of transfer of shares of foreign companies which are listed and regularly traded on recognized stock exchanges abroad. The criteria for recognition of stock exchanges and for determination of the regularly trading threshold may also be suitably clarified.

If this approach is not considered feasible, the following two proposals may be considered as an alternative:-

(i) A limited exclusion for transfers that take place on the stock exchange (as opposed to blanket exclusion for all listed shares). Such a provision will be similar to the domestic law exemption under Section 10(38) for transactions taking place on the stock exchange.

(ii) Exclusion from withholding in respect of all transactions in respect of listed securities. Given that there are serious practical challenges set out above on the withholding aspects, this could provide much needed relief.

- There are no provisions in the Act which exempts the Participatory-Note (P-Note) holders from the applicability of the provisions of indirect transfer on sale of P-Notes outside India.

Therefore, it is recommended that the provisions should be made in the Act so as to explicitly exempt the P-Note holders from the applicability of the provisions of indirect transfer so as to provide certainty to Foreign Institutional Investors (FII) (who pay taxes in India on their income earned/derived in India) to encourage more foreign investments in India.

- Intra-group transfers as part of group re-organizations (other than amalgamation and demerger) should also be exempt from the indirect transfer provisions.
- While Explanation 5 to Section 9(1)(i) of the Act provides that shares of a foreign company which derives directly or indirectly its substantial value from the assets located in India shall be deemed to be situated in India. Section 47(vicc) provides exemption only if the shares of foreign company derive substantial value from shares of an Indian company. While the intent may be to exempt all cases of demerger where foreign company derives substantial value from assets located in India, the reading of Section 47(vicc) indicates that the said exemption would be available only in cases where the shares of the foreign company derive substantial value from shares of Indian company. Due to this inconsistency in the language of Section 47(vicc) vis-à-vis Explanation 5 to Section 9(1)(i), transfer of shares of a foreign company which derives its value predominantly from assets located in India (other than shares of an Indian company) under a scheme of demerger may be deprived of the aforesaid exemption. Similar inconsistencies also exit in the language of section 47(viab) of the Act.

  It is recommended that Section 47(vicc) should be amended to provide that "any transfer in a demerger, of a capital asset, being a share of a foreign company, referred to in Explanation 5 to clause (i) of sub-section (1) of section 9, which derives, directly or indirectly, its value substantially from the assets located in India, held by the demerged foreign company to the resulting foreign company, if,—……." Similar amendment should also be made in Section 47(viab) of the Act (i.e. in case of amalgamation).
- The onus of reporting has been cast on the Indian entity. Generally, the Indian entity may not have information relating to overseas indirect transfer, therefore, the onus of reporting should not be cast on the Indian entity. The onus placed on the Indian concern to report certain events or transaction under section 285A of the Act is impractical and/or onerous for the below reasons.
  - Considering that the Indian concern has exposure to enormous penalty. The exposure can multiply if there are multiple or repetitive transactions during the same year (including stock exchange transactions). The exposure could then be as high as 2% of the value of each transaction.
  - It is quite likely that, except in some apparent cases where Indian company is directly involved, the Indian Company may not have any knowledge whatever (or, may not have precise or accurate knowledge) about transactions at the shareholder or upper layer in the chain. Further, there is no need for a presumption that the vertical chain structure is necessarily a tax avoidance gimmick, such that Indian concern can be presumed to be a party to such avoidance. Such a presumption may not only be factually incorrect, but may also reflect a climate of distrust for taxpayers.
- Considering, that the provisions relate to indirect transfers, the onus, if at all, should be cast on the parties to the transaction and not the Indian entity. Alternatively, that the requirement should be made applicable only in those cases where Indian company is a party to the transaction or has full knowledge of the transaction and yet there is a willful non-disclosure. As next best alternative, it must be limited to a case where the transaction results in change in control and management of Indian company.

  Also, the Finance Act, 2015, prescribes a threshold for applicability for the indirect transfer provisions. There should also be a minimum threshold prescribed for reporting of transactions by the Indian entity.

- The expression "Indian concern" may have different meanings. It may even encompass permanent establishment or other forms of permanent establishments of a foreign company. Clarity needs to be provided on this aspect also.
- In the context of amalgamations and demergers, section 47 of the Act provides for exclusion from capital gains tax subject to certain conditions. However, these exclusions are proving inadequate, with increased cross border economic activity and transactions.

  For instance, although specific exemptions are provided for under section 47 for companies which are amalgamated/demerged in an offshore transaction that gives rise to indirect transfer tax in India, no corresponding exemption has been provided to the shareholders of such companies. This may be contrasted with the position in respect of domestic amalgamations/demergers where exclusion is provided in section 47 at both the company and the shareholder level.

  Similarly, no exemption is provided for Indian shareholders owning shares in foreign companies which undergo an amalgamation/demerger.

  Given the above, it is recommended that a specific provision along the lines of section 47(vii) of the Act may be inserted to protect shareholders of foreign amalgamating/demerged company. These must be provided for in the Act at the earliest.

4.16.2. Tax neutrality in case of Overseas Reorganization

Issues

- The provisions of the Act are framed to provide tax neutrality only in cases where the amalgamated company is an Indian company. Section 47(vii) of the Act provides that a transfer of shares by the shareholder of an amalgamating company would not be liable to capital gains tax subject to the following conditions:
  - The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company, and
  - The amalgamated company is an Indian company.
- Clearly, the above exemption would be allowed only in case a foreign company is merged into an Indian company and not vice-versa. In other words, if an Indian company merges into a foreign company and the payment of consideration to the shareholders of the merging company is in cash, or in Depository Receipts, or partly in cash and partly in Depository Receipts, as envisaged in Section 234 of the Companies Act, 2013, the amalgamating company and its shareholders would be subject to capital gains tax in India.
- In the emerging global scenario it is important that the merger of Indian companies into foreign companies should be legally recognised and made pari-passu with the merger of foreign companies into Indian companies, particularly for income tax purposes.

Recommendation

- It is suggested that the requirement of transferee company to be an Indian Company under Section 47(vi) and (vii) of the Act should be removed.

4.16.3. Review of Retrospective Amendments made by Finance Act, 2012

(a) Clarification on definition of software royalty – Section 9(1)(vi)

In Section 9(1)(vi) of the Act, Explanation 4 has been inserted with effect from the 1 June 1976, clarifying that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Royalty internationally applies to payments for use of a copyright, patent, trademark or such intellectual property. As per international commentaries and jurisprudence, any payments for use of a copyrighted article would not typically get covered under the term 'Royalty'. The Government should consider the adversity of the amendments made by Finance Act, 2012 on the businesses and make changes in the law to reverse its effect. It is suggested to roll back Explanation 4 to Section 9(1)(vi) of the Act. Further, it is suggested that in view of the international tax practices and keeping in mind the impact on Indian industry, it should be clarified that the payments for use of copyrighted software made to non-residents would not be covered under the definition of 'royalty'.

Alternatively, the amendment should have only prospective application.

(b) Clarification on inclusion of Explanation 5 to Section 9(1)(vi) of the Act

In Section 9(1)(vi) of the Act, Explanation 5 has been inserted clarifying that royalty includes and has always included consideration in respect of any right, property or information, whether or not:

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Issues

- Explanation 5 conflicts with the existing Explanation 2 to Section 9(1)(vi) of the Act in as much as there cannot be any transfer, right to use or imparting without the possession or control in the right, property or information vesting with the buyer/ payer. Explanation 5 also has the effect of taxing the consideration as royalty even if there is no transfer, right to use or imparting of any right, property or information to the payer.
- The provisions of this explanation are also not in line with the internationally accepted principles.
- By virtue of the above amendment, the scope of the term Royalty gets expanded to cover payments which are not intended to be covered. The mere fact that a transaction involves use of equipment by a service provider, without the customer having control/ physical possession of such equipment, payment for such facility/ services cannot be treated as royalty. For example, where a person boards a bus or train by purchasing the requisite ticket, it cannot be said that the person is making payment for availing the bus or train on hire as he does not have the control over such equipment. Rather the customer is merely availing the facility of transportation, the consideration for which facility is not in the nature of Royalty.

Recommendations

- It is suggested that Explanation 5 to Section 9(1)(vi) of the Act inserted by the Finance Act, 2012 may be omitted altogether, as this is clearly against the basic principle of the definition of the term royalty provided under Explanation 2 clause (iva) and as also understood internationally.
- Alternatively, in order to avoid ambiguity, the amendment should be modified to objectively provide the rationale behind the insertion of the Explanation 5 and should list out the specific transactions, which it seeks to cover.

- Alternatively, the amendment should have only prospective application.

(c) Clarification on definition of process royalty – Section 9(1)(vi)

In Section 9(1)(vi) of the Act, Explanation 6 was inserted, with retrospective effect from the 1st June 1976, clarifying that the expression 'process' includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

Issues

- The amendment may result in inclusion of charges for the use of transponder capacity or connectivity/ bandwidth within the definition of 'Royalty'.
- Services in the nature of provision of transponder capacity or connectivity/ bandwidth are merely facilities provided. As per international tax practices and OECD Commentary, payments for such facilities should not be treated as 'royalty'.
- Explanation 6 even includes payments towards provision of basic telephone service within the ambit of the term 'royalty'. The business income derived by the telecom providers, if classified as royalty, will significantly alter the tax consequences on the receiver of the consideration for the services provided and will burden the payer with TDS compliances.
- Taxation of foreign companies for such facilities and subsequent passing on of the tax cost to India Inc. would entail a significant tax outgo for India Inc., especially companies operating in the field of media and entertainment (satellite and broadcasting companies), IT and ITES companies and telecom.
- The retrospective application of the amendment is grossly unfair and further aggravates the situation.

Recommendations

- In line with international practices and the OECD Commentary, it is suggested that the terms 'transmission', 'up-linking', 'amplification', 'downlinking' could be specifically defined in the Act to remove ambiguity on its scope/ coverage in the definition of 'royalty'
- The definition of the term 'transmission' should explicitly clarify that payments for the use of a 'facility' as a service charge, without any control on the process and where the payer is only interested in the service and not in the use of process, should not be covered within its meaning.
- A clarification should be provided that basic services such as telephone/mobile charges and broadband/ internet connectivity charges, payment to cable operators for viewing the television channels, electricity charges, wheeling/transmission charges paid to state electricity grid or to private electricity transmission companies would be outside the ambit of royalty.
- Alternatively, the amendment should have only prospective application.

Issues

- With the insertion of Explanation 4 and Explanation 6 to Section 9(1)(vi) of the Act, there is an ambiguity as to whether subscription charges paid for download of e-content, access to online database, reports, journals etc. can fall within the purview of "Royalty".

- It has been held by various Courts that the information that is available in public domain is collated and presented in a proper form by applying the taxpayer's methodology and the payment for the same is not to be construed as royalty. It is in line with the international standards and supported by the OECD commentary, which provides that data retrieval or delivery of exclusive or other high value data cannot be characterized as royalty or FTS.
- Taxation of foreign companies/publishers for providing access to such online database or in the form of CD as royalty and subsequent passing on of the tax cost to Indian industry would entail a significant tax outgo for India Inc. and will especially impact the education system in India.
- The retrospective application of the amendment is grossly unfair and would further aggravate the situation.

Recommendations

- It is suggested that the terms 'transmission by satellite, cable, optic fibre or by any other similar technology' could be specifically defined in the Act to remove ambiguity on its scope/coverage definition of 'royalty' and also a detailed circular may be issued elucidating the types of payments covered within the purview of the said terms and thus constituting royalty.
- It is recommended to suitably exclude the payment for the use/access to online databases, reports, journals etc. and any other payments made by the payer from the purview of royalty, which are essentially made for the use of a 'facility' as a service charge and where (a) the payer is only interested in the service and not in the use of process/ technology used for transmission (b) does not have any control on the process/ technology used for transmission.
- Alternatively, the amendment should have only prospective application.

(d) Amendment to the Explanation inserted after Section 9(2)

Issues

- Section 9 of the Act provides for situations where income is deemed to accrue or arise in India. Vide Finance Act, 1976, source rule was provided in Section 9 through insertion of clauses (v), (vi) and (vii) in sub-Section (1) for income in the nature of interest, royalty / FTS respectively. It was provided, inter-alia that in case of payments as mentioned under these clauses, income would be deemed to accrue or arise in India to the non-resident under the circumstances specified therein.
- The intention of introducing the source rule was to bring to tax interest, royalty and FTS, by creating a legal fiction in Section 9 of the Act, even in cases where services are provided outside India as long as they are utilised in India. The source rule, therefore, means that the situs of rendering of services is not relevant. It is the situs of the payer and the situs of the utilisation of services which will determine the taxability of such services in India.
- This was the settled position of law till 2007. However, the Supreme Court, in the case of Ishikawajima-Harima Heavy Industries Ltd (288 ITR 408) held that despite the legal fiction in Section 9 of the Act, for any such income to be taxable in India, there must be sufficient territorial nexus between such income and the territory of India. It further held that for establishing such territorial nexus, the services have to be rendered in India as well as utilised in India.
- This interpretation was not in accordance with the legislative intent that the situs of rendering service in India is not relevant as long as the services are utilised in India. Therefore, to remove doubts regarding the source rule, an Explanation was inserted below sub-section (2) of Section 9 of the Act with retrospective effect from 1st June 1976 vide Finance Act, 2007. The Explanation sought to clarify that where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub-Section (1) of Section 9 of the Act, such income shall be included

in the total income of the non-resident, regardless of whether the non-resident has a residence or place of business or business connection in India.

- However, the Karnataka HC, in the case of Jindal Thermal Power Company Ltd. v. DCIT (TDS) (286 ITR 182), has held that the Explanation, in its present form, does not take away the requirement of rendering of services in India for any income to be deemed to accrue or arise to a non-resident under Section 9 of the Act. It has been held that on a plain reading of the Explanation, the criteria of rendering services in India and the utilisation of the service in India laid down by the Supreme Court in its decision in the case of Ishikawajima-Harima Heavy Industries Ltd. remains unaltered and unaffected by the Explanation.
- With a view to removing any doubt about the legislative intent of the aforesaid source rule, the Finance Act, 2010 substituted the existing Explanation with a new Explanation to specifically state that the income of a non-resident shall be deemed to accrue or arise in India under clause (v) or (vi) or (vii) of sub-Section (1) of Section 9 of the Act and shall be included in his total income, whether or not:
  - the non-resident has a residence or place of business or business connection in India or
  - the non-resident has rendered services in India.
- This was made effective retrospectively from 1st June, 1976. The retrospective nature of the amendment is a cause of concern amongst taxpayers since it would lead to reopening of past assessments.

Recommendation

- The relevant provisions of Section 9 of the Act, in force since 1976, have been interpreted by the Supreme Court in India requiring the taxpayer to also satisfy the condition of 'rendering of service in India' for being taxable in India. It would therefore be only fair to make this provision apply prospectively. Alternatively, a provision be inserted to clarify that past transactions would not be re-opened or contested by the tax officers on the strength of this provision.

4.16.4. Requirement for Non-residents to comply with TDS obligations - Section 195

The Finance Act, 2012 extended the obligation to deduct tax at source 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 1 April 1962.

Issue

- The amendment will result in a significant expansion in the scope of TDS provisions under the Act and will cover all non-residents, regardless of their presence/ connection with India.

Recommendations

- In the decision of the Supreme Court in the case of Vodafone International Holdings B.V. [(2012) 345 ITR 1 (SC)], it was observed that the provisions of Section 195 of the Act would not apply to payments between two non-residents situated outside India subject to certain conditions. The Supreme Court also referred to tax presence as being a relevant factor in order to determine whether a non-resident has an obligation to deduct tax at source in India under Section 195 of the Act.

- The amendment by the Finance Act, 2012, however, seeks to expressly extend the scope of TDS obligations to all persons including non-residents, irrespective of whether they have a residence/ place of business/ business connection or any other presence in India. The amendment should be modified to restrict the applicability of TDS provisions to residents and non-residents having a tax presence in India.
- Alternatively, the amendment should be made effective only prospectively. Making such a provision applicable with retrospective effect will operate harshly on persons who may have made payments based on the law prevalent prior to the amendment.

4.16.5. Taxation of Foreign Dividends and Capital Gains - Section 115BBD and Section 47

- A special tax regime under Section 115BBD of the Act provides for taxing dividend income @ 15% from specified foreign companies (with shareholding of the Indian company of 26% or more).
- Capital gains tax regime for unlisted companies are not beneficial as compared to exemption on long term capital gains from sale of shares of companies listed on Indian stock exchange. Also, the gains derived by overseas holding companies from divesture in overseas operating companies are also retained at overseas holding company level.

Issues

- The benefit of reduced rate of tax on dividends as per Section 115BBD of the Act is restrictive and is available only to Indian companies only and not to other persons.
- Long term capital gains earned by Indian holding company from transfer of shares in foreign companies is taxable in India @20%.
- There are no provisions under the Act for availing underlying tax credit on dividends and such tax credit can be availed only through a few tax treaties.
- Capital gains arising pursuant to certain business restructuring overseas (viz. amalgamation of foreign companies held by Indian company, demerger) are not exempt.

Recommendations

- The reduced rate of tax on dividends received from a specified foreign company should also be extended to all persons (including a company) as defined in Section 2(31) of the Act.
- Alternatively, tax on such dividends should be treated akin to MAT, creditable against the normal tax liability and payable only if the tax on normal income is less than the tax on such dividends.

4.16.6. Cascading effect of DDT on dividend received from Foreign Companies - Section 115-O

As per the amendment in Section 115-O of the Act vide Finance Act 2013, dividend taxed as per Section 115BBD of the Act received by the Indian company from its foreign subsidiary (i.e. where equity shareholding of the Indian company is more than 50%), then any dividend distribution by such Indian Holding Company to its shareholders in the same FY to the extent of such foreign dividends will not be liable to DDT.

Issue

- As per Section 115BBD of the Act, dividend received from a specified foreign company i.e. a foreign company in which the holding of the Indian company is 26% or more in the nominal value of equity share capital, is subject to tax at a lower rate of 15%. However, as per provisions of Section 115-O of the Act, where dividend is received

from a foreign subsidiary (i.e. more than 50% equity shareholding) which is subject to tax @15% under Section 115BBD of the Act, then such dividend will be reduced from the DDT base on any further dividend distributed by the Indian company. In other words, where the Indian company holds 26% to 50% in nominal value of the equity share capital of the foreign company, then such dividend would not be excluded for computing DDT base of the Indian parent.

Recommendation

- It is suggested that the requirement relating to shareholding of more than 50% in the foreign subsidiary for the purpose of Section 115-O of the Act should be reduced to 26%, in the specified company to remove the cascading effect of DDT. Also, the objective of incentivizing repatriation of funds shall be successful when the dividend received from a specified foreign company and distributed by the Indian company is not liable to DDT, thereby removing the cascading effect.

4.16.7. Information to be furnished for making remittance abroad - Section 195(6)

Issues

- The Finance Act, 2015 amended Section 195(6) which provides as follows:

  'The person responsible for paying to a non-resident, (not being a company), or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall furnish the information relating to payment of such sum, in such form and manner, as may be prescribed.'

- As per section 195(6) read with Rule 37BB of the Income-tax Rules, 1962 (the Rules), a person making remittance to a non-resident is required to submit Form 15CA electronically on the website designated by the income tax department and is further required to get a certificate from a Chartered Accountant (CA) in Form 15CB in respect of the particulars filled in Form 15CA.

- In August 2013, the Central Board of Direct Taxes (CBDT) had amended Rule 37BB of the Rules vide its Notification No. 58 of 2013, dated 5 August 2013, to broaden the requirement of collecting information and reporting requirements for all remittances outside India. The Rule also prescribes to provide information in cases where amounts are not liable to be taxed under the Act.

- The CBDT issued notification no. 67 of 2013, dated 2 September 2013, which has further revised the scope and the format of reporting of information under Rule 37BB of the Rules. It provides that the person responsible for making any payment including any interest or salary or any other sum chargeable to tax under the Act shall be required to furnish details in the prescribed forms. The notification also provides a specific list of payments which are not required to be reported under the revised rule. The amended Rule has come into force from 1 October 2013.

- There was ambiguity with respect to whether the amended rule would apply to transactions which are not chargeable to tax such as import of goods or payments in the nature of Fees for Technical Services (FTS)/ royalty, which are not taxable in India by virtue of beneficial Double Taxation Avoidance Agreements (DTAA) provisions. "Import of goods" is one of the transactions, which was included in the specified list, prescribed vide notification no. 58 of 2013 and then deleted from the specified list vide notification no 67 of 2013.

- In view of above amendment to Section 195(6) made by the Finance Act, 2015 once again the issue has arisen as to whether the taxpayer needs to obtain a CA certificate in form 15CB and provide particulars in form 15CA for payments which are not chargeable to tax.

- The amendment mandates reporting of even non-taxable transactions. As the foreign remittances in case of entities having multi-territorial operations are generally voluminous, reporting of each transaction along with obtaining a CA certificate could be a very daunting task. This would increase the number of certificates that would have to be taken by the payer further entailing an increase in the compliance cost.

  The above coupled with the fact that not all payments made to non-residents are necessarily chargeable to tax, there being several considerations which contribute to conclude about the taxability of payments made to non-residents. The amendment would severely increase the compliance burden associated with Form 15CA and 15CB reporting in case where the payments are not chargeable to tax.

- At present there is no provision to cancel or correct the erroneous Form 15CA and an assessee is required to fill and upload a fresh form in case of any error, which makes the task more tedious.

- The Finance Act, 2015 has also introduced penalty in case of failure to furnish information or furnishing of inaccurate information as required to be furnished under Section 195(6), to the extent of INR one lakh.

Recommendations

- Considering the far reaching implications on ease of doing business, Government should consider withdrawal of amended section 195(6) of the Act.

- If provisions are not withdrawn, new rules should be notified at the earliest.

- It is recommended that CBDT should issue a clarification providing a list of payments which are excluded for the purpose of complying with the requirements of Form 15CA and Form 15CB. This is needed more so in respect of regular trade payments (imports) and it will also reduce hassles of doing business with India. Even payments which have been specifically exempt under the Act (for e.g. dividend payments, life insurance maturity proceeds, etc.), personal remittances (for e.g. payments for travel, education, maintenance of family abroad, etc.) capital account transactions (falling outside the ambit of Section 4, 5 and 9 of the Act) should be specifically excluded for the purpose of complying with the requirements of Form 15CA and 15CB.

- New rules should provide for sufficiently high monetary threshold beyond which compliance will get triggered. This will ensure that small value transactions do not fall within the procedural net.

- Since rules are yet to be notified, non-compliance in the interim period should not have any penal consequences for the taxpayer.

- A system should be there in place so as to enable the payers to edit/cancel the erroneous Form15CA rather than filling all the details in fresh.

- It should be clarified that penalty ought to be levied only if there is a non-disclosure or inaccurate disclosure of information wilfully leading to non-deduction of tax on remittances which are chargeable to tax under the provisions of the Act.

4.16.8. Mandatory application to tax officer to determine sum chargeable to tax - Section 195

- Finance Act 2012 has introduced sub-Section (7) to Section 195 of the Act under which it is mandatory to make an application to the tax officer to determine the appropriate proportion of sum chargeable under the Act.

- This provision will apply to notified persons/ cases and will apply regardless of whether such transaction is chargeable to tax or not.

Issue

- Compulsory clearance from the Revenue Authorities on notified overseas payments adds to the compliance burden and can impact legitimate commercial activities.

Recommendations

- The Supreme Court in the case of GE India Technology Centre observed that, there exists no obligation to deduct tax under Section 195 of the Act unless sum payable to the non-resident is 'chargeable' under Act.
- Considering, the volume of international transactions/ payments, the imposition of a requirement to obtain clearance from the tax office would prove very onerous and slow down the pace of commercial transactions. It is submitted that the present system of reporting together with TDS provisions are sufficient to ensure appropriate deduction of tax on overseas payments. Hence, Section 195(7) of the Act should be deleted.
- Without prejudice to the above recommendation, the list of persons/ cases to be notified under this provision should be tailored so as to not affect genuine commercial transactions.

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

Issue

- 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. This additionally requires the non-resident company to mandatorily approach the tax office to seek a lower TDS certificate, the process being time-consuming and non-taxpayer friendly. Often, the non-resident company face a lot of difficulties justifying its request for a lower TDS certificate in the initial years of its operations, when it has no past assessments in India. From the tax officer's perspective, this results in excess tax collection by way of TDS only to be refunded later together with interest in addition to significant administrative burden, which may not be commensurate with the benefits of an efficient tax collection mechanism.

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. Further, at the beginning of a tax year, the non-resident taxpayer who has an India branch office or 'a place of business within India' should be permitted to admit PE and opt for a TDS mechanism as is applicable to a resident company. It would go a long way in facilitating ease of doing business in India and the tax officer would be in a position to better monitor and regulate such non-resident companies. Further, it would also achieve the stated objective in the Kelkar Report (December 2002) to abolish the system of approaching the tax officer for obtaining certificates for deduction at lower rates and minimize the interface between the taxpayer and tax officer.

4.16.10. Tax Residency Certificate (TRC)

- The Finance Act, 2012 had provided that in order to be eligible to claim relief under the DTAA, a taxpayer is required to produce a TRC issued by the Government of the respective country or the specified territory in which such taxpayer is resident, containing certain prescribed particulars. Subsequently, the CBDT prescribed the details to be included in the TRC.
- The Finance Act, 2013 has done away with the requirement of obtaining prescribed particulars in the TRC. In other words, the taxpayer can continue to obtain the TRC as issued by the foreign authorities. The Finance Act, 2013 also introduced a provision to clarify that the taxpayer shall now be required to furnish such other information or document as may be prescribed.

- The CBDT subsequently issued a notification amending the Rule 21AB of the Rules, prescribing the additional information required to be furnished by non-residents along with the TRC. The details are required to be furnished in Form 10F.

Issues

- Even though the requirement to furnish TRC containing prescribed particulars has been dispensed with, however, depending on the jurisdiction, obtaining a TRC certificate may also be a time consuming and 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.
- The deductor would like to obtain the TRC at the time of the transaction/ depositing the tax (to ensure that the payee is eligible for DTAA benefits), the payee would typically be able to obtain TRC only after the relevant year.
- As per the Rule 21AB of the Rules, an Indian resident who wishes to obtain TRC from Indian Revenue 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 taxpayer. 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.
- Rule 21AB of the Rules does not clarify the authority for signing Form 10F, which causes confusion to the taxpayers and the Revenue Authorities.

Recommendations

- The requirement to obtain TRC for a taxpayer to prove that he is a resident of the other state shall be deleted as there may be circumstances wherein the taxpayer who is a bona fide tax resident of the other contracting state is unable to procure a TRC owing to circumstances outside his control. At assessment stage, it is anyway incumbent upon the tax officer to ascertain complete details before allowing DTAA benefits. In such a scenario, even though the tax officer may otherwise be satisfied that the DTAA benefits must be allowed, only owing to the procedural lapse of not obtaining the TRC which is beyond the taxpayer's control, the tax officer would be compelled to deny DTAA benefits, which will cause needless hardship.
- Without prejudice, even if the requirement to obtain TRC must stay, it is recommended that the TRC should be made mandatory only for cases where the total payment to a non-resident exceeds Rs. 1 crore in a FY. This would mitigate hardship in respect of small payments.
- It is also recommended that the requirement to furnish TRC should be cast upon the payee at the time of the assessment of the payee and the deductor/ payer should not be made liable to collect TRC from the payee at the time of TDS.
- The time limit to issue TRC in Form 10FB should be specified and to further specify that in case the tax officer refuses to issue a TRC, the application of the taxpayer should be disposed by the tax officer by passing a speaking order and clearly specifying the reasons for rejecting the application of the taxpayer.
- It may be specified that persons prescribed under Section 140(c) of the Act for the purpose of signing the return of income would be eligible to sign Form 10F.

4.16.11. Multiple defect notices issued for returns filed by non-residents

Non-resident assessees entitled to avail of beneficial provisions of the double taxation avoidance agreement and assessees having income chargeable to tax at special rates of tax (viz. royalty, FTS, etc.) are required to report the same in 'Schedule SI' of the ITR-6. As the non-resident does not have an office or place of business in India and is also not required to maintain any specific books of accounts, the details of profit and loss account and the balance sheet are not

required to be filled in the ITR-6. However, due to an inherent technical default in the excel utility for ITR-6, at the time of generating the xml file for uploading on the income-tax e-filing website, the gross total income is always reported as 'NIL' instead of the aggregate amount reported in 'Schedule SI'.

Further, at the time of processing the ROI, assessees have been repeatedly issued defect notices under section 139(9) for some/ all of the following reasons:-

a) Taxes are being paid even where the gross total income is Nil

b) Non-filing schedules 'Part A – P & L' and 'Part A – BS'

c) Credit for TDS is being claimed, and no corresponding income has been offered to tax.

In the meanwhile, no action has been taken to rectify the technical default in the excel utility. Accordingly, non-processing of the returns due to the aforementioned defect notices without any commensurate measures to rectify the excel utility has resulted in a huge quantum of refunds due to assessees remaining unpaid.

It is hereby suggested that appropriate measures be taken to rectify the technical default in the excel utility for ITR-6. Further, for returns filed using the existing utility (including ROIs for which defect notices have been issued), it is suggested that the said anomaly is taken into consideration by the CPC at the time of processing of the return under section 143(1) and the return is processed after incorporating the income reported in 'Schedule – SI' as part of the gross total income.

4.16.12 Clarity on taxability of Global Depository Receipts

GDR is a foreign currency denominated financial instrument issued outside India by a foreign depository to investors, against an underlying Indian security which is deposited with a domestic custodian in India.

Earlier, GDRs were governed by 'Issue of Foreign Currency Convertible Bonds and Ordinary Shares (through depository receipts mechanism) Scheme 1993' ("1993 Scheme"). Based on the recommendations of the Sahoo Committee and various other stakeholders, the Central Government repealed the 1993 Scheme (excluding provisions governing foreign currency convertible bonds) and replaced it with the Depository Receipts Scheme, 2014 ("2014 Scheme") with effect from December 15, 2014.

Key changes introduced under the 2014 Scheme vis-a-vis the 1993 Scheme, inter-alia, include the following:-

1993 Scheme vis- vis 2014 Scheme

(a) GDRs could be issued only by Indian listed companies. GDRs can be issued by both listed and unlisted Indian companies whether public or private.

(b) GDRs could be issued only against underlying shares. GDRs can be issued against underlying permissible securities such as shares, debt instruments etc.

(c) The Scheme specifically laid down the manner of taxation on conversion of GDRs into shares. The Scheme is silent on the manner of taxation on conversion of GDRs into shares/securities.

It may be pertinent to note that section 47(viia) of the Income Tax Act, 1961 ('the Act') provides for specific exemption on transfer of GDRs from one non-resident to another non-resident outside India. However, the Act was silent with respect to cost of acquisition ("cost") and period of holding ("period") to be considered of underlying shares which will be received on conversion of GDRs into shares.

The Finance Act 2015 ("FA 2015") now provides that on conversion of GDRs into the underlying listed company shares, the cost of the shares should be the price prevailing on a recognised stock exchange on the date of advice for conversion

and the period of holding shall be reckoned from such date. However, the cost and period in a scenario where GDRs are issued against unlisted shares or other permissible securities such as debentures etc. have not been specified as the FA 2015 only prescribes the mechanism for determining the cost and period in case of "listed shares". Also, the definition of GDR as per Explanation to section 115ACA of the Act has been changed to provide that Global Depository Receipts" means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to investors against the issue of,—

(i) ordinary shares of issuing company, being a company listed on a recognised stock exchange in India; or

(ii) foreign currency convertible bonds of issuing company

As a result of the above amendment made in Explanation to section 115ACA of the Act, there is an apprehension that a tax officer can deny the exemption on transfer of GDR made outside India by a non-resident to another non-resident if such GDR has been issued against the shares of an unlisted Indian company. It can be alleged that exemption under section 47(viia) of the Act is only in respect of GDR issued against shares of a listed Indian company. However, it is a well settled position that transfer of GDRs outside India by a non-resident to another non-resident is not taxable in India. The amendment made by Finance Act, 2015 is also not in line with 2014 Scheme which provides that GDRs can be issued by both listed and unlisted Indian companies whether public or private. The ambiguity created by the amendment can be a huge dent to the start-up investments. This will have an impact of relocating new start-ups to other locations. Such kind of distinction created between listed and unlisted companies (due to change in the definition of GDR) also does not serve any purpose as the GDRs have to be listed on a stock exchange outside India which is sufficient to bring transparency in trading of these GDRs.

FICCI recommends that the Government should specifically provide that the tax benefit on GDRs issued against the ordinary shares of an unlisted company will be in parity with GDRs issued against shares of a listed company, as long as these GDRs are traded on a recognised stock exchange outside India.

4.17. Mergers & Acquisitions

4.17.1. MAT Credit - Section 115JAA

Issues

- MAT credit is akin to advance payment of tax.
- Benefit of MAT credit cannot be denied to successors in case of reorganization.

Recommendation

- Section 115JAA of the Act should be amended to provide that successors in case of amalgamation, demerger or any other form of reorganization should be eligible to claim benefit of MAT Credit.

4.17.2. Carry forward and set off of Accumulated Losses in Amalgamation or Merger

Issues

- Currently, Section 72A of the Act allows carry forward of loss and accumulated depreciation in case of amalgamation/ demerger of the following type of companies:
  - a company owning an industrial undertaking or a ship or a hotel with another company,
  - a banking company,
  - one or more public sector company or companies engaged in the business of operation of aircraft

- Apparently, the benefit is not available to all the companies engaged in the business of providing services. Considering the facts that many multinational companies have entered in the Indian service market and it has become imperative for the small companies to consolidate their resources to survive, the benefit applicable under the provision of Section 72A of the Act should be extended to all companies irrespective of their line of operations.
- More so, Section 72A(2) of the Act prescribes stringent condition about continuity of holding of assets by the amalgamating company for at least 2 years prior to transfer and by the amalgamated company for 5 years post transfer. Similarly it requires that the amalgamating company should be in the business for at least 3 years prior to the amalgamation. The conditions in the hands of the amalgamated company are sufficient to control misuse of the provisions and therefore, the conditions applicable to the amalgamating company should be deleted. Also, holding of assets and continuation of business for 5 years is quite a long period.
- Where such loss of specified business under section 35AD of the Act is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company.

Recommendations

- Section 72A of the Act should be amended to allow benefit of carry forward of losses, pursuant to amalgamation, to all companies irrespective of their line of business especially services business.
- Section 72(A)(2) of the Act be amended to delete conditions under sub-clause(a) relating to amalgamating company.
- Also, Section 72A(2)(b) of the Act should be amended to reduce the period of holding assets and carrying on of business to 3 years.

4.17.3. Amendment in Section 2(42A) of the Act

Issues

- The Finance (No. 2) Act, 2014 has amended Section 2(42A) of the Act, which provides that unlisted shares and units of non-equity mutual funds should be considered short term capital asset if the same are not held for more than 36 months.
- Under the earlier provisions, if shares/ units were held for more than 12 months, the same were considered to be long term capital asset and was liable to lower rate of tax. Therefore, the investor would have acquired the shares/ units on the basis that the same could be sold after 12 months and tax impact will be at a lower rate. This impacts the investor confidence about reliability of tax policies.

Recommendations

- It is recommended that this proposal should be dropped and the erstwhile holding limit for unlisted shares and a unit of a mutual fund (other than an equity oriented mutual fund) as a long term capital assets should be continued i.e. more than 12 months.
- Alternatively, the amendment should be made applicable from 31st March, 2015 (instead of 10th July 2014) so as to avoid undue hardship to the investors who purchased shares/ units before 1st April, 2014 but could not redeem such shares/ unit before 10th July, 2014.

4.17.4. Change of rate of tax on sale of units of a Mutual Fund - Section 112

Issue

- The concessional rate of tax of 10% on long term capital gain is no more available to the units of a mutual fund. This amendment in Section 112 would again impact debt schemes of Mutual fund (MF)

Recommendation

- This proposal should be dropped and accordingly beneficial rate of tax (i.e. 10%) should continue to be made applicable as earlier on such schemes.

4.17.5. Grossing-up of a Dividend Distribution Tax in relation to Mutual Fund - Section 115R

Issues

- The Finance (No. 2) Act, 2014 has amended Section 115R wherein the DDT in relation to the unit holders is required to be grossed up. Accordingly, the DDT to be paid after grossing up of the amount distributed as dividend.
- This amendment in Section 112 would impact debt schemes of Mutual fund (MF)

Recommendation

- This amendment should be deleted and the erstwhile method of computation of DDT should continue to be applied on income distributed by a mutual fund. Grossing up effect is especially very steep in the case of mutual funds on account of the higher DDT (vis-à-vis Dividend on shares).

4.17.6. Status of widely held company to be considered on date of Transaction

Issues

- Section 2(18) of the Act defines widely held company. This definition has wide implication on carry forward of loss, taxability under Section 56(2) of the Act and in various other provisions.
- It includes a listed company, only if its shares are listed on exchange as on last date of the relevant year. Further, it includes subsidiary of listed company, only if the shares of such subsidiary were held throughout the relevant year by the listed company. These provisions lead to situations which does not seem intended.
- Therefore, it stands logical that the conditions of listing, holding of shares etc. should be subject matter of test on the date of transaction and should not be stretched to be continuing till the end of that FY.

Recommendation

- Section 2(18) of the Act should be suitably amended to provide test of conditions on the date of relevant transaction.

4.17.7. Transactions without consideration or for inadequate consideration

Issues

- The Finance Act, 2010 inserted clause (viia) in Section 56(2) of the Act with a view to curb abusive transactions.
- Section 47 of the Act and other provisions of the Act exempts certain transactions from taxation. However, proviso to Section 56(2)(viia) of the Act excludes only a part of such exempted transactions from its applicability. Consequently, those transactions which may otherwise be exempt under Section 47 of the Act are still liable to tax under Section 56(2)(viia) of the Act.

- Section 56(2)(viia) of the Act is applicable to receipt of shares without consideration or with inadequate consideration. These are anti-abuse provisions intended to curb tax avoidance. Consequently, it should be applicable to transactions liable to tax and not otherwise. Thus, this Section should be applicable to receipt of shares which are not covered under Section 47.
- Without prejudice to the above recommendation, it needs to be clarified that the following transactions would be excluded from its ambit:

  Issue of shares including:

  – right issue
  – Preferential allotments
  – Conversion of financial instruments
  – Bonus shares
  – Split/ subdivision/ consolidation of shares.
  – Receipt pursuant to stock lending scheme.
  – Receipt by Trustee Company.
  – Buyback of shares.
  – By offshore investors in cases where purchase price is determined by Indian laws in force (e.g. SEBI rules, FEMA guidelines).

Being anti-abuse provision, it should be applicable to transactions between associated concerns and not to other transactions. The amendment will adversely impact genuine cases where the shares are transferred at a pre-determined price for agreed commercial and bonafide considerations. For example:

- Joint venture or investment agreements particularly for unlisted company, frequently make provisions for put and call options to be exercised at agreed prices, which are compliant with all relevant exchange control and related laws, though they may not necessarily be at fair market value. This is, often, to permit Indian promoters to enjoy some upside benefit if their companies perform better than the rate of return expected by the investor. To levy income-tax liability on such promoters purely on a notional unrealized gain, when they acquire shares from the investors at the negotiated price is clearly unwarranted and, possibly, unintended.
- Likewise, there may be default forced sale provisions in such agreements that allow a non-defaulting party to acquire shares from a defaulting party at a price below market value. Again, to tax the non-defaulting acquirer for the discount would be unfair and possibly, also unintended.

Recommendations

- All transactions which are specifically exempted from capital gains tax under Section 47 of the Act or other provisions of the Act should be kept outside the purview of the said Sections 56(2)(viia) of the Act.
- Section 56(2)(viia) of the Act should be suitably amended to provide that it applies to receipt of properties being shares in closely held company from related/ connected entities. It must be clear that it is not applicable to genuine business/ commercial transactions.
- Section 56(2)(viia) of the Act should be suitably amended to provide that the Section should be applicable only if the shares being received by the taxpayer are in existence and held by another person.
- Rule 11UA of the rules should be suitably amended to value unquoted equity shares on a fully diluted basis.

4.17.8. Amalgamation/ Demerger into Parent/ Subsidiary/ Co-subsidiary - Section 47

Issues

- Section 47 of the Act exempts certain transactions from being taxed under the head 'capital gains' by specifying such transactions not to be regarded as 'transfers' under Section 45 of the Act.
- Sub-Section (vii) of Section 47 of the Act states:

  "any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if-

  (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where shareholder itself is the amalgamated company.

  (b) the amalgamated company is an Indian Company."
- Section 42 of the Companies Act 1956/ 19 of the Companies Act, 2013 does not allow a subsidiary company to hold shares in the parent company. Pursuant to such merger, in case where subsidiary was holding shares in transferor company, the parent company cannot allot shares to it.
- Section 2(19AA) of the Act defines 'demerger' and specifies conditions which are conflicting in nature. First condition requires that at least 75% shareholders of transferor company should become shareholders of transferee company. Second condition provides that shares should be issued to the shareholders of the transferor company on a proportionate basis. If one logically reads the two conditions, it means that shares should be issued on a proportionate basis to the shareholders of demerged company, to whom shares are issued under first condition. However, to avoid litigation, clarity needs to be provided.
- Section 41 of the Act provides that certain income subject to conditions, relating to business of predecessor, will be taxable in hands of successor even though it arises post succession. However, similar provision is not there in Section 43B, 35DD etc. of the Act where expenses need to be claimed post restructuring in hands of successor.

Recommendations

- Section 47(vii) of the Act should be extended to specifically cover:-
  - shareholder of amalgamating company being subsidiary of amalgamated company
  - Amalgamation of direct subsidiary with step-down subsidiary,
  - Amalgamation involving amalgamating company holding shares in amalgamated companies.
- Section 2(19AA) of the Act be amended to provide that the shares of the resulting company should be issued on a proportionate basis to the shareholders of demerged company to whom shares are issued under first condition. It should be clear that proportionate basis does not apply to all the shareholders.
- A new Section be inserted in chapter IV providing that in case of reorganization, deduction in relation to:-
  - to expenditures incurred in pre-reorganisation period but allowable during post-reorganisation period and
  - expenditures incurred during the previous year but allowable on certain criteria, for e.g. payment basis under Section 43B of the Act, etc. will be allowed to successor as it would have been allowed to the predecessor.

4.17.9. Conversion of one type of share into other type of share of the same company

Issues

- Section 47(x) of the Act provides that, any transfer by way of debentures, debenture-stock or deposit certificates in any form, of a company into shares or debentures of that company, will not be treated as a 'transfer' for the purposes of Section 45 of the Act. Section 49(2A) of the Act provides that, where a share or debenture in a company, became the property of the taxpayer on such conversion, the cost of acquisition to the taxpayer shall be deemed to be that part of the cost of debenture, debenture-stock or deposit certificates in relation to which such share or debenture was acquired by the taxpayer. However, the period of holding of earlier instrument has not been considered while calculating the period of holding for the new instrument.
- It is noteworthy that while inserting clause (x), the intent of the legislature was that no taxable capital gains can arise at the time of conversion of convertible debentures, deposit certificates or shares of the company into debentures or shares of that company, since it amounts to conversion of an asset held by a taxpayer from one form to another and no other party involved to whom any transfer is made. In fact, clause (x) of Section 47 of the Act was further amended by the Finance Act, 1992 to include 'bonds' in the said provision.
- However, it appears that there has been an inadvertent omission in both the foregoing provisions, i.e., conversion of preference shares or warrants into equity shares of a company have not been specifically covered under the said provisions. Similar to Section 49(2A), Section 55(2)(b)(v) of the Act provides that cost of shares received on conversion should be cost of the shares which were converted. Thus, there does not seem to be any difference in taxing of conversion of debenture or share. However, legislature has missed to provide exemption to conversion of preference shares.

Recommendations

- Section 47(x) of the Act should be amended to include cases of conversion of one type of shares or warrants into shares or other type of shares.
- Section 47(x) of the Act should be amended to include cases of conversion of loan / ECB into shares or other type of shares. This could be limited to loans which have terms / features similar to debentures and bonds.
- Section 47(x) of the Act should be amended to also include cases of conversion of IDRs into shares.
- Section 2(42A) of the Act should be amended to provide that the period of holding of earlier instrument should be included for computing the period of holding of new instrument.

4.17.10. Transfer of capital asset between Holding Company and Subsidiary –Section 47

Issues

- Under the existing provisions of clause (iv) and (v) of Section 47 of the Act, transfer of a capital asset by a holding company to its subsidiary company and vice versa is not regarded as a 'transfer' for the purposes of capital gains if inter-alia, the parent company holds whole of the share capital of subsidiary company.
- In order to carry out business in today's challenging business environment, business houses create multilayer corporate structure for complying with various regulatory and contractual requirements as well as risk ring fencing for its lenders.

Recommendation

- It is therefore, suggested that benefits of clause (iv) and (v) of Section 47 may be extended to step down subsidiaries where the parent company holds whole of share capital of such subsidiary directly or through other 100% held subsidiary.

4.17.11. Non-Compliance of conditions applicable to certain re-organizations - Section 47

Issues

- Section 47A(1) of the Act provides that in case holding company does not continue to hold 100% of shares of the subsidiary company or converts/treats the transferred asset as stock-in-trade, within a period of 8 years from the date of the transfer of capital asset, the gains exempted under Section 47(iv)/ (v) of the Act shall be taxable in the hands of the transferor company in the year of transfer. It shall be noted that a period of 8 years is too long.
- Further, in any case such income should be taxable in the year of event specified in the Section and not in the year of transfer of capital asset.

Recommendations

- Section 47A (1) of the Act should be amended to reduce "period of 8 years" to reasonable period.
- Further, in any case, such income should be taxable in the year of event specified in the section and not in the year of transfer of capital asset.
- Words 'profits & gains' in Section 47A(1) of the Act should be replaced with the word 'income'.

4.17.12. Conversion into Limited Liability Partnership/ conversion of Firm into Company

Issues

- Chapter X of the LLP Act allows following conversions:
  - Partnership firm (Firm) into LLP (Section 55 of the LLP Act)
  - Private limited/ unlisted public company into LLP (Section 56/ 57 of the LLP Act)

  In view of the above, the Finance Act 2010 provided tax neutrality to conversion of Company into LLP under Section 56/ 57 of the LLP Act. However, there is no provision allowing tax neutrality to conversion of firm into LLP under Section 55 of the LLP Act.
- Section 47(xiiib) of the Act provides tax neutrality to conversion of Company into LLP subject to certain stringent conditions. Such conditions should be made less stringent or some relaxation should be provided in application of the same as discussed below:
  - It is available only to a Company having Turnover of less than Rs. 60 lakhs for 3 years prior to such conversion. In the current economic scenario, this limit of Rs. 60 lakhs needs to be removed. There is no reason, why companies with large turnover, which otherwise qualify, should not be eligible for conversion with tax neutrality.
  - Another condition is that all the shareholders of the company, immediately before the conversion, should become partners of the LLP. This condition should be made applicable only in respect of equity shareholders and not preference shareholders, since preference shares are in the nature of quasi equity.
  - Further, it is necessary that the aggregate of the profit sharing ratio of the shareholders of the company, in the LLP shall not be less than 50% at any time during the period of five years from the date of conversion. This condition should be applicable only to voluntary transfers and not to all the transfers. Say, this condition should not apply in case of dilution resulting from death or disqualification of a partner or amalgamation of a corporate partner.

- For claiming tax neutrality, it is provided that accumulated profits of the company as on the date of conversion should not be paid to the partners of the LLP for a period of three years from date of conversion. Under the Act, LLP is considered akin to a partnership firm and there is no restriction on distribution of the profits of the partnership firm. Further in case of firm, there is no requirement to show reserves and surplus separately, but the same is credited to partner's capital account. Thus, there should not be any restriction on LLP in relation to payment out of profits. Further, the term accumulated profits is not defined and may include other reserves also.
- MAT payment under Section 115JB of the Act is prepayment of taxes actually becoming due in subsequent years under normal provisions of the Act. Consequently, Section 115JAA of the Act allows credit for such payments in the year the company becomes liable to pay tax under normal provisions of the Act. There is no reason, why such credit should not be allowed to LLP, which is converted from a company eligible to such credits, if it is paying taxes under normal provisions of the Act.
- Section 47(xiii)/ (xiiib) and (xiv) of the Act requires that the members of the firm/ shareholders of the company should continue to maintain profit sharing/ shareholding for 5 years. It should be noted that 5 years is a fairly long time and therefore, it should be restricted to 3 years.
- Section 47A(4) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiiib) of the Act, the gains on conversion of company/ transfer of shares shall be the profits & gains taxable in the hands of the LLP/ shareholders in the year of such non-compliance. Similarly, proviso to Section 72A(6A) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiiib) of the Act, the losses/ unabsorbed depreciation of the company utilized by the LLP shall be income of the LLP for the year of such non-compliance.
- Section 47A(3) of the Act provides that in case of non-compliance of any condition provided in Section 47(xiii) or (xiv) of the Act, the gains on conversion of partnership or proprietary concern shall be profits & gains taxable in the hands of the Company in the year of such non-compliance. Similar to Section 72A(6A), 72A(6) deals with cases covered under Section 47(xiii) and (xiv).

Recommendations

- Section 47(xiii) of the Act should be suitably amended to include conversion of a Firm into LLP along with conversion of Firm into a Company.
- Turnover criteria should be removed from Section 47(xiiib) of the Act.
- Words "equity shareholder" should substitute the word "shareholder" wherever it appears in Section 47(xiiib) of the Act.
- Insert proviso under clause (d) in proviso to Section 47(xiiib) of the Act to provide that it should not be applicable to a case where a change in profit sharing takes place consequent to death of a partner or pursuant to any other transaction covered under Section 47 of the Act.
- Condition of non-payment out of accumulated profits specified in clause (f) to proviso to Section 47(xiiib) of the Act should be removed. If not removed, term accumulated profit should be appropriately defined.
- Provisions of Section 115JAA of the Act allowing utilization of MAT credit should be amended to allowed credit for MAT paid by the company to the successor LLP.
- Sections 47(xiii)/ (xiiib)/ (xiv) should be amended to reduce period of continuing same profit sharing/ shareholding from 5 years to 3 years.
- Words profits & gains in Section 47A(3)/ (4) of the Act should be replaced with the income.

4.17.13. Continuation of deduction under Section 80-IA in case of re-organization

Issues

- Section 80-IA of the Act provides deduction in relation to profits of certain undertakings. It was well settled that in the case of restructuring of any entity owning such undertaking, the benefits of deduction will be available to entity owning the undertaking post restructuring.
- Board Circular Letter F.No. 15/5/63-IT (AI), dated 13th December, 1963 specifically provided that in the year of corporate restructuring, the benefit shall be available to transferor entity up to the date of transfer and to the transferee entity for the remaining period of tax holiday.
- Sub-Section (12) provided that in the year of restructuring deduction will not be allowable to the transferor entity but same will be allowed to the transferee entity as it would have been allowed, had the restructuring not taken place. In totality, this will restrict the total period of deduction to not more than the total period for which the deduction should have been allowed under the provisions of the Act.
- However, sub-Section (12A) was inserted in Section 80-IA with effect from 1st April, 2008 to provide that nothing contained in sub-Section (12) shall apply to reorganization post 1st April, 2007. A view is expressed that post insertion of sub Section (12A), benefit of deduction under Section 80-IA of the Act will not be available to the amalgamated/ resulting entity.

Recommendations

- Section 80-IA(12A) of the Act be deleted to enable restructuring of eligible entities.
- Section 80-IA(12) of the Act should be amended to provide for allowing deduction to the amalgamating/ demerged entity for the period till transfer date and to the amalgamated/ resulting entity post transfer.

4.17.14. Amendment to Section 68

The first proviso to Section 68 of the Act provides that in case of closely held company share application money shall be considered as income of the company unless the investor provides necessary explanation to the satisfaction of the Assessing Officer.

Issues

- This amendment is not needed and desirable. Any tax avoidance which is structured through excessive securities premium could be brought under the purview of GAAR provisions through adequate methodology and rules. The overall principles enunciated under GAAR provisions to treat an arrangement as Impermissible Avoidance Arrangement should be applied to the share subscription transaction for determining the taxability of securities premium account in the hands of company.
- This amendment may overlap with provisions of Section 56(2)(viib) of the Act and may be taxed twice.

Recommendation

- It is suggested that the first proviso to Section 68 should be deleted.

4.18. Capital Gains

4.18.1. Issues under Section 54EC of the Act

Issues

- Section 54EC of the Act provides tax exemption on capital gains arising from the transfer of a long term capital asset, if invested in long-term specified assets within a period of six months from the date of such transfer. The investments in such bonds, in a FY and the subsequent FY, should not exceed Rs. 50 lakhs.

- Further, there might be a situation where, the specified assets are not available during the said period of six months. Also, it may be possible that the price/ rate/ cost at which the specified asset is available during the stipulated period may not be viable for the taxpayer to invest.
- Purpose behind granting of exemption is to promote investment in specified assets. There does not seem to be any rationale behind prescribing the monetary limit of Rs. 50 lakhs per investor or specifying the stringent time line of 6 months. Especially in the context that such funds would in any case be used for meeting the infrastructure requirements.
- The specified assets for the purpose of section 54EC are only bonds issued by National Highways Authority of India or by Rural Electrification Corporation Limited. The Government should also include 'mutual fund units' within the purview of specified assets to channelize more investments in the capital markets.

Recommendations

- Currently, huge amounts are required to be deployed in the infrastructure sector to give the sector the much needed boost and this vehicle could be used for raising such infrastructure development funds. Thus, there is a need to revisit the limits prescribed.
- Moreover, the interest income on such bonds, which are presently fully taxable, should be awarded 'non-taxable' status.
- Proviso to Section 54EC(1) of the Act which restricts the investment in such bonds not exceeding Rs. 50 lakhs in a FY should be deleted.
- Recently inserted Second Proviso to Section 54EC(1) of the Act should also be deleted which restricts the investment in the FY of transfer and its subsequent FY, with respect to the asset transferred, in such bonds not exceeding Rs. 50 lakhs.
- The time period of 6 months should be liberalized and the exemption should be permitted for the investments made before the due date of filing of return of income under Section 139(1) of the Act.
- The list of specified assets should be broadened by including mutual fund units redeemable after three years.

4.18.2. Cut-off date for ascertaining cost and Index factor - Section 48/55

Issues

- Section 55 (2)(b) (i) and (ii) of the Act provides that in case of asset acquired before 1 April 1981, taxpayer has an option to replace cost of such asset by market value thereof.
- Section 48 of the Act provides that for computation of long term capital gain, "indexed cost of acquisition" is deductible from the full value of the consideration received from the transfer of certain capital assets. Indexed cost means cost of acquisition adjusted for inflation index. Again, base for ascertainment of index factor is 1st April, 1981. Cost Inflation Index is notified every year having regard to 75% of average rise in the Consumer Price Index for urban and non-manual employees for the immediately preceding previous year to such previous year. It may thus be seen that such indexation benefit is notional and does not take care of full inflationary impact and causes inequities to the taxpayers. Thus, the cut-off date for cost replacement and base for index being 30 year old needs to be revised.
- Further, in case of taxpayer, acquiring assets through specified modes, period of holding of earlier transferor is added to period of holding of taxpayer, however, index benefit is allowed only from the date of holding of the asset by the taxpayer. This seems to be an unintended anomaly and needs to be set right.

Recommendations

- Cut-off date for cost replacement in Section 55 of the Act and for index factor in Section 48 of the Act should be shifted to 1st April 2001.
- Index benefit even to the taxpayer acquiring assets through specified modes should commence from the date of acquisition in the hands of original purchaser.

4.18.3. Rate of Tax applicable to Short-term Capital Gains - Section 111A

Issues

- Section 111A of the Act provides that short-term capital gains on sale of shares of listed companies or units of equity oriented fund should be taxed at 15%. The rate was 10% till 31 March 2009.
- The difference between normal income and capital gain arising on transfer of assets is well recognized even under the Act. It is a known fact that owner of an asset incurs a lot of expenditure for maintaining an asset. In case such asset is used in business, deduction is allowed for such maintenance and other expenses. However, no such deduction is allowed if such asset is a non-business asset. Thus, it makes a strong case that rate of tax in case of capital gains should be different from the rate applicable to other incomes. This distinction is recognized to some extent in Section 111A and 112 of the Act. However, for short term gains on assets other than listed shares, such difference is not recognized.

Recommendations

- The rate for listed shares should be restored to 10% as was the position till 31st March 2009.
- Section 111A of the Act should be amended to provide the rate of tax for short term gain on transfer of assets other than listed shares to be at 20%.

4.18.4. Abolition of tax on gains arising from transfer of Listed Securities

Issues

- In case of the taxpayer who is an investor and is also engaged in the business of trading in securities, there is an ongoing dispute as to the taxability of the gains arising on account of the transfer of the shares held as investment.
- As per National Stock Exchange, India is one of the costliest destinations to trade in securities. STT, along with other taxes, and high brokerage structure makes trading in securities in India almost five-six times higher than in advanced countries.

Recommendations

- At present, only the long term capital gains arising on transfer of listed shares routed via a recognized stock exchange are exempt. Various courts have laid down guidelines to determine the nature of the gains. The guidelines are based on the facts of the particular case and cannot be applied to all the cases, therefore, leaving the issue unresolved and causing undue hardships to the taxpayers.
- The Shome Committee Report on 1st September 2012 on GAAR recommended that the Government should abolish the tax on gains arising from transfer of listed securities, whether in the nature of capital gains or business income, to both residents and non-residents.
- Hence, it is recommended that the capital gains tax levied on the transfer of listed securities be abolished.
- Alternatively, suitable amendments should be brought in the Act, to provide a clear distinction between the income from trading activities & income from investment activities.

4.18.5. Insertion of Section 50D in the Act

Section 50D is inserted to provide that in cases involving transfer of assets, if the consideration is not determinable, fair value of the consideration received or accruing shall be deemed to be consideration.

Issues

- Method of determining fair value is not specified under the Act.
- Section overlaps with certain other Sections providing similar mechanism for determining consideration, e.g. Section 45(3) dealing with transfer of a capital asset.

Recommendation

- Method for determination of fair value should be specified under the Act. Applicability of Section 50D of the Act should be restricted to the transactions not covered under other similar provisions.

4.19. Additional Income-tax on distributed income for buy-back of Unlisted Shares

The Finance Act, 2013 has introduced additional income tax of 20% to the extent of distributed income paid to the shareholder in a buy back scheme for purchase of its own shares. It has also been provided that income arising to the shareholder as a result of such buy back will be exempt from tax.

Issues

- The Memorandum to the Finance Bill, 2013 states that the purpose of introducing such provisions is to curb avoidance of payment of tax by way of DDT. However, these provisions would also cover genuine transactions within its purview which is against the intent of the law.
- The rate of DDT is 15% under Section 115-O of the Act. However, levy of additional tax on distributed income by way of buyback is at the higher rate of 20%.
- The provision suffers from many deficiencies:-
  - Distributed income has been defined as consideration paid by the company on buy back of shares as reduced by the amount which was received by the company for issue of such shares. The reduction of issue price from consideration paid for computation of distributed income may not be appropriate as it would lead to double taxation under the following situations:
    (a) Where the shareholder has acquired the shares through secondary transaction by paying cost which is higher than the issue price received by the company.
    (b) Where shares are allotted to an individual by his employer/ former employer. In such a scenario, the benefit is taxable as a perquisite under Section 17(2)(vi) of the Act. In case, when such shares are sold subsequently by the individual (either under a buy back or otherwise) for the purpose of computing the individual's capital gains, the cost of acquisition is taken as the FMV considered for the perquisite valuation as per Section 49(2AA) of the Act.
- In light of the definition of 'distributed income', the company will have to pay the tax on the difference between the consideration paid upon buyback of shares and the amount received upon issue of such shares.
- In case the company has raised capital from different persons at different prices at different points of time, the provisions of the Chapter do not provide whether (i) the company would need to take average price of such shares for the purpose of calculating the distributed income (i.e. determine distributed income at Company level) or (ii) it would need to calculate the distributed income separately in respect of each shareholder participating

in the buy-back after taking into account the respective cost of acquisition of each such shareholder or (iii) the company would need to determine the distributed income vis-à-vis per share.

- In case the company has to calculate the distributed income separately in respect of shareholder, then tracking the actual issue price in case of each shareholder participating in the buyback could get onerous in the following instances:
  - shares are in demat mode, where the company's shareholder register would reflect only the name of the depositary participant and not the names of each shareholder/ beneficiary; and
  - in case there have been multiple corporate actions/ business reorganizations/ mergers & demergers, etc. involving the company as this would alter the initial issue price for each share.

Recommendation

- In view of the above, the formula for computation of distributed income may be prescribed at the company level for each buy-back (rather than specific to shareholders).The buy-back distribution tax should be made akin to DDT.

Other Issues and Recommendations

Issues

- The Act does not provide for the manner to determine amount received by the company on issue of shares at the time of corporate actions such as bonus issuance, share split, share consolidation, merger of company, etc. In these cases, whilst the company has not received actual cash flow, there would be a change in fair value of the share due to such corporate actions, which will impact the cost/ number of shares held by the shareholders.
- It has been provided that the income arising to the shareholders in respect of buy back of unlisted shares by the company would be exempt in the hands of the shareholder. This would result in denial of carry forward/ set-off of losses resulting from buy back.
- The construct of Chapter XII-DA in the Act does not enable the shareholder to take benefit of indexation on the cost of acquisition, since the company is paying tax on such distributed income without considering indexation benefit. This is very much detrimental to the interest of long term shareholders since they will be losing out the indexation benefit, even if they are holding the shares for a long time. The provision totally ignores the holding period of shares by the shareholder.
- It has been provided that the additional income-tax payable by the company shall be the final tax on similar lines as DDT. In Section 115-O of the Act, for computing the DDT, on distribution of dividends by the company to its shareholders, the recipient holding company is allowed credit for dividends received. No such similar provisions are there in Section 115QA of the Act.
- The profit arising on buy back of shares in the hands of the shareholder company, will remain in its books and may be liable for DDT on subsequent distribution of dividend by the company out of its accumulated profits (which includes profits on buy back of shares). This would lead to double taxation.
- As explained in the Memorandum, the purpose of introduction of this provision is to curb avoidance of DDT. Therefore, provision should tax what was being avoided, i.e. dividend. Companies Act, 1956/2013 does not allow utilization of securities premium for payment of dividend. Even Section 115-O of the Act does not levy tax on such distribution. Section 115-O of the Act levies tax on dividend as defined under Section 2(22) of the Act which restricts quantum of dividend to the extent of accumulated profits. Buy back is permitted even out of securities

premium which, by no stretch of imagination can be considered to be accumulated profit, hence it should not be made liable to tax under new provisions.

- Section 46A of the Act is specifically dealing with this type of transactions and therefore, clarity on applicability of Section 46A of the Act needs to be provided.
- The transaction of buy back, though, taxable as distribution tax under the newly inserted provisions of the Act, may still be taxable as capital gains in the foreign jurisdiction. A mechanism may be provided under the Act for allowing credit of the taxes paid under Section 115QA of the Act to avoid double taxation.
- Considering the commercial and regulatory difficulties for structuring exit through IPO, put/ call options, etc., buy-back of shares provides the Venture Capital (VC)/ Private Equity (PE) funds with a likely and feasible exit avenue on which they can possibly rely upon. Levy of distribution tax on exit through such route would be unfair to the VC/ PE funds.

Recommendations

- This amendment (provisions inserted through Chapter XII-DA) should be rolled back or the applicability of the provision should be restricted to cases involving avoidance of DDT.
- Alternatively, the rate of tax on distributed income as per the provision of Section 115QA of the Act should be restricted to 15% as applicable to DDT.
- The computation of distributed income should be based on cost of shares in the hands of the shareholder and not the issue price of the company in case of situations stipulated above. Further, it should be specified that in case where shares are bought back by an employer/ former employer, distributed income would mean consideration paid by the company on buy back of shares as reduced by the fair market value which was considered for the purpose of perquisite valuation under Section 17(2)(vi) of the Act.
- Appropriate guidelines should be issued with respect to determination of the issue price under situations highlighted above.
- A mechanism for availing credit of such tax should be notified as imposing such tax as a final tax, with no credit available is grossly unjustified.
- It is recommended that VC/ PE funds should be specifically exempted from applicability of the said chapter.

4.20. Taxability of Immovable Property received for inadequate consideration - Section 56(2)

Section 56(2)(vii)(b) of the Act provides that receipt of immovable property by an individual or HUF for a consideration which is less than stamp duty value of the property by more than Rs. 50,000, will be taxable as income from other sources on the stamp duty value in excess of the consideration.

Issues

- Section 56(2)(vii) of the Act in respect of transfer of immovable property for inadequate consideration was originally inserted by Finance Act, 2009, but later on deleted by Finance Act, 2010 with retrospective effect from date of insertion. There does not seem to be any reason for reintroduction of the same.
- The provision levies tax on inadequacy of consideration. Section 50C/43CA of the Act deals with such inadequacy in hands of the seller/ transferor. Section 56(2)(vii) of the Act will tax the same inadequacy in the hands of the purchaser as 'income from other sources', where sale consideration is less than the stamp duty of the property by an amount exceeding Rs. 50,000 as stamp duty value less sale consideration. Both, seller and purchaser, pay tax on same inadequacy of consideration and thus, there is double taxation to that extent.

Recommendations

- Clause (ii) to Section 56(2)(vii)(b) of the Act should be deleted as it will lead to double taxation, which could not be the intended objective of the Government.
- Alternatively, Section 50C/ 43CA of the Act may need to be correspondingly modified to exclude such transaction which has been taxed under Section 56(2)(vii)(b) of the Act.

4.21. Transfer Pricing

4.21.1. Transfer Pricing - Marketing Intangibles

Issues

- Marketing intangibles are crucial sources of value and its value is derived from the company's levels of Advertising, Marketing and Promotion expenditures (AMP) which adds intrinsic value to a company. Revenue authorities are increasingly scrutinizing the cross border transfer, use and further development of intangibles relating to brand and licenses. The ruling of the Delhi HC in the case of Maruti Suzuki India, which discusses the creation and compensation for marketing intangibles only, underlines this trend. Further, the Special Bench of the Delhi Tribunal in the case of LG Electronics India Pvt. Ltd. held that transfer pricing adjustment in relation to AMP expenditure incurred by the taxpayer for creating or improving the marketing intangible for and on behalf of the foreign Associated Enterprise (AE) is permissible. It also held that the said function can be construed as provision of service by the taxpayer to the AE for which, earning a mark-up in respect of AMP expenditure incurred for and on behalf of the AE, is appropriate.
- Recently, the Delhi High Court in the case of Sony Ericsson Mobile Communication India Pvt. Ltd. and several other connected matters upheld the tax department's jurisdiction to consider AMP expenditure as an international transaction subject to transfer pricing. The High Court further held that various legal ratios accepted and applied by the Income-tax Appellate Tribunals relying upon the Special Bench ruling in the case of LG Electronics as erroneous and unacceptable. The High Court held that distribution and marketing are intertwined functions and can be analyzed together as a bundled transaction and that segregation of non-routine AMP expenditure using the bright line approach is not appropriate. In line with the findings of the Delhi Tribunal in the case of BMW India Private Limited, the High Court also held that separate remuneration for the AMP activities may not be required if such compensation is already provided by way of lower purchase price or reduced payment of royalty. It has been observed by the High Court that, for justifying argument of "margin", selection of comparables, having similar intensity of functions on account of AMP, as the taxpayer, is crucial. Proper adjustments are suggested by the High Court to eliminate the material differences. However, High Court did not provide guidance on the nature of adjustments that may be required.
- In light of the amendment introduced vide Finance Act 2012 which specifically includes marketing intangibles in the expanded definition of international transactions, the Special Bench ruling in the case of LG Electronics India Pvt. Ltd., and the High Court's judgment in case Sony Ericsson and BMW India, identifying a transaction relating to marketing intangible development and substantiating the arm's length compensation for the transfer price of the intangibles would pose great challenges without specific guidance relating to these aspects in the Indian transfer pricing regulations

Recommendation

- Accordingly, in line with the Organization for Economic Co-operation and Development (OECD) principles and recommendations given by the OECD under Action 8 of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Action Plan, guidance should be issued to recognize certain methodologies/ approaches for evaluating the arm's length character of transactions involving marketing intangibles.

4.21.2. Transfer Pricing of Manufacturing Intangibles

Issues

- Compensation for use of manufacturing intangibles has generally been in the form of royalty payouts and is commonly benchmarked by adopting the aggregated approach.
- However, this approach is increasingly challenged by the Revenue Authorities, who insist on adopting transaction-specific approach, and the taxpayer is required to substantiate the economic and commercial benefits derived from the royalty payout.

Recommendation

- With the removal of the limits exchange control that was prescribed by the Foreign Exchange Management Act Regulations, it is necessary that guidance be provided to test such transactions particularly in cases of start-up or loss making companies.

4.21.3. Transfer Pricing of Intra Group Financial Transactions/ Management services

Issues

- Management services are services where an entity in a multinational group renders shared services in the nature of legal, administrative, human resources, information technology, finance, sales/marketing, etc. to its group affiliates.
- One of the important issues that draw the attention of the Revenue Authorities is the arm's length nature of the compensation paid for such intra-group services to related entities. Another important aspect is demonstrating the benefits derived by the service recipient. The entire onus to substantiate the arm's length payment and benefit received and establishing the 'cost-benefit' analysis by way of maintaining service agreements, basis of charge out rates, allocation keys, evidence of services/ benefits received etc., is upon the taxpayer.

Recommendation

- Accordingly, in the absence of any guidance or industry benchmarks in public domain for testing payments towards intra-group services, detailed guidelines in line with the OECD principles and recommendations given by the OECD under Action 10 of the OECD/G20 BEPS Action Plan,, for maintaining specific documentation outlining the various costs incurred in relation thereto and the related benefits derived there from, should be introduced in the regulations. Even the concept of Low value-adding intra-group services as recommended in discussion draft to Intra-group services issued under the above-mentioned Action Plan should be introduced which will result in stream lining the taxpayers and the Revenue authorities' resources towards more high-value transactions.

4.21.4. Interest on Inter-company Loans and Guarantee fees

Issues

- Transfer pricing of cross-border financial transactions deals with inter-company loans, debentures, corporate guarantee charges, cash-pooling arrangements, debtors discounting, etc., and intends to arrive at arm's-length outcome in a related-party scenario. Typically, interest rates on loan transactions between third parties depend on factors like borrowers' credit rating, loan tenor, prevailing market conditions, loan seniority, security to lender(s), etc.
- The Comparable Uncontrolled Price (CUP) method, which is commonly used for arriving at arm's-length interest rates for intra-group loan transactions, demands a high degree of comparability and necessitates complex adjustments. Pricing a guarantee is even more challenging in the absence of comparable data and warrants

application of sophisticated transfer pricing techniques. In India, lack of guidelines often leads to application of arbitrary methods for pricing of inter-company financial transactions. The Tribunal has laid emphasis on the credit quality of the borrower while holding that inter-company loans should attract arm's-length interest charge. Further, vide the Finance Act, 2012, the definition of international transactions has been expanded to specifically include capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business which would now give rise to a whole gamut of such financial transactions to be reported by the taxpayer.

Recommendation

- Given the increasing global trend of cross border financing and inter-company lending, it is of paramount importance to introduce appropriate guidance governing the pricing of inter-company funding. Further, considering the increased amount of litigation pertaining to the inter-company loans and guarantee transaction, with no clear view of the higher appellate authorities, appropriate clarification on the approach/methodology to be adopted for analyzing these transactions is required.

4.21.5. Transfer Pricing Methods - Profit Split Method (PSM)

Issue

- PSM is applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so inter-related that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction. The method involves valuation of non-routine intangible, assigning the combined profit or loss according to each party based on allocation keys and using of projected financials. Lack of clarity on valuation of intangibles and use of complex analysis for splitting the profit or loss has been experienced as the major reasons for the reluctance in using this method in India, both from a taxpayer and revenue perspective.

Recommendation

- Issuance of guidance for application of this method and valuation norms can bring about clarity to the taxpayer on usage of this method especially in light of some recent Tax Tribunal judgments accepting the use of PSM as the most appropriate method.

4.21.6. Transfer Pricing documentation and scrutiny requirement

Issues

- The documentation requirements are attracted if the aggregate value of the transactions exceeds INR 1 Crore.
- The monetary threshold for mandatory 'transfer pricing' audit is INR 15 Crore.

Recommendations

- These monetary limits have remained static after the introduction of transfer pricing regulations in the Act and seem to be on lower side especially in case of companies, which has associates in various countries. This limit for maintenance of mandatory documentation and initiating scrutiny proceedings requires an upward revision. Also, documentation requirements should enable the Revenue Authorities to arrive at ALP without subjecting the concerned parties to undue cost, time and harassment.
- It is suggested that the threshold for maintaining TP documentation and also for mandatory TP audit should be increased.

- It is further recommended to align the documentation requirements and audit processes to the recommendations made under Action 13 of the OECD/G20 BEPS Action Plan i.e. TP documentation to be maintained under a three-tier structure [Master File, Local File and Country-by-Country (CbC) Report]. OECD has also recommended that all the data provided in the Master File and CbC report should be used only for risk assessment purposes by the Revenue authorities. The OECD has also issued further guidance on implementation of CbC reporting specifying a threshold of € 750 million (approximately INR 5250 crores) and suggested ways for information exchange mechanisms between various governments.

4.21.7. Adjustments for differences in Functions and Risks

Issues

- The Indian TP regulations provide for making reasonably accurate adjustments to take into account differences between international transactions and uncontrolled transactions, considering the specific characteristics relating thereto.
- However, in practice there is no guidance or clarity on the manner in which these adjustments are to be made. For example, adjustments in areas such as differences in levels of working capital, differences in risk profile, differences in volumes, pricing on marginal cost, startup losses or capacity utilization and so on, have generally not been permitted by the Revenue Authorities in the course of transfer pricing audits as upheld in certain Tribunal decisions as well.

Recommendation

- Accordingly, suitable guidance on the manner of carrying out economic and risk adjustments to comparable and taxpayer's data is necessary. Further, the Revenue Authorities should be encouraged to duly consider in the course of transfer pricing audits, business strategies and commercial or economic realities such as market entry strategies, market penetration, and non-recovery of initial set-up costs, unfavorable economic conditions and other legitimate business peculiarities while determining the arm's length pricing.

4.21.8. Valuation under Customs and Transfer Pricing

Both Customs and TP require taxpayer to establish arm's length principle with respect to transactions between related parties. Objective under respective laws is to provide safeguard measures to ensure that taxable values (whether it is import value of goods or reported tax profits) are the correct values on which respective taxes are levied. The above objective, while established on a common platform has diverse end-results as seen below:

– To increase Customs duty amounts, the Customs (GATT Valuation) Cell would prefer to increase the import value of goods.

– To increase tax, the Revenue Authorities would prefer to reduce purchase price of goods.

Issues

- The diverse end-results create ambiguity in the manner in which the taxpayer should report values under the Customs and the Transfer Pricing. We have judicial precedents which favor and contradict the use of custom valuation in transfer pricing. In the case of Coastal Energy Pvt. Ltd., the Chennai Tribunal endorsed the Transfer Pricing Officer (TPO) decision to apply the customs data for transfer pricing analysis. Similarly, in the case of Liberty Agri Products Pvt. Ltd. the Chennai Tribunal again held that arm's length price on imports for transfer pricing purposes is to be determined using the rate for customs. Contrastingly, a decision from the Delhi Tribunal in the case of Panasonic Ltd. and the Mumbai Tribunal in the case of Serdia Pharmaceutical highlighted the distinctive objective of Customs valuation and the necessity for separate arm's length analysis as per transfer

pricing provisions. Further, in a Chennai Tribunal decision in the case of Mobis India Ltd, the Tribunal held that customs valuation was not acceptable as comparable for ALP determination as the purpose of customs valuation does not fit in the scheme of TP analysis under the Act.

- These contradicting decisions necessitate a greater need for convergence of transfer pricing mechanism under the Act and the Customs Regulations.

Recommendation

- There is a need for a common platform that would provide a 'middle-path' of arm's length price that is equally acceptable under Customs Law and under the Transfer Pricing.

4.21.9. Definition of International Transaction

Issues

Certain clauses of the explanation in the definition of "international transaction" as per section 92B of the Act override the chief machinery section for transfer pricing i.e. section 92(1) of the Act.

- Clause (c) of the Explanation (Capital financing) - The current language seems to cover transactions such as issue of shares, borrowing or lending transactions (principle loan amount) under its ambit. However, these transactions do not have any impact on the profit and loss account of the taxpayers and hence lead to unnecessary compliance burden in respect of these transactions as well as the potential exposure to penalty in case of non-compliance.
- Clause (e) of the Explanation (Business restructuring) – The current clause covers transactions of business restructuring, irrespective of the fact that it has a bearing on the profit, income, losses or assets.

Recommendations

- The definitions are contrary to the provisions of Section 92 of the Act and hence should be deleted/ modified accordingly.
- The words "irrespective of the fact that it has a bearing on the profit, income, losses or assets" need modification or deletion as they are contrary to provisions of section 92(1) and section 92B of the Act.
- Further, the Act does not define what is meant by "business restructuring or reorganization". A clear definition may be included (in Section 92F) so as to provide clarity to the taxpayers/ tax authorities to avoid any undue litigation on the topic.

4.21.10. Safe Harbour

- On 19th September 2013, the final Safe Harbour Rules (SHRs) were released after considering the comments of various stakeholders.
- Safe Harbour has been introduced for Software development Services (IT services), ITES, Knowledge Process Outsourcing Services (KPO services), Contract Research and Development (Contract R&D) relating to IT services and generic pharmaceuticals, for manufacture and export of core and non-core automobile components and for financial transactions like loan and guarantees.

KPO services and Contract R&D services - Issues and recommendations

- Cost plus margins proposed are too high and above the taxpayer's expectations - The Safe harbour ratio of 25% in the case of KPO services seems to be in a higher range. A downward reduction in the currently prescribed rates would encourage more taxpayers to opt for the Safe harbour regime.

- Clarity required in categorization (e.g. for ITES v/s KPO and for IT services v/s Contract R&D relating to IT) – Contrary to industry expectations, the categorization between ITES and KPO services and IT services and contract R&D relating to software development has not been done away with. To provide distinction from routine business process outsourcing services, the definition of KPO services includes only those services that require "application of knowledge and advanced analytical and technical skills". The definitions of various eligible international transactions, including that of the ITES and KPO and IT services and contract R&D services relating to software development, as provided in the SHRs leave lot of room for subjective interpretations and consequent controversies/ disputes on categorization of services.
- Moreover, the provisions in the SHRs relating to tax officer's review of taxpayer's continued eligibility in subsequent AYs also add to the uncertainty on categorization of services and eligibility for the Safe Harbour.
- The rules have artificially segregated IT services into software and contract R&D services and IT-enabled services into Business Process Outsourcing ('BPO') services and KPO service. The industry feels that this complicates the matter as many of the activities may be overlapping and compliance would require a more technical analysis than envisaged in the rules. It is recommended that additional/ clear criterions are introduced for classification of services. In any case, if such classification is made, it should not be merely based on the nature of services provided and there should be certain other criteria to determine the classification e.g. value of outcome of the activity performed vis-à-vis the ultimate customer etc.

Advancing of intra-group loans – Issues and recommendations

- The credit rating of the borrower is one of the prime considerations for any loan transaction and this has also been duly recognized by the Rangachary Committee (RC) report by recommending different interest rates (for loans above INR 50 crores) for High, Medium, Low and Junk category of borrowers.
- Adoption of 30th June as the date for establishing Base Rate - Considering the dynamic nature of the financial market, the interest rate prevailing as on the date on which loan is granted is of prime importance. Accordingly, interest rate closest to the date of lending, as may be available, should be adopted.
- Benchmarking interest rate year on year – Typically, the interest rate should be fixed at the time of entering into the loan arrangement. It should be eligible for Safe Harbour throughout the term of the loan and not just the AYs opted for by the taxpayer for Safe Harbour (valid maximum up to a period of 5 years starting with AY 2013-14 during which SHR are applicable).

Providing intra-group guarantees – Issues and recommendations

- Downward revision of proposed Safe Harbour rate for guarantee commission/ fees: The rate of 2/ 1.75% in the case of guarantees below and above INR 100 crores respectively is on the higher side. In many cases the guarantee fee charged by banks could be much lesser.
- The credit rating of the borrower is one of the prime considerations for any guarantee transaction and this has also been duly recognized by the RC report by recommending different interest rates (for loans above INR 100 crores) for High, Medium, Low and Junk category of borrowers.
- The above SHRs may not necessarily cover Wholly Owned Subsidiaries. It should cover transactions with all AEs.

General Issues and Recommendations

- Requirement for contemporaneous documentation will continue to apply in its entirety even in case a taxpayer has opted for SHR - Accordingly, the basic objective of simplicity and easy compliance is not being met by the SHR provisions. However, the RC report has recommended that the taxpayers opting for Safe Harbour should

be required to maintain only basic documentation like the details of international transaction, shareholding structure, nature of business and industry and functional analysis. It is therefore recommended that the SHR be amended to provide that the taxpayers opting for Safe Harbour should be exempted from all the documentation requirements and should be required to maintain only basic documentation as recommended by the RC.

- The margins prescribed under the Safe Harbour rules are very high and do not reflect industry benchmarks. The Government must re-evaluate these in the light of current economic environment and the fact that continued insistence on such high margins erodes competitiveness of Indian service providers and results in shifting work out of India.
- Safe harbor rules do not provide protection against double taxation. The taxpayer stands the risk of facing double taxation if the resident country of the taxpayer does not accept the safe harbor norms of India.

  MAP should be available for taxpayers who opt for Safe Harbour, as recommended by the OECD. This would greatly increase the attractiveness of the framework.
- Currently, SHRs have been notified in case of specified domestic transactions of government owned electricity companies prescribing limited documentation requirements for such companies. It is recommended that more such industries should be covered for simplified documentation.
- It is recommended that a clarification should be issued that the Safe Harbour would not become a basis for the Revenue Authorities to challenge the arm' length pricing of the taxpayer in prior years.

4.21.11. Specified Domestic Transaction

'Specified Domestic Transactions' now get covered in the scope of Transfer Pricing provisions if the aggregate amount of all such transactions entered by the taxpayer in the previous year exceeds INR 20 crores (w.e.f FY 2015-16, before that it was INR 5 crores)

Issues

- The term 'specified domestic transaction' has been defined to inter alia mean any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of Section 40A of the Act. Such expenditure could possibly include capital expenditure made to such a related person. It should therefore be clarified that these provisions pertain to revenue expenditure only.
- This amendment also covers a scenario wherein the payment of remuneration by the company to its director or relative of such directors is also required to be at arm's length. The same casts an onerous responsibility on the company vis - à- vis justification of the arm's length nature of such payments.
- Currently, there are no provisions relating to corresponding adjustment in transfer pricing regulations in respect to specified domestic transactions. It is important that if any adjustment [upward or downward] is made under the domestic transfer pricing provisions, then corresponding adjustment in the hands of the other party should be invariably be made.
- Presently, three different Sections of the Act prescribe varying thresholds for determination of 'related party' which are as under:-
  - Substantial Interest – Not less than 20% of voting power – Explanation to Section 40A(2)
  - Associated Enterprises - Not less than 26% of voting power- Section 92A(2)(a) & (b)
  - Associated Person - Not less than 26% of voting power - Section 80A read with Section 35AD(8)

Recommendations

- Necessary guidance for benchmarking directors' remuneration should be provided, as by the nature itself these could be very peculiar transactions depending on the extent of ownership, technical ability, seniority etc.
- This amendment seeks to cover a situation wherein there could not be any loss to the exchequer. The same is not in line with the suggestion provided by the Supreme Court in the case of Glaxo Smithkline. The Supreme Court had provided the situation wherein transfer pricing should be applicable in case of transactions between a profit making and a loss unit/company. The other scenario which was envisaged by the Supreme Court was transactions between units/taxpayers having different tax rates. Other than the scenarios contemplated above, a corresponding adjustment should be allowed and hence provided for in the statue.
- It should be suitably clarified that the transfer pricing provisions would only apply to revenue expenditure referred to in Section 40A(2)(a) of the Act, and not to payments made to persons specified in Section 40A(2)(b) of the Act.
- 'Any other transaction as may be prescribed' covered under Section 92BA of the Act may be notified and should be made applicable from prospective effect to avoid undue hardship to the taxpayers.
- Necessary amendments should be made in the domestic transfer pricing provisions to provide for the corresponding adjustments.
- It is suggested that the threshold for determination of 'related party' prescribed in the aforesaid sections should be harmonized and necessary amendments in this regard should be carried out.
- The words "close connection" appearing in Section 80-IA(10) of the Act needs to be clarified to avoid ambiguity in the application of provisions of Section 92BA of the Act.
- Further, clarity should be provided with regard to inter-unit allocation of costs between eligible and non-eligible units i.e. whether corporate cost allocations from a non-tax holiday unit of a company to a tax holiday unit of the same company would get covered within the provisions of Section 80-IA(8) and consequently need to be reported as a specified domestic transaction.
- The Advance Pricing Agreement (APA) provisions are being made applicable to only international transactions. The same should also be made applicable to domestic transactions covered by transfer pricing regulations.

4.21.12. 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 FAQs clarifying certain issues. In this regard, some of the aspects that need to be further addressed are as under:

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.
- 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.

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.

  Thus, it is recommended that the provision should be made applicable to similar nature of transactions and with different AEs.

- It is recommended that this provision should be relaxed and should not result in the cancellation of the entire APA.

4.21.13. Advance Pricing Agreements ('APA') and Mutual Agreement Procedure ('MAP')

Issue

- No bilateral APA is allowed for settling transfer pricing disputes in the absence of Article 9(2) in certain DTAAs for allowing corresponding transfer pricing relief in the host country (e.g. Germany, France, Singapore).

Recommendation

- A taxpayer should be allowed to file a bilateral APA even in cases where Article 9(2) [corresponding adjustment] is not provided for in the DTAA with a treaty partner. This is an internationally accepted principle and should be allowed for taxpayers in India as well. Otherwise India should renegotiate its treaties to include Article 9(2). Such enablement would be a huge relief for taxpayers.

4.21.14. Amendments in electronic version of Form 3CEB

Issues and Recommendations

- The software utility designed for electronic version of Form 3CEB does not provide reporting of transactions in any currency other than Indian rupees. It is suggested to provide reporting of transactions undertaken by banks in foreign currency to provide reporting of transactions in foreign currency.
- Currently, voluminous transactions are required to be manually punched in electronic versions of Form 3CEB available on income tax website. This results in mammoth manual efforts and increases chances of erroneous reporting. Therefore, it is suggested to provide excel utility of Form 3CEB on the income tax website for reporting of certain transaction terms in text form.

4.21.15. Penalty for failure to keep and maintain information and document etc.

Issue

- The Finance Act, 2012 has substituted Section 271AA with effect from 1st July 2012 which reads as under:-

  "271AA. Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an international transaction or specified domestic transaction-

  i. fails to keep and maintain any such information and document as required by sub-Section (1) or sub-Section (2) of Section 92D;

  ii. fails to report such transaction which he is required to do so; or

  iii. maintains or furnishes an incorrect information or document,

the Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to 2% of the value of each international transaction or specified domestic transaction entered into by such person."

While the quantum of addition itself is disputable in transfer pricing assessments, fixing the penalty on the assessed income would increase the burden of the taxpayer considerably.

Due to retrospective extension of scope of international transaction, the tax officer or Commissioner (Appeals) can ask the taxpayer to pay penalty under the said Section 271AA @ 2% of value of international transaction due to failure to keep information in addition to another 2% under Section 271G for not furnishing the information besides regular penalty under Section 271(1)(c) of the Act. This would result in multiple tax demand on arbitrary values.

Recommendation

- It is, therefore, suggested that penalty should be restricted to tax in dispute and not linked to the value of transaction.

Issue

- While the Finance Act, 2014, extended the power to levy penalty under Section 271G to the TPO for failure to furnish information/ TP documentation, which was earlier restricted to tax officer or the Commissioner (Appeals), interestingly, there has been no amendment to Section 271AA (which prescribes the power to levy penalty for failure to keep and maintain information and document, etc. in respect of certain transactions), currently provided only to the tax officer or the Commissioner (Appeals), possibly seeking to limit powers to levy penalty for matters relating to non-compliance with statutory provisions, only to tax officers/ Commissioner (Appeals), while extending powers to levy penalty to TPOs for matters relating to proceedings in the course of conduct of TP audits.

Recommendation

- Considering that clause (iii) to Section 271AA also states that penalty shall be levied for maintaining or "furnishing" incorrect information or document, as the act of "furnishing" is typically associated with a TP audit proceedings, it is recommended that there should be some consistency on this front.

4.22. Financial Services

4.22.1. Taxation of Long Term Capital Gains on Transfer of Unlisted Securities

Issues

- The Finance Act, 2012 had amended Section 112(1)(c) of the Act to provide a concessional long term capital gains of 10% on transfer of capital assets being unlisted securities in the hands of non-residents (including foreign companies).
- However, the manner in which the term 'unlisted securities' has been defined may lead to the unintentional consequence of the 10% concessional tax rate not applying to gains arising on transfer of shares of private companies held as long term capital assets.
- Unlisted securities have been defined vide Explanation (ab) to Section 112(1) of the Act as follows "Unlisted securities means securities other than listed securities". Explanation (aa) defines

  "listed securities" as follows:

  "Listed securities mean the securities which are listed on any recognised stock exchange in India".

- Further, Explanation (a) to Section 112(1) of the Act, provides that "the expression 'securities' shall have the meaning assigned to it in clause (h) of Section 2 of the Securities Contracts (Regulations) Act, 1956 (32 of 1956)". The relevant extract of the expression 'securities' as defined in Section 2(h) of the Securities Contracts (Regulations) Act, 1956 ("SCRA") is as under:

  "Section 2(h) - Securities include –

  Shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

  ii……"

- For the purposes of Section 112 of the Act, it therefore becomes imperative to examine the scope of the term "securities" under the SCRA. Based on various judicial precedents, it has been held that the shares of a private limited company were not securities as defined in Section 2(h) of the SCRA. It was held that the shares must be marketable to qualify as a security under the SCRA. As the shares of a private company are not freely transferable, they were not held to be marketable and hence not a security for the purposes of Section 2(h) of the SCRA.
- Therefore, based on the above interpretation of the term 'securities', the aforesaid benefit of the concessional rate of 10% under Section 112(1)(c) of the Act may be available only on long term capital gains arising on transfer of unlisted marketable securities i.e. long term capital gains arising on the sale of shares of a private company may not qualify for the above concessional rate of taxation.
- The intention of the legislature was to extend the benefit of the 10% concessional tax rate on long term capital gains arising on transfer of unlisted securities by any non-resident. However, based on various judicial precedents on interpretation of the term "securities" as per SCRA could lead to litigation on this matter. There appears no basis to exclude gains arising from transfer of private companies from the above favourable regime. Moreover, a significant portion of the investments made by the PE funds in India is actually in private limited companies for several regulatory/ commercial reasons.

Recommendation

- In order to create certainty and avoid undue litigation, it is requested that all long term capital gains arising to non-residents on transfer of all unlisted securities should be subject to concessional tax rate of 10% under Section 112(1)(c) of the Act with retrospective effect from April 1, 2013. In this regard, we suggest that the term "securities" in Explanation (a) to Section 112(1) should be defined as under:

  "shares, scrips, stocks, bonds, debentures, debenture stock, warrants or other securities of like nature issued by a private company, public company, any other body corporate and funds registered with Securities and Exchange Board of India ('SEBI') under SEBI (Alternative Investment Funds) Regulations, 2012 and SEBI (Venture Capital Funds) Regulations, 1996 and includes other securities as specified in Section 2(h) of SCRA"

4.22.2. Income Characterization – Capital Gains vs. Business Income

Issues

- Venture capital investments typically come from high net-worth sophisticated and long term investors and institutions. Unlike several other types of investments, venture capitalists provide fund to build up resources and enterprises with the intention of enhancing the long term growth and value of companies and target returns on their capital by increasing shareholder value through expansion and development of the company. The objective of VC funds is to make long term investments, as distinguished from other investors such as hedge funds and traders, who deal in securities with much shorter holding periods with the intention to make short term windfall

gains. For example, VC funds, by their very nature, are long term investors with comparatively low frequency of transactions. VC funds are not permitted to make investments out of borrowed funds. Moreover, under the extant regulatory framework, a SEBI registered VC fund cannot undertake any activity other than investment activity. Accordingly, the purpose of a VC Fund is to make investment as against engaging into the business of dealing in shares.

- Therefore, any income of a SEBI registered VC/ AIF funds (other than Category III AIF which are undertaking derivatives or complex trading transactions) from sale of shares/ securities should be in the nature of 'capital gains' and not 'business income'.

Recommendation

- The provisions of the Act should be suitably amended to explicitly provide that income from sale of investments by SEBI registered VC/ AIF funds (other than Category III AIF which are undertaking derivatives or complex trading transactions) would be treated as 'capital gains' and taxed accordingly, including a pass through basis in the hands of the investors. This would simplify the system of taxation, bring certainty and eliminate needless litigation on the income characterization issue.

4.22.3. Safe Harbour provisions for Fund Managers present in India

In order to encourage fund managers to shift their base to India and mitigate concerns of adverse tax consequences in making this shift, the Finance Act, 2015 has clarified that management of overseas funds by fund managers in India shall not create a business connection of the overseas funds in India subject to certain prescribed conditions. The Finance Act, 2015 has prescribed various conditions to be fulfilled to become an 'eligible investment fund' and an 'eligible fund manager' through an insertion of a new section 9A to the Act.

Issues

- The conditions prescribed by the section are quite onerous. They seem to target the large institutional fund investors as it is difficult for private equity funds to fulfill the conditions. Accordingly, the conditions should be streamlined to provide clarity to all.
- The qualifying conditions contained in the section may not be practically feasible, especially in case of anchor investors or buyout deals e.g. restrictions on minimum number of investors, maximum amount of investments by each investor severally and jointly with other investors, prohibition on funds controlling any business in India.
- Also, an eligible fund manager should not be a 'connected person' of the offshore fund wherein the definition of the term 'connected persons' is very wide.
- The conditions do not provide an exemption from establishment of business connection in case a fund is resident in a country with which India has not entered into a Double Taxation Avoidance Agreement ("DTAA"). Therefore, it would be difficult to avail similar benefits for the fund managers of such jurisdictions.
- 'Control and management' has not been clarified by the amendment. The issue being highly subjective and therefore litigative should be clarified.
- In order to be registered with Securities and Exchange Board of India ("SEBI"), a Foreign Portfolio Investors ("FPI") should have minimum of 20 members and no member should have participating interest in excess of 49 percent. However, the Finance Act, 2015 stipulates that an offshore fund should have minimum 25 members and no member should have participating interest in excess of 10 per cent. These conditions should be aligned as per the SEBI conditions to ensure uniformity in both the laws.

Recommendations

- The eligible fund should be defined on the lines of "broad based funds" as defined under SEBI (FPI) Regulations. A draft is as under:

  '"Private Equity Fund" shall mean

  a) appropriately regulated broad based funds; OR

  b) broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated

  which collect funds from foreign investors for investing it in accordance with a defined investment policy for the benefit of its investors.

  Explanation 1:

  For the purposes of this clause, a Private Equity Fund shall be considered to be "appropriately regulated" if it is regulated or supervised by the securities market regulator of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India

Explanation 2:

A. For the purposes of this clause, "broad based fund" shall mean a fund, established or incorporated outside India, which has at least twenty investors, with no investor holding more than forty-nine per cent of the shares or units of the fund.

   Provided that if the broad based fund has an institutional investor who holds more than forty nine per cent of the shares or units in the fund, then such institutional investor must itself be a broad based fund.

B. For the purpose of clause A of this Explanation, for ascertaining the number of investors in a fund, direct investors as well as underlying investors shall be considered.

C. For the purpose of clause B of this Explanation, only investors of entities which have been set up for the sole purpose of pooling funds and making investments, shall be considered for the purpose of determining underlying investors.'

- In addition to safe harbour in respect of business connection and residency risk, certainty on treaty eligibility, subject to holding a valid tax residency certificate in the home country, should be provided for offshore PE funds.

4.22.4. Issue of shares at a value higher than Fair Market Value to VCF/ VCC - Section 56(2)

Issues

- Though Finance Act 2012 specifically carved out sub category VCF under Category I AIF from the provisions of Section 56(2)(viib) of the Act, certain unintended consequences as stated below have arisen which impact the VC industry at large. The industry being tightly regulated by SEBI is facing certain unintended consequences which include:

  – Certain unintended transactions (for e.g.; – capital reserve arising pursuant to merger) may also get covered within the purview of Section 56(2)(viib) of the Act, which is not desirable.

  – It is quite common for VC investors to enter into "ratchet structures" with the issuer company /promoter wherein convertibles are issued and conversion price is formula based and linked to the company's performance, adjustment of shareholding percentage etc. In certain scenarios, such ratchet could result in the company issuing shares to parties (other than VCF/ VCC) at high premium attracting tax implications

in the hands of the issuer company under the above amendment. Thus, the provisions of Section 56(2)(viib) of the Act could adversely affect bona fide, arm's length ratchet structures agreed with resident promoters/ other investors wherein they are required to infuse funds or convert at a substantial premium for the adjustment of shareholding.

– Also, this issue is relevant for the angel investment industry investing in start-up ventures, where the immediate valuation of the entity may not be a benchmark for the investment being made by angel investors. Start-up ventures, at the stage where angels invest, usually have no revenues or profits and the valuation is based on the potential and promise of the idea, the background and competence of the founding team, etc. and is usually a simple matter of negotiation between the founders and the angel investors. It is often wrong for one party or the other but it is simply impossible to create a frozen logic for such investments, be it DCF or a valuation by merchant bankers, etc. Any such mechanism, or others that may be proposed, would be impractical and unfortunately push the parties concerned to contrive adherence, an extremely undesirable outcome as both founders/ angel investors would like to operate within the letter and the intent of the law.

a. Subjecting the valuation of the investment to an FMV by Revenue Authorities does not work, as explained above. The Revenue Authorities would not have the domain understanding to value the innovation (in fact even two different angel investors would value the same company differently). This will subject all investments in start-up companies to re-evaluation and will open a plethora of disputes / appeals. This will scare angel investors away.

b. This provision characterizes the investment by Angels as Income in the hands of the investee company, which is fundamentally incorrect. The Angel Investor's investment is to grow the company and create revenues/ income in the company. By changing the nature of the inflow into the company, the company and the investor sign away 30% of the investment (less the FMV) to tax: starving the company of critical cash flow investment. So investors who are investing tax paid monies will not invest as this will attract another round of tax albeit through the investee company. This amounts to double taxation.

- As this Section only applies to domestic investors, it discriminates against them as compared to foreign investors, who are not subject to this clause.

  – The above provision may also hinder the ability of investee companies to make genuine arm's length inorganic acquisitions.

  – Exclusion under Section 56(2)(viib) of the Act should apply to shares issued to all Category I and II AIFs and not only to the sub category "venture capital fund".

- It is also noted that despite the fact that the above provisions have been introduced for shares issued from April 01, 2012 onwards, VCUs are being issued with tax demands on premium received prior to April 01, 2012. This causes an unnecessary burden on portfolio companies and increases their litigation and compliance costs. Accordingly, it is represented that appropriate instructions should be issued to tax officers to refrain from this practice.

- There may be instances where the company receives consideration in one tax year but issues shares in the following tax year or in certain cases does not issue shares but refunds the share application money to the shareholder, there is lack of clarity in such cases as to the year in which the provision would apply or whether the provision would apply at all.

- It would be prejudicial to subject the Issuer Company to such adverse provisions which did not exist in law when the transactions were entered into.

Recommendations

- Given that the said provision is intended to effectively be an 'anti- avoidance' provision, the following situations where no 'tax- avoidance' ought to be involved merit exclusion. Consequently:-
  - Applicability should be restricted to issue of shares in consideration for cash.
  - The issue of shares pursuant to otherwise exempt transactions such as merger, demerger, inorganic acquisitions etc. should be excluded from the purview of Section 56(2)(viib) of the Act.
  - It is recommended that it should be suitably provided for in the Section that it would apply only in the year of issue of shares.
  - It should be suitably clarified to provide that the Section does not require every closely held company that issues shares to a resident to suo-motto offer such income to tax. Further, the tax officer should be empowered to invoke this Section only if at the time of assessment, the tax officer is of the view that premium charged by the company from the resident shareholder is in excess of the fair market value of shares issued.
  - The provision should not be made applicable to bona fide ratchet structures.
- Investments made by an Investor who is part of a recognized, formal Angel group, should be exempted from this clause, subject to the following definitions and stipulations:-
  - An Angel Investor group may be defined as a formal group, of which the angel investors are members and collectively invest their own money (directly or through their investment vehicle) in an unlisted entity, at the seed stage, in which there is no family connection and where the investment by an individual is less than Rs. 5 crores and by the angel group, less than Rs. 10 crores.
  - Seed stage is defined as a business whose turnover is below Rs. 25 crores; the limits on investments and turnover threshold for the seed stage should be indexed to inflation.
  - The value of the shares may be determined as of the date of the issue of the shares or any date earlier than the date of issue of shares, not being a date which is more than 180 days earlier than the date of issue of shares.
  - The investee company should not have received more than Rs.10 crores before the Angel round from any source.
  - The valuation of the company, at the time of the angel investment, should not exceed Rs. 50 crores (as valued by the angel group).
  - Angel Groups would ensure that no investments are made in companies where family members are involved. All Angel Investors all invest through a single shareholder Agreement in which the Angel group entity also holds a percentage of the same investment. This would ensure there is a body reviewing and updating activity in the investee company and will also be subject to Audit.
  - Investor KYC information (like PAN nos.) will be made available to the Angel Group & Investee companies.
  - Investment by business incubators which have been recognized or promoted by the Government of India should be exempted.

- Recognition of an Angel Group could be on the following basis:
  a. Number of years in existence: at least 3 years
  b. Number of investor members in the Group averaged over the last 2 years: At least 150 members
  c. Number of investments made in different companies: at least 25
  d. the Angel Group is an entity with a proper Secretariat & operations : for at least 3 years
  e. Angel Group entity be recognized either by the Finance Ministry or any other appropriate entity of the government
- The provision should not be made applicable to all Category I and II AIFs.
- The provision should not be made applicable to any issuance of securities under any arrangement/ instrument/ transaction existing prior to the said amendment.
- Specific instructions should be issued to tax officer to refrain from challenging the share premium paid by VCF to VCU on subscription of shares prior to April 1, 2012.

4.22.5. Taxation of Securitization Trust

The Finance Act, 2013, has provided a special taxation regime in respect of taxation of income of securitization trusts whereby income earned by securitization trust regulated by SEBI/ RBI will be exempt. Securitization trusts distributing income to its investors (other than those exempt from tax) will be liable to pay tax on income distribution. However, income received by an investor from securitization trusts will be exempt from tax. Certain issues involved in this new taxation regime are given below:-

Issues

- The effect of this change is a mortal blow to the Pass Through Certificates (PTC) market. Banks, insurance companies, NBFCs and other taxpaying entities will be severely impacted. RBI has guidelines on securitization of standard assets which banks and NBFCs have to follow mandatorily. Also, NBFC-MFI (Microfinance Institutions) securitize a large part of their portfolio with banks, financial institutions, larger NBFCs and corporate and accordingly, tax on distribution of income by securitization trusts would severely impact them also.
- The special tax regime would create challenge under Section 14A of the Act as it would entail disallowance under the said Section in the hands of the investor who has effectively borne additional income-tax under Section 115TA of the Act.
- No credit can be taken by the investor in respect of the distribution tax. As such it becomes a straightforward loss of income for the PTC holder.
- The distribution tax is a tax on gross income; however the net income of the investors in securitized instruments is only a small fraction of the gross income.
- The trustee would need to maintain a list of investors at any given point of time. This is required as there could be a tax exempt investor who could have sold his investment to a taxable investor or vice versa. This change will impact the distribution tax to be payable by the trustee in the subsequent payout.
- There are no grandfathering provisions with respect to existing structures. As transactions worth thousands of crores which were structured through SPVs without apprehending what is proposed in the Budget should not be subjected to a new tax regime.

Recommendations

- In order to offer level playing field to all investors, it is recommended that the income distributed by trusts should not be subject to distribution tax and should be offered to tax by the investors as per the normal tax regime. This will enable the investor to claim credit of such taxes against its normal tax liability. In such cases, unending litigation on disallowance under Section 14A of the Act will also culminate, since such income will no longer be exempt in the hands of the investor.
- It is recommended that the existing transactions (entered before June 1, 2013) should be explicitly excluded from this new taxation regime.

4.22.6. Clarification on lower TDS rates on Corporate Bonds and Government Securities

Issues

- Rate of TDS in respect of interest earned by FIIs and Qualified Foreign Investors ('QFIs') on bonds issued by Indian companies and Government securities has been reduced from 20% (for FIIs)/ 40% (for QFIs) to 5% vide Section 194LD of the Finance Act 2013. This is a welcome change by the Government to encourage foreign debt in India. However, the benefit of reduced rate was made available only if:
  - The coupon rate on corporate bonds does not exceed the rate as notified by the Central Government; and
  - The benefit will be available in respect of interest income accruing to FIIs and QFIs between the period June 01, 2013 and 30th June 2017 irrespective of the date of investment.
- Currently, on technical reading of the provision, a FII/ QFI shall not be able to avail the benefit of the concessional tax rate if its coupon rate exceeds the notified rate of Central Government. Thus, in order to encourage foreign debt investment in India, it is represented that the benefit of reduced TDS rate shall be made available to all FIIs/ QFIs irrespective of the notified rate (i.e. the coupon rate as notified by the Government).
- Section 194D of the Act inter-alia states that the benefit is available to interest payable on "bonds" of Indian companies.

Recommendations

With the intent to encourage foreign debt investment in India by FIIs/ QFIs, it is represented that:

- Section 194LD of the Act to be amended to state that benefit of reduced TDS rate shall be available to all FIIs/ QFIs irrespective of the notified rate (i.e. the ceiling coupon rate to be notified).
- Without prejudice to above, it is represented that interest up to the notified rate be subject to beneficial rate and any incremental coupon above the notified rate be subject to normal tax rates as applicable under the Act or treaty (as opposed to the entire interest income being taxable at the normal tax rates as per the Act/ treaty).
- Language of Section 194LD may be amended to explicitly cover "debentures" in addition to bonds as well especially considering private corporate debt is typically raised through debentures.

4.23. Tax Deducted at Source (TDS)

4.23.1. TDS on monthly and year end provision entries in books of Accounts

Issues

- Most of the companies record provision entries towards various expenditures on a monthly basis to report performance to their parent entities. These entries are reversed in the subsequent month.

- These accruals are made on very broad estimates. The tax officers have been insisting that tax be deducted on these provisional entries.
- Year-end provisions are made by assessees to follow accrual system of accounting. Very often provision for expenses at the year-end are made based on best estimates available with the assessee even if the supporting invoice is received at the subsequent date. As per the current tax regime, tax is required to be deducted on such provisions which often leads to excess deduction and deposit of tax, disputes with the vendor and unnecessary burden posed on the payer in carrying extensive reconciliations.

Recommendation

- It is recommended that relief from deduction of tax at source should be given on payments that are accrued but are not due to the payee and for which the payees are not identifiable and represents only a provision made in accordance with accounting policy.

4.23.2. Reduced Withholding Tax on Income by way of Interest under Section 194LC

In order to enable low cost finance to Indian companies, the Finance Act, 2012 has inserted Section 194LC in the Act which provides for lower withholding tax @ 5% on interest payments by Indian companies on borrowings made in foreign currency (under a loan agreement or by way of issue of long term infrastructure bonds). The Finance (No 2) Act, 2014, amended the section to include all long term bonds (including infrastructure bonds).

Issue

- Apart from loans and bonds, debentures are also widely used for raising funds by the Indian companies. Currently, there is no clarity whether interest payment on such debentures would be eligible for reduced withholding tax rate under section 194LC of the Act.

Recommendation

- The concessional tax rate of 5% on interest should be made applicable on other debt securities including debentures, trade credit issued/ availed by any Indian company. Further, it is also suggested that the rate of tax on interest through all kinds of foreign currency borrowings (including issue of bonds and debentures) should be completely eliminated in the long-run to promote foreign exchange inflows into India.

4.23.3. TDS credit

Issues

- 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 dumped at the Registered office of the company (being PAN based address). The accumulation of TDS certificates at the registered office of the deductee makes it difficult for them 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.

Recommendations

- In view of the above, it is suggested that TDS certificates issued by the deductors, which are furnished by the deductees in the tax assessment, should be given due cognizance 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. At the same time, it is also 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.

4.23.4. Enhancement of Limits for TDS - Section 194C and others

Issues

- Under Section 194C of the Act, TDS is applicable in respect of contracts for manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. However, in a large number of instances, it is observed that the material which is purchased from the customer represents a small fraction of the total cost and this provision has created huge operating problems, since the transaction may be a 'principal–to principal' contract for purchase and sale of goods and the profit margin may be very small.
- Currently, any payment for contract services rendered which exceeds Rs. 30,000 at a time or Rs. 75,000 per annum requires the person responsible for making such payments to deduct tax at source under Section 194C of the Act.
- Also, any payment for commission or brokerage as per Section 194H of the Act, which exceeds Rs.5,000 (at a time or in aggregate per annum) requires the person responsible for making such payments to deduct tax at source under Section 194H of the Act. These limits were fixed many years ago and TDS on such small amounts involves deployment of relatively large amount of resources in terms of manpower, systems and other costs at the taxpayer's, end without any significant benefits to the revenue.

Recommendations

- It is suggested that the provisions of Section 194C of the Act be should be applicable only in such cases where the material purchased from the customer is substantial in nature, i.e., say it exceeds 40% of the total material cost (inclusive of raw materials and packing materials).
- It is recommended that the threshold limit should be increased to Rs. 50,000 for single payment and Rs. 100,000 for aggregate annual limit under Section 194C of the Act and the threshold limit for deduction of tax at source on commission/ brokerage be increased to Rs. 25,000 from the present Rs. 5,000.

- On similar basis, considering the inflation quotient, the threshold limits for other TDS provisions should also be enhanced as follows:-

Section	Category	Enhancement requested
194A	Interest on Bank Deposits	TDS limit of existing Rs.10,000 to be increased to Rs.1.00 Lakhs since the basic exemption limit of Income increased substantially and the senior citizens are affected in this category.
194C	Payment to Contractors	Existing Rs.30,000 (single payment) and Rs.75,000 (aggregate) to be enhanced to Rs.1.00 Lakhs and to Rs.2.50 Lakhs respectively.
194H	Commission or Brokerage Payment	Existing threshold limit of Rs.5,000 be enhanced to Rs.50,000 for the year.
194I	Payment of rent	The existing limit of Rs.1.80 Lakhs per year to be enhanced to Rs.3.00 Lakhs.
194J	Payment to Professionals	The existing limit of Rs.30,000 to be enhanced to Rs.1.00 Lakhs

4.23.5. TDS on transfer of Immovable Properties (other than agricultural land) - Section 194IA

Section 194IA of the Act provides that every transferee at the time of payment or credit of sum as a consideration for transfer of immovable property to resident transferor shall deduct tax @ 1% on such sum.

Issues

- This provision has led to lot of practical difficulties. Some of the issues are elucidated below:
  - Considering that the tax is required to be deducted on the gross transaction value rather than net gains, transferors will have a cash-flow impact in situations where the sales are at a loss or at no gains and cases where capital gains are exempt for the seller. This may lead to a refund situation which can only be claimed by the seller at the time of filing his return of income.
  - The provision poses severe hardship for real estate companies who are burdened with the task of collecting and preserving the physical copies of voluminous number of TDS certificates for making and substantiating the claim for TDS.
  - There are going to be difficulties in complying with the provision, in cases where the properties are bought by availing loan from the bank and payment is made directly by bank to the real estate companies or the transferors as the case may be.
- This amendment is for widening the tax base and to bring the transferors in tax net. Considering, the existing inflation, even a builder building one single building will have turnover of more than Rs. 1 crore and will be liable to tax audit under Section 44AB and will be under tax net.
- Threshold limit of Rs. 50 lakhs for the applicability of the provision is very low. The provision will pose onerous compliance requirement even on small purchasers.

Recommendations

- It is suggested that the provision of Section 194IA of the Act should be deleted.
- Alternatively, the provision should be made applicable to secondary transactions and not to first purchase from the builder/ developer.

Further, threshold limit for the applicability of the above provision should be increased from Rs. 50 lakhs to Rs. 1 crore.

4.23.6. TDS on interest component included in Tribunal Awards to victims of Motor Accidents

Issue

- The Revenue Authorities generally treat the amount of interest paid on delayed compensation awarded under Motor Vehicle Act, 1988 as 'interest' liable for TDS under Section 194A of the Act

Recommendation

- It is suggested that such interest be excluded from the purview of TDS under Section 194A of the Act.

4.24. Personal Tax

4.24.1. Taxation of Employee Stock Option Plans for migratory employees - Section 17

Issues

- Section 17(2)(vi) of the Act, read with Rule 3 of the Rules deal with taxation of Employee Stock Option Plans (ESOPs). It is provided that the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate shall be taxable as perquisite in the hands of the employee. For this purpose, the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the taxpayer, as reduced by the amount actually paid by, or recovered from, the taxpayer in respect of such security or shares.
- In this connection, what has not been appreciated is that ESOP shares stand on a different footing because on the date of exercise, the shares are subject to lock-in condition and cannot be considered to be a benefit and therefore, ought not to be fictionally treated as benefit and brought under the ambit of perquisites for taxation purposes. The Supreme Court, in CIT v. Infosys Technologies Ltd., [2008] 2 SCC 272, at page 277, had aptly held:

  "During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs. 165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."
- It may be mentioned that only when Fringe Benefit Tax (FBT) was introduced by the Finance Act 2005, these provisions were changed for the purposes of taxation of ESOPs under FBT regime. Unfortunately, those very provisions have now been brought back by way of insertion in sub-clause (vi) of sub-Section (2) of Section 17 of the Act, after the abolition of FBT, which has caused a lot of anxiety. It is imperative that the earlier tax treatment be restored to facilitate the employers in retaining talented persons in the organization.

Recommendation

- It is suggested that ESOPs should not be subject to tax on notional perquisite value and taxed only on capital gains arising from the sale of shares, as was the position till 31st March 2006.

Issues

- Notwithstanding the above recommendation, taxation of ESOPs creates an issue in the case of migrating employees, who move from one country to another, while performing services for the company during the period between the grant date and the allotment date of the ESOP. The domestic tax law is unsettled on the taxation of such migrating employees and does not clearly provide for such cases.
- There was a specific clarification on proportionate taxability of benefits under the erstwhile FBT regime, where the employee was based in India only for a part of the period between grant and vesting. However, there is no specific provision in this regard under the amended taxation regime from 1st April 2009.
- Considering the various judicial precedents on the issue only the proportionate benefit of ESOP pertaining to the services rendered by taxpayer in India should be taxable in India and not the entire benefit.

Recommendation

- A specific clarification should be inserted with respect to taxability of only proportionate ESOP benefit based on residential status of the individual, where an employee was based in India for only a part of the period between grant and vesting.

4.24.2. Taxation of contribution to Superannuation Fund in excess of Rs. 1 lakh - Section 17

Issues

- Section 17(2)(vii) inserted by the Finance (No.2) Act, 2009, provides that the amount of any contribution to any approved superannuation fund by the employer in excess of Rs. 1 lakh will be taxable as perquisite in the hands of the employee.
- It has to be appreciated that contributions to superannuation fund may or may not result in superannuation benefits to the employees, since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Further, the pension payments are subject to tax at the time of actual receipt by the employee after his retirement. This may lead to partial double taxation for the employee where the contributions had been taxed earlier also (when the contributions exceeded INR one lakh).

Recommendation

- It is recommended that employer contribution to approved superannuation fund be made fully exempt from tax.

4.24.3. Taxation of Rent Free Accommodation (RFA)/Concessional RFA

Issues

- Section 17(2) of the Act provides for valuation of perquisite in case of provision of rent free accommodation by the employer to the employee or by way of concession in rent in respect of such accommodation provided. In case of accommodation provided by the employer other than Central Government or any State Government, Rule 3 of the Rules provides for valuation of perquisite at specified rate of 15% or 10% or 7.5% of salary based on the size of population as per 2001 census. However, the above method of determination of the perquisite suffers from various inequities:-
    - An employee staying in the same company owned accommodation will have a different perquisite value with increase in salary and further, employees with difference in salaries will have a different perquisite value in respect of the same accommodation.

- The determination of the perquisite value of the accommodation based on the salary of the employee irrespective of the size/fair rental value of the accommodation is completely illogical and unfair.
- The perquisite value in respect of accommodation provided to employees of Central/State Government is based on license fee charged for such accommodation as reduced by rent actually paid by the employee. The valuation rules cast discrimination between employee of Central/State Government and any other employee.

Recommendation

- FICCI recommends that the rule for computing perquisite value of rent free accommodation should be suitably amended. For computing the perquisite value, the value of the accommodation should be Fair Rental Value based on the valuation report obtained from the municipal authorities (without making any discrimination between employee of Central/State Government and any other employee).

4.24.4. Deduction for Investment in Infrastructure bonds

Issue

- Finance Act, 2010 had introduced section 80CCF w.e.f. April 1, 2011, which stipulates that deduction would be available to the individuals in respect of subscription in notified long term infrastructure bonds. The said deduction is available only for investments made in previous year relevant for Assessment Year 2011-12 and 2012-13. The Finance Bill, 2015 had proposed for re-introduction of tax free infrastructure bonds. It is desirable that the benefit under this section is not limited to two years as the intent behind the introduction of this section is to promote raising of funds for infrastructural development.

Recommendation

- It is recommended that suitable changes be made in section 80CCF of the Act so that this deduction is available for AY 2016-17 and onwards.

4.24.5. Revival of Standard Deduction

Issues

- 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. In many countries like Malaysia, Indonesia, Germany, France, Japan, Thailand etc., allowance in the form of standard deduction is available for salaried employees for expenses connected with salary income. To illustrate in Thailand the deduction is as high as 40% of income subject to certain limits.

Recommendations

- The standard deduction for salaried employees should be reinstated to at least Rs. 100,000 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.

- This should also reduce the disparity between salaried and business class with only the latter being eligible for deduction for expenses incurred by them for earning their income.

4.24.6. Transportation Allowance - Section 10

Issues

- 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. 1600 per month in terms of Section 10(14) of the Act read with Rule 2BB of the Rules. The limit was marginally increased from Rs. 800 per month to Rs. 1600 per month in the last budget.
- The exemption limit of Rs. 1600 per month seems quite nominal considering the ever rising fuel costs and resultant conveyance costs.

Recommendation

- The exemption limit of Rs. 1600 per month needs to be considerably raised upwards, say to minimum of Rs. 3,000 per month to bring it in line with the rising conveyance costs.

4.24.7. Education Allowance

Issues

- The education allowance granted by the employer to the employee to meet the cost of education expenditure up to 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 the year 2000 with retrospective effect from 1 August 1997 and seems quite nominal considering the ever rising cost of education.

Recommendation

- The exemption limit of Rs. 100 per month needs to be considerably raised upwards, say to minimum of Rs. 1,000 per month to bring it in line with the rising inflation and cost of education.

4.24.8. Reimbursement of Medical Expenditure - Section 10

Issues

- 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.
- This limit was last revised long back and needs to be revisited in light of the rising medical and hospitalization costs especially for private hospitals.
- The expenditure incurred by/ for retired employees in respect of medical treatment on self/ family is currently not exempt from tax.

Recommendations

- 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.
- Further, the exemption in respect of expenditure on medical reimbursements/ hospitalization expenditure in approved hospitals should also be extended to retired employees.

4.24.9. Tax Exemption in respect of Leave Travel Concession (LTC) - Section 10

Issues

- Presently, the economy class air fare for going to anywhere in India is tax exempt (twice in block of four years). However, this exemption is being allowed only for travel within India.
- Lately, owing to low airfares and package tours, a number of Indians prefer going abroad, instead of availing LTC, particularly to neighbouring countries like Thailand, Malaysia, Sri Lanka, Mauritius, etc., as the fares thereto are at times less than for travelling to some far away destination within India.

Recommendations

- It is therefore recommended to grant tax exemption for economy class airfare for travel abroad also, so long these are within the overall airfare tax exemption conditions for travelling in India. Here, it is pertinent to note that in a recent ruling by the Chandigarh Bench of the Tribunal, in the case of Om Prakash Gupta vs. ITO (ITA no. 938/CHD/2011-taxsutra.com) it has been held that amount received by the taxpayer on account of Leave Travel Concession (LTC), which was received by taxpayer on account of travel to both Foreign and Indian destination and the journey concluded by visit to a place in India, is not eligible for income tax exemption as the taxpayer has also travelled to a foreign destination. However, considering the current prevailing trend in respect of foreign travel, there is a need to include overseas travel as well or at least to exempt proportionate expenses pertaining to travel within India in case of joint travel (within India and overseas destination).
- Further, under Rule 2B of the Rules, the amount exempt in respect of LTC by air is to the extent of the economy fare of National Carrier i.e. Indian Airlines. It is suggested that word “National Carrier” should be deleted from Rule 2B.
- Moreover, as per the current provisions, Leave Travel Concession/ Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years. It is suggested that the concept of calendar year should be replaced with FY (April – March) in line with the other provisions of the Income Tax Law and further exemption should be made available in respect of at least one journey in each FY.

4.24.10. Taxation of Social Security Contributions in the hands of Expatriates - Section 17

Issues

- In respect of an expatriate employee deputed to India, the home employer and employee may be required to contribute to social security schemes under the local law of country. In most cases, the contributions made to these schemes may not vest on the employee at the time of making the contributions and thereby do not provide any immediate benefit to the employee. Further, the employee contributions may also be mandatory under the law of the home country. Both the employer and employee contributions may be available as a deduction from taxable income in the home country of the expatriates.
- However, currently there is no provision under the Act, which provides for the taxability or otherwise in respect of such contributions from taxable income, though there have been several favourable judicial precedents to this effect such as CIT v. L.W. Russel [1964] 53 ITR 91 (SC),Gallotti Raoul v. ACIT [1997] 61 ITD 453 (Mum), ITO v. Lukas Fole (Pune) (2009-TIOL-556), CIT v. NHK Japan Broadcasting Corporation [Civil Appeal No. 1712 of 2009 – SC].
- Recently, even the Delhi HC pronounced the decision in case of Yoshio Kubo, wherein it was held that employer’s contribution to overseas social security, pension and medical/ health insurance do not qualify as perquisite under Section 17(1)(v) of the Act and are not taxable in the hands of the employees.

Recommendation

- It needs to be clarified under the Act, that employer contributions to such social security schemes should be exempt in the hands of the individual employee based on the principle of vesting. Further, the employee contributions should be available as a deduction where the same are mandatory and constitute diversion of income by overriding title.

4.24.11. Provision of treaty benefits while calculating TDS under Section 192

Issues

- Currently, there is no provision in the Act, enabling the employer to consider admissible treaty benefits (e.g. credits for taxes paid in another country/ treaty exclusions of income), while TDS under Section 192 of the Act from salary income.
- This creates cash flow issues for the expatriates who are initially subject to deduction of tax by their employers and then are required to claim large refunds on account of treaty benefits at the time of filing their return of income. Many of these expatriates may complete their assignments and leave India prior to obtaining their tax refunds which also creates issues with respect to credit of their refund amounts.

Recommendation

- Since the credit is otherwise admissible in terms of Section 90/ 91 of the Act, a suitable amendment may be incorporated in Section 192 of the Act providing for the employer to consider such credits/ exclusions at the time of deducting taxes.

4.24.12. Threshold limit under Section 80C of the Act

Issues

- Over the years, investments made in various avenues available under Section 80C of the Act have helped the Government to raise funds as well as the individuals to save tax.
- However, with too many investment/ expenditures clubbed into the existing overall limit of Rs. 150,000 (including contribution to pension funds under Section 80CCC, pension scheme under Section 80CCD of the Act), individuals sometimes are discouraged from making further investments.

Recommendations

- There must be a clear distinction between long-term and short-term savings. So far there has not been any significant support in tax policy to actively encourage “long-term savings” which is very much needed. Life insurance and pensions are the main segments of the financial services that address the needs of individuals in the long-term. It would be equally desirable to have many more such tax-exempt investment avenues to mobilize funds for infrastructural and overall economic development. Therefore, the Government may consider separate exemption limits for such important avenues.
- Further, the Government may look at increasing the overall deduction limit to at least Rs. 200,000 to boost further investment and increase tax savings for the individual.
- Term deposits for a period of 5 years or more with a scheduled bank, in accordance with a scheme framed and notified by the Central Government, by an individual/ HUF is eligible for inclusion in gross qualifying amount for the purpose of deduction under Section 80C of the Act. For other eligible investments such as bonds and mutual funds, the lock in period is 3 years and to ensure parity, the period of term deposits for claiming deduction under Section 80C of the Act should also be reduced to 3 years from existing 5 years.

4.24.13. Overall deduction in respect of amount paid under Pension/ Annuity Plans

Issue

- As per Section 80CCE of the Act, the overall ceiling for deduction is Rs.1.5 Lakhs for the payments covered by Section 80C, payment towards annuity plans covered by Section 80CCC and payment towards NPS covered by Section 80CCD.

Recommendation

- The overall ceiling limit of Section 80CCE should be enhanced to augment savings in the economy to promote economic growth.

4.24.14. Deduction for Educational Expenses - Section 80D

Issue

- Education of children these days imposes a heavy burden on the middle class. A good beginning was made in 2003 by providing deduction for tuition fees under Section 80C of the Act. But Section 80C of the Act is particularly a provision granting incentive for savings and also considering the long list of eligible investments in this Section, there is very little relief to the individual on account of the education fees incurred by him.

Recommendation

- It is therefore recommended to de-link deduction for educational expenses for children from Section 80C and provide under a separate provision like Section 80D of the Act for medical insurance. A reference to the Ministry of Education to find out the tuition fee for an average middle class household will give an indication about the limit of the deduction.

4.24.15. Deduction in respect of rent paid by Taxpayers not receiving a HRA

Issue

- Under Section 80GG of the Act, the maximum deduction available to individuals who do not receive a House Rent Allowance (HRA), in respect of rent paid is only Rs. 2,000 per month. The said limit was last revised in 1998 and is very low in light of the huge rental costs especially in the metro cities.

Recommendation

- The exemption needs to be increased to at least Rs. 10,000 per month in view of the huge rental escalation. As in the case of HRA exemption, the Government may also consider introducing separate limits for metro and non-metro cities.

4.24.16. Deduction in respect of Interest on deposits in Savings Account - Section 80TTA

Issue

- Section 80TTA was inserted by the Finance Act, 2012 to provide deduction of up to Rs.10,000/- in the hands of individuals and HUFs in respect of interest on savings account with banks, post offices and co-operative societies carrying on business of banking. However, it is unlikely that salaried individuals would keep their entire savings in a savings bank account, which earns a much lower rate of interest as compared to term deposits. They are likely to transfer some portion of their savings to several deposits to earn comparatively better returns.

Recommendation

- It is suggested that the scope of Section 80TTA of the Act should be widened to incorporate all types of deposits (such as term deposits, recurring deposits etc.) made within the banking channels, thereby inducing savings for the growth of the economy.

4.24.17. Electronic Meal Card

Issues and Recommendations

- As per the revised perquisite rules reinstated in December 2009, if food and non-alcoholic beverages are provided during working hours at office or business premises or through non-transferable paid vouchers usable only at eating joints, the value of facility to the extent of Rs. 50 per meal is exempt from the tax. This limit of Rs.50 is very meagre and needs to be revised.
- Many employers these days provide this facility through electronic meal swipe cards. However, the current rules expressly provide exemption to paid vouchers and not electronic cards though such cards were expressly exempted under the erstwhile FBT regime subject to conditions. Accordingly, their treatment is not free from doubt.
- The said exemption along with increased limit should be extended to electronic meal vouchers.

4.24.18. Exemption for payment of Leave Encashment - Section 10

Issue

- The exemption limit for leave encashment paid at the time of retirement or otherwise is notified by the CBDT in accordance with the powers given under Section 10(10AA) of the Act. The current limit of Rs. 3 lakhs was notified in 1998) and needs to be raised substantially with immediate effect.

Recommendation

- It is, therefore, suggested that the limit should be raised to Rs.10 lakhs in line with the increase in the limit of gratuity.

4.24.19. Income of minors - to increase exemption limits under Section 10(32) of the Act

Issue

- As per Section 10(32) of the Act, in case the income of an individual includes the income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of Rs.1,500 in respect of each minor child if the income of such minor as includible under Section 64(1A) exceeds that amount. The current limit of Rs. 1,500 was fixed by the Finance Act, 1992 and needs to be raised substantially with immediate effect.

Recommendation

- It is suggested that the limit of exemption under Section 10(32) of the Act should be raised to at least Rs. 10,000 for each minor child.

4.25. Other Direct Tax provisions

4.25.1. Calculation of Interest for delay in deposit of taxes deducted - meaning of 'Month'

Issue

- As per Section 201 (1A) of the Act, interest on late deduction of TDS is calculated @1% for every month or part of month from the date on which tax was actually deductible to the date on which tax was deducted and interest on late deposit of TDS is calculated at 1.5% for every month or part of month from the date on which tax was deducted to the date on which tax is actually paid. However, for the purpose of calculating period of delay, the Revenue Authorities calculate interest on a calendar month basis. For instance, where tax was deductible on 30 June and the tax so deducted was remitted on 8 July, interest has to be paid for June and July (i.e. 2 months) for a one day delay.

Recommendation

- In order to mitigate this hardship caused to the taxpayer, it is suggested that 'month' be defined as a period of 30 days to avoid litigation on this issue. This would make the reckoning of period while interpreting the tax law more meaningful and clear.

4.25.2. Interest payable in case of default in furnishing Return - Section 234A

Issue

- Where return of income is filed after the due date, interest under Section 234A of the Act is levied from the due date of filing return till the date of actual filing. Currently, while computing the amount on which interest is payable, self-assessment tax paid by the taxpayer is not considered. Consequently, the taxpayer has to pay a higher amount of interest.

Recommendation

- Since interest is not a penalty and the reason for levy of interest is only to compensate the revenue, in order to avoid it from being deprived of the payment of tax on the due date, it is suggested that in cases where the tax on self-assessment is paid under Section 140A of the Act before the due date for filing return on income but return has been filed after the due date, such tax on self-assessment should be considered as item of deduction for the levy of interest under Section 234A of the Act.

4.25.3. Monetary Limit for Audit of Accounts

Issue

Currently the limits for audit of accounts of taxpayers are as follows:-

Particulars	Existing Limit (Rs. Lakhs)
Sales turnover/ Gross receipts of business	100
Gross receipts of profession	25

Recommendation

Given the growth in volume of economic activity, the limits need to be revised as under:-

Particulars	Proposed (Rs. Lakhs)
Sales turnover/ Gross receipts of business	500
Gross receipts of profession	50

4.25.4. Relaxation on mandatory requirement of PAN - Section 206AA

Section 206AA of the Act provides that if PAN is not furnished by payee, the rate of TDS would be 20% or rate in force or rates specified in relevant provisions of the Act, whichever is higher. The provisions further lay down that no certificate under Section 197 of the Act shall be granted unless the applicant has stated his PAN in the application. It also further lays down that declaration in Form 15G/ 15H for Nil deduction of tax would not be valid unless PAN is furnished in such declaration. Further, it has been specified that where the recipient of the income has furnished invalid/ incorrect PAN, it shall be deemed that such person has not furnished PAN and accordingly, tax would be required to be deducted at the highest of the specified three rates while making payment to such persons.

Issues

- A plain reading of the provisions of Section 206AA of the Act also suggests that in case the foreign company does not have a PAN in India, the provisions of the Act would override the provisions contained in the respective DTAA, resulting in a situation of treaty override. This is likely to create hardships for the foreign company in availing appropriate tax credit in its country of residence (for the excess tax deducted over and above the specified rate in the DTAA) and also result in protracted litigation, which increases the cost of doing business in India and therefore, discourages foreign entities from entering into transactions in India.
- These provisions may act detrimental not only to the recipients of income but also may be detrimental to the payer of such income. A payer may have deducted tax as per the provision of the Act at the specified rates under a bonafide belief that the PAN furnished by the income recipient is correct. In case the same is found to be invalid/ incorrect, the payer may have to deduct tax @ 20% or higher. In case the payer has already made the payment of the sum to the receiver, then it would create the problem of recovery of the differential amount from the recipient of the income.
- Further, considering the uncertainty in the Indian tax systems, it is seen that the foreign entities generally prefer a tax protected agreement wherein the tax liability is to be borne by the payer of the income. In such cases, the cost to be borne by the payer of the income would escalate by substantial amount as not only the rate of tax would go up but even such higher rate would be required to be grossed up. This will create liquidity issues for the payer of income thereby increasing costs of the payer for doing business in India and importing foreign technology.

Recommendations

- We suggest that quoting of PAN should be made optional for the following category of persons:
  - Individuals, including senior citizens, farmers/ seed growers, and transporters etc. whose total income do not exceed the exemption limit or are illiterate.
  - Foreign companies.
- In addition, the onerous responsibility and consequences faced by the payer of the income in case the recipient furnishes incorrect/ invalid PAN should also be relaxed.

INDIRECT TAXES

MEASURES TO RATIONALIZE THE INDIRECT TAX SYSTEM

5.1.1. Provide Clarity in Tax Matters

One of the main reasons for litigation and consequential hazy tax environment is the lack of clarity on the stand of the Revenue on certain specific issues. As a result, tax authorities of different jurisdictions adopt different stands in dealing with such issues, thereby resulting in lack of consistency and unnecessary litigation. Government should be proactive in providing clarifications so that the disputes are nipped in the bud. It should come out with status notes, position papers on contentious issues after due consultations with the stakeholders to set at rest uncertainties, if any. Even if the matter is sub-judice, Government should declare its position as to its understanding and intent of the legislation. It should direct its field officers to follow the interpretation as declared unless it's overturned by a competent judicial forum.

5.1.2. Standing Committee for Stakeholder Consultations/Clarifications

An Expert Standing Committee could be set-up by the Government to offer clarifications to the taxpayers in case of introduction of a new legislation / amendments in existing legislations or new procedures to be followed by the taxpayer. The Expert Standing Committee should be permitted to hold stakeholder consultations and further be allowed to co-opt experts for specific issues. The Expert Standing Committee should provide a framework for dialogue with the taxpayers with a view to resolve taxpayer doubts and disputes (especially misinterpretations and misunderstandings) early in the process.

5.1.3. Introduce Accountability for Assessing Officers

In the present tax system, the first stage where a fair decision can be expected is at the level of Tribunals. The revenue focussed approach of the Assessing Officers is borne out of the fact that 70 to 80 % of the decision of the Tribunals are against the Revenue. Currently, the Assessing Officers routinely confirm the tax demands against the taxpayers primarily with a view to achieve targets and also the general approach to err in favour of Revenue. Certain measures need to be put in place to bring about an attitudinal change so that the officers are encouraged to take fair and judicious decisions.

Apart from annual performance appraisals, there should be periodic special review of the officers at the time of their promotion/posting to evaluate their ability to be fair and judicious. Given the fact that most of the decisions are set aside on appeal at the stage of Tribunal, a system needs to be created to capture the results of the appeals against the orders of the officers. Accordingly, there should be a periodical review of the trait of fairness and judiciousness of the Assessing Officers based on the outcomes of the appeals at least up to the Tribunal level. Such a measure would in the long term improve the quality of orders passed by the Assessing Officers and Commissioners handling appellate work.

5.1.4. Time Limit for Adjudiction of Show Cause Notices

At present, no statutory time limit is prescribed for adjudication of show cause notices issued by the officers of the Customs, Central Excise and the Service Tax department. As a result, there are certain cases, where the show cause notices are not adjudicated by the authorities for a number of years. This practice is more common where the show cause notices are issued pursuant to audit objections raised by C&AG. These show-cause notices are transferred to call books and not adjudicated for a long period of time. This creates an uncertainty for the noticee as a number of business decisions are kept on hold due to lack of clarity on the issues for which the dispute is raised by the department vide issuance of show cause notice.

It is suggested that some time limit be prescribed for adjudication of Show Cause Notices issued by the department so that the issues are not kept open indefinitely. Suitable amendment should be made in law to provide that if the Show

Cause Notice issued by the department is not disposed of within the specified time limit for reasons not attributable to the noticee, the notice shall be deemed to have never been issued and the matter settled in favour of noticee.

5.1.5. Provision for setting aside show cause notices by an Empowered Authority

Many a times, especially in respect of indirect taxes, revenue officers issue show cause notices entailing huge amount of revenue, which are patently illegal and contrary to the settled position of law. When such cases are brought to the notice of the senior officers of the Board, they express their inability to intervene in the quasi-judicial process while conceding that the notice is devoid of any merit. The assessee is burdened with a liability in its books of accounts and has to incur substantial legal expenses and administrative costs in defending the notice and carry it through the process of adjudication, appeal etc.

It is suggested that the laws be appropriately amended to constitute an Authority comprising of senior officers/tax experts which is empowered to examine show cause notices which are prima-facie illegal and against judicial pronouncements, and declare such notices as null and void. Appropriate safeguards (specify thresholds, high fees for such reviews etc.) be built in to ensure that only genuine cases and a minimal number of cases is placed before such an Authority for a decision.

5.1.6. Safeguards against invoking the extended time-limit of 5 years for demanding disputed duties and taxes

The Customs, Central Excise and Service Tax laws permit the tax officers to raise a demand for a period of past 5 years in case any short levy is noticed because of a wilful mis-declaration, collusion or fraud on the part of the assessee. In normal cases of disputes, the demand can be raised for a period of past one year only. It is observed that the Revenue Officers invoke mis-declaration / fraud etc. as a matter of routine and issue show cause notices demanding duties and taxes for the past 5 years. Even though the law requires the extended period of 5 years to be invoked only with the approval of the Commissioner of Customs, Central Excise or Service Tax, it is observed that such concurrence is granted by the senior officers routinely without carefully examining the merits of the case. Relief in such cases is granted only when the matter reaches the Appellate Tribunal in appeal.

It is suggested that appropriate safeguards be provided to prevent invocation of the extended period of demand in a routine manner.

5.1.7. Audit Objections by C&AG

Show Cause Notices (SCNs) are routinely issued based on observations / objections of the Comptroller and Auditor General (C & AG) even where such CAG observations are contrary to judicial rulings / clarification issued by the CBEC. Even though the CBEC has in the past discouraged blind adoption of CAG objections and issuance of SCN on the basis thereof, as a general practice, all CAG observations are converted into SCN allegations immediately on receipt of the CAG audit observations to prevent “loss of revenue” because of ‘time bar’.

It is recommended that-

(a) The law could stipulate that all audit reports under service tax, central excise including post clearance customs audit must be made available to the assessee within a time bound manner to ensure that taxpayers are made aware of potential issues that they could be faced with and further given time to prepare for a timely resolution of the ensuing adjudication. This provision should be made applicable to CAG audit reports as well.

(b) Further to the same, the practice of issuing protective SCNs / demands following objections by the CAG needs to be reviewed. Once an objection has been raised, the department should evaluate the objection and decide whether the objection is sustainable or not. Such evaluation should be completed within a prescribed time limit (of say one month) of the receipt of the audit report. In case the department agrees with the CAG, a show-cause notice should be issued within a period of 1 month from such evaluation / agreement.

(c) In case, the department does not agree with the Audit contention, no notice should be issued to the taxpayer. In such a case, the department should convince the CAG about the correctness of the decision made by them. In case no consensus is reached between the department and the CAG on the merits of the issue within a prescribed time frame (say 3 months), a SCN should be issued and adjudication commenced with the adjudication being undertaken by the Special Adjudication Cell on a fast track basis.

(d) The practice of issuing a show-cause notice as soon as the Audit report is received, without examining the merits thereof, should be discontinued.

5.1.8. Pre Deposit and Stay of Recovery before Appellate Authorities

As per the Finance Act, 2014, a new Section has been introduced under Excise, Customs and Service Tax law which prescribes a mandatory fixed pre-deposit of 7.5% of duty/ penalty demanded for filing appeal with Commissioner (Appeals) or the Tribunal at the first stage and another 10% of duty demanded or penalty imposed for filing second stage appeal before the Tribunal.

It is normally seen that a large number of demands are being issued by the department without following the settled case laws in similar issues. Further, some demands are issued for mere procedural lapses and huge penalties are also imposed by the department in such cases. In a majority of such cases, at Tribunal level, demands are invariably quashed or amounts are drastically reduced and appeals against such orders by the revenue are dismissed with consequential benefit of refund of pre deposits. As per reply given to a question in Lok Sabha, only 19.7% of the decisions rendered by the CESTAT in 2011-12 were in favour of the Revenue. More than 80% of the decisions of the Tribunal are against the Revenue Authorities. There can be no justification to indiscriminately compel every appellant to make a pre-deposit for his appeal being entertained.

No doubt the Indian judicial system including quasi-judicial authorities, are at present, burdened with a huge load of cases. But there can be better means to provide speedy as well as fair justice. Such measures can include ensuring better quality in adjudication proceedings, increase in manpower and fixing responsibility for frivolous, un-sustained demands, setting a reasonable but mandatory time limit for completion of adjudication and appeal proceedings at all levels etc.

In view of the above concerns, it is suggested that the concept of merit based pre-deposit be re-introduced and the mandatory pre-deposit should be withdrawn.

If the aforesaid suggestion is not acceptable, FICCI would like to submit following suggestions for consideration:-

(a) Given the adverse success rate of the litigation in favour of Revenue, there should be no pre-deposit for filing appeals before Commissioner(Appeals)

(b) The provisions of pre-deposit should not apply in the following situations:

  (i) Matters where duty demanded is less than Rs. 25 Lakh. This would reduce the cost of administration in monitoring payments and refund of pre deposits in large number of low value appeals

  (ii) In case of appeals filed by individuals

  (iii) In case, the appellant has received a favourable order of Tribunal in his own case earlier on the same issue

  (iv) Where order has been passed by the Adjudication Authority or Appellate Authority:

    - without following principles of natural justice
    - without jurisdiction
    - with errors in computation of demand which are apparent

SERVICE TAX - LEVY AND EXEMPTIONS

5.2.1. Reverse Charge Mechanism

The reverse charge mechanism has resulted in:

(i) Significant increase in complexity and cost of compliance in case of corporate bodies in terms of identification of status of service provider, payment of tax per applicable ratio for the specific type of service, maintenance of records, submission of returns, Departmental audits etc.

(ii) Undermining of threshold limits and exemptions prescribed under service tax laws. This is due to the fact that in case of payment of tax under the reverse charge mechanism threshold limits are not applicable, leading to situations where the service recipient, being a corporate body, has to pay service tax in respect of specified services provided by non-corporate service providers even if such service providers are below the prescribed threshold limits.

(iii) Chances of short/excess payment of service tax consequent to differences in understanding of service provider and service recipient on whether a particular service falls under the services notified for taxation under the reverse charge mechanism.

(iv) Scope for dispute and litigation with the Department on interpretation and valuation. For example, whether a particular service is a manpower supply service (to be taxed under reverse charge mechanism) or not would depend on the facts of the case and is open for interpretation.

In an era of growing transparency and simplicity in tax laws the enlargement of list of services under the reverse charge mechanism is a retrograde step and has burdened the service recipient with responsibilities that are rightly those of the Department. In addition to increasing the complexity of compliance, the enlargement of the list of services under the reverse charge mechanism has also diluted the threshold levels prescribed under law since, even if a service provider is exempt from tax by virtue of being below threshold limits, under reverse charge mechanism the service recipient (body corporate in this case) will have to pay the service tax.

To remove this inequity it is suggested that the reverse charge mechanism should be resorted to in rare circumstances. For the sake of administrative convenience it is suggested that the reverse charge be restricted to services provided in India by parties outside India, services provided by non-executive directors to a company and road transportation services provided by GTA. In any case the partial reverse charge should be given up; the tax should be collected in whole either by the service provider or by the service recipient.

5.2.2. Exemption from Service Tax in respect of various Input Services procured by Power Industry

There is a well adverted policy of the Government of India that the power sector is a priority sector on account of our national concerns relating to the energy generation and energy security. Levy of service tax on input services is an additional burden / sunk cost on the power sector and would substantially add to their operational cost in turn increasing price of supply of electricity to consumers.

Though there are Excise/Customs duty exemptions for power sector like other infrastructure sectors, still service tax is applicable in respect of various input services procured by power sector. Some of these are - project report & analysis, engineering & architect services, consultancy services, site formation & clearance, excavation, earth moving & demolition, erection, commissioning & installation of plant, goods transport agency for supply of goods, repairs & maintenance, supply of tangible goods (like heavy machinery), business support services, business auxiliary services.

There are already various service tax exemptions provided to other infrastructure sectors such as canal, dam or other irrigation works, pipeline, water treatment/ sewerage treatment/ or disposal, road, bridge, tunnel or terminal for use by general public etc.

In order to bring parity to power sector vis-a-vis other infrastructure sectors and thereby to make power available at reasonable price for industrial & domestic consumption , refund of service tax should be provided for tax paid on various input services availed by power sector.

5.2.3. Service Tax on Administrative Charges for the Pradhan Mantri Jeevan Jyoti Bima Yojana

As per the scheme, the premium for insuring is Rs. 330/- per annum. The participating bank will debit the amount of Rs. 330/- in the account of the policy holder. The bank will retain Rs. 41/- towards administrative charges and remit the balance of Rs. 289/- to Life Insurance Companies. Though the amount of premium is exempt from service tax, the reimbursement of administrative charges is not exempt. If the output service (premium) is considered as exempt, a proportional amount of cenvat is required to be reversed by the service provider as per the Cenvat Credit Rules. It is suggested that service tax exemption be given to the reimbursement of administrative charges and the scheme should be made tax neutral in all aspects.

5.2.4. Service Tax on Transmission and Distribution of Electricity

Under the Negative list “transmission or distribution of electricity by an electricity transmission or distribution utility” is not taxable (sec. 66D). Further, the definition of “electricity transmission or distribution utility” under sec 65B(23) of the Finance Act inter alia covers distribution licensee and “any other entity entrusted with such function by the Central Government or, as the case may be, the State Government”

Under the negative list, service provided by an entity approved by Central or State Government is not taxable. However, any franchisee appointed by a private party (Distribution Licensee) is not covered under the negative list. Earlier notification no 32/2010 dated 22.06.2010 specifically exempted the taxable service provided to any person, by a distribution licensee, a distribution franchisee or any other person.

It is requested that the benefit of earlier notification should be extended to current exemption list. All the franchisees appointed by a private party (Distribution Licensee) should also be covered under the definition of “electricity transmission or distribution utility.”

5.2.5. Service Tax on payments made by Head Office in India to branches in Foreign Countries and vice versa

Under the service tax regime, an Explanation 3(b) has been inserted to the definition of ‘service’ under section 65B (44) to provide that any transaction between an establishment outside India and an establishment in India would be treated as a ‘service’. A branch or any other establishment of a person located in a non-taxable territory would be deemed to be a distinct “person” for service tax purposes.

Indian Companies having branches overseas remit funds to the branches to cover their day to day expenses including services consumed locally by the branches. For example, Indian exporters (‘Indian Office’) need to establish non-trading representative offices abroad (‘Foreign Office’) to boost their exports. These Foreign Offices are not revenue generating and therefore Indian Office has to necessarily fund their activities.

Similarly, an Offshore Company if awarded a contract for execution of work in India may set-up a branch / project office in India for the onshore part of the work. In such case, since the Offshore entity is the Contracting party and would raise invoices to the customer, the day to day operation cost of the Indian branch/ project office is being met by the remittances made by the Offshore Company.

The deeming provision intends to tax such imprest remittances made by the Indian Office to the Foreign Office or vice versa. It may be noted that there are many situations in which the tax levied on such imprest remittances are leading to double tax situation. For instance,

(a) Remittances used by the branch/ project offices to fund their activities suffer local taxes in their respective countries. The branch/ project Office, being non-revenue generating in many cases, does not get any credit of the taxes so suffered.

(b) In case of remittances made by the Offshore Company to Indian branch/ project office for execution of the project, the branch/ project office get exposed to service tax in India, which becomes cost for the Company, as neither the offshore office nor the branch/ project office has the ability to claim credit of such taxes. Again when the Head Office will raise bills to its customer, the transaction would become liable to service tax in the hands of customer under reverse charge

Thus, taxation of imprest remittances in/ out of India results in double taxation where the same transaction is taxed twice. In case of remittance of fund by the Indian head office to offshore branch office, an argument may be placed that service tax paid by the Indian Office can be claimed as Cenvat, however, it must be noted that substantial portion of Cenvat credit so availed is lost through application of Rule 7 and Rule 6 of the Cenvat Credit Rules 2004.

Perhaps the intention of the Government is to levy service tax only on the services provided by offshore office to the office located in taxable territory (i.e. on import of service transactions), however due to the language of explanation any transaction between offices of same legal entity located in two taxable territories (including the transaction of providing funds without any service being involved) are getting exposed to service tax, resulting into multiplicity of taxes and adding to the tax cost.

It is recommended that the imprest remittances by the Indian Office to Foreign Office and vice versa should be kept out of service tax levy.

5.2.6. Cold Chain Services to be exempt from levy of Service Tax

Major Dairy and Milk products which are meant for mass human consumption have a limited shelf life and need to be preserved at defined temperatures to keep them fit for human consumption. The government though have encouraged setting up of cold storage facilities on one hand have adversely effected the usage of the same by levy of service tax on them. With proposed GST expected to be around 20% to 22% this would further adversely hit the Dairy industry.

Services provided in cold storage facilities used for storage of products for human consumption should be exempted from levy of Service Tax to relieve ultimate consumers from additional burden. This would encourage the industry to set up cold storage facilities in rural areas as well and ensure availability of dairy products in such pockets.

5.2.7. Stock Broker services rendered to FII / NRIs

The Finance Act (No 2) 2014 has amended the definition of 'intermediary' to include intermediary of 'goods' in its scope. Accordingly, with effect from 1 October 2014, an intermediary of goods, such as a commission agent (i.e. a buying or selling agent) shall be covered under Rule 9(c) of the Place of Supply of Services Rules, 2012 (POPS) and the taxability of the service would depend on location of such intermediary.

The above amendment would have effect of including 'stock brokering' service under Rule 9(c) of POPS as the definition of 'goods' includes 'securities'. The stock brokering service rendered by the brokers to FPI/ NRIs would also be covered under Rule 9(c) and would attract service tax since the broker is located in India. This would have an impact on business of non-resident investors, as it will increase the transaction costs.

Without prejudice to the above, several brokers in Mumbai have received letters / notices from the Service tax department, Mumbai asking them to pay service tax on brokerage charged to FPIs/ NRIs under pre-amended rule as well. This contradicts the current position of the Government to subject the stock broking services to tax with effect from 1 October 2014.

Hence, it needs to be expressly clarified that the levy of service tax will be effective prospectively from 1 October 2014 and no other provision in the pre-amended law would be invoked to tax stock broking services to FPIs and NRIs with retrospective effect from 1 July 2012.

Appropriate amendment should be made in Rule 9(c) to expressly include stock broker as intermediaries and clarify that stock brokering service is taxable with effect from 1 October 2014 and not prior to that date.

5.2.8. Double Taxation of Licensed Intellectual Property Right (VAT and Service Tax)

Temporary transfer or permitting the use or enjoyment of any intellectual property right is liable to service tax.

In light of various settled judicial precedents, intellectual property right (IPR) has also been held to be 'goods' and accordingly, since software supplied electronically constitutes goods, it is subjected to VAT under the respective State VAT legislations. Further the 'temporary transfer of right to use software' is construed as a service and subject to levy of Service Tax. However there is still confusion and litigation existing as many State Governments are still levying sales tax on supply of temporary IPR, given the fact that the definition of sale in few state VAT legislations includes 'right to use'. The objective should be to do away with double taxation and bring about clarity on the fact whether IPR is 'goods' or 'service'.

It is recommended that suitable explanations should be added in the Finance Act itself to ensure that sale of IPR is taxed only once – either under VAT as goods or under Service tax legislation as taxable service.

5.2.9. Service Tax on Regulatory/Statutory Fees paid to Foreign Governments/Government Agency

In the budget presented for the year 2015-16, the definition of the term "Government" has been defined to mean departments of Central Government or State Government or Department of such Government, Union territory and its departments. [Definition of "Government" under Section 65B(26A)].

Chemical/Pharma companies are required to pay statutory fees to the Foreign Governments/agencies for registration of their products etc. A change in the definition has resulted in such payments being taxable in the hands of the Indian companies on reverse charge basis. This will result in huge service tax outflow, blocking of working capital.

Exemption from service tax should be provided on such payments made to any Foreign Government and agencies as they are statutory in nature.

5.2.10. Increase in Exemption Limit for levy of Service Tax

The value limit of Rupees ten lakhs for exemption from the levy of service tax in a financial year has not been revised for many years despite increases in the various cost indices. It is requested that the exemption limit may be increased to a total of Rupees twenty lakhs. The request is being made since introduction of GST is uncertain in the near future and the increase in the exemption limit need not await introduction of GST.

5.2.11. Service Tax on Maintenance, Repair, Overhaul and Upgradation of Aircraft for Ministry of Defence

Services of maintenance, repair, overhaul and upgradation of aircraft and aircraft parts are liable to service tax. Under the mega exemption notification (notification no.25/2012), there was an entry under serial no.25(b), which provided exemption to services provided to Government, a local authority or a governmental authority by way of 'repair or maintenance of a vessel or an aircraft'. The exemption with respect to aircraft was withdrawn with effect from April 1, 2013.

Exemption provided to repair of aircrafts should be re-introduced by suitably amending Notification no.25/2012-ST, dated 20-06-2012. Such exemption should also cover repair, maintenance, etc. being provided to aircraft equipment, components and parts as well. Exemption should be extended to services that are ultimately used / consumed for the official purposes of Ministry of Defence.

5.2.12. Service Tax Exemption for Defence PSUs for Specified Services

Section 68(2)of the Finance Act read with Notification 30/2012 and Rule 2(1)(d)(i)(G) of the Service Tax Rules, 1994 mandates service recipient in India to pay service tax, if any taxable service is provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory provided the place of provision of services is in taxable territory (i.e. India) in terms of the Place of Provision of Service Rules, 2012.

In case of Defence PSUs, there are numerous technology transfer agreements for transfer of right to use technology relating to manufacture, overhaul, and maintenance of defence equipment. As per section 66E of the Finance Act, temporary transfer or permitting the use or enjoyment of any intellectual property right is a declared service and chargeable to service tax. Accordingly, service tax has been levied on royalty or fees paid under these technology transfer agreements leading to increase in cost of manufacture of defence equipment. It may be noted that DPSUs are not in a position to avail CENVAT credit of service tax paid on these charges as finished goods are exempt and hence such service tax paid always results as a cost in the hands of DPSUs which in turn increases the cost of products supplied to Ministry of Defence.

It is suggested to grant exemption on services availed by DPSUs towards technology transfer or setting up of manufacturing facility for defence in line with the exemption granted to RBI. This will reduce the cost of finished goods and also save tax compliance cost for DPSUs.

5.2.13. Service Tax liability on Mandatory Deputation of ONGC personnel to Government of India

Government of India (the Ministry of Petroleum and Natural Gas), vide Resolution No. O-20013/2/92-ONG, D-III, and dated April 8, 1993 ('the Resolution') has set up an independent regulatory body namely the Directorate General of Hydrocarbons ('DGH'), under the administrative control of the Ministry of Petroleum and Natural Gas (MoP&NG).

DGH is a technical arm of the MoP&NG and its expenditure is funded by the grants from the Oil Industry Development Board which is nodal agency for the development of the Oil Industry, which, in turn, is provided by the Central Government. The manpower of DGH consists of personnel from the MoP&NG and also from Oil Industry on deputation/ tenure basis. The employees deputed by ONGC to DGH are paid salary and allowances by ONGC, which are subsequently recovered from DGH.

It may be observed that, deputation of manpower to DGH is based on specific directive of the Government of India to fulfil certain security, safety and regulatory objectives that are part of the sovereign function of the Government and, there being no intention to provide or receive service on both sides, either as a provider on the part of ONGC or as a recipient on the part of the Government of India.

It is requested that an exemption/clarification may be issued that mandatory deputation of personnel from PSU in Directorate General of Hydrocarbons or any Government Department, is not a taxable service. Also, on implementation of GST, these recommendations may please be incorporated mutatis-mutandis.

5.2.14. Assessment of Drawings and Designs Imported for the implementation of Projects to Customs Duty and Service Tax

While executing large projects and plants in India, the imported drawings and designs form an indispensable and integral part of the entire project. Generally, such drawings and designs relate to installation of imported as well as indigenous equipment, manufacture of indigenous equipment, undertaking civil and structural work in India, etc.

The drawings and designs are imported in printed form on paper (referred as hard copy), which are used for the aforementioned purposes. Apart from hard copy, the same drawings and designs are also imported in electronic form i.e., on Discs (referred as soft copy), which are used for future reference purpose. There is only one consideration agreed for drawings and designs.

When hard copy is imported, it is classified under Chapter Heading 4911 of Customs Tariff and the consideration for such drawings and designs gets fully and unconditionally exempt from levy of Customs Duty by virtue of Serial no. 275 of Notification No. 12/2012-Cus dated 17.3.2012. The exemption has been in existence from 1994 onwards till date.

When soft copy is imported, the customs department is classifying them under Chapter Heading 85239090 of Customs Tariff and the consideration for such drawings and designs is being subjected to levy of customs duty on the ground that there is no exemption notification for soft copy classifiable under Chapter Heading 85239090.

The above anomalous position is arising due to the fact that drawings and designs are imported in different form through two different media and the customs implication differ based on form of media.

It is considered to be good practice to structure the tariff in a tax neutral manner. In other words, the tax liability or outcome should not vary depending upon the mode of carrying out the transaction. The tax structure should be such that the consequences are same irrespective of the method adopted for undertaking any transaction. This theory and principle has been accepted and applied by CBEC as is evident from TRU Budget Circular dated 29.2.2008, para 4.1.5 which is reproduced below:

> *"4.1.5 Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service."*

In fact, tax neutral approach is foreseen from the manner in which the Information Technology software is treated. Similar tax neutral approach needs to be given to imported drawings and designs. The soft copy should be treated at par with hard copy and hence, no customs duty should be levied on the soft copy as well.

Also, the imported drawings and designs are subjected to service tax on reverse charge basis by virtue of Section 66B read with Rule 2(1)(d)(G) on the ground that the imported drawings and designs received in the form of CD is in the nature of service. It is inequitable and illogical to treat drawings and designs as goods and services at the same time.

It is requested that a clarification / notification may be issued providing that the imported drawings and designs would not be subjected to customs duty and service tax, at the same time.

5.2.15. Service Tax on NRI Remittance Related Services

The Central Board of Excise and Customs (CBEC) has issued a circular No. 180/06/2014 – ST dated 14th October 2014 which has the effect of imposing a service tax on NRI remittance fees incurred for disbursing money to NRI families in India. This circular was issued reversing the earlier circular issued by CBEC on 10th July, 2012, which clarified that no service tax is leviable on the services related to NRI renitences though there is no change in service tax law or remittance model.

India is the largest migrant remittance receiving nation of the world with remittance from Non-Resident Indians (NRIs) exceeding USD 70 billion annually. NRIs remit the money to their dependents in India either through banking channels or by using money transfer services provided by Money Transfer Service Operators (MTSOs). The MTSOs do not have any presence in India and have appointed various representatives to disburse money to the persons nominated by NRIs. These representatives receive a commission from MTSOs for disbursing the money to the beneficiary in India. As per the new circular, the banks and financial institutions or agents which levy a fee or commission for facilitating the delivery of NRI money in India will have to pay service tax.

NRI remittances have remained the most important constituent of India's economic development for the past three decades. It is pertinent to note that a significant percentage of the country's population is dependent upon NRI remittances for their livelihood. The Service tax levy has increased the cost of sending money to India for the NRIs, which would consequently mean, lesser disposable income in the hands of NRI families. This may incentivize NRIs to route their money through illegal channels such as the hawala network promoting money laundering and black money creation/transfer.

It is recommended that the circular dated 14th October 2014 may be withdrawn and it may be clarified that the NRI remittance related services provided by an Indian entity/bank to a foreign money transfer service operator (MTSO) will not attract service tax and qualify as an export of services. Alternatively, a specific exemption be provided exempting such services.

SERVICE TAX - CLARIFICATIONS

5.2.16. Adjustment of Service Tax paid on Amounts Written off

With the introduction of Point of Taxation Rules, 2011 Service Tax is payable on accrual or receipt whichever is earlier. The Service Tax liability is discharged irrespective of receipt of payment from the customer. While the Service Tax liability is discharged on an accrual basis, in case of bad debts there is no recourse for adjustment of Service Tax paid thereon. This tax treatment is not fair to the banks as the banks are forced to pay tax without actually earning anything.

As Service Tax is an indirect tax which should be recovered from the ultimate user of the service, it is recommended that the Bank should be allowed to adjust the proportionate Service Tax which could not be recovered against service tax liability for the subsequent period. Particularly in the case of Credit Card etc. where due to inherent nature of the business delinquencies are high, relief for Bad Debts must be allowed.

5.2.17. Service Tax implication on the Foreign Bank Charges

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 "authorized 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 utilize 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 service is provided by a person (Foreign Bank) located in a non-taxable territory to Exporter (which is located in taxable territory). The actual service recipient is the Indian customer. The bank in India merely facilitates the payments in the capacity as Authorised Dealer. Hence, the Indian Banks cannot be considered as service recipients. Given this, as per Rule 2 (1) (d) of Service Tax Rules, 1994 read with Not. No. 30/2012-ST, Service Tax would be payable by the recipient of the service i.e. the Indian customer. Clarification may be issued whether in such transactions Service Tax on the Foreign Bank charges is payable by the Indian customers or the banks.

5.2.18. Levy of Service Tax on amount recovered towards Penalty, Fines, Liquidated Damages etc.

Section 66B of Chapter V of the Finance Act is the present charging section according to which service tax is leviable at the rate of 14% on the value of services, other than those specified in the Negative List, provided or agreed to be provided in the taxable territory by one person to another.

Section 65B(44) of the Act defines the term "service" to mean any activity carried out by a person for another for consideration, including declared services with certain exclusions. The term "activity" has not been defined in the Act. The ministry of Finance, in the Guidance Note dated 20.06.2012 has observed that in the absence of any specific definition the term "activity" shall be given the meaning as it is understood commonly to include an act done, a work done, a deed done , an operation carried out , execution of an act , provision of a facility etc. It is further stated that activity could be active or passive and would also include forbearance to act.

As per Sec 66E(e) of the Finance Act, 1994, "agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act" shall be a declared service and liable to service tax. It is clear form above that in order to attract the levy of service tax, there should be an activity and the activity should be undertaken by one person to another person for a consideration.

The Central Excise Department in some cases is demanding service tax based on the above provision on the amount recovered as penalty, fine or liquidated damages by the customers from the vendors.

In this regard, it is important to note that such recoveries done by the customer is not a consideration for any service provided by the customers to its vendors as there exists no reciprocity in such cases and the amount recovered from vendor is in the nature of compensation only. In contract, compensation is being paid by one of the contracting parties to the other for any loss or injury caused to the latter by some conduct in breach of the terms of the contract.

Reference can be drawn from the CBEC circular ref no 96/7/2007/-ST dated 23.08.2007 which clarifies that an amount collected for delayed payment of telephone bill is not to be treated as consideration charged for provision of telecom service and therefore, does not form part of the value of the taxable services under section 67 read with Service Tax (Determination of Value) Rules, 2006.

It has also been clarified vide Circular No 121/3/2010- ST dated 26.04.2010 that detention charges collected to hold a marine container beyond the holding period is determined by the shipping companies/steamer agent is not chargeable to service tax, the same being in the nature of a "penal rent" not a consideration for a service.

It is suggested that CBEC should issue necessary clarification in the matter to avoid disputes

5.2.19. Promoting Digital India – Remove Dual Levy of Taxes

To promote Digital India, cost of digitizing should be made optimal. Pre-packaged or canned software licenses are goods as held by the Apex Court in 2004 in the case of Tata Consultancy Services (TCS). Consequently, States levy VAT / CST on the sale of such software licenses. Levy of VAT / CST is also accepted in the trade.

Traditionally, Pre-packaged Software was delivered via CD, Disc, and Floppy etc. and hence the Apex Court in the TCS decision referred the same. With advancement in technology, Software is downloadable through internet. Since medium of delivery is through internet and it's not as per Apex Court's decision, Department considers it as a service and levies service tax. Levy of VAT/CST is being made by the States following the TCS decision and service tax by Central Government leading to dual levy.

Software would remain goods whether it is delivered on media or downloaded on the internet. Levy of service tax on an item which is goods is not appropriate and requires to be eliminated to avoid dual levy.

Hence it should be clarified that Pre-packaged or canned software in whatever form delivered is goods and therefore not subject to service tax. This will go a long way in reducing the cost of digitization, which is one of the primary thrust areas of the Government.

5.2.20. Exemption from levy of Services Tax on common costs apportioned by the operator to UJV

As per the Production Sharing Contract ("PSC") signed by the members of Unincorporated Joint Venture (UJV) with the Government of India, one of the participant member is designated as an "operator". Apportionment of Common Costs amongst members is consequent to a contractual obligation for carrying Petroleum Operations under the PSC and qualifies as transactions in money without any element of service and without any element of consideration so as to attract Service tax. Without prejudice, as operator is contractor under PSC and apportionment of Common Costs is towards production of crude oil and natural gas, the same will fall under negative list as provided in section 66D(f) of the Finance Act.

To obviate any controversy, it is requested that a suitable clarification may be issued stating that Service tax would not be leviable on the Common Costs apportioned by the operator to the UJV formed in pursuance of Production Sharing Contracts ("PSC") with Government of India for Oil and Gas.

5.2.21. Sharing of Services by Group Companies

In today's business scenario, "business groups" manage multiple lines of business through separate legal entities, subsidiaries, or group companies. Thus, sharing of expenses/ costs and allocation of expenses between these companies of the same group becomes inevitable. One of the group companies enters into a master agreement with a vendor for supply of common services such as housekeeping, security, electronic data transfer (EDP), manpower supply, catering etc. to one or more group companies or engages employees at corporate level on the role of one group company who will handle work relating to purchase, marketing, electronic data transfer (EDP), HR etc. in respect of all the companies. The cost is allocated to all group companies without mark up. The distribution is being done as per standard accounting policies laid down and to obtain operational efficiency in addition to administrative convenience. The cost allocation could be on the basis of time and resource usage by a unit or company or the allocation could be on the basis of some pre decided factors like turnover, no. of employees, consumption value of raw material, number of user (for IT/EDP services), manufacturing capacities etc. However, in any case no profit element/ mark-up is there.

Services have been provided a very wide definition, basis which a doubt has been raised by the field formation that the words any activity includes allocation/sharing of expenses between the group companies and are liable for payment of service tax on the amount of expenses so allocated or shared. Such burden of cost leads to high cost of products and adds to unnecessary litigation cost.

Necessary clarification on this aspect needs to be issued to avoid disputes. Since group companies are getting only reimbursement of expenses actually incurred, it does not amount to provision of service.

5.2.22. Taxability of Interchange Fees in a Card/ATM Transaction

In a card transaction, acquiring Bank (bank owning the POS machine or ATM) discharges full Service Tax liability on the entire Merchant Service fees (MSF) earned. Further, a portion of MSF shared with the issuing Bank (Bank who issues the card) commonly referred as 'interchange income' is subject to Service Tax in the hands of issuing Bank.

The interchange fees should not be liable to Service Tax on following grounds:

(i) In a card transaction, the Acquiring Bank discharges full Service Tax liability on the entire MSF earned which includes the interchange shared with the issuing Bank. Thus, there are no leakages of Service Tax.

(ii) No contract of service between the issuing bank and the acquiring Bank and the interchange income is mere passing of fees that has already suffered tax in the hands of acquiring bank.

(iii) The settlement of fees between the issuing bank and the acquiring bank is done by the Card association. The Acquiring bank will not be able to claim the Cenvat credit as interchange fees is not at all an input for the acquiring bank and further no invoice system presently prevailing for raising of invoice either by the issuing bank or the card association.

Necessary clarification to be issued that interchange fee received by a bank should not be liable to Service Tax provided that Service Tax has been paid on the entire MSF by the acquiring Bank.

5.2.23. Clarification on outdoor Catering Services

Vide Notification No.25/2012-ST dated 20th June, 2012 the services which are exempt from payment of service tax were notified. Vide Entry No.19 services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess other than those having the facility of air-conditioning or central air-heating in any part of the establishment at any time during the year and a licence to serve alcoholic beverages is exempt from payment of service tax. On representation from industry, the authorities have introduced another entry vide Notification No.14/2013-ST dated 22nd October, 2013 vide Entry No.19A that services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under Factories Act, 1948 (63 of 1948), having the facility of air-conditioning at any time during the year to give relief to the air-conditioned canteen maintained in a factory.

Insertion of entry No. 19A in addition to the S.No.19 implies that non-air-conditioned canteen maintained in a factory is already covered under S.No.19. The tax authorities in the field are giving a narrow interpretation that a non-air conditioned factory canteen is not entitled to the said benefit and the benefit in case of an air-conditioned canteen is available only if the catering is undertaken by the factory themselves and not by appointing a third party service provider. The aforesaid facts clearly establish that non-air conditioned factory canteens are already covered under S.No.19.

Hence a clarification may be issued to clear these doubts.

5.2.24. Medical Services provided by Clinical establishments

Medical services provided by Clinical establishments are exempt from Service tax. The Hospital provides services to patient and they engage doctors for providing such services. Hospital raises their memo of fees by specifying Operation Charges, Doctor Fees and medical Consumables. The Department is taking a view that Hospital provides infrastructure to Doctor and intends to recover the Service tax on such charges. There is a need to clarify that such services are also in the nature of medical services and exempt from Service tax.

5.2.25. Service Tax on Contributions made towards Implementation of CSR Projects

Under the directives of the Department of Public Enterprises, Government of India (GOI), large public sector undertakings (PSUs) are required to spend 2% of their profit towards various welfare measures under Corporate Social Responsibility (CSR) projects. Accordingly, large PSUs are making contributions for welfare activities, which is primarily the function of the Government. A similar stipulation has been made under the Companies Act.

GOI Guidelines provide that, the implementation of the project create a positive image about the company in the public's perception. Accordingly, while taking up any CSR project it is ensured that the PSU's trade name or logo is properly displayed. However, the Service Tax Department has expressed a view that these transactions are covered under sponsorship, as the PSU is getting mileage from the CSR Project, and are subject to service tax.

This display of trade name or logo at the CSR site for creating a positive image should not be construed as mileage for commercial advantage to PSUs and therefore should not be subject to service tax.

It is recommended that a clarification may be issued to the effect that CSR activities being carried out by Central PSUs in terms of GOI Guidelines are not services leviable to service tax.

SERVICE TAX - PROCEDURES AND MISCELLANEOUS ISSUES

5.2.26. Due Date for Payment of Service Tax

Currently due date of payment of service tax in government treasury is 6th of the following month. It is practically very difficult for the assessee to reconcile its monthly accounts and compute the service tax liability by 5th of the next month. Further, payment of service tax for March is required to be deposited in the government treasury by 31st March itself which is practically difficult as in certain cases the value of services is computed as a percentage of sales and the sales continue till 31 March of the year. The problem is compounded in case of assessees having multiple business points spread over the country. Assessees are forced to deposit service tax on adhoc basis as actual amount cannot be computed before the close of the financial year. Further, in view of non-availability of provisions for adjusting service tax liability against subsequent payment, the amount even if paid on estimated basis will get blocked till the refund, if any, is granted by service tax authorities.

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

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.

5.2.27. Interest on delayed payment of Service Tax

As per Budget 2014, with effect from 01-10-2014, rates of Interest for delay in payment of Service Tax matters have been increased as per slabs of 18% for first 6 months, 24% for next six months and thereafter 30% for period beyond 1 year. This is exorbitant and applicable only in Service Tax matters. The rate of interest on delayed payment of Excise and Customs duty irrespective of time gap is flatly at 18%. Further, the government offers interest at 6% on pre-deposits and delayed refunds across Service Tax, Excise and Customs.

There are many occasions where under a bonafide belief or due to interpretational issues, service tax liability is not discharged by the assessee. In such cases, levy of interest at the rate of 30% is not justifiable. In case, the assessee has collected the service tax from the recipient of service and has not deposited the same with the Government, levy of such a higher rate of interest is fully justified. However, levy of such higher rate of interest in cases disputed because of interpretation of law is unfair and unjust. This is a castigatory measure and translates into a heavy litigation cost since the appellate process normally extends beyond a year.

It is recommended that the interest rates should be reduced from 24/30 percent back to 18 percent so as to reduce the undue cost burden on an assessee. Higher rate of interest may be prescribed for situations where the taxpayer has admitted his tax liability but still has not deposited the tax with the Government. Liabilities arising out of differences in interpretation of law, valuation or applicability of any exemption notification need to be kept out of the purview of penal rates of interest. Interest rates should be uniformly applicable at the same rate of 18% across Service tax Excise and Customs matters.

5.2.28. Service Tax – Reimbursements

Finance Act 2015 has included the reimbursements sought by service providers within the definition of "Consideration" for the purpose of determining the value of taxable service. It may be pertinent to note that Clearing & Handling Agents (CHAs), during the course of providing CHA service also make payments for certain expenses, on behalf of service recipient on a Principal to Agent basis and seek reimbursements of the same from the service recipient. The imposition of service tax on such reimbursements adds to the overall cost structure of the exporter. Exporters can seek refund of service tax either on-line at a prescribed rate (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) or seek refund manually establishing the actual service tax suffered by the exporter in the course of export. The rate prescribed for claiming refunds on-line has not been increased appropriately to cognise for the additional service tax suffered on reimbursements.

Reimbursements claimed by Service Providers purely on a Principal to Agent basis, as above be specifically excluded from the definition of "consideration". Alternately, the prescribed rates (as per Schedule of Rates, under Notification No. 41/2012-ST dated 29th June 2012) be increased appropriately to cover for the incremental cost on account of service tax on such reimbursements.

5.2.29. Service category based Registration to be removed

Registration provisions under service tax require the assessee to register for various service categories in which he is dealing. Therefore, the assessee has to amend the service tax registration certificate time and again to incorporate new service category as a provider or receiver of said service.

Frequent amendments to the existing registration to incorporate new services, increases administrative burden on the assessee and departmental officers without any value addition to the Department

It is recommended that assessees be provided with facility for self-declaration and certification under ACES for any addition of new service category. System approval should be introduced for addition or deletion of service category.

5.2.30. Disclosure of Service category in the Invoice

As per rule 4A of the Service Tax Rules, 1994, it is not mandatory to mention the service category under which service tax is being charged by the Service Provider.

This leads to interpretation of service category by the service recipient in order to (i) pay the reverse charge of service tax; (ii) avail Cenvat Credit or (iii) claim service tax refunds / exemption. The service category determined by the service recipient may be different from the service category under which service is provided or service tax is paid by the service provider.

Rule 4A of the Service Rules, 1994 should be amended to provide that the description of a service in the invoice shall be the same as the service tax category under which service tax is paid / payable. This would aid the officers and assessee to reduce unnecessary litigation.

5.2.31. Non-Taxability of Export of Testing Services

Rule 4 of the POPS Rules deals with performance based services. It states that place of provision of service shall be the location where the service is actually performed. In case of testing of software or hardware products, the place of provision of service is treated as the place where services are actually performed though the actual use and enjoyment of service is at overseas location and made liable to tax despite of receipt of money in foreign currency.

Levying service tax on testing services which are exported would result in exporting taxes overseas, impacting global competitiveness of Indian IT Industry.

It is recommended that sub rule 4(a) of the POPS Rules should be amended to provide an exception that in respect of testing service performed on goods, the place of provision of service is the location of the service recipient (i.e. to whom the test report or exception report, if any, is required to be delivered.)

5.2.32. Point of Taxation for Life Insurance Services

Considering peculiar nature of Life Insurance wherein-

(a) Life insurance premium are always paid in advance.

Service tax Rules provide that receipt of the payment as provision of service as per the point of taxation (POT) for levying the service tax.

(b) Break up of premium into charges and investment is not available till the associated units are allocated in case of ULIP.

Hence point of taxation should be when the units are created.

(c) The contract for insurance is not made till the policy is issued.

Therefore, no obligation to render service arises till contract for insurance is made. Hence, service tax should be applied once contract of insurance is signed i.e. issuance of policy.

Tax obligation however, arises on accrual or realization whichever is earlier. It is suggested that recognition should be as under:

(a) Receipt of premium as Point of Taxation under Life Insurance Services for policies other than ULIP

(b) In case of ULIPs Point of Taxation is the date when the associated units are allotted.

(c) Service tax should be applied on issuance of policy and not on proposal deposit.

CENTRAL EXCISE - LEVY AND EXEMPTIONS

5.3.1. Withdraw National Calamity Contingent Duty

NCCD amounting to Rs 50 per MT of crude oil purchased may be withdrawn as it is an additional burden on the businesses. Further there is a multitude of other taxes and duties on crude oil.

A quote from the speech while introducing the Finance Bill 2003, “Unfortunately, the Nation has been facing a severe drought this year. The funds raised earlier under the National Calamity Contingent Duty are not sufficient. It is, therefore, proposed to impose a 1 per cent National Calamity Contingent Duty on polyester filament yarn, motor cars, multi utility vehicles and two-wheelers. Similarly, crude, domestic or imported, will also be subjected to a duty of Rs.50 per metric tonne for this purpose. However, these new levies will be limited to one year only. “

Though the Govt. said it was only for one year, it has been extended thereafter. Thus what was introduced for only one year to combat drought still continues. NCCD under Finance Act 2003 is levied as a surcharge over and above the basic customs duty levied under the Customs Tariff Act.

It is suggested that NCCD be withdrawn. Alternatively, NCCD may be allowed to be taken as CENVAT credit in the excise duty payment on clearance of manufactured goods from the factory.

5.3.2. Option to avail Exemption from Payment of Excise Duty

Finance Act, 2005, by amending Section 5 A of the Central Excise Act with effect from 14th May, 2005, had made a change in the position with respect to exemption on payment of central excise duty on an exempted product. As per the

amendment if any excisable goods are exempted from the payment of excise duty unconditionally, the manufacturer of such goods will be bound to avail the exemption. Prior to this amendment the exemption was optional to the manufacturer and the manufacturer was free to work under CENVAT scheme if the exemption does not suit him.

Such a provision in the Central Excise Act acts as a disincentive for manufacturers who intend to set up factories for the manufacture of exempted goods by making huge investment in capital goods as they cannot avail of the cenvat credit of the duties paid. The situation gets worse in case the exempted goods so manufactured happen to be used as inputs in the manufacture of dutiable goods. The excise duty paid by the manufacturer is a total loss because the CENVAT chain is broken.

It is requested that the provision of availment of exemption being optional should be restored.

5.3.3. Excise Duty Rationalization and Simplification on Cement

Excise duty on Cement is levied @12.5% + Rs. 125/-per MT. Duty rates on cement are one of the highest. Other core industries such as coal and steel attract duty at around 6%. Cement is one of the core infrastructure industries and it requires large-scale investments and capacity additions in view of the expected GDP growth and projected demand for cement over the medium to long term.

Further, the excise duty structure for both cement as well as cement clinker has become quite complicated in the last few years. Earlier it was at a specific rate per MT. Now, it is levied on the basis of ad valorem cum specific rates and is further also related to the declared MRP of the product.

Hence, to bring rates of duty on cement at par with other core and infrastructure industries, the Excise Duty rate should be rationalized and reduced from the current 12.5% plus specific duty to 6-8% without addition of Specific Duty. Also, the duty structure be simplified to be either on specific rate per MT or on ad valorem basis and without relating to MRP etc.

5.3.4. Exemption for Waste Water Recycle, Reuse & Zero Liquid Discharge (ZLD) Systems

By 2020 (5 years from now) it is predicted that India will be one of the most water stressed countries of the world i.e., minimum water will not be available to majority of its population and its industry and to meet its requirement, India will have to use its waste water.

Government has come out with a policy that most of the industry (a list is available) have to use either their own waste water recycled or, recycle & reuse sewage of major metros like Chennai, Mumbai, Delhi. Besides, under Clean Ganga Action Plan, the Ministry of Environment & Forests and Ministry of Water Resources along with CPCB have mandated that industries along the Ganga river must implement Zero Liquid Discharge (no water is discharged by the industries, 80 – 85% of the water is reused).

Waste water recycle and reuse and ZLD are expensive technologies that require 2 times the investment of a water treatment plant and hence the payback is very high making investment unviable. If incentives by the way of tax rebates are offered in line with similar incentives available for initiatives like Solar Power, Renewable Power by MNES, then there will be significant impetus on implementation of Waste Water Recycle, Reuse & Zero Liquid Discharge (ZLD) Systems. Excise Duty on filtering and purifying machinery under heading 8421 21 90 is applicable without any concession as well VAT/CST is leviable on sale of such systems.

It is requested that no taxes and duties should be imposed on manufacture and sale of waste water recycle & reuse systems including ZLD systems at least for the next 5 years. 100% Depreciation should be allowed in the year of installation of Waste Water Recycle, Reuse & ZLD system.

5.3.5. Excise Duty on Fly Ash

Excise duty is payable on generation of fly ash, though it is not a manufactured product as has been held by the Supreme Court. This is also against the fundamental principles of levy of excise duty. However, excise duty is being charged on fly ash because of the entry at S. No. 27 of Central Excise Notification no.1/2011. Thus power generating companies which otherwise are not covered under Excise law have to make excise compliances due to generation of fly ash in thermal plants.

It is requested that fly ash should be kept out of Excise coverage.

5.3.6. Extension of Concessional Rate of Excise Duty on Capital Goods for Food Processing Industry

Vide Notification No 12/2104 C.E. dated 11th July, 2014 concessional rate of excise duty has been provided for process / packing machinery used in the manufacture of agricultural / apiary / horticultural / dairy / poultry / aquatic / marine produce and meat.

While the food processing industry welcomes the above initiative which will help reduce the capital cost, a large portion of processed food industry which deals with basic essential packaged foods for common man such as staples, biscuits and so on are deprived of the benefit of concessional rate of excise duty on process / packing machinery. Organised packaged food processing industry procures substantial process / packaging machinery and this discrimination within the same industry is inequitable.

It is recommended that concessional rate of excise duty on process / packing machinery be extended to the entire food processing industry instead of limiting the same to certain sectors within the industry.

5.3.7. Exemption for inputs for Aircrafts supplied to Government

Supply of aircrafts to Government is exempt from excise duty under notification no. 12/2012. However, there is no exemption available on inputs, which are used in the manufacture of aircrafts and aircrafts parts for supplying to Ministry of Defence for its official use. Excise duty is payable on procurement of inputs. Exemption on all goods manufactured by PSUs (including Hindustan Aeronautics Limited) for supply to Defence ministry was withdrawn with effect from June 1, 2015 vide Notification No. 39/1995-CE.

Inputs to be used for the manufacture of aircraft and aircraft parts to be supplied to Government should be exempted. All goods manufactured and supplied by Vendors/Contractors/Sub-Contractors to HAL unit, for the purpose of manufacture and supply to the Ministry of Defence for official use should be eligible for exemption subject to actual user condition.

This would enable reduction in cost of finished goods that are procured by MoD and also would encourage indigenous manufacturers and would enable them to be price competitive for supply to Defence PSUs which will result in foreign exchange savings and also import substitution to the country.

5.3.8. Increase in Excise Exemption Limit for Biscuits from Rs. 100/Kg to Rs. 125/Kg

At present lower priced-biscuits (i.e. biscuits sold at a MRP equal to or less than Rs. 100/Kg) enjoy an exemption from central excise duty. The exemption was granted in the Year 2007 taking into consideration that lower priced biscuits are a healthy, hygienic, safe and nutritious staple intended for mass consumption by the lower income strata of the society.

Since 2007 the cost of raw materials used in the manufacture of biscuits (primarily wheat flour, oil and sugar) has increased exponentially – having more than doubled, along with sharp increase in labour, transportation and energy costs. Under the circumstances the exemption limit of Rs. 100/Kg that was provided for biscuits meant for mass consumption is proving to be inadequate.

It is recommended that the exemption limit be increased from Rs. 100/Kg to Rs. 125/Kg such that the popular variants of biscuits remain within the reach of the common man.

5.3.9. Incentives for Manufacture of Compressors with Non-ODS Technology

Notification No 12/2012 CE dated 17/3/2012 allows for exemption from payment of Excise Duty on Capital Goods required for –

(i) Substitution of Ozone depleting Substances

(ii) Setting up New Capacities for Non –ODS Technologies

It is requested that this exemption be extended to include Raw Materials/Consumables, R&D Equipment, Testing and Calibration equipment.

CENTRAL EXCISE - PROCEDURES AND OTHER ISSUES

5.3.10. Excise Duty on Sales Tax/VAT Benefit given by State Governments

Excise duty is payable on transaction value of sale of goods i.e. price charged by seller from buyer. Sales tax and other taxes are to be deducted from above Transaction Value if such tax is actually paid/ payable on such goods.

As a measure to promote specified areas and industries, various State Governments grant benefits to industries which are linked to the sales tax payable by these industries. Such benefits could be by way of:-

(i) Exemption from payment of sales tax for a particular period.

(ii) Deferment of payment of sales tax for a particular period.

(iii) Grant of incentive equivalent to sales tax payable by the units.

The Central Board of Excise and Customs examined the issue of exclusion of these amounts for computation of the value of goods on which excise duty is paid and addressed the same in Board Circular No.378/11/98-CX dated 12.03.1998. The Board in its said circular stated that only in situation (i) above, the sales tax is not deductible as no sales tax is payable by the assessee in accordance with the law. However for situation (ii) and (iii) above, the Board clarified that the amount of sales tax is deductible for the determination of assessable value of goods for levy of Excise Duty.

The said circular of 12.03.1998 is still applicable even after amendment to Section 4 of the Central Excise Act with effect from 01.07.2000. This is evident from Circular No.679/70/2002-CX dated 04.12.2002 wherein the earlier Board Circular of 12.03.1998 was referred and it was clarified that where deferment of payment of sales tax for a particular period is allowed by the State Government as an incentive, interest on money retained by the assessee for that period cannot be considered as an “additional consideration” for levy of excise duty.

It is also important to note that CBEC issued a Circular No. 671/62/2002-CX dated 09.10.2002 which correctly laid down the principle that only that amount of sales tax will be permissible as deduction under section 4 as is equal to the amount legally permissible under the local sales tax laws to be charged/billed from the customer/buyer. Thus where the local sales tax law entitles the seller to charge a particular amount as sales tax from its buyers, then the same must be allowed as a deduction from the transaction value even if later on the State Government, to incentivize the manufacturer, allows him to retain a part of the sales tax collected by him as a subsidy.

On a broader perspective also, schemes of grant of incentive by the State Governments by way of retention of part or whole of sales tax collected are only methods for extending the benefits as they can be easily managed and accounted for. Alternatively, the State Governments could have collected the entire sales tax amount and thereafter, given back by issuing cheque for the whole or part of it to the same industries as subsidies, grants, etc. However such a methodology can be cumbersome for both the Government as well as the industries.

Likewise, some State Governments also grant incentive by way of deferment of sales tax for a particular period or allow the assessee to pay a part of the sales tax amount upfront in lieu of deferment of sales tax to be paid after a particular period. There can be a situation where the assessee collects the sales tax from the buyers of its goods but deposits the entire amount to the State Government after a particular period, say 5 years. In such a situation, the Board vide its circular dated 04.12.2002 has already clarified that interest on money retained by the assessee for that period cannot be considered as an "additional consideration" for levy of excise duty. On the other hand, some states like State of Haryana, allow the assesse to pay 50% of the sales tax amount upfront in lieu of deferment of sales tax. Thus in essence the State Government allows the upfront payment of 50% of tax amount in lieu of payment of 100% tax after say 5 years. Thus, it is also in nature of interest which has been held by the CBEC to be not includible in the assessable value for excise duty payment.

Hon'ble Supreme Court in the case of Super Syntex (India) Ltd. has held that under the present provisions of Section 4 of the Central Excise Act which came into effect from 01.07.2000, a part of the sales tax amount collected and retained by the manufacturer, as allowed under an incentive scheme launched by the State Government, should be added to the assessable value of the product for the payment of excise duty.

A similar judgment has also been subsequently delivered by the Hon'ble Supreme Court in case of CCE v Maruti Suzuki India Limited (Civil appeal No.5183 of 2004)

Thus, till the pronouncement of the above judgments by Hon'ble Supreme Court, the understanding prevailing in the government as clarified by way of CBEC circulars & industry was that a part of the sales tax amount collected and retained by the manufacturer, as allowed under an incentive scheme launched by the State Government, by way of deferment or otherwise, should not be added to the assessable value of the product for the payment of excise duty.

Various manufacturers across the country and operating in different business segments are facing serious problems in light of this judgment of the Hon'ble Supreme Court in as much as the excise department is asking them to pay excise duty and interest on the sales tax incentive amounts granted to them by various State Governments.

It is suggested that suitable legislative amendments be made to solve problem relating to State Government incentives. Substance of amendment can be following:-

The amount of sales tax collected and retained by the manufacturer, as allowed under an incentive scheme launched by the State Government, shall be considered as equivalent to sales tax actually paid under the excise law and thus shall not be added to the assessable value of goods for excise duty calculation.

5.3.11. Interest on differential Excise Duty paid due to price increase after removal of Goods

The Supreme Court in CCE Vs. SKF India Ltd. (2009 (239) ELT 385), has held that the interest is leviable on differential duty payable because of revision of prices subsequent to removal of goods.

Demand of interest is not justified as at the time of removal there was no short payment or non-payment and differential duty was not determined by the CE Department but the same was paid by the manufacturers on their own. Therefore, keeping in view the aforesaid practice of industry, it would affect the manufacturers if there is a levy of interest on the duty payable on the supplementary invoices raised due to revision of price subsequent to the removal of goods. Further, the aforesaid interest so paid on supplementary invoice will not be eligible for CENVAT Credit and hence would add the cost of the product.

It is suggested that an explanation to Section 11 AB of the Central Excise Act 1944 may be added to the effect that no interest would be payable on account of differential duty paid because of any price revision subsequent to the removal of goods.

5.3.12. Credit of Duty on Goods Brought to the Manufacturer's Depot/Stockyard

As per Rule 16 of Central Excise Rules, 2002, where any goods on which duty had been paid at the time of removal thereof are brought to any factory for being re-made, refined, re-conditioned or for any other reason, the assessee shall be entitled to take CENVAT credit of the duty paid as if such goods are received as inputs under the CENVAT Credit Rules, 2002 and utilise this credit according to the said rules.

As per the above provision a manufacturer can take CENVAT credit of the goods only in case the goods are brought back to the factory. However, there is no provision for bringing back such goods to the depot/stockyard of the manufacturer. A large manufacturing unit operates through number of depots/stockyards situated across the country. Bringing back goods to the factory results in increased expenditure on account of freight cost, if the factory is situated at a long distance from the customer's place.

It is suggested that the existing rule should be suitably amended so that goods can also be brought back to the depot/ stockyard of the manufacturer in such situations.

5.3.13. Issue of Excise Invoices by Exchange Accredited Warehouses

Under the Exchange trading system, the commodities deposited into the warehouse may change hands many times before actual physical delivery of goods. Due to multiple changes of ownership, the ultimate buyer may not receive the goods from the first stage dealer or the second stage dealer, even when there is no physical movement of goods. This disentitles the ultimate buyer from availing CENVAT credit of CENVAT duty already paid. This problem discourages delivery of commodities such as base metals on exchanges.

It is recommended that Cenvat credit should be allowed for the first removal of excisable goods from exchange designated warehouse after initial deposition in the same warehouse. Exchange accredited warehouses may be permitted to issue excise invoices to buyers obtaining physical delivery of goods, against which CENVAT credit may be allowed. The need to issue excise invoices for trades of commodity exchanges may be waived. The above procedure will not result in any loss of revenue since the goods will be under the physical control of the accredited warehouse and will be delivered by the warehouse only after issue of excise invoices to the buyers taking delivery.

5.3.14. Warehousing provision for the Steel Industry

In the steel business, it is a practice that most of the materials are sold from stockyards/depots which are situated across the country and there is a time lag between dispatch of material from the manufacturing plant and sale from the stockyard/depot. As such, there is possibility of a difference in the price prevailing at the time of despatch of materials from the plant and the price prevailing at the time of final sale of material from the stockyard.

As per Rule 20 of Central Excise Rules 2002, the Central Government may by notification, extend the facility of removal of any excisable goods from the factory of production to a warehouse, or from one warehouse to another warehouse without payment of duty subject to such conditions, including penalty and interest etc. At present this benefit is available to benzene, toluene etc. Steel industries should also be allowed this facility under Rule 20 of Central Excise Rules 2002. This will simplify the existing procedure, as, excise duty will be paid on final selling price from stockyard. This will ensure correct payment of duty and the procedure will be simpler compared to existing practice of paying duty on normal transaction value which may differ from final price. Such change will eliminate disputes relating to valuation at the time of dispatch from plant while, at the same time, achieving the purpose of levy of duty on final selling price.

5.3.15. Printing of Digital Signature on the Invoice

Computerization and communication technology has developed manifold and many industries have implemented the best available ERP Software like SAP after making huge investments. In large sector industries thousands of the invoices are generated on daily basis and signing each page of the invoices manually consumes lot of time and effort.

CBEC vide notification no 8/2015-Central Excise (N.T.), dated March 1, 2015 inserted rule 11(8) of Central Excise Rule 2002 which is as under:

> *"An invoice issued under this rule by a manufacturer may be authenticated by means of a digital signature:*
>
> *Provided that where the duplicate copy of the invoice meant for transporter is digitally signed, a hard copy of the duplicate copy of the invoice meant for transporter and by the manufacturer shall be used for transport of goods."*

CBEC vide the above notification has allowed authentication of invoice by means of digital signature. However, the duplicate copy of invoice should be self-attested by the manufacturer. The notification has put a condition of self-attestation of the duplicate for transporter copy which is not serving the purpose as in this process, once the invoices will have to be digitally signed and then self-attestation is also required to be done on duplicate copy. An assessee will have to spend some amount of time and resources as is being done today.

It is requested that requirement of self-attestation of duplicate copy should be dispensed with at least for the large tax payers.

5.3.16. Appropriation under Section 11

Presently department officers sanction refund orders and adjust the same unilaterally against demands which are not confirmed through Adjudication orders. This is incorrect and such adjustment can be made only if the demands are confirmed and after the expiry of the period for filing appeal/stay application.

Even though this issue has been clearly clarified by CBEC in Chapter 18 of the Manual, it is felt that the Section 11 should be amended to clearly state that only confirmed demands can be appropriated against the sanctioned refunds.

CUSTOMS - EXEMPTIONS

5.4.1. Import of Specified Goods for Petroleum operations – Simplification of conditions of Import

ONGC, a National Oil Company is having 401 Blocks allotted on nomination basis and 86 Blocks allotted under New Exploration and Licensing Policy (NELP) for exploration and production of hydrocarbons in addition to few Pre-NELP Blocks. Normally, ONGC charter hires Drilling Rigs, Offshore Vessel or other capital equipment for Petroleum operation in both nominated as well as NELP blocks on long term contract of 3 to 5 years.

Notification No. 12/2012-Cus dated 17/3/2012 provides customs duty exemption to specified goods for petroleum operations under entries 356, 358 and 359 as follows:-

(i) Vide S. No. 356 of notification No. 12/2012-Cus, dated 17/3/2012, the exemption from customs duty is available on import of specified goods (List 13 annexed with notification) in connection with petroleum operations undertaken under Mining Lease issued/renewed after 01.04.1999 and granted by the Government of India or any State Government to the Oil and Natural Gas Corporation or Oil India Limited on nomination basis, subject submission of certificate from DGH and other conditions prescribed.

(ii) Vide S. No. 358 of notification No. 12/2012-Cus, dated 17/3/2012, the exemption from customs duty is available on import of specified goods (List 13 annexed with notification) in connection with petroleum operations undertaken under specified contracts subject to submission of certificate from DGH and other conditions prescribed.

(iii) Vide S. No. 359 of notification No. 12/2012-Cus, dated 17/3/2012, the specified goods (List 13 annexed with notification) required in connection with petroleum explorations undertaken under specified contracts under the New Exploration Licensing Policy are exempt from basic customs duty as well as CVD, subject submission of certificate from DGH and other conditions prescribed.

The objective of exemption granted under Sl. Nos. 356, 358 or 359 of Notification 12/2012-Cus is to exempt the import of specified goods in connection with petroleum operations from customs duty. Whether the goods are essential for such use is certified by the DGH. The conditions prescribed under these three entries are similar. The List of specified goods allowed to be imported is similar for Sl. Nos. 356, 358 and 359. Conditions Nos. 41, 43 & 44 under Sl. Nos. 356, 358 & 359 respectively are also similar.

It is recommended that all these three Sl. Nos. 356, 358 & 359 should be merged into one so that once the conditions are all fulfilled for availing of exemption at the time of import, the specified goods can move for petroleum operation from eligible Nominated Blocks to a NELP/Pre NELP oil field or vice-versa without the requirement of obtaining certificate subject to the condition that there is no change in Licensee/Contractor or sub-contractor or both. This will obviate the delay in movement of highly costly equipment, substantial saving in cost by effective utilization of Drilling Rigs/ equipment, and also saving in compliance cost.

In case if there is change in Licensee/Contractor or sub-contractor or both, the condition of Notification No 28/2013-cus dated 16/05/2013 would be required to be fulfilled.

5.4.2. Exemption from payment of Custom Duty on import of Liquefied Natural Gas (LNG)

LNG is a clean fuel and mainly used in fertilizer and power sector. Recognizing the shortage of Gas, Government has encouraged import of LNG. Since LNG falls in the same logical category as Crude Oil, these must have the same treatment for purposes of taxation as applied to Crude Oil.

Since custom duty on crude oil has already been made zero, import of LNG presently attracting 5% Custom duty should also be exempt. Through Finance Act 2012, Govt. has exempted levy of Custom duty on import of LNG for Power Sector. However, this exemption should be extended to other sectors also.

It is recommended that exemption from payment of Custom Duty on import of Liquefied Natural Gas (LNG) may be granted for domestic use.

5.4.3. Reduction of Custom Duty on Safflower seeds to avoid Inverted Duty Structure

India has been importing Safflower seeds and Safflower Oil from Australia since 2003. At the moment import duty on Crude Safflower Oil (HS Code 15121120) is 12.5% vide Customs Notification Number 46/2015 Date 17th Sep, 2015 and 30% of Safflower Seeds (HS Code 1207990). Due to the prohibitive nature of duty structure in importing oilseeds, bulk of the imports has been in oil form. We believe that a favourable duty structure for importing oilseeds will help domestic industry, producers as well as consumers for the following reasons, namely:-

(a) Increase in domestic crushing leading to better capacity utilization in domestic manufacturing industry

(b) Localization of crushing activity will result in availability of Safflower De-Oiled Cake. Safflower DOC is a rich source of protein and other nutrients and is widely used for cattle feed. Indian crushers can readily export the feed to international buyers (Middle East)

(c) Currently, all Safflower grown in India is of Linoleic variety. Due to the absence of domestic oleic cultivation, the industry needs to import the oleic variety from Australia and other countries. Therefore, even if zero duty imports are allowed, the imports will not substitute the domestic production as the two are not interchangeable. Hence, it will reduce the cost of healthy Safflower edible oil to the consumers without adversely affecting the Indian producers.

(d) Globally all the major consumers of edible oil have a duty structure favouring import of oilseeds over imports of oil. This is done in order to make the local crushing industry viable and also to replace imports of De-Oiled cakes with domestic production.

Correcting this inverted nature of imported duties in India will go a long way in benefitting industry and consumers alike.

5.4.4. Reduction of Custom Duty on Oat Flakes

With lifestyle diseases like diabetes (almost 6.2 million people are affected) and heart diseases (2.4 million Indians die from cardiac diseases every year) on the rise, it is imperative to promote healthy food in India.

Oats is considered to be the "super" grain due to its multiple health benefits like:

(a) Fights cholesterol

(b) Fibre for digestive wellbeing

(c) Great source of protein

(d) Reduces blood sugar

(e) Lowers risk for heart disease

Usage of Oats in Indian diet is very low. As per USDA data compared to usage of 15 kg per capita in Europe & 7 kg per capita in North Americas, the consumption in India is 0.01 kg per capita. Unaffordability is one of the prime reasons why the consumption in India is low. Current duty structure for Oats flakes demands a Customs duty of 30% and a Special Duty of 4% in addition to the Education Cess over this. This significantly makes the product costlier & unaffordable for a large section of the society.

In order to make this product available for larger population to avail its health benefits and to promote the eventual growth of this food item in India, we request for the removal of Import duty on oat flakes.

5.4.5. Exemption for X-ray Baggage Inspection Systems and other Airport Security Systems

Exemption from duties of Customs on all Airport Security systems including X-ray baggage inspection system and part thereof required by Airport Operator, upon certification of MoCA.

X-ray baggage inspection system and parts thereof are eligible for nil basic customs duty subject to the condition that import should be by Government or its authorized person for anti-smuggling or by CISF, Police Force, Central Reserve Police Force, National Security Guard (NSG) or Special Protection Group (SPG) for bomb detection and disposal. Import of x-ray baggage inspection system at Airports is for security purpose and security is sovereign function (Reserved Activity) as per State Support Agreement (SSA) with Ministry of Civil Aviation (MoCA) and import cost is met out of Security Component of Passenger Service Fee. However, since import is not directly undertaken by the above specified agencies but by respective Airport operators, duty concession is not available though money is being paid out of funds of Government of India. Hence, this condition needs to be amended to expand its scope to cover other security systems also and to incorporate import by respective Airport operators subject to production of an eligibility certificate from the Government (MoCA). This concession should not be limited to x-ray machines alone because there are other machines, which are used for bomb detection and disposal. Further, it should also include other goods required for Airport security. Entry for exemption should be amended to read as "X-ray baggage inspection system and other airport security systems and parts thereof" (falling under chapter 84, 90 or any other chapter). Following systems should be included in the list of eligible items:-

(a) X-ray baggage inspection system and parts thereof,

(b) Explosive detectors,

(c) Bomb/suspect luggage containment vessels/units.

(d) Robots for handling of bombs or suspected baggage,

(e) Parameter security intrusion system and accessories

(f) Access control system,

(g) Hydraulic bollards,

(h) Boom barriers

(i) Cameras for CCTV.

5.4.6. Measures to address Accumulated Credit of Special Additional Duty (SAD)

Special Additional Duty (SAD) of 4% was introduced in the Finance Bill of 2005 on goods imported into India having regard to the sales tax / value added tax and other local taxes suffered by like goods in India to create a level playing field for the domestic manufacturers.

Though, the Cenvat Credit Rules allow the manufacturer to avail credit of SAD against duty payment for the clearance of final products, it is not possible to fully utilize SAD levied on imported raw material in cases where the value addition in the conversion of raw material into finished goods is minimal. This results in accumulation of SAD credit year on year, adversely affecting the cash flow.

Stainless Steel Industry with import of approximately 55% of its Raw Material (such as SS scrap/ MS Scrap/ Nickel) coupled with minimal value addition is suffering from vast accumulation of SAD credit. Appreciating the Industry concerns, Special Additional Duty of Customs (SAD) on melting scrap of iron or steel and stainless steel scrap for the purpose of melting was reduced from 4% to 2% vide Notification No. 11/2015-Cus dated 01.03.2015.

It is suggested that to further address the concern, SAD may completely be waived on imports of SS scrap/ MS Scrap / Nickel/ Ferro chrome / Ferro Nickel / Ferro Moly by end-use manufacturers.

5.4.7. Procurement of goods by a SEZ unit from a trader

The tax/duty free procurement of goods by a SEZ ('Special Economic Zone') unit is the basic framework of the SEZ scheme to ensure that taxes are not exported and goods can be supplied at the best competitive price.

A SEZ unit fulfils its raw materials requirements by procuring goods from indigenous manufacturers, from outside India (import) and from traders. At present, while a SEZ unit can import or procure goods from the manufacturer duty-free, there are no provisions to permit procurement of goods from importer traders without payment of duty. Accordingly, this results in export of taxes which is inherently against the SEZ scheme.

An argument can be placed that instead of procuring goods from a trader on payment of duty, the SEZ unit can import the goods or procure goods directly from the manufacturer without payment of duty. However, it must be noted that tax considerations are not the only considerations for formulating the source of procurements. There are business considerations which are equally if not more important. For example, the goods requirements might not be otherwise available, logistics cost etc.

The framework of the SEZ scheme permits an exporter to procure the goods solely on business considerations without any interference of tax considerations.

Accordingly, it is of paramount importance that keeping with the spirit of SEZ scheme, necessary legal provisions should be set in place to ensure duty free procurements of goods by a SEZ unit from traders.

5.4.8. Exemption of SAD on Import of Pulp and other inputs by the Paper Industry

In the Union Budget for 2015-16, exemption of SAD on inputs to be used by various industries has been announced so as to provide relief on accumulation of CENVAT credit. Pulp and Paper Industry is a highly capital intensive industry

where input credit on capital items is substantial and on top of it, 2.4% SAD is levied on import of pulp which further accumulates CENVAT credit, resulting into blockage of working capital.

Therefore, the Government should favourably consider the exemption of SAD on import of pulp and other inputs by the Pulp & Paper Industry.

5.4.9. Custom Duties on Soy Products

Soy Protein is a high quality complete source of plant origin protein which is equal in quality to Milk, Eggs and Meat. In addition to the protein quality, Soy protein offers health benefits such as reduction of cholesterol and risk of heart diseases and certain types of cancers.

Soy protein is commercially available as Soy Protein Isolate (3504 00 91) and Soy Protein Concentrate (2106 10 00) and other products made from soy proteins such as Soya Beverage powders (2106 90 99). These are used in making a variety of processed food products such as infant formulations, bakery products, soya milk, protein bars, etc. for Health and Nutrition industry. Products such as Soya Beverage Powders have been imported into India for over a decade for use by the Nutrition & Health industry to formulate Lactose-free products for the lactose intolerant consumers. Since these products are currently not produced in India and imported at high level of duties [Soy Protein Isolate at 10%, Soy Protein Concentrate also at 10% and Soya Beverage powders at 30%] compared to other Asian countries as well as other product categories in India, the products are not reaching to wider population at affordable prices. The prevalence of very high rates of total aggregate custom duties for Soy Protein Isolates (22%), Concentrates (22%) and Beverage Powders (45%) in India is acting as hindrance to the growth of the Health and Nutrition industry.

It is recommended that the rates of duties on these products may be brought on par with rates of duty available for overall industry in general and the food industry in particular

5.4.10. Assessment of Drawings and Designs Imported for the Manufacture of Projects

While executing large projects and plants in India, the imported drawings and designs form an indispensable and integral part of the entire project. Generally, such drawings and designs relate to installation of imported as well as indigenous equipment, manufacture of indigenous equipment, undertaking civil and structural work in India, etc.

The drawings and designs are imported in printed form on paper (referred as hard copy), which are used for the aforementioned purposes. Apart from hard copy, the same drawings and designs are also imported in electronic form i.e., on Discs (referred as soft copy), which are used for future reference purpose. There is only one consideration agreed for drawings and designs.

When hard copy is imported, it is classified under Chapter Heading 4911 of Customs Tariff and the consideration for such drawings and designs gets fully and unconditionally exempt from levy of Customs Duty by virtue of Serial no. 275 of Notification No. 12/2012-Cus dated 17.3.2012. The exemption has been in existence from 1994 onwards till date.

When soft copy is imported, the customs department is classifying them under Chapter Heading 85239090 of Customs Tariff and the consideration for such drawings and designs is being subjected to levy of customs duty on the ground that there is no exemption notification for soft copy classifiable under Chapter Heading 85239090.

The above anomalous position is arising due to the fact that drawings and designs are imported in different form through two different media and the customs implication differ based on form of media.

It is considered to be good practice to structure the tariff in a tax neutral manner. In other words, the tax liability or outcome should not vary depending upon the mode of carrying out the transaction. The tax structure should be such that the consequences are same irrespective of the method adopted for undertaking any transaction. This theory and

principle has been accepted and applied by CBEC as is evident from TRU Budget Circular dated 29.2.2008, para 4.1.5 which is reproduced below:

> *"4.1.5 Software and upgrades of software are also supplied electronically, known as digital delivery. Taxation is to be neutral and should not depend on forms of delivery. Such supply of IT software electronically shall be covered within the scope of the proposed service."*

In fact, tax neutral approach is foreseen from the manner in which the Information Technology software is treated. Similar tax neutral approach needs to be given to imported drawings and designs. The soft copy should be treated at par with hard copy and hence, no customs duty should be levied on the soft copy as well.

Also, the imported drawings and designs are subjected to service tax on reverse charge basis by virtue of Section 66B read with Rule 2(1)(d)(G) on the ground that the imported drawings and designs received in the form of CD is in the nature of service. It is inequitable and illogical to treat drawings and designs as goods and services at the same time.

It is requested that a clarification / notification may be issued providing that the imported drawings and designs would not be subjected to customs duty and service tax, at the same time.

5.4.11. Reduction in Custom Duty on Food Processing Machinery & Equipment

India has a high rate of import duty on plant machinery required for food processing industry as compared to other countries in the region. The industry though being large is still in a nascent stage of development. In India only 2.2% of the total foods and vegetables produced are processed as compared to 65% in US and 23% in China. Penetration of processed food industry is low in India, 5-6% of all food items with sufficient head room to grow. Food processing is essential to avoid wastage of food, currently 40% of food and vegetables perish due to lack of processing facilities. The industry has a huge potential for employment generation. The industry is largely unorganized with relatively low levels of processing and value adds. At present customs duty on food processing machinery and their parts is very high, ranges from 22% to 28%. Therefore it is requested to exempt plant and machinery for food processing sector which will go a long way in promoting growth of the food processing industry.

5.4.12. Reduction of Customs Duty on Safety Related Auto Parts

Basic Customs duty may be reduced on the lifesaving safety related auto parts as follows:-

Seat Belts 2%

Air Bag Assembly 5%

Anti-lock braking system 5%

5.4.13. Installation Certificates from Jurisdictional Excise officer under EPCG Scheme

Para 5.3.1 of Handbook of procedures (Vol.1) of Foreign Trade policy, provides for the submission of Installation certificate from Jurisdictional Excise officer in respect of items procured under EPCG licence.

The relevant text has been produced below-

> *"Authorization holder shall produce to the concerned RA a certificate from the Jurisdictional Central Excise Authority, confirming installation of Capital Goods at factory premises of authorization holder or his supporting manufacturer(s) /vendor(s) within six months from date of completion of import."*

Customs Circular No.14 /2008 dated 26.09.2008 also provides that -

> The Authorization holder under the EPCG Scheme shall produce to the concerned Regional Authority, a certificate from the jurisdictional Central Excise Authority, confirming installation of capital goods at factory premises of Authorization holder or his supporting manufacturer(s) /vendor (s) within six months from the date of completion of imports.

In large manufacturing companies, Installation of Capital equipment requires assembling various resources and expertise and is dependent on various activities like, site clearance, civil work, structural work, availability of shutdown, safety preparation in unsafe site conditions, etc. Installation of capital equipment starts only after completion of these pre-requisite activities. Delay in any of these activities will have adverse impact on schedule of installation of capital equipment. In many cases the time taken in installation of capital goods exceeds six months. Although, there is a provision for extension of time for installation of equipment but it requires time and efforts in following the procedures related to obtaining extension of time.

In view of the situations mentioned above it is requested to extend the permissible limit for installation of capital items from 6 months to 12 months.

5.4.14. Fabrics and Garments under Customs Tariff Chapters 51, 52, 54, 55, 61 & 62

Fabrics and garments covered in above stated chapters attract different specific duties of Customs at 8 digit HS code level depending on the fibre content, gram per sq. meter (GSM) of fabric, weave type etc.

The difference in the product description under various sub–classifications cannot be determined or identified by physical inspection and requires submission of samples for chemical tests by Textile Committee. This results in inordinate delays in clearance of goods.

The structure of specific duties applicable to goods covered under the aforesaid Chapters should be harmonised and rationalised to obviate the necessity of testing. In the event some testing is found to be essential, test reports from any accredited testing laboratory should be accepted. If necessary, the sample fabric affixed on the test report can be matched with the import consignment.

5.4.15. Correction of Inverted Duty Structure on Capacitor Grade Polypropylene Granules

Customs duty on imports of “capacitor grade polypropylene granules” ITC HS Code 39021000 is 7.5%, while capacitor grade BOPP Film is attracting zero percent customs duty in view of its application in electronic sector. Thus, it is a case of inverted duty structure.

Currently “Capacitor grade Polypropylene Granules” are not produced in India. Production of capacitor grade BOPP Film requires a very special kind of polypropylene granules with very high purity, ultra-low ash content and high isotacticity.

Considering the average import price of the product at present (Rs. 350 per kg), it is estimated that the average value of the consumption over the next four years shall be in the region of US$ 50 million per year. Considering targeted market share of 75% by Indian industry and 60% costs on account of polypropylene granules, the proposal implies significant foreign exchange savings in region of US$ 15 million per annum for the country.

5.4.16. Incentives for Manufacture of Compressors with Non-ODS Technology

The duty on the R134A synthetic refrigeration oil is 7.5% as per notification number 12/2012-Customs. With a view to incentivize manufacture of Compressors with Non-ODS Technology, it is suggested that this rate of duty be further reduced to 5%.

CUSTOMS - PROCEDURES AND OTHER ISSUES

5.4.17. Refund of Customs Duties to SEZ

Presently there is no procedure for refund of excess customs duty paid by an SEZ on its domestic sales. While customs department is of the view that this should be refunded by SEZ authorities (Read Ministry of Commerce) as there is no provision in the Customs Act 1962, SEZ authorities are of the view that there is no provision to refund customs duties in SEZ Act/Rules.

Since duty is paid under the Customs code, in our view refund should also be sanctioned by customs authorities. Gujarat High court has also taken view that customs duty refund should be sanctioned by Jurisdictional Commissioner of Customs.

Hence, until a procedure in provided in the SEZ Act/Rules, Customs should sanction such refund claims.

5.4.18. Review of Special Valuation Branch (SVB) Procedures

With the opening up of the Indian economy, the number and volume of transactions of import and export between related entities has gone up substantially. The existing mechanism of examination of such transactions by the Special Valuation Branches (SVBs) in the Custom Houses is inadequate to determine the true price of the goods imported or exported. Apart from the considerable time taken to finalize the prices, there are also questions about the processes deployed for such determination. Uncertainties prevail over the time frame for assessment and passing of orders by the SVB authorities. Especially delays in renewing the SVB order even when where there is no change in fact pattern has been causing severe hardship to the companies. Since import duty has almost attained ASEAN level and many FTA's are in place, there is little scope of under invoicing / duty evasion.

Following measures may be considered by the Government for facilitating the trade:-

(a) Currently, the procedures followed by the Special Valuation Branches of the Custom Houses are codified in departmental circulars. The processes should be given a legal backing by amending the Customs Act and laying down appropriately binding rules or regulations.

(b) Statutory timelines should be prescribed for issue of orders by SVB, their acceptance by Review Cell, audit, cancellation of provisional duty bonds, refunds of deposits etc.

(c) In the event of failure to complete the processes within prescribed time limits, no further extra duty deposits should be charged and the duty deposits already paid should be refunded. 1% EDD should be waived for ACP / AEO status holders.

(d) Renewal of SVB orders should be done once in 5 years instead of every 3 years. No duty deposits should be asked for during SVB renewal process

(e) Not to insist on "unjust enrichment" condition while refunding EDD

(f) Initial burden of proof that transaction value is not at arm's length should lay on SVB instead of the assessee

An Advance Pricing Agreement (APA) Mechanism on the lines of the one recently notified by the Ministry of Finance (CBDT) under Transfer Pricing Regulations may be considered.

CENVAT CREDIT

5.5.1. Rationalisation of CENVAT Credit Scheme

Implementation of the concept of Negative List of Services has resulted in all activities undertaken by a person for another for a consideration being brought under the tax net. However, the restrictions, exceptions and limitations on availability of input tax credit still continue. This anomaly has led to an inequitable situation whereby the taxation of services is universal while the credit for the tax paid on input services continues to be restricted.

In order to correct this inequity and to provide much needed relief to industry the service tax laws in general and, specifically, the definition of input service should be amended to allow input tax credit without any restrictions – in line with the principles of GST. Further, in order to ensure that the CENVAT Credit scheme meets its objectives it is important that unnecessary qualifications/categorizations like 'input', 'input service' and 'capital goods' be done away with and all input side tax costs in relation to business activity should be allowed as credit.

5.5.2. Credit of Service Tax on Services for Goods Manufactured Through Job Workers

As per the provisions of CENVAT Credit Rules, 2004 CENVAT credit on inputs and capital goods may be availed by a manufacturer as long as such inputs / capital goods are physically received in his factory premises under cover of a valid Central Excise Invoice and are used by him in or in relation to manufacture. Credit of service tax may be availed by an assessee on payment of the same to any input service provider, as long as the input service is received in or in relation to manufacture. The credit is, thus, only available on the basis of Invoice payments.

In the case of Brand Owners who employ job-workers exclusively for manufacture of goods, the benefit of CENVAT credit on inputs is available since the job-worker can claim the CENVAT credit and offset his central excise liabilities against the said credit. However, as far as service tax is concerned, since the payments for taxable input services are generally affected by the Brand Owner instead of the job-worker, the benefit of service tax credit is not available. This is due to the fact that the Brand Owner cannot avail the credit since he is not the manufacturer and the manufacturer, i.e., the job-worker, cannot avail the credit since he does not pay for the taxable input service. Consequently, under the Rules the Brand Owner employing job-workers exclusively is discriminated vis-à-vis Brand Owners having their own manufacturing facilities, in so far as credit of service tax is concerned.

A typical example would be one where the principal manufacturer undertakes advertising and sales promotion, market research; storage up to the place of removal for the goods manufactured by it as well as by its job workers and discharges the service tax liability thereon.

The CENVAT Credit Rules also provide for an Input Service Distributor (ISD) mechanism whereby the credit of service tax can be distributed by an office of the manufacturer or producer of final products or provider of output service, which receives invoices issued under Rule 4A of the Service Tax Rules 1994 towards purchase of input services. Hence, by definition, the ISD cannot distribute credit of service tax to job-workers in case the input services are paid for by the principal, i.e., the Brand Owner.

Accordingly, the provisions of the CENVAT Credit Rules, 2004 create an inequitable situation, in that, the benefit of CENVAT credit pertaining to inputs and capital goods is available to the assessee irrespective of whether manufacture is in-house or at job worker premises whereas the benefit of service tax credit is available only if the manufacture is at the assessee's own unit. Moreover, neither the principal manufacturer nor the job worker is entitled to take credit of the service tax paid on above services whose value is included in the assessable value for payment of excise duty. This leads to a cascading effect which is against the basic principle of Cenvat. This inequity dilutes the cost competitiveness of assessees who own brands and use job workers exclusively for manufacture of goods - more so since, the scope of the service tax has been expanded following the introduction of 'negative list' based approach to Service Tax.

It is recommended that the CENVAT Credit Rules be amended to provide a mechanism that enables availment and distribution of credit of service tax by brand owners to job-workers. This will ensure cost competitiveness of the brand owners and protect the long-term interests of job-workers.

5.5.3. Eligibility to avail CENVAT Credit on Capital Goods in the Year of Receipt

In terms of Rule 4(2) of the CENVAT Credit Rules, 2004 the credit of CENVAT in respect of capital goods has to be distributed over two years. In the year in which the capital goods are received in the factory credit equivalent to 50% of CENVAT can be availed. The balance 50% can be availed only during the next financial year. As a result of this a lot of time and effort is expended in tracking each item of capital goods in terms of year of entry, amount of credit available in each year, etc. Apart from the cost involved in such tracking, this also leads to errors and, consequently, long-drawn disputes/litigation with the Department.

It is recommended that the CENVAT Credit Rules, 2004 be amended appropriately to enable credit of full CENVAT in respect of capital goods in the year of receipt in to the factory. This would be in line with the provisions on CENVAT credit in respect of inputs.

5.5.4. Removal of Restrictions in Availment of Cenvat Credit on Services related to Civil Construction

The definition of 'input service' places restrictions on availment of cenvat credit on certain services which inter-alia include services related to civil construction, services related to motor vehicles i.e. cab services, services which are used for consumption of any employee. Presently Cenvat is not available on laying of foundation or building up capital structures. Thus duty paid on steel, cement, iron, plates used for civil structure are not cenvatable.

In so far as civil construction related services are concerned many a times construction of a property is essential for provision of output services i.e. without construction of property the manufacturer or service provider cannot undertake its activities. For instance, without construction of factory building, the manufacturer cannot manufacture the goods, without construction of office complex or shopping mall, the service provider would not be able to provide renting services, without construction of a tower the telecom service provider cannot provide telecom services and without the construction of pipeline a service provider cannot provide services of transportation of goods through pipeline. Hence, in cases where the construction services form integral part of provision of services, credit should not be denied to the manufacturer or service provider.

It is recommended that necessary amendment should be made in the definition of "input service" to allow credit when the civil works are used for manufacture of excisable goods or for provision of taxable services. The credit should be denied only in cases where the immovable property is used for sale or for non-taxable purposes.

5.5.5. Interest under Amended Rule 14 of Cenvat Credit Rules 2004

As per the amended Rule 14 effective from 01.03.2015, a provision has been made for deemed utilization of Cenvat credit as extracted below:

For the purposes of sub-rule (1), all credits taken during a month shall be deemed to have been taken on the last day of the month and the utilization thereof shall be deemed to have occurred in the following manner, namely: -

(i) the opening balance of the month has been utilized first;

(ii) credit admissible in terms of these rules taken during the month has been utilized next;

(iii) credit inadmissible in terms of these rules taken during the month has been utilized thereafter.

The net effect of this rule will be that, if any ineligible / debatable credit is taken, it will be exempt from interest only for one month. In the subsequent month, the previous month's closing balance will become, opening balance of the subsequent month and under the deeming provision, the opening balance, which includes ineligible credit taken in the previous month, will be deemed to be utilized first.

In other words, the relief provided in Budget 2012 by amending Rule 14 by replacing the phrase "taken or utilized" by "taken and utilized" has been taken away. This coupled with the restriction of availing Cenvat credit within one year from the date of document, issued under Rule 9 of CCR, 2004 puts the assesse in a very difficult situation as the disputed matters take several years to get resolved.

It is suggested that the deeming provision for utilization of Cenvat Credit in Rule 14 may be deleted, so that the assesse can avail the credit but keep the credit unutilized by maintaining closing balance which is higher than the amount in dispute. The unutilized Cenvat credit can simply be reversed if the matter goes against the assesse, without being burdened with any interest.

5.5.6. Denial of Cenvat Credit for Movement of Goods from one Factory of LTU to another

In terms of Rule 12A of Cenvat Credit Rules, 2004, a large tax payer can transfer cenvat credit available with one of his registered manufacturing premises to his other manufacturing premises so as to effectively utilize the credit while discharging duty on the final product. This is one of the major benefits provided to manufacturers having multi manufacturing locations and being part of LTU.

By amendment to Rule 12(4) of Cenvat Credit Rules, 2004, vide notification No.21/2014 CE (N.T), the Government has taken away this benefit. Such an action is retrograde and against the commitment of the Government to have a stable and predictable tax regime. The concept of LTU is to treat the assessee as a "single manufacturer" and the amendment violates this concept.

Considering the fact that the manufacturers are already facing financial hardship, the amendment to Rule 12(4) looks to be draconian and the Government need to re-think and restore the transfer of cenvat credit from one manufacturing location to other who form part of Large Tax Payers unit.

5.5.7. Eligible Document for availing CENVAT Credit in respect of Regulated Entities (e.g. banks)

In the case of services involving multiple banks, the regulators decide the settlement agency. Considering the number of transactions, the service provider does not issue any bill as the cost of issuing such invoices, processing the same and storage of the same involves huge cost and time. Considering that such agencies are regulated entities, the law should carve out exception on the lines of first proviso to Rule 4A of the Service Tax Rules, whereby the invoice etc. is not required when credit is taken in respect of payment made on the basis of advice/statement issued by these settlement agencies.

5.5.8. Allowing payment of Service Tax on import of services through Cenvat credit

Sec 66B read with Sec 68 (2) of the Finance Act, 1994 requires the service recipient in India to pay service tax on services received from overseas supplier. As per Rule 3(4) of the Cenvat Credit Rules, 2004, Cenvat credit available with the service recipient cannot be utilized for payment of service tax on import of services. The service recipient is required to discharge this liability in cash. Service exporters are not able to utilize the available Cenvat credit to discharge the liability on import of services. The additional requirement of payment of cash to discharge such tax liability on "reverse charge" basis inflates the pool of unutilized Cenvat credit already available with the exporter. Such payment of tax in cash impacts the working capital requirements of the exporters. The issue gets further aggravated in the absence of efficient and effective mechanism for refund of tax.

Since the payment of reverse charge is neutral to the Revenue, it is recommended that the reverse charge liability for exporter of services be allowed to be paid through Cenvat with appropriate mechanism for re-credit the same under Cenvat Credit Rules 2004.

5.5.9. Allowing Cenvat credit based on Supplementary Invoice

As per rule 9 (1) (bb) of the Cenvat Credit Rules, 2004, supplementary invoice issued by the service provider to recover service tax which is recoverable from him on account of non-levy or non-payment or short payment of appropriate service tax, is not a valid invoice / document to claim Cenvat credit of service tax. For the default of the service provider, the service receiver is burdened with additional cost who is contractually bound to pay service tax.

It is recommended that Rule 9(1) (bb) should be amended to allow Cenvat credit on all supplementary tax invoices. Delay in collection of taxes by the service provider should not result in the service receiver being ineligible to take Cenvat credit.

5.5.10. Utilization of Education Cess & Secondary Higher Education Cess

Levy of Education Cess and Secondary & Higher Education Cess has been removed / subsumed with effect from 1st March, 2015.

As per Rule 3(7)(b) of the CENVAT Credit Rules, 2004, CENVAT Credit of Education Cess and Secondary Education Cess can be utilized respectively for payment of Education Cess/Secondary Education Cess only. Credit of Education Cess and Secondary and Higher Education Cess paid on inputs or capital goods received in the factory of manufacture of final product on or after the 1st day of March, 2015 can be utilized for payment of the duty of excise. Similarly, the credit of Education Cess and Secondary and Higher Education Cess paid on input services received by the manufacturer of final product on or after the 1st day of March, 2015 can be utilized for payment of the duty of excise.

However, there are many cases where the material and services are received in the factory before 1st March 2015 but the credit has been availed after 1st March 2015. This aspect has not been considered in the notification and hence it is not clear as to whether the cenvat credit on Education Cess and Secondary & Higher Education Cess availed on the inputs, capital goods and input services received before 1st March 2015 can be utilized for payment of excise duty after 1st March 2015.

It is suggested that CBEC should issue a clarification and allow the utilization of cenvat credit on Education Cess and Secondary & Higher Education Cess availed on material and services received before 1st March 2015 for payment of Central Excise duty and accordingly Cenvat Credit Rules should be amended.

5.5.11. Obligation of a Manufacturer in case of Clearance of By-product/Waste/Refuse

As per Rule 6 of Cenvat Credit Rules, 2004, Cenvat Credit shall not be allowed on such quantity of inputs which are used in relation to the manufacture of exempted goods. In many manufacturing processes unintended emergence of by-products takes place. As per the recent decision of Hon'ble Supreme Court in the matter of M/s Hindustan Zinc Ltd vs Union of India (2014-TIOL-55-SC-CX), provision of Rule 6 of Cenvat Credit Rules is not applicable in the case of by-products.

It is suggested that a clarification in this regard should be issued to avoid unnecessary dispute.

5.5.12. Cenvat Credit on Inputs and Capital goods installed outside factory for Specified Purposes

As per Rule 2(a)(A)(1) of the Cenvat Credit Rules, 2004, CENVAT in respect of Capital Goods can be availed, when it is used in the factory of manufacturer of the final products. Further, Rule 2(a)(A)(1a) also extends the eligibility of CENVAT on the Capital Goods used outside the factory of manufacturer of the final products, when the same is used for generation of electricity for captive use within the factory. Similarly, as per the Rule 2(k)(i) of the Cenvat Credit Rules ,2004 , cenvat credit of "input" is available on the goods used in the factory of manufacturer .

A large manufacturing unit is required to undertake installation of certain Capital goods / Inputs outside the factory without which it is not possible to carry out the manufacturing process. For example railway tracks are laid outside the factory which is interconnected with Indian Railways network for bringing raw materials inside the factory. Similar is the case of pumping stations, water pipelines, etc. installed outside factory which helps in continuous supply of water to the plant which is required in manufacturing process.

Suitable amendment may please be made in this regard so that credit can be availed for Capital Goods / Inputs which are installed outside the factory premises for supplying essential raw material / utilities to the plant for enabling manufacturing.

5.5.13. CENVAT credit of Service Tax paid on Cab Services

As regards CENVAT credit of service tax paid on Rent-a-Cab service, currently the definition of 'input services' excludes 'rent a cab' service from the main part of the definition. Transportation is a key cost element for IT/ITES companies.

It constitutes about 4-5% of total cost. Provision of transportation is not just for the comfort of the employees but to ensure safety, security and on time arrival of its employees. Just as freight on raw materials is a critical manufacturing cost, cost incurred on transportation of employees is a critical cost of providing services by the IT/ITES Companies. Therefore, expenditure on rent-a-cab service etc. in case of IT/ITES Companies is a genuine business expenditure used in manufacture/ output service and the credit of the same should thus be available.

CENTRAL SALES TAX

5.6.1. Rate of Central Sales Tax

Central Sales Tax (CST) rate of 2 per cent has continued to remain the same since 2008, though the rate was expected to be reduced to 1 per cent with effect from 1st April, 2009 and to Nil from 1.4.2010 on implementation of Goods and Services Tax. In view of the fact that there is uncertainty on the introduction of GST in the near future, it is imperative that concessional rate of CST be reduced from 2% to 1% as committed earlier.

It is suggested that the CST rate be reduced to 1%.

5.6.2. Other changes in CST laws

Central Sales Tax laws be amended -

(i) such that job-workers receiving materials by way of inter-State stock transfer from their Principals are permitted to issue Form F to the Principals.

(ii) so as to permit the dealers to submit the Statutory Declarations or Certificates at any time before the Assessment Order for the relevant period is passed.

(iii) to allow purchase of all goods by a dealer in the course of inter-state trade, at a concessional rate, so long as such goods are used in the factory by the manufacturer of final products.

(iv) to allow purchase of all goods by a dealer in the course of inter-state trade, at a concessional rate, so long as the same is used in connection with marketing and distribution related activities.

5.6.3. Amendment of CST Act - Issue of "C" Forms for activity of "Transmission of Electricity"

The provision of Section 8(3)(b) of Central Sales Tax Act, 1956 provided that the benefit of concessional rate of CST for purchase of goods is available to a registered dealer who is in the generation or distribution of electricity or any other form of power. The inclusion of the words "generation or distribution of electricity or any other form of power" was made vide CST II Amendment 1958, which came into force from 1.10.1958.

The Electricity Act was enacted in 1910 before the Central Sales Tax Act, when the Transmission business was the part of the Generation and Distribution business. Due to the privatization and unbundling of power sector, the activities of "generation", "transmission" and "distribution" of electricity were segregated in the year 1992. However no corresponding amendment was made in the CST Act.

Since the word "transmission" is not appearing in section 8(3)(b) of the CST, some of the states (namely Utter Pradesh) are denying the benefit of registration and concessional forms to interstate transmission companies.

The objects and reason for including electricity sector in section 8(3)(b) of the CST Act indicate the intention of the legislature to allow the sector to be benefitted with the purchase of goods at concessional rate of tax and there by pass on the benefit to the consumers. Without inclusion of the word "Transmission", the states are interpreting the provisions differently leading to disputed tax demands and litigation.

Transmission being integral part of the electricity business, the word "Transmission" is to be added in section 8(3)(b) of the CST Act so that there is no legal issue about entitlement to registration and availment of concessional CST rate by transmission utilities under the Central Sales Tax Act.

5.6.4. Concurrent demand of CST from Origin State and local VAT from the Destination State

The provisions of section 9 deal with the levy and collection of tax and penalties under the Central Sales Tax Act, 1956. It explicitly states that tax shall be collected by the state from which the movement of goods commences. However, due to revenue collection pressures and lack of awareness, the VAT authorities of states to which the goods are consigned also demand VAT with respect to sales made to the consumers in their respective states. In other words, there is a double claim of tax -from the origin state from which the movement of the goods occasioned and the destination state where the consumers are located.

The current appeal and fast track dispute resolution mechanism provided u/s 18A of CST Act, 1956 prescribe that if a dealer receives a tax demand u/s 6A(2) or (3) from a state on stock transfer of goods and on whose sales he has already paid tax in another state , he can directly appeal to VAT tribunal of the origin state. However, no such appeal procedure has been prescribed for a vice-versa situation i.e. where the Central Sales Tax has already been paid in one state on inter-state sales of goods and where the other state also demands VAT on the same, alleging the same to be local sales in its state. In most of the states, a tax payer is even compelled to make a substantial pre-deposit to even file an appeal before the first appellate authority. Further, in an eventuality of such inter-state transaction being held as local sale, there is no recourse to claiming refund of CST paid to the Origin state; or for the settlement of the tax paid amongst the States.

In wake of the above, it is recommended that expeditious appellate mechanism prescribed under section 18A of the CST Act, be extended to disputes entailing whether transaction qualifies to be inter-state sale under section 3 of the CST Act, involving two States seeking to tax the same transaction (i.e., the origin State seeking to tax the transaction as an interstate sale and the destination State seeking to treat the transaction as a local sale).

5.6.5. Scope of the Authority for Advance Rulings

It is requested that Advance Ruling Authority constituted under the CST Act may be empowered to issue clarification in respect of the following amongst others:

- CST liability on transactions entailing interstate movement of goods
- CST liability on transaction in the course of export or import

This mechanism should aid in reducing litigation and in providing certainty of tax position to dealers.

5.6.6. Levy of CST on Sale from SEZ units to DTA units

While under the SEZ Act, such sales are treated as an import transaction for the purpose of levy of Customs duties, such transactions are not treated as sale in the course of import for the purposes of CST Act. If such sales are treated as "Sale in the course of import under Section 5(2) of the Central Sales tax Act, 1956", they are exempt from levy of CST. In that event, Special additional duty (SAD) of 4% is leviable on such transactions. Presently when such goods are cleared into domestic tariff area, there is an exemption from SAD but CST is payable. CST is a cost to the buyers and no credit is available. However, SAD is cenvatable and hence the buyers who are manufacturers or dealers in excise, get the credit back.

The SEZ Act allows units in the zones to sell as much as they want to in DTA provided their overall foreign exchange earnings is more than the foreign exchange spent by them. However, payment of CST on domestic inter-state sales makes the products costly and thereby uncompetitive in the markets.

Hence, in order to encourage more domestic sales and also to ensure that the cost of the finished products is reduced, it is requested that such sales from SEZ units to DTA units should be treated as sale in the course of import and exempt from levy of CST.

5.6.7. Enable SEZs to issue Form I to Subcontractors

Under SEZ Act and Rules, SEZ units/Developers and also the contractors and subcontractors appointed by the SEZ Units/ Developers are entitled for CST exemption on interstate procurement of goods used for setting up and for authorized operations, on furnishing duly signed Form I.

However, under the CST Act there is no enabling provision or rule which provides for issuance of Form I to the vendors of contractor or subcontractor appointed by the SEZ units/Developer. This results in additional cost to the SEZ unit to the extent of CST charged by the suppliers to sub-contractor. This defeats the very intention of providing fiscal benefits to SEZ units/developers under the SEZ Act.

It is recommended to make suitable amendment to the CST Act to enable SEZ units to issue Form I directly to the vendor/manufacturer/importer of the goods even though the purchaser is the contractor or sub-contractor, as long as contractor/subcontractor also gives a declaration that such goods are received by the SEZ units/developer for its authorized operation or for use in setting up of SEZ. A copy of the Form I issued to the manufacturer can be given to the sub-contractor for him to claim the exemption as well.

Alternatively, the bill-to-ship-to model being freely used in the commercial field, it is suggested that Form I (to be issued by the SEZ entity) be amended to reflect both the supplying vendor's name as well as the contractor's name, so that the entire leg of the inter-state transaction is exempt from levy of CST and the true intent of the SEZ regime is achieved.

5.6.8. Central Sales Tax exemption for STP/EOU/EHTP

Currently, units located in a SEZ do not have to pay Central Sales Tax (CST), in lieu of issuance of Form I. The rationale of exempting SEZ from the levy of CST is not to export taxes and make Indian exports globally competitive. However, this facility is available to a unit located in SEZ only, and not to STP/EOU/EHTP. Therefore, STPs/EOUs/EHTPs have to procure goods by paying CST, and then apply for a refund of the CST so paid. This adds to the administrative cost on the part of the revenue and to the working capital requirements on the side of the STP/EOU/EHTP.

There is no rationale for not extending the 0% CST rate facility to EOU/STP/EHTP exporters on the lines similar to that of SEZ units especially since mechanism for reimbursement of CST tax to STP/EHTPs is available. From the viewpoint of administrative ease, 0% CST rate mechanism works more efficiently than the mechanism for reimbursement.

Similar to the CST exemption provided to SEZ units, STP/EOU/EHTP units should also be allowed to avail CST exemption against Form I on interstate purchases made.

5.6.9. Loss of Tax Cost In Cases of Sales Returns

As per Section 8A of the Central Sales Tax Act, 1956, the sale price of goods returned to the dealer by the purchaser of goods shall be deducted from the aggregate of the sale prices, provided inter-alia that the goods are returned within a period of six months from the date of delivery of goods. Additionally, as per the same Section 8A, deduction can be made from the turnover of dealer the value of sales returns within a period of six months only from date of delivery.

In India the apparel industry operates on a "two seasons" basis – winter and summer. The summer season is, in fact, a long season and closure of the season within six months is not feasible. As per industry practice, about 60% of the estimated demand for a season is placed in stores at the pre-season launch phase. At the end of the season, unsold garments (typically about 30% of the total goods placed) are returned to brand-owner by way of sales returns.

In most of the cases, sales returns are received after a period of six months from date of delivery, resulting in non-adjustment of CST paid on earlier sale. The problem is compounded by the fact that Assessing Authority issue Form C for the value of net purchases (which is net of returns) as disclosed in the VAT / CST return. Hence, Form C is not issued by the buyer for returns, which results in additional liability of differential tax for the dealer for returns received beyond six months.

It is recommended that in case of readymade garments period for acceptance of sales return may be extended to one year from date of delivery of goods, and, suitable clarifications be provided for issuance of Form – C on gross value of goods purchased. Alternately, the deduction for sales returns be allowed only for value of sales returns within a period of six months.

5.6.10. Inclusion of Asbestos Cement Roofing Sheets in the list of Declared Goods

The chrysotile asbestos cement roofing sheets are by and large used by the poor people in the villages for their housing purpose in place of thatched roofing and clay tiles. Almost 90% of AC roofing sheets produced in the country go for such rural house roofing all over India. AC roofing has proven over the last 60 years to be the most ideal permanent roof for the economically weaker sections and the poor (families under BPL). The primary raw-materials for manufacturing chrysotile fiber cement roofing sheets are cement, fly ash and chrysotile type of asbestos fiber in the ratio of roughly 55% cement, 35% fly ash and 10% chrysotile asbestos. The chrysotile asbestos fiber is used as a reinforcement material in the product. AC sheets cost less than one third of equivalent alternative metal sheeting. Hence AC sheet roofing is preferred by the financially weaker sections of society.

Galvanized iron (corrugated and plain sheets) by virtue of their being a declared goods under section 14 of CST Act enjoy the benefit of goods classified as of special importance in Inter-State trade and commerce. If the galvanized iron (GI) corrugated sheets are treated as essential goods, chrysotile asbestos cement sheets which are also used for roofing, deserve an equal consideration, being a poor man's requirement which benefits the rural population.

It is requested that the asbestos cement roofing sheets may be included in the list of declared goods of special importance putting it in the list of such goods under section 14 of the CST Act 1956.

5.6.11. Provide Special Tax Treatment for Inter-State Swapping of Natural Gas

GAIL is supplying Natural Gas/RLNG belonging to GAIL as well as belonging to other supplier/producers such as RIL, IOCL, GSPC etc. to various consumers in fertilizer, Power, CNG and other industrial sectors throughout the country through its cross-country pipeline network. Presently, the domestic gas is available in the state of Gujarat, Maharashtra, Andhra Pradesh, Rajasthan, Tamil Nadu and in a very little quantity in Tripura and Assam. LNG import is possible in the coastal areas like Andhra Pradesh, Kerala, Maharashtra, Gujarat, Tamil Nadu, Orissa and Bengal. The Demand of Natural Gas however exists all across the country to meet the requirement of various sectors like power, fertilizer, City Gas Distribution (for transport and domestic use), Petrochemical, LPG, Steel Industry etc.

To cater this demand, aggregation of the domestic and imported Natural Gas is essential and has to be comingled and transported in the cross country common pipeline network. In the larger public interest, Domestic Natural Gas is presently supplied to the consumers as per allocation and directives given by the Government. The price of domestic gas is also controlled by the Government whereas the imported gas is procured at significantly higher price based on international exchange indices.

The gas produced/available (produced in KG D6) on east coast in AP largely belongs to M/s RIL and the Gas available on west coast largely (produced by ONGC or imported) belongs to GAIL. Gas available from different sources is invariably comingled or needs to be swapped on account of factors such as:

For comingling:-

(i) Cross country pipelines are connected to multiple sources

(ii) PNGRB guidelines for common access of pipelines to all suppliers

(iii) Nature of commodity requiring economical and safe transportation through pipeline.

(iv) Not viable to have pipeline Infrastructure for each source separately

For swapping:-

(i) Connectivity of the consumers to the source of Gas vis a vis corresponding contractual arrangement between parties

(ii) Affordability of the consumers

(iii) MOP&NG directions for larger public interest

(iv) Optimization of facilities related to transportation of Natural Gas.

For efficient and equitable distribution of gas from the different sources to the different States, Central Government has issued the guideline for Gas swapping vide MOP&NG order no. (L-12011/10/2011-GP). Even pooling of gas from different sources (pooling of high priced imported gas with low priced domestic gas) is required to supply of gas at reasonable price to different consumers across various sectors. The concept of gas pooling is pursued by MOP&NG also for the most optimal utilization of Natural Gas.

There were no tax implications in commingling, swapping or pooling of Natural Gas/ RLNG from different sources so long as the gas belonged to one supplier. Since commingling, swapping or pooling of Natural Gas took place in one state, it was also possible to demonstrate physical movement. However, as a result of extension of the commingling, swapping or pooling of Natural Gas/ RLNG among the sources located in different states (i.e. AP/ Maharashtra & Gujarat) or gas belonging to different suppliers (i.e. GAIL, RIL, GSPC, IOC etc.), the tax implications are going to become more & more complex and are becoming unmanageable.

As per section 3 of CST Act, 1956, sale or purchase of goods is deemed to be in the course of inter-state trade or commerce if the sale or purchase occasions the movement of goods from one state to another. Since the requirement of section 3 stipulates physical movement of goods, it is difficult to comply with this requirement due to reasons explained above.

Due to above trends, it has also become difficult to demonstrate physical movement of Gas emanating from each source corresponding to its final delivery/sale to consumers. Since tax treatment under existing VAT/CST laws is largely dependent on physical movement of goods, it is very challenging to ascertain real tax liability under these circumstances.

Considering the importance of Natural Gas in economic development of the nation and its environmental friendly nature, there is an urgent requirement of special tax treatment/special tax regime for sale and purchase of Natural Gas under CST Act, 1956 which will benefit all the gas consumers in power & fertilizer sector. It will remove the barriers in smooth trade of Natural Gas and will also remove tax distortions in gas sector caused by double taxation and cascading effect.

Recently, the Ministry of Finance (MoF), Govt. of India (Department of Revenue) vide Office Memorandum dated 21st July 2015 has issued clarification that contractual movement of gas (as evidenced by commercial documentation) would be considered as physical movement of goods from one State to another for the purpose of Section 3 of the Central Sales Tax Act 1956.

While the intent of Government is the step in right direction, we find following legal infirmities in this regard:

(a) As per our understanding, Central Government cannot issue a clarification, which is inconsistent with the provisions of Central Sales Tax Act (CST Act). We find that the Central Govt.'s powers to issue the clarifications are limited only to provide clarify or to give effect to a provision of the CST Act and not to issue clarification which would alter or give different meaning to the provision contained in section 3 of the CST Act. Accordingly, the Office Memorandum dated 21st July 2015 has no legal validity.

(b) Section 3 of CST Act 1956 formulates principles as to when a sale of goods could be termed as inter-State sale. In terms of section 3 of the CST Act and pursuant to Hon'ble Supreme Court rulings in many cases, physical movement of goods from one State to another State is a prerequisite to determine whether any sale has occurred in the course of inter-State or not. The implication of the Office Memorandum dated 21st July 2015 would be that such physical movement of natural gas would no longer be a condition to determine whether the sale of natural gas is an inter-State sale or not. The key ingredients would be (i) contractual [instead of physical] movement of gas, and (ii) injecting of gas in the pipeline system in one State and taking out equivalent quantity of gas from the pipeline system in another State. However, section 3 of the CST Act does not recognise "contractual movement" of goods. Thus, the clarification issued as per the Office Memorandum dated 21st July 2015 is fraught with an emerging situation, which is not legally binding on the States. If States do not consider such contractual movement as inter-State movement and impose demands of tax, interest and penalty in this regard, it will have huge tax implications on the sellers and their buyers leading to uncertainties and litigations.

In order to achieve the desired objective set out in the aforesaid OM, it is necessary that such a clarification is given effect by way of an amendment to the CST Act, 1956 to ensure that such a provision is legally binding on all the stakeholders, viz- State governments, tax authorities, and sellers and buyers of natural gas.

Government may consider inserting a new section 3A in the CST Act in the following manner:

"3A. A sale or purchase of natural gas (which includes re-gasified natural gas) shall be deemed to take place in the course of inter-State trade or commerce if the sale or purchase-

(a) occasions the contractual movement of natural gas from one State to another; or

(b) is effected by a transfer of documents of title to natural gas during its contractual movement from one State to another.

Explanation: "contractual movement" means movement of natural gas in pursuance of a contract between the seller and the buyer of such natural gas when it is transported through common carrier pipeline (s) / distribution network operated by one or more operators."

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