Salient Features of the Finance Bill, 2010

DIRECT TAXES

VED JAIN

INTRODUCTION

The Finance Minister, Mr. Pranab Mukherjee presented the budget for the year 2010-11 on 26th February, 2010. The Finance Minister had a difficult task to address the issue of rising inflation, increase in fiscal deficit, withdrawal of stimulus package and at the same time to provide enough money to boost growth and give impetus to the economy. In the current fiscal year 2009-10 there was a significant improvement in the economy after a slow-down in the second half of 2008-09 following the financial crisis that began in the industrialized nations in 2007 and that spread to the economy across the world. The growth rate in the last two quarters of the year 2008-09 has come down to 6%. There were apprehensions that this trend would persist for some time. The policy makers had taken a calculated risk in providing substantial stimulus packages to counter the negative fallout of the slow-down resulting in increased fiscal deficit. The fiscal deficit for the country increased to 5.9% of GDP in year 2008-09 and went up to 6.8% in the year 2009-10 as against 2.6% in 2007-08. The recession continued in the developing world during the year 2009-10. However, Indian economy posted a remarkable recovery in terms of overall growth as is evident from the figures of tax collection which justify the optimism shown by the Finance Minister in this budget for the Indian economy.

The total tax collections for the year 2009-10 are expected to be Rs.6,33,095 Crore as against Rs.6,05,298 Crores in the year 2008-09 and Rs.5,93,147 Crores for the year 2007-08. The increase in tax collection on account of direct taxes is far more impressive as compared to indirect taxes. The total direct tax collections during the year 2009-10 are expected to increase to Rs.3,86,497 Crores from Rs.3,33,960 Crores in the year 2008-09, whereas indirect tax collections are expected to decrease to Rs.2,46,598 Crores as against Rs.2,71,338 Crores in the year 2008-09. However, the indirect tax collections are projected to be Rs.3,17,254 Crores for the year 2010-11, an increase of 29% on the indirect tax collections for the year 2009-10, because of the partial withdrawal of the stimulus package. The direct tax collections are projected to be Rs.4,29,397 Crores for the year 2010-11, an increase of just 11% on the direct tax collections estimated for 2009-10, mainly because of the relief given to individual taxpayers by the restructuring of tax slabs. An interesting aspect of the direct tax collections are that there is a substantial increase over the period in the income tax collected from the corporates. While the collection of income tax from non- corporates has remained almost static, the income tax from corporates within a period of three years has increased by 56% from Rs.1,92,911 Crores to Rs.3,01,331 Crores. On the other hand income tax from non-corporates has increased just by 17% from 1,02,644 crores to Rs.1,20,566 and for the year 2010-11 it is even estimated to be around 4% less than estimated for the year 2009-10 as can be seen from Table A .

Table A : Comparison of tax paid by Corporates

(Rs. In Crores)

Year	**2007-08**	**2008-09**	**2009-10**	**2010-11**
Corporates	1,92,911	2,13,395	2,55,076	3,01,331
Non Corporates	1,02,644	1,06,046	1,25,021	1,20,566

Another noticeable feature of the direct tax collection from corporates is that 77.68% of it is paid just by 1,261 big companies and another 9.14% is paid by 2,907 companies, meaning thereby that only 4,168 companies are contributing about 87% of corporate tax out of more than 9 lakhs companies registered under the Companies Act, 1956. Out of the total 3,66,233 companies which filed the return electronically for A.Y 2009-10 till 31st December, 2009, 1,32,356 companies reported losses and 24,529 companies reported NIL income while 1,88,584 companies had income less than Rs.1 Crore. Table B below gives an analysis of the percentage of share of corporate income tax of different levels of companies for the assessment year 2009-10.

Table B : Analysis of tax paid by Corporates

Assessment Year 2009-10

Profit Before Taxes	**Number of Companies**	**Share in Total Corporate Income Tax Payable (in %)**
Less than Zero	1,32,356	0.36
Zero	24,529	1.39
Rs.0-1 Crore	1,88,584	3.56
Rs.1-10 Crores	16,596	7.87
Rs.10-50 Crores	2,907	9.14
Rs.50-100 Crores	531	5.37
Rs.100-500 Crores	551	16.60
Greater than Rs.500 Crores	179	55.71
TOTAL	3,66,233	67.17

The above analysis shows that corporate tax collection is heavily dependent on a very few large corporates and that a substantial number of corporates are still not contributing much to the revenue. A similar analysis of firms can also provide interesting results. However, data on the firms is not in the public domain.

On the front of direct taxes, the Finance Bill has fifty-six clauses providing amendments to the various provisions of the Income Tax Act and the Wealth Tax Act. The focus of these amendments is to lower the tax burden on the individual tax payer, widening the scope of small business enterprises, to reduce compliance burden, to encourage research and development by enhancing benefit, to streamline some of the provisions relating to tax deducted at source and to provide funds for the infrastructure development by allowing the additional benefit.

A welcome change in this year's Finance Bill is to remove the anomalies and discrimination against the tax payer by amending certain provisions of the Income Tax Act retrospectively which were not only harsh, but inequitable as well. This Finance Bill makes an attempt to address a few of these amendments carried out in the past and one can hope that in the coming years some other harsh and inequitable provisions introduced in the past will also get addressed, so that compliance becomes much easier and punitive action is commensurate with the nature of the default.

The various amendments proposed in the Finance Bill are analyzed below. Unless otherwise stated, all these amendments are proposed to be effective from April 1, 2011, i.e., assessment year 2011-12 relevant to the income earned in the financial year 2010-11.

A. TAX RATES

1. Tax Slabs restructured

The Finance Bill in a bold move has restructured the tax slabs applicable to individual, HUF, Association of Persons, Body of Individuals and Artificial Juridical Persons. Though there is no change in the threshold limit of Rs.1,60,000, the slab has been widened to lower the tax incidence. The new tax rates are as under:

Income	Tax Rates
Upto Rs.1,60,000	NIL
Rs.1,60,001 - 5,00,000	10%
Rs.5,00,001 - 8,00,000	20%
Above Rs.8,00,000	30%

The threshold limit for a woman resident in India will continue to be Rs.1,90,000 and for a resident senior citizen shall continue to be Rs.2,40,000. No surcharge is applicable as the same was abolished last year. However, educational cess and higher education cess at the rate of 2% and 1% respectively shall be payable. The above restructuring has given a substantial benefit to tax payers having income above Rs.3,00,000. An idea of the benefit can be had from the following table:

Table C : Benefit to tax payers as per the proposed slabs

Income	**Tax * payable as per the existing provision**	**Tax* Payable as per the proposed provision**	**Benefit***
1,60,000	Nil	Nil	Nil
3,00,000	14,420	14,420	Nil
5,00,000	55,620	35,020	20,600
8,00,000	1,48,320	96,820	51,500

* includes educational cess

The Finance Bill, besides restructuring the tax slabs has also introduced another provision, allowing deductions up to Rs.20,000 on investment in 'Long Term Infrastructure Bonds'. This deduction shall be in addition to the existing deduction of Rs.1,00,000 allowed under section 80C of the Income Tax Act in respect of Life Insurance Premium, contribution to Provident Fund etc. and Rs.15,000 allowed under section 80D in respect of health insurance premium. Combined with the above deduction and the deduction in respect of interest on the housing loan of Rs.1,50,000, there will be no tax liability on income upto Rs.4,45,000 in the case of individuals, Rs.4,75,000 in case of resident women and Rs.5,30,000 in case of a resident senior citizen. The average tax liability upto an income of Rs.10,00,000 shall now be less than 8% as against 12.82 at present as can be seen from the table below :

Table D : Average Income Tax Liability

Income	**Proposed Tax Liability**	**Existing Tax Liability**
Income	10,00,000	10,00,000
Deductions* 80C	 1,00,000	 1,00,000

80D	15,000	15,000
80CCF	20,000	--
Interest on Housing Loans	1,50,000	1,50,000
Total Deductions	2,85,000	2,65,000
Taxable Income	7,15,000	7,35,000
Tax thereon (including cess)	79,310	1,28,235
Average Tax on income of Rs.10,00,000	7.93%	12.82%

(*) The above deductions are available to all tax payers and does not include higher exemption limit for women / senior citizens and specific deductions available under various other provisions of the Act such as interest on loan for higher education under section 80E, donation to charitable trusts under section 80G, rent paid for housing accommodation under section 80GG, donation for research under section 80GGA. etc.

The above comparison further reveals that there is around 40% reduction in the tax liability on an income of Rs.10 lakhs from Rs.1,28,235 to Rs.79,310.

2. MAT Rate raised from 15% to 18%

The Finance Bill proposes to enhance the Minimum Alternate Tax (MAT) rate from 15% to 18%. This increase in MAT is in continuation for the second year as The Finance (No.2) Bill, 2009 had increased the rate from 10% to 15%. Thus within a period of 2 years there is a substantial increase of 80% from 10% to 18%. With the rationalization of the rates of depreciation under the Income Tax Act with that of the Companies Act the difference on account of depreciation in the book profits and the taxable income is not much. However, companies enjoying exemption under the various provisions of the Income Tax Act will now be required to pay tax on exempted income @ 18% as against 30% otherwise payable had the income not being exempt. This increase in the MAT rate is an indication of the intention of the government to withdraw the exemptions presently available. This increase in MAT rate will affect all companies claiming exemption in respect of income from Free Trade Zone, Software Technology Park under section 10A and Export Oriented Unit under section 10B of the Act for which the assessment year 2011-12 is the last year for claiming exemption. Similar will be the case of the companies claiming deduction in respect of income from infrastructure facilities, telecom, power generation etc. under section 80-IA; companies claiming deduction in respect of income from multiplex theatre, convention centre, housing projects, hospitals etc., under section 80-IB; companies claiming exemption in respect of undertakings in the State of Himachal Pradesh & Uttaranchal under section 80-IC; and companies claiming exemption in respect of undertakings in North Eastern States under section 80-IE of the Act. However, these companies in the subsequent year will be eligible to take credit of the MAT paid in earlier years. Thus in a way MAT is not an additional tax but an advance tax paid for subsequent years. No MAT is payable in respect of the income from Special Economic Zone exempt under section 10AA of the Act.

An interesting feature of liability under MAT is in respect of long term capital gain on non Securities Transactions Tax (STT) paid equity shares. Such long term capital gain without any indexation benefit will be liable for MAT @ 18% as against the rate of 20% applicable after indexation in respect of non STT paid Long Term Capital Gain. Thus, the MAT liability can be more than the normal tax liability in case such company does not have the possibility of claiming credit of the MAT in future. The net effect of this is not only double taxation by way of STT and MAT but MAT rate goes beyond the normal tax rate. Similar will be the case in respect of Short Term Capital Gain arising on STT paid equity shares where normal tax rate applicable is 15% under section 111A of the Act. Thus, this increase in MAT rate will make the provision of section 10(38) exempting Long Term Capital Gain in respect of STT paid shares, section 48 allowing indexed cost of acquisition consequent to cost inflation index, section 111A taxing Short Term Capital Gain on STT paid shares @ 15% and section 112 taxing Long Term Capital Gain after indexation @ 20% virtually redundant in the case of a company which does not have other income chargeable to tax.

3. Rate of Surcharge reduced from 10% to 7.5%

The Finance Minister, keeping his commitment to gradually withdraw the surcharge has reduced the surcharge applicable to domestic companies if its total income exceeds Rs.1 Crore from 10% to 7.5%. The surcharge applicable to a company other than domestic company shall continue to be @ 2.5%. No surcharge is payable by any other entity i.e.

individual, HUF, Firm etc. This reduction in surcharge will bring down the tax rate applicable to companies on its taxable income as well as dividend distribution tax payable besides reducing the effective increase in MAT rate as can be seen from the Table E below:

Table E : Net impact of reduction of Surcharge to 7.5%

(Figures in per cent)

Particulars	**Normal Tax Rate**	**Dividend Distribution Tax (Rate)**	**Minimum Alternate Tax Rate**
Existing rate	30	15	15.00
Existing Surcharge @ 10%	3	1.5	1.500
Existing Effective Rate	33	16.5	16.5
New Normal rate	30	15	18.00
Proposed Surcharge @ 7.5%	2.25	1.125	1.35
Proposed Effective Rate	32.25	16.125	19.35
(Savings)/increase	(-) 0.75	(-) 0.375	(+) 2.85

Thus all corporates liable to pay normal tax (other than those liable to pay MAT) will be benefited first by 0.75% in tax on its regular income and further 0.375% while distributing dividend, whereas corporates liable to pay MAT will have to pay higher MAT by 2.85% whereas the benefit will be of 0.375% while paying dividend distribution tax.

Reduction in surcharge from 10% to 7.5% will not have any impact on corporates whose income does not exceed Rs.1 crore as surcharge is not applicable to such companies.

B. DEDUCTIONS

1. Investment in Long Term infrastructure Bonds

The Finance Bill proposes to provide an additional deduction to individual & HUF to the extent of Rs.20,000 in respect of investment made in the Long Term Infrastructure Bonds by inserting a new section 80CCF. This deduction will be in addition to the existing deduction of Rs.1 Lakh available under section 80C of the Act in respect of Life Insurance Premium, contribution to Provident Fund etc.

2. Contribution to CGHS Schemes to be eligible under Section 80D

The Finance Bill proposes to include the amount contributed by serving and retired government servants to Central Government Health Schemes as eligible deduction under section 80D which allows deduction in respect of premium paid towards a health insurance policy upto Rs.15,000 and enhanced deduction of Rs.20,000 in case of senior citizens. It may be clarified that this is not an additional deduction but will be part of the deduction presently available under section 80D in respect of health insurance premium.

C. CHARITABLE TRUSTS / INSTITUTIONS

1. Receipt of commercial nature upto Rs.10 lakhs not to affect 'charitable purpose'

The Finance Bill proposes to address the hardship cause by the amendments made by the Finance Act, 2008 in the definition of 'charitable purpose' under section 2(15) of the Act whereby an absolute restriction was placed in respect of receipts if it involves carrying on of any act in the nature of trade/commerce or business or any act of rendering any service for a cess or a fee or any other consideration. This has caused a lot of hardship to all NGO's which have been providing valuable service to the society. It has been proposed that such an organization shall still be within the definition of 'charitable purpose' if the total receipts of such nature do not exceed Rs.10 Lakhs in a year. Thus, there is a partial relief. It may be noted that the moment the receipt of such nature exceeds Rs.10 lakhs the institution shall not be covered within the definition of the charitable purpose and the whole of the income will become liable for taxation and the benefit of sections 11 & 12 will not be available. Further it may be noted that this restriction of rendering services for a fee is not applicable in respect of relief of poor, education, medical relief, preservation of environment, monuments, places or objects of artistic or historic importance. The restriction is applicable in respect of the objective of 'any other object of general public utility'. This amendment is proposed to be retrospective from A.Y . 2009-10 i.e. from the year when restriction was introduced.

2. Commissioner can cancel old registration granted under Section 12A.

The Finance Bill proposes to amend the lacuna left out by the Finance (No.2) Act, 2004 whereby power was given to the commissioner to cancel the registration granted to any charitable trust/institution under section 12AA of the Act. The said amendment did not cover such registration granted under the old provision of section 12A of the Act.

Now it is proposed that the commissioner shall have the power to cancel the registration granted under old section 12A as well, in case he is satisfied that the activities of such a trust/ an institution are not genuine or are not being carried out in accordance with the objects of trust or institution.

D. SALARIES AND INCOME FROM HOUSE PROPERTY – NO CHANGE EXCEPT SARAL FORM

The Finance Bill proposes no amendment in respect of any provision relating to income under the head 'Salaries' and 'Income from House Property'. However, the Finance Minister has promised to come out with the Saral-II form to simplify filing of return by salaried tax payers.

E. BUSINESS INCOME

1. No disallowance if TDS paid before the due date of filing return

The Finance Bill proposes to remove the hardship arising consequent to the provision of section 40a(ia) whereby the entire expenditure incurred in respect of interest, commission, brokerage, rent, royalty, fee paid for professional or technical services, payment to contractor or sub-contractor is disallowed in case TDS has not been deducted or after deduction has not been paid. As per the proposed amendment the disallowance can be made only when the same has not been paid before the due date of filing the return. Thus, this amendment partially addresses the undue hardship of the provision. As per this provision, the entire expenditure gets disallowed and is added to the taxable income resulting in the same getting taxed @ 30 per cent, as against failure to deduct tax @ 1% or 10% as the case may be. Though the proviso provides for deduction of such expenditure in the subsequent year in which TDS is paid , this does not mitigate the hardship of huge tax demand in one year and heavy losses in subsequent year consequent to disallowance of expenditure in the year in which it is incurred and being allowed in the subsequent year. The assessee may not be in a position to pay such huge demand of taxes in the year in which it gets disallowed. Further, this punitive provision is too harsh. For a default of TDS @ 1% to 10% the assessee is made liable to pay tax upto 30 times of the default amount. Ideally there should be no such disallowance as there are enough mechanism available under section 201(1), 201(1A) to recover such amount along with interest, to levy penalty for default under section 271C and to prosecute in case the person fails to pay tax after deduction, under section 276B of the Act. Even if this provision is to be retained it will be advisable to allow rectification under section 155 of the Act of the original assessment as and when the tax is paid rather than allowing deduction in the subsequent year. The TDS provisions are quiet complex and many a times because of dispute on interpretation there is every possibility that the same may not have been paid before the due date of filing of return.

Further, the proviso makes it incumbent that the tax has to be deducted and paid in case claim of expenditure is to be allowed in the subsequent year. Under the existing TDS provisions, there is no mechanism available to the deductee of claiming credit of such taxes paid once he has filed a return. The existing provision of section 155(14) read with explanation (c) to section 139(9) provides for rectification only in those cases where claim for TDS has been made in the return and a certificate is not enclosed with the return. It does not provide for those cases where TDS has not been deducted and accordingly not claimed by the deductee in the return but later on the same is deducted and paid by the deductor to claim the expenditure in terms of proviso to section 40a(ia). Accordingly, there is a need to amend section 155(14) to allow rectification where TDS is later on deducted and paid by the deductor.

This amendment is proposed to be effective retrospectively from 1st April, 2010. But, still there can be a dispute on interpretation as to whether the amendment is clarificatory in nature and hence applicable retrospectively from the date when clause (ia) was introduced as was the case of similar amendment in section 43B of the Act.

2. Limit of turnover for presumptive taxation increased for small business

The Finance Bill proposes to increase the limit of turnover or gross receipts of small business covered by the presumptive taxation under section 44AD of the Act. The Finance

(No.2) Act, 2009 had introduced section 44AD whereby 8% of the total turnover of the gross receipts of the business shall be deemed to be the income of such business chargeable to tax. The scheme was applicable to only such business whose total turnover or gross receipts do not exceed Rs.40 lakhs. The present Finance Bill proposes to increase the same to Rs.60 lakhs. Such persons are not required to maintain the accounts and get audit under section 44AB of the Act. Sixty Lakhs turnover per annum means a turnover of Rs.20,000 per day considering 300 working days in a year and the total tax liability on gross total income of Rs.4,80,000 in case of an individual after claiming deduction of Rs.1 Lakh under section 80C and Rs.20,000 under the newly introduced section 80CCF will be just Rs.20,600/- on taxable income of Rs.3,60,000/- i.e. 0.33% of the turnover. This proviso is also applicable to a firm and the firm can claim deduction on account of interest and remuneration to the partners against the presumptive income of 8% of the turnover.

3. Tax Audit limit increased

The Finance Bill proposes to increase the limit to get the accounts audited from Rs. 40 Lakhs to Rs.60 Lakhs in case of a business and from Rs.10 Lakhs to Rs.15 Lakhs in case of a profession.

4. Special Economic Zones (SEZ)

The Finance Bill now proposes to remove the anomaly in computation of the eligible income of SEZ. Section 10AA was introduced by the SEZ Act, 2005 providing exemption in respect of income of a unit in SEZ. However, while prescribing the formula for the computation of the eligible income there was a drafting error whereby the eligible income of eligible undertaking was to be apportioned in the ratio of export turnover to the total turnover of the 'assessee' instead of the total turnover of the eligible 'undertaking'. The Finance (No.2) Bill, 2009 had removed this anomaly prospectively i.e. from the assessment Year 2010-11 only. This Finance Bill proposes to remove this anomaly retrospectively by making the amendment effective from assessment year 2006-07.

5. Incentive for new hotels of two star category and above

The scope of section 35AD which was introduced last year in respect of the setting up and operating of a cold chain facility, a warehousing facility for storage of agricultural product and laying and operating cross country natural gas or crude oil pipe line network is being widened to allow investment-linked tax incentive to new hotels of two-star category and above anywhere in India. Benefit will be available to the business of building and operating a new hotel of two- star category and above,that starts functioning after 1st April, 2010. As per the provision of section 35AD the whole of the capital expenditure other than that incurred on land, goodwill and financial instruments is allowed as deduction in the year in which the business is commenced. However, this provision may not be so much beneficial except in the cases where eligible business is in position to earn substantial profits in the initial years of its operation. There is a restriction under section 73A of the Act in respect of such eligible business whereby loss computed in such business can not be set off against any other business and the same can be carried forward and set off against income of such eligible business only. In the case of a new business normally there is no substantial profit in the initial years to take the benefit of entire capital expenditure. The capital expenditure allowed under this section otherwise can be claimed as depreciation over a period of years. A capital expenditure whether allowed to be claimed in the first year or over a period of years by way of depreciation does not provide any additional advantage to the tax payer.

6. Enhanced benefit for research & development

Presently under section 35(1) clause (i) deduction is allowed in respect of expenditure (other than capital expenditure) incurred on scientific research related to the business. Further under clause (ii) a weighted deduction of 125% is allowed on any amount paid to scientific research associations and a weighted deduction of 125% is allowed under clause (iii) in respect of the amount paid to any approved university, college or other institution to be used for research in social science and statistical science. Under section 35(2AA) amount paid to National Laboratory or to a University, IIT, to be used for approved scientific research is eligible for weighted deduction of 125%. Under section 35(2AB), a company engaged in the business of manufacturing or production of any article or thing including biotechnology is eligible to claim weighted deduction of 150% of the expenditure (including capital expenditure other than cost of land or building) incurred on approved in-house scientific research. The Finance Bill proposes to widen the scope of the research so as to include social sciences or statistical research by deleting the word ‘scientific’.

Further, the weighted deduction in respect of clause (ii) i.e. the amount paid to any research association is proposed to be increased from 125% to 175%. Similarly in respect of amount paid to National Laboratory, IIT etc. under section 35(2AA) the weighted deduction is proposed to be increased from 125% to 175% and the weighted deduction in respect of in-house approved research under section 35(2AB) is proposed to be increased from 150% to 200%. Further, the scope of section 10(21) is also being widened by deleting the words ‘scientific’ so as to include within its scope ‘social science and statistical research’. With the proposed amendment, income of a research association, if approved under section 35(I)(ii) including that of social science and statistical research shall be exempt and the person who contributes to such association shall be eligible to claim weighted deduction of 175%.

The proposed amendment can go a long way in giving boost to research activities. Now a tax payer can promote research by way of contribution to research association whereby persons having common interest in a particular area can form a research association and contribute money to such a research association. On the amount so contributed each of the contributor can claim weighted deduction of 175 per cent and income of such a research association will be exempt under section 10(21). Alternatively, a company engaged in the business of manufacturing can carry on an in-house research and claim weighted deduction of 200 per cent in respect of the expenditure incurred on in-house research. This way the effective expenditure shall be just 35 per cent and almost 65 per cent contribution towards such expenditure shall be that on the government account as can be seen from the following example.

Table F : Impact of proposed changes of Section 35

Particulars	**Company not carrying on in-house research**	**Company carrying on approved in-house research**	**Company contributing to approved research association**
Income	10,00,00,000	10,00,00,000	10,00,00,000
Expenditure on research including capital expenditure other than on land or	Nil	1,00,00,000	1,00,00,000

building			
Taxable Income after weighed deduction @ 200% and 175%	10,00,00,000	8,00,00,000	8,25,00,000
Tax Payable	3,22,50,000	2,58,00,000	2,66,06,250
Net funds available **1-(2+4)**	6,77,50,000	6,42,00,000	6,33,93,750

Thus with an additional amount of just Rs.35,50,000 the company can have the benefit of in-house research expenditure of Rs.1 Crore which may include capital assets other than land and building to be owned and enjoyed by the company.

Corresponding amendment is being proposed in section 80GGA of the Act which allows deduction to all taxpayers not even carrying on business in respect of donation for scientific research or rural development by deleting the words 'scientific' so as to include 'social science and statistical research'. Thus, the amount contributed to a research association which has research in social science and statistical research as its objects shall also be eligible for deduction.

7. Extension of time for starting hotel & convention centre for Commonwealth Games

The time for starting hotel & convention centre for Commonwealth Games in the National Capital Region (NCR) for claiming exemption under section 80-ID is being extended from 31.03.2010 to 31.07.2010. This extension is being given in view of non-completion of hotels and convention centres in the NCR of Delhi for Commonwealth Games.

F. CAPITAL GAIN

Conversion of a private or unlisted public company into Limited Liability Partnership (LLP) not to attract capital gain tax

The Finance Bill proposes to exempt conversion of a private company or an unlisted public company into an LLP from the levy of capital gain tax to exclude such transfer from the definition of transfer by inserting clause (xiiib) to section 47 of the Act. As per this amendment any transfer of capital asset or intangible asset by a private company or an unlisted public company, as a result of conversion of a company into LLP (as per the provision of section 56 and 57 of the LLP Act), shall not be regarded as ‘transfer’ liable for Capital Gain, provided the following conditions are fulfilled:

the total sales, turnover or gross receipts in the business of the company do not exceed sixty lakh rupees in any of the preceding previous years;

the shareholders of the company become partners of the LLP in the same proportion as their shareholding in the company;

no consideration other than share in profit and capital contribution in the LLP arises to partners.

The erstwhile shareholders of the company continue to be entitled to receive at least 50 per cent of the profits of the LLP for a period of five years from the date of conversion.

All assets and liabilities of the company become the assets and liabilities of the LLP; and

no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of three years from the date of conversion.

In case the conditions stipulated above are not complied with, the benefit availed of by the company shall be deemed to be the profits and gains of the successor LLP chargeable to tax for the previous year in which the requirements are not complied with.

The LLP shall be eligible to carry forward and set off business loss and unabsorbed depreciation of the company. The depreciation allowed in the year of conversion shall be apportioned between the predecessor company and LLP in the ratio of the number of days.

The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company as on the date of conversion.

The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost which the predecessor company incurred for acquiring it. The period for which such asset is held by the previous owner, i.e., the company, shall be included for determining whether the asset is a short term capital asset or a long term capital asset in terms of section 2(42A).

Credit under section 115JAA in respect of MAT paid by the company shall not be allowed to the successor LLP. However, successor LLP shall be eligible to claim amortization of expenditure incurred under Voluntary Retirement Scheme (VRS) by the company for the remaining period in terms of section 35DDA.

An idea of how much benefit this conversion can provide can be had by making comparison of tax implications on a company and on an LLP. Under the existing provision, a company is liable to pay regular tax and MAT on book profits if the regular tax is less than that MAT and also pay Dividend Distribution Tax while distributing profit to the shareholders. In addition thereto there is a restriction on payment of any money or advance to shareholders which is considered to be deemed dividend under section 2(22)(e) of the Act. As against this LLP is recognized under the Income Tax Act as a firm and it is neither liable for MAT nor for dividend distribution tax. Neither provision of section 2(22)(e) is applicable (except for 3 years on conversion as stipulated in the conditions). The LLP can also pay interest on the amount of capital of the partner but the restriction is regarding the rate of interest @ 12% under section 40 (b)(iv). The company cannot pay interest on capital. However, there is no restriction on the rate of interest but in view of section 40A (2)(b) the rate of interest paid to shareholders / directors in case of company has to be commensurate with the fair market value. The remuneration paid to directors subject to section 40A(2)(b) is fully allowable, whereas in case of an LLP the remuneration to partners is governed by section 40(b)(v) whereby remuneration to partner on the first Rs.3 Lakhs of book profit cannot be more than 90% of book profit and on the remaining profit cannot be more than 60% of book profit.

Thus in the overall analysis for a profit making company, it may be more suitable to have an LLP which has all the advantages so far as liability and corporate status are concerned and also minimal restrictions, applicability of the MAT, Dividend Distribution Tax and deemed dividend. Thus the proposed amendment of allowing conversion of a company into LLP may help in case the company wants to get converted to LLP. Under the proposed amendment even the accumulated profits of a company will not be subject to Dividend Distribution Tax in case the stipulation stated therein of three years not to pay the amount to partner is complied with.

The Finance Bill, however, has put a condition allowing only those companies whose turnover or gross receipts in business are not more than Rs.60 lakhs in any of the three preceding years. As such companies carrying on business and having turnover beyond this limit will not be able to get the benefit. But those companies which are investment companies or which have income from house property, capital gains and income from other sources irrespective of the amount of such income can take the advantage of conversion. Companies in business need to plan for three years so as to bring the turnover below Rs.60 lakhs before it can take advantage of this newly introduced provision. It may be noted that MAT paid by the company will not be eligible for credit. Further, one needs to be cautious about the penal provision in the Limited Liability Partnership Act for various defaults such as not filing documents in time, etc. which are quite harsh.

G. INCOME FROM OTHER SOURCES

1. *Acquisition of shares by company or firm at less than Fair Market Value (FMV) to be taxed as Income From Other Sources*

The Finance (No.2) Act, 2009 had introduced section 56(2)(vii) taxing in the hands of an individual or HUF, where any property such as share & security, jewellery, archaeological collection, drawing, painting, sculptures and any work of art is received without consideration or for a consideration less than the aggregate Fair Market Value by an amount exceeding Rs.50,000, the difference as deemed income from other sources of the individual or the HUF. The above amendment was applicable to an individual and HUF only. The Finance Bill proposes to widen the scope of such income by taxing in the hand of a company or a firm other than widely held companies where shares of a company are received without consideration or for a consideration less than fair market value by an amount exceeding Rs.50,000 as deemed income. Thus transfer of shares of a company whether to an individual or HUF or to a company has to be at Fair Market Value and in case it is less than that, the difference shall be deemed as income from other sources of the receiver. This amendment will be applicable from 1st June, 2010 and as such transfer made before this date will be outside the purview of the proposed amendment.

Interestingly, this is not applicable to listed companies. The listed companies can still buy shares of other companies at a value less than fair market value.

Further, 'Bullion' has been included within the definition of the term 'property'. A corresponding amendment has been made in section 2(24) to include the above income in the definition of income and in section 49 to provide that the cost of acquisition in such cases shall be the value which has been taken into account for the purpose of this section. This amendment shall be effective from 1st June, 2010.

2. Immovable property to be outside the purview of this provision

The Finance Bill proposes to exclude immovable property from the purview of this section which was included by Finance (No.2) Act of 2009.

3. Only capital asset other than immovable property to be covered within the scope of Section 56(2)(vii)

Further, the Finance Bill has introduced clarificatory amendment to provide that the property which is in the nature of a capital asset of the recipient would only be covered by this provision. Accordingly, any such property if purchased as stock-in-trade, raw material or consumable stores by the recipient shall not be covered by this provision. This clarificatory amendment has been introduced retrospectively with effect from 1st October, 2009. It may be noted that as per the proposed amendment this restriction of capital asset shall be applicable for individual and HUF. The shares purchased by a company even as stock-in-trade will be covered by the proposed clause (viia) as no such exclusion has been inserted in this clause.

4. Assessing Officer being empowered to refer the matter to Valuation Officer for determination of Fair Market Value

The scope of section 142A empowers the assessing officer to refer the matter to a Valuation Officer where an estimate of the value of any unexplained investment made outside the books of accounts as referred to in section 69, or where an estimate of investment not fully disclosed in the books of accounts as referred in section 69B, or where an estimate of value of any unexplained money, bullion, jewellery or other valuable article found with the assessee is to be made so as to include determination of the Fair Market Value of any property acquired without consideration or at a consideration less than the Fair Market Value, taxable as 'Income From Other Sources' under section 56(2) of the Act. This amendment shall be effective from 1st July, 2010.

H. TAX DEDUCTION AT SOURCE

1. Threshold limit for TDS raised

The Finance Bill proposes to raise the threshold limit applicable for deduction of tax at source under the various heads as under:

Table G : Proposed changes in threshold for applicability of TDS

Section	Nature of Expenditure	Existing threshold limit (Rupees)	Proposed threshold limit (Rupees)	Rate of TDS
194B	Winning from Lottery or Crossword puzzle	5,000	10,000	30%
194BB	Winnings from Horse Race	2,500	5,000	30%
194C	Payment to contractors (for single transaction)	20,000	30,000	1% (if paid to individual or HUF) 2% (for others)
	(For aggregate of transactions during the year)	50,000	75,000	
194D	Insurance Commission	5,000	20,000	10%
194H	Commission or Brokerage	2,500	5,000	10%
194-I	Rent	1,20,000	1,80,000	2% For plant & machinery 10% for land & building
194-J	Fee for professional or technical services	20,000	30,000	10%

The above amendment shall be effective from 1st July 2010. If the threshold limit has been reached before 1st July, 2010, then the existing threshold limit will be applicable, but in case threshold limit has not been reached by 1st July 2010, the new threshold limit will be applicable for determining the liability to deduct TDS.

2. TDS certificate need to be issued

The Finance Bill proposes to delete section 203(3) and proviso to section 206C (5) whereby it was provided that no TDS or TCS certificate need to be issued on or after 1.4.2010. With the deletion of these provisions it will be mandatory to issue TDS/TCS certificate and on failure to issue such certificate, penalty under section 272A(2) @ Rs.100 for every day of default shall be leviable, subject to the maximum of the amount of TDS/TCS.

3. Higher rate of interest in case tax is not paid after deduction

The Finance Bill proposes to create a separate class of default in respect of tax deducted but not paid to levy interest at a higher rate of 1.5% per month, i.e., 18% p.a. as against 1% p.m. (i.e 12% p.a.) applicable in case the tax is deducted late after the due date. The rationale behind this amendment is that the tax once deducted belongs to the government and the person withholding the same needs to be penalized by charging higher rate of interest.

It may further be noted that the benefit of the proposed amendment under section 40a(ia) of making the payment before the due date of filing the return shall be available only in those cases where tax has been deducted during the previous year but paid after the end of the previous year and before the due date of filing the return. Accordingly, all such persons in terms of section 201(1A) need to pay a higher rate of interest @ 18% from the date tax was deducted till the date it is actually paid before furnishing the statement under section 200(3) of the Act.

In case any person claims that tax has been deducted after the end of the previous year and hence a higher interest rate of 18% is not applicable, such a person will not be eligible for the benefit of the proposed amendment to section 40a(ia) as this benefit is available only when the tax has been deducted during the previous year itself.

I. PENALTY

1. Penalty for default in tax audit enhanced

The Finance Bill proposes to amend the provisions of section 271B of the Act, raising the amount of maximum penalty leviable from Rs.1 Lakh to Rs.1,50,000. Accordingly, penalty for default in getting the accounts audited under section 44AB shall be ½ % of the total sales turnover or gross receipts subject to maximum of Rs. 1,50,000.

J. NON-RESIDENT

1. Clarificatory amendment regarding income deemed to accrue or arise in India

The Finance Bill proposes to make a clarificatory amendment retrospectively from 1st June, 1976 to provide that income of a non-resident in respect of interest, royalty or fee for technical services shall be deemed to accrue or arise in India irrespective of the fact that non-resident has a residence or place of business or business connection in India or non-resident has rendered services in India. The above amendment has been made to overrule the judgement of Karnataka High Court in the case of **Jindal Thermal Power Company Ltd. Vs DCIT(TDS)** whereby it was held that income shall be deemed to accrue or arise in India under section 9 only when the requirement of rendering of service in India is fulfilled. This was done on the basis of the judgement of Supreme Court in the case of **Ishikawajima Harima Heavy Industries Ltd. Vs DIT (SC) 288 ITR 408,** where it was held that both the criteria of rendering services in India and utilization of services in India need to be met for applying the deeming fiction of section 9(1). The above amendment has been made to ensure the intent of the legislation that the 'situs' of the payer and the 'situs' of the utilization of services determine the taxability of such services and the 'situs' of rendering services is not relevant.

2. Income by way of fee for technical services in respect of mineral oils not covered by presumptive taxation

The Finance Bill proposes to amend section 44BB which provides presumptive computation of income of a non-resident engaged in the business of prospecting or extraction of mineral oil to provide that this section shall not be applicable in respect of income by way of fee for technical services which shall be governed by section 44DA of the Act. Such income by way of fee for technical services shall be computed as per the provisions applicable to Profits and Gains from Business or Profession.

K. SETTLEMENT COMMISSION

1. Search assessments to be eligible for settlement

The Finance Bill proposes to allow filing of application for settlement in the case of a search where assessment proceedings are taken up under section 153A or 153C as the case may be. As per the proposal, such application for settlement can be filed at any time after the issue of notice under section 153A or 153C and before the assessment is completed. However, such application can be filed only when the amount of additional tax payable on the income disclosed in application of settlement exceeds Rs.50 lakhs. Further, in other cases, i.e., where regular assessment is pending before the Assessing Officer the amount of additional tax payable is being increased from Rs.3 Lakh to Rs.10 lakhs in case assessee wants to file application for settlement.

The additional tax along with interest has to be deposited before filing the application. Further, the period for passing the final settlement order in respect of an application filed on or after 1.6.2010 is being increased from 12 months to 18 months from the end of the month in which the application is filed. A corresponding amendment is being proposed in the Wealth Tax Act also.

The above amendment shall be applicable from 1st June 2010 and in cases where search assessment under section 153A or under section 153C is pending as on 1st June 2010, these persons shall become eligible to file application for settlement before the assessing officer passes the assessment order.

L. MISCELLANEOUS

1. High Court to have power to condone delay in filing appeals

The Finance Bill proposes to amend section 260A(2) to empower the High Court to admit an appeal after the expiry of a period of 120 days if it is satisfied that there was a sufficient cause for not filing the appeal in time. This amendment is proposed to be retrospective from 1st October 1998. A similar amendment is being made in section 256(2A) to admit a reference beyond the period of six months on being satisfied about the reasons for delay. This amendment is being made retrospectively, w.e.f., 1st June 1981. A corresponding amendment has been proposed in the Wealth Tax Act also.

2. Central processing of returns

In view of delay in setting up the Central Processing Centre the period for setting up of this centre under section 143(1B) & under section 115WE is being extended from 31st March 2010 to 31st March 2011. This amendment is also being made retrospectively from 1st April 2010.

3. Document Identification Number (DIN)

The Finance (No.2) Act, 2009 had made it mandatory to allot DIN to every document, letter, correspondence, notice received or issued by the department on or after 1st October, 2010. This Finance Bill proposes to extend the period in respect of DIN from 1st October 2010 to 1st July 2011 by amending the provisions of section 282B of the Act. The extension is being proposed to provide time to develop the infrastructure and facility for the same.

4. Taxation of income of non-life insurance business

The Finance Bill proposes to amend the first schedule of the Income Tax Act to undo the amendment made by the Finance (No.2) Act, 2009 which provided that while computing income of non-life insurance business, appreciation in investment taken credit for in the accounts shall be treated as income liable for taxation. Now, it is being proposed that unrealized gains or losses will not be included in the income and the same shall be added or deducted only on the realized investment.