PRE-BUDGET MEMORANDUM ON
DIRECT TAXES
2007-2008

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Direct Taxes:

1. Fringe Benefit Tax:

1.1 All assessee except [Charitable Trust registered u/s. 12AA, Political Parties and persons eligible for exemption u/s. 10(23C)] are required to pay taxes on the fringe benefit provided by the employer to the employee and also to the non-employee by creating fiction of deemed fringe benefit.

The procedure and compliance of fringe benefit tax provision has increased substantially. The small business entity and the other business entity situated in a smaller areas are facing tremendous difficulties in compliance of FBT provision.

1.2 The principle of taxing the fringe benefit provided by the employer to the employee which is not taxed in the hands of the employer or employee is appreciated. However, the businessman would wish that with the increase in business activity and competition the procedure and compliance should be reduced.

1.3 **It is therefore suggested that:**

(i) The FBT provision should be abolished and the loss of revenue may be recovered by a regular tax provision and

(ii) In the alternative, there should be a threshold limit of turnover beyond which only the FBT provisions are applicable. This will avoid undue hardship to the businessman from procedure and compliance.

(iii) The genuine business expenses incurred on non-employees should be excluded from the purview of FBT. Otherwise, it is an artificial disallowance of expenses, which was removed by the Government in the past.

(iv) The clear distinction should be provided as to the nature of benefits which are chargeable to tax in the hands of an employee u/s. 17 and benefit chargeable to FBT in the hands of employer.

2. Depreciation [Section 32]

2.1 Additional Depreciation u/s. 32(l)(iia)

1. In the Union Budget 2005-06, the additional depreciation u/s 32(1)(iia) was increased from 15% to 20%, in respect of Plant and Machinery installed after 31.3.2005.

   However, where the Plant and machinery is put to use for less than 180 days in a year, second proviso to section 32(1) restricts the additional depreciation to 50% i.e. from 20% to 10%.

   There is no reason for reducing the additional depreciation to 50%, which is available only one time on new plant and machinery installed. The whole purpose of giving incentive for setting up/expanding industrial undertakings,

which require huge investment, is defeated by reducing the rate of additional depreciation to half. Furthermore, there is no provision to allow balance 50% additional depreciation in subsequent year, unlike normal depreciation.

In addition disputes have arisen in respect of Plant & Machinery acquired in earlier years being installed after 31.3.2005. This primarily occurs in projects where assets are acquired over a period of time, but the capitalization is done only when the project is completed.

Suggestions:

The rate of additional depreciation under sub-section (iia) of section 32(1) should not be reduced to half, where the Plant and machinery under substantial expansion are put to use than 180 days. Alternatively, it should be specifically provided that balance amount of additional depreciation would be allowed in immediately subsequent year.

Further, a suitable proviso be added in section 32(l)(iia) to the effect that additional depreciation shall be allowed in all cases where the Plant & Machinery has been installed after 31.3.2005 notwithstanding that the same was acquired in full or in part on or before 31.03.2005.

2.2. A substantial reduction has been made in depreciation rates effective from Ass. Year 2006-07 in view of amendment to Rules vide Not. No. 67/2005 dated 28/02/05. Further benefit of additional depreciation applicable to Plant & Machinery as prescribed u/s 32(l)(iia) is not granted to hotels since it is not regarded as an industrial undertaking engaged in the business of manufacture or production of any article or thing.

Suggestions:

Benefit of additional depreciation should be made available to even service sector including hotel sector which is contributing in a good way to the economy. Other factor, which also needs consideration, is that in the current scenario to have competitive advantage service sector makes substantial investment in Plant and Machinery including intangible assets.

3. <u>Section 35D</u>

Expenses incurred for raising additional capital be treated for deduction under Section 35D

As per the law pronounced by the courts on the subject, the expenses incurred for raising additional capital do not qualify for deduction (being held as capital expenditure) in computing business profits except under section 35D, which allows a staggered deduction over five years in very limited circumstances where the expenses are incurred before the commencement of assessee's business or in connection with expansion of his industrial undertaking.

The purpose of raising additional capital, being the broadening of capital base for increasing investment requirements of the business, is the same even where it does not fall within the conditions prescribed under section 35D, Further, a company that raises money by a large initial public issue is in a more advantageous position than the one which phases its public issues over a period of time.

Suggestions:

The expenses on raising additional capital should be allowed over a reasonable time period, say 3 to 5 years, even in cases not covered by section 35D. Alternatively, section 35D may be amended to allow deduction of expenses on raising additional capital in all cases.

4. Employee contribution to P.F. under Section 36(1)(va):

The Finance Act, 2003 amended Section 43B to provide that employees contribution to PF shall be allowed as deduction, if such contribution is paid on or before due date of filing of return of income. Section 43B covers only employers contribution and employees contribution is governed by Section 36(1)(va).

Therefore, it is suggested that corresponding amendment by also made to Section 36(1)(va) in respect of employees contribution to PF etc. to bring it in line with the employers contribution. The amendment should be made with retrospective effect from the date on which Section 43B was amended i.e. with effect from 1st April, 2004.

This is particularly required since the PF contribution comprising of employer's and employee is paid together by way of a single challan and therefore there is no reason to give different treatment under Tax Laws.

5. Section 40A(3) – Payment in Cash:

The Taxation Laws (Amendment) Act, 2006 has amended section 40A(3) to provide that the expenditure incurred otherwise then through account payee cheque or bank DD in excess of Rs. 20,000 shall be subject to disallowance of 20% of the amount expended.

Having regard to the market practice prevailing in the country particularly for the transporters which carries goods from one place to another place at different destination and in case of a consignment business, the freight amount exceeds Rs. 20,000 in almost all the cases.

With the amendment of Section 40A(3) as above, the business community is facing tremendous difficulty in complying the provisions and this affect the genuine business transactions.

We may bring to your notice that the freight charges and other expenses which are covered under Section 194C of the I.T. Act are subject to TDS if the total payment during the year exceeds Rs. 50,000.

It is therefore suggested that the limit u/s. 40A(3) may be raised to Rs. 50,000 to avoid genuine hardship in the business transaction and to bring in line with the provisions of Section 194C.

6. Section 40(a)(ia) – Disallowance of Expenditure for Failure to deduct TDS:

6.1 The Finance (No.2) Act, 2004 by inserting a new clause (ia) in Section 40(a) seeks to provide that interest, commission, brokerage, fees for professional services, fees for technical services or payments under a contract or sub-contract payable to a resident will not be allowed as deduction unless tax has been deducted at source and paid in accordance with provisions of Section 200.

This provision is unjust. Tax deducted at source is only one mode of recovery of tax. The person paying the amount is in fact, doing a service to the Government by deducting the tax and paying it to the Government without any compensation. To penalize him by refusing the deduction of expenditure even for a small default is unfair.

There are many cases where there can be two opinions on whether tax was deductible at all. If under a bonafide belief that tax was not required to be deducted the assessee does not deduct tax but if the Department takes a view that tax was deductible, then the assessee would be refused the deduction of whole of the expenditure. Thus, even in a bonafide case because the assessee has failed to deduct 1% from payment to a sub-contractor or short deducted few rupees from a payment, he may lose 100% deduction.

Under the Income Tax Act, if there is a failure to deduct tax or to pay tax deducted, there are provisions to levy interest, penalty and also to recover the tax either from person who has failed to deduct tax at source or person receiving the payment. In extreme cases, the defaulter can even be prosecuted.

In this background and with such wide powers at the disposal of the Department, provision to disallow the deduction of expenditure to the assessee is unfair and extremely harsh.

The provision also goes against the mercantile system of accounting and distorts taxable income increasing the gap between the book result and taxable income.

6.2 Alternatively, the disallowance should not be made if the payment for TDS is made before the due date of filing return of income of the payer in line with Section 43B.

6.3 Scope of disallowance of expense despite payment of tax:

As per one literal reading of the law, an assessee who has deducted tax at source in year one, deposits such tax in year two, he will become entitled to deduction of underlying expenditure in year two. If, however, the assessee who has deducted such tax in year one pays such tax belatedly during the same previous year, he may, as per one interpretation, forever suffer disallowance of an expenditure which is otherwise a genuine expenditure incurred for business purposes.

We submit that this is unintended. A law which does not deny deduction of expenditure to an assessee, who deposits tax in year two, can never intend to deny deduction to an assessee who might have committed a minor or insignificant default. This is needed to amend the language to eliminate such doubts.

6.4 Short Payment results in total disallowance.

Also, a literal interpretation of the provision may bear out that there is likelihood of disallowance should there be short payment of tax. Though the default may be marginal, the entirety of the underlying expenditure will stand disallowed in the assessment of income. This can happen due to administrative lapse or error. Surely, the legislative intent can never be so uncivilized.

6.5 Need for corrective action.

There are a number of other situations which demand that these provisions touching the length and breadth of the country are implemented pragmatically - if necessary, by a suitable amendment to the law without compromising on the avowed objective of inculcating TDS discipline. As one alternative, power may be given to the Commissioners to waive defaults in genuine cases. The situations which need consideration are:

(a) One can visualize the cases wherein there is small or arithmetical error in compliance resulting in short payment of tax.

(b) There could be valid and bonafide cases in which, based on honest difference of opinion, an assessee finds that he has complied with a wrong section or finds that an inadvertent default has been committed.

(c) There would be multiple cases in which, by the time, error is detected by the assessee, the recipient of income would have already paid up his taxes and/or would have been assessed to tax.

(d) Indeed, in real life situations, there can be numerous other circumstances which are beyond the control of assessee: - for example, say, bank's strike, calamities, personal disabilities in case of proprietary or partnership concerns. Court stay, litigation and what not.

We are sure, it can never be the Government intention to introduce this provision to collect duplicate revenue from citizens nor can it be the intention to inflict undue hardship without paying heed to the reasons which lead to unintended default or delay.

7. <u>Set off of deemed short term Capital Loss- Amendment of section 74 r.w.s. 50</u>

Section 74 permits set off of short term capital loss only against Capital Gains. Section 50 provides for computation of capital gains in case of depreciable assets. Sub-section (2) states that where any block of assets ceases to exist as such for the reason that all the assets in the said block are transferred during the previous year then

the income as a result of such transfer shall be deemed to be short term capital gain. Similarly loss arising on account of such transfer shall be deemed to be short term capital loss.

There is a difference between section 54 and section 74. Section 50 separately deals with business assets, which are depreciable, whereas section 74 is for carry forward and set off of capital gain.

Loss on account of sale of depreciable asset u/s. 50 should be considered as business loss and should not be clubbed with section 74.

Suggestion:

Section 50 should be suitably amended to treat short term capital loss arising u/s. 50 as business loss. This is because in essence, the deemed short term capital loss u/s. 50 is actually business loss arising on the block of assets which are used for purpose of business.

8. Corporate Restructuring

8.1 Amalgamation

In order to Carry Forward and Set-off of accumulated loss and unabsorbed depreciation allowance in case of amalgamation the conditions specified have to be satisfied which *inter-alia* includes that Amalgamated company: -

- Holds continuously for a minimum period of 5 years from the date of amalgamation at least 75% in the Book Value of Fixed Assets of the amalgamating Company acquired in a scheme of amalgamation.
- Continues the business of the amalgamating Company for a minimum period of 5 years from the date of amalgamation.
- Fulfils such other conditions as may be prescribed (by CBDT).

In order to revive and carry out the business of the amalgamating company more effectively and efficiently and to improve the performance and quality, it may be necessary for the amalgamated company to undertake substantial modernisation of the plant and machinery and also replace the existing machineries.

Suggestions:

In view of the above it is suggested that the condition as to maintaining the 75% of the assets of the amalgamating company for a continuous period of 5 years should be deleted. Alternatively, at least condition of 75% of Book Value should be substituted by 50%.

Amalgamated Company should be allowed to change business activities of amalgamating company since this would facilitate early revival.

8.2 Demerger

Demerger means the transfer of one or more undertaking, pursuant to a scheme of arrangement u/s 391 to 394 of the Companies Act.

The Income-tax Act provides that in case of a Demerger, in order to claim exemption and other allowances from tax, the following conditions have to be satisfied:

- All the liabilities relating to the undertaking, being transferred by the demerged company, immediately before the demerger, should become the liabilities of the resulting company by virtue of the demerger.
- All the property of the undertaking being transferred by the demerged company immediately before the demerger should become the property of the resulting company by virtue of demerger.

Presently the law provides that the consideration should be paid only to the shareholders of the demerged company and not to the demerged company.

Suggestions:

- It is suggested that the clause requiring transfer of all liabilities should be deleted, since there are various liabilities, which are not easily transferable separately, or where lenders want the corporate liabilities to be retained with the demerged company.
- Part of the property, which is agreed between the parties, should be required to be transferred instead of all the properties.
- Suitable amendments be made that not only the shareholders but also the demerged company qualifies to receive consideration.

9. Stock Valuation Section 145A

Section 145A of Income -tax Act 1961, which was inserted by the Finance (No,2) Act, 1998 w.e.f. 1/4/99, provides that valuation of purchase and sale of goods and inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation. The explanation to section 145A further clarifies that the tax, duty, cess or fee shall include all such payments not withstanding any right arising as a consequence to such payment. In other words u/s 145A the amount of CENVAT on inputs and excise duty on uncleared finished goods lying in the factory is required to be included in the cost of inventories for valuation of closing stock. The amount of CENVAT on inputs used in the manufacture of finished goods is in the nature of advance payment of duty payable by the assessee on clearance of finished goods and hence adjustable against the excise duty liability on the finished goods.

The provisions of section 145A are at variance with requirements of Accounting Standards (AS-2)-Revised, on 'valuation of inventories' issued by the Institute of Chartered Accountants of India which is mandatory w.e.f, 1/4/99. The Companies Act, 1956 requires the Companies to follow Accounting Standards issued by the Institute of Chartered Accountants of India in preparation of Balance Sheet and Profit and Loss A/c of the Company. Similarly SEBI also require the listed company to follow the Accounting Standards in preparation of Annual Accounts of the Company.

The revised AS-2 on inventory valuation provides that the cost of purchases and inventory should not include duties and taxes, which are recoverable from the taxing authorities. Therefore/ CENVAT on inputs cannot be included in the value of inventories for valuation of closing stock as per aforesaid Accounting Standard.

The valuation of closing stock of inventories as per Accounting Standards is at variance with the requirements of section 145A. It may be appreciated that if the method of valuation of closing stock is consistently followed from year to year/ the profit of the business under one method of valuation of closing stock would not be different from the other method of valuation of closing stock over a period of time. The value of closing stock of one year would be the value of opening stock next year and so on. Hence, the profits do not arise out of valuation of stock.

Further, provisions of section 145A cannot be adopted for valuation of stock of stores and spares, which are treated as capital goods under Rule 57R of the Central Excise Rules 1944. The manufacturer is entitled to claim the CENVAT on stores and spares (capital goods) under Rule 57T only if the depreciation on CENVAT amount is not claimed or the amount of CENVAT is not claimed as deduction in computing income under the provisions of Income- tax Act 1961. If the amount of excise duty on such stores, spares is included in the valuation of stock, it would imply that on consumption the amount of excise duty is being claimed as a deduction or if the spares are used in capital assets, then the depreciation on CENVAT amount included in value of such capital goods is being claimed.

Suggestions:

The conflict in the provisions of section 145A of Act, the Accounting Standard and the Central Excise Act 1944 results in avoidable complications and increases the paper work in making adjustments to the value of closing stock of inventories as per Accounting Standard, to determine the income under the provisions of Income-tax Act, 1961 and then make corresponding changes to the opening stock of next year and so on. Therefore, the provisions of section 145A need to be harmonized with the Accounting Standard and the provisions of Central Excise.

10. Minimum Alternate Tax (MAT): Section 115JB

10.1 MAT - unabsorbed loss after providing depreciation as per Books of Accounts should be reduced in computing booking profit The Finance Act 2000 inserted Sec.ll5JB in place of section 115JA in the Income-tax Act 1962 with effect from 1-4-2001. It provides for minimum alternate tax on companies based on book profit computed as per Schedule VI to the Companies Act 1956 and adjusted as per explanation to section 115JB. Clause (iii) of the explanation provides that the amount of loss brought forward or unabsorbed depreciation, whichever is less as per books of accounts, is to be reduced from the book profit. The explanation further provides that the loss shall not include depreciation and the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil. In restricting the amount to be reduced from Book Profit, to the Book loss or Book unabsorbed depreciation whichever is lower, the very purpose of giving relief to the companies which have been incurring losses and have just turned the corner, is defeated. By this method, the

full benefit of loss incurred including depreciation in earlier years is not given in computing book profits for the purposes of levying MAT. Thus, this explanation is highly unjustified and puts unnecessary tax burden on companies which have actually incurred book losses including book depreciation in earlier years and would not be in a position to entirely set off past book losses before they are subjected to MAT on book profit computed in an artificial manner.

The objective of levying MAT was to tax book profit of companies without giving them any benefit in respect of various deductions and special allowances available to them under the normal provisions of the Act. It was not the intention of the legislature to tax companies when they had unabsorbed book loses including book depreciation. While inserting section 115J by the Finance Bill 1987 the Finance Minister has stated that "representations have been received that in computing book profits for the purpose of determining the minimum tax, losses and unabsorbed depreciation pertaining to earlier years should be allowed to set off. Otherwise new projects that have just begun to make profits after some years of losses and sick companies that have just turned the corner will become subject to minimum tax. There is merit in this suggestion." Accordingly, Clause (iv) was inserted in explanation to Sec. 115J which provided that the amount of loss or depreciation as per Sec. 205(l)(b) of the Companies Act, 1956 would be set off.

The Hon'ble Supreme Court in the case of Surana Steels (P) Ltd. v. DCIT 237 ITR 777 has held that the word *'loss'* as used in sec. 205(l)(b) of the Companies Act, 1956 signifies the amount arrived at after taking into account the amount of depreciation charged in the profit & loss A/c and that it has to be so read and understood in the context of sec. 115J of the Act. Although Supreme Court's decision was in the context of sec. 115JA the principle laid down in that decision, is squarely applicable to the provisions of sec. 115JB of the Act. Otherwise also there is no logic in denying the benefit of book losses including unabsorbed depreciation before levying MAT on book profits.

Suggestions:

It is suggested that explanation to sec 115JB should be amended to provide that loss includes depreciation and both loss and unabsorbed depreciation as per Books of Accounts would be reduced from the book profit for levying the MAT. This will also remove the genuine hardship to the Trading Companies, since in this companies the amount of depreciation is not much.

10.2 Exclusion of long-term capital gains and deductions u/s 80-IA/80-IB while computing book profit under MAT. MAT is payable by companies even on long term capital gain, though the same might not be taxable because of indexation or investment in approved securities in accordance with the provisions of sections 54EC/54ED of the Act.

Earlier, profits and gains derived by an industrial undertaking from the business of generation/distribution of electricity were excluded in arriving at the income liable to minimum alternate tax u/s 115JA of Income-tax Act. As a result of the new provisions contained in sec. 115 JB of the Act, companies operating windmills and deriving income from generation/distribution of electricity are affected adversely. It is

therefore suggested that profits derived by an industrial undertaking from the generation/distribution of electricity and other infrastructural development project be excluded from the computation of "book profit" as defined u/s 115 JB of the Income-tax Act.

Suggestions:

Section 115JB should be amended to provide for exclusion of long term capital gains and deduction allowable under section 80-IA/80-IB in computing Book Profit for the purposes of levying MAT.

10.3 Rate of MAT and Long term Capital Gains

While on one hand, by virtue of amendments made by the Finance Act 2006, tax payable on Book Profits has been increased from 7.5% to 10%, on the other hand profits on sale of equity shares or units of equity oriented funds (held for a period exceeding 12 months) which are exempt u/s. 10(38) of the Act would no longer be excluded while computing Book Profits u/s, 115JB.

The net effect of these amendments is that certain category of corporate assessees (i.e. those paying MAT on their Books Profits) are back to pre STT regime of 10% tax on Long Term Capital Gains arising for listed securities, STT being an additional hit.

When STT was introduced it was hailed as a major shift in the regime of taxation of Capital Gains. The effect of the amendment is that there is virtually a roll back of benefits in case of one category of assessees, namely MAT paying Corporate assessees, whereas the other assessees (corporate assessees paying tax under the regular provisions of the Act and non corporate assessees) continue to enjoy the benefits of the STT regime.

Suggestions:

- MAT Rate be reduced from 10% to the earlier rate of 7.5%.
- As it would be unfair to single out one category of assessees and deny them the benefit of STT regime, it is suggested that the amendment made by Finance Act 2006, be withdrawn with retrospective effect.

  Without prejudice to the above, in case the said amendment has to be retained it should be provided that such corporate aseessees who are hit by the amendment would be entitled to the credit of STT as tax paid.

10.4 Deferred tax

Clause (a) of the explanation to section 115JB provides for increasing the book profits by income-tax paid or payable and the provision there for

There is a doubt whether debit to P&L A/c of deferred tax is liable to be added back, whether as part of *"income -tax paid or payable and the provision therefor"* or *"as amount or amounts set aside to provisions made for meeting liabilities other than ascertained liabilities"*.

Suggestions:

This issue should be suitably clarified

10.5 Applicability of MAT on Undertakings claiming benefit u/s. 80-IC

The New Industrial Undertakings established in backward areas of Himachal Pradesh, Uttaranchal, North-Eastern States, etc., enjoy a tax holiday for 5/10 years u/s 80-IC of the Income-tax Act, 1961. In spite of the tax holiday, these units are liable for payment of income-tax u/s. 115JB on their book profits, which is against the intent and purposes of the Industrial Policy and fiscal incentives provided.

Suggestion:

In view of the above, it is submitted that section 115JB may be amended to provide exemption to undertakings claiming tax holiday u/s. 80-IC from payment of MAT.

11. Speculative Transactions - S. 43(5) & S. 73 (Taxation of Derivatives)

11.1 Derivatives - Exclusion from definition of Speculative Transaction - Section 43(5)

As rightly mentioned in the Explanatory Memorandum to Finance Bill, 2005, recent systemic and technological changes introduced by stock markets have resulted in sufficient transparency to prevent generation of fictitious losses through artificial transactions or shifting of incidence of loss from one person to another, and that screen based computerized trading provides for an excellent audit trail, and therefore the present distinction between speculative and non-speculative transactions is no more required. It is therefore suggested that the exclusion from the definition of speculative transaction should be extended to transactions in shares and other securities executed on recognized stock exchanges.

Further, transactions in commodity derivatives, are also executed on screen-based systems, which leave an audit trail. It is therefore suggested that the exemption should also be extended to commodity derivatives entered into on recognized commodity exchanges.

One of the conditions for the exclusion is that the contract note issued by the stock broker should contain the Unique Identification Number allotted under the Securities Contracts (Regulation) Act, SEBI Act, or the Depositories Act. The requirement of obtaining Unique Identification Number under MAPIN Database only applies to an investor's transaction exceeding Rs.1,00,000/- and the effective date of applicability is 1st January 2006. As you are aware, SEBI has suspended the scheme of MAPIN for the time being. In view of the above, it is suggested that mentioning of the trader's Permanent Account Number on the broker's note should be regarded as sufficient for the purpose, without the requirement of mentioning Unique Identification Number.

Further, the requirement refers to a contract note issued to every client having such numbers. It is suggested that the requirement should be that the contract notes in respect of such transactions of the client should bear such number.

Also, in order that the transaction falls out of the definition of “speculative transaction”, it should be entered into on a recognised stock exchange. For this purpose, a notification has been issued [F.No. 142/38/2005-TPL] on 25th January, 2006. As per the said Notification, both BSE and NSE have been notified. However, the drafting of the said Notification has created a controversy. In the said Notification, it is mentioned that “the Central Government hereby notifies the following stock exchanges as recognised stock exchanges for the purposes of the said clause with effect from the date of publication of this notification in the Official Gazette (emphasis supplied). As a result, a plain reading of the section and the Notification suggests that transactions which otherwise satisfy all conditions laid down but which were entered into after 1st April, 2005 but prior to the date of publication of the notification in the Official Gazette will not be excluded from the definition of speculative transaction. Such an interpretation is bound to result in a lot of hardship and also litigation. Therefore, a suitable clarification may be issued to exempt all eligible transactions entered into on BSE or NSE after 1st April, 2005 from the definition of speculative transactions.

11.2 Deemed speculation loss in case of companies - Explanation to S. 73

As per the provisions of section 73 of the Act, any loss, computed in respect of a speculation business carried on by the assessee, cannot be set off except against profits and gains, if any, of another speculation business.

As per Explanation 2 to section 28 of the Act, where speculative transactions carried on by an assessee are of a nature so as to constitute a business, the business (referred to as "speculation business") shall be deemed to be distinct and separate from any other business.

As per Section 43(5) of the Act, "speculative transaction " means a transaction in which a contract for the purchase or sale of any commodity, including stocks and shares, is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scripts.

Accordingly, speculative business is normally understood as business in respect of transactions where settlement takes place without actual delivery.

However, as per Explanation to section 73 of the Act, where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads, "Interest or securities", "Income from house property", "Capital gains" and "Income from other sources" or the company the principal business of which is the business of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

Accordingly, as per the Explanation to Section 73, in case of most companies, even delivery based share transactions are deemed to be speculative. The present provisions deeming even delivery based purchase and sale of shares as speculative business discriminate between corporate and non-corporate assessees.

Automation of the trading mechanism, screen based trading, controls on reporting of capital market transactions by share brokers, submission of AIRs, dematerialization and other measures initiated by SEBI over last few years have brought total transparency in share trading, leaving little scope for manipulation of share trades by transfer of profits/losses from one person to another. In any case, corporates are more regulated compared to non-corporates and hence, disadvantage to companies in terms of discriminatory tax provision as described above can hardly be justifiable.

The need of the hour is to encourage corporatisation which could bring about more transparency and healthy business practices. However, the present provisions act as a disincentive for corporatisation.

Further, when derivatives which are in the nature of speculative transactions are not considered as speculative transaction, there is least logic to continue deeming fiction of treating the transactions in shares entered by a company as speculative transaction.

It is, therefore, suggested that the aforesaid Explanation to section 73 of the Act ought to be deleted.

11.3 Treatment of Profit from Derivative Transactions

The Finance Act, 2006 amended the definition of speculative transaction u/s. 43(5) to treat the transactions of derivatives on the recognized stock exchange as normal business transaction.

However, there is no clarity as to whether the profit/loss made from the derivatives transactions should be treated as Capital Gain or a Business Income. This creates number of issues and invites litigations.

It is therefore suggested that the clarification should be issued to the effect that the profit/loss from the Derivative Transactions should be treated in the same manner as other securities and accordingly would be chargeable to Capital Gain Tax or Business Income based on the well accepted principles.

12. Provisions Relating To Gift : Ss.2(24)(xiii) & 56(2)(V)

As per Section 56(2)(v) and Section 2(24)(xiii), any receipt in the nature of gift, subject to certain exceptions, is taxed as income if the aggregate receipts during the year exceed Rs.50,000/-. The rationale behind insertion is to prevent money laundering.

12.1 Measures of Rationalisation

(A) The following receipts should be exempted from the charge:

a) Gift to and from Hindu undivided family by or to a member of the family.

b) Any receipt which is in the nature of damages or accident compensation or which is received on compassionate grounds.

c) Any receipt which is in the nature of prize or reward for performance at state, national or international level.

d) Any receipt, which is not in the nature of a gift.

e) Any compensation received from an insurance company under any insurance policy.

f) Any donation or charity received by a victim of a natural or other calamity or the family members of such a victim from any person or organization. At present, such compensation received from the Central Government is exempted. However, considering the severe hardship and trauma faced by the victims and their family members in such cases, there is a need to extend the exemption to donations or charity received from others also. Necessary safeguards may be set in place to avoid misuse of this concession.

g) Such other receipts as may be notified by the CBDT.

(B) Further, there is an anomaly in the existing provisions inasmuch as a gift received by a person from his father's brother is exempted from tax but if the same person (i.e. the nephew) makes a gift to his father's brother, then the latter would have to pay tax on the gifted amount if it exceeds Rs. 50,000 in a year. This anomaly needs to be removed immediately.

(C) An unintended outcome of the amendment made to Section 56 by the Taxation Laws (Amendment) Act, 2006 is that if a person receives gifts aggregating to more than Rs. 50,000 in a year from persons other than relatives then the entire amount of gifts would be taxed as income in his hands instead of only the amount in excess of Rs. 50,000. It is suggested in order to avoid ambiguity and resulting disputes and litigation, the section be amended to clearly lay down a basic threshold limit for exemption of Rs. 50,000 per year for aggregate gifts received during the year from non relatives.

13. Deemed Dividend - S. 2(22)(e)

13.1 Clause (22), of section 2 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.

13.2 Apart from payment to the shareholder himself, a loan or advance to a firm in which he is a partner with a 20% share, or to an association or body of which he is a member and entitled to 20% of its income, is also considered, to be deemed dividend, and is taxed accordingly.

13.3 The object clearly is to prevent tax-avoidance by making an advance or loan (which would not be taxable), instead of distributing the amount as a dividend, which is subject to income tax.

13.4 The provision suffers from many inequities:

a) 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.

b) 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.

In the light of all these infirmities, it is submitted that there is a strong case for deletion of the mischievous sub-clause (e). This would also serve the desirable objects of rationalization and simplification. At present, no tax is payable by the shareholder on dividend received from companies and only the company pays dividend distribution tax @ 12.5%. 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 dividend distribution tax.

14. Capital Gains

14.1 STT and Separating Cost in Capital Transactions - S. 88E & S. 48

Section 88E provides for mechanism of granting relief to assessee in respect of STT paid on business transactions which generate income chargeable under the head "Profits and Gains of business or profession". The real life experience has shown that the whole working is cumbersome apart from being complex and prone to differing interpretation. Since levy of STT is nominal compared to the overall value of transactions and since with the introduction of screen based trading, there is hardly any scope for undertaking oblique transactions for tax avoidance purposes, there is need to make life of tax payers simple by providing for a strait-jacket rebate of the full amount of STT against tax payable by the assessee in that year, while restricting the upper limit of rebate to the actual tax payable by the assessee.

Under section 48 of the Act, an investor of securities is not entitled to treat STT payment as his cost of asset in the computation of capital gains income as and when the securities are sold. This is not only against the commercial principle of determining cost of acquisition of an asset, it also leads to the enormous difficulty for lay investors in separating out STT element of cost from each transaction. We believe that the provision is investor unfriendly with nominal consequences in terms of tax

liability. We therefore suggest that simplicity may be achieved by omitting that proviso.

14.2 Indexation

With a view to provide hedge to assessees against inflation, section 55(2)(b) has, very wisely, provided for substitution of FMV as on 1st April 1981 as the cost of acquisition of asset at the option of assessee. Since the mark up of inflationary trend is perceived to be higher than the rate of indexation which is computed under section 48, there is need to substitute 1st April 1996 as the base date in section 55(2)(b) of the Act in place of 1st April 1981.

15. Taxing insurance claim as capital gains

As per section 45(1 A), any gain arising out of insurance claim in cash or kind, on account of damage or destruction of a capital asset, is liable to capital gain tax. The distinction between the destruction and damage of an asset is not considered while drafting this provision.

In case of a partial destruction, the life of asset comes to an end, while in case of damage, the asset continues to be in existence and normally insurance company compensates for expense incurred for restoring the damaged assets to its working condition.

Suggestions:

In case of damage, the insurance claim is a revenue receipt and restoration of an asset is a revenue expense. Thus damage cannot be considered as transfer within the scope of section 2(47),

16. Dividend Distribution Tax - Section 115-O

16.1 Rate of Tax

Section 115-O provides for levy of dividend distribution tax (DDT) on dividend declared / distributed / paid by a domestic company. A Company is required to pay additional income tax at the rate of 12.5 per cent on its distributed profits in terms of section 115-O of the Act. DDT per-se is double taxation in the hands of the company - first, tax is paid on profits made and again when the post-tax profit is distributed as dividend. It would be desirable to avoid such double taxation element.

DOT also creates a bias in favour of undistributed profits as against distributed profits. While this bias may encourage retention of profits and accelerate the pace of capital formation, it is equally necessary to ensure that the shareholders get commensurate yields on their equity holdings, otherwise, they would prefer to choose alternative options for their investments, which may not be desirable for the corporate growth. A company has to make an optimal balance between the retention and distribution of post tax profits.

Further, dividends distributed by wholly owned subsidiary of a domestic company to its holding company are also subject to DDT.

Suggestions

- In this perspective, it would be desirable to do away the Dividend Tax altogether. However, if it is not possible to do away the Dividend Tax, the rate ought to be reduced from 12.5% to 10%.

- There should be no levy of DDT where dividends are distributed by a wholly owned subsidiary to its holding company which is also a domestic company. The payment of dividend by a wholly owned subsidiary to its holding company both being tax residents of India is akin to a pass through transaction and logically DDT should only be levied when the holding company declares dividend to its shareholders.

16.2 Multiple incidence of DDT

There is a multiple incidence of DDT on the flow of dividends from subsidiary companies to parent /holding companies. The cascading effect of such multiple incidence of DDT acts as a barrier to creation of a holding company regime in India and hinders down stream investment by holding companies in India.

Suggestion:

It is suggested that in line with erstwhile section 80M credit be available to the holding parent company of the proportionate dividend distribution tax paid by subsidiary companies against its own DDT liability at the time of payment to shareholders. It will prevent economic double taxation of the same income, once in the hands of the subsidiary and again in the hands of the parent, and will promote a holding company regime facilitating downstream investments by them in India.

16.3 Tax Credit of DDT

From a foreign shareholder's perspective, DDT may not be preferred since it is generally not eligible for claiming tax credit against his home country tax. Some countries like the UK and Mauritius had notified that they would give credit for such tax. However, for other countries this issue is still unresolved.

Suggestion:

It is, therefore, imperative that DTAAs be amended to include the distribution tax within its purview.

17. Disentitlement of Benefits - Section 80AC

Exemption/deduction u/s 80-1 A, 80-1AB, 80-IB and 80-IC the Income-Tax Act, 1961, is allowable to industrial undertakings established in backward areas. The exemptions/deductions are allowable on fulfillment of certain conditions specified in the relevant provisions. As per section 80AC, inserted by Finance Act, 2006, the

aforesaid exemptions /deductions will be denied in case the income- tax return is not furnished on or before the specified due date.

The aforesaid provision is very harsh. Every assessee tries to file its tax returns in time. On late filing of return, mandatory interest u/s 234A, B and C is payable. There may be unforeseen circumstances like fire, strike, earthquake, flood etc. at a place, where the assessee's accounts are maintained and due to which delay in filing of tax return may take place.

Suggestions:

It is suggested that in cases, which are beyond the control of the assessee, such exemptions/deductions should not be denied. In any case, the Chief Commissioners and/or the CBDT may be at least empowered to condone delays in such cases.

18. Deduction For Housing Projects : S. 80 IB

18.1 Time limit for completion of project

The Finance (No.2) Act, 2004 has provided under section 80IB(10) that where the housing project is approved on or after 1 April 2004 the completion of the construction of the housing project should be within four years from the end of the financial year in which the housing project is approved. Further the date of completion certificate issued by the local authority would be considered as the date of completion.

It is suggested that as the condition for completing the housing project within a period of four years is too stringent especially having regard to larger projects, the condition should ideally be removed. It will be appreciated that it would be in the commercial interest of any builder to complete the project as early as possible and that there is no incentive for anyone to delay the project. If for any unavoidable reasons (like third party litigation or unavailability of required building material etc.) a project gets delayed by even one day, the entire deduction would get jeopardised. Recent litigation in the Bombay High Court regarding use of TDR (which took several years to get resolved), is appropriate example to show that if the matter gets in litigation, it is beyond the control of the developers to complete the project within the time limit prescribed.

Secondly, the date of completion is considered as the date of issue of the completion certificate by the local authority. It is a known fact that in the city like Mumbai, more than 80% of the buildings do not get completion certificate on account of some technical or procedural issues. It is therefore suggested that the date of completion should be based on the certificate obtained from qualified Architects rather than from the Local Authority.

18.2 Limit on the built up area of shops etc.

The Finance (No.2) Act, 2004 has provided that the profits derived from 'housing projects' would qualify for deduction if the built up area of the shops and other

commercial establishments included in the housing project do not exceed five per cent of the aggregate built-up area of the housing project or two thousand square feet, whichever is less.

It appears that the words "whichever is less" in s. 80IB(10)(d) have crept in by mistake and that they should have been "whichever is higher". It can never be legislative intent to restrict the presence of commercial area to 2000 sq. feet regardless of the size and location of the project. Indeed, for a large housing project, the prescribed shopping area of 2000 square feet is too low. It is learnt that in some cases the local authority requires a minimum of 25% area as shopping area. Having regard thereto, alternatively, the limit could be 10% of the aggregate built up area or the minimum area required by the local authority whichever is higher.

Besides, even in cases where the local authority has, in the past, duly approved the housing project with shops or other commercial establishments consuming more than the above limit, such project would still be denied the deduction for non-fulfillment of the condition relating to the built up area of the shops and other commercial establishments included in the housing project.

It is suggested that the limits, if, any be introduced only for the projects that were approved on or after 1 April 2004.In any case, if shop or other commercial establishments are constructed in accordance with the approval of the local authority, then pro-rata deduction commensurate with consumption beyond the permissible limit under this section should be disallowed.

19. Issues Pertaining To SEZ Sector

19.1 Deduction for existing Units in SEZ under section 10AA

Section 10AA provides for deduction in respect of profits and gains derived from the export of articles or things manufactured in, or services provided from, a unit that begins to manufacture or produce ... or provide any service on or after April 1,2005.

It appears from plain reading of the newly inserted provisions [viz. sub-section (7B) of section 10A and sub-section (1) & (4) of section 10AA], that the units in SEZ presently eligible for deduction under section 10A (i.e. which have begun to manufacture or produce an article / thing / computer software before April 1, 2005) do not qualify for the benefit under the new section 10AA and would continue to be governed by provisions of section 10A and get tax concessions of only 10 years period. On the other hand, a non-SEZ unit, presently availing tax concession under section 10A, would be covered by 10AA upon its migration to SEZ and enjoy the tax-concession for the unexpired period of 10 years and a further period of 5 years (as per first proviso to section 10AA). This puts the early entrants into SEZ in a disadvantageous position compared to those who enter SEZ now (unless such units in one SEZ migrate to another SEZ!).

Suggestions:

a) The provisions contained in the provisos to section 10AA may be suitable amended to bring out the legislative intent.

b) It is suggested that all units in SEZs whether starting operations on or before 31st March 2005, or after 31st March 2005, and also the non-SEZs units migrating to SEZs should be explicitly covered by the new regime of section 10AA.

19.2 Defining "Services" in section 10AA

Section 10AA grants deduction in respect of profits and gains derived, *interalia,* from services provided from units in SEZ. Section 10AA does not define the word "services". However, there is specific reference to "computer software" as forming part of definition of "services" in the provisions relating to computation of deduction under section 10AA [viz. in sub-section (7) and in definition of "export turnover" given in Expl. 1].

The scope of "services" intended to be covered for purposes of conferring benefit under section 10AA has not been specified. The word "services" has a specific meaning assigned in clause (z) of section 2 of the SEZ Act to mean such tradable services which are ..... notified by the central government and which earn foreign exchange. The said definition cannot be used for purposes of section 10AA of the Act unless there is mandate to that effect in the section. By implication/ an entrepreneur is entitled to deduction of income earned from providing all such services/ which a unit in SEZ can possibly carry-out in an SEZ. Further, the condition of actual receipt of export proceeds in foreign exchange cannot be read into the provisions of section 10AA.

Suggestions:

a) Section 10AA should be amended to define the intended scope of "any services" referred in section 10AA.
b) Computer Software and Information Technology Enabled Services [ITES] may be defined as being included in "services".

19.3 Scope of exemption from MAT

Sub-section (6) has been inserted in section 115JB to provide exemption from MAT to an "Entrepreneur" or "Developer" in respect of income accruing or arising from any business carried on, or services rendered, in a "Unit" or "SEZ"/ as the case may be.

The plain reading of the provision indicates that exemption from MAT is available to a Developer in respect of income accruing or arising from any business carried on/ or services rendered/ in a SEZ.

This may be construed as not referring to income accruing or arising from any business of developing a SEZ since there can be no business carried on/ or services rendered/ in a SEZ prior to its development. This does not appear to be so intended.

Suggestions:

It may be clarified that the exemption from MAT to a "Developer" is available in respect of income arising from an undertaking or enterprise engaged in

(i) Developing a SEZ; or
(ii) Developing & operating a SEZ; or
(iii) Developing/ operating & maintaining a SEZ.

19.4 Tax on Dividend distribution Section 115-O

Sub-section (6) has been inserted in section 115-O by the Special Economic Zones Act/ 2005 w.e.f. 10.02.2006 providing that no dividend distribution tax shall be levied on the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a SEZ on any amount declared, distributed or paid by way of dividend out of its current income, either in the hands of the enterprise or the person

- There is no clarity as to how the exemption would be available in respect of an enterprise engaged in the SEZ activity AND any other business activity. Will it be eligible and if yes/ whether completely exempt, irrespective of quantum of profits from the SEZ activity?
- The use of the expression 'out of its current income' is also likely to create difficulties in case dividend on income earned by a Developer (after 1st April, 2005 only) is declared not in the year in which the income is exempt but later on.

Suggestion:

It is suggested that:

- Section 115-O(6) be amended to provide the mechanism for computation of dividend which will be exempt from dividend distribution tax.
- Replace the expression 'on or after the 1st day of April, 2005 out of its current income' by the expression 'on income accruing or arising on or after 1st April/ 2005'

19.5 Section 80-IA(4)(iii)/80-IB(2nd Proviso)

Initially section 80-IA was intended to grant benefit to enterprises engaged in development of infrastructure facility (read road/ bridge, airports etc.). Thereafter the benefits were extended to various other sectors like developers of industrial park/ SEZ/ etc. [The development of infrastructure was understood to be made on "BOT" (Built Operate Transfer basis)]

Under section 80-IA(4)(iii) the benefit is made available to any undertaking which develops, develops and operates or maintains and operates an industrial park or SEZ.

However, where the developer of an industrial park / SEZ transfers the operations and maintenance of the industrial park/ SEZ to another/ then it appears that the benefit u/s. 80-IA is made available to the transferee undertaking and it is not clear as to whether the benefits would be available to the developer also, from income arising from development, who makes substantial investment for development of SEZ.

Generally, any development of real estate results in sale or lease transactions. However, in case of such park/SEZ, the only revenue source is lease as the sale per se is not allowed.

Hence, the lease rentals should be considered as income from business in respect of such properties.

Suggestions:

- Even if the operation and maintenance is transferred, it may be clarified that the benefit shall be available to the developer for income arising from development activity.
- The developer should get benefit in respect of its rental income from the lease, irrespective of whether the income is assessed as income from house property or as Profits of business of the developer.

20. Issues Pertaining to 10A/10B/BPOs

20.1 Extending Section 10A / 10B benefits to supporting manufacturers / software developers

It is important that the benefits under the Act percolate to entities at all levels. This can be achieved by extending the benefits of section 10A and 10B of the Act to supporting manufacturers / software developers to the extent of value addition on the same lines as provided in sub-section (1A) of section 80-HHC to supporting manufacturers. The tax benefits, translated into cost-benefits, will ensure better export market and price realization from the foreign customers. Most importantly, it will encourage sub-contracts/partnerships between big and small companies and create an export oriented environment.

Suggestions:

Provisions similar to sec.80HHC etc. need to be brought in, in these sections also.

20.2 Issues of shares outside India in lieu of export proceeds

Sub-section (3) of section 10A / 10B of the Act provides the deduction from export of articles, thing & computer software if the money is brought into India within the period of six months or extended period as allowed by the competent authority.

It is not clear if issue of shares outside India in lieu of the export proceeds to be received in India will qualify as receipt of such export proceeds in India for purposes of claiming deduction under section 10A / 10B.

Suggestions:

The issues may be clarified by providing suitable explanation to sub-section (3) of section 10A/ 10B.

20.3 Whether statutory levies like excise and sales tax are to be excluded from export/total turnover?

Court rulings have held that statutory levies should be excluded from 'total turnover' so that the same is comparable to 'export turnover'.

Suggestions:

A clarification to this effect would avoid unnecessary litigation on this issue.

20.4 Income referred in section 10A / 10B - whether an admissible deduction or exemption?

Sub-section (6) of section 10A / 10B restricts the carry forward of business losses [referred in section 72(1)] and loss under the head capital gains [referred in section 74(4)] in respect of undertakings eligible for deduction under the sections but does not restrict set-off against other income as provided in section 71, Section 10A / 10B fall in the chapter III *(Incomes ivhich do not form part of Total Income)* but it uses the words "deduction.,., shall be allowed" - this gives rise to the following issues:

(1) Is the income referred in section 10A / 10B an eligible deduction in computing total income or an income exempt from taxation. A negative exempt income cannot normally be set-off. Accordingly, can the losses suffered by undertaking eligible for section 10A benefits, be set off against other incomes of the assessee.

(2) At what stage should the deduction under the sections be claimed - whether the deduction should be claimed from "Profits and Gains of the undertaking" or "Profits and Gains of the business income of the assessee" or "Gross Total Income" or after chapter VI-A deduction but before arriving at Total Income (which is subject to tax)?

Suggestions:

This position may be clarified:

1) If it is an admissible deduction, the provisions of this section may be moved to Chapter VI-A (if it is an admissible deduction from Gross Total Income) or to Chapter IV (if it is an admissible deduction in computing business income). Alternatively, the stage of claiming deduction may be clarified.

2) If it is an exemption, it may be specifically provided in section 71 that business losses and loss under the head capital gains in respect of undertakings eligible for exemption under these sections may be allowed to set off against other incomes or capital gains, respectively, notwithstanding that such income is exempt under Chapter HI of the Act.

20.5 Profits eligible for deduction under section 10A/10B

Sub-section (1) of section 10A / 10B provides for deduction of the profits derived by an undertaking from the export of articles or things or computer software. Sub section (4) of section 10A / 10B states that for the purposes of sub section (1), the profits derived from the export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

The word profits derived from "the export of articles or things or computer software" is narrower in meaning as compared to "profits of the business of the undertaking".

Suggestions:

a) It may be clarified whether the narrower or the broader' meaning should be construed for the purposes of deduction under section 10A?

b) What is the income stream that qualifies for deduction under section 10A / 10B? As illustrative cases, whether interest on savings with bank or on security or other deposits maintained with bank or other authorities in course of business/ duty drawbacks on exports, etc. is eligible for deduction?

c) The term "Profits of the business of the undertaking" is not defined for the purposes of section 10A of the Act. In Explanation 2 to section 10A, the term "Profits of the business of the undertaking" should be defined.

d) Similar changes may be made in section 10B as well.

20.6 Eligibility for tax holiday benefit for EHTP/ STP units converted u/s 10A

CBDT Circular No. 1 issued in January 2005 has clarified that EOU becomes entitled to tax holiday benefit from the date the required approval to operate as an EOU is received by the assessee. It has also been further clarified that the period of entitlement of tax holiday benefit for the eligible assessee shall be available only for the period remaining within 10 years period (beginning from the date of commencement of manufacturing activity).

Such clarification has not been provided in case of unit located in EHTP/ STP, which are covered under section 10A of the Act.

Suggestions:

Similar clarification by way of amendment and/or as an explanation to section 10A may be issued in respect of all units covered under the section.

20.7 Section 10A(7A) /10B(7A)

The provisions of section 10A(7A) of the Act provide that deduction under the section shall not be available in respect of de-merged unit or the amalgamating company in the year of demerger or amalgamation. Instead it is available to the resulting company or the amalgamated company, as the case may be.

It is an accepted position that the benefits attached to a unit move with the unit. The specific provision under sub-section (7A) on amalgamated company and demerged units gives rise to the following issues:

a) It is unfair to deny deduction to the transferor company as the transferee company can claim deduction in respect of profits for only the period after transfer.

b) It gives rise to a possible interpretation that such continuation of benefit under section 10A is available only to amalgamated / resulting company and not in other cases such as slump sale.

Suggestions:

Suitable amendments may be made to the sub-section to provide that the in all cases (whether amalgamation, demerger or slump sale), the transferor and transferee company can get deduction for respective number of days of ownership before and after transfer.

20.8 Clarifications necessary for Foreign companies

By virtue of business connections in India, there is a concern that a non-resident outsourcing IT enabled BPO work to India has the obligation of filing a tax return in India and also being assessed to tax in India. It would be in the interest of the industry to have clarification on the following:

1. The non-resident shall not be liable to tax in India for such outsourced work and consequentially shall not be required to file any return of income in India. CBDT Circular No 5 dated September 28, 2004 on BPO taxation does not explicitly put to rest the concerns of overseas companies.

2. Arm's length price for activities outsourced shall be determined only on the basis of activities performed by Indian BPO unit without attributing any profits of the non-resident; AND

For shortfall in "Arm's length price", if any, consequential adjustment shall be made only in the hands of Indian BPO unit (not non-resident).

21. International Taxation

21.1 Software Import

With the IT revolution, virtually all technical systems are IT driven. Often software is imported along with or as a necessary adjunct for the functioning of imported equipment. Payment for such software is often treated by the tax department as royalty. This makes the import costlier as the contracts for such purchase are at times made net of taxes in India.

Suggestions:

This position can be corrected (in line with the principles reiterated in a few IT AT judgments) by making an amendment clarifying that *'royalty* 'under *section 9(l)(vi)* of the Act does not include such cross-border sale of software unless the buyer gets the underlying copyright(s) in the software which can be used for reaping commercial profits by replicating the software.

21.2 Taxation of Income of Non Residents

The Act [sections 115A, 115AB, 115AC, 115ACA and 115AD] provides for taxation at varying rates depending upon the nature of income sought to be taxed. Examples of such income include income from Royalties, Fees for technical services, income from GDRs, dividends, interests, etc. The provisions have become more complex and need to be simplified (in line with the legislature's move towards simplification of tax laws over the past few years).

Suggestions:

All the said provisions should be consolidated / aligned and a uniform tax rate be provided in respect of all types of income earned by all the non-residents.

21.3 Royalty and Fee for Technical Services

Currently, section 115A provides that Royalties or Fee for Technical Services (FTS) received by non-residents are taxed at a concessional rate of 10% only if the agreement under which these Royalties/FTS are received is approved by the Central Government or relates to a matter that is covered under the Industrial Policy.

After the enactment of the Foreign Exchange Management Act, 1999 the Government has liberalized the exchange control regulations and currently any payment to a non-resident on account of current account transactions is allowed unless specifically made subject to approval either by the Central Government or by the RBI. In view of the fact of opening up and aligning of Indian economy with the world economy and considering that India is promoted as 'manufacturing base' for the world market, the variant taxable rates are not appropriate. The RBI has, in certain cases such as payments on account of royalty and fees for technical services to non-residents, has granted 'automatic approval' for payments up to a certain monetary limit

Suggestions:

It is suggested that section 115A be amended to clarify that payment of Royalties/FTS to non-residents under agreements in accordance with FEMA shall be taxed at the preferential rate specified under section 115A. Further, the reference to Central Govt. approval and Industrial policy may be omitted. Alternatively, payments under non-approved agreements may be subject to slightly higher rate of tax on gross basis [presently such payments are subject to tax @ 40% in case of foreign companies and 30% in the case of other nonresidents (as increased by applicable surcharge and education cess) as against the rate of 10% on payments under approved agreements or agreements covered by Industrial policy].

21.4 Entitlement to avail DTA benefit

Presently, under certain treaties, a person is entitled to claim tax credit if he is 'liable to tax' in the other Contracting State. There is lack of clarity whether the words 'liable to tax' means 'liable to pay tax' or 'liable to tax, notwithstanding exemption or concession under any incentive provisions' as per the laws governing taxation in the other contracting State. In other words, the scope of liability to tax is not defined.

Suggestions:

The term "liable to tax" should be defined in Act (in section 90 and 91) to the effect that there should be tax laws in force in the other State, which provide for taxation of such person (i.e. being a "taxable subject" in that country), irrespective that such tax laws fully or partly exempt such person from charge of tax on any income in any manner.

21.5 Parity between Section 90 & 91

Under the provisions of section 90, assessees may opt to be governed by the provisions of relevant DTA or of the Act, whichever is more beneficial. On the other hand, under the provisions of section 91, assessee is entitled to credit of taxes paid in another country with which India does not have a DTA provided that such income is taxed in India as well.

If an assessees covered by section 90 (i.e. where India has a DTA with another country) opts to be governed by the Act, he is no longer entitled to the credit of taxes paid by him in the other country. This is anomalous since assessees covered by section 91 (i.e. where India does not have a DTA with another country) are entitled to such credit being governed by Act.

Suggestions:

Section 90 should provide for such tax credit and bring the assessee in parity with one governed by section 91 where the assessee opts to be governed by the provisions of the Act.

21.6 Foreign tax credit to PEs of foreign branches

Section 91 contains enabling provisions for claiming tax credit by residents for taxes paid in foreign country. The section does not contain any enabling provision by which a foreign company/its PE can claim credit for taxes paid by it (as withholding tax or otherwise) in a third country on incomes derived therefrom. In the circumstances, such foreign company / its PE is worse off than an Indian tax resident as it is denied the tax credit which a resident would be entitled to. The only recourse available to the foreign company / its PE is the non-discrimination clause contained in the treaty between India and the country of residency of such foreign company.

Suggestions:

The Act should contain enabling provision allowing credit to such foreign company / its PE for taxes paid in other countries on incomes received by it from such third country and taxable in India. This provision can be beneficially used in absence of such treaty or such provision in the Treaty.

21.7 Procedure for granting Tax Credit available under DTA

1. Indian Companies are extending their businesses across the border and their income is subject to tax at source in other countries. Credit for such taxes paid abroad is allowed against its Indian tax liability on such foreign sourced income under section 91 or under Tax Treaties. There are no prescribed guidelines/rules as regards the documentation required for claiming credit for such foreign tax.

Suggestions:

Suitable amendment be made in the Act requiring that rules in this regard may be prescribed. CBDT may, in its turn, formulate appropriate Rules to provide the necessary documentation in connection with claim and grant of credit for foreign tax paid by Indian companies

2. In certain cases the assessee may not be in a position to claim any credit because of loss or in some cases, only partial credit will be available. Assessees must be allowed to carry forward (for five years) such unutilized credit.

Suggestions:

Section 90/91 be suitably amended to allow such relief which is due to assesses. In USA such relief is granted vide provisions of sub-section (c) of section 904 of Federal Tax Act of USA.

21.8 Applicability of Tax Audit Report and MAT on Non-Residents not having PE in India [Section 44AB / 115IB 1

There is lack of clarity whether non-residents not having a PE in India but subject to tax on presumptive or gross basis under section 115A / DTAs are subject to provisions relating to:

(i) Tax audit report under section 44AB;
(ii) MAT under section 115JB;

Further, the non-residents not having a PE in India but subject to tax in India on presumptive or gross basis under section 115A / DTAs are also subject to TP regulation requiring documentation and furnishing TP Report. Taking a conservative approach i.e. filing of tax audit report or certificate of MAT, etc. leads to practical difficulties (such as in getting accounts audited, engaging professionals for certification, etc.) without any corresponding tax benefit.

Suggestions

It may be clarified that provisions relating to

- Tax audit report under section 44AB;
- MAT under section 115JB;
- Transfer Pricing

shall apply only to the payer and not to the recipient of such income except that they shall be subject to such provisions where the assessee is taxable on net-basis.

21.9 Head Office Expenditures [Section 44C]

The deduction of an amount upto 5% of adjusted total income is allowed as head office expenditure in the case of non-residents of the business of the branch in India from the limit of 5% as given in section 44C. Such expenditure should be fully allowed as a deduction. The law is not very clear to exclude expenditure incurred outside India by head office exclusively for and on behalf

Suggestions:

Explanation (iv) of section 44C be amended to clarify with retrospective effect from June *1,* 1976 that "head office expenditure" shall not include expenditure incurred outside India which specifically relates to the assessee's business or profession in India.

21.10 Royalty and FTS attributed to PE [Section 44 BA]

Section 44DA was inserted by the Finance Act, 2003 with a view to align the Act, which hitherto provided for taxation of royalty & fee for technical services (FTS) attributable even to a permanent establishment (PE) on gross basis, with Tax Treaty provisions requiring taxations of profits attributable to a PE on a net income basis. The provision intended to enable the non-residents claim taxation on net-income basis has become a compulsion on, both, the assessee and tax authorities to compute net-income by way of royalty/ FTS, which could be onerous and subject to protracted litigation.

Suggestions:

The assessee should be given an option of being subject to tax on income by way of royalty/ FTS on a gross-income basis or net-income basis in both PE and non-PE situations.

21.11 Applicability of PAN provisions on Non Residents [Section 139A]

Section 139A(8)(d) states that the Board may make rules providing for the class or classes of persons to whom the provisions of this section shall not apply. Rule 114C read with section 2(30) specifies, inter-alia, non residents for this purpose. However, in recent interaction, the tax authorities have indicated that they are of the view that even non-residents need to comply with PAN obligations. The authorities have cited the deletion of the first proviso to sub-section (5A) of section 139A as indicative of

the intention of the legislature that compliance of PAN is mandatory for non-residents as well. The deleted proviso had made an exemption from 139A for certain categories of non-residents. There is confusion as to whether compliance with PAN provisions is mandatory for non-residents.

Suggestions:

Provision needs to be suitably amended to clarify the situation.

21.12 Section 9(1) (i) Expln. (b)

The section provides that when the operations of non-residents are restricted to purchase of goods from India for export, no income shall be deemed to have accrued or arisen in India.

Meaning of the expression "operations which are confined to the purchase of goods in India for the purpose of export" is subject to varying interpretations. There is a conflict of view in cases where the customized goods are purchased from Indian vendors and the process of customization is supervised by the buyer. In such cases disputes have been raised whether such activities of customization and supervision thereof would be covered by the expression "operations which are confined to the purchase of goods in India for the purpose of export",

Suggestions:

An Explanation should be provided to define the activity of "operations which are confined to the purchase of goods in India for the purpose of export" i.e. whether it would include the activity of purchase of customized goods made as per the specification and with the supervision of buyer.

21.13 Correspondence on Internet

The Income-tax Department should create facilities so as to enable taxpayers to correspond with the officers of the Income-tax Department on the Internet. This may be useful for making the assessment process efficient

22. Transfer Pricing

22.1 Sub-section (2) of the Section 92A

Sub-section (2) of the section 92A enumerates situations where two enterprises shall be deemed to be associated enterprises. Certain limbs of the aforesaid subsection could result in significant practical difficulties in application of these provisions. These are:-

i) a loan advanced by one enterprise to the other enterprise which constitutes not less than 51% of the book value of the total assets of the other enterprise would result in both enterprises being treated as associated enterprises even if none of the enterprises hold any equity stake in other enterprise;

ii) an Indian enterprise which is wholly dependent upon the foreign enterprise for the know-how for manufacture of its goods would also constitute an associated enterprise, notwithstanding the fact that the goods manufactured by the Indian enterprise could be sold to various other customers other than the foreign enterprise.

iii) If 90% or more of the raw materials required for the manufacturing or processing of goods are supplied by one enterprise to another enterprise where the prices and other conditions are influenced by the supplier, both enterprises would become associated enterprises. It is unclear whether 90% would be in terms of value of the raw material or in terms of quantity, or whether the same refers to the raw material content in the final products. It is also unclear as to under what circumstances, an enterprise could be said to be in a position to influence the prices and other conditions relating to the supply of raw materials to the other enterprise.

Goods or articles manufactured by one enterprise (say "X") and sold to other enterprise (say "Y") or to any other enterprise specified by "Y" where the price of the goods is influenced by "Y" would result in "X" & "Y" being associated enterprises. The lack of clarity of the term "influenced" in this context, would give rise to litigation.

iv) It is further submitted that unlike clause (h) of section 92A(2) which provides for 90% or more of the raw material and consumables required for manufacture or processing of goods there is no such criteria specified in clause (I) for sale of goods or articles manufactured. Accordingly two

v) Transfer Pricing Officers (TPOs) have interpreted that the 5% flexibility as envisaged in the Proviso is to accommodate cases where the value of transaction(s) falls within the stated range of the arithmetic mean. The above interpretation implies that if the actual value of transaction falls within the tolerance band, no adjustment is required and the book value of transactions is to be considered at arm's length. Once it breaches that 5% range, the benefit of 5% is not to be allowed.

Suggestions:

(i) Section 92C(2) read with the proviso to the section, clearly provides (not implied or envisaged) that at the option of the assessee, a price chosen by the assessee on the continuum of (+) 5% to (-) 5% of the mean of prices shall be an Arm's Length Price (ALP) for the purposes of section 92.

(ii) Based on a plain reading of the section 92C(2) and the proviso to the section, it is clear that the option can be exercised by the assessee, and this is not subject to any conditions.

(iii) In no event does the proviso suggest that the option to use a (+/-) 5% range on arithmetic mean of prices would only be available when the actual transaction value falls within the tolerance band of 5%.

(iv) It is suggested that appropriate clarification should be provided on this matter, and the 5% range should be made available in all circumstances.

(v) Further, 15% flexibility should be provided as against current 5% or alternatively, an inter-quartile range should be permissible.

22.2 Absence of a residuary TP method

Section 92C(1) requires selection of the most appropriate method out of the prescribed five methods or any other method as may be notified by the Board.

The five methods may not be suitable in certain cases like transfer of intangibles (where it may be necessary to apply other internationally recognized methods like the Discounted Cash Flow method, Economic Return method, Capital Asset Pricing Method, etc).

Further, section 92B(1) defines international transactions to include cost contribution agreements and section 92(3) requires cost apportionment/ allocation under such arrangements to be undertaken on an arm's length basis. However, none of the methods prescribed by section 92C(1) may be applicable for such arrangements,

Suggestions:

Accordingly, it is recommended that the law should permit the application of any other pricing method [including those specified by the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators issued by the Organisation for Economic Co-operation and Development (OECD Guidelines)], the results of which are in accordance with the arm's length principle. TP rules of most countries (US, UK, etc) contain a similar residuary clause under which non-specified TP methods are permitted to be used by the taxpayer.

22.3 Penalty in respect of an International Transaction

Explanation 7 to section 271(l)(c) inserted by the Finance Act, 2001 provides that any addition or disallowance made by the Assessing Officer in respect of an international transaction entered into would represent concealed income and the onus is on the assessee to prove that the price charged or paid in such a transaction is in accordance with the provisions contained in section 92C and that he has acted in good faith and with due diligence. Such a levy of penalty on all additions / disallowance is harsh and excessive.

Further, section 271AA is inserted to provide that if a person who has entered into an international transaction fails to keep and maintain any information or documents as required by section 92D then that person may be directed to pay a penalty of 2% of the value of international transaction for each failure.

This penalty is very high. In addition, failure to furnish a report of an accountant will be punishable with a penalty of Rs.1,00,000/- irrespective of the value of international transaction. It is submitted that the introduction of such stringent provisions and harsh penalties is unwarranted in view of the fact that invariably all agreements for double

taxation avoidance made by India contain adequate provisions to check tax evasion by associated enterprises.

Suggestions:

- There ought to be a maximum cap on all penalty provisions relating to transfer pricing violations, to avoid these anti-avoidance provisions from degenerating into mere revenue gathering exercises.
- Penalty for non maintenance of documents should be not be related to the transaction value but could be related to the difference.
- In the penalty clauses (271AA and 271BA) word *"shall* "should be replaced by *"may"*. Further, specialised CIT(A) should be appointed to deal with international taxation cases.

22.4 Section 92B(1): Transactions between an Indian entity and a PE of a Foreign associated enterprise

The TP regulations include transactions between an Indian associated enterprise of a foreign company and an Indian Permanent Establishment (PE) of the group within the ambit of the TP code.

As Indian PEs are subject to taxation on "net-profit" basis and such transactions are actually "domestic transactions" that may not result in any cross-border transfer of profits.

Suggestions:

It is suggested that such transactions should be excluded from the TP regulation.

22.5 Advance Pricing Agreement

In most of the developed countries there exists an Advance Pricing Agreement (APA) Mechanism whereby the transfer price considered appropriate by the assessee is determined/pre-agreed with the Government. The advance ruling provisions contained in Chapter XIX-B of the Act as currently framed do not cover such APAs.

Suggestions:

It is suggested that since the Government has recognised that transfer pricing is a key issue having far-reaching implications, it would be necessary to develop such a mechanism and provisions in this regard may also be incorporated.

22.6 Section 92(3)

This section provides that in an international transaction, the cost or expense allocated or apportioned or contributed by the associated enterprise shall be determined having regard to the arm's length price of the benefit or service or facility in respect of which such cost or expense is incurred. The Rules do not specifically provide for the manner in which the arm's length price is to be determined under the aforesaid provisions.

Suggestions:

Necessary guidelines should be issued to cover such circumstances.

22.7 Time limit for issuing notice under section 92CA (2)

Presently, for issuing notice for scrutiny assessment under section 143(2), there is a time limit. Also, for passing an order under section 143(3), there is a time limit under section 153. However, no time limit is prescribed for referring a case for TP assessment by the Assessing officer to the Transfer Pricing Officer.

In many instances, the notice under section 92CA(2) is issued by the TPO when the time limit of completing the assessment (as per section 153) is about to expire. In such cases the TP assessment proceedings are conducted in a manner and time that cannot do justice to a complex issue like Transfer Pricing.

Suggestions:

A time limit for issuing a notice under section 92CA(2) should be introduced, so that there is sufficient time for completion of TP assessments.

22.8 Lack of measures to ensure secrecy of information

There are no specific provisions in the legislation to ensure secrecy of strategic pricing and other information provided by taxpayers to Transfer Pricing Officers. As the information would be of strategic importance, in the absence of adequate safeguards in the Act to ensure secrecy of such information, taxpayers would be hesitant to provide full details/ information to the tax authorities.

Suggestions:

It is suggested that specific provisions be introduced in the Act, which prescribe that any information provided to the tax department by the taxpayers under the TP provisions would be confidential information (similar to VDIS schemes) and not shared by the authorities with the public. The Government may consider enforcement of such provisions under section 138(2) of the Act.

22.9 Taxpayers having international transactions upto Rs 1 crore [Sections 92D, 92E]

Rule 10D(2) extends concessional documentation and information maintenance requirements to taxpayers having aggregate international transactions below the prescribed threshold of one crore rupees. However, such taxpayers are still required to obtain the accountant's report prescribed by Rule IDE. This report inter alia requires certification by the accountant that the taxpayer has maintained proper documents and information "as prescribed".

In view of the fact that effectively the rules do not prescribe any specific documentation for such taxpayers, obtaining the accountant's report by such taxpayers may raise practical difficulties.

Suggestions:

It is suggested that such tax payers should be exempted from filing Form 3CEB.

22.10 Applicability of TF documentation/ compliance requirements (Section 92D, Section 92E) in cases where the charging provision (Section 92) is not triggered

There are various instances where the taxpayer does not have any income chargeable to India tax. (e.g. taxpayers in pre-commencement stage of operations, etc).

In such cases, the charging section 92 is not triggered. However, the way sections 92D (IP Documentation) and 92E (Accountants' certificate) are worded, existence of an 'international transaction' with an associated enterprise results in compliance requirements, without reference to the charging section.

Suggestions:

The law should clarify if the charging section is not attracted, compliance sections would also not be applicable.

22.11 Applicability of the TP regulations to expenses incurred by taxpayers chargeable to India tax on a deemed basis under Section 44B, 44BB, 44BBA, 44BBB, 115A and Article 12 of DTAs etc [Section 92(2)1]

Many non-resident taxpayers are charged to India tax on a 'deemed basis' under various provisions like 44B, 44BB, 44BBA, 44BBB, etc. Under these provisions, a specified % of the taxpayers' gross receipt is deemed to be their India taxable income (irrespective of quantum of actual expenses incurred in earning such income).

Such non-residents may be obtaining services/ facilities (for India operations) from group entities. Payments/accruals by these taxpayers to their affiliates may - technically be covered within the ambit of the TP code (being expenses deemed to be allowed in computing taxable income). In such cases, these taxpayers may be required to substantiate the arm's length character of such expenses and also maintain prescribed documents, obtain the accountant's report, etc. However, this may not serve much purpose as the quantum of expense of such nonresidents has no bearing on their taxable income and an adjustment to their transfer price may not have any impact on their deemed India taxable income. Further, this also runs against the basic intent of these deeming provisions, which seek to avoid the inherent complications of scrutinizing the expenses of such non-residents.

Suggestions:

Accordingly, expense streams of taxpayers chargeable to India tax on a 'deemed basis' of taxation should be excluded from the ambit of the TP code.

22.12 Double Taxation of Group Profits

Second Proviso to section 92C(4) states that -

"Provided further that where the total income of an associated enterprise is computed under this sub-section on determination of the arm's length price paid to another associated enterprise from which tax has been deducted under the provision of Chapter XVIIB, the income of the other associated enterprises shall not be recomputed by reason of such determination of arm's length price in the case of the first mentioned enterprise"

This Proviso would inevitably lead to double taxation of group profits and is against the principles of natural justice.

Suggestions:

It is suggested that this Proviso should be deleted as it may result in tax loss to the foreign associated enterprise to the extent of withholding tax charged by India on the TP adjustment amount. This goes against the basic intent of . Avoidance of double taxation as set out in the corresponding adjustment clause of the respective DTA.

22.13 Data for comparability Analysis

Rule 10D(4) requires the taxpayer to maintain contemporaneous TP documentation. Such documentation inter-alia comprises the comparability analysis.

However, Rule 10B(4) requires that the data to be used in analyzing the comparability of an uncontrolled transaction with an international transaction needs to be the data relating to the financial year in which the international transaction has been entered into. The proviso to this rule permits the use of past two year data if such past data reveals facts, which could have an influence on the determination of transfer prices.

Paras 1.49 and 1.50 of the OECD Guidelines state that;

"In order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price. For example, the use of data from past years will show whether a taxpayer's reported loss on. a transaction is part of a history of losses on similar transactions, the result of particular economic conditions in a prior year that increased costs in the subsequent year, or a reflection of the fact that a product is at the end of its life cycle. Such an analysis may be particularly useful where as a last resort a transactional profit method is applied.

Multiple year data will also be useful in providing information about the relevant business and product life cycles of the comparables. Differences in business or product life cycles may have a material effect on transfer pricing conditions that needs to be assessed in determining comparability. The data from earlier years may show whether the independent enterprise engaged in a comparable transaction was affected by comparable economic conditions in a comparable manner, or whether different conditions in an earlier year materially affected its price or profit so that it should not be used as a comparable.

Further para 3.44 of the OECD Guidelines states that:

"Multiple year data should be considered in the transactional net margin method for both the enterprise under examination and independent enterprises to the extent their net margins are being compared, to take into account the effects on profits of product life cycles and short term economic conditions. For example, multiple year data could show whether the independent enterprises that engaged in comparable uncontrolled transactions had suffered from the effects of market conditions in the same way and over a similar period as the associated enterprise under examination. Such data could also show whether similar business patterns over a similar length of time affected the profits of comparable independent enterprises in the same way as the enterprise under examination."

The use of current (single) year data instead of average data from the past few years does not even-out product or business life cycles or specific economic conditions that may impact individual companies. Generally, the transfer pricing rules of most countries (including the United States and United Kingdom) permit the use of average data of past few years for the purpose of comparability analysis.

Further the search for uncontrolled comparables relies primarily on external databases. These databases do not contain reliable/audited data of the current financial year as current year audited accounts of comparables are not filed and updated on the databases on a contemporaneous basis.

Suggestions:

It is recommended that Rule 10B(4) should be reworded and the taxpayer should be given complete flexibility to use past 2 years data without any restrictions. Further, without prejudice to the above suggestion/ there should not be any restriction on using just past 2 years data, instead the assessee should be given flexibility to use the appropriate number of years of past data, based on / taking into account, the business/commercial realities and other factors like product life cycles, business cycles, industry characteristics, etc.

22.14 Conducting a fresh search/economic analysis during assessment proceedings

For the purpose of applying the margin based TP methods, it is necessary to compute margins of functionally comparable companies from publicly available data/ databases. These databases are updated regularly. However, the assessee can compute the margins of the comparables only from the latest available information in such databases.

The law also recognizes the practical difficulty in using the data of the same financial year for which arm's length margins are being computed. Hence Rule 10C(1) read with sub-clause (2)(c) states that in selecting the most appropriate method, factors such as the availability of data necessary for application of the method shall be taken into account.

Rule 10B(4) specifies that the most appropriate data to be used shall be the data relating to the financial year in which the transaction is entered into and where relevant, the data relating to the two years preceding such financial year. Further, sub-rule (4) of Rule 10D provides that *"The information and documents specified under sub-rules (1) and (2), should, as far as possible, be contemporaneous and should exist latest by the specified date referred to in clause (iv) of section 92F.*

From a harmonious reading of the above, data relating to financial year in which international transaction(s) has been entered into should mean data available in the financial year when the international transaction was entered into.

The above also finds support in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators issued by the OECD.

Para 5.9 of the OECD 1995 Guidelines states:

"......In considering whether documentation is adequate, a tax administration should have regard to the extent to which that information reasonably could have been available to the taxpayer at the time transfer pricing was established."

Para 5.10 of the OECD Guidelines states:

"Tax administrations further should not require taxpayers to produce documents that are not in the actual possession or control of tlic taxpayer or otherwise reasonably available, e.g. information that cannot be legally obtained, or that is not actually available to the taxpayer because it is confidential to the taxpayer's competitor or because it is unpublished and cannot be obtained bp normal enquiry or market data."

While conducting assessments, TPOs are performing fresh searches for financial information of comparable companies, as available at the time of assessment. There would be fresh updated data available in the databases, which was not available to the assessee at the time of computing the arm's length margins/prices.

Suggestions:

One of the vital aspects of the information and documents prescribed under the legislation is that it should be 'contemporaneous'. The term, as defined in the Oxford English dictionary means something existing at or occurring in the same period of time or happening or being at the same time. It is therefore submitted that contemporaneous data should be data as available at the time when the international transaction(s) was entered into.

Conducting a fresh search/economic analysis based on information currently available but not available at the time of determining the arm's length price is not the intent of the Regulations and is practically impossible.

Accordingly, the TPOs should also use the same data as was available to the assessee at the time of setting its prices/preparing the documentation. This should be clearly laid out in the Rules.

23. Surcharge on TDS Provisions:

As per the TDS provisions under chapter XVII, the rate of TDS prescribed under the respective section or under the Finance Act, the same is required to be increased by a surcharge and education cess. The small business community and the accountants at the small places faces difficulties in deducting the TDS at the proper rate. The mistake arises in increasing the rate of TDS by surcharge and the education cess. Further, the surcharge is changed from year to year by the Finance act and the accountant commits the mistake in applying the proper rate of surcharge and education cess. There is no mistake made in applying the proper rate of TDS and the mistake arises only in applying the correct rate of surcharge and education cess.

The consequences of not applying the correct rate of surcharge and education cess are very harsh in as much as the entire genuine business expenditure is disallowed u/s. 40(a)(ia).

It is therefore suggested that the provision should be made to provide that the TDS should be deducted at the prescribed rate without applying the surcharge and education cess. This will also help the businessman to make complicated calculations in fractions and will help to comply the law relating to TDS.

24. Section 194H – TDS on Commission

Section 194H of the Income - tax Act has been introduced w.e.f. 1.6.2001 for deduction of tax at source from payment in the nature of commission or brokerage. No such deduction will be made where the amount of payment or the aggregate amount of payments, in a financial year, do not exceed Rs.2500/-. The exemption slab of Rs.2500/- is very low and it has unnecessarily increased the work load of the assessees who are responsible for making such deduction.

Suggestions:

It is suggested that this exemption limit of Rs.2500/- should be increased to Rs.20,000/-

25. TDS on rent u/s. 194I from Rentals of Equipment:

25.1 The Taxation Laws (Amendment) Act, 2006 has amended the definition of the Rent to include rent paid for plant & machinery, furniture etc. However, the rate of TDS is continued at 15% for individual payee and 20% for others.

Normally, in the business of giving the machinery and furniture on rent, the margin of profit is not more than 4% to 5%. Therefore, the rate of TDS for such rent income should be reduced to 2%. Otherwise, the business persons engaged in giving machinery and furniture on rent will face the hardship of cash flow and will be required to claim huge refunds.

25.2 The Taxation Laws (Amendment) Act, 2006 has widened the scope of Sections 194I and 194J considerably. Now, Section 194I also covers rent for plant and machinery and other specified assets. Similarly, Section 194J now also covers payment of royalty. Now, Section 9(1)(vi) defines "royalty" to include consideration paid for the use or right to use any industrial, commercial or scientific equipment.

There is therefore, confusion about the section under which tax is required to be deducted from rent for plant and machinery. Since the rate of TDS under both the sections is different, a clarification as to which section should cover the rent for such assets would help in avoiding unnecessary disputes and litigation Particularly when non deduction of tax as required by TDS provisions, attracts disallowance of the entire expenditure.

26. Quarterly TDS/TCS Returns:

Under the present provisions u/s. 206, the assessee is required to file quarterly TDS and TCS Returns. This increases the hardship and also the compliance cost. It also increases paper work for non corporate assessee.

It is therefore suggested that the TDS and TCS returns should be filed on halfyearly basis instead of quarterly basis.

27. Interest on Refunds and Interest payable by the assessee.

At present the rate of interest payable on refunds by department is less than the rate of interest charged by the department from the assessee. Further, the interest on refunds is subject to tax by the assessee, where as the interest paid by the tax payer is not allowable as deduction. This further creates inequity.

The interest rate on the refunds due to the assessee and on the amount payable by the assessee to the government should be same on the ground of equity.

28. Procedural/ Appelate / Assessment Related Matters

28.1 Assessment

Under the present provisions and the judicial opinion, the belated return filed u/s. 142(1) can be revised u/s. 139(5). However, the return filed u/s. 139(4) can not be revised. There is no reason to differentiate the return filed u/s. 142(1) and u/s. 139(4). It is an unintended provision.

It is suggested to amend the provision to the effect that the return filed u/s. 139(4) can also be revised u/s. 139(5) within the prescribed time.

28.2 Income escaping assessment: Section 147,148,149

1. Under the existing provisions of section 147 of the Act, an Assessing Officer can reopen the assessment at any time within a period of 4 years from the end of the relevant assessment year, even where the assessment u/s. 143(3) or u/s. 147 of the Act has been made for the relevant assessment year.

If the assessee has made full and true disclosure of all material facts necessary for the purpose of assessment of his income, the Assessing Officer should not be allowed to reopen the assessment u/s. 147 of the Act without bringing on record any fresh facts, evidences or reasoning in support.

Suggestions:

- If there is no change in the facts and circumstances of the case and it is the case of mere change of opinion, the Assessing Officer should not be allowed to reopen the assessment u/s. 147 of the Act after expiry of one year from the end of the assessment year. The necessary amendment to this effect may be made by inserting second Proviso to section 147 of the Act.

- Section 148 has been amended doing away with the minimum period of " 30 days within which an assessee is required to submit his return of income for the purpose of reassessment. With this amendment the period within which an assessee is required to submit his return of income for the purpose of reassessment will be left to the discretion of the assessing officer.

- Time limit of not less than 30 days should be provided for filing return of income.

2. The Hon'ble Supreme Court, in GKN Drive Shafts (India) Ltd. v. ITO (2003) 259 ITR 19 (SC), spelled out a definite procedure to be followed by the authorities before initiating re-assessment proceedings under section 147. The SC held that before initiating the assessment proceedings under section 147, the Assessing Officer was duty bound to furnish reasons within a reasonable time and, upon objections to the same being raised by the assessee, to dispose of the same by passing a speaking order. However, such procedure is not being followed by the tax authorities in all cases. The assessees, in such a case, have no recourse but to go to the High Court which is a very expensive proposition, making it unfeasible for many, and thus, effectively, defeating the rule laid down by the SC.

Suggestions:

It is suggested that definite procedural steps be legislated in section 147/148 to make the procedure mandatory. This would also enable review by appellate authorities [CIT(A)/ ITAT] of the speaking order to be passed by the Assessing Officer in examining the validity of proceedings under section 148/ 147. This will have concomitant benefits on the entire assessment process.

28.3 Time Limits for disposing off rectification applications u/s 154

Section 154 (8) provides for time limit for disposal of rectification application made after 1-6-2001 within six months either in favour or against the assessee. But the section does not provide for the remedy/recourse available to the assessee, if an order disposing off the rectification application is not passed within the time limit. In other

words, merely providing time limit for disposal of rectification application is meaningless.

Suggestions:

The section requires to be suitably amended to provide for the remedy/recourse to assessee in case of non-disposal of application within time limit.

28.3 Non-speaking orders

Non-speaking orders of assessment, etc. are passed either without giving an opportunity to the assessee to raise an objection, or without meeting the objection, to the additions. This is often known to be done by Assessing Officers under pressure of raising revenue. Such non-speaking orders, apart from having a delirious effect on the morale of both the tax payer and the tax practitioners, lead to increasing litigation. This also gives rise to false tax demands, which are bound to be quashed in appeals. Forcing tax recovery of demands raised on such orders results in harassment to the assessees.

Suggestions

The Act should contain procedure requiring the Assessing Officer:

(i) to state all the facts as brought on record by the assessee;
(ii) to give notice to the assessee of specific additions intended to be made and to allow reasonable time to meet his case,
(iii) to list all the case laws cited by the assessee in support of his case and giving reason(s) for not following it;
(iv) to state reason(s) for allowing lesser time to gather facts where such an application by the assessee is rejected.

This will save avoidable burden on appellate authorities.

29. Penalties

Bar of Limitation for imposing Penalties – S.275

After the insertion of the Proviso to Section 275(1)(a), there have been several instances where penalties have been levied even in cases where the Appellate Commissioner has deleted the subject additions. This is wholly unnecessary and unanticipated. The amendments made vide Taxation Laws (Amendment) Act, 2006, are welcome changes and will go a long way in avoiding unnecessary harassment of tax payers and unnecessary litigation. However, practically, there is a need to issue instructions to the Assessing Officers to follow the amendments made in letter and spirit.