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Presents

GUIDE TO ANALYSIS OF
BUDGET 2018

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Clause by Clause Analysis

Knowledge Partner

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1. Tax Rates

i. Personal Tax Rates

Income (Rs)	Rate of tax (AY 2019-20)
Upto 2,50,000	Nil
2,50,001-5,00,000	5%
5,00,001-10,00,000	20%
10,00,001 and above	30%

Note:
The above exemption limit shall be considered as ₹3,00,000 in case of senior citizens aged 60 years but less than 80 years and ₹5,00,000 in case of super senior citizens of the age 80 years or more.

Surcharge of 10% of income tax if net income exceeds fifty lakh rupees but not more than 1 crore and surcharge of 15% if net income exceeds 1 crore, subject to Marginal Relief.

It is proposed to abolish existing Education Cess of 2% and Secondary Higher Education Cess of 1% leviable on the amount of income tax and surcharge, if any and a new cess by the name "Health and Education Cess" at the rate of 4% will be levied.

Rebate under Section 87A continues for a resident individual (whose income does not exceed 5,00,000. The amount of rebate is 100% of income tax calculated before education cess or 5,000 whichever is less.

ii. Corporate tax rates

Income	Proposed Rate of tax (A Y. 2019-20)
Domestic Company having turnover or gross receipts less than or equal to 250 Crore in previous year 2016-17	25%*
Domestic Company having turnover or gross receipts more than 250 Crore in previous year 2016-17	30%
Domestic Company having total income more than 1 Crore	25% or 30% plus surcharge of 7%
Domestic Company having total income more than 1 Crore	25% or 30% plus surcharge of 12%
Other Company having total income less than 1 Crore	40%
Other Company having total income more than 1 Crore but less than 10 Crore	40% plus 2%
Other Company having total income more than 10 Crore	40% plus 5%

Note:

It is proposed to abolish existing Education Cess of 2% and Secondary Higher Education Cess of 1% leviable on the amount of income tax and surcharge, if any and a new cess by the name "Health and Education Cess" at the rate of 4% will be levied.

** It is proposed to reduce the rate of corporate tax to 25% to companies whose turnover or receipts shall not exceed 250 crores in preceding financial year 2016-17. Earlier the reduced rate was applicable to companies whose turnover or receipts was less than or equal to 50 crores.*

iii. Firms

Flat Rate of 30%, Surcharge @ 12% of income tax if net income exceeds ₹1 Crore.

It is proposed to abolish existing Education Cess of 2% and Secondary Higher Education Cess of 1% leviable on the amount of income tax and surcharge, if any and a new cess by the name "Health and Education Cess" at the rate of 4% will be levied.

iv Cooperative Societies

Particular	Rate of Tax
Having total income of less than 10,001	10%
Having total income of more than 10,000 but less than 20,001	1,000 plus 20% income in excess of ₹ 10,000
Having total income of more than 20,000	3,000 plus 30% of total income in excess of ₹ 20,000

Note:
Surcharge @ 12% of income tax if net income exceeds ₹1 Crore

It is proposed to abolish existing Education Cess of 2% and Secondary Higher Education Cess of 1% leviable on the amount of income tax and surcharge, if any and a new cess by the name "Health and Education Cess" at the rate of 4% will be levied.

2. Individual Tax

2.1 Standard Deduction of Rs. 40,000 for Salaried Employees [Section 16 and 17]

It is proposed to insert a new clause (ia) under section 16 to provided standard deduction of Rs. 40,000/- or the amount of salary, whichever is less for computing the income chargeable under the head salary.

It is also proposed to omit the clause (v) of proviso of section 17(2) (viii) which provides deduction of Medical reimbursement paid by the employer to employee upto Rs. 15,000/-

This decision to allow standard deduction shall significantly benefit the pensioners also, who normally do not enjoy any allowance on account of transport and medical expenses.

Note:
The Honorable Finance Minister in his budget speech announced to disallow the transport allowance deduction to salaried employees. The said disallowance will come later by way of separate notification under Section 10(14).

2.2 Taxability of compensation received in connection of termination of employment. [Section 56]

It is proposed to insert a new clause (xi) in sub-section (2) of the section 56 so as to provide that any compensation or other payment due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to income-tax under the head "Income from other sources".

2.3 New Deduction for Interest Income for senior citizen (Section 80TTB)

The proposed new section, inter alia, provides that where the gross total income of an assessee, being a senior citizen, includes any income by way of interest on deposits with a banking company to which the Banking Regulation Act, 1949, applies (including any bank or banking institution referred to in section 51 of that Act) or a co-operative society engaged in the business of banking (including a co-operative land mortgage bank or a co-operative land development bank) or a Post Office as defined in clause (k) of section 2 of the Indian Post Office Act, 1898, a deduction of an amount up to fifty thousand rupees shall be allowed.

It is further proposed to provide that where the income referred to in this section is derived from any deposit held by, or on behalf of, a firm, an association of persons or a body of individuals, no deduction shall be allowed under this section in respect of such income in computing the total income of any partner of the firm or any member of the association or any individual of the body.

The Senior Citizen covered under this section will not eligible for deduction under Section 80TTA ie, deduction in the respect of saving bank upto Rs. 10,000.

2.4 Deduction in respect of Mediclaim policy (Section 80 D)

The existing provisions of Section 80D provides that for medical insurance or preventive health check-up of a senior citizen, deduction of thirty thousand rupees shall be allowed. Further, in the case of very senior citizens, the said section also provides for a deduction of medical expenditure within the overall limits of thirty thousand rupees.

It is proposed to amend the said section so as to provide that the

deduction of fifty thousand rupees in aggregate shall be allowed to senior citizens in respect of medical insurance or preventive health check-up or medical expenditure.

It is further proposed to provide that where an amount is paid in lump sum in the previous year to effect or to keep in force an insurance on the health of a person specified therein for more than a year, then, subject to the provisions of this section, there shall be allowed for each of the relevant previous years, a deduction equal to the appropriate fraction of the amount.

It is also proposed to define the expressions "appropriate fraction" and "relevant previous years" as follows:-

(i) "appropriate fraction" means the fraction, the numerator of which is one and the denominator of which is the total number of relevant previous years;

(ii) "relevant previous year" means the previous year beginning with the previous year in which such amount is paid and the subsequent previous year or years during which the insurance shall have effect or be in force.';

2.5 Deduction in respect of Medical treatment (Section 80 DDB)

As per existing provisions under the section 80DDB, a deduction is available to an individual and Hindu undivided family with regard to amount paid for medical treatment of specified diseases in respect of very senior citizen upto eighty thousand rupees and in case of senior citizens sixty thousand rupees subject to other conditions.

It is proposed to amend the said section so as to increase the existing limit of deduction available to an individual and Hindu undivided family with regard to amount paid for medical treatment of specified diseases in respect of senior citizen shall be one hundred thousand rupees.

3. Business Taxation

3.1 Amendment in Section 44AE

Under the existing law, the presumptive income for plying, hiring or leasing goods carriage is equal to an amount of Rs. 7500 or amount actually earned by the assessee, whichever is higher, for every month or part of month.

It is proposed to substitute the above limit for heavy goods vehicle from Rs.7500 to Rs. 1000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which the heavy goods vehicle is owned by the assessee in the previous year or an amount claimed to have been actually earned from such vehicle, whichever is higher. For other than heavy goods vehicle, the limit of Rs. 7500 shall remain same.

3.2 Taxability of conversion of stock into capital asset [Section 28]

It is proposed to provide that the fair market value of inventory as on date of its conversion of its capital asset shall be chargeable to tax under PGBP.

3.3 Insertion of new clause (xviii) under Section 36(1).

It is proposed to insert a new clause 36(1)(xviii) to provide that marked to market loss or other expected loss shall be allowed, if computed in accordance with the income computation and disclosure standards notified under 145(2).

Consequential amendment has been made by insertion of sub

section 13 of section 40A.

This amendment shall be applicable retrospectively i.e. from FY 2017-18.

3.4 Clarification for trading in agricultural commodity derivative [Section 43]

Under the exiting proviso (e) of section 43(5) it is stated that transaction in respect of trading in commodity derivatives carried out in recognized stock exchange, which is chargeable to commodity transaction tax, shall not be considered as speculative income.

Now, It is proposed to insert a new proviso after proviso (e) in section 43(5) to clarify that for transaction in respect of trading in agricultural commodity derivatives, the requirement of chargeability to commodity transactions tax under Chapter VII of the Finance Act, 2013 shall not apply which means that the trading in agricultural commodity derivatives shall always be considered as non speculative transaction whether traded in recognized stock exchange or not.

3.5 Taxation of foreign exchange fluctuation [Section 43AA]

It is proposed to insert a new section 43AA to provide that any gain or loss arising on account of any change in foreign exchange rates shall be treated as income or loss, as the case may be, and such gain or loss shall be computed in accordance with the income computation and disclosure standards notified under 145(2).

It is further proposed to provide that gain or loss arising on account of the change in foreign exchange rates shall be in respect of all foreign currency transactions including those relating to monetary items and non-monetary items or translation of financial statements of foreign operations or forward exchange contracts or foreign currency translation reserves.

This amendment shall apply retrospectively i.e. starting from FY 2017-18.

3.6 New provision for construction and service contracts [Section 43CB]

The proposed new section provides that profits and gains of a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the income computation and disclosure standards notified under 145(2).

It is further proposed to provide that in the case of a contract for providing services with duration less than ninety days, the profits and gains shall be determined on the basis of project completion method. It is also proposed to provide that in the case of a contract for provision of services involving indeterminate number of acts over a specific period of time, the profits and gains arising from such contract shall be determined on the basis of a straight line method.

It is also proposed to provide that for this purpose the contract revenue shall include retention money and the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.

This amendment shall apply retrospectively i.e. starting from FY 2017-18.

3.7 Relief in MAT under Section 115JB (w.e.f. A.Y. 2018-2019)

The existing section provides for levy of tax on certain companies on the basis of book profit which is determined after making certain adjustments to the net profit disclosed in the profit and loss account prepared in accordance with the provisions of the Companies Act,

2013.

It is proposed to amend Explanation 1 to the said section so as to provide that in case of a company, against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016, the aggregate amount of unabsorbed depreciation and loss brought forward shall be allowed to be reduced from the book profit and the loss shall not include depreciation.

It is also proposed to insert a new Explanation 4A in the said section so as to clarify that the provisions of the said section shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the rates specified in the said sections.

3.8 Relief under AMT under Section 115JC

The existing section provides that where in the case of a person, other than a company, the regular income-tax payable for any previous year is less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of that person for such previous year and the assessee shall be liable to pay income-tax on such total income at the rate of eighteen and one-half per cent.

It is proposed to amend the said section so as to provide that for the assessee being a person which, is a unit located in an International Financial Service Centre and derives its income solely in convertible foreign exchange, the rate of tax shall be nine per cent.

3.9 Changes wrt carry forward and set off of Losses (Section 79)

The said section, inter alia, provides that where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless on the last day of the previous year the shares of the company carrying not less than fifty-one per cent. of the voting power were beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent. of the voting power on the last day of the year or years in which the loss was incurred.

It is proposed to amend the aforesaid section to provide that nothing contained in the said section shall apply to a company where a change in the shareholding takes place in a previous year pursuant to approved resolution plan under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner

3.10 Tax on Company for deemed dividend (Section 115-O)

In case of deemed dividend under Section 2(22)(e), the tax was levied in the hands of recipient instead of Company. Now, it is proposed to amend this situation by inserting a proviso so as to provide that the company is liable to pay 30% (without grossing up) Dividend Distribution Tax, if the payment is in the nature of dividend under Section 2(22)(e).

3.11 Incorporating Provisions of ICDS with retrospective effect (A.Y. 2017-2018) (Section 145A and 145B)

The proposed new section 145A provides that for the purpose of determining the income chargeable under the head "Profits and gains of business or profession",— (i) the valuation of inventory shall

be made at lower of actual cost or net realisable value in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145; (ii) the valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation; (iii) the valuation of inventory being securities not listed on a recognised stock exchange; or listed but not quoted on a recognised stock exchange with regularity from time to time, shall be valued at actual cost initially recognised in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145; (iv) inventory being securities other than those referred to in clause (iii), shall be valued at lower of actual cost or net realisable value in accordance with the income computation and disclosure standards notified under sub-section (2) of section 145 and for this purpose the comparison of actual cost and net realisable value shall be done category-wise.

It is also proposed to provide for an Explanation in the said section so as to provide that any tax, duty, cess or fee, by whatever name called, under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment for the purposes of the said section.

The proposed new section 145B provides that notwithstanding anything to the contrary contained in section 145, the interest received by an assessee on any compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the year in which it is received.

It is further proposed to provide that the claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

It is also proposed to provide that income referred to in sub-clause (xviii) of clause (24) of section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income tax for any earlier previous year.

4. Capital Gains

4.1 Transaction not regarded as Transfer

Section 47 of the Act provides that certain transactions are not to be regarded as transfer for the purpose of capital gains. A new exemption is being given by inserting a new clause (VIIaab) to Section 47 so as to provide that any transfer of a capital asset, being bond or global depository receipt referred to in Sub-Section (1) of Section 115AC or rupee denominated bond of an Indian Company or derivative, made by a non resident on a recognized stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency, shall not be regarded as transfer.

4.2 Relaxation with respect to Stamp Duty Valuation Rate U/s 50C

Section 50C of the Act contains special provision for full value of consideration in certain cases. The said section provides that in case of transfer of a capital asset being land or building or both, the value adopted or assessed or assessable by the stamp valuation authority for the purpose of payment of stamp duty in respect of such transfer shall be taken as the full value of consideration for the purposes of computation of Capital gains if the same is more than the full value of consideration. It is proposed to insert a proviso to sub-section (1) of the said section so as to provide that where the value adopted or assessed or assessable by the stamp valuation authority does not exceed one hundred and five per cent. of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.

The corresponding amendment is also being proposed for business assesee under section 43CA and under the head other sources

under section 56(2)(x).

4.3 Exemption of Long Term Capital Gains for Investment in Bonds (Section 54EC)

The earlier provision of Section 54EC provides that Long term capital gains from transfer of Long Term Capital Asset shall be exempt if the gain amount should be invested in specified bonds within a period of 6 months from the date of transfer. The maximum amount to be invested was Rs. 50 Lakhs with a lock in period of 3 years.

It is proposed to amend the said section to restrict the definition of Long Term Capital Asset, for this section, to Land or Building or both only. This implies that the Long Term Capital Gain on any other capital asset except Land or Building would not be eligible for exemption under Section 54EC.

Further the lock in period of 3 years has been extended to 5 years for all bonds purchased on or after 01st April 2018.

4.4 Withdrawal of Capital Gain exemption in case of Listed Shares (Section 10(38))

The existing provisions for Section 10 provides for exemption from tax on the income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust subject to certain conditions specified in the said clause.

It is proposed to amend the said clause so as to provide that the provisions of said clause shall not apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018.

4.5 New Tax on Long Term Capital Gain for Listed Shares (Section 112A)

The proposed new section 112A provides that where the total income of an assessee, includes any income chargeable under the head "Capital gains", arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, subject to the conditions specified under the section, the tax payable by the assessee on the capital gains exceeding one lakh rupees shall be calculated at the rate of ten per cent.

It is further proposed to provide that in the case of an individual or a Hindu undivided family, being a resident, where the total income as reduced by such long-term capital gains is below the maximum amount which is not chargeable to income-tax, then, such long-term capital gains shall be reduced by the amount by which the total income as so reduced falls short of the maximum amount which is not chargeable to income-tax.

It is also proposed to provide that capital gains arising from a transaction undertaken on a recognized stock exchange located in any International Financial Services Centre and where the consideration for such transaction is received or receivable in foreign currency, shall be eligible under this section without payment of securities transaction tax.

It is also proposed to provide that the provisions of this section shall not apply to any income arising from the transfer of a long term capital asset, being an equity share in a company, if the transaction of acquisition, other than the acquisition notified by the Central Government in this behalf, of such equity share is entered into on or after the 1st day of October, 2004 and such transaction is not chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004.

It is also proposed to provide that capital gains under the said section

shall be computed without giving effect to the first and second proviso to section 48.

It is also proposed to provide that the cost of acquisition for the purposes of computing capital gains under the section in respect of capital asset acquired by the assessee before the 1st day of February, 2018, shall be as deemed to be higher of:-

a. The actual cost of acquisition of such asset,
   and
b. The lower of:-
   1. The fair market value of such asset; and
   2. The full value of consideration received or accruing as a result of the transfer of the capital asset.

It is also proposed to provide that where the gross total income of an assessee includes any long-term capital gains, deduction under Chapter VI-A shall be allowed from the gross total income as reduced by such capital gains.

It is also proposed to provide that where the total income of an assessee includes any long-term capital gains referred to in the said section, the rebate under section 87A shall be allowed from the income-tax on the total income as reduced by tax payable on such capital gains.

5. Income from Other Sources

5.1 Exemption from Section 56(2)(x) for Transfer between Holding and Subsidiary (wef A.Y. 2018-2019)

It is proposed to amend the fourth proviso to clause (x) of the said sub-section so as to exclude the transfer of capital asset between holding company and its wholly owned Indian subsidiary company and between subsidiary company and its Indian holding company, which are not regarded as transfer under clause (iv) or clause (v) of section 47, from the scope of clause (x) of the said sub-section.

6. Deductions

6.1 Mandatory Filling of Return of Income for claiming deductions (Section 80 AC)

The section 80AC provides that where, in computing the total income of an assessee of the previous year relevant to the assessment year commencing on the 1st day of April, 2006 or any subsequent assessment year, any deduction admissible under section 80-IA or section 80-IAB or section 80-IB or section 80-IC or section 80-ID or section 80-IE, shall be allowed to him only if he furnishes a return of his income for such assessment year on or before the due date specified under section 139(1).

It is proposed to substitute the said section so as to provide that in computing the total income of an assessee of the previous year relevant to the assessment year commencing on or after the 1st day of April, 2018, deduction under any other provisions of Chapter VIA under the heading "C.—Deductions in respect of certain incomes" shall be allowed only if the return is filed within the due date specified under section 139 (1).

This means that for claiming deduction under Section 80JJA, 80JJAA, 80LA, 80O, 80P, 80Q, 80QQA, 80QQB, 80R, 80RR, 80RRA, 80RRB, filling Return of Income under Section 139(1) is now mandatory. In case of belated return, deduction under above section cannot be claimed.

6.2 Tax Holiday for new start- up (Section 80 IAC)

The said section, inter alia, provides that deduction under the said section shall be available to an eligible start-up, if it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April,

2019; the total turnover of its business does not exceed twenty-five crore rupees in any of the previous years beginning on or after the 1st day of April, 2016 and ending on the 31st day of March, 2021; and it is engaged in the eligible business.

It is proposed to amend the said section so as to provide that deduction under the said section shall be available to an eligible start-up, if it is incorporated on or after the 1st day of April, 2016 but before the 1st day of April, 2021; the total turnover of its business does not exceed twenty-five crore rupees in any of the seven previous years beginning from the year in which it is incorporated.

It is also proposed to amend the definition of "eligible business" to mean a business carried out by an eligible start up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation.

This means that the benefit of tax holiday for new start-ups has been extended till 31st March 2021 and the definition of eligible business for claiming this tax holiday has been rationalized.

6.3 Deduction in respect of employment of new employees (Section 80JJAA)

The said section provides for a deduction of thirty per cent. of emoluments paid to a new employee for three years. In order to claim the deduction, the new employee must be employed for more than two hundred and forty days in the year of employment or one hundred and fifty days in case of business of manufacturing of apparel, subject to certain conditions.

It is proposed to amend the said section so as to provide that in the case of business of manufacturing of footwear or leather products, the minimum number of days of employment in the years of employment shall be one hundred and fifty days in place of two

hundred and forty days.

It is further proposed to provide that where a new employee is employed during the previous year for a period of less than two hundred and forty days or one hundred and fifty days, as the case may be, but is employed for a period of two hundred and forty days or one hundred and fifty days, as the case may be, in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year and the provisions of this section shall apply accordingly.

This implies that the benefit of reduced number of days which were earlier available to manufacturing of apparel industry has been extended to manufacturing of footwear and leather products.

Also, new employees who do not qualify for this deduction in the first year would be eligible for the same in next year.

6.4 New Deduction for Producer Companies (Section 80PA)

It is proposed to insert the said new section so as to provide that in case of an assessee, being a Producer Company, having a total turnover of one hundred crore rupees or less in any previous year, the gross total income includes any income from the marketing of agricultural produce grown by its members, or the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members, or the processing of the agricultural produce of its members, the whole of the amount of income or profits and gains and business attributable to any one or more of such activities shall be deducted in computing the total income of the assessee for the previous year relevant to any assessment year commencing on or after the 1st day of April, 2019, but before the 1st day of April, 2025.

It is further proposed to provide that where the assessee is entitled

also to deduction under any other provision or provisions of Chapter VIA, the deduction under this section shall be allowed from the gross total income as reduced by the deductions under such other provision or provisions of the said Chapter.

It is also proposed to define the expressions "eligible business", "member" and "Producer Company" for the purposes of the said new section

7. Changes in International Tax

7.1 Extension of Scope of Business Connection (Section 9(1)(i))

Explanation 2 to clause (i) of sub-section (1) of the said section provides that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident, has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident.

The proviso to the said Explanation provides that such business connection shall not include any business activity specified therein.

The OECD under BEPS Action Plan 7 reviewed the definition of 'PE' with a view to preventing avoidance of payment of tax by circumventing the existing PE definition by way of commissionaire arrangements or fragmentation of business activities. In order to tackle such tax avoidance scheme, the BEPS Action plan 7 recommended modifications to paragraph (5) of Article 5 to provide that an agent would include not only a person who habitually concludes contracts on behalf of the non-resident, but also a person who habitually plays a principal role leading to the conclusion of contracts. Similarly Action Plan 7 also recommends the introduction of an anti fragmentation rule as per paragraph 4.1 of Article 5 of OECD Model tax conventions, 2017 so as to prevent the tax payer from resorting to fragmentation of functions which are otherwise a whole activity in order to avail the benefit of exemption under paragraph 4 of Article 5 of DTAAs.

Further, with a view to preventing base erosion and profit shifting, the recommendations under BEPS Action Plan 7 have now been included in Article 12 of Multilateral Convention to Implement Tax Treaty Related Measures (herein referred to as 'MLI'), to which India is also a signatory. Consequently, these provisions will automatically modify India's bilateral tax treaties covered by MLI, where treaty partner has also opted for Article 12. As a result , the DAPE provisions in Article 5(5) of India's tax treaties, as modified by MLI, shall become wider in scope than the current provisions in Explanation 2 to section 9(1)(i). Similarly, the antifragmentation rule introduced as per paragraph 4.1 of Article 5 of the OECD Model Tax Conventions, 2017 has narrowed the scope of the exception under Article 5(4), thereby expanding the scope of PE in DTAA vis-a-vis domestic provisions contained in Explanation 2 to section 9(1)(i). In effect, the relevant provisions in the DTAAs are wider in scope than the domestic law. However, sub-section (2) of section 90 of the Act provides that the provisions of the domestic law would prevail over corresponding provisions in the DTAAs, to the extent they are beneficial. Since, in the instant situations, the provisions of the domestic law being narrower in scope are more beneficial than the provisions in the DTAAs, as modified by MLI, such wider provisions in the DTAAs are ineffective.

It is proposed to substitute clause (a) of the said Explanation 2 so as to provide that "business connection" shall include any business activity carried through a person who, acting on behalf of the non-resident, has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident and the contracts are—

(i) in the name of the non-resident; or
(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or
(iii) for the provision of services by that non-resident.

7.2 "Business connection" to include "Significant Economic presence"

The oranges upon the trees in California are not acquired wealth until they are picked, not even at that stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where the consumer can use them. These stages, upto the point where wealth reached fruition, may be shared in by different territorial authorities." (excerpts from a report on double taxation submitted to League of Nations in early 1920s)

Accordingly, both the residence and source countries claim the right to taxation.

Taxation of business profits on the basis of economic allegiance has always been the underlying basis of existing international taxation rules. Economists gave primacy to the economic allegiance rather than physical location and made it clear that physical presence was important only to the extent it represented the economic location.

Ordinarily, as per the allocation of taxing rules under Article 7 of DTAAs, business profit of an enterprise is taxable in the country in which the taxpayer is a resident. If an enterprise carries on its business in another country through a 'Permanent Establishment' situated therin, such other country may also tax the business profits attributable to the 'Permant Establishment'. For this purpose, 'Permanent Establishment' means a 'fixed place of business' through which the business of an enterprise is wholly or partly carried out provided that the business activities are not of preparatory or auxiliary in nature and such business activities are not carried out by a dependent agent.

For a long time, nexus based on physical presence was used as a proxy to regular economic allegiance of a non-resident. However, with the advancement in information and communication technology in the

last few decades, new business models operating remotely through digital medium have emerged. Under these new business models, the non-resident enterprises interact with customers in another country without having any physical presence in that country resulting in avoidance of taxation in the source country. Therefore, the existing nexus rule based on physical presence do not hold good anymore for taxation of business profits in source country. As a result, the rights of the source country to tax business profits that are derived from its economy is unfairly and unreasonably eroded.

OECD under its BEPS Action Plan 1 addressed the tax challenges in a digital economy wherein it has discussed several options to tackle the direct tax challenges arising in digital businesses. One such option is a new nexus rule based on "significant economic presence". As per the Action Plan 1 Report, a non-resident enterprise would create a taxable presence in a country if it has a significance economic presence in that country on the basis of factors that have a purposeful and sustained interaction 9 with the economy by the aid of technology and other automated tools. It further recommended that revenue factor may be used in combination with the aforesaid factors to determine 'significance economic presence'.

The scope of existing provisions of clause (i) of sub-section (1) of section 9 is restrictive as it essentially provides for physical presence based nexus rule for taxation of business income of the non-resident in India. Explanation 2 to the said section which defines 'business connection' is also narrow in its scope since it limits the taxability of certain activities or transactions of non-resident to those carried out through a dependent agent. Therefore, emerging business models such as digitized businesses, which do not require physical presence of itself or any agent in India, is not covered within the scope of clause (i) of sub-section (1) of section 9 of the Act.

It is further proposed to insert a new Explanation 2A in clause (i) of sub-section (1) of the said section so as to provide that the significant economic presence of a non-resident in India shall

constitute "business connection" of the non-resident in India and the "significant economic presence" for this purpose, shall mean— (a) any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or (b) systematic and continuous soliciting of its business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

It is further proposed to provide that the transactions or activities shall constitute significant economic presence in India, whether or not the non-resident has a residence or place of business in India or renders services in India.

It is also proposed to provide that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

7.3 Exemption of income of Foreign Company from sale of leftover stock of crude oil on termination of agreement or arrangement

Clause (48A) of section 10 provides that any income accruing or arising to a foreign company on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India shall be exempt, if(i) storage and sale is pursuant to an agreement or an arrangement entered into or approved, by the Central Government; and (ii) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government.

Further clause (48B) of section 10 provides that any income accruing or arising to a foreign company on account of sale of leftover stock of

crude oil after the expiry of the agreement or arrangement shall be exempt subject to such conditions as may be notified by the Central Government.

The benefit of exemption is presently not available on sale out of the leftover stock of crude in case of termination of the said agreement or the arrangement.

Given the strategic nature of the project benefitting India to augment its strategic petroleum reserves, it is proposed to amend clause (48B) of section 10 to provide that the benefit of tax exemption in respect of income from left over stock will be available even if the agreement or the arrangement is terminated in accordance with the terms mentioned therein.

7.4 Taxation of long-term capital gains in the case of Foreign Institutional Investor

The existing provisions of section 115AD of the Act inter alia, provide that where the total income of a Foreign Institutional Investor (FII) includes income by way of long-term capital gains arising from the transfer of certain securities, such capital gains shall be chargeable to tax at the rate of ten per cent. However, long term capital gains arising from transfer of long term capital asset being equity shares of a company or a unit of equity oriented fund or a unit of business trusts, is exempt from income-tax under clause (38) of section 10 of the Act.

Consequent to the proposal for withdrawal of exemption under clause (38) of section 10 of the Act, such long term capital gain will become taxable in the hands of FIIs also. As in the case of domestic investors, the FIIs will also be liable to tax on such long term capital gains only in respect of amount of such gains exceeding one lakh rupees. The provisions of section 115AD are proposed to be amended accordingly.

7.5 Rationalisation of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015

Section 46 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 provides for the procedure for imposing penalty.

Sub-section (4) of the said section provides that an order imposing a penalty shall be made with the approval of the Joint Commissioner, in the circumstances specified therein.

The Assistant Director or the Deputy Director, investigating a case of undisclosed foreign income or asset, can also be assigned the concurrent jurisdiction of the Assessing Officer and, therefore, can also initiate penalty.

However, the said authorities shall require approval of the superior officers of the rank of Joint Director or Additional Director for imposition of penalty. Accordingly, it is proposed to amend the said sub-section so as to provide that the Joint Director shall also be vested with the power to approve an order imposing a penalty.

It is also proposed to amend clause (b) of the said sub-section so as to include reference to the Assistant Director and Deputy Director therein. Section 55 of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 provides for institution of proceedings for an offence under that Act.

Sub-section (1) of the said section provides that a person shall not be proceeded against for an offence under section 49 to section 53 except with the sanction of the Principal Commissioner or Commissioner or the Commissioner (Appeals).

Sub-section (2) of the said section provides that the Principal Chief Commissioner or the Chief Commissioner may issue such instructions, or directions, to the tax authorities referred to in sub-

section (1), as he may think fit for the institution of proceedings.

It is proposed to amend the said sub-section so as to empower the Principal Director General or the Director General also to issue instructions or directions to the tax authorities under the said sub-section.

It is also proposed to amend the marginal heading of the said section accordingly so as to include the reference of Principal Director General or Director General.

7.6 Exemption to National Technical Research Organization (Section 10(6)(D))

It is proposed to insert a new clause (6D) in the said section so as to exempt that any income arising to a non-resident, not being a company, or a foreign company, by way of royalty from or fees for technical services rendered in or outside India to the National Technical Research Organization.

8. Transfer pricing

8.1 Country by Country Reporting rationalized

The said section, inter alia, provides for specific reporting regime containing revised standards for transfer pricing documentation and a template for country-by-country reporting. Sub-section (2) of the said section provides that the parent entity or the alternate reporting entity of an international group which is resident in India shall furnish a report in respect of the international group on or before the due date specified under sub-section (1) of section 139 for furnishing of return of income of the relevant accounting year.

It is proposed to amend the said sub-section so as to provide that the said report for every reporting accounting year shall be furnished within a period of twelve months from the end of said reporting accounting year.

It is further proposed to amend sub-section (3) to give reference therein of the report to be furnished under sub-section (4). It is also proposed to amend sub-section (4) so as to provide in cae of a constituent entity, resident in India, whose parent entity is outside India that,—

(a) report of the nature referred to in sub-section (2) shall be furnished within the period specified in sub-section (2); and
(b) an additional condition for filing of report by said entity in a case where a country or territory, of which the parent entity is resident, is not obligated to file the report of the nature referred to in sub-section (2).

It is also proposed to amend sub-section (5) so as to provide that the due date for furnishing of the report of the nature referred to in sub-section (2) by said entity with the tax authority of the country or territory of which such entity is resident, would be the due date specified by that country or territory.

It is also proposed to consequentially substitute clause (b) of sub-section (9) so as to provide that the term "agreement" would mean a combination of,—

(i) an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A; and

(ii) an agreement as may be notified by the Central Government for exchange of the report referred to in sub-section (2) and subsection (4).

It is also proposed to consequentially amend clause (j) of sub-section (9) so as to also make reference to the report referred to in sub-section (4). These amendments are clarificatory in nature.

9. Penalty

9.1 Penalty on Chartered Accountant made appealable before ITAT (Section 253)

Last year a penalty of Rs. 10,0000 was imposed on Chartered Accountant under Section 271J. The said penalty can be levied by the assessing officer by assessing officer or CIT(Appeals). However the said penalty was not appealable.

It is proposed to amend clause (a) of the section 253 so as to make an order passed by a Commissioner (Appeals) under section 271J also appealable to the Appellate Tribunal.

However there was no corresponding amendment under Section 246A for appeal of penalty levied by Assessing Officer.

9.2 Penalty wrt failure to furnish AIR (Section 271FA)

The said section provides that if a person who is required to furnish the statement of financial transaction or reportable account under sub-section (1) of section 285BA, fails to furnish such statement within the prescribed time, he shall be liable to pay penalty of one hundred rupees for every day of default. The proviso to the said section further provides that in case such person fails to furnish the statement of financial transaction or reportable account within the period specified in the notice issued under sub-section (5) of section 285BA, he shall be liable to pay penalty of five hundred rupees for every day of default.

It is proposed to amend the said section so as to increase the penalty from one hundred rupees to five hundred rupees and from five hundred rupees to one thousand rupees, for each day of continuing

default.

9.3 Relaxation in prosecution In case of Non Fillers (Section 276CC)

Sub-clause (b) of clause (ii) of the proviso to the said section provides that a person shall not be proceeded against under the said section for any assessment year commencing on or after the 1st day of April, 1975, if the tax payable by him on the total income determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed three thousand rupees.

It is proposed to amend the provisions of the said sub-clause (b) so as to provide that the conditions specified therein shall not be applicable in respect of a company.

10. Miscellaneous Amendments

10.1 Widening of scope of Accumulated profits for the purposes of Dividend

Section 2 of the Act defines various terms used in the Act. Clause (22) of the said section defines "dividend" to include distribution of accumulated profits (whether capitalized or not) to its shareholders by a company, whether it is in the nature of,— (a) release of all or any of its assets, (b) issue of debentures in any form (with or without interest) or distribution of bonus to its preference shareholders, (c) distribution of proceeds on liquidation, (d) on the reduction of capital, or (e) in the case of an unlisted company, any loan or advance given to a shareholder having shareholding of 10% or above, or to a concern in which such shareholder holds substantial interest (exceeding 20% of shareholding or interest) or any payment by such company on behalf of or for the individual benefit of such shareholder.

Explanation 2 to the said clause provides the definition of the term 'accumulated profits' for the purposes of the said clause, as all profits of the company up to the date of distribution or payment or liquidation, subject to certain conditions.

Instances have come to light whereby companies are resorting to abusive arrangements in order to escape liability of paying tax on distributed profits. Under such arrangements, companies with large accumulated profits adopt the amalgamation route to reduce capital and circumvent the provisions of sub-clause (d) of clause (22) of section 2 of the Act. With a view to preventing such abusive arrangements and similar other abusive arrangements, it is proposed to insert a new Explanation 2A in clause (22) of section 2 of the Act to widen the scope of the term 'accumulated profits' so as to provide that in the case of an amalgamated company, accumulated profits, whether capitalised or not, or losses as the case may be, shall be

increased by the accumulated profits of the amalgamating company, whether capitalized or not, on the date of amalgamation.

10.2 Dividend Distribution Tax by Equity Oriented Fund (Section 115-R)

The said section, inter alia, provides that any amount of income distributed by the specified company or a Mutual Fund to its unit holders shall be chargeable to tax and such specified company or Mutual Fund shall be liable to pay additional income-tax on such distributed income at the rate specified in the said section. However, in respect of any income distributed to a unit holder of equity oriented funds in respect of any distribution made from such funds is not chargeable to tax under the said section.

It is proposed to amend the said section so as to provide that where any income is distributed to any person by an equity oriented fund, the fund shall be liable to pay additional income-tax at the rate of ten per cent. on income so distributed.

10.3 Restriction on Charitable Organization (Section 11 and Section 10(23C))

The section 11 and section 10(23C) provides for exemption in respect of income derived from property held under trust for charitable or religious purposes to the extent to which such income is applied or accumulated during the previous year for certain purposes in accordance with the relevant provisions.

At present, there are no restrictions on payments made in cash by charitable or religious trusts or institutions. There are also no checks on whether such trusts or institutions follow the provisions of deduction of tax at source under Chapter XVII-B of the Act. This has led to lack of an audit trail for verification of application of income.

In order to encourage a less cash economy and to reduce the generation and circulation of black money, It is proposed to insert a new Explanation to the said section so as to provide that for the purposes of determining the amount of application under clause (a) or clause (b) of sub-section (1) thereof, the provisions of sub-clause (ia) of clause (a) of section 40 and sub-sections (3) and (3A) of section 40A, shall, mutatis mutandis, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession".

10.4 Persons other than Individual also now required to apply for PAN mandatorily. (Section 139A)

Any other person other than individual who enters into financial transaction of Rs. 2,50,000 or more in aggregate in a Financial year is now required to apply for Pan.

The managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person other than individual as mentioned above is also required to apply for PAN. Also, any person competent to act on behalf of the person other than individual is also required to apply for PAN.

In order to use PAN as Unique Entity Number (UEN) for non-individual entities, it is proposed that every person, not being an individual, which enters into a financial transaction of an amount aggregating to two lakh and fifty thousand rupees or more in a financial year shall be required to apply to the Assessing Officer for allotment of PAN.

10.5 Amendment in Sec-140, now income tax return to be verified by Insolvency Professional

During the resolution process under the Insolvency and Bankruptcy Code, 2016; now the return is to be verified by an insolvency professional appointed by the Adjudicating Authority under the Insolvency and Bankruptcy Code, 2016.

This amendment will take effect from 1st April, 2018 and will, accordingly apply to return filed on or after the said date.

10.6 Amendment in Sec-143 and insertion of new scheme for assessment

Third Proviso under section 143(1) will be inserted where no adjustment shall be allowed i.e. no addition of income shall be made where there is mismatch in Form 26AS and Form 16/16A and whether that income appearing is included in computing the total income or not.

This is applicable in relation to a return furnished for the assessment year commencing on or after the 1st day of April, 2018.

Section 143 (3A) will be inserted where by the Central government will insert new scheme for scrutiny assessments, by way of notification in the Official Gazette. The new scheme will be inserted with an object to impart greater efficiency, transparency and accountability through elimination of direct interface, optimal utilization of resources and introduction of team based assessment with dynamic jurisdiction.

Section 143 (3B) will be inserted where Central Government may direct any exception, modification or adaptation for implementing the above scheme of making assessment of total income or loss and no direction will be allowed after 31st March 2020.

Section 143 (3C) states that the notification under 3A and 3B will be laid before each house of parliament immediately. These amendments will take effect from 1st April, 2018.

Notes

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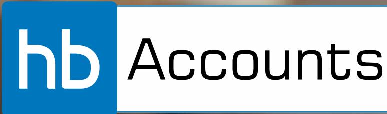

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