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THE BUDGET ASSAYER

An Analysis of the Union Budget FY 2016-17

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FOREWORD

It is with great pleasure that I present to you, the latest issue of the Cyril Amarchand Mangaldas Budget Assayer, our comprehensive analysis of the Union Budget for FY 2016-17. Continuing with our efforts to provide a holistic and analytic perspective of the Budget this year, we have taken a close look at the provisions of the Budget with special emphasis on 'Startup India' and 'Make in India' initiatives of the Central Government.

The third budget of the NDA Government comes amidst a sluggish global economy battling contraction of the global trade and sliding financial markets. However, despite a slowdown in global growth from 3.4% in 2014 to 3.1% in 2015, the growth of the Indian GDP has accelerated to 7.6% compared to around 6% in the last three years. The scourge of inflation has also been controlled to some extent, with the CPI inflation brought down to 5.4 % from over 9% in the past three years. The FM has set the fiscal deficit target at an ambitious 3.5 % of GDP, lower than the 3.9% in 2015-16. Without any significant increase in the tax rates and additional funding being made available for agriculture, infrastructure and banking sectors, achieving the deficit target is going to be quite a tightrope walk for the Government.

Contrary to all expectations, the Budget has not centered around corporate sector reforms. It focuses on infrastructure development in the agricultural and rural sectors in its pursuit of speedier economic development, and promises various benefits to the small taxpayers and farmers. Focused attention has been paid to employment generation and social welfare including healthcare and affordable housing. The FM has also attempted to address the biggest criticisms of the NDA government in this term i.e. the lack of attention to the plight of the agrarian sector.

The Government has made efforts to deliver on its promise of an investor-friendly tax regime. The ghost of 'legacy cases' may yet be laid to rest, as the FM offers a chance of settlement in the guise of 'dispute resolution' to the companies fighting such cases. As promised, the Budget also contains a slew of proposals aimed at simplification of tax laws and reduction in tax litigation, both on direct and indirect tax front. While this Budget seems to contain one of the maximum number of amendments in the recent past, most of the proposed amendments seem to be well received by the stakeholders since these endeavor to simplify various contentious issues that had given rise to profligacy of litigations.

The Budget has evoked mixed sentiments from the various stakeholders. The corporate sector is relieved about the deferral of POEM but is apprehensive about the impending GAAR and the proposed phase-out of incentives to businesses. Consumers feel burdened by the levy of additional cess on taxable services and on purchase of cars. However, the market

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sentiment so far has been positive, with the SENSEX and NIFTY on a consistent rally, following a sharp drop that was experienced immediately when the FM was giving his budget speech.

In accordance with our tradition, we have dedicated most of our efforts to analysing the impact of the budget on the tax regime and its impact on the taxpayers. We hope you will find our work informative and helpful in your decision making process.

We would appreciate your feedback on our work and do look forward to receiving your comments at **budget.assayer@cyrilshroff.com**.

Yours Sincerely,

Cyril Shroff
Managing Partner
Mumbai

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EXECUTIVE SUMMARY

The Union Budget 2016 has been presented in the wake of particularly turbulent times for the global economy. National sentiment towards the anticipated Budget was guarded, given the ambiguous and unusually wide range of 7-7.75% growth for 2016 projected by the Economic Survey of India.

The Budget announces its agenda as 'Transform India' with nine broad themes, namely agriculture and farmer's welfare, rural sector and social sector reforms, education, skill and job creation, infrastructure and investment, financial sector reforms, governance and ease of doing business, fiscal discipline and tax reforms. These focused areas evidence a fine balancing of interests of diverse sections of the populace.

The Budget focuses mainly on the agricultural and rural sector with special emphasis on infrastructural development therein. Aiming to double the income of the farmers by 2022, the Budget brings out a long term irrigation fund in NABARD, schemes for sustainable management of groundwater and encouragement to organic farming, a new crop insurance scheme and an e-marketing platform for agricultural marketing.

The Budget also introduces a multitude of incentives for Startups such as tax deduction on profits for 3 out of first 5 years and conditional exemption from LTCG to the investors. There has been no change in the personal income tax slabs and the overall rates of taxation for businesses and individuals also remain the same, with few exceptions. Dedicated effort has been made to rationalise tax laws, with the Finance Bill containing nearly 238 clauses and several substantive provisions, by far the largest in recent times.[1]

The FM in Budget 2015 had proposed a reduction of the general corporate tax rates alongside gradual phasing out of the various incentives and deductions available under the IT Act. Pursuant to this plan, companies having a turnover of less than INR 50 million are proposed to be taxed at a concessional rate of 29%.[2] New manufacturing concerns solely engaged in manufacturing are proposed to be given an option of being taxed at a concessional rate of 25% subject to the company foregoing certain incentives under the IT Act. Further, it is proposed to curtail several incentives, such as restriction of the highest rate of depreciation to 40%, reduction of weighted deductions on account of expenditure on scientific research to 100% and a sunset date of March 31, 2020 for tax holiday to SEZ units.

Finance Bill finally gives effect to the assurances by CBDT to foreign companies in the past year by proposing to exempt foreign companies (including corporate FIIs/ FPIs) from the levy of MAT with effect from April 1,

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[1] All provisions of the Finance Bill mentioned in this document are proposed to come into effect on April 1, 2017 unless otherwise specified
[2] All rates mentioned in this document are exclusive of the applicable surcharge and education cess unless otherwise specified

2001 instead of the earlier applicable date of April 1, 2015. The exemption is extended to companies not having a PE in India and not otherwise obligated to seek registration under any corporate law. Foreign companies are further relieved by the one year deferral of the application of new residency criteria of POEM for companies. However, there has been no deferral of the implementation of GAAR and they are expected to come into force from April 1, 2017.

In a surprising turn of events, dividend income from Indian companies in the hands of resident non-corporate entities exceeding INR 1 million is sought to be taxed at the rate of 10% on the principle of progressive taxation. The proposed increase of STT from 0.017% to 0.05% on options not exercised is another unexpected proposal contained in the Budget.

Other important amendments pertaining to the new equalization levy on e-commerce payments, transfer pricing documentation and country by country reporting are proposed to be introduced as per the recommendations of the OECD in respect of the BEPS Action Plans. Equalization levy is proposed on payments made for online advertisements to non-resident e-commerce companies not having a PE in India. BEPS Action Plans require implementation of revised standards for transfer pricing documentation and country-wise reporting by enterprises of their income, earnings, taxes paid etc. It would bring about significant procedural changes and add to the compliance costs of MNCs.

In a bid to create a 'R&D hub' in the country, the Finance Bill proposes to incentivize R&D activities undertaken in India by proposing to tax royalty income earned in respect of patents developed and registered in India at a concessional rate of 10% on the gross amount of royalty received. It is also proposed to extend the benefit of additional depreciation of 20% for new plant and machinery acquired by assessees in the business of transmission of power. Aiming to boost commercial real estate development, the distributions made by the SPVs to REITs and INVITs, are proposed to be exempted from levy of DDT, subject to certain conditions.

With a view to reduce tax litigation, the FM has introduced the Income Declaration Scheme, which provides a limited period compliance window for domestic taxpayers to declare past transgressions at total 45% tax (including interest and penalty), with immunity from further prosecution. A second scheme called Direct Tax Dispute Resolution Scheme has been proposed for settlement of appeals pending before the CIT (A) and CWT(A) and those arising out of retrospective amendments to the IT Act & the WT Act by payment of disputed tax and interest. There would be no penalty for tax arrears up to INR 1 million and 25% of minimum imposable penalty for arrears above INR 1 million.

Further, on the indirect tax front, the commitment towards reduction in litigation has been reiterated in the present budget proposals. The Government has proposes to introduce a dispute resolution scheme for indirect taxes; introduce additional benches of the Customs, Excise and Service Tax Appellate Tribunal; withdrawal of cases pending for more than 15 years with a pecuniary limit up to INR 5 lakhs. Interest and penalty provisions under the indirect tax regime have been rationalized. However, the extension of the limitation period for customs, excise and service tax has been a disappointment to say the least.

Amendments have been made in the credit provisions with a view to enable seamless flow of credit as well as simplifying the provisions. The powers of Central Board of Excise and Customs have also been enhanced. The Central Excise and Customs Tariffs have been amended to bring them in line with the Harmonized System of Nomenclature. Further, a majority of the other changes are aimed at pruning of the existing exemptions and widening the tax base.

Therefore, overall most of the Budget changes have been aimed at giving greater thrust on the present government's flagship projects, with special focus on Infrastructure, Agriculture, Social Welfare, Health and promotion of the manufacturing sector.

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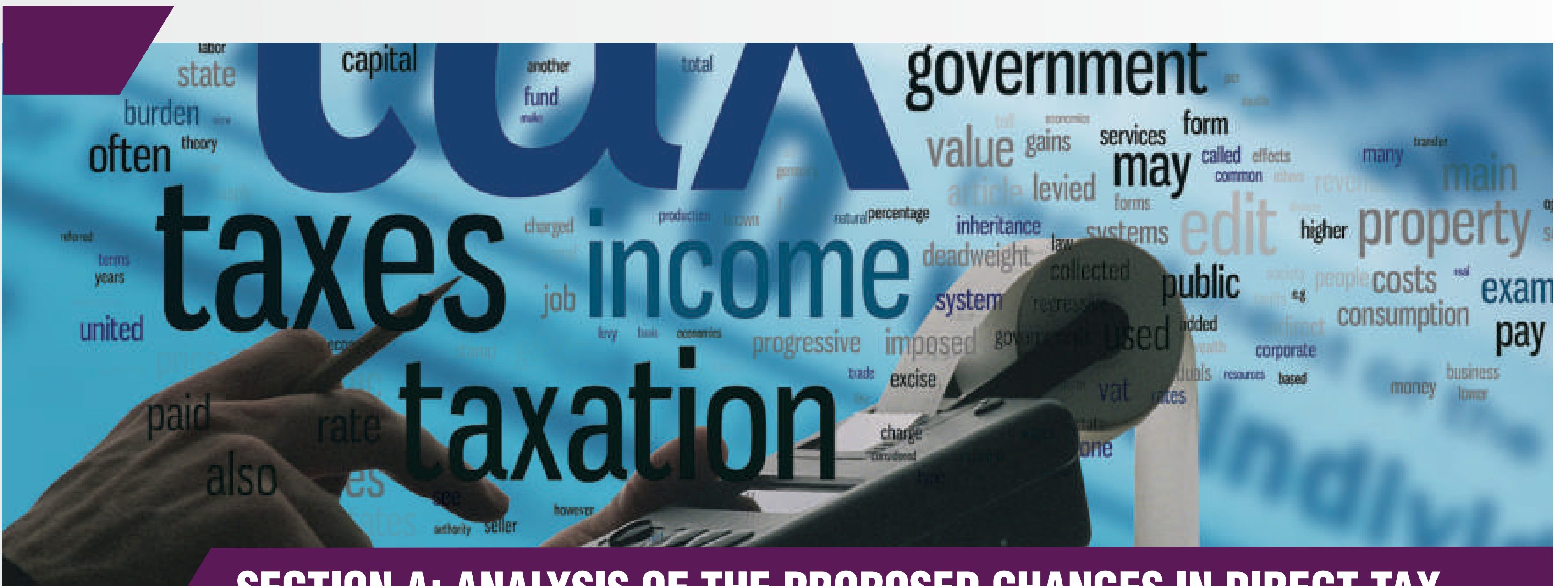

SECTION A: ANALYSIS OF THE PROPOSED CHANGES IN DIRECT TAX

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I. RATES OF TAX

1. Corporate Tax Rates

There is no change in the tax rate (including the surcharge) applicable to the domestic and foreign companies. The FM in his speech for the Budget 2015-16 had announced a four year roadmap in terms of reduction of basic tax rates for domestic companies from 30% to 25%, over a period of four years starting from the FY 2016-17.

While there is no reduction in the overall basic rate of corporate tax as expected, the following changes are proposed towards reduction in the corporate tax rate:

i. New manufacturing companies incorporated on or after March 1, 2016 and engaged solely in the production of an article or a thing, are proposed to be given an option to be taxed at the rate of 25%, provided they forego profit or investment linked deductions, investment allowance and accelerated depreciation allowed under the IT Act and certain other specified conditions.

ii. Companies with total turnover or gross receipts in the FY 2014-15 not exceeding INR 50 million are proposed to be taxed at the rate of 29%.

Reduction of MAT rate from 18.5% to 9% is proposed for companies whose units are located in IFSC and deriving their income solely in convertible foreign exchange.

Justifying his action in not introducing a universal reduction in the corporate tax rate, the FM has clarified that since the proposed rationalisation of corporate tax rates has to be carried out in a revenue neutral manner and the gradual phasing out of the existing benefits and incentives is going to be net revenue accretive for the Government in the years to come, the corporate tax rate reduction also had to be introduced in a phased manner so as to ensure that the cash flows of the Government are not significantly impacted.

2. Other tax rates

There is no change in the basic tax rates for individuals, HUF, AOP, BOI and firms (including LLP). However, the applicable rate of surcharge for individuals, HUF, AOP and BOI having total income in excess of INR 10 million is proposed to be increased from 12% to 15%.

Income by way of dividends received by resident individuals, HUF, firm (including LLP) from domestic companies, in excess of INR 1 million (calculated on gross basis) is proposed to be taxed at the rate of 10%. On a perusal of the changes proposed in the Finance Bill, it is possible to interpret that this provision shall be triggered only if the concerned taxpayers receive dividends in excess of INR 1 million from one domestic company and it is not necessary to aggregate all dividends received by the concerned taxpayer. The alternate interpretation that suggests that aggregate of all dividends received by the concerned taxpayer should be considered while examining the applicability of this provision is also possible. Unless this issue is clarified before the changes are formalized, it may become contentious.

> **“Tax @10% on dividend income above 1 million.”**

3. Securities Transaction Tax

The rate of STT on sale of an option in securities, where option is not exercised, is proposed to be increased from 0.017% to 0.05% of the option premium, with effect from June 1, 2016.

As an incentive to the units located in an IFSC, STT would not be payable on taxable transactions entered into by any person on a recognized stock exchange located in an IFSC, where the consideration for such transaction is paid or payable in foreign currency.

II. TAX INCENTIVES AND EXEMPTIONS

1. Tax incentives for Startups

On January 16, 2016, the Prime Minister had unveiled the Startup Action Plan that laid the foundation for igniting the fire of innovation for those with absolute novel ideas with regards to entrepreneurship. The idea was not only to facilitate entrepreneurship and create ample revolutionary opportunities of expansion, but also to provide incentives to the youth of India and

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encourage them to think out–of-the-box to get innovative solutions that assists people at large who, in turn, propel the country towards consistent growth and development.

As promised by the Government, 3 out of 4 incentives that were proposed to be introduced for Startups found their place in the Finance Bill, to be effective from AY 2017-18 (i.e. FY 2016-2017) have been discussed here under:

- **Tax deduction for profits from eligible business:**

  It is proposed to insert a new section 80–IAC, to provide a deduction of 100% of the profits and gains derived from an eligible business in the hands of an eligible Startup. Such a deduction can be claimed by the eligible Startup in any 3 consecutive assessment years out of 5 years, beginning from the year in which the eligible Startup is incorporated.

  For this purpose, the eligible Startup means a company engaged in eligible business, which fulfills the following conditions:

  i. It is incorporated on or after the April 1, 2016 but before April 1, 2019;

  ii. The total turnover of its business does not exceed INR 250 million in any of the previous years beginning on or after April 1, 2016 and ending on March 31, 2021; and

  iii. It holds a certificate of eligible business from the Inter-Ministerial Board of Certification, as notified in the Official Gazette by the Central Government.

  The term 'eligible business' means a business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property.

  This deduction shall be available to the eligible Startup, which fulfills the following conditions:

  i. The eligible Startup is not formed by splitting up, or reconstruction, of a business already in existence, subject to certain exception provided therein;

  ii. The eligible Startup is not formed by the transfer to a new business of machinery or plant previously used for any purpose, subject to certain exceptions provided therein.

  Further, the eligible Startup will also be required to comply with other conditions, like, the accounts of the Startup to be audited by a Chartered Accountant and a report would have to be submitted along with the tax return, transactions between the eligible business and other businesses carried out by the taxpayer to be executed at ALP, etc.

  The eligible Startup would be subject to MAT of 18.5%, tax credit for which would be available against the normal income tax payable, subject to fulfillment of conditions.

  However, the incentives to Startups, as proposed in the Finance Bill, seem to be at variance with the Startup Action Plan. For example, while the Startup Action Plan proposed to provide the tax deduction benefit subject to non-distribution of dividends by the Startup companies, no such condition is proposed by the Finance Bill. Further, as per the Startup Action Plan, a Startup could be incorporated as a company, LLP or a registered partnership firm. However, the definition of an eligible Startup in the Finance Bill refers to a company only thereby implying that the benefits shall not be extended to LLPs and partnership firms.

- **Exemption from LTCGs to investors:**

  i. It is proposed to introduce section 54EE, to provide an exemption for investors from tax on LTCGs, if such LTCGs are invested in the units (which are issued before April 1, 2019) of a fund to be notified by the Central Government **("Fund of Funds")**. This Fund of Funds is proposed to be set up under the Startup Action Plan, for which the Government intends to raise INR 25,000 million annually.

     The exemption shall be available, subject to the conditions that the amounts shall remain invested for 3 years and that the investment in the fund shall be up to INR 5 million in the year of transfer and the subsequent year. Proportionate exemption would also be available if the investment in the fund is less than the amount of LTCGs.

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If the units are transferred within a period of 3 years from the date of their acquisition, the exemption granted earlier would be withdrawn and the capital gains shall be chargeable to tax in the year in which the units are transferred. In case the investor takes any loan or advance on the security of the units, such units would be deemed to have been transferred on the date on which the loan or advance is taken.

ii. Under the existing provisions of the IT Act, LTCGs arising from the transfer of a residential property (i.e. a house or a plot of land) are exempt from tax, if the individual / HUF invests the sale consideration in the shares of a SME, in which the taxpayer holds more than 50% share capital or voting rights and the SME utilizes such proceeds within 1 year to purchase new specified assets, subject to meeting certain other conditions.

This existing provision is proposed to be extended to investment in shares of an eligible Startup (i.e. technology driven Startup, as certified by the Inter-Ministerial Board of Certification).

Further, the existing provisions require that the company should invest the proceeds in the purchase of new specified assets, being new plant and machinery but does not include, *inter-alia*, computers or computer software. In order to ensure effortless functioning of business activities in case of Startups where computers or computer software form the core asset base owing to the nature of business, it is proposed to amend the definition of new specified assets to also include computer and computer software in such cases.

- One of the incentives that formed a part of the Startup Action Plan, but could not make place in the Budget 2016, pertains to receipt of consideration for issue of shares in excess of fair market value by the eligible Startup company. Currently, if the venture capital undertakings receive consideration for issue of shares that exceeds the fair market value of the shares, the aggregate consideration as exceeds the fair market value of the shares is not taxable under the provisions of section 56(2)(viib) of the IT Act in the hands of the venture capital undertakings. The Startup Action Plan proposed to extend similar benefits to Startup companies too. However, there is no mention about the same in the Finance Bill.

While this is one of the most ambitious initiatives of the Government, it remains to be seen how the Startups would actually perform and whether they would be able to meet the pre-determined objectives of the Government in relation to 'Doing Business in India'.

2. Taxation of income from Patents

The Government's aim is to make India an innovation hub and, therefore, in order to encourage indigenous R&D activities, the Government has decided to introduce a patent box regime that proposes to provide a concessional taxation regime for income from patents. The aim is to provide an additional incentive for companies to undertake R&D activities in lieu of abundance of highly skilled manpower available in the country and also to retain and commercialise both existing and new patents from India instead of transferring them outside India. This will encourage companies to locate the high value jobs associated with the development, manufacture and exploitation of patents in India. This would also facilitate compliance with the BEPS project recommended by the OECD, which prescribes the taxation of income arising from exploitation of intellectual property in the jurisdiction where substantial R&D activity has taken place, as opposed to the jurisdiction of legal ownership only. Under the existing provisions of the IT Act, the resident assessee who has commercialised the patent, pays tax on income at the tax rate of 30%, after deducting business expenses. It is now proposed that where the total income of an eligible assessee, includes any income by way of 'royalty' in respect of a patent developed and registered in India, then such royalty shall be taxable at the concessional tax rate of 10% on the gross amount of the 'royalty' received. No deduction in respect

> **"Concessional tax on royalty from Indian patents."**

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of any expenditure or allowance shall be allowed while computing the total income of the taxpayer. This concessional tax regime is proposed to be applicable from the FY 2016-17.

For the purpose of this concessional tax regime, an eligible assessee means a person resident in India, who is the true and the first inventor of the invention and whose name is entered on the patent register as the patentee in accordance with the Patents Act, 1970 and includes every person, being the true and the first inventor of the invention, where more than one person is registered as patentee under the Patents Act, 1970 in respect of that patent. Further, the term 'royalty' means consideration (including any lump sum consideration, but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains' or consideration for sale of produce manufactured with the use of patented process or the patented article for commercial use) for the (i) transfer of all or any rights (including the granting of a license) in respect of a patent; or (ii) imparting of any information concerning the working of, or the use of, a patent; or (iii) use of any patent; or (iv) rendering of any connected services.

Additionally, it is also proposed that the income earned from patents would not be subject to MAT and accordingly, appropriate adjustments would be made while computing the 'book-profits' of the company for the purpose of calculating the MAT.

The above beneficial tax provisions will go a long way in ensuring that the ownership of patents does not migrate outside India, but is exploited from India.

It is pertinent to note that the decision regarding ownership of patents is taken after considering multiple factors like the risk appetite of the inventor / scientist, the patent protection regime in India and the conducive environment available in India to carry out R&D activities in the concerned jurisdiction, in addition to the financial factors like availability of tax incentives, etc. Absence of all the above factors has been the reason for India's abysmal record in creation of patents, etc. in spite of her being one of the maximum scientist producing countries. This has also resulted in significant amount of brain drain wherein the highly skilled and trained manpower have migrated overseas for better environment and career prospects. Thus, this issue has to be dealt with a multi-pronged strategy by addressing all possible hindrances.

3. Special tax regime for certain manufacturing companies

In order to give impetus to the 'Make in India' initiative of the Government, a new provision has been inserted which provides an option to a domestic company incorporated and set up on or after March 1, 2016, to offer its total income to tax at 25%. This lower rate of tax is subject to the company being a company engaged in the business of manufacturing or production of an article or thing and the company not claiming deductions/incentives/ set off of any brought forward losses from previous years. Only depreciation under section 32 would be claimed by such an entity. Once the company adopts this option of taxation, any accumulated losses from previous years will be deemed to have been given full effect and shall not be allowed for any subsequent years. The company can exercise this option on or before the due date as specified in under section 139(1) for filing of tax return for the relevant previous year.

> **"Tax rate of 25% for new manufacturing companies."**

While a 25% corporate tax rate may be attractive, it should be borne in mind that a new manufacturing entity may not earn profits in the initial years. Thus, it has to be analysed whether the entity will be better off availing this lower taxation regime or carrying forward previous years losses and setting them off; before opting for this concessional corporate taxation regime.

4. Tax incentives to IFSC

IFSC is a hub of several financial services which are provided to various persons. The units in an IFSC have their own laws and regulations, which are different from those that are applicable to the rest of India. In order to incentivize the growth of IFSC into a world class financial services hub, certain additional tax incentives are proposed by

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the Finance Bill. While clearly absorbing the ideas and advantages of setting up IFSCs in India, the Government had announced that the first IFSC centre would be set up in Gujarat International Finance Tec-City **("GIFT")** near Ahmedabad. Thereafter, specific rules and regulations were issued by various regulators like the SEBI, the RBI and the IRDAI in 2015. It is one of the most ambitious projects being undertaken in the Indian financial infrastructure space; designed to be at par with globally benchmarked financial centres such as Shinjuku, Tokyo, Shanghai, La Defense, Paris, London Dockyards, etc.

Under the existing provisions of the IT Act, a deduction of 100% is allowed in respect of business profits earned by a unit in the IFSC for the first 5 consecutive AYs and 50% for the next 5 consecutive AYs. No sunset clause has been proposed with regard to this provision implying thereby that this provision will continue to be there to promote international financial services to operate from India and the likelihood of similar other IFSCs to come up in India cannot be ruled out.

As a part of the historically initiated measures to revamp the IFSC structure in India, it is proposed to provide the following tax incentives to an IFSC:

i. Exemption from capital gains, even when no STT is paid

Under the existing provisions of the IT Act, LTCG on transfer of an equity share of a company are exempt from tax, if STT is paid on such transactions. In a case, where STT is not paid, it may be possible to take a stand that the non-residents can pay tax at the rate of 10% on the amount of LTCG.

It is now proposed that LTCG arising from transaction undertaken in foreign currency on a recognized stock exchange located in IFSC, even when STT is not paid would be exempt from tax. This is likely to give substantial benefit to the investors.

It would be important to note that under the existing provisions of the IT Act, STCG on transfer of equity shares, on which STT is paid are taxable at the rate of 15%. However, in a case, where no STT is paid, STCG are taxed at the higher rate (i.e. 40% in the hands of non-residents). Surprisingly, the concessional rate of taxation in respect of STCG earned by a foreign investor from the sale of listed securities has not been extended to the transactions proposed to be undertaken through a recognized stock exchange located in an IFSC.

ii. Reduction of MAT

Under the existing provisions of the IT Act, if the tax payable by the company on the total income is less than 18.5% of the 'adjusted book profits'; MAT at the rate of 18.5% is payable on the 'adjusted book profits'. 'Adjusted book profits' are arrived at after making specific additions and reductions from the net profit / loss as per the profit and loss account of the company.

In order to provide a competitive tax regime to an IFSC, it is proposed that in case of a company, being a unit located in IFSC and deriving income solely in convertible foreign exchange, MAT shall be chargeable at a concessional rate of 9%.

While the gross total income is eligible for 100% deduction for the first 5 consecutive AYs, a MAT of 9% would still be payable in case the company is able to generate profits during the first years of its operations. A reduction in the rate of MAT from 18.5% to 9% should encourage investors to set up their units in IFSCs.

iii. Exemption of DDT

Under the existing provisions of the IT Act, domestic companies are required to pay DDT at the rate of 15% on gross basis.

In addition to the above incentives, it is proposed that no DDT shall be payable by a company, being a unit of an IFSC that derives income solely in convertible foreign exchange. Further, such dividend income would be exempt from tax in the hands of the shareholders.

In case global financial institutions set up branches / units in the IFSC (rather than a new

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company), a question that needs consideration is how the proposed exemption would be calculated, since the dividends are declared by the company and not by the units of the company. Alternatively, it is also possible that this provision has been purposely framed in this manner so as to encourage financial institutions to set up a new company in the IFSC and keep this company separate from their businesses being carried out in India.

iv. Exemption of STT and CTT

Currently, STT and CTT are required to be paid on transactions on securities and commodities on the stock exchanges, except in certain cases.

It is proposed that with effect from June 1, 2016, STT and CTT shall not be payable on securities transactions (or commodities transaction, as the case may be) entered into by an person on a recognized stock exchange located in an IFSC, where the consideration for such transaction is paid/ payable in foreign currency.

5. DDT exemption on distribution by SPV to REIT/ INVIT

Taking a leaf out of the successful implementation of REIT regimes across the world, the SEBI had notified the SEBI (REIT) Regulations, 2014 in September 2014. Consequently, in order to provide certainty on the tax front, the Finance Act, 2014 had introduced a special tax regime governing taxability of the income earned through a REIT and INVIT (collectively called as **"Business Trust"**) structure. Thereafter, certain other amendments were made by the Finance Act, 2015 to further rationalise the taxation regime. However, the tax regime was not attractive enough to kick-start Business Trust structures at the ground level.

As may be known, a Business Trust can hold the income generating assets either directly or through an SPV being a company or an LLP. While the existing provisions provided pass through status to rental income and interest income earned by Business Trusts, in case the assets were held by the SPV, it entailed an additional leakage in the form of DDT when the distributions were made by the SPV to the REIT. This made the Business Trust structures tax inefficient since an additional 20% tax shall have to be paid by way of DDT. This issue was further compounded because the SEBI Regulations required both the SPVs and the Business Trusts to distribute 90% of their operating income to the investors and thus, DDT became a recurring cost for Business Trusts.

> **"No DDT on distribution by SPV to REIT/ INVIT."**

To address the above hurdle in implementation of Business Trusts, Finance Bill proposes the following –

i. exemption shall be granted from levy of DDT in respect of distributions by SPV to the Business Trust provided the Business Trust holds 100% of the share capital of the SPV or all of the share capital other than that which is required to be held by any other entity as per any law or direction;

ii. the exemption shall be only be in respect of dividends paid out of current income after the date when the Business Trust acquires the requisite shareholding in the SPV. The dividends paid out of accumulated and current profits up to this date shall be liable for levy of DDT as and when any dividend out of these profits is distributed;

iii. such dividend received by the Business Trust and its investor shall not be taxable in the hands of trust or investors.

The above amendment is definitely a welcome step for the industry and taxpayers could now consider using Business Trusts to implement their desired business initiatives. However, given that the exemption is limited to only SPVs having 100% shareholding; it may appeal only a certain limited section of the real estate industry and investors.

A few other expectations in respect of Business Trust that have not yet been fulfilled in spite of repeated submissions by the industry are enumerated below –

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i. Exemption from MAT liability for the sponsor on transfer of shares of the SPVs in exchange for units of the Business Trust;

ii. Tax deferral scheme made available to the sponsor on transfer of SPVs shares to the Business Trust has not been extended to direct transfer of assets and to transfer of interest in LLP; and

iii. The units of the Business Trust, in order to qualify as LTCG, need to be held for 3 years. The holding period of such units has not been brought down to 1 year to be at par with other listed securities.

6. Extending the benefit of additional depreciation to power transmission companies

Under the existing provisions of the IT Act, an additional depreciation of 20% is allowed in the case of any new machinery or plant, which has been acquired and installed by a taxpayer engaged in the business of generation or generation and distribution of power. This additional depreciation is available over and above the depreciation normally allowed under the provisions of the IT Act.

The benefit of additional depreciation is not available to a taxpayer engaged in the business of transmission of power.

In order to rationalise the incentive provided to power sector, it is proposed to be provide an additional depreciation of 20% of actual cost of new machinery or plant acquired and installed in a previous year to a taxpayer engaged in transmission of power. However, this additional depreciation shall not be allowed in respect of –

> **"Additional depreciation @ 20% for power transmission."**

i. Any machinery or plant which, before its installation, was used either within or outside India by any other person;

ii. Any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of guest house;

iii. Any office appliances or road transport vehicles; or

iv. Any machinery or plant, whose actual cost has been already allowed as deduction in computing the business profits.

This amendment is expected to incentivise transmission companies to invest more in newer equipments / technologies and also to expand their business in various parts of India, thus aiding the Government's efforts to electrify 100% villages by May 1, 2018. The proposed benefit would increase transmission capacity at a lower cost which is particularly important as poor grid connectivity is a hindrance to electrification of remote rural areas.

7. Additional deduction for employment generation

Under the existing provisions of the IT Act, deduction of 30% of additional wages paid to new regular workmen in a factory is allowed to the assessee for 3 yrs. The deduction is subject to the new workmen being employed for not less than 300 days in a previous year and an increase of at least 10% in total number of workmen employed on the last day of the preceding year.

Aiming to extend this employment generation incentive to all sectors, the provisions of the existing section are proposed to be substituted. As per the proposed provisions, deduction of 30% of additional employee cost for 3 years would be allowed to the assessee who is required to undergo a statutory audit under the IT Act, subject to meeting with certain conditions, like:

i. The business should not be formed by splitting up, or the reconstruction of an existing business, subject to certain exceptions provided;

ii. The business is not acquired by the assessee by way of transfer from any other person or as a result of the business reorganisation;

iii. The assessee furnishes an audit report from the Chartered Accountant, along with its tax return.

The deduction shall be available in respect of cost incurred on any employee, whose total

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emoluments are less than or equal to INR 25,000 per month. However, no deduction shall be allowed in respect of cost incurred on those employees, for whom the entire contribution under the notified Employees Pension Scheme is paid by the Government.

Further, the minimum number of days of the employment in a financial year would be 240 days (as against current specified period of 300 days). The current requirement of 10% increase in the number of employees during the FY is also proposed to be done away and thus, any increase in the number of employees will be eligible for the deduction under the proposed substituted provision.

The proposed provision provides that in the first year of the new business, 30% of the emoluments paid or payable to the employees during the FY shall be allowed. This means that the assessee would be entitled to claim deduction of 130% of the emoluments in the first year of the new business.

This tax benefit will have a direct impact on generation of employment in various sectors (including service sectors). More such employment generation reforms are sorely needed, as the rate of unemployment in India remains quite high at 9.6%, according to the 2011 census data. Of the employed population, only 6% is in the formal sector. The Government recognizes tackling unemployment as a pressing issue. Moreover, with more than 65% of her population being less than 35 years and most of them being educated, this has to be tackled on a war footing basis or else, it could lead to severe social unrest. At the same time, it is also very important to provide this young population with the requisite skill set so that they can be gainfully employed in the recognized sector. In this regard, the initiatives launched by the Government to provide technical and skilled education are well timed and would go a long way to achieving the objectives.

8. Rationalisation of additional investment allowance

Under the existing provisions of the IT Act, investment allowance of 15% is allowed on the investment made in new assets (plant and machinery) exceeding INR 250 million in a FY by a company engaged in the business of manufacturing or production of any article or thing, subject to the acquisition and installation being completed in the same FY. This tax incentive is available up to March 31, 2017. This had caused genuine hardship in cases where the assets acquired could not be installed by the manufacturing companies within the same FY.

It is proposed that the acquisition of plant and machinery of the specified amount has to be made in the previous year, but installation may be made by March 31, 2017 in order to avail the benefit of investment allowance. Further, the deduction would be allowed in the year of installation. This amendment is proposed to be made retrospectively from the FY 2015-16.

III. IMPACT ON FOREIGN INVESTMENTS

1. Place of Effective Management

The IT Act was amended last year to introduce a new tax residency criterion being POEM, applicable with effect from April 1, 2016. Prior to this amendment, a company was regarded as resident in India if it *inter alia* had, during that year, the control and management of affairs situated wholly in India. As a result of the amendment made in Finance Act, 2015, POEM has been defined as a place where the key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole, in substance, are made. A foreign company having POEM in India would be construed as a tax resident of India and accordingly, would be taxed on its worldwide income in India.

There are several issues regarding the applicability of the provisions of the IT Act to companies having a POEM in India. As a tax resident of India, such a company would need to comply with all the requirements under the IT Act such as payment of advance tax, applicability of TDS provisions, computation of total income, set off of losses and manner of application of transfer pricing regime. A foreign company which has not been assessed previously in India, would not have undertaken the requisite compliance requirements within the prescribed period.

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Further, any computation of depreciation applicable to the company would also arise, since in the previous years there would have been no such computation. Additionally, at the time of determination of the POEM, the previous year would have closed and the company would be unable to fulfil procedural requirements. Moreover, the draft Guidelines issued by the CBDT as to what constitutes POEM and how will it work in actual business situations have not yet been finalized.

Due to lack of clarity regarding the above-mentioned implementation issues and absence of appropriate rules in place to provide guidance for applicability of POEM, the provision has been deferred by 1 year, to be effective from April 1, 2017.

Despite the deferral, the Finance Bill, has inserted a new Chapter XII-BC in the IT Act, in relation to the special provisions relating to foreign company's residence in India. The new section 115JH provides that where a foreign company is for the first time said to be resident in India in any previous year, then a notification would be issued for every previous year, to provide for modifications and adaptations in relation to computation of total income, treatment of unabsorbed depreciation, set off or carry forward of losses, collection and recovery and provisions that would apply to such foreign company. A further proviso also provides where such POEM is determined to exist during the course of assessment proceedings, then, the specific provisions (as applicable to a foreign company having POEM for the first time) would continue to apply. The section also provides that where any benefit, exemption or relief has been claimed, and subsequently, it is found that the foreign company has failed to comply, then the tax officer may re-compute the tax liability without giving effect to the exceptions, modifications and adaptations. These are, however, transition provisions and once these transition provisions end, the normal provisions of the IT Act would apply.

> **"POEM deferred till April 1, 2017."**

It is interesting to note that there appears to be an assumption that if a foreign company constitutes POEM in one year, it would continue to do so for all subsequent years as well. In this regard, it is pertinent to note that the residential status of an entity has to be determined on a year by year basis, especially in the context of POEM which is a deeming provision. In other words, whether a foreign company has established a POEM in India or not, shall have to be examined every year. Thus, it is not clear what might happen if the foreign entity ceases to have a POEM in India in a subsequent year after having established POEM during one year.

It may be recalled that in late 2015, the CBDT had issued draft rules for discussion by stakeholders, in relation to the guidelines for determination of POEM in India.

These draft guidelines provided substantive and quantitative criteria for the determination of POEM of foreign companies in India, along with factors, which by themselves would not lead to a conclusion that POEM of a company is situated in India. Further, they detailed the process to be followed by the AO in case of determination of a company's POEM in India. The CBDT has not yet issued the final guidelines regarding POEM.

In view of the above referred uncertainties, foreign companies shall have to be cautious in carrying out their business activities as inadvertent constitution of a POEM in India could result in severe unintended tax consequences for them.

2. Exemption from furnishing of PAN

Under the existing provisions of the IT Act the recipient of any sum which is subject to withholding under the IT Act is required to furnish his PAN to the person responsible for withholding such tax, failing which tax is required to be withheld at the rates in force or at the rate of 20%, whichever is higher. Non-residents are also subject to this requirement except in respect of payment of interest on specific long-term bonds. This has been an unduly onerous burden for a non-resident who is otherwise not obliged to obtain PAN in India.

In a welcome change, it is now proposed to exclude non-residents from the requirement to

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furnish PAN, with effect from June 1, 2016 provided certain prescribed conditions are satisfied. These conditions are yet to be provided and clarity is awaited in respect of the same. This will help reducing the unnecessary administrative burden being imposed upon non-residents who are, otherwise not required to obtain a PAN in India.

3. **Rationalisation of MAT provisions for foreign companies**

MAT is levied under section 115JB of the IT Act which provides that where the total income of a company in any previous year is less than 18.5% of its book profit, such book profit shall be deemed to be the total income of the company and the company shall be liable to pay tax at 18.5% of its book profit. The Finance Act, 2015 had granted partial relief to the non-resident investors from the applicability of MAT by providing that capital gains arising from the transfer of securities accruing or arising to non-resident companies will be excluded from the chargeability of MAT. However, this amendment did not clarify the issue of applicability of MAT to FII/FPIs or to foreign companies for the period prior to April 1, 2015 and the tax authorities had started raising demands against FIIs/FPIs asking them to deposit MAT for this prior period.

> **No MAT on foreign companies.**

Pursuant to an uproar by foreign investors, the Government had appointed a Committee, headed by Justice A.P. Shah, to look into the applicability of MAT to FIIs/FPIs for the period prior to April 1, 2015. Based on the Committee's recommendations, the Government issued a Press Release[3] and CBDT issued an Instruction[4], clarifying that the MAT provisions will not be applicable to FIIs / FPIs for the periods prior to April 1, 2015. Subsequently, another Government Press Release[5] was also issued to clarify the non-applicability of the MAT provisions to all foreign companies prior to April 1, 2015. Thereafter, the Government in the case of Castleton Investment Ltd.[6] had granted an undertaking to the Hon'ble SC that they will not pursue their claims against foreign companies on account of MAT. The Hon'ble SC disposed off the SLP in the case of Castleton accordingly.

Following up on the various notifications issued by the CBDT and the undertaking submitted to the Hon'ble SC, the Finance Bill sets out an additional explanation clarifying that the provisions of section 115JB shall not apply and deemed to have never applied to a foreign company with retrospective effect from April 1, 2001 (i.e. AY 2001-2002):

i. The assessee is a resident of a country or a specified territory with which India has a DTAA or agreement with specified associations, and the assessee does not have a PE in India or

ii. The assessee is a resident of a country with which India does not have an agreement of the nature as stated in (a) above, and the assessee is not required to seek registration under any law for the time being in force relating to companies.

This amendment will be a huge relief to foreign companies including FIIs and FPIs who do not have a place of business or a PE in India since they were already susceptible to tax demands on them on account of MAT. While the Government continues with its avowed commitment not to introduce any amendment with retrospective effect, it is heartening to note that it is not shying away from introducing retrospective clarifications granting relief to taxpayers who otherwise would have had to deal with long drawn litigations.

4. **Concessional tax rate on capital gains from sale of private company shares**

Under the existing provisions of the IT Act, any LTCGs arising to a non-resident from any transfer of unlisted 'securities' are taxed at a concessional rate of 10%. The term 'securities' is defined with reference to section 2(h) of the Securities Contracts (Regulation) Act, 1956 ("**SCRA**") and it includes, shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.

[3] Press Release issued by the MOF, dated September 1, 2015
[4] CBDT Instruction No. 9/2015, dated September 2, 2015
[5] Press Release issued by the MOF dated September 24, 2015
[6] Castleton Investment Ltd. vs. Director of Income Tax (International Taxation), [2015] 280 CTR 409 (SC)

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A question that needed consideration was whether only those securities that are 'marketable' can qualify as 'securities' and whether shares of a private company do not qualify, since the shares of a private company are not 'marketable' freely. There are number of arguments to support the proposition that even private company's shares are covered under the term 'securities'. While there is no tax jurisprudence on the subject, there are some rulings[7] in the context of corporate law, where the Courts have considered that the shares of a private company are not freely marketable and accordingly concluded that shares of a private company may not be covered within the ambit of "securities" as they are defined in accordance with section 2(h) of the SCRA.

With a view to clarify the position, it is proposed to extend the concessional rate of taxation of LTCGs on transfer of unlisted securities to the transfer of 'shares of a closely held company'.[8] This clarification would enable non-resident transferor of shares of private companies to avail the concessional tax rate of 10% on LTCGs. This is a very welcome measure for foreign investors, as their tax exposure upon exit from private companies would reduce and would put at rest the ambiguity raised in this behalf. It is also pertinent to note that most of the investments made by foreign investors have been in private limited companies and hence, this amendment would most definitely be beneficial to them.

Having said this, it may be noted that this amendment has been introduced from the FY 2016-17 and the past cases may still have to be litigated to get an explicit ruling from the Courts.

5. Relaxation in safe harbour rules for offshore funds

Certain safe harbour rules were introduced for offshore funds in the last Budget to facilitate migration / relocation of fund managers into India. The said rules provided an exception from constituting business connection or Indian tax residency, in case of eligible investment fund managed by an eligible fund manager in India

> **"Safe Harbour Rules extended to non-DTAA offshore funds."**

This benefit was available only if funds and fund managers satisfied the eligibility conditions which *inter alia* were related to the residence of fund, its corpus size, its investor base, investment diversification and payment of remuneration to fund manager on arm's length basis, etc. While the amendment was well intentioned, the eligibility conditions were largely criticised for being extremely stringent, onerous and subjective in certain cases. It is, therefore, proposed by the Finance Bill to provide some relaxation from these conditions.

One of the conditions is that the fund has to be resident of a country or territory with which India has entered into a DTAA or a TIEA. It is proposed to broaden this condition to include a fund established or incorporated or registered outside India in a country or a specified territory notified by the Central Government in this behalf. This amendment would allow funds which do not qualify as residents of a foreign country due to the domestic laws of that country like large pension funds or mutual funds from USA or SICAVs (open ended collective investment schemes) from Luxembourg, to become eligible.

Another limitation in the erstwhile conditions prevented funds to control and manage, directly or indirectly, any business in India or from India. The Finance Bill now proposes to restrict this condition by deleting the words "or from India" and, therefore, a fund would continue to be eligible for this scheme even if it carries on or controls or manages businesses from India. This amendment aims to focus on the nature of activities carried out in India.

While the above amendments intend to provide certain flexibility to offshore funds investing in India, relaxation in certain other conditions like those pertaining to investor base, corpus size, etc. shall also be worth considering as that would enlarge the base significantly.

6. Taxation of Rupee denominated bonds

The RBI has permitted the Indian companies to issue Rupee denominated bonds (**"RDB"**)

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[7] Dahiben Umedbhai Patel and Other, 57 Com Cas 700 (Bom HC); Norman J Hamilton, 49 Com Cas 1(Bom HC)
[8] Section 2(18) of the IT Act

(generally known as **"Offshore Masala Bonds"**) outside India to raise funds from sources situated outside India. The RDBs are subscribed to and cleared, settled and traded between investors outside India and thus, are similar to offshore foreign denominated bonds, which are issued pursuant to the FEMA (Borrowing or Lending in Foreign Exchange) Regulations, 2000. The RDB has become one of the important sources of funding for Indian businesses, since the issue proceeds from RDBs can be used by the Indian companies for their general corporate (including working capital) purposes. There are number of Indian companies, who have already lined up in issuance of RDBs in the overseas market. However, due to certain adverse tax consequences, Indian companies were finding it difficult to create requisite amount of traction to issue RDBs. The industry approached the Government for seeking certain tax benefits similar to the tax benefits provided to the offshore foreign denominated bonds. The CBDT, after considering representations made by the industry, issued a Press Release[9], clarifying certain tax issues relating to RDBs. Further, the Press Release also provided that requisite legislative amendments would be carried out through Finance Bill.

The Finance Bill proposes the following amendments:

a) Capital gains on rupee appreciation at the time of redemption of RDB

Under the RDB, the non-resident investor bears the risk of currency fluctuation. It is proposed that any gains arising on account of appreciation of rupee against a foreign currency at the time of redemption of RDB of an Indian company subscribed by him shall not be considered as a part of the full value of consideration for determining the capital gains on redemption of RDB. In other words, gains (if any) arising on account of appreciation of rupee would be exempt from tax in India.

It would be noted that such benefit would be available only to the initial non-resident investor who had subscribed to the RDBs, thus indicating that the benefit will be available only to the original subscriber of the RDBs and not to the subsequent investors who had purchased it from one of the original subscribers. This seems to be an oversight because there seems to be no reason as to why subsequent investors should not be granted this benefit.

b) Withholding on interest income

Under the existing provisions of the IT Act, any interest payable to a non-resident investor on RDB is subject to tax withholding of 40%, subject to any beneficial rate provided under the DTAA entered into between India and the country of residence of the investor. Though the CBDT had, vide abovementioned Press Release clarified that RDB would be treated at par with the foreign currency bonds inasmuch as such RDB would qualify for the lower tax rate of 5%, no amendment to this effect has been introduced through the Finance Bill. This could also lead to unwarranted litigation.

c) Taxation of capital gains on sale of RDB outside India

Under the existing provisions of the IT Act, any capital gains arising on transfer of a capital asset situated in India is deemed to accrued or arise in India and the same is subject to capital gains tax, subject to any beneficial treatment provided under the DTAA entered into between India and the country of residence of the investor. The stakeholders had raised a concern to the Government regarding the situs of RDB, considering the fact that such RDB would be issued outside India and it can be said that the situs is outside India. However, no amendment has been made by the Finance Bill in this regard.

The success of RDB would depend upon the tax treatment provided on incomes from RDB. It is very critical that the Government clarifies unequivocally that the benefit of lower tax rate of 5% is available in respect of interest income from RDBs and also provides clarification on the tax treatment of capital gains arising from the sale of RDBs outside India.

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[9] Press Release issued by the MOF, dated October 29, 2015

IV. PHASING OUT OF DEDUCTIONS AND EXPENSES

The FM had, in his previous Budget Speech, indicated that the rate of corporate tax will be reduced from 30% to 25% over the next four years along with corresponding phasing out of exemptions and deductions for simplification of the tax laws. The MOF had released a press note on November 20, 2015, detailing the exemptions/deductions proposed to be phased out and had also invited comments from the stakeholders in relation to the same. Based on the responses received from the stakeholders, the incentives proposed to be phased out from April 1, 2017 (i.e. FY 2017-18 and subsequent years) are tabulated below:

Sr. No.	Sections	Nature of Incentive / deduction	Proposed phase out measures	Proposal as per press note
1.	10AA	Profit linked deductions (~ 50-100%) for new units in SEZ in respect of profits derived from export of articles or things or services.	No deduction shall be available to units commencing the specified activities on or after April 1, 2020 (FY 2020-21 onwards).	No deduction for specified activity commencing from April 1, 2017.
2.	32 read with rule 5 of the IT Rules	Accelerated depreciation available up to 100% in respect of certain block of assets to give impetus to investment in certain industrial sectors.	Highest rate of depreciation shall be restricted to 40% from April 1, 2017 (FY 2017-18 onwards). The new rate is proposed to be made applicable to all the assets (whether old or new) falling in the relevant block of assets.	Depreciation restricted to 60% from FY 2017-18.
3.	35(1)(ii)	Weighted deduction of 175% of any sum paid to an approved scientific research association, university, college or other institution, if such sum is used for scientific research.	Weighted deduction shall be restricted to 150% from April 1, 2017 to March 31, 2020 (i.e. FY 2017-18 to FY 2019-20). Deduction shall be restricted to 100% from April 1, 2020 (i.e. FY 2020-21 onwards).	Deduction restricted to 100% from FY 2017-18
4.	35(1)(iia)	Weighted deduction of 125% for any sum contributed to an approved scientific research company.	Deduction shall be restricted to 100% from April 1, 2017 (i.e. FY 2017-18 onwards).	-do-
5.	35(1)(iii)	Weighted deduction of 125% for contribution for research in social science or statistical research to an approved research association, university, college or other institution.	Deduction shall be restricted to 100% from April 1, 2017 (i.e. FY 2017-18 onwards).	-do-
6.	35(2AA)	Weighted deduction to the extent of 200 % of any sum paid to a National Laboratory or a university or an Indian Institute of Technology or a specified person for the purpose of approved scientific research programme.	Weighted deduction shall be restricted to 150% from April 1, 2017 to March 31, 2020 (i.e. from FY 2017-18 to FY 2019-20) and Deduction shall be restricted to 100% from April 1, 2020 (i.e. FY 2020-21 onwards).	-do-

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Sr. No.	Sections	Nature of Incentive / deduction	Proposed phase out measures	Proposal as per press note
7.	35(2AB)	Weighted deduction of 200% of the expenditure (not being expenditure in the nature of cost of any land or building) incurred by a company, engaged in the business of bio-technology or in the production of any article or thing except some items appearing in the negative list specified in Schedule-XI, on scientific research on approved in-house R&D facility.	Weighted deduction shall be restricted to 150% from April 1, 2017 to March 31, 2020 (i.e. from FY 2017-18 to FY 2019-20). Deduction shall be restricted to 100% from April 1, 2020 (i.e. FY 2020-21 onwards).	Deduction restricted to 100% from FY 2017-18.
8.	35AC	Deduction of 100% for expenditure incurred by way of payment of any sum to a public sector company or a local authority or to an approved association or institution, etc. on certain eligible social development project or a scheme.	No deduction shall be available with effect from April 1, 2017 (FY 2017-18 onwards).	No deduction from FY 2017-18.
9.	35AD	Weighted deduction of 150% of capital expenditure (other than expenditure on land, goodwill and financial assets) for cold chain facility, warehousing facility for storage of agricultural produce, affordable housing project, production of fertiliser and hospital.	Deduction shall be restricted to 100% from April 1, 2017 (i.e. FY 2017-18 onwards).	Deduction restricted to 100% from FY 2017-18
10.	35CCC	Weighted deduction of 150 % of expenditure incurred on notified agricultural extension project.	Deduction shall be restricted to 100% from April 1, 2017 (i.e. FY 2017-18 onwards).	-do-
11.	35CCD	Weighted deduction of 150% on any expenditure incurred (not being expenditure in the nature of cost of any land or building) on any notified skill development project by a company.	Deduction shall be restricted to 100% from April 1, 2020 (FY 2020-21 onwards).	-do-
12.	Section 80IA; 80IAB, and 80IB	Profit linked deductions of 100% for profits derived from- • Development, operation and maintenance of an infrastructure facility (section 80-IA); • Development of SEZ (section 80-IAB); • Production of mineral oil and natural gas (section 80-IB(9)).	No deduction shall be available for specified activity commencing from April 1, 2017 (FY 2017-18 onwards).	No deduction for specified activity commencing from April 1, 2017.

It would be noted that the Government has accepted the stakeholders suggestions in many cases and have continued granting higher deductions / incentives for a longer period as against the period proposed in the press note (like, deduction for research expenditure under sections 35(1)(ii), 35(2AA), 35(2AB), etc.). It would be noted that the deductions / incentives would be phased out from the FY 2017-18 and therefore, we hope that the Government considers a reduction in the corporate tax rates from the FY 2017-18.

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V. COUNTRY-BY-COUNTRY REPORT ("CbC") AND MASTER FILE

The OECD BEPS Action Plan 13 has suggested a three-tiered standardized approach to transfer pricing documentation. In line with the broad recommendations of the OECD in the BEPS Action Plan 13, the Finance Bill proposes to modify and enlarge the scope of transfer pricing documentation to adopt a CbC structure. The proposed CbC reporting regime requires MNEs to adopt an annual reporting for each tax jurisdiction in which they do business. The proposed CbC will adopt the OECD mandated three tier approach consisting of:

i. A master file containing standardized information relevant for all MNE group members (contents are yet to be prescribed);

ii. A local file referring specifically to material transactions of the local taxpayer; and

iii. A country by country report containing certain information relating to the global allocation of the MNEs income and taxes paid together with certain indicators of the location of economic activity within the MNE group like revenue, profits, employees, tangible assets, nature and details of business activities etc.

An Indian parent entity is required to furnish the CbC report in respect of the group by the due date of furnishing of return of income for the relevant financial year (i.e. November 30). For Indian subsidiaries with parent companies resident outside India, the CbC will be filed by the parent entity in its home country or by a designated entity in its home country. The Indian tax authorities will access the CbC through mutual exchange of information agreements with such country, failing which the Indian subsidiary will be required to furnish the report.

> **Scope of transfer pricing documentation extended.**

The CbC provisions would not be applicable if the total consolidated group revenue as reflected in the consolidated financial statement for the preceding year does not exceed Euro 750 million.

Further, penal consequences have been imposed in case of failure to furnish the reports or on furnishing of inaccurate information in such reports.

VI. EQUALIZATION LEVY

Transactions in the digital economy have been creating several challenges from a tax perspective, since the existing tax laws do not cater to or provide for taxability in case of such transactions. The typical direct tax issues relating to e-commerce transactions include difficulties in characterizing the nature of payments, establishing a nexus or link between a taxable transaction, activity and taxing jurisdiction, difficulty in identifying the jurisdiction of the transaction, activity and taxpayer for income tax purposes. Further, various Governments have expressed their concerns over tax planning by MNEs to artificially reduce the taxable income in a high tax jurisdiction, by moving the taxable profits to a low tax jurisdiction in which essentially no activity is performed.

These challenges from a tax perspective were highlighted by the OECD in its BEPS project and Action 1 of the 2015 final report on digital economy. The BEPS report acknowledged that in the realm of direct taxation, the main policy challenges raised by a digital economy are nexus, data and characterization. Accordingly, the OECD BEPS report has recommended; in its Action Plan 1, several options to tackle the direct tax challenges and gives countries the option to introduce any of the safeguards suggested provided they respect existing treaty obligations

The Finance Bill proposes to introduce an Equalization levy (**"EL"**) at the rate of 6% on the payment towards specified services being made by a person being a resident and a non-resident having a PE in India, to non-residents who do not have any permanent establishment in India in case the consideration exceeds INR 0.1 million in a year. Specified services have been defined to mean online advertisement, provision of digital advertising space or any other facility of service for the purpose of online advertisement. It is also

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pertinent to note that the Central Government could also notify any other service that can be included within the ambit of specified service for the purposes of this EL.

It has been clarified that this levy would apply only in case of B2B transactions. However, the EL would not be charged in certain exceptional situations as under:

- Where the non-resident providing the specified service has a PE in India and the specified service is effectively connected with such PE;
- The aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a PE in India, does not exceed INR 0.1 million ;
- Where the payment for the specified service by the person resident in India, or the PE in India is not for the purpose of carrying out business or profession.

The proposed amendment provides that the EL shall be applicable only in a case where aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from the taxpayers exceeds INR 0.1 million. A question may arise as to whether the EL is attracted on the amounts as paid earlier as well as to be paid/ payable in future or only prospective payments would be subject to such a levy on exceeding the limit of INR 0.1 million per non-resident. In this regard, based on a Supreme Court decision[10], the CBDT had issued a Circular[11] (with reference to section 194C of the IT Act) which stated that where the total payment under a contract is likely to exceed the prescribed amount for the entire period during which the contract will remain in force, income tax will have to be deducted. Further, it states that in a case where, at the time the contract was entered into, it was expected that the total payment liable to tax withholding would not exceed the prescribed limit but later on, it is found that the payment exceeds the prescribed amount, deducted should be made in respect of earlier payments as well. Based on the same rationale, it can be assumed that a similar practice may be adopted in case of the EL as well.

The OCED BEPS Final Report had provided EL as an alternative to address the broader tax challenges of the digital economy. OECD BEPS Action 1 suggests an EL to be intended to serve as a way to tax a non-resident enterprise's "significant economic presence" in a country. Also, in order to provide clarity, certainty and equity to all stakeholders, and to avoid undue burden on small and medium sized businesses, the EL is intended to be applied only in cases where it is determined that a non-resident enterprise has a significant economic presence[12]. The OCED Final Report states that a non-resident would have a significant economic presence in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools. These factors would be combined with a factor based on the revenue derived from remote transactions into the country (i.e. transactions covered, provide a threshold; etc.), digital factors (i.e. local domain name, local digital platform, etc.), user based factors (i.e. monthly active users, online contract conclusion, etc.) etc. in order to ensure that only cases of significant economic presence are covered, to limit compliance costs of the taxpayers and provide certainty for cross border activities[13].

While the intention of the OCED was to tax only those non- resident enterprises that have a significant economic presence in India, it seems the FM has not considered the repercussions of not having taken into account one of the most crucial aspects of OECDs recommendations.

Considering the general quantum of expenditure that are generally applicable in case of advertisements, online or offline, it is likely that a large number of transactions would attract the EL. Thus, it may have been prudent to have a higher threshold limit.

Constitutionality of this levy: It is pertinent to note that as per the provisions (List II, Entry 55) of the Indian Constitution, only the state governments are empowered to levy taxes on

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[10] Associated Cement Co. Ltd. vs. CIT, [1993] 201 ITR 435 (SC)
[11] Circular No. 681 dated March 8, 1994
[12] Para 302 of the Final OECD BEPS Report, 2015
[13] Para 278, 279, 280 of the Final OECD BEPS Report, 2015

advertisements other than advertisements published in newspapers and advertisements broadcast by radio or television. As the proposed EL is not covered within the ambit of the Central Government, the constitutionality of this levy can be challenged.

Foreign credit and double taxation: In order to combat the challenges of double taxation, it is proposed by the Finance Bill to provide that any income arising on account of specified services[14] provided on which EL is chargeable shall be excluded from the total income of the assessee. Technically, fees paid for online advertisements are not taxable in India since they do not fall within the ambit of royalty or fees for technical services and certain judicial precedents support this view. However, the Government now seeks to tax such income in the garb of 'EL'. It is pertinent to note that the EL is not in the nature of 'income tax'. Therefore, while such income is included in the total income of the taxpayer in its country of residence, no credit of such EL paid in India would be available to the taxpayer of the foreign jurisdiction.

Going forward, it is quite possible that a few more services may be notified by the Central Government within the ambit of 'specified service' on which an EL could be charged. Therefore, it is also possible that those services could fall within the ambit of fees for technical services on account of which there could be income tax implications in India, the credit of which could be available to the non-resident in its country of residence.

In addition to withholding of taxes at the rate of 6%, there would be a service tax levy to the extent of 15% on a reverse charge basis on account of which the total tax cost could sum up to 21%. Assuming that the foreign companies engaged in the business of digital transactions demand their service fees on grossed up basis, then the net cost for the Indian payer could exceed 24% which will have to be borne by the Indian payers. Of course, certain payers may be eligible to claim an input tax credit on the advertisement fees against any output service tax liability. But, the 6% levy would continue to be a cost to the taxpayer.

"Levy @ 6% on online advertisement fees paid to non-residents."

Expense deduction of EL: If the service fees are subject to EL and the Indian payer agrees to gross up the EL, a question may arise whether an expense deduction would be available to the Indian payer, while computing its profits and gains of business. An EL is not in the nature of income tax. However, it is nothing but an additional cost that would be borne by the taxpayers towards advertisements. Therefore, logically, it should be added to the advertisement cost of the business. Thus, it could be claimed as an expense deduction under section 37 of the IT Act which provides that expenses incurred wholly and exclusively for the purpose of business can be claimed as a deduction.

Disallowance of payments made on account of failure to deduct/pay levies: It is proposed by the Finance Bill to disallow the consideration paid or payable to a non-resident for specified service if such levy has not been deducted or after deduction, has not been paid to the credit of the government exchequer on or before the due date of filing the return of income. Also, where the EL has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date of filing the return of income, such sum would be allowed as a deduction in the previous year in which such levy has been paid.

Additional compliances: The amount of EL collected is required to be paid to the credit of the Central Government within 7 days from the end of the month in which the levy is deducted. Any person who fails to deduct the levy is liable to pay the same to the credit of the Central Government along with interest at the rate of 1% per month or part of the month and applicable penalty. Therefore, even if the amount of levy has not been adjusted against the consideration paid/ payable to the non-resident, the taxpayers would be required to bear the additional costs in such cases.

Further, the taxpayers are required to furnish a statement to the AO in such form and manner as prescribed and within the prescribed time limits setting forth the particulars of all specified

[14] Specified services has been defined under Chapter VII to the Finance Bill, 2016 to mean online advertisement, any provision for digital advertising space, or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf.

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services during the financial year. If any person fails to furnish such a statement or wishes to make a revision in such statement, the taxpayers can do so within a period of 2 years from the end of the FY in which the specified service was provided along with a penalty of INR 100 per day during which the failure continues. However, no penalties can be imposed if a reasonable cause is established.

It is also proposed to introduce rules by the Central Government for the purpose of implementation of this Chapter.

VII. INCOME DECLARATION SCHEME

Counteracting the menace of unaccounted money has been one of the primary concerns of the present government. Several measures have been taken during the course of its regime to bring the unaccounted money into the tax net, including setting up of Special Investigation Team and the enactment of Black Money Act.

A one-time compliance window was also introduced in the Black Money Act to provide an opportunity to the tax evaders to disclose the unaccounted foreign income/assets and pay tax as well as penalty so as to negate the stringent provisions of the Black Money Act. While introduction of Black Money Act did not yield any significant revenue for the Government, it is widely believed now that this has acted as a deterrent in the creation of further unaccounted money.

After dealing with foreign unaccounted money, the Finance Bill proposes to deal with domestic unaccounted money through introduction of the Income Declaration Scheme, 2016 (“**ID Scheme**”). As per the Scheme, taxpayers are allowed to disclose their undisclosed income or undisclosed income represented in the form of any asset in order to clear up their past transgression by paying an amount equivalent to 45% of such undisclosed income (which represents 30% tax, 7.5% surcharge and 7.5% penalty on the undisclosed income).

The broad overview of the ID Scheme is as follows:

a. The ID Scheme allows any person to declare any undisclosed income chargeable to tax under the IT Act for any AY prior to AY 2017-18, for which no return of income was filed as required under the IT Act or there was failure to disclose any income in a return of income filed prior to June 1, 2016 or such income has escaped assessment by reason of omission or failure on part of such person;

b. When the income is declared in the form of investment in any asset, the fair market value of such asset[15] as on June 1, 2016 shall be deemed to be the undisclosed income for the purposes of the ID Scheme;

c. The amount declared under the ID Scheme shall not be included in the total income of the declarant for any assessment year under the IT Act, provided the declarant pays the requisite tax, surcharge and penalty within the stipulated period;

d. Similarly, the declarant need not pay wealth tax in respect of the assets which were not declared under the return filed under the provisions of the WT Act in respect of the assets declared under the ID Scheme and in respect of those cases, where the assets were understated in return filed under the WT Act, the vires of WT Act will not get attracted in respect of the voluntarily disclosed income utilized for acquiring such assets;

e. The declarant shall not be entitled to re-open any assessment or reassessment made under the IT Act or the WT Act, or claim any set off or relief in any appeal, in respect of undisclosed income declared or any amount of tax and surcharge paid thereon. Similarly, no deduction in respect of any expenditure or allowance shall be allowed against the declared income;

f. The ID Scheme also provides following immunities to the declarant:

   i. The declaration made under the ID Scheme shall not be admissible as evidence against the declarant for the purpose of imposing penalty or initiating prosecution proceedings under the provisions of the IT Act and WT Act;

[15] To be determined in the prescribed manner

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ii. Immunity from the provisions of the Benami Transactions (Prohibitions) Act, 1988 (**"BT Act"**) in respect of income declared under the ID Scheme provided the Benamidar transfers the asset to the declarant within the notified period;

g. However, the ID Scheme would not be available in respect of any undisclosed income wherein

i. a notice has already been issued by the tax authorities under specified provisions[16] of the IT Act and the proceeding is pending before the AO; or

ii. where a search/survey proceeding has been conducted and the time limit for issuance of notice has not expired; or

iii. where any information has been received under Exchange of Information under various DTAAs in respect of the undisclosed income; or

iv. cases covered under specified legislations like Indian Penal Code, etc;

h. If a declaration made by misrepresentation or suppression of facts, such declaration shall be considered as void and shall be deemed never to have been made under the ID Scheme; and

i. Where subsequent to declaration, the declarant fails to deposit the amount due within the notified period; such income shall be chargeable under the provisions of the IT Act in the previous year in which the declaration is made.

The notified period for the instant window Scheme is planned to be opened from June 1, 2016 to September 30, 2016 and with an option to pay the declared amount within 2 months from the date of declaration.

It is pertinent to highlight here that the ID Scheme specifically provides that it would not be applicable to any undisclosed foreign income and assets chargeable to tax under the Black Money Act. As Black Money Act covers undisclosed foreign income and assets of residents, it appears that the ID Scheme is intended to cover only undisclosed domestic income and assets even though the ID Scheme does not explicitly mention that it covers only domestic income and assets.

Further, it may be noted that under the one-time compliance window of the Black Money Act, undisclosed foreign assets were chargeable at a rate as high as 60% whereas under the instant scheme the declared income is chargeable at the rate of 45%.

Furthermore, it is important to highlight that whilst the objective behind the instant Scheme seems to bring out a one-time compliance window similar to that of the compliance window provided under The Voluntary Disclosure of Income Scheme (**"VDIS"**) 1997 and the Black Money Act, one may not lose sight of the fact that the regular introduction of compliance windows may result in litigations challenging the constitutional validity of the Scheme. It may be pertinent to note that while hearing a PIL filed with the Hon'ble SC challenging the constitutional validity of VDIS, the Court had insisted on an affidavit from the then FM that no further amnesty schemes shall be launched. While it is being presented as a compliance scheme instead of an amnesty scheme since it levies a penalty @7.5%, the possibility of judicial interference on the implementation of instant Scheme cannot be ruled out.

> **"Unearthing Domestic Black Money."**

Also, unlike the earlier VDIS, the immunity is being provided only in respect of the penal and prosecution provisions enshrined in the IT Act, WT Act and BT Act but not against other commercial laws such as Foreign Exchange Regulation Act, 1973, Foreign Exchange Management Act, 1999, Prevention of Money Laundering Act, 2002, Companies Act, 2013, etc.

VIII. DIRECT TAX DISPUTE RESOLUTION SCHEME

With a view to reduce the huge backlog of pending tax litigations, to enable the Government to realize its dues expeditiously and to assist the

[16] Section 142 or 143(2) or 148 or 153A or 153C of the IT Act

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Government to deploy its limited bandwidth on more important avenues, the Budget has proposed to introduce The Direct Tax Dispute Resolution Scheme, 2016 (**"DRS Scheme"**). This can be seen as another step in moving towards a non-adversarial tax regime. The past year, the Government had taken several measures to achieve a tax-friendly environment, which include issuing internal circulars to the revenue authorities asking them to refrain from indulging in the scrutiny proceedings involving long and non-specific questionnaires, to refrain them from making high-pitched assessments without proper basis, to provide individual specific targets to dispose off pending tax litigations, making the entire assessment process free from human interactions and resolving over 100 transfer pricing disputes through a Mutual Agreement Procedure with USA, etc. to name a few.

The proposed DRS Scheme provides an opportunity to the taxpayers to settle their specified disputes pending as on February 29, 2016 with the revenue authorities on payment of disputed taxes and/or interest/ penalty. The framework of the DRS Scheme is as follows:

i. The proposed DRS Scheme allows the taxpayers to settle the following disputes with the revenue authorities:

   a. Appeals pending at the first appellate level. i.e., pending before the CIT(A) or CWT(A) as on February 29, 2016 ; and

   b. Proceedings pending at any appellate level as on February 29, 2016, provided the dispute arose by virtue of the retrospective amendment incorporated into the IT Act or the WT Act. It includes the writ petitions pending before Hon'ble HC or the SC as well as the proceeding initiated by virtue of any bilateral agreement between India and other Country

ii. The taxpayer can file a declaration in respect of the abovementioned disputes to the designated authority and amount payable under the proposed DRS Scheme shall be determined in the following manner:

   a. In cases of quantum appeal pending at the first appellate level and the disputed tax does not exceed INR 1 million, the whole of disputed tax and the interest on disputed tax till the date of assessment or reassessment;

   b. If the disputed tax exceeds INR 1 million in the quantum appeal, the whole of disputed tax and the interest on disputed tax till the date of assessment or reassessment, along with 25% of minimum penalty leviable;

   c. In cases of penalty appeal, 25% of minimum penalty leviable and the tax and interest payable on the total income finally determined;

   d. In cases of disputes arose in pursuance of the retrospective amendment, only the amount of tax so determined.

iii. The appeal pending before the CIT(A) shall be deemed to be withdrawn upon filing of the declaration to the designate authority and in respect of cases pertaining to retrospective amendment, the declarant shall file an undertaking waiving his right to seek remedy in any other forum and also furnish proof of withdrawal of proceedings pending;

iv. The declarant shall avail immunity from penal and prosecution provisions of the IT Act and the WT Act and would also avail waiver from the IT Act and the WT Act; Further, it was also stated that matters covered under the DRS Scheme will not be re-opened under the IT Act or WT Act or under any other law;

v. The provisions of the DRS Scheme shall not apply to certain cases covered under specified legislations such as Indian Penal Code, the Unlawful Activities (Prevention) Act, 1967, etc. and similarly, they shall also not apply in respect of any undisclosed income wherein assessment or assessment has been completed subsequent to the search / seizure / survey proceedings under the provisions of IT Act and WT Act, as applicable;

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vi. Further, the DRS Scheme would also not apply in cases where the prosecution proceedings have already been initiated or where the assessment or reassessment is done in pursuance of the information received under the Exchange of Information under various DTAAs in respect of the undisclosed income or where the undisclosed income/asset is from outside India;

vii. The designate authority shall determine the amount payable by the declarant within 60 days from the date of receipt of the declaration and the declarant shall pay the sum determined within 30 days from the date of receipt of the certificate;

Thus, the DRS Scheme intends to confer the benefit of reduced penalty, i.e., 25% of the minimum penalty leviable, in respect of the appeals pending at CIT(A) and the benefit of waiver of penalty and interest in respect of dispute arising out of retrospective amendment. In other words, the taxpayer shall have to pay entire disputed tax and the interest on disputed tax till the date of assessment/reassessment along with 25% of minimum penalty leviable in respect of cases pending with CIT(A) and in respect of cases that arose out of the retrospective amendment, the taxpayer can avail the benefit by paying only the disputed tax amount.

It needs to be mentioned here that some of the retrospective amendments made in the IT Act vide Finance Act, 2012 drew sharp criticism from all the stakeholders, as it was purportedly passed to nullify some of the landmark judgements[17] of the Courts, such as inclusion of an Explanation to Section 9(1)(i) and 9(1)(vi) of the IT Act which retrospectively sought to tax the indirect transfer of business assets and payments made in respect of transponder charges, etc. Such taxpayers could avail the benefits enshrined under the DRS Scheme by paying only the disputed tax amount.

While the initiative is laudable, it remains to be seen if this proposal motivates taxpayers to settle their disputes. The first impression that one gets from the perusal of this DRS Scheme is that only such taxpayers who have filed absolutely frivolous appeals that are devoid of any merits would only be interested in this type of settlement. There are already existing provisions that enables taxpayers to approach the tax authorities for waiver of interest and penalty would anyways not be leviable if the issue involves any substantial question of law. It may have been far more successful had certain additional incentives been granted to taxpayers under the DRS Scheme so that even such taxpayers who are confident of the technical merits of their cases, would also have been encouraged to explore the possibility of getting an early resolution of the pending disputes.

IX. TAXATION OF SHARE TRANSACTIONS

1. Buyback Of shares

Under the existing provisions[18] of the IT Act, an additional income tax at the rate of 20% is charged on distribution of income on account of buyback of unlisted shares of a company (**"Buyback Tax"**). The term 'distributed income' has been defined to mean the consideration paid by the company on buyback as reduced by the amount which was received by the company for issue of such shares. Further, the term 'buyback' has been defined to mean purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956.

> **"Any kind of buyback covered for BBT."**

Contradicting views have arisen on whether the existing provisions are restricted only to a buyback under section 77A of the Companies Act, 1956 or would cover even a buyback under section 68 of the Companies Act, 2013 or a buyback carried out by way of a court approved scheme of arrangement under the Companies Act, 1956. It is proposed by the Finance Bill to eliminate this ambiguity to provide that the provisions of this section would apply to any purchase by a company of its own shares in accordance with "any law for the time being in force relating to companies". Thus, the provisions of buyback under either Companies Act, 1956 or 2013 would apply. Further, any scheme of arrangement under the Companies

[17] Vodafone International Holdings B.V. vs. Union of India, 341 ITR 1
[18] Section 115QA of the IT Act.

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Act would also be brought within the ambit of this provision, including for e.g. a capital reduction.

It is pertinent to note, however, that there is absolutely no guidance on how the consideration received by a company at the time of issue of shares is required to be computed at the time of buyback. Further, there is no specific methodology that is required to be followed by the taxpayers. It could also happen that shares are issued by companies in tranches, at different points of times or may have been issued in lieu of existing shares under amalgamation, merger or demerger. For instance, if company A merges into company B; in consideration of which shares of company B are issued to the shareholders of company A and subsequently, if Company A undertakes a buyback of its shares, it appears that A would be obliged to pay Buyback Tax on the entire buyback consideration since the distributed income has been defined as consideration paid by the company on buyback of shares as reduced by the amount which was received by the company for issue of such shares. Since in case of issuance of shares in merger/demerger, Company A would not "receive" any amount for issuance of shares, it is likely that the entire buyback consideration would be liable to BBT. To combat this issue and provide clarity, the Finance Bill proposes to provide the manner of determination of such amount received by the company, presumably in the IT Rules.

While the Budget has clarified on certain ambiguities in this regard, the introduction of rules for determination of consideration received by a company at the time of issue of its shares is awaited.

These amendments will take effect from June 1, 2016. Since the amendments appear to be prospective, the past periods (i.e. from June 1, 2013 until May 31, 2016) may not be affected by this amendment.

2. Receipt of Shares on Amalgamation etc.

Section 56(2)(vii) of the IT Act provides that specified property (which includes shares of a company) received by an individual or HUF without consideration or inadequate consideration is taxable in the hands of the recipient as 'income from other sources'. On similar lines, section 56(2)(viia) provides that shares of a closely-held company received by another closely-held company or a firm without consideration or inadequate consideration is taxable in the hands of the recipient as 'income from other sources' is taxable in the hands of the recipient.

However, certain receipts have been specifically excluded from the ambit of this tax. Receipt of shares of a transferee company in lieu of shares of the transferor company pursuant to amalgamation or demerger or business re-organization of a co-operative bank treated as exempt transfers under section 47 are specifically excluded from the ambit of section 56(2)(viia). However, no such specific exclusion was provided under section 56(2)(vii).

It is proposed to amend section 56(2)(vii) to exclude the shares received in pursuance of amalgamation or demerger or business re-organization of a cooperative bank from the ambit of deemed income determined under Section 56(2)(vii) of the IT Act similar to section 56(2)(viia).

It may be noted here that even prior to this amendment, several arguments could have been made on merits to contend that receipt of shares on amalgamation/ demerger/ reorganization would not be covered under section 56(2)(vii). However, the Memorandum specifically states that the provisions of section 56(2)(vii) apply where shares of a company are received as a consequence of demerger or amalgamation of a company. The proposed amendment to exclude such a transaction from the ambit of section 56(2)(vii) is prospective in nature which will be effective from April 1, 2016 onwards. In view of this, this amendment could lead to the tax authorities contending that all cases prior to April 1, 2016 where shares were received pursuant to amalgamation / demerger could be taxed under Section 56(2)(vii) of the IT Act depending on the manner in which the consideration is ascertained.

It is advisable that the Government makes this amendment clarificatory or retrospective in nature so that unnecessary litigation can be avoided.

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3. **Reduction of holding period for shares of unlisted companies**

Under the existing provisions of the IT Act, the capital gains arising from transfer of unlisted shares are taxed as LTCGs, if the unlisted shares were held by the transferor for more than 3 years. The holding requirement for listed shares is 12 months. The FM in the Budget Speech has proposed the reduction of holding threshold for unlisted shares from 3 years to 2 years. However, the same seems to have been inadvertently left out in the Finance Bill. It is thus expected to be included in the Finance Bill before it becomes Finance Act.

If the above referred amendment is introduced, it would enhance liquidity for investors in private companies or other unlisted companies, as they would be able to avail the concessional rates of taxation for LTCGs upon exit sooner. With the increased focus on Startups and Make in India and the efforts being made to promote a culture of innovation, most of these activities would be undertaken by unlisted companies and thus, this welcome change would also create a conducive atmosphere to promote entrepreneurship.

4. **Tax neutral conversion of company into LLP**

Under the existing provisions of the IT Act, conversion of a company into a limited liability partnership is tax neutral, subject to the fulfilment of certain conditions . It is proposed by the Finance Bill to introduce an additional condition over and above the currently existing conditions to provide that the value of the total assets in the books of accounts of the company in any of the 3 years preceding the previous year in which the conversion takes place should not exceed INR 50 million.

This amendment, read with the other proposal of levying an additional tax of 10% on dividends received by individuals, HUFs and partnership firms including LLPs could potentially drive promoters to corporatize their holding vehicles.

X. PROCEDURES AND PENALTIES

1. **Rationalisation of time limit for assessment**

It is a well known fact that the process takes its own time when it comes to finalizing an assessment in respect of any taxpayer. In certain cases, there is no prescribed time limit which leads to prolonged agony and thereby causes undue hardship and harassment to the taxpayers.

It is desirable that the income-tax proceedings are finalized more expeditiously with digitization of various processes in the income tax department. As a consequence, the time limits for concluding assessments, reassessments and recomputation matters are proposed to be narrowed down. A brief outline of the same is provided hereunder:

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Nature of order passed	Existing time limit	Proposed time limit
Assessment order (section 143(3)/ 144 of the IT Act)	2 years from the end of the relevant AY	21 months from the end of the relevant AY
Reassessment order (section 147 of the IT Act)	1 year from the end of the FY in which the notice was served	9 months from the end of the FY in which the notice was served
Order giving effect to an ITAT/ CIT order for fresh assessment (section 254/ 263/ 264 of the IT Act)	1 year from the end of the FY in which the order is received or passed by the prescribed authority	9 months from the ends of the FY in which the order is received or passed by the prescribed authority
Order giving effect to a order of the CIT / settlement commission / appellate authority in cases other than fresh assessment.	1 year from the end of the FY in which the order is received or passed	3 months from the end of the month in which the order is received or passed. The prescribed authority may extend this period by 6 months on provision of reasons in writing by the AO
Order giving effect to any finding or direction contained in an order of appellate or revisionary authority	No time limit	On or before the expiry of 12 months from the end of the month in which such order is received by the prescribed authority
Assessment in case of a partner as a consequence of an assessment made on the firm	No time limit	On or before the expiry of 12 months from the end of the month in which the assessment order in the case of the firm is passed
Assessment in search cases (section 153A of the IT Act)	2 years from the end of the FY in which last of the authorizations for search were executed	21 months from the end of the FY in which last of the authorizations for search were executed
Assessment in search cases (section 153C of the IT Act)	2 years from the end of the FY in which last of the authorizations for search was executed or 1 year from the end of the FY in which books of accounts etc. are in possession of the AO, whichever is later	21 months from the end of the FY in which last of the authorizations for search was executed or 9 months from the end of the FY in which books of accounts etc. are in possession of the AO, whichever is later

In respect of certain cases pending as on June 1, 2016, separate timelines in this regard have been prescribed. While rationalisation of the time limits would go on to reduce the time required to complete the assessment process, one hopes and prays that it does not result in the deterioration of the quality of assessments because that would result in significant increase in litigations. With the reduced time period and avoidance of human interface during the assessment process, whether this would yield a positive impact or not, only time will tell!

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2. Rationalisation of penalty provisions (other than search cases)

Currently, penalty is leviable at the rate of 100% to 300% of the tax sought to be evaded in cases where the taxpayer has concealed particulars of income or furnished inaccurate particulars of income under section 271(1)(c)of the IT Act. However, the actual rate of penalty is left to the discretion of the AO. Additionally, there is a rise in the litigation on the issue of whether a particular addition/ disallowance/change in head of income etc. amounts to concealment of income or furnishing of inaccurate particulars of income. Therefore, in order to bring objectivity, certainty and clarity in penalty provisions, it is proposed by the Finance Bill to do away with the entire provision of section 271 of the IT Act and substitute the same with newly introduced section 270A.

Section 270A provides that penalty shall be leviable at the rate of 50% of tax payable on under-reported income. However, if the under-reporting results from misreporting of income by the taxpayer, penalty shall be leviable at the rate of 200% of the tax payable on under-reported income. Thus, it is proposed by the Finance Bill to replace concealment and furnishing of inaccurate particulars of income with under-reporting and misreporting of income.

It is proposed by the Finance Bill that a person shall be considered to have under-reported his income, if:

i. the income assessed is greater than the income determined in the return processed under section 143(1)(a) of the IT Act;

ii. the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;

iii. the income reassessed is greater than the income assessed or reassessed immediately before such reassessment;

iv. the amount of deemed total income assessed or reassessed as per section 115JB or section 115JC, as the case may be, is greater than the deemed total income determined in the return processed under section 143(1)(a) of the IT Act;

v. the amount of deemed total income assessed as per the provisions of section 115JB or section 115JC is greater than the maximum amount not chargeable to tax, where no return has been filed;

vi. the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

The extent of under-reported income has to be calculated in the prescribed manner under section 270A and illustrations for the same have been provided in the Memorandum.

Further, the proposed section 270A provides that a person shall be said to have misreported income in the following cases:

i. misrepresentation or suppression of facts,

ii. failure to record investments in books of accounts;

iii. claim of expenditure not substantiated by any evidence;

iv. recording of any false entry in the books of accounts;

v. failure to record any receipt in books of accounts having a bearing on total income; and;

vi. failure to report any international transaction or any transaction deemed to be an international transaction or any specified domestic transaction.

In certain cases, where satisfactory and bonafide explanation along with all material facts have been provided by the taxpayer to the AO or there is a discrepancy in the method of accounting though the accounts are complete and accurate, and certain other specific situations mentioned under section 270A, such cases would not fall within the purview of under-reported income and accordingly, the risk of penalty is mitigated to that extent.

While it is intended to bring in objectivity and certainty and take away the discretionary powers of the AO, under the existing provisions, there is a

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possibility of penalty being levied at 100% of the tax sought to be evaded (in case of concealment of income or furnishing of inaccurate particulars of income), but under the corresponding proposed provisions, if the case is covered under misreporting of income, penalty would be leviable at the rate of 200% of the amount of tax.

Further, no addition or disallowance of an amount shall form the basis for imposition of penalty; if such addition or disallowance has formed the basis of imposition of penalty in the case of the person for the same or any other AY.

Immunity from penalty and prosecution

In case of under-reporting of income, under the newly introduced section 270AA, an application can be made by the taxpayer to the AO to grant immunity from imposition of penalty and initiation of prosecution proceedings in the prescribed manner. However, immunity from penalty and prosecution is not available in cases of misreporting of income.

"Penalty @ 50% to 200% of tax on under reported income."

3. **Rationalisation of penalty provisions (search cases)**

Under the existing provisions of the IT Act, where a search has been initiated and certain conditions are satisfied like admission of undisclosed income and declaration of the same in the return of income, etc., penalty is leviable on the taxpayer at the rate of 10% or 20% of the undisclosed income.

However, if the said conditions are not satisfied, penalty is leviable on the taxpayer at the rate of 30% to 90% of the undisclosed income. To reduce the discretion available to the AO in such situations, it is proposed to provide that penalty shall be leviable at a flat rate of 60% of the undisclosed income in such situations.

This is yet another amendment that proposes to snatch away the discretionary powers of the income tax department so as to reduce litigation and ensure some level of objectivity and certainty to taxpayers who have been largely affected on account of sudden, unpleasant and deeply taxing raids.

4. **Stay of Demand**

The earlier instructions issued by the CBDT provided that a demand will be stayed only if there are valid reasons for doing so. Further, it stated that mere filing of an appeal against the assessment order will not be a sufficient reason to stay the demand. While granting a stay, the AO was allowed to impose such conditions as he thought fit and could also require the assessee to offer suitable security to safeguard the interest of the Revenue. In practice, the AOs generally insisted on payment of a very high proportion of the disputed demand (many times to the tune of 50% of the tax demanded) before granting stay and it used to cause significant hardship to the taxpayer. The situation was even more burdensome especially in case of high pitched assessments.

In order to streamline the process of grant of stay and standardize the quantum of lump sum payment required to be made by the assessee as a pre-condition for stay of demand disputed before the CIT(A), the CBDT has issued revised guidelines[26] around the time the Finance Bill was presented by the FM and these guidelines are effective from February 29, 2016. This has been done along the lines of the assurance given by the FM in his Budget Speech.

According to the revised guidelines, in a case where the outstanding demand is disputed before the CIT(A), the AO shall grant stay of demand till the disposal of the said appeal before CIT(A) on payment of 15% of the disputed demand and the AO shall dispose off the stay petition within 2 weeks of filing of the petition.

However, this is subject to certain exceptions as provided below:

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[26] CBDT Memorandum No. F.No.404/72/93-ITCC dated February 29, 2016

Situation	Action
The AO is of the view that the nature of addition resulting in a demand is such that payment of an amount higher than 15% is warranted (eg. in a case where addition on the same issue has been confirmed by appellate authorities in earlier years or the decision of the SC/or jurisdictional HC is in favour of Revenue or addition is based on credible evidence collected in a search or survey operation, etc.)	The AO shall refer the matter to the administrative PCIT/CIT, who after considering all the relevant facts shall decide the quantum and proportion of demand to be paid by the assessee as lump sum payment for granting of stay of balance demand. The PCIT/ CIT shall dispose off the stay petition within 2 weeks of making such reference
The AO is of the view that the nature of addition resulting in a demand is such that payment of an amount lower than 15% is warranted (eg. in a case where addition on the same issue has been deleted by appellate authorities in earlier years or the decision of the SC or jurisdictional HC is in favour of the assessee, etc.)	
Stay of demand is granted by the AO on payment of 15% of the demand and but the assessee is still aggrieved.	The assessee may approach the jurisdictional administrative PCIT/CIT for a review of the decision of the AO. The PCIT/ CIT shall dispose off the review petition within 2 weeks of filing of the petition.

In granting stay, the AO may impose such conditions as he deems fit which may, inter-alia, include the following –

i. require an undertaking from the assessee that he will co-operate in the early disposal of appeal failing which the stay order will be cancelled;

ii. reserve the right to review the order passed after the expiry of a reasonable period (say 6 months) or if the assessee has not co-operated in the early disposal of appeal, or where a subsequent pronouncement by a higher appellate authority or court alters the above situation;

iii. reserve the right to adjust refunds arising, if any, against the demand, to the extent of the amount required for granting and subject to the provisions of section 245 of the IT Act.

These guidelines are certainly a positive step towards non-adversarial tax regime by reducing the subjectivity and discretionary powers of the AO in respect of stay of demand. In absence of any adverse judicial precedents, it is proposed to cap the demand to deposit the outstanding tax demands at 15% of the total outstanding demands. It is also important to note that this amount can be further reduced if the taxpayer can provide the AO/ PCIT/ CIT with favourable judicial precedents or the decision of its own case for earlier years. This is surprising because in case the taxpayer already has favourable verdicts in his favour from higher authorities, it should be binding on the AO and other jurisdictional authorities and hence, the tax demand should be stayed automatically without payment of any taxes.

In spite of certain shortcomings, this is still an extremely positive move by the Government and the CBDT which will much needed relief to the taxpayers from undue harassment and coercion while they are in litigation against tax authorities.

5. Change in time limit for filing returns

It is proposed to reduce the time limit to file belated return of income by one year i.e. the same can be furnished at any time before the end of the relevant assessment year or before completion of the assessment whichever is earlier.

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XI. OTHERS

1. New taxation regime for securitization trusts and investors

Under the existing provisions[27] of the IT Act, a special taxation regime for taxation of securitisation trusts has been laid down which provides that any amount of income distributed by the securitisation trust to its investors is chargeable to additional tax at the rate of 25% in case where the income is distributed to Individuals / HUFs and at the rate of 30% on incomes distributed to any other person. Further, no tax is to be levied if the distribution was made to an exempt entity. As a consequence of levy of income distribution tax, the income earned by the investors and the securitisation trusts was exempt from tax.

This prevalent regime suffered from various tax inefficiencies for the investors (especially, the banks and the financial institutions), some of them have been listed here under:

i. expenses incurred by the investors for earning the income from securitisation trusts were not allowed as tax deductible expenditure, in view of specific provisions of section 14A of the IT Act;

ii. non-resident and resident investors were unable to take benefits of their specific tax status and the beneficial tax rate applicable to them (including the beneficial tax rate, if any, as per the DTAA);

Further, the existing tax regime applicable to securitization trusts does not apply to trusts set up under the SARFAESI Act.

The Finance Bill now proposes to substitute the current system of taxation with effect from June 1, 2016, to provide complete pass through to the securitisation trusts, including those created by ARCs.

It is also proposed by the Finance Bill to include the following elements as a part of rationalising the provisions pertaining to securitization trust:

i. The definition of securitisation trust is proposed to include the trusts set up under the SARFAESI Act so as to include an SPV defined under SEBI (Public Offer and Listing of Securitized Debt Instrument) Regulations, 2008 or as defined in the guidelines on securitization of standard assets issued by RBI or being setup by a securitization company or a reconstruction company in accordance with the SARFAESI Act or in pursuance of any guidelines or directions issued for the said purposes by the RBI.

ii. The income of the securitisation trust shall continue to be exempt. However, the income of the securitisation trust will be taxable in the hands of the investors, as per the tax rates applicable to the investors.

iii. The income accrued or received from the securitisation trust shall be taxable in the hands of the investor in the same manner and to the same extent, as it would have been taxed had the investor directly made the investments in the underlying assets and not through the trust.

iv. The securitisation trust would be required to withhold taxes at the rate of 25% in case of payments made to resident investors being Individuals or HUFs and 30% in all other cases. Also, payments made to non-resident investors would attract withholding tax at the rates in force. However, where the investors are of the view that the income is subject to lower tax rate or NIL deduction of tax, they can approach the tax officer and obtain a lower or NIL withholding tax certificate.

v. The securitisation trust would be required to provide a breakup regarding the nature and proportion of its income to the investors and also to the prescribed tax authorities.

It would be important to note that the existing provisions were introduced in the Finance Act, 2013, on account of the on-going litigation between the tax authorities and the Mutual funds. The tax authorities were contending that the securitisation trust was in the nature of an AOP and the trust was carrying out business activities. Accordingly, income from securitisation trust was in the nature of business income, which was chargeable to tax in the hands of the trust at the MMR. Further, it was contended that the trust was

[27] Chapter XII-EA of the IT Act.

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liable to pay tax, irrespective of the fact that its beneficiaries were Mutual funds, who were not required to pay any tax in view of the section 10(23) of the IT Act.

The incomes from the securitisation trust may be in the nature of business income in the hands of certain investors (especially, the banks and financial institutions). However, since the investors now have the ability to obtain a lower or NIL withholding tax certificate from the tax authorities, the affected beneficiaries may obtain the requisite withholding tax certificate from the tax authorities so that the trust deducts only the appropriate amount of taxes.

Also, the amended provisions are applicable from June 1, 2016 and therefore, any income proposed to be distributed by the securitisation trusts till May 2016 would suffer additional tax payable by the securitisation trusts.

2. Rationalisation of tax withholding provisions for AIF Category I and II

Under the existing provisions of the IT Act, a special tax regime has been provided for AIF Category–I and II investors. The special tax regime is intended to give pass through status in respect of investment funds, which are collective investment vehicles. Under this regime, the income (other than business income) of the investment fund is exempt in the hands of the investment fund and the income received by the investor from the investment fund (other than income which is taxed in the hands of investment fund) is taxable in the hands of the investor.

Under the existing provision[28] of the IT Act, where income (other than business income) is payable by an investment fund to its investors, the person responsible for making the payments shall be required to withhold taxes at the rate of 10%. While it ignored the issues pertaining to residential status, it was unclear as to whether the non-resident investors would be subject to the same rate of withholding tax. Further, for the purposes of withholding tax, the non-resident investor was unable to claim the benefit of lower or NIL rate of taxation, which was available to him under the relevant DTAA and tax was deducted at the rate of 10% even when no tax was payable under the relevant DTAA. Also, there was no facility for any investor to approach the AO for seeking certificate for withholding tax at a lower or NIL rate.

In order to rationalise the withholding tax regime, it is proposed that the person responsible for making the payment to the resident investor shall deduct tax at the rate of 10% and at the 'rates in force' where the payment is made to a non-resident investor. Further, it is also proposed that a certificate for withholding tax at a lower rate or NIL rate can be obtained in relation to the aforesaid payments.

> **"Benefit of DTAA made available to non-resident investors."**

The proposed amendment would solve the cash flow issues that were created in the hands of the non-resident investors. However, an issue to which the Government has turned a blind eye to is; whether the withholding of taxes at the rate of 10% / 'rates in force' on payments to resident and non-resident investors would also apply while distributing dividend income (on which DDT has been paid) and LTCGs (which are exempt under section 10(34)) earned by the investment fund. Since these incomes are exempt in the hands of the investment fund itself, the question of levying taxes in the hands of the investors cannot arise since the incomes from investment funds are taxable in the hands of investors as if they had themselves earned it. As of now, there is no clarity on this aspect and the investors would need to approach the tax officer for a NIL withholding tax certificate in respect of these incomes.

3. Rationalisation of Rule 8D of the IT Rules

Ever since the Finance Act, 2001 inserted section 14A into the IT Act, there had been considerable amount of litigation questioning the validity of the disallowance made on account of expenditure incurred by the taxpayers to earn the exempt income. Introduction of sub-section (2) and (3) to section 14A of the IT Act provided a leeway to the tax authorities to mechanically determine the quantum of disallowance through a prescribed method, i.e., Rule 8D of the IT Rules, even in cases

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[28] Section 194LBB of the IT Act

where taxpayers contended that no such expenditure had been incurred.

Rule 8D of the IT Rules determines the quantum of disallowance through the aggregate of following three limbs:

i. Amount of expenditure incurred directly to earn the exempt income;

ii. Proportionate interest expenditure on borrowed funds with reference to investments and the total assets of the taxpayer; and

iii. Amount equal to 0.5% of the average value of the investments.

This had led to plethora of legal disputes such as whether a disallowance under the extant provisions can be retrospectively made, whether a disallowance can be made when no exempt income was actually earned by taxpayers, whether the disallowance can exceed the exempt income and in particular, there were instances where the disallowances made by the revenue authorities exceeded the total expenditure incurred by the taxpayers.

Under these circumstances, this Budget has proposed to rationalise the provisions of Rule 8D of the IT Rules by limiting the disallowance to 1% of the average monthly value of investments yielding exempt income, but shall not exceed the actual expenditure claimed.

At the outset, it can be stated that it is a welcome respite for the taxpayers since the instant proposal would reduce the customary disallowances made by the revenue authorities by invoking section 14A of the IT Act read with Rule 8D of the IT Rules. It is also commendable that the proposal takes into consideration only the value of investments which yield the exempt income and not the entire investments of the taxpayer, for the purpose of quantifying the disallowance of expenditure relatable to exempt income.

It appears that the instant proposal intends to do away with the entire methodology prescribed under clause (2) to Rule 8D of the IT Rules and replace it with a much simpler clause stating that the disallowance shall be limited to 1% of the average value of the investments yielding exempt income, but shall not exceed the actual expenditure claimed.

It would be a moot question when the taxpayer claims that no expenditure has been incurred to earn the exempt income. It is pertinent to highlight here that the Hon'ble Punjab and Haryana HC[29] has held that disallowance under section 14A of the IT Act cannot stand if it is found that no expenditure have been incurred for earning the exempt income.

On the other hand, it is also to be noted that section 14A of the IT Act might not have any applicability in respect of the cases which are covered under the proposed section 115BBDA of the IT Act, since the said section makes the dividend income taxable.

4. Deduction of bad and doubtful debts in case of NBFCs

Under the existing provisions of the IT Act, various entities like scheduled banks, foreign banks and certain financial institutions/corporations etc. are eligible to claim deduction of up to a specified percentage of its total income, in lieu of provision for bad and doubtful debts, made by such entities. This beneficial deduction was, however, not available to NBFCs.

Now, in a bid to rationalise the provisions, a new sub-clause (d) is proposed to be inserted under section 36(1)(viia) would allow an NBFC to claim deduction of an amount not exceeding 5% of the total income (before making any deduction under this clause and Chapter VI-A). This amendment would bring NBFCs in parity with banking companies to a limited extent. It may be pertinent to note that Banks are allowed to claim deduction on account of provision of bad debts at a higher cap of 7.5%. This proposed amendment could negate the decision of Hon'ble Kerala HC in Art Leasing Ltd. v. CIT[30].

5. Tax collection at source on sale of luxury goods

In order to bring more high value transactions within the tax net, it is proposed to impose an obligation on the seller to collect tax at source at

[29] CIT vs. Hero Cycles Ltd., [2010] 323 ITR 518
[30] Art Leasing Ltd. vs. CIT, [2010] 187 taxman 29 (Ker. HC)

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the rate of 1% for sale of motor vehicle of value exceeding INR 1 million.

There is no increase in tax, as collection of tax at source only shifts the payment of tax by the buyer to an earlier point in time and later provides to the buyer; a credit against his tax liability. However, individuals would feel a direct impact of the proposed amendment as luxury cars would get costlier due to an additional sum collected from buyers towards the seller's TCS obligations and increased administrative cost for sellers.

More importantly, the FM has indicated in his speech that this provision has been introduced with the primary objective of collecting data regarding high spenders which will also help in checking tax evasion. If that was the objective, then there is no reason to apply this provision during B2B transactions i.e. when the manufacturer transfers vehicles to the distributors or when the distributors then sell to the retailers since they are already part of the organised sector and the probability of their evading taxes is pretty remote. It would unnecessarily create cash flow concerns for the industry. This provision should, however, be applicable in respect of B2C transactions i.e. when the retailer sells the cars to the end customers. We understand that the Government is seized of the issue and an appropriate decision shall be taken shortly.

> **Complete pass through for securitization trusts.**

6. **Spectrum fee amortisation**

A spectrum fee for auction of airwaves has been recently introduced by the Government. There is uncertainty about the tax implications of the same, i.e. whether it would be allowed depreciation as an 'intangible asset' under section 32 of the IT Act or amortization as a 'license to operate telecommunication business' under section 35ABB of the IT Act.

It is proposed to insert a new section 35ABA in the IT Act in order to clarify the tax treatment of the spectrum fee. The section provides for deductions with respect to spectrum fee paid, in equal instalments over the permitted period of use of the spectrum, along with tax treatment in case of transfer of spectrum (including consequent to amalgamation of companies).

The provisions come as a great relief to telecom companies in the country, in view of the fact that the cost of Indian telecom spectrum is one of the highest in the world.

XII. UNFULFILLED EXPECTATIONS

The Budget evoked mixed responses amongst the stake holders. The industry was anticipating a few more proposals from the Government to facilitate a business-friendly environment, in alignment with the Government's ambitious initiatives such as 'Make in India', 'Startup India', 'Skill India' and 'Digital India', besides also opening up the economy for the overseas market.

In light of the recommendations made by the Easwar Committee and Tax Administration Reform Commission ("**TARC**"), as well as the Government's own promises to ease tax norms and administrative hassles, there was widespread expectation. It was anticipated that the Government would take positive steps towards not only providing impetus to its ambitious initiatives, but also to ease compliances, simplify procedures, provide certainty and predictability in tax laws, etc.

Whilst the recommendations made by the TARC sought to overhaul the entire system through radical measures, such as integration of CBDT and CBEC, capacity building of departments, improving the quality of assessment, etc., the Easwar Committee Report concentrated more on rationalising the exiting provisions of the IT Act to reduce litigation and to promote ease of doing business in India.

This Budget raised considerable hope amongst the corporate India. The Government, however, did not provide the necessary impetus to the industry, albeit many of the recommendations of the Easwar Committee have been adopted and some measures have been taken into account to boost the growth and employment generation in India such as providing incentives for the Startups, implementation of the so-called 'patent-box' regime and few others.

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The following are some of the wishes of corporate India that did not form part of this year's Budget proposals:

a. **Deferment of Income Computation and Disclosure Standards ("ICDS")**

While deferment of POEM saved many from cumbersome compliance procedures, the taxpayers were sincerely hoping for the deferment of ICDS.[1] The Easwar Committee noted that the taxpayers are already grappling with the regulatory changes of the Companies Act, 2013, Indian Accounting Standards and the proposed GST and therefore, the industry should be allowed more time to deal with another change of this nature.

b. **Concessional rate of tax for interest on RDBs**

As stated in paragraph III(6) of Section A, the CBDT had vide a Press Release[2], clarified that RDBs would be treated at par with the foreign currency bonds in as much as RDBs would qualify for the lower tax rate of 5%. However, no amendment to this effect has been introduced through the Finance Bill. It is also learnt from the news reports that even the concessional tax rate of 5% did not make these bonds an attractive investment and the top rated issuers, including IRFC, HDFC, NTPC along with other investors, had reportedly approached the Government to either scrap or relax the 5% TDS on these bonds, as the same was seen as an impediment for attracting foreign investments.

c. **Startup Incentives**

As stated in paragraph II(1) of Section A, Startups would be subject to MAT, although an incentive in the form of a tax holiday is proposed to be provided.

It would be important to note that the initial years of any company are known for volatility and the Startups may not earn substantial profits. Secondly, the eligibility conditions for claiming the tax holiday, like having Inter-Ministerial Board approval and turnover should not exceed INR 25 crores could narrow down the tax benefit considerably. Further, the benefit granted to venture capital undertakings under section 56(2)(viib) of the IT Act has not been extended to Startups.

d. **Taxability of gains on sale of shares as capital gains**

Over the years, disputes have arisen on the aspect of the tax authorities characterizing the gains on sale of shares, which have been held for less than 12 months, as business income. The Easwar Committee noted that the absence of legislative guidance on this aspect has created uncertainty / avoidable litigation and therefore recommended that gains arising from the sale of shares, held for less than 12 months and which do not exceed 5 lakhs, should be chargeable as 'capital gains'.

e. **Exemption for SEZ units from MAT**

The Union Commerce Ministry made a strong recommendation to the Finance Ministry for the removal of MAT on the SEZ units, on the basis that this would counter the steady rise in import of a large number of items from various developing countries, including China and would also invite challenges while encouraging the idea of 'Make in India'.

In addition to the above, there were several other expectations like, clarity on taxation of indirect transfers, taxation of foreign currency denominated bonds, taxation of unsponsored American Depository Receipts/Global Depository Receipts programmes as well as depository receipts that are issued on the back of other Indian securities (i.e. non-equity shares), extension of sunset date in respect of concessional tax rate of 5% on offshore bonds / government securities, extension of pass through status to all categories of AIFs, reducing the period of holding of units of a Business Trust from 36 months to 12 months to qualify as long term capital asset, etc., which are not forming a part of the Finance Bill.

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[1] The CBDT by Notification No. 892(E) dated March 31, 2015 replaced the accounting standards with the ICDS to be adopted as the method of accounting.

[2] Dated October 29, 2015

SECTION B: ANALYSIS OF PROPOSED CHANGES IN INDIRECT TAX

I. SERVICE TAX

1. Rate

- **Krishi Kalyan Cess**

Krishi Kalyan Cess is proposed to be levied with effect from June 01, 2016 at 0.5% on the value of all or any taxable services. Accordingly, the effective rate of Service tax with effect from June 01, 2016 would be 15%.

Krishi Kalyan Cess would be levied and collected in line with the Service tax. However, it appears that the credit of Krishi Kalyan Cess paid on input services would be allowed only for the payment of the proposed Krishi Kalyan Cess. This would, therefore, effectively be a cost for the companies carrying out the manufacturing activities.

2. Scope of 'Service'

- **Definition of 'service'**

The definition of 'service' is proposed to be amended to include the activity of distribution and selling of lottery on behalf of the State Government in accordance with provisions of the Lotteries (Regulation) Act 1998. This change will be effective from the date of enactment of the Finance Bill.

- **Inclusion of assignment by the Government of the right to use the radio frequency spectrum and subsequent transfer thereof in declare list of 'service'**

Allocation of 2G and 3G telecom airwaves generates substantial revenue for the Government. Various judicial precedents[1] have time and again held that the electromagnetic waves and radio frequencies are not marketable and hence would not qualify to be 'goods'. Accordingly, the sale of spectrum would not attract VAT or CST.

The Government has made an attempt to bring clarity on the issue of taxability under service tax law by the proposed inclusion of 'the assignment of the right to use the radio frequency spectrum and subsequent transfers thereof' under the list of 'declared service' in Section 66E of the FA. However, the response of State VAT authorities remains to be seen on this position. This change will be effective from the date of enactment of the Finance Bill.

- **Changes in the Negative List**

i. Transportation of passengers through stage carriage, whether air conditioned or not, is excluded from Service tax under the Negative List. It is proposed to remove this exclusion from the Negative List.

Such service by an air conditioned stage carriage is proposed to be taxed at the value 40% as applicable to the transportation of passengers through contract carriage.

ii. Services by way of transportation of goods by an aircraft or a vessel from outside India to customs station of clearance in India are excluded from Service tax under the Negative List. The said entry in Negative List is proposed to be omitted.

3. Valuation

- **Alternate rate of Service tax on single premium annuity policies**

Clause (ia) is proposed to be inserted in Rule 6(7A) of STR with effect from April 01, 2016 to provide an alternate rate of Service tax to an insurer carrying on the business of life insurance at the rate of 1.4% on payment of single premium annuity (insurance) policies.

- **Abatement of Service tax**

The scheme of abatements is proposed to be rationalised with effect from April 01, 2016, as follows:

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[1] Bharat Sanchar Nigam Ltd v. Union of India 2006 (2) STR 161 (SC); Bharti Airtel Ltd v. State of Karnataka 2012 (25) STR 514 (Kar.)

Sr. No.	Taxable Service	Existing abatement %	Proposed abatement %	Change in condition
1.	Tour operator services by way of arranging or booking accommodation only	90	90	Cost of accommodation is included in invoice along with service charge
2.	Tour operator services for (i) A package tours where transportation, accommodation, food, tourist guide and other similar services are provided (ii) Other tours	75 60	70 70	No change in conditions
3.	Chit fund foreman to chit fund	Nil	30	No credit of inputs, input services and capital goods
4.	Rent-a-cab	60	60	Cost of fuel is included in the consideration
5.	Construction of a complex, building or civil structure where whole or part consideration is received prior to issuance of completion certificate by competent authority- (i) Residential unit with carpet area less than 2000 sq. feet and amount charged is less than INR 1 Crores (ii) Other units	75 70	70 70	No change in conditions
6.	Transport of passengers by rail	70	70	Credit of input services would be allowed with restriction on credit of inputs and capital goods
7.	Transport of goods (i) by rail (ii) by rail in containers by any person other than Indian Railways (iii) by vessel	70 70 70	70 60 70	Credit of input services would be allowed with restriction on credit of inputs and capital goods
8.	GTA services for transport of used house-hold goods	70	60	No change in conditions

4. Phasing out of exemptions

- **Withdrawal of exemptions**

i. Certain legal services would be taxable with effect from April 01, 2016

  - The scope of exemption on legal services is proposed to be pruned to exclude the services provided by the senior advocates to an advocate, a firm of advocates or a person ordinarily carrying out any activity relating to industry, commerce or any other business or profession.
  - Exemption in respect of the services by a person represented on an arbitral tribunal to an arbitral tribunal has also been proposed to be withdrawn.

ii. Monorail or metro projects to be excluded from Service tax benefits with effect from March 01, 2016

It is pertinent to note that the exemption has been withdrawn for the contracts which are entered and the applicable stamp duty has been discharged thereon after March 01, 2016.

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iii. Exemption on transportation of passengers, with or without baggage, by ropeway, cable car or aerial tramway has been proposed to be withdrawn with effect from April 01, 2016.

While on the whole, the pruning of exemptions is in lines with the Government's intention to move towards a GST regime; the removal of the exemption on construction, erection, commissioning or installation of original works pertaining to monorail or metro projects has also had the unintended consequence of creating a distinction between a monorail or metro rail or any other kind of rail, or between Government railway and non-government railway[2].

- **Exemptions consequent to budgetary changes**

i. Travel by non-air conditioned stage carriage

Transportation of passengers through non-air conditioned stage carriage would be exempt from Service tax under the Notification No. 25/2012-ST dated June 20, 2012 (**"Mega Exemption Notification"**) by way of newly inserted entry 23(bb).

ii. Transportation of goods by an aircraft from outside India to customs station of clearance in India

Transportation of goods by an aircraft from outside India to customs station of clearance in India would be exempted from Service tax by inclusion of entry 53 in the Mega Exemption.

These changes will be effective from the date of enactment of the Finance Bill.

5. Tax incentives and exemptions

- **Exemption on educations services rationalised**

Educations services for pre-school, higher secondary, education as a part of curriculum recognized by law or education as a part of an approved vocational educational course are excluded from Service tax under the Negative List. Similar exemption is provided under Mega Exemption Notification.

By way of omission of the said entry in Negative List and corresponding amendments in/ inclusion of the definition of 'educational institution' and 'approved vocational educational course' in the Mega Exemption Notification, the aforesaid services would continue to be non-taxable through the exemption route. This change will be effective from the date of enactment of the Finance Bill.

- **Exemption for software**

Sale of the Information Technology Software on a media as packaged software and valued at the retail sale price for the purpose of levy of Excise duty or the Additional duty of Customs under Section 3(1) of the Customs Tariff Act, 1975 would be exempt from Service tax subject to following conditions:

i. Value of the package software has been determined under Section 4A of the Central Excise Act, 1944;

ii. Appropriate Excise duty or the Customs duty, as the case may be, has been paid on such packaged software; and

iii. No amount is charged in excess of the retail sale price of such packaged software.

Further, in respect of 'media with recorded information technology software', exemption from payment of Excise Duty is provided to the extent of taxable value on which Service Tax is leviable under Section 66B read with Section 66E of the FA.

Courts have held that the packaged or canned software when put on a media are goods.[3] Thus, Service tax would not be levied on sale of package software. It is pertinent to note that the packaged software, which is not valued at MRP, is exempt from Excise duty. Whereas, package software valued at MRP, is exigible to Excise duty. This change will be effective from March 01, 2016. However, this amendment creates a doubt as to whether Service tax was applicable earlier in case of software sold on a media.

[2] In the matters of Afcons Infrastructure Ltd. v. Commissioner of Central Excise 2015 (38) STR 194; DMRC v. Municipal Corporation of Delhi 2008 (103) DRJ 369; Courts have held in past that the 'there is no distinction between a monorail or metro rail or any other kind of rail, or between Government railway and non-government railway'

[3] Tata consulting services v. State of Andhra Pradesh 2002 (178) ELT 22 (SC)

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- **Restoration of exemptions to cater construction contracts entered prior to March 01, 2015**

  In the previous budget, the Government withdrew the exemption from Service tax on construction related services of certain categories of infrastructures. Doubts were raised about the fate of these exemptions on continuing contracts entered prior to April 01, 2015.

  The Government has introduced new sections in the FA i.e. Section 102 and Section 103 to provide for refund of Service tax paid during April 01, 2015 to February 29, 2016 on the following services subject to the contract being entered into as well as discharge of the applicable stamp duty prior to March 01, 2015:

i. Services provided to the Government or the Local Authority or the Governmental Authority; by way of construction, erection, repair, maintenance etc of

ii. Civil structure or original work other than for industry or commerce or business or profession;

iii. Residence for self use; and

iv. A structure for use as an educational, clinical or art/ cultural establishment.

v. Services of construction, erection, commissioning or installation of original works pertaining to the airport or the port subject to obtaining certificate in relation to contract date from the Ministry of Civil Aviation/ the Ministry of Shipping.

  The refund claim for Service tax paid on aforesaid services could be filed within six months from the date of enactment of the Finance Bill.

  Independent of the above, the Government has proposed to exempt the aforesaid services from Service tax prospectively as well till March 31, 2020 under newly inserted serial number 12A and 14A, respectively, in Mega Exemption Notification. These changes will be effective from the date of enactment of the Finance Bill.

- **Retrospective exemption to construction works for irrigation projects for Governmental Authority**

  Vide Notification No. 02/2014-ST dated January 01, 2014; the definition of the 'Governmental Authority' was amended to include entities set up by Government but not necessarily by an Act of Parliament or State Legislature within its ambit.

  It has been proposed through Section 101 in the Finance Bill to extend the benefit arising out of the aforesaid change to the services in the nature of construction, erection, maintenance or alteration of canal, dam or other irrigation works provided to an entity set up by the Government, retrospectively from July 01, 2012 to January 29, 2014. This change will be effective from the date of enactment of the Finance Bill.

- **Exemptions to promote flagship schemes of the Government**

i. Focus on affordable insurance

With an aim to provide affordable insurance services to the masses, the Government proposed to provide exemptions to the following services by way of inclusion of entry 50, 26(q) and 26C in the Mega Exemption Notification:

- Services provided by Insurance Regulatory and Development Authority of India (**"IRDAI"**);
- Services of general insurance business provided under Niramaya Health Insurance scheme launched by National Trust for the Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disability in collaboration with private/public insurance companies; and
- Services of life insurance by way of annuity under the National Pension System regulated by PFRDA under the

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Pension Fund Regulatory and Development Authority Act, 2013.

The aforesaid changes would be applicable from March 01, 2016.

- **Boost for Skill India Mission**

In order to promote the 'Skill India' mission under which the Government aims at setting up 1500 Multi Skill Training Institutes across the country, the following exemptions have been proposed by way of inclusion of entry 9C and 9D in the Mega Exemption Notification with effect from April 01, 2016:

i. Services provided by way of skill/vocational training by Deen Dayal Upadhyay Grameen Kaushalya Yojana training partners; and

ii. Services of assessments under Skill Development Initiative (**"SDI"**) Scheme by the bodies empanelled centrally by Directorate General of Training, Ministry of Skill Development & Entrepreneurship.

- **Housing for all**

The Government has time and again committed to provide housing to all citizens of the country by the year 2022. In order to facilitate this commitment, exemption to Services by way of construction, erection etc. of a civil structure or any other original works pertaining to the following have been proposed by way of inclusion of entry 13(ba), 13(bb) and 14(ca) with effect from April 01, 2016:

i. "In-situ Rehabilitation of existing slum dwellers using land as a resource through private participation" component of Housing for All (**"HFA"**) (Urban) Mission / Pradhan Mantri Awas Yojana (**"PMAY"**), except in respect of such dwelling units of the projects which are not constructed for existing slum dwellers.

ii. "Beneficiary-led individual house construction / enhancement" component of HFA (Urban) Mission/ PMAY.

iii. Low cost houses up to a carpet area of 60 sq. m per house in a housing project approved by the competent authority under the "Affordable housing in partnership" component of PMAY or any housing scheme of a State Government.

- **Others**

i. Services provided by SEBI by way of protecting the interests of investors in securities and to promote the development of, and to regulate, the securities market.

ii. Services provided by Employees Provident Fund Organization (**"EPFO"**) to employees.

iii. Services provided by Biotechnology Industry Research Assistance Council (**"BIRAC"**) approved biotechnology incubator to the incubatee.

iv. Services provided by National Centre for Cold Chain Development under Department of Agriculture, Cooperation and Farmer's Welfare, Government of India, by way of knowledge dissemination.

The aforesaid changes would be applicable from April 01, 2016.

6. Ease of doing Business

- **Clarifications to rest litigation on certain issues**

i. Incentives received by Air travel agents from the Computer Reservation Systems

Taxability of the incentives received by the Air travel agents from a Computer Reservation Systems has always been a matter of dispute between the tax payers and the Service tax authorities. Conflicting views[4] of the judicial authorities on this issue have not helped the cause.

It has been clarified that such incentives for target booking of air tickets or for loyalty booking of air tickets using the software of Computer Reservation Systems would qualify as a 'service' and be exigible to Service tax.

ii. Services by certain educational institutions

- Liability to pay Service tax would not arise in respect of services provided by the

[4] International Travel House Pvt. Ltd. 2014 (33) STR 606 (Comm. Appeals); Balmer Lawrie & Co. Ltd. v. Commissioner of Service tax 2014 (35) STR 599 (Tri-Del.)

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Indian Institute of Management (**"IIM"**) by way of the following educational programmes with effect from March 01, 2016:

- 2 year full time Post Graduate Programme in Management (**"PGPM"**), other than the executive development programme, admissions to which are made through the Common Admission Test conducted by IIMs;
- 5 year Integrated Programme in Management; and
- Fellowship Programme in Management.

A new entry 9A has been inserted in the Mega Exemption Notification to this effect. It has further been clarified that since these courses are for obtaining a qualification recognized by law, levy of Service tax on these courses would be infructuous for past period also in light of Negative List and various judicial precedents[5]. This change will be effective from the date of enactment of the Finance Bill.

- It has further been clarified that the services provided by the Institute of Language Management to various schools/ institutes would be eligible to Service tax as it is neither covered under the Negative List nor exempt by Mega Exemption Notification or any other notification.

  An analysis of the aforesaid changes, evidently is an endeavor of the Government to facilitate investments in India by providing clarity on disputed issues.

7. **Procedure and penalties**

- **Relaxation of prosecution proceedings**

  The monetary limit for specified offences is proposed to be increased to INR 2 Crores from INR 50 Lakhs. Specified offences are as follows:

  i. Evasion of Service tax;

  ii. Availment and utilization of CENVAT Credit without actual receipt of taxable services or excisable goods;

  iii. Maintenance of false books of accounts; and

  iv. Failure to deposit the Service tax collected beyond the period of six months from the due date payment.

  The power to arrest under the FA is proposed to be restricted to cases where the amount of Service tax is collected but not deposited for six months with the Service tax authority exceeds INR 2 Crores.

  These changes will be with effect from the date enactment of the Finance Bill

- **Reverse Charge Mechanism**

  Reverse Charge Mechanism is proposed to be amended in line with the legislative/ policy amendments under the Service tax law with effect from April 01, 2016 (as otherwise provided). The following changes are proposed:

Sr. No	Service	% payable by service provider		% payable by service recipient	
		Existing	Proposed	Existing	Proposed
1.	Services by mutual fund agent or distributor to a mutual fund or asset management company	Nil	100	100	Nil
2.	Services by Government or Local Authority excluding renting of immovable property and other specified services	Nil	100	Nil	100
3.	Services availed from the foreign shipping lines by a business entity located in India would be effective from June 01, 2016	-	Nil	-	100

[5] Great Lakes Institute of Management Ltd. v. Commissioner of Service tax 2013 (32) STR 305 (Tri-LB)

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Amendment in the reverse charge provisions would have following implications:

i. Services by agents or distributors which would have otherwise been covered under threshold exemption were taxed in the hands of mutual fund or asset management company. With removal of Reverse Charge Mechanism on such services, cost of such services would be reduced.

ii. The words 'by way of support services' have been omitted. Therefore, liability to pay Service tax on any service (except the specified services) provided by the Government has been casted upon the service recipient.

- **Relaxation of compliance for startups and small businesses**

i. One Person Company (**"OPC"**) would be eligible to the benefits of quarterly deposit of Service tax and payment on receipt basis up to the receipts of INR 50 Lakhs.

ii. HUF would also be allowed to pay Service tax on quarterly basis but in accordance with POTR.

These changes will be effective from April 01, 2016.

- **POTR synchronized with Section 67A of the FA**

Section 67A provides that the applicable rate of Service tax on the provision of a taxable service would be the rate as applicable at the time when such taxable service has been provided or agreed to be provided.

Whereas, POTR generally provides that the rate of Service tax would be the rate as applicable at the time of receipt of payment or issuance of the invoice for the taxable service. Hence, there is a contradiction between the substantive provisions of law i.e. Section 67A and the subordinate legislation i.e. POTR.

Various judicial precedents have held that the taxable event under Service tax law would be the provision of service. Accordingly, Service tax would be levied at the rate as applicable on the date of provision of the taxable service.

In order to put an end to this issue, enabling provisions have been introduced in Section 67A by way of insertion of sub-section(2) which grants power to define that the point in time with respect of Service tax shall be such as may be prescribed. Corresponding changes have been made in POTR. This change will be effective from the date of enactment of the Finance Bill.

- **Introduction of new levy to be parallel to taxability of a new service for POTR**

With the introduction of the Krishi Kalyan Cess, the disputes would have aroused on the determination of the point of tax as was the case when the Swachh Bharat Cess was levied in November 2015.

Explanations 1 and 2 have been added to Rule 5 of POTR with effect from March 01, 2016, which deals with the point of time of levy of Service tax on services taxed for the first time, to clarify that this rule would also be applicable in cases of the new levies. Accordingly, Service tax and / or new levy would be applicable on cases where a service or levy becomes taxable for the first time provided payment is received or invoice is issued after 14 days of such service/ levy becoming taxable.

- **Annual return of Service tax**

Annual return of Service tax would be introduced with effect from April 01, 2016 which would be required to be filed by the 30th day of November of the succeeding financial year. Such annual return would be allowed to be revised within period of 1 month from a the date of the submission of the original annual return.

Further, fee for late filing of annual returns would be INR 100 per day of delay subject to a maximum of INR 20,000.

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II. CENTRAL EXCISE

1. Changes in Valuation and Rates of Duty

- **Infrastructure Cess**

  The Infrastructure Cess on the motor vehicles falling under Chapter Heading 8703 of the CETA has been proposed to be introduced. The effective rates of the Infrastructure Cess prescribed are as below:

i. Nil Rate of Duty: Three wheeled vehicles, Electrically operated vehicles, Hybrid vehicles, Hydrogen vehicles based on fuel cell technology, Motor vehicles which after clearance have been registered for use solely as taxi (subject to prescribed conditions), Cars for physically handicapped persons (subject to prescribed conditions), and Motor vehicles cleared as ambulances or registered for use solely as ambulance (subject to prescribed conditions)

ii. 1% Duty: Petrol/LPG/CNG driven motor vehicles of length not exceeding 4m and engine capacity not exceeding 1200cc

iii. 2.5% Duty: Diesel driven motor vehicles of length not exceeding 4m and engine capacity not exceeding 1500cc

iv. 4% Duty: All categories of motor vehicles other than those listed

These changes are going to make most categories of vehicles more expensive for the final consumer. This may incentivize consumers to purchase hybrid/clean fuel/electric powered vehicles.

- **Increase in rates for the Clean Environment Cess (Formerly Clean Energy Cess)**

i. The Clean Energy Cess has now been renamed as the Clean Environment Cess.

ii. The Tenth Schedule to the Finance Act, 2010 dealing with Clean Environment Cess is amended to increase the schedule rate from INR 300 per tonne to INR 400 per tonne. Therefore, the effective rate of Clean Environment Cess is increased to INR 400 per tone.

iii. Exemption from payment of Clean Environment Cess on coal, lignite or peat produced or extracted as per traditional and customary rights enjoyed by local tribals without any license or lease is also extended to the State of Nagaland.

- **Changes in the Rate of Duty on various goods**

i. A glance through the changes as suggested by Budget, it can again be seen that the major thrust has been to reduce the rates of products under categories like capital goods, renewable energy, agriculture, etc. This goes in line with the present Government's mission to promote "Make in India", Swachh Bharat Abhiyan and green sources of energy. Conversely, tobacco and tobacco products, pan masala, jewellery, garments shall become more expensive due to increase in rates.

ii. There is no change to the peak rate of duty which has been maintained at 12.5%

iii. The Pan Masala Packing Machines (Capacity Determination and Collection of Duty) Rules, 2008 is proposed to be amended whereby the break-up of duty payment for apportionment between various duties, shall be revised. Similar amendments have been carried out under the Chewing Tobacco and Unmanufactured Tobacco Packing Machines (Capacity Determination and Collection of Duty) Rules, 2010. These amendments are made towards increase of duty on such applicable products.

iv. The proposed changes in the effective rates of goods in the Finance Bill is given as below:

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
	Aerated Beverages			
1.	Specified Aerated Beverages	18%	21%	↑
	Tobacco and Tobacco Products			
2.	Cigar and cheroots and Cigarillos	12.5% or INR 3375 per thousand, whichever is higher	12.5% or INR 3755 per thousand, whichever is higher	↑
3.	Cigarettes and Cigarillos of tobacco substitutes	INR3375 per thousand	INR 3755 per thousand	↑
4.	Others of tobacco substitutes	12.5% or INR 3375 per thousand, whichever is higher	12.5% or INR 3755 per thousand, whichever is higher	↑
5.	Gutkha, chewing tobacco (including filter khaini) and jarda scented tobacco	70%	81%	↑
6.	Unmanufactured Tobacco	55%	64%	↑
7.	Paper rolled biris (whether handmade or machine made) and other biris (other than handmade biris)	INR 30 per thousand	INR 80 per thousand	↑
8.	Filter and Non-filter cigarettes not exceeding 65 mm	INR 70 per thousand sticks	INR 215 per thousand sticks	↑
9.	Non-filter cigarettes exceeding 65 mm but not exceeding 70 mm	INR 110 per thousand sticks	INR 370 per thousand sticks	↑
10.	Filter cigarettes exceeding 65 mm but not exceeding 70 mm	INR 70 per thousand sticks	INR 260 per thousand sticks	↑
11.	Filter cigarettes exceeding 70 mm but not exceeding 75 mm	INR 110 per thousand sticks	INR 370 per thousand sticks	↑
12.	Other	INR 180 per thousand sticks	INR 560 per thousand sticks	↑
	Food Processing			
13.	Refrigerated containers	12.5%	6%	↓
	Fertilisers			
14.	Micronutrients which are covered under Sr. No. 1(f) of Schedule 1 Part (A) of the FCO and are manufactured by the manufacturers which are registered under the FCO	12.5%	6%	↓
15.	Physical mixture of fertilizers manufactured by Co-operative Societies, holding certificate of manufacture for mixture of fertilizers under the FCO	1% (without CENVAT credit) or 6% (with CENVAT credit)	Nil	↓
	Textiles			
16.	Branded readymade garments and made up articles of textiles of retail sale price of INR 1000 or more	Nil (without CENVAT credit) or 6%/12.5% (with CENVAT credit)	2% (without CENVAT credit) or 12.5% (with CENVAT credit)	↑
17.	Polyester Stable Fiber / Polyester Filament Yarn, manufactured from plastic scrap or plastic waste including waste PET bottles	2% (without CENVAT credit) or 6% (with CENVAT credit)	2% (without CENVAT credit) or 12.5% (with CENVAT credit)	↑

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
	Footwear			
18.	Rubber sheets & resin rubber sheets for soles and heels	12.5%	6%	↓
19.	Increase the abatement from RSP for the purposes of excise duty assessment for all categories of footwear	25%	30%	↑
	Metals			
20.	To change excise duty structure on disposable containers made of aluminium foils.	2% (without CENVAT credit) or 6% (with CENVAT credit)	2% (without CENVAT credit) or 12.5% (with CENVAT credit)	↑
	Precious Metals and Jewellery			
21.	Refined gold bars manufactured from gold dore bar, silver dore bar, gold ore or concentrate, silver ore or concentrate, copper ore or concentrate.	9%	9.5%	↑
22.	Refined silver manufactured from silver ore or concentrate, silver dore bar, or gold dore bar.	8%	8.5%	↑
23.	Articles of Jewellery (excluding silver jewellery, other than studded with diamonds or other precious stones namely, ruby, emerald and sapphire) with a higher threshold exemption up to INR 6 crore in a year and eligibility limit of INR 12 crore.	Nil	1% (without CENVAT credit) or 12.5% (with CENVAT credit)	↑
	Renewable Energy			
24.	Unsaturated Polyester Resin (polyester based infusion resin and hand layup resin), Hardeners/Hardener for adhesive resin, VEA and Epoxy Resin used for manufacture of rotor blades and intermediates, parts and sub parts of rotor blades for wind operated electricity generators	Nil	6%	↑
25.	Carbon pultrusion used for manufacture of rotor blades and intermediates, parts and sub-parts of rotor blades for wind operated electricity generators	12.5%	6%	↑
	Solar Lamp			
26.	Civil Aviation	12.5%	Nil	↓
27.	Aviation Turbine Fuel other than for supply to Scheduled Commuter Airlines from the Regional Connectivity Scheme airports	8%	14%	↑
28.	Tools and tool kits when procured for MRO of aircraft subject to a certification by the Directorate General of Civil Aviation	Applicable Excise Duty as per the prevalent rates	Nil	↓
	Electronics & IT Hardware			
29.	Charger / adapter, battery and wired headsets / speakers for supply to mobile phone manufacturers as original equipment manufacturer	Nil	2% (without CENVAT credit) or 12.5% (with CENVAT credit)	↑

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
30.	Inputs, parts and components, subparts for manufacture of charger / adapter, battery and wired headsets / speakers of mobile phone, subject to actual user condition.	12.5% / Nil	Nil	↓
31.	Routers, broadband Modems, Set-top boxes for gaining access to internet, set top boxes for TV, DVR / NVR, CCTV camera / IP camera, lithium ion battery (other than those for mobile handsets)	12.5%	4% (without CENVAT credit) or 12.5% (with CENVAT credit)	↓
32.	Parts and components, subparts for manufacture of Routers, broadband Modems, Set-top boxes for gaining access to internet, set top boxes for TV, DVR / NVR, CCTV camera / IP camera, lithium ion battery (other than those for mobile handsets)	12.5%	Nil	↓
	Machinery			
33.	Electric motor, shafts, sleeve, chamber, impeller, washer required for the manufacture of centrifugal pump	12.5%	6%	↓
	Automobiles			
34.	Specified parts of Electric Vehicles and Hybrid Vehicles	6% up to March 01, 2016	6% without any time limit	↓
35.	Engine for hybrid electric vehicle	12.5%	6%	
	Miscellaneous			
36.	Excise duty on sacks and bags of all plastics is being rationalised at 15%.	12.5% / 15%	15%	↓
37.	Disposable sterilized dialyzer and micro barrier of artificial kidney	12.5%	Nil	↑
38.	Ready Mix Concrete manufactured at the site of construction for use in construction work at such site	2% (without Credit of inputs) or 6% (with Credit of inputs)	Nil	↓
39.	Parts of railway or tramway locomotives or rolling stock and railway or tramway track fixtures and fittings, railway safety or traffic control equipment, etc.	12.5%	6%	↓
40.	Remnant kerosene, presently available for manufacture of Linear alkyl Benzene and heavy alkylate to N-paraffin. At present, exemption is restricted to manufacturers of LAB and HA.	14%	Nil	↓

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- **Exemptions of Central Excise Duty**

  The following changes have been affected on the front of exemptions available under Central Excise law:

i. Area based exemption benefit available to new industrial unit (situated at Jammu and Kashmir, Assam, Tripura, Meghalaya, Mizoram, Manipur, Nagaland, Arunachal Pradesh and Sikkim) engaged in production of refined gold or silver which commences the commercial production on or after March 01, 2016 or an existing unit which undertakes substantial expansion of existing capacity has been withdrawn. In this regard, this goes in line with the aim of the Budget to tax jewellery manufacturers.

ii. SSI exemption has been made applicable to the clearances of articles of jewellery (other than certain specified articles of Chapter Heading 7113) up to INR 6 Crores subject to the condition that clearance of such goods in preceding FY shall not exceed INR 12 Crores. However, threshold limit for the month of March, 2016 for the said goods is INR 50 lakhs.

iii. SSI exemption is applicable to the clearances of goods bearing a brand name or sold under a brand name and having a retail sale price of INR 1000/- and above, falling under Chapter 61, 62 and 63 (except laminated jute bags falling under Chapter Heading 6305, 6309 00 00, 6310). However, for the month of March 2016 shall be restricted to INR 12.5 lakhs.

- **Abatement of Duty**

i. The prescribed abatement for articles of apparel, not knitted or crocheted falling under CETH 6201 under Notification No 20/2001-C.E. (N.T.) has been increased. Duty will now be have to be paid on 60% of the RSP, as compared to 30% of the RSP previously as per the prescribed rates.

ii. The fixed tariff value in respect of articles of jewellery (other than silver jewellery), falling under CETH 7113 of the First Schedule to the CETA, at the rate of 30% of the transaction value as declared in the invoice, as notified by Notification No. 9/2012-C.E.(N.T.) dated March 17, 2012 is proposed to be rescinded.

2. Substantive Changes under Central Excise Law

- **Expansion of the powers of the CBEC:** Section 37B of the CE Act is proposed to be amended in order to maintain uniformity in Department practices. The proposal is to empower the CBEC to also issue instructions with respect to implementation of any provisions of the CE Act, in addition to the already existing powers in respect of classification and levy of duties of excise on goods. This allows the CBEC to have enhanced powers in respect of implementation of the CE Act and allied rules.

- **Amendment of list of goods considered to be deemed manufacture under the Third Schedule of the CE Act:**

i. Entry No. 40 of the Third Schedule has been amended to include all goods under CETH 3401 (soaps). Further, an abatement of 30% has been extended to all goods under CETH 3401.

ii. Entry No. 40 of the Third Schedule has been amended to include all goods under CETH 3402 (organic surface active agents). Further, an abatement of 30% has been extended to all goods under CETH 3402.

iii. A new entry 63A has been introduced covering all goods falling under CETH 8517 62 i.e. wrist wearable devices (smart

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watches). Abatement of 35% has been specified for this entry.

iv. Entries 100 and 100A has been amended to include "accessories" of vehicles in addition to the existing "parts, components and assemblies". Abatement of 30% shall also apply in case of accessories of vehicles.

v. Rate of abatement on RSP of footwear increased from 25% to 30%.

vi. Abatement of 25% of RSP extended to Aluminium foil of thickness not exceeding 0.2 mm.

vii. Proposed amendment of Entry No. 58 to include glazed tiles, in addition to vitrified tiles, whether polished or not. Accordingly Entry No. 59 to be omitted in view of amendment to entry no. 58. This amendment is proposed to come into effect on January 01, 2017, in view of the latest editorial changes to the HSN.

3. **Thrust on Ease of Doing Business**

Various substantive and procedural laws have been amended with a view to promote the ease of doing business in India, which has been a major theme in the Budget. This includes expansion of various powers of the Central Government to take quicker action and substantive and procedural simplification of various requirements under Central Excise laws for the assessees in order to make business in India easier.

- **Simplification of Registration processes**

i. Notification No. 36/2001-C.E.(N.T) is proposed to be amended w.e.f. March 01, 2016. The erstwhile provisions had provided that if two or more premises of the same factory were separated by public road, railway line or canal, a single registration could be allowed by the Central Excise Officer. In terms of the new proposal, the benefit of a single registration will be granted subject to the following three conditions:

a. the two or more premises of the same factory are located within the jurisdiction of a Range Superintendent; and

b. the manufacturing process is interlinked; and

c. the units are not operating under any area based exemption notifications

This is a move towards a simplified process where a manufacturer who has more than one unit located within a specified jurisdiction can now avail a single registration in respect of all such units.

v. Every manufacturing factory or premises engaged in the manufacture or production of specified articles of jewellery falling under chapter heading 7113 of the First Schedule to the CETA and having a centralised billing or accounting system in respect of such specified goods manufactured or produced by different factories or premises, is proposed to be exempted from registering individual factories/premises under Rule 9 of the CE Rules. Instead, such manufacturer may opt for registering only the factory or premises or office, from where such centralised billing or accounting is done subject to conditions, safeguards and procedures. This amendment is a welcome move towards removal of obtaining individual registrations for each unit and making it easier for manufacturers having multiple units to choose to operate out of one specified unit having central billing and accounting.

- **Amendments to form and method of publication of a Notification**

i. The condition of publishing and offering for sale of any Notifications issued under Section 5A(1) or Section 5A(2A) by the Directorate of

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Publicity and Public Relations, Customs and Central Excise, New Delhi under CBEC, is proposed to be omitted.

ii. This amendment has been proposed to overcome the judgment of the Apex Court in the case of **Union of India vs. Param Industries Ltd.** [6] wherein it was *inter alia* held that though the Notification may have been published in the Gazette on a particular date, however it was not offered for sale, which event took place much thereafter and therefore the Department was not entitled to claim differential duty in respect of the new Notification. This empowers the Central Government to quickly issue notifications on various issues and exercise its power of delegated legislation.

- **Tax Certainties and Procedural Simplification**

i. The requirement of providing self attested copies of digitally signed duplicate invoices by the manufacturer to a transporter, for the purpose of transportation of goods is proposed to be omitted w.e.f. April 01, 2016.

ii. The requirements of submitting an Annual Financial Information Statement and an Annual Installed Capacity Statement along with returns are proposed to be done away with. Instead, only an Annual Return is proposed to be submitted for the preceding FY. This proposal shall apply to a 100% EOU as far as applicable. Accordingly, penalty of INR 100 per day, for delay in submission of returns and said statements shall apply to delay in the submission of returns. These changes shall come into effect from w.e.f. April 01, 2016.

iii. It is proposed that an assessee who has filed returns within the prescribed period, may file revised returns including Annual Returns by the end of the calendar month in which the original return was filed. Further, the "relevant date" for recovery of duty in cases where revised returns are filed shall be the date on which the revised returns were filed. This is the first time the provision for revision of returns have been provided under Central Excise laws, bringing it to parity with Service Tax laws.

iv. For the purposes of Excise duty exemption on machinery/components for setting up of power or bio gas (CNG) generation project using non- conventional materials, the condition that there has to be a valid agreement (subject to the satisfaction of Deputy Commissioner / Assistant Commissioner) between importer and urban local body for processing of municipal solid waste has been inserted. This move is also promoted towards the flagship government programmes of “Make in India” and Swachh Bharat Abhiyan.

v. The proposed supersession of the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable and Other Goods) Rules, 2001 with the Central Excise (Removal of Goods at Concessional Rate of Duty for Manufacture of Excisable and Other Goods) Rules, 2016 seeks to simplify the procedure for a manufacturer intending to avail the benefit of an exemption notification issued under Section 5A of the CE Act. Such manufacturer will no longer be required to make an additional application to the Deputy / Assistant Commissioner of Central Excise, but will now only be required to make a self-declaration in duplicate in the prescribed form. Therefore, this proposed amendment is a move towards removal of obtaining permissions and making it easier for manufacturers to remove goods at concessional rate of duty.

vi. The procedure for claiming rebate of duty under Rule 18 of the CE Rules of excisable goods used in the manufacture of goods that

[6] Union of India vs. Param Industries Ltd., [2015] (321) ELT 192,

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are exported is proposed to be simplified. It is now proposed that the Deputy / Assistant Commissioner will no longer be required to verify the correctness of the ratio of the input and output in light of the amended requirement to file a Chartered Engineer's certificate unless there are doubts as regards the correctness of such information. Further, one of the conditions for claiming rebate of duty on export of goods to countries other than Nepal and Bhutan is proposed to be amended to provide that the Indian market price of the excisable goods at the time of exportation shall not be less than the amount of rebate claimed as opposed to earlier provision that referred only to market price. In terms of the new amended notification, a claim for rebate of duty paid on all excisable goods will now be required to be lodged with the Deputy / Assistant Commissioner before the expiry of the time prescribed. The new condition that the market price to be considered would be the Indian market price is being introduced to overcome the judgment of the Hon'ble Delhi HC in the case of **Dr. Reddy's Laboratories vs. Union of India.**[7]

vii. Rule 7(4) of the CE Rules is proposed to be substituted w.e.f. March 01, 2016, where an assessee shall be liable to pay interest on any amount paid or payable on the goods under provisional assessment, but not paid on the due date, at the prescribed rates, for the period starting first day after the due date till the date of actual payment, whether such amount is paid before or after the issue of order for final assessment. Previously, interest was only payable on amount due to the Central Government consequent to final assessment from the first day of the month succeeding the month for which such amount was determined, till the date of payment thereof. This amendment is effected to clarify the intention of the legislature and overcome the decision of the Hon'ble HC of Bombay in **CEAT Limited v. CCE**.[8]

III. CUSTOMS

1. Changes in Rates of Duty

The median rate of basic customs duty on most non-agricultural products remains unchanged @ 10%. The present budget is committed towards creating an atmosphere facilitating the ease of doing business in the Indian economy with special emphasis on the 'Make in India' and 'Startup India' objective. Major amendments have been proposed to benefit various sectors namely agricultural, rural, social, education, infrastructure, finance and personal finance.

Export duty has been reduced from 20% to 15% on the export of calcined and non-calcined natural Bauxite. Export of Chromium ores and concentrates, iron ore fines and lumps (iron content below 58%) have been exempted from the levy of export duty.

The proposed item wise changes in rates of duty have been tabularized as below:

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[7] Dr. Reddy's Laboratories vs. Union of India, [2014] (309) ELT (423)
[8] CEAT Limited v. CCE [2015] (317) ELT 192

Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
	Articles of rubber			
41.	Natural latex rubber made balloons falling under specified headings	10%	20%	↑
	Metals			
42.	Primary aluminum	5%	7.5%	↑
43.	Zinc alloys	5%	7.5%	↑
	Jewellery			
44.	Imitation Jewellery	10%	15%	↑
	Renewable energy			
45.	Industrial solar water heater	7.5%	10%	↑
	Capital goods and parts thereof			
46.	Increase the tariff rate of BCD for 211 specified tariff lines in Chapters 84, 85 and 90	7.5%	10%	↑
	(a) The effective rates for 96 specified tariff lines will increase	7.5%	10%	↑
	(b) The effective rate for 115 tariff lines will be maintained	7.5%	7.5%	=
	Export duty			
	Ores and concentrates			
47.	Iron ore fines with Fe content below 58%	10%	Nil	↓
48.	Iron ore lumps with Fe content below 58%	30%	Nil	↓
49.	Chromium ores and concentrates, all sorts	30%	Nil	↓
50.	Bauxite (natural), not calcined or calcined	20%	15%	↓
	Basic customs duty (Import)			
	Food processing			
51.	Cashew nuts in shell	Nil	5%	↑
52.	Cold chain including pre-cooling unit, packhouses, sorting and grading lines and ripening chambers	10%	5%	↓
53.	Refrigerated containers	10%	5%	↓
	Mineral fuels and mineral oils			
54.	Coal; briquettes, ovoids and similar solid fuels manufactured from coal	2.5% /10%	2.5%	↓
55.	Lignite, whether or not agglomerated, excluding jet	10%	2.5%	↓

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
56.	Peat (including peat litter), whether or not agglomerated	10%	2.5%	↓
57.	Coke and semi-coke of coal, of lignite or of peat, whether or not agglomerated; retort carbon	5% /10%	5%	↓
58.	Coal gas, water gas, producer gas and similar gases, other than petroleum gases and other gaseous hydrocarbons	10%	5%	↓
59.	Tar distilled from coal, from lignite or from peat and other mineral tars, whether or not dehydrated or partially distilled, including reconstituted tars	10%	5%	↓
60.	Oils and other products of the distillation of high temperature coal tar similar products in which the weight of the aromatic constituents exceeds that of the non-aromatic constituents	2.5% / 5% / 10%	2.5%	↓
61.	Pitch and pitch coke, obtained from coal tar or from other mineral tars	5% / 10%	5%	↓
	Petroleum exploration and production			
62.	Goods required for exploration & production of hydrocarbon activities undertaken under Petroleum Exploration Licenses (**"PEL"**) or Mining Leases (**"ML"**) issued or renewed before 1st April 1999	Applicable BCD and CVD	BCD - Nil CVD – Nil	↓
	Chemicals and petrochemicals			
63.	All acyclic hydrocarbons and all cyclic hydrocarbons [other than para-xylene which attracts Nil BCD and styrene which attracts 2% BCD]	5% / 2.5%	2.5%	↓
64.	Denatured ethyl alcohol (Ethanol) subject to actual user condition	5%	2.5%	↓
65.	Orthoxylene for the manufacture of phthalic anhydride subject to actual user condition	SAD – 4%	SAD – 2%	↓
66.	Electrolysers, membranes and their parts required by caustic soda / potash unit using membrane cell technology	2.5%	Nil	↓
	Paper, paperboard and newsprint			
67.	Wood in chips or particles for manufacture of paper, paperboard and news print	5%	Nil	↓
68.	Plans, drawings and designs	Nil	10%	↑
	Textiles			
69.	Specified fibres and yarns	5%	2.5%	↓

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
70.	Specified fabrics [for manufacture of textile garments for export] of value equivalent to 1% of FOB value of exports in the preceding financial year subject to the specified conditions. The entitlement for the month of March 2016 shall be one twelfth of one per cent. of the FOB value of exports in the financial year 2014-15.	Applicable BCD	Nil	↓
	Electronics / Hardware			
71.	Polypropylene granules / resins for the manufacture of capacitor grade plastic films	7.5%	Nil	↓
72.	E-Readers Nil	7.5%	↑	
73.	Parts of E-readers	Applicable BCD	5%	
74.	Magnetron of capacity of 1 KW to 1.5 KW for use in manufacture of domestic microwave ovens subject to actual user condition.	10%	Nil	↓
75.	Machinery, electrical equipment and instrument and parts thereof (except populated PCBs) for semiconductor wafer fabrication / LCD fabrication units	Applicable BCD SAD	Nil BCD Nil SAD	↓
76.	Machinery, electrical equipment and instrument and parts thereof (except populated PCBs) imported for Assembly, Test, Marking and Packaging of semiconductor chips (ATMP)	Applicable BCD SAD	Nil BCD Nil SAD	↓
77.	The exemption from basic customs duty, CV duty, SAD on charger / adapter, battery and wired headsets / speakers for manufacture of mobile phone being withdrawn	BCD-Nil CVD - Nil SAD - Nil	Applicable BCD CVD – 12.5% SAD – 4%	↑
78.	Inputs, parts and components, subparts for manufacture of charger / adapter, battery and wired headsets / speakers of mobile phones, subject to actual user condition	Applicable BCD, CVD SAD	Nil BCD Nil CVD Nil SAD	↓
79.	Parts and components, subparts for manufacture of Routers, broadband Modems, Set-top boxes for gaining access to internet, set top boxes for TV, digital video recorder (**“DVR”**) / network video recorder (**“NVR”**), CCTV camera / IP camera, lithium ion battery [other than those for mobile handsets]	Applicable BCD, CVD SAD	Nil BCD Nil CVD Nil SAD	↓

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
80.	Magnetic - Heads (all types), Ceramic / Magnetic cartridges and stylus, Antennas, EHT cables, Level meters/level indicators/ tuning indicators/ peak level meters/ battery meter/VC meters / Tape counters, Tone arms, Electron guns	Nil BCD	Applicable BCD	↑
81.	To exclude specified telecommunication equipment [Soft switches and Voice over Internet Protocol (**"VoIP"**) equipment namely VoIP phones, media gateways, gateway controllers and session border controllers, Optical Transport equipment; combination of one / more of Packet Optical Transport Product/Switch (**"POTP/POTS"**), Optical Transport Network(**"OTN"**) products, and IP Radios, Carrier Ethernet Switch, Packet Transport Node (**"PTN"**) products, Multiprotocol Label Switching-Transport Profile (**"MPLS-TP"**) products, Multiple Input / Multiple Output (**"MIMO"**) and Long Term Evolution (**"LTE"**) Products on which 10% BCD was imposed in 2014-15 Budget being non-ITA I bound] from the purview of the other exemption.	Nil BCD	10%	↑
82.	Preform of silica for manufacture of telecom grade optical fibre /cables	Nil	10%	↑
83.	Specified capital goods and inputs for use in manufacture of Micro fuses, Sub-miniature fuses, Resettable fuses, and Thermal fuses	Applicable BCD	Nil	↓
84.	Neodymium Magnet (before Magnetization) and Magnet Resin (Strontium Ferrite compound/before formed, before magnetization) for manufacture of BLDC motors, subject to actual user condition	Applicable BCD	2.5%	↓
85.	Populated PCBs for manufacture of personal computers (laptop or desktop)	Nil SAD	4% SAD	↑
86.	Populated PCBs for manufacture of mobile phone/tablet computer	Nil SAD	2% SAD	↑
	Metals, glass and ceramics			
87.	Silica sand 5%	2.5%	↓	
88.	Brass scrap 5%	2.5%	↓	
89.	Other aluminium products	7.5%	10%	↑
	Jewellery			
90.	Gold dore bars	8% CVD	8.75% CVD	↑
	Automobiles			
91.	Golf cars	10%	60%	↑

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
92.	Specified parts of electric and hybrid vehicles	BCD-Nil CVD – 6% Up to 31.03.2016	BCD-Nil CVD – 6% Without time Limit	↑
93.	Aluminium Oxide for use in the manufacture of Wash Coat, which is used in the manufacture of catalytic converters, subject to actual user condition	7.5%	5%	↓
94.	Engine for xEV (hybrid electric vehicle)	Applicable BCD and CVD	Nil BCD 6% CVD	↓
	Capital goods			
95.	Specified machinery required for construction of roads	CVD – Nil	CVD – 12.5%	↑
	Defence production			
96.	Direct imports of specified goods by Government of India or State Governments, with effect from 01.4.2016	BCD Nil CVD – Nil SAD – Nil	Applicable BCD, CVD and SAD	↑
97.	Imports of specified goods for defence purposes by contractors of the Government of India, PSUs or sub-contractors of PSUs, with effect from 01.4.2016	BCD Nil Applicable CVD and SAD	Applicable BCD, CVD and SAD	↑
	Maintenance, repair and overhaul [MRO] of aircrafts			
98.	Tools and tool kits when imported by MROs for maintenance, repair, and overhauling [MRO] of aircraft subject to a certification by the Directorate General of Civil Aviation	Applicable BCD, CVD and SAD	Nil BCD Nil CVD Nil SAD	↓
	Simplify the procedure for availment of exemption from customs duties on parts, testing equipment, tools and tool-kits for maintenance, repair and overhaul of aircraft based on records and subject to actual user condition			
	Remove the restriction of one year for utilization of duty free parts for maintenance, repair and overhaul of aircraft			
	Further relax the existing conditions of stay [up to 60 days], so as to provide for stay up to 6 months of the foreign aircraft for maintenance, repair or overhauling, and provide for further extension of such period by DGCA as deemed fit			
	Ship repair units			
99.	Capital goods and spare thereof, raw materials, parts, material handling equipment and consumable for repairs of ocean-going vessels by a ship repair unit subject to actual user condition.	Applicable excise duty	Nil	↓

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Sr. No.	Description	Pre-Budget Rate	Post Budget Rate	Change
	Simplify the procedure for availment of exemption from Basic Customs Duty, CVD and SAD by ship repair units based on records and subject to actual user condition			
	Miscellaneous			
100.	Braille paper	10%	Nil	↓
101.	Disposable sterilized dialyzer and micro barrier of artificial kidney	Applicable BCD, CVD, SAD	Nil BCD Nil CVD Nil SAD	↓
102.	Solar tempered glass / solar tempered (anti-reflective coated) glass, subject to actual user condition	Nil	5%	↑
103.	Medical Use Fission Molybdenum-99 imported by Board of Radiation and Isotope			
	Technology (**“BRIT”)** for manufacture of radio pharmaceuticals	7.5%	Nil	↓
104.	Pulp of wood for manufacture of sanitary pads, napkins & tampons	5%	2.5%	↓
105.	Super Absorbent Polymer when used for the manufacture of sanitary pads, napkins & tampons	7.5%	5%	↓
106.	Merge the exemptions from customs duties on specified goods imported for petroleum exploration under various types of licenses or mining leases, pre-NELP contracts, NELP contracts, Marginal Fields Policy and the Coal Bed Methane Policy into a single exemption with a unified list of specified goods and conditions	Nil BCD Nil CVD Nil SAD	Nil BCD Nil CVD Nil SAD	=
107.	Specified goods required for exploration & production of hydrocarbon activities undertaken under PEL or ML issued or renewed before 1st April 1999	Applicable BCD, CVD, SAD	Applicable BCD, CVD, SAD	
108.	Prescribe actual user condition for the imports of Phosphoric Acid and Anhydrous Ammonia at concessional BCD/CVD for manufacture of Fertilizers			
109.	Prescribe actual user condition for imports of LCD/LED/OLED Panels imported at Nil BCD for manufacture of LCD/LED/OLED TVs			
110.	“Foreign Satellite data” on storage media when imported by National Remote Sensing Centre (**“NRSC”**), Hyderabad	Applicable BCD, CVD, SAD	Nil BCD Nil CVD Nil SAD	

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2. **Exemptions of customs duty**

   The following key exemptions have been effected on the front of exemptions available under customs duty:

   i. The levy of Basic Customs duty (**"BCD"**), Countervailing Duty (**"CVD"**) and Additional Customs Duty (**"SAD"**) have been wholely exempted on the import of tools and tool kits, when imported by maintenance, repair and overhauling entities (**"MROs"**), for maintenance, repair, and overhauling of aircraft, foreign satellite data on storage media when imported by National Remote Sensing Centre, Hyderabad, Parts and components, subparts for manufacture of routers, broadband modems, set-top boxes, CCTV camera, lithium ion battery (other than those for mobile handsets), inputs, parts and components, subparts for manufacture of charger / adapter, battery and wired headsets / speakers of mobile phones and specified goods required for exploration and production of hydrocarbon activities undertaken under petroleum exploration licenses or mining leases issued or renewed before April 01, 1999.

   ii. BCD rate on the import of aluminium oxide for use in the manufacture of wash coat, which is used in the manufacture of catalytic converters, has been reduced from 7.5% to 5%

   iii. The rates of CVD have been amended from 8% to 8.75% on gold dore bars and from 7% to 7.75% on silver dore.

   iv. In respect of 'media with recorded information technology software', exemption from payment of CVD is provided to the extent of the taxable value on which Service Tax is leviable under Section 66B read with Section 66E of the FA. This is aimed at bringing certainty in taxation and is a welcome move.

3. **Thrust on the Ease of Doing Business**

   Various substantive and procedural laws have been amended vide Clauses 113 to 136 of the Finance Bill, with a view to promote the ease of doing business in India, which has been a major theme in the Budget. This includes enhancement in the powers of CBEC to take quicker actions and substantive and procedural simplifications of various requirements under the Customs laws in order to make business in India easier.

- **Substantive changes in the Customs Laws**

i. It is proposed to amend section 53 of the Customs Act, 1962 (**"Act"**), dealing with the transit of certain goods without payment of duty, so as to subject such transit to such conditions as may be prescribed.

   The said proposal is intended to empower the Central Board of Excise and Customs (**"CBEC"**) to frame regulations in relation to transit of goods without payment of duty.

ii. It is proposed that section 8C of the Customs Tariff Act, 1985 (**"Tariff Act"**), which empowers the Government to impose safeguard duty on Import of goods from People's Republic of China (**"China"**), causing or threatening to cause material injury to the domestic producers of like goods, is proposed to be omitted.

   Section 8B of the Tariff Act provides for product specific Safeguard duty whereas Section 8C deals with transitional safeguards mechanism under Article 16 of China's Accession Protocol, which was granted to WTO members the time of the extension of WTO membership to China. Under the said mechanism, the WTO members were empowered to take emergency measures in the nature of levy of transitional safeguard duty on imports from China. However, on account of the expiry of such grant in December 2013, the said section has been proposed to be amended.

   Further, in effect thereto, notifications issued by the Government of India relating to Advance License and Duty Free Import Authorization which involved the levy of safeguard duty with references to the said section have been proposed to be amended

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so as to exclude section 8C and specify only section 8B.

Changes in warehousing provisions

iii. The Customs Act is proposed to be amended to include a new class of warehouses within the definition of "warehouse".

These new class of warehouses, contrary to the general record based control over warehouses, would require continued physical control of the department and would be licensed for storing specified goods.

iv. The licensing of warehouses by the Principal Commissioner or Commissioner, in place of Deputy/Assistant Commissioner has been proposed.

v. New regulations are proposed to be introduced with respect to the process of cancellation of warehousing licences granted under section 57, 58 and 58A.

vi. The bond amount for duty deferred warehousing is proposed to be enhanced from twice to thrice the amount of duty involved. Further, it is proposed that a security also be furnished for availing such facility.

vii. The date shall be the date of the order made by the proper officer permitting the removal of goods from a customs station for the purpose of deposit in a warehouse is proposed to be the date of removal of goods from the customs station.

viii. It is proposed to extend the period of warehousing of goods used by Export Oriented Undertakings, Units under Electronic Hardware Technology Parks, Software Technology Parks, Ship Building Yards and other units manufacturing under bond. Further, the Principal Commissioners and Commissioners have been empowered to extend the warehousing period up to one year at a time.

ix. It is proposed that warehousing services be privatized, and rent of warehouses be determined by way of free market determination of rates.

x. The rights of the owner with respect to warehoused goods is proposed to be to be extended.

xi. It is proposed that the Principal Commissioner of Customs / Commissioner of Customs instead of the Deputy / Assistant Commissioner of Customs be empowered to grant permission to manufacture and carry out other operations in relation to goods in the warehouse.

xii. The fees payable to the custom authorities for supervision of manufacturing facilities under Bond is proposed to be done away with. Such payment is proposed to be made to the custodian of the warehouse.

xiii. It is proposed to provide for cancellation of bond in case of transfer of ownership of the goods, and thereby align the said section with sub-section (5) of section 59.

xiv. Provisions pertaining to the responsibilities and liabilities of warehouse keepers or custodians are proposed to be introduced.

It appears that the appointment of the Principal Commissioner of Customs / Commissioner of Customs as the decision making authority may speed up the whole process thereby, facilitating the ease of doing business. However, it may lead to a rise in corruption in as much as the actual processing of files would be undertaken by the lower officers. Further, with the privatization of warehouses, rent charges payment may not be linked with compliances for the purpose of licensing as rent would now be a matter of concern for the owner of the warehouse as opposed to that of the department under the erstwhile regimes. In toto the proposed modifications to the warehousing regime are a welcome change. However, only time will tell how it pans out on a functional level.

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xv. It is proposed to introduce provisions for deferred payment of customs duties for importers and exporters with a proven track record. Further, it is proposed that where an exporter fails to pay export duty by the due date, he be required to pay interest at the prescribed rate.

xvi. The Central Government is proposed to be empowered to make rules relating to the due date and manner of making deferred payment of duties, taxes, cesses or any other charges under Sections 47 and 51.

- **Procedural Simplifications**

i. The Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 1996, have been replaced effective from April 01, 2016.

As per the new rules, a manufacturer shall not have to obtain a specific registration from the jurisdictional Central Excise Officer, to claim benefit under an exemption notification issued under Section 25(1) of the Customs Act. The manufacturer shall only be required to make a self- declaration to avail such benefit. Such self-declaration is required to set out details such as the name, address, details of excisable goods produced and the nature and description of the imported goods used in manufacture. Further, the time limit for the re-export of the defective or unutilized imported goods by a manufacturer availing the benefits under the said rule, has been reduce to three months as opposed to six months as prescribed under the erstwhile rule.

The relaxation with respect to specific registration requirements appears to be a progressive amendment treading towards the ease of doing business. However, the reduction of the time limit for re-export of unutilized or defective goods may lead to difficulties for the manufacturer at a functional level.

ii. The Baggage Rules, 1998 have been substituted with Baggage Rules of 2016

Country of Origin	Eligibility	Allowances (Duty free)
Nepal, Bhutan and Myanmar (arrival by land)	All passengers	Used personal effects
Other that Nepal, Bhutan and Myanmar	Passengers of Indian origin and foreigners residing in India (excluding infants)	• Used personal effects • Travel souvenirs • Articles up to INR 50,000
	Tourists (foreign origin, excluding infants)	• Used personal effects • Travel souvenirs
	Infant	• Articles up to INR 15,000
Nepal, Bhutan and Myanmar (arrival by sea/air)	All passengers (excluding infants)	Used personal effects • Used personal effects • Travel souvenirs • Articles up to INR 15,000
	Infant	Used personal effects

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iii. Vide the new Rules, entitlement to duty free allowances have been provided to any passenger over 2 years of age as opposed to 10 years in the erstwhile rules.

iv. Jewellery would be excluded from the definition of personal effects. Therefore, all personal Jewellery brought in by an incoming passenger whether carried on person or accompanied in the baggage shall be dutiable.

v. The Customs Baggage Declaration Regulations, 2013 are proposed to be amended (with effect from April 01, 2016) to provide that only those passengers who come to India and have anything to declare or are carrying dutiable or prohibited goods will be required to file a declaration in terms of the said amended Regulations.

IV. CENVAT CREDIT RULES

The CCR, being the backbone of central indirect taxes, has been in dire need of change, post broadening of the tax base by various amendments in the past. With GST in the horizon, Budget has sought to bridge the gap between the broad-based output tax regime and the relatively narrower allowance of credits on the input side. In this regard, changes have also being made to the provisions relating to input service distributor, including extension of this facility to transfer input services credit to outsourced manufacturers, under certain circumstances. The amendments in the CCR will also enable manufacturers with multiple manufacturing units to maintain a common warehouse for inputs and distribute inputs with credits to the individual manufacturing units. Further, the general theme of the amendments to the CCR has been in the nature of beneficial amendments to the availability of credits on various activities which was not allowed prior to the introduction of Budget.

The major highlights and implications of the largest scale changes to the CENVAT structure in recent memory has been discussed as under.

1. Changes under the definition clause

Various definitions under the CCR have been amended. In many cases, the change has effected the credit seam positively. The changes proposed to the definitions under the CCR are:

- **The definition of “capital goods” has been amended:**

i. Wagons falling under Sub-heading 860692 have been explicitly mentioned as capital goods. This overcomes the decision of the Hon’ble CESTAT, Mumbai[9] which had held that wagons under Chapter 86 cannot be considered as capital goods.

ii. Restriction of credit with regard to “the equipments and appliances used in an office” has been done away with.

iii. Pumping of water for captive use has also been specifically included under the definition of capital goods. This has been done to overcome the decision of the Larger Bench of the Hon’ble CESTAT, Delhi[10] which had disallowed credit on such goods.

- The definition of “exempted service” has been amended and the phrase 'services by way of transportation of goods by a vessel from customs station of clearance in India to a place outside India', has been excluded. Services not taxable per se as per Rule 10 of POP Rules as destination of goods outside India, however, reversal not required to be undertaken for services provided by way of transportation of goods from Indian customs station to outside India. Consequential amendments also carried out in Rule 6(7).
- The definition of the term “inputs” has been amended to include within its scope 'capital goods' which have a value up to ten thousand rupees per piece. This amendment also clarifies that goods used for the 'pumping of water' would be construed as inputs.
- The scope of applicability of the term “input service distributor” has been extended to an office of an “outsourced manufacturing unit”.

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[9] Bulk Cements Corporation (India) Ltd. vs. CCE, 2013 (294) ELT 433 (Tri-Mum)
[10] Vikas Industrial Gas vs. CCE, 2000 (118) ELT 257 (Tri. - Delhi).

2. **Key Amendments**

   - **Mechanism of Reversal under Rule 6**

     Rule 6 has been substantially amended with a view to remove ambiguities and associated litigation. The major highlights and implications of such changes have been discussed below:

i. Manufacturers exclusively engaged in manufacturing of exempted goods or service providers who exclusively provide exempted services shall not be eligible for credit of any inputs and input services

ii. Manufacturers engaged in manufacturing both exempted and non-exempted goods or service providers engaged in providing both exempted and non-exempted services, can follow any one of the following options for reversal of ineligible CENVAT Credit:

   - Pay an amount equal to six per cent of value of the exempted goods and seven per cent of value of the exempted services. However, such payment is now limited to the total credit available with the assessee at the end of the period to which the payment relates.
   - Several judicial precedents have held this principle in the past.[11]
   - Pay an amount of ineligible CENVAT Credit as determined under sub-rule (3A) as per the steps provided below:

   - Ineligible Credit (A): CENVAT Credit attributable to inputs and input services used exclusively in or in relation to the manufacture of exempted goods / exempted services to be treated as ineligible credit and shall be reversed
   - Eligible Credit (B): CENVAT Credit attributable to inputs and input services used exclusively in or in relation to the manufacture of non-exempted goods / non-exempted services to be treated as eligible credit and shall not have to be reversed
   - Common Credit (C = Total Credit less A less B): CENVAT Credit left after attribution of the above eligible and ineligible credits shall be called as "common credits". Out of this common credit, credit proportionately attributable towards value of exempted goods / services is to be treated as ineligible common credit and shall be required to be reversed and balance may consequently be availed.
   - The formula to be applied to calculate 'ineligible common credit' denoted as D shall be $D = (E/F) \times C$.

     Where E is the sum total of - (a) value of exempted services provided and (b) value of exempted goods removed

     F is the sum total of - (a) value of non-exempted services provided, (b) value of exempted services provided, (c) value of non-exempted goods removed, and (d) value of exempted goods removed.
   - Payments under Rule 6(3A) are to be undertaken provisionally every month based on values of the preceding FY. An amount equal to difference between provisional ineligible credits and actual ineligible credits shall be required to be paid (on or before the 30th June of the succeeding FY) along with interest at 15% (previously 24%) with respect to shortfall of payment, if applicable.
   - New provision to provide that where a manufacturer or a provider of output service has failed to exercise the option under sub-rule (3) and follow the procedure provided under sub-rule (3A), the jurisdictional Central Excise Officer, may, at his discretion, based on amount of CENVAT Credit involved, allow proportionate reversal in terms of Rule 6(3A) with interest calculated at the rate of 15% per annum from the due date till the date of payment thereof. This provision aims to overcome decision of the Hon'ble CESTAT, Mumbai[12] which held that

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[11] Sirpur Paper Mills Ltd. vs. Commissioner of C. Ex., Hyderabad, 2006 (205) ELT 188 (Tri. - Bang.); Hindustan Coca Cola Beverages v. CCE, Guntur, 2015 (329) E.L.T. 408 (Tri. - Bang.)
[12] Mercedes Benz India Pvt. Ltd. vs. CCE, Pune – I, 2015 (40) STR 381 (Tri. - Mum.)

Revenue cannot insist on availment of a particular option and procedural lapse in intimation to avail option under Rule 6 would not disentitle the assessee to opt for the exercise of option as per Rule 6(3A)(ii).

This amendment requires the identification of those input services which have been used exclusively for non-exempted goods or non-exempted services. In case such credit is not identified the CENVAT Credit towards such input services would form part of common credit pool and therefore would result in higher reversal of CENVAT Credit. There used to be doubts regarding the computation of proportionate credit as prescribed under Rule 6(3A). In a relevant stay order, the Hon'ble CESTAT, Mumbai expressed the prima facie view that in terms of sub-rule (3A), the ratio is to be applied on total credit and not on common credit.[13] However, a conflicting decision of the Hon'ble CESTAT, Bangalore stated that the ratio is to be applied on the common credit pool, and not on the total credit.[14] This confusion resulted in various disputes, wherein the authorities initiated proceeding against those computing reversal based on common credits. This issue has now been laid to rest, with specific amendment in this regard.

iii. A banking and financial institution including non-banking financial company, engaged in providing services by way of extending deposits, loans or advances, will have either of the following options for reversal of CENVAT Credit:

- Reversal in terms of amended Rule 6(3) i.e. seven percent of value of the exempted services
- Proportionate reversal under Rule 6(3A)
- Pay for every month an amount equal to 50% of the CENVAT Credit availed on inputs and input services in the month.

iv. Further, amendment to sub-rule 4 of Rule 6 of the CCR provides that where the capital goods are used for the manufacture of exempted goods or provision of exempted service for two years from the date of commencement of commercial production or provision of service, no CENVAT Credit shall be allowed on such capital goods. This amendment is to overcome the decision of Hon'ble CESTAT, Delhi[15] wherein it was held that the usage of the capital goods, irrespective of any time limit, for both taxable and exempted activities is not the requisite criteria to avail the CENVAT Credit on the capital goods.

v. Credit taken on inputs and input services used in providing a service by way of transportation of goods by a vessel from customs station of clearance in India to a place outside India shall not be required to be reversed by shipping lines. In any case, the service of transportation of goods by a vessel to a place outside India is presently not taxable in view of Rule 10 of the POP Rules, which determines the place of provision of service as the place of destination of the goods. Thus, this amendment coupled with the corresponding amendment in the definition of exempted service is aimed at allowing credit of eligible inputs, input services and capital goods for providing the said service.

- **Mechanism of Input Service Distribution**

With a view to improve credit flows between different manufacturing / service locations, Rule 7 dealing with distribution of credit on input services by an Input Service Distributor is being completely rewritten by way of substitution of the existing Rule 7 of the CCR.

i. ISD can now distribute CENVAT Credit to 'outsourced manufacturing units' also in addition to their own manufacturing units.

ii. Outsourced manufacturing unit' has been defined to mean either:

- A job-worker who is required to pay duty on the value determined under the provisions of Rule 10A of the CE Valuation

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[13] Thyssenkrup Industries Pvt. Ltd. vs. CCE, 2014 (310) ELT 317 (Tri-Mum)
[14] IBM India (Pvt.) Ltd. v. CCE, Bangalore-LTU, Final Order No. 20300/2015 dated February 11, 2015
[15] Brindavan Beverages Pvt. Ltd. vs. CCE, Meerut, 2014-TIOL-2136-CESTAT-DEL.

Rules, on the goods manufactured for the Input Service Distributor

- A manufacturer who manufactures goods, for the Input Service Distributor under a contract, bearing the brand name of the Input Service Distributor and is required to pay duty on the value determined under the provisions of Section 4A of the CE Act.

This is a welcome move towards ensuring the seamless flow of credits. It is interesting to note that this amendment results in the overcoming of the decision[16] of the Hon'ble CESTAT, Mumbai wherein the Tribunal denied the availment of CENVAT Credit by a job worker against the ISD invoice issued by the principal manufacturer.

iii. The provisions of Rule 6 of the CCR relating to reversal of credit in respect of inputs and input services used in manufacture of exempted goods or for provision of exempted services, shall not apply to the ISD. This is a welcome change as the amendment seeks to dispel the doubts as to the inter-play between the operation of Rule 6 and Rule 7 by unambiguously stating that Rule 6 is not to be applied by an ISD while distributing the credit. It is the unit to whom the credit has been distributed, is to apply Rule 6 upon receiving the distributed credit.

iv. Further, new provisions have been inserted in the CCR to enable manufacturers with multiple manufacturing units to avail the CENVAT Credit on the basis of Excise invoice issued by the warehouse storing raw material, packing material etc. of the said manufacturer. Procedure as applicable to a first stage dealer or a second stage dealer would apply, *mutatis mutandis*, to such a warehouse of the manufacturer. The introduction of Rule 7B for permitting distribution of credit pertaining to inputs is intended to make the CCR more comprehensive in coverage.

- **Changes in the Conditions for Availing credit**

i. The CCR has been amended to restrict the credit of duties/taxes, except credit of NCCD, for payment of NCCD. Earlier, the 5th proviso to Rule 3(4) provided that CENVAT Credit of only NCCD can be utilized for payment of NCCD, except for credits of specified duties on specified goods, which has now been done away with.

ii. The facility of hundred per cent CENVAT Credit of capital goods as available to small scale industrial manufacturer having clearance within the threshold limit of INR 4 Crore is also extended to the Gems and Jewellery Sector. However, the threshold limit for the Gems and Jewellery Sector has been pegged at INR 12 Crore.

iii. CENVAT Credit on jigs, fixtures moulds and dies or tools sent to a job worker or another manufacturer would also be allowed where such goods are sent without bringing the same to the premises of the Assessee. In this regard, the decision[17] of the Hon'ble CESTAT, Mumbai, it was held that availment of credit in respect of materials directly purchased / received by the job worker without receiving the goods in their premises was implied and not explicitly provided in the CCR. Now, this has been explicitly provided.

iv. CENVAT Credit of Service Tax in respect of services provided by way of assignment of "right to use" any natural resources shall be spread over the period for which the "right to use" has been assigned. In this regard, the amount of CENVAT credit available is to be determined as under:

- Amount of CENVAT Credit that shall be taken in a FY = Service Tax paid on the charges payable for the assignment of the right to use / No. of Years for which the rights have been assigned.
- Full credit available in case such rights are further assigned to another person against a consideration.
- In respect of annual or monthly user charges, the credit shall be allowed in the same FY in which they are paid.

v. Credit can now be availed basis invoice issued by a 'Service Provider' for clearance of

[16] Sunbell Alloys Co. Of India Ltd. vs. CCE, Belapur, 2014 (34) STR 597 (Tri. - Mumbai).
[17] Eaton Fluid Power Ltd. vs. CCE, 2014 (308) ELT 602 (Tri-Mum)

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inputs or capital goods as such. Earlier, only the invoice issued by a 'manufacturer' for removal of inputs or capital goods as such was prescribed as valid document for availment of credit.

vi. The existing Rule 9A, which required furnishing declaration by 30th April of each FY by a manufacturer, has been amended. As per the amended Rule 9A, a manufacturer of final products or provider of output services, shall be required to submit to the Superintendent of Central Excise, an annual return in the prescribed format for each financial year, by the 30th day of November of the succeeding year.

vii. Time limit for filing of application for refund of CENVAT Credit in Form A of under Rule 5 of CCR has been amended. Accordingly, the new time limits are as follows:

- In case of a 'manufacturer', the time limit to file a refund claim will be as per the period specified in Section 11B of the CE Act.
- In case of 'services provider', the time limit will be one year from the date of
  - Receipt of payment in convertible foreign exchange where the provision of services has been complete prior to receipt of payment.
  - The date of issue of invoice, where payment for the service has been received in advance prior to the date of issue to invoice.

The amendment in the notification seeks to separately and explicitly provide the manner of computation of time limit in respect of service providers.

V. COMMON CHANGES UNDER SERVICE TAX, CENTRAL EXCISE & CUSTOMS LAWS

1. Rationalization of interest rates

Interest payable on delay in payment of Excise duty, Customs duty and Service tax has been rationalised to 15% per annum from the date of enactment of the Finance Bill. The revised rates of interest are as follows:

Levy	Duration of delay from date of payment	Existing	Proposed
Excise duty	Entire period of delay	18%	15%
Customs duty	Entire period of delay	18%	15%
Service tax	First 6 months	18%	15% However, if Service tax is collected but not deposited then 24% The aforesaid proposed rate of 15% would be reduced to 12% for assesses with value of taxable services less than INR 60 Lakhs in the preceding financial year.
	Beyond first 6 months up to next 6 months	24%	
	Beyond 1 year	30%	

2. Extension of limitation period

The limitation period for the recovery of Customs, Central Excise and Service tax is proposed to be increased as follows with effect from the date enactment of the Finance Bill:

Sr. No.	Situation	Existing	Proposed
Customs and Central Excise	In case of fraud, collusion, willful misstatement etc.	5 years	5 years
	Other cases	1.5 years	2 years
Service Tax	In case of fraud, collusion, willful misstatement etc.	5 years	5 years
	Other cases	1.5 years	2.5 years

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Increase in the time limit for initiation of proceedings on a tax payer in cases where he is not accused for any *malafide* seems to be a cover for lethargic attitude of indirect tax authorities.

3. **The Indirect Tax Dispute Resolution Scheme, 2016**

With a view to reduce the pendency of matters before the Commissioner (Appeals) and in turn the burden on the Appellate Tribunal, the Finance Bill has proposed a dispute resolution scheme termed as The Indirect Tax Dispute Resolution Scheme, 2016 (**"ITDR"**).

ITDR is proposed to be effective from June 01, 2016 with the following salient features:

- **Scope**

i. **Applicability**

ITDR would be applicable for all disputes in respect of the Customs Act, CE Act and FA, which would be pending before the Commissioner (Appeals) as on March 01, 2016

ii. **Exclusions**

However, ITDR would not apply to the following cases:

- Where the order appealed to Commissioner (Appeals) is in respect of
  - search and seizure proceedings;
  - narcotic drugs or prohibited goods; or
- offences punishable under the Indian Penal Code, Prevention of Corruption Act etc; or
- Where prosecution is initiated before June 01, 2016

iii. **Period for declaration:** June 01, 2016 to December 31, 2016

iv. **Amount payable:** Amount of Customs duty/ Excise duty/ Service tax along with applicable interest and 25% of the amount of penalty imposed

- **Benefits:**

i. The authority, not below the rank of Assistant Commissioner shall pass an order of discharge of dues;

ii. The appeal pending before Commissioner (Appeals) would stand disposed;

iii. The declarer would be immune from all proceedings including prosecution;

iv. The order passed under ITDR would be final and shall not be subjected to be reopened; and

v. The order passed under ITDR would have no binding effect.

4. **Deemed conclusion of proceedings**

It is proposed to include a provision for deemed conclusion of proceedings against the directors, etc. where tax / duty along with interest and the proposed penalty is paid within 30 days of issuance of the show cause notice. This change will be with effect from the date enactment of the Finance Bill.

VI. CENTRAL SALES TAX

Gas sold or purchased and transported through inter-state pipelines has been deemed to be movement of goods from one state to another, and have been thus made liable to Central Sales Tax as an inter-state sale. This amendment shall come into force once the Finance Bill is passed. This amendment is aimed to rest various litigations across the country and provide tax certainty and overcome situations where state VAT authorities have proceeded against assessees for inter-state supply of gas for intra-state sale within the respective states. In this connection, the Hon'ble High Court of Allahabad dealing with this issue in the case of **Reliance Industries Limited vs. State of U.P.**[18] held that so long as the seller injects the gas into the pipeline in one State, and the buyer receives an equivalent quantity of the gas in another State, the transaction would qualify as an inter¬state sale liable to CST. The amendment reinforces the judgement of the Hon'ble High Court. However, it may be noted that the Revenue has thereafter preferred an appeal against the decision of the High Court, which is pending before the Hon'ble SC.

[18] Reliance Industries Limited vs. State of U.P. , [2012]-VIL-66-ALH

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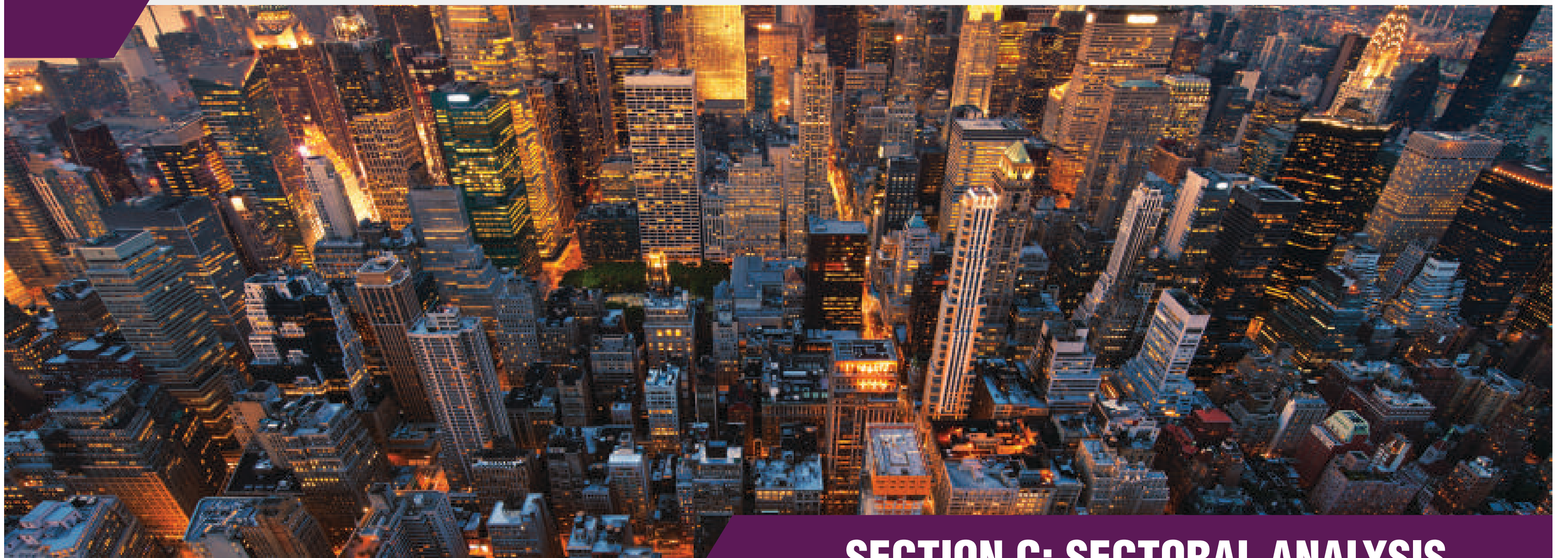

SECTION C: SECTORAL ANALYSIS

I. INFRASTRUCTURE

1. Policy related developments

The key highlights for the infrastructure sector as per the Budget Speech are as follows.

a. PPP

Three new initiates have been announced to incentivize and boost private sector participation in infrastructure sector:

i. Public Utility (Resolution of Disputes) Bill to streamline processes for dispute resolution in infra contracts including construction contracts, concession contracts and other public utility contracts;

ii. Guidelines for renegotiation of PPP Concession Agreements, to enable renegotiation of long term concessions which may be affected by unforeseen events/uncertainties, without affecting transparency;

iii. New credit rating system for infrastructure projects which will not be guided by standard perceptions of risk, but will emphasize upon in-built credit enhancement structures.

b. Power

With a view to diversify sources of power, a 15-20 year plan is being prepared to tap the nuclear power potential of the country, including budgetary allocation of about INR 30 billion per annum. Further, the Government will permit mobilization of additional finances to the extent of INR 313 billion by various public sector utilities such as NHAI, PFC, REC, IREDA, NABARD and Inland Water Authority by way of bond issues in 2016-17.

c. Roads and Railways

With a view to speed up road construction processes, it has been proposed that INR 550 billion will be allocated for roads and highways in the Budget, along with a top up of INR 150 billion to be raised by NHAI through bonds. Coupled with the Pradhan Mantri Tram Sadak Yojna allocation, this would bring the total investment in road sector to approximately INR 970 billion during 2016-17. Further, approximately 10,000 km of national highways are proposed to be approved and about 50,000 km of State Highways are also proposed to be upgraded to National Highways in 2016-17. In relation to passenger traffic, it is proposed to enact amendments in the Motor Vehicles Act with a view to opening up the road sector including enablers for operation of buses on various routes, more efficient public transport system, greater public convenience, abolition of permit raj. States will have a choice for adopting the new legal framework.

Total outlay on roads and railways will be INR 2180 billion in 2016-17.

d. Ports

About INR 8 billion has been allocated with the view of development of Greenfield ports both in eastern and western coasts of India. Works on National Waterways are also proposed to be expedited.

e. Oil & Gas

In view of the near stoppage of production and increased demand (including import demand) for natural resources such as oil and gas, proposals for diversification of discovery and exploration activities to access new areas which are yet to commence production of natural resources, and incentivizing gas production from unexploited areas (such as deep-water, ultra deep-water and high pressure-high temperature areas) is under consideration. The proposal would include provision of regulated marketing freedom and pre-determined ceiling price based on landed cost of alternative fuels.

f. Civil Aviation

With a view to revive unserved and underserved airports in various States and enhance regional connectivity, an action plan is being prepared whereby such revival can be undertaken along with the relevant State Governments. Further 10 of 25 non-functional air strips of AAI are proposed to be developed.

g. Government investment in new projects

With a view to enhance resources for investment in new projects by leveraging of assets of Central Public Sector Enterprises ("CPSE"), it has been

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decided to encourage CPSEs to divest individual assets such as land, manufacturing units to release their asset value thereby enabling investment in new projects. The Department of Disinvestment has been renamed as Department of Investment and Public Assets Management and the mechanism for Government investment is proposed to be enhanced in terms of efficiency by addressing issues such as capital restructuring, dividend etc.

2. **Tax related developments**

a. The benefit of additional depreciation of 20% on new plant and machinery currently available to enterprises engaged in power generation and distribution is proposed to be extended to enterprises engaged in power transmission. Please see paragraph II(6) in Section A of this document for a detailed analysis of the same.

b. There have been specific relaxations on account of restoration of exemptions for construction and related services provided to government sector, ports, airports, etc. New exemptions have been proposed to facilitate the commitment of the Government of "Housing for All" by the year 2020.

c. A special cess, i.e. the Infrastructure Cess, has also been introduced on manufacture of specified vehicles which shall cater towards the Government's impetus towards infrastructure development.

d. The Clean Energy Cess has been renamed the Clean Environment Cess and the rates have been specifically increased to cater to the commitment of the government in the Swachh Bharat Abhiyan. The government has also furthered its commitment towards a special focus on development of clean and sustainable power, and has accordingly decreased the rates of Central Excise duty on various products and capital goods catering to the renewable energy sector.

e. Concessional rates of duty announced to promote inter alia food processing, agriculture and renewable energy sectors, in line with the Central Government's agenda to "Make in India".

As has been a regular feature in every Budget, Excise Duty on aerated beverages, tobacco and tobacco products increased with immediate effect. Further, concessional rates of customs duty announced to promote inter alia fossil fuel sector, textiles sector and goods used in maintenance, repair and overhaul of vessels and aircrafts. Customs Duty on jewellery, renewable energy sector, specified automobiles, certain capital goods and parts thereof, etc. has been increased with immediate effect, in line with a thrust on the Government's flagship "Make in India" Scheme.

II. INVESTMENT FUNDS

1. **Policy related developments**

a. **FDI permitted into AIFs**

Following the FM's Union Budget Speech in February 2015 in which he proposed to allow foreign investment in AIFs, on November 16, 2015, the RBI amended the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 (**"FEMA 20"**) by, amongst other things, inserting a new Schedule 11 to permit foreign investment under the automatic route (i.e. without the requirement of prior regulatory or government approval) in entities registered and regulated under relevant regulations of SEBI or any other relevant authority, including, amongst others, AIFs. Schedule 11 sets out the conditions applicable to an AIF that accepts foreign investment. Schedule 11 was further amended on February 15, 2015 and states, amongst other things, the following:

i. Persons resident outside India, including FPIs and NRIs, can invest in units of AIFs, for which payment must be made by way of inward remittance through normal banking channels including by way of debit through NRE or FCNR account.

ii. While NRIs can invest in such units through its NRE or FCNR account as stated in Schedule

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11, Schedule 4 has also been amended vide notification dated February 15, 2016 pursuant to which NRIs may acquire units of investment vehicles (including AIFs) through their NRE, NRO or FCNR accounts.

iii. Downstream investment by an AIF will be regarded as 'foreign investment' if either the sponsor or the manager is not Indian 'owned and controlled' as defined under Regulation 14 of FEMA 20. If the foregoing condition is not satisfied, in making investments such AIF will have to comply with the sectoral caps and conditions and/or restrictions as applicable to the investee company of the AIF per the FDI Policy or Schedule 1 of FEMA 20. In cases where the abovementioned condition is satisfied, the AIF may make investments in such sectors and in such instruments as are permissible for an Indian resident investor. Therefore, the extent of foreign investment in the AIF will not be a factor in determining if its investments are to be treated as foreign investment (which has been expressly clarified). However, a Category III AIF with foreign investment (irrespective of the quantum) is permitted to make investments in only those instruments or securities in which an FPI is allowed to invest under FEMA 20.

iv. For sponsors or managers that are organized in a form other than companies or LLPs, SEBI has been given the power to determine whether such sponsor or manager is foreign owned or controlled. However, for AIFs whose sponsors and managers are individuals, the sponsors and mangers should be resident Indian citizens for the investments of the AIF to be treated as 'domestic' investments. Further, Schedule 11 states that 'control' of the AIF should be in the hands of the sponsor and the manager (with the general exclusion of others).

b. ODI by AIFs

In furtherance of RBI's circular dated December 9, 2014 permitting purchase of foreign securities by AIFs subject to the FEMA ODI Regulations and other terms and conditions as may be notified by the RBI and the SEBI from time to time, the SEBI issued a circular on October 1, 2015 (**"ODI Circular"**) permitting overseas investments by AIFs subject to the prior approval of the SEBI and fulfilment of certain conditions in the ODI Circular, which includes the following:

i. The investment by an AIF should be in equity and equity linked instruments of 'off-shore venture capital undertakings' (**"OVCU"**) being a foreign company whose shares are not listed on any recognised stock exchange in India or overseas.

ii. OVCU should have an 'Indian connection'. Though 'Indian connection' has not been defined in the ODI Circular, SEBI has by way of an example highlighted that an 'Indian connection' can be said to be present if a company has a front office overseas while its back office operations are carried out in India.

iii. Overseas investments by AIFs should not exceed 25% of the investible funds in case of a single AIF, and the combined limit for all AIFs and venture capital funds is USD 500 million (allocation for which will be on a first come-first served basis).

iv. SEBI approval is required for making overseas investment and the investment overseas needs to be made within 6 months from the date of approval.

2. Tax related developments

a. Exemption from DDT on income distribution by SPV to REIT and INVIT

The distributions made by the SPVs to REITs and INVITs, are proposed to be exempted from levy of DDT, subject to certain conditions. Please refer to paragraph II(5) of Section A in this document for a detailed analysis of the same.

b. Relaxation in safe harbour rules for offshore funds

Specific relaxations have been proposed in the safe harbour rules to extend their benefit to more funds, such as those specified countries / territories notified by the Central Government, or

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carrying out business from India. Please refer to paragraph III(5) of Section A in this document for a detailed analysis of the same.

c. Rationalisation of tax withholding provisions for AIF Category I and II

In order to rationalise the withholding tax regime, it is proposed that the person responsible for making the payment to the resident investor shall deduct tax at the rate of 10% and at the 'rates in force' where the payment is to a non-resident investor. It is also possible for the investor to obtain a lower withholding or a NIL withholding tax certificate from the tax authorities on the basis of which the fund may withhold taxes at the rate of either NIL or a lower rate. Please refer to paragraph XI(3) of Section A in this document for further details on the same.

d. Services by mutual fund agent / distributor has been removed from reverse charge

Services by agents and distributors of mutual fund or asset management companies were previously taxable under the Reverse Charge Mechanism in the hands of the mutual fund or asset management company. Now, these services are to be taxable in the hands of the agent or the distributor. This would reduce the cost of these services, as the services of the agents or the distributors operating below the threshold exemption shall not be taxable, which was previously taxable under the Reverse Charge Mechanism.

III. FINANCIAL SERVICES

1. Policy related developments

a. Reforms in Foreign Investment Policy

i. **Insurance and Pension Sectors:** The budget has proposed that foreign investment in the insurance and pension sectors will be permitted up to 49% under the automatic route. This will, however, be subject to such companies retaining Indian management and control. Such management / control tests will have to be determined based on guidelines issued by the respective regulators, i.e. IRDAI and PFRDA.

ii. **NBFCs:** Current regulations for FDI in NBFCs only allow investment in the automatic route only for 18 identified sectors. The budget proposes liberalization of norms for investment in NBFCs beyond these sectors for activities regulated by financial services regulators. The effect of this proposal on the NBFC sector could be huge. This could also provide a positive impact particularly on the newly evolving financial technology (fin-tech) sector which has been coming up in a significant way in the recent years.

iii. **ARCs:** ARCs will be allowed FDI up to 100%.

iv. **Stock Exchanges:** With a view to have Indian stock exchanges adopt global technology and market practice standards, investment limit for foreign entities in Indian stock exchanges is proposed to be enhanced from 5% to 15%. This will bring the foreign investment norms at par with the permitted domestic investment in these entities.

v. **Marketing of Food:** The budget proposes to allow up to 100% FDI under the automatic route for marketing food products produced and manufactured in India. In line with the broader theme of the budget this year, this liberalisation is intended to benefit farmers and incentivize the food processing industry.

vi. **Broadening of FDI Instruments:** In a significant announcement, the FM has proposed expansion of the recognised instruments through which FDI can be made to include 'hybrid instruments'. This measure will give much greater flexibility to investors in terms of choice of instruments.

vii. **FPI Investments:**

a. **FPI Investments in Security Receipts:** It is proposed that FPIs will now be allowed to invest in up to 100% of each tranche of security receipts issued by ARCs. These investments will however be subject to the sectoral caps that are applicable.

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b. **FPI Investment in listed CPSEs:** Investment limit for FPIs in Central Public Sector Enterprises is not proposed to be increased from 24% to 49%. Since this would under the current regime require shareholder (i.e. government) approval, this measure is intended to accelerate FPI investment limits in these enterprises.

c. **Investments in the bond market:** It is proposed that the Investment basket of FPIs will be expanded to include unlisted debt securities and pass through securities issued by securitisation SPVs.

b. Corporate Bond Market

In line with the long-term policy objective of the past few years, the Government has proposed numerous measures for the deepening of the corporate bond market in India and easing pressure on the Indian banking system. These include:

i. A proposal to set up a dedicated fund by the Life Insurance Corporation of India ('**LIC**") for the purpose of credit enhancement to infrastructure projects. The credit enhancement provided by this fund is intended to raise the credit rating of bonds issued by infrastructure companies, particularly for long term investment. Depending on the form and extent of credit enhancement permitted, this may provide borrowers in the infrastructure sector a viable alternative to multiple refinancing from banks and FIs under RBI's current regime.

ii. It proposed that RBI will issue guidelines to encourage large borrowers to access certain portion of their financing needs through market mechanisms instead of the banks.

iii. As noted earlier, it is proposed to allow FPI investment in unlisted debt securities and PTCs issued by securitisation SPVs.

iv. Other measure include setting up an electronic auction platform for primary debt offers (measures in this regard are already afoot with the SEBI having issued draft guidelines in the second half of 2015) and an information repository for corporate bonds, covering both primary and secondary market segments will be developed jointly by RBI and SEBI.

c. Financial Sector Reforms

Pursuant to the long term goals under the Financial Sector Legislative Reforms Commission (“**FSLRC**”) recommendations of 2014, the FM has proposed further phased reforms in the financial sector. The following initiatives were announced in the 2016 budget:

i. The budget announced a comprehensive code on resolution of bankruptcy in financial firms to be presented in parliament in 2016-17. This follows the Insolvency and Bankruptcy Code 2015 which was presented in the winter session of parliament in 2015, but excluded financial firms from its purview.

ii. Following the FSLRC recommendations, a financial data management centre is proposed to be set up under the Financial Stability Development Council (“**FSDC**”) to facilitate integrated data aggregation and analysis in the financial sector.

iii. Amendments are proposed in the SARFAESI Act to enable the sponsor of ARCs to hold up to 100% stake in the ARC and permit non-institutional investors to invest in securitization receipts issued by ARC. This is intended to ease the stressed asset related issues that have plagued Indian banks in the last few years.

iv. Additionally, the Finance Bill proposes amendments to the RBI Act 1934 to give RBI greater powers for monetary policy regulation through formation of an empowered committee for this purpose.

v. Other measures proposed include development of new derivate products by the SEBI as well as the RBI facilitating retail participation in government securities through stock exchanges and access to NDS-OM trading platform.

vi. It is also proposed to set up additional benches of the Securities Appellate Tribunal and strengthening of the Debt Recovery

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Tribunals through improvement of existing infrastructure.

d. RDBs

The RBI on September 29, 2015 issued guidelines on 'Issuance of Rupee denominated bonds overseas' (**"Rupee Bond Circular"**). Pursuant to the Rupee Bond Circular, any company or body corporate (including NBFCs), as well as real estate investment trusts and infrastructure investment trusts, can issue plain vanilla rupee denominated overseas bonds with a five-year minimum maturity period. These issuances can be listed or unlisted and may only be made in a FATF compliant jurisdiction and any investor from such a FATF compliant jurisdiction can invest in such RDBs.

Banks incorporated in India cannot subscribe to such RDBs; however, they can act as arrangers and underwriters for such issuances. There is no all-in cost ceiling for RDB issuances and pricing is in accordance with market conditions. The foreign currency to Rupee conversion will be at the market rate on the settlement date. Furthermore, investors are allowed to hedge their rupee exposure through permitted derivative products with: (a) an AD Bank in India; (b) the offshore branches or subsidiaries of Indian banks; or (c) branches of foreign banks with a presence in India.

The RBI, on November 30, 2015 released final guidelines on the revised ECB framework (**"Revised ECB Framework"**), which has classified ECBs under three categories:

i. medium term foreign currency denominated ECBs with minimum average maturity of 3 to 5 years (Track I);

ii. long term foreign currency denominated ECBs with minimum average maturity of 10 years (Track II); and

iii. Indian rupee denominated ECBs with minimum average maturity of 3 to 5 years (Track III).

The Revised ECB Framework permits more resident entities as eligible borrowers, recognises more entities as lenders and expands permitted end-use requirements as well as periodic reviews of-all in cost ceilings for such borrowings. Special carve-outs were also made to take care of sector specific needs.

The RBI thereafter issued the "Master Direction on External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers" dated January 1, 2016 which consolidated the Rupee Bond Circular and the Revised ECB Framework.

2. Tax related developments

a. Tax incentives to IFSC

In addition to the already existing incentive provided to IFSCs, it is proposed by the Finance Bill to provide additional incentives in terms of relaxed tax norms to encourage the set up of IFSCs so as to boost the financial and economic status of India and facilitate vibrant growth and development. Please refer to paragraph II(4) of Section A in this document for a detailed analysis of the same.

b. New Taxation Regime for securitization trust and its investors

The current system of taxation of securitization trusts is proposed to be amended to provide complete pass through to the securitization trust, including those securitization trusts that are created by ARCs. Please refer to paragraph XI(1) of Section A in this document for a detailed analysis of the same.

c. Focus on affordable insurance for the masses

In addition to the already existing incentive provided to various classes of insurance under service tax, certain specified insurance services under various flagship programmes of the government have now also been exempted. Further, services by the IRDA have also been exempt from the purview of service tax. Also, alternate rate of payment of service tax in case of single premium insurance policies have been reduced to cater to the growth in the sector.

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SECTION D: ANNEXURES

I. TAXATION OF INDIVIDUALS

There is no change in tax rates and the basic exemption limits. The tax rate for an individual (male/female), who is less than 60 years continues to be same as last year and is as follows:

Sr. No.	Taxable Income Slabs (in INR)	ETR (% of income)
1.	0 to 2,50,000	0%
2.	2,50,001 to 5,00,000	10.3%
3.	5,00,001 to 10,00,000	INR 25,750 plus 20.6%
4.	10,00,000 and above	INR 128,750 plus 30.9%

Surcharge levied on the income of super-rich individuals /HUFs / AOP / BOI / artificial juridical persons, i.e. those having total income more than INR 10 million is proposed to be increased from 12% to 15%. The ETR for such taxpayers would therefore be 35.54%.

1. Increase in threshold limits for tax audit

Currently, all individuals engaged in a profession and having gross receipts exceeding INR 2.5 million are required to get their accounts audited. In order to reduce the compliance burden, the threshold for auditing of accounts is proposed to be raised to INR 5 million.

2. Receipts from the EPF

Receipts from Recognised Provident Funds and Superannuation Funds are currently afforded EEE ("Exempt Exempt Exempt") status with respect to monthly contribution, annual accrued income, withdrawals for specific purposes and final withdrawal. However, in a highly criticised move, the FM had proposed to exempt from tax 40% of the accumulated balance attributable to contributions on withdrawal, and the balance 60% would be exempt from tax subject to its investment in annuity products, i.e. a pension plan. If the PF holder chooses not to invest in an annuity product, withdrawals from 60% of the corpus of the fund would be taxable. Public Provident Funds would continue to remain completely tax exempt.

Following the public outrage on the announcements especially labour unions and based on various representations, the FM on made an announcement in Parliament on March 8 withdrawing the aforesaid proposal and stated that the same would require comprehensive analysis. The FM clarified that the objective of the proposal was "not to get more revenue but to encourage more private sector employees to go for pension security after retirement instead of withdrawing the entire money from the PF account. However, we can now achieve the same objective based on suggestions received.

3. Enhancement of Rent Deduction

One of the noteworthy reliefs provided to the small taxpayers is the enhancement of rent deduction availed by them under Section 80GG of the IT Act. The existing provision allows them the deduction of INR 2,000 per month i.e., 24,000 per annum for the residents who do not have their own house and do not get any house rent allowance from their employer. The Budget proposed to enhance the deduction to INR 5,000 per month, which gives them a total deduction of INR 60,000 per annum.

II. TAXATION OF TRUSTS AND INSTITUTIONS

1. Additional Income Tax on Ineligible Trusts

Sections 11 and 12 of the IT Act provide for exemption to trusts or institutions in respect of income derived from property held under trust and voluntary contributions if the same is applied for the charitable purposes subject to various other conditions.

However, no provision in the IT Act ensures that the corpus and asset base of the trust accreted over a period of time, with promise of it being used for charitable purpose, continues to be utilised for charitable purposes and is not used for any other purpose. There is a need to ensure that the benefit conferred over the years by way of exemption is not misused and plug the gap in law that allows the charitable trusts having built up corpus / wealth through exemptions being converted into non-charitable organisation with no tax consequences.

Therefore, it is proposed by the Finance Bill to levy additional income tax (in the nature of exit tax) on the trusts which have become ineligible for grant of registration under Section 12AA of the IT Act.

[31] Section 56(2)(vii) of the IT Act

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The trusts registered under Section 12AA of the IT Act would be subjected to the additional income tax at a maximum marginal rate on the accreted income, in addition to the income-tax chargeable in respect of its total income, in the following situations-

i. If it is converted into any form which is not eligible for grant of deduction under Section 12AA of the IT Act; or

ii. If it is merged with any entity other than an entity registered under Section 12AA of the IT Act; or

iii. Upon dissolution, it has failed to transfer all its assets to an entity eligible for registration under Section 12AA of the IT Act or to a specified entity eligible for exemption under section 10(23C) of the IT Act within a year.

The term 'accreted income' has been defined as the fair market value of the assets of the trust, in excess of the liability of that trust, on the specified date and the same shall be computed in the prescribed manner.

The proposed chapter also prescribes a deeming provision, under which a trust shall be deemed to have been converted into ineligible trusts-

i. If the registration granted under Section 12AA of the IT Act has been cancelled; or

ii. Its objects have been modified which are not in conformity with the conditions of registrations under Section 12AA of the Act and has either not applied for fresh registration under Section 12AA of the IT Act or its fresh application has been rejected under Section 12AA of the IT Act.

The ineligible trust is required to pay the additional income tax within 14 days from the date of cancellation of registration or within the time prescribed under certain other circumstances.

It may be noted here that it is not reasonable to mandate the trusts to deposit the additional income tax within 14 days from the date of cancellation of registration or as the case may be, since the trust may want to challenge the denial/cancellation of its registration before the Courts. Therefore, the proposed charge of additional income-tax on the ineligible trust should necessarily be postponed until the final decision of the court, if the denial/cancellation of registration has been challenged.

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III. GLOSSARY

ABBREVIATION	MEANING
AAI	Airport Authority of India
AD	Authorised Dealer
AIF	Alternate Investment Fund
ALP	Arms Length Price
AO	Assessing Officer
AOP	Association of Person
ARC	Asset Reconstruction Company
AY	Assessment Year
Black Money Act	Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015
BEPS	Base Erosion and Profit Sharing
BOI	Body of Individual
Budget	Union Budget 2016-2017
CBDT	Chairperson, Central Board of Direct Taxes
CIT	Commissioner of Income Tax
CCIT	Chief Commissioner of Income Tax
CIT(A)	Commissioner of Income Tax(Appeal)
CWT(A)	Commissioner of Wealth Tax(Appeal)
Committee	Justice AP Shah Committee
CPI	Consumer Price Index
Courts	Courts of competent jurisdiction in India
CTT	Commodities Transaction Tax
DDT	Dividend Distribution Tax
DTAA	Double Taxation Avoidance Agreement
ECB	External Commercial Borrowings
EL	Equalization Levy
EPF	Employees Provident Fund
ETR	Effective Tax Rate
FATF	Financial Action Task Force
FCNR	Foreign Currency Non-resident (Account)
FDI	Foreign Direct Investment
FEMA	Foreign Exchange Management Act, 1999
FEMA ODI Regulations	FEMA (Transfer or Issue of Any Foreign Security) Regulations, 2004

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ABBREVIATION	MEANING
FI	Financial Institutions
FII	Foreign Institutional Investor
Finance Bill	Finance Bill, 2016
FM	Finance Minister
FPI	Foreign Portfolio Investment
FTS	Fee for Technical Services
FY	Financial Year
GAAR	General Anti Avoidance Rules
GDP	Gross Domestic Product
HC	High Court
HUF	Hindu undivided family
IFSC	International Financial Services Centre
INR	Indian National Rupee
INVIT	Infrastructure Investment Trust
IRDAI	Insurance Regulatory Development Authority of India
IREDA	Indian Renewable Energy Development Agency Limited
ITAT	Income Tax Appellate Tribunal
IT Act	Income Tax Act, 1961
IT Rules	Income Tax Rules, 1962
ITR	Income Tax Reporter
LLP	Limited Liability Partnership
LTCG	Long-Term Capital Gains
MAT	Minimum Alternative Tax
Memorandum	Memorandum to the Finance Bill, 2016
MMR	Maximum Marginal Rate
MOF	Ministry of Finance
MNC	Multinational Corporation
MNE	Multinational Enterprise
NABARD	National Bank for Agriculture and Rural Development
NBFC	Non Banking Financial Companies
NDS-OM	Negotiated Dealing System–Order Matching
NHAI	National Highway Authority of India
NRE	Non-resident External (Account)
NRI	Non-resident Indian

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ABBREVIATION	MEANING
ODI	Overseas Direct Investment
OECD	Organization for Economic Cooperation and Development
PAN	Permanent Account Number
PCCIT	Principal Chief Commissioner of Income Tax
PE	Permanent Establishment
PIL	Public Interest Litigation
PFC	Power Finance Corporation Limited
PFRDA	Pension Fund Regulatory and Development Authority
POEM	Place of Effective Management
PPF	Public Provident Fund
PPP	Public Private Partnership
PTC	Pass Through Certificate
RBI	Reserve Bank of India
R&D	Research and Development
REC	Rural Electrification Corporation Limited
REIT	Real Estate Investment Trust
Revenue	Department of Revenue, Ministry of Finance, Government of India
RPF	Recognized Provident Fund
SARFAESI Act	The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
SC	Supreme Court
SEBI	Securities and Exchange Board of India
SEZ	Special Economic Zone
SLP	Special Leave Petition
SME	Small and Medium-sized Enterprise
SPV	Special Purpose Vehicle
STCG	Short-Term Capital Gains
STT	Securities Transaction Tax
TDS	Tax Deducted at Source
TCS	Tax Collected at Source
TIEA	Tax Information Exchange Agreement
TRC	Tax Residency Certificate
USD	United States Dollar
WPI	Wholesale Price Index
WT Act	Wealth Tax Act

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Acknowledgments

We acknowledge the contributions received from S R Patnaik, Mekhla Anand, Kalpesh Unadkat, Shruti KP, Namita Agarwal, Akhil Gupta, Rijoy Bhaumik, V.P. Thangadurai, Shiladitya Dash, Niyati Dholakia and Pragya Gupta under the overall guidance of Mrs. Vandana Shroff.

We also acknowledge the assistance from Niloufer Lam, Ganesh Rao, Ruchira Shroff, Pallabi Ghosal, Aditya Jha, Arpan Chowdhury, Aayushi Anand, Ananya Sonthalia and Madhumita Paul.

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