PRE-BUDGET MEMORANDUM 2017-18 ON DIRECT TAXES

1. TAX RATES :

Corporate Tax Rates :

In the context of the worldwide economic problems and its consequent effect in India, it is suggested that the corporate tax rate be brought down to 25% within the next 2 – 3 years and surcharge and education cess be removed in respect of corporates. This will result in generating more surpluses in the hands of companies with consequential boost to investment and growth and accelerate the GDP growth in India.

2. INCOME COMPUTATION DISCLOSURE STANDARDS (ICDS) :

Various Accounting Standards like Ind AS are becoming applicable for companies along with the provisions of the new Companies Act. 2013.

The Government is now propagating the 'Make in India' concept for bringing about buoyancy and growth in the Indian economy. For the purpose, it is necessary to ensure that "doing business in India" is easy and hassle free.

In this context, the introduction of Tax Accounting Standards, termed as 'ICDS' is a retrograde step since it introduces difficulties and complications by necessitating the maintenance of a parallel set of Books for tax purposes over and above the prescribed Books maintained under the Company Law. Also, it will result in disputes and litigation by changing the basic accounting principles and standards for which the legal positions have been established over the years and which will no longer be valid. In fact, this will create uncertainty and deterrence in the conduct of business in India.

Therefore, it is suggested that ICDS should be withdrawn.

3. CORPORATE SOCIAL RESPONSIBILITY COSTS :

Section 135 of the Companies Act 2013 and The Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) as notified make CSR expenditure a statutory requirement for all practical purposes (as per the spirit of the law), in respect of companies falling under the ambit of such regulations. In this connection, it may also be noted that the CSR expenditure under law is in effect calibrated to the average Pre-tax profits (as computed under Section 198 of the Companies Act 2013, akin to managerial remuneration) earned during the preceding three years and is therefore a charge on profits (just like managerial remuneration) and not an appropriation thereof (which is a shareholder prerogative).

In the Finance (No.2) Act, 2014 it was mentioned that under section 37(1) Explanation 2, all CSR expenditure shall not be deemed to be an expenditure for the purpose of business on the rationale that it is an application of income.

It may be noted that every expenditure represents application of income and not an appropriation, if the charge/debit is made before determination of the PBT. In that context, CSR is an item of expenditure similar to any other standard item like rent, repairs and insurance. Moreover, such expenditure which is to be incurred under the new Companies Act and determined @2% of the pre-tax profits, is automatically an expenditure for business purpose even though it may not be incurred in the normal course of business. Also, statutorily sharing the burden with the Government "*in providing social services*" under law cannot be termed as getting subsidy from the Government through the said deduction since it is a statutory expenditure and is not in the nature of any tax or dividend.

In fact, the alternative argument of it not being an expenditure for tax computation purposes is itself not sustainable since it then becomes a "tax" which cannot be introduced under the Companies Act.

The industry therefore expects that such CSR expenditure would be allowed as a deduction under the Income Tax Act and Rules and all the more so, as certain elements of eligible CSR expenditure such as those covered under sections 30 to 36 are fully deductible even under the present tax laws, as explained in the Memorandum.

In fact, the High Level Committee on CSR formed by the Ministry of Corporate Affairs had observed that certain items of CSR are allowable under the Income Tax Act, whereas other items are not allowable and this has resulted in inconsistencies and lack of uniformity in the treatment for tax purposes and this has to be corrected.

It is therefore recommended that the amendment made under section 37(1), Explanation 2 be dropped and the Income Tax Act expressly stipulate that all expenditure incurred by companies in accordance with Section 135 of the Companies Act 2013 and the CSR Rules be allowed as a deduction under law so as to bring about fairness and uniformity in tax treatment and eliminate potential disputes & litigation that would otherwise arise in this regard.

4. SECTION 80IA BENEFIT – POWER GENERATION :

Under Section 80 IA of the Income Tax Act, deduction in respect of profits and gains from power undertakings (including for captive power generation plants) is available for any ten consecutive assessment years out of fifteen years beginning from the year in which the undertaking generates power. This benefit is available provided the power undertaking begins to generate power at any time before 31st March, 2017.

In the current scenario, new power undertakings in the area of solar and other renewable energy sources are becoming critical, especially in the context of protection of the global environment.
Therefore, the provisions of section 80IA, should be extended till 31st March, 2020, specially in respect of generation of power from renewable sources like solar, wind etc.

Sub-section 12A to section 80IA imposes a restriction on any merged or demerged undertaking for not allowing the benefit of deduction from taxable income after such restructuring. In fact, this benefit is not passed on to the successor of business for the unexpired period after the said restructuring. This is extremely unfair and should be deleted, since it adversely affects a lot of corporate restructuring decisions.

5. DEDUCTION IN RESPECT OF EXPENDITURE ON BRAND BUILDING :

In India, there is an over abundance of foreign brands. These range from run-of- the- mill to high-end luxury products. Even for items of daily consumption, the brands consumed by millions of household are predominantly owned by overseas enterprises. Be it baby food, home care, personal care products, tooth pastes, shaving creams, breakfast cereals, tea, coffee, ice creams, confectionary, chocolates, washing machines, laptops, personal computers, refrigerators, mobile phones, televisions, air conditioners, motor cars, etc., the leading brands in the Indian market are the property of foreign enterprises. Every time these products are consumed, value flows out of the country to pay for trademarks used, licenses provided, services consumed and so on.

Until December 16, 2009, the Government had imposed a cap on royalty payments for technological collaboration which was 5% on domestic sales and 8% on exports. Lumpsum royalty payments were capped at US $ 2 million. For use of a brand name, royalty could be paid at upto 1% of sales and 2% of exports. Beyond these levels, approval of the Foreign Investment Promotion Board (FIPB) was required. However, royalty payments have increased sharply since December 2009, when the caps were withdrawn and everything was put under the automatic route. In 2009-10, about US $ 4.44 billion was paid as royalty by Indian companies which was 13% of the Foreign Direct Investment (FDI) inflow into India that year. In 2012-13, Indian companies royalty payments increased to US $ 6.99 billion or 18% of India's FDI inflows that year. These pay-outs have increased 57.43% in the space of four years.

This unenviable situation is indeed a disheartening reflection of the competitive capabilities of India's home grown brands which are few and far between. However, instead of bemoaning the huge outgo in terms of royalty and other payments, it is much more important to align national and corporate energies to create world class Indian brands. World class brands lend a huge intangible value to products and services enabling them to command a premium and loyalty from consumers. Moreover, successful brands reflect the innovative capacity of their countries and they enrich their national economies. For example, the net sales of Samsung is equivalent to 20% of GDP of South Korea. In fact, a successful global brand is a sustained source of wealth creation. Also, world class brands can contribute increasingly to import substitution, value added exports as well as larger value capture from global markets. In fact, this can transform the country from one dominated by foreign brands to a player of substance in the global arena.

The creation of world class brands demands tremendous staying power with substantial investment commitments over the long run. It requires deep consumer insight, continuous nurturing of R & D, differentiated product development capacity, brand building capability, cutting edge manufacturing and an extensive trade marketing and distribution network. This will also result in job creation and retention of value in the country.

Therefore, it is vital that the policy environment incentivises the creation of Indian brands. For example, since foreign brands entail a royalty outflow, a similar percentage (say 5%) of turnover of Indian brands should also be admissible as a "standard deduction" for income tax purposes. Moreover, a larger deduction of say 10% of turnover should be admissible for new brands for the first 10-15 years of their commercial launch. Alternatively, a weighted deduction of 200% of the relevant expenditure on brand building should be allowed as a deduction. This will create a level playing field for domestic enterprises. Moreover, this will help in making the Indian brands globally competitive and thereby control the current account deficit problem on a sustainable basis.

6. **"MAKE IN INDIA" : ENCOURAGING INNOVATION TO DELIVER CORPORATE INITIATIVES FOR LARGER SOCIETAL VALUE CREATION**:

- In line with the Hon'ble Prime Minister's call for qualitative and sustainable industrial growth in the form of "Make in India : Zero Defect and Zero Effect", there is a strong need to encourage and incentivise the immense transformational capacity of corporates in innovating business models that can synergistically deliver economic and social value simultaneously.

- Sustainability in Business Development in its truest sense can only take place when economic growth fosters social equity. Growth must translate into the creation of sustainable livelihoods and replenishment of scarce environmental resources. Limits to future growth will be defined more by vulnerabilities flowing from social inequities, environmental degradation, and climate change than by any other economic factor.

- Government can support the development of a Responsible Business "Trustmark" Rating System that could be used to convey to the consumer a company's environmental and social performance. An enterprise could be awarded credits by way of "Trustmark Rating", based on an objective evaluation of its triple bottom line performance. An accumulation of such credits could earn the enterprise Trustmark Ratings on a progressive scale. These Ratings could then be displayed on products and services of the company to help consumers make an informed choice.

- Government must consider the provision of a differentiated and preferential set of incentives, fiscal or financial, to companies that demonstrate leadership in sustainability performance. Companies with high "Trustmark" ratings should be provided with incentives like priority fast track clearances, purchase preferences, lower levies of central excise duty for manufacture of "green", eco-friendly products, weighted deduction for the expenditure under the Income Tax Law and so on. This would spur powerful market drivers that will incentivise innovation for larger triple bottom line impact.

- Banks and Financial Institutions could also factor in the Trustmark Ratings in their lending operations providing benefits to more responsible corporations. Going forward, it may even be possible to trade in these "Trustmarks", if a system similar to carbon credits or energy efficiency certificates can be developed so that organisations with surplus credits are able to monetise their efforts.

7. LIMITLESS ROYALTY PAYMENTS – A DRAIN ON THE ECONOMY :

- India is now a global market with free competition by international players in most areas of economic activity.

- International companies are in India to exploit this global market and compete with other international and domestic players.

- To compete effectively, they bring their brands, knowhow, technology and other intellectual property in their own self-interest.

- Hence, incentives in the form of royalty pay-outs by their Indian subsidiaries are neither justified nor required.

- **Payment of royalty by Indian subsidiaries to their overseas parent entities is extremely illogical and injurious to India's current account balance, government exchequer and minority shareholders.** In the year 2012-13, the pay-out was US$ 7 billion representing 20% of India's annual FDI inflows, and is growing exponentially in the subsequent years. It is therefore recommended that such royalty payments should not be permitted. Otherwise, the Income Tax Law should provide for higher quantum of withholding tax.

- **Indian players seeking access to intellectual property to compete effectively with the international players in the Indian global market should continue to be allowed to pay royalty to unrelated parties on an arm's length basis, without government intervention.**

8. TAXABILITY OF EXPORT COMMISSION PAID TO NON-RESIDENT EXPORT AGENTS :

a. A non-resident export agent renders export promotion and marketing services outside India and also receives payment for such services outside India. Generally, the services rendered by an export commission agent would restrict to soliciting customers in the foreign location, liaising with the customers, coordination, negotiation and procuring the export orders etc. They do not render any technical services and the payment is only towards the functions and responsibilities that a commission agent is expected to discharge.

b. Accordingly, the export commission paid to such non-resident export agents does not accrue or arise/ be received or deemed to accrue or to be received in India and thus are not taxable in India as per Section 5 of the Income Tax Act, 1961 (the Act). Further, the said export commission to non-resident agents cannot be

deemed to arise from any business connection in India, as the entire service is carried out outside India and hence it not taxable in India as per Section 9(1)(i) of the Act . Accordingly, no withholding tax u/s 195 applies to such export commission paid to non-resident agents.

c. Reliance is also placed on several Court rulings wherein it has been held that export commission paid to non-resident agents for services rendered by the agent outside India are not taxable in India :

- ***In CIT vs Toshoku Ltd., Guntur and Ors [125 ITR 525 (SC)]*** – The Supreme Court has held that since non-resident taxpayer did not carry on any business operations in India, amounts earned for services rendered outside India could not be deemed to be incomes which had either accrued or arisen in India.

- **In CIT vs Eon Technology (P) Ltd [(2011) [343 ITR 366 (Delhi)]** – The Delhi High Court has held that when an agent was not rendering any service or performing any activity in India itself, commission income cannot be said to have accrued, arisen to or received by agent in India.

- **In the case of PanalfaAutolektrik Ltd [(2014) 49 taxmann.com 412 (Delhi)** – The Delhi High Court has held that services rendered by the non-resident cannot be said to be in the nature of 'managerial', 'technical' or 'consultancy' services and hence, the commission cannot be treated as 'fees for technical services'. Thus, the export commission was not taxable in India.

  There are various other judicial precedents wherein it has been held that commission paid to export agents outside India would not be taxable in India and accordingly, no withholding tax would apply on such payments made by Indian assesses:

- *Armayesh Global vs ACIT, [51 SOT 564 (ITAT Mum)]*
- *Gujarat Reclaim and Rubber Products Ltd vsAdd.CIT [60 SOT 22 (ITAT Mum)]*
- *ITO vs Trident Exports [149 ITD 361 (ITAT Chennai)]*
- *DCIT vsDivi's Laboratories Ltd [10 ITR (Trib) 505 (ITAT Hyd)]*
- *DCIT vs Transformers & Electricals Kerala Ltd. [35 ITR(T) 440 (ITAT Cochin)]*
- *DCIT vs Sandoz (P) Ltd [137 ITD 326 (ITAT Mum)]*
- *ACIT vs Farida Shoes (P) Ltd [(2013) 34 taxmann.com 268 (Chennai ITAT)]*
- *ACIT vs Model Exims [(2014) 45 taxmann.com 140 (Lucknow ITAT)]*
- *IVAX Paper Chemicals Ltd vs Additional CIT [(2014) 44 taxmann.com 173 (Hyd. ITAT)]*

Legal issue Involved:

d. The CBDT had issued Circular No 23 dated 23 July 1969 and Circular No. 786 dated 7 February 2000 wherein it was clarified that where the non-resident agent operates outside the country, no part of his income arises in India. Further, since the payment would be remitted directly abroad it cannot be held to have been received by or on behalf of the agent in India. Such payments were therefore held to be not taxable in India.

e. However, CBDT vide Circular No. 7/2009 dated 22.10.2009, withdrew their earlier Circular no. 23 dated 23.07.1969 along with Circular No. 786 dated 07.02.2000.

f. **This withdrawal of the circular have led some Assessing Officers to erroneously believe that export commission paid to non-resident export agents are taxable in India and they are arbitrarily disallowing all the export commission expenditures under section 40(a)(i) during assessments on the pretext of non-deduction of tax at source on such export commission , which are legally not taxable in India.**
This has led to unnecessary harassment of the assessees and has needlessly increased the litigation cost of the assesses.

g. It may be worthwhile to point out that the Circular 23/1969 was introduced after a Supreme Court ruling in the case of CIT v. R.D. Aggarwal & Co. [(1965) 56 ITR 20] , as explained in Para 2 of the said circular. **Thus, the position stated in Circular 23/1969 or Circular No. 786 dated 07.02.2000were mere clarifications regarding applicability of the provisions of Section 9 of the Act, and are in no way any alteration to the principals laid down in Section 9 of the Act. Thus, withdrawal of this Circular by the CBDT will not change the provisions of the law which clearly expounds that export commission paid to non-resident are not taxable in India since the export agents have rendered all services outside India (no income accrues or is deemed to accrue in India) and payments have been received by them in their foreign bank accounts (no income is received or is deemed to be received in India).**

<u>Recommendation:</u>

CBDT should come out with a clear clarification that export commission payments to non-resident agents are not taxable in India, in case:

- ***They render the services entirely outside India***
- ***They receive the payment abroad i.e. do not receive the payment in India.***

9. TAX ADMINISTRATIVE REFORMS :

- The Government had announced that the focus should be on ‘Ease of doing Business’. In the context of the same, the Tax Administrative Reforms Commission (TARC) was set up under Dr ParthasarathiShome.

- The Shome Committee has already submitted its report to the Government, which amongst various things, has suggested that there should be a very strong “customer focus” to ensure that tax payer services receive maximum priority. Also, it has suggested various other measures like merger of CBDT and CBEC, research based analysis of policy, bottoms up approach for fixation of revenue targets, impact assessment studies for various tax policy measures and bifurcation of the administrative functions from that of law making. However, no feedback is currently available on the implementation of the said committee’s recommendations till date. It is suggested that the various aspects of the Shome Committee’s recommendations be examined at the earliest and given effect to for the ones which are accepted. This by itself will help in improving the Revenue Department’s role and alignment of various tax policy measures in line with global practices.

10. **CAPITAL GAINS ON DEBT ORIENTED MUTUAL FUNDS :**

More than 6.7 million retail investors[1], in addition to a significantly large number of institutional investors have been impacted adversely by the proposals in the last Budget for increasing the tenure of debt–oriented Mutual Funds from 12 months to 36 months for availing long term capital gains benefit and increasing the capital gains tax rate on such funds to 20%.

The debt market is critical to the growth of a developing economy like India where large amount of capital is required for achieving industrial and infrastructure growth. A robust debt market enables (i) efficient mobilisation and allocation of resources in the economy (ii) greater funding avenues to the Government as well as public-sector

[1] **Report in Business Standard, Mumbai, 15th July 2014**

and private sector projects at a competitive cost of borrowing (iii) unlocking of illiquid retail investments, e.g., gold, and (iv) deepening of the Corporate Bond market.

Currently, in case of equity shares held in a company or any other security (including debentures / bonds) listed in a recognised stock exchange in India or a unit of the Unit Trust of India or a unit of a Mutual Fund or a zero coupon bond, the period of holding for qualifying as a short term capital asset is not more than 12 months.

Debt-oriented mutual funds invest in debt securities a majority of which are listed and exposed to interest rate risk as reflected in daily price changes. Such risk is fully borne by the investor as Mutual Funds are pass-through structures. However, the Budget proposals will result in differential tax treatment for Mutual Fund Units and listed Securities, though both are subject to market risk in terms of price change. By doing so, investment in debt-oriented mutual funds are being equated to other asset classes like real estate and gold despite performing an altogether different role for the Indian Economy. Such a policy stance may not be appropriate.

Further, mutual funds are active and key participants in the Corporate Bond market and meet the funding requirements of many sectors of the economy at highly competitive rates particularly in the case of NBFCs. Also, mutual funds are counterparties to 35% of the secondary trades that take place in Bonds. Hence, to support and deepen the Corporate Bond market, it is essential to strengthen the Mutual Fund industry which plays the role of aggregating savings in the economy.

The existing tax provisions on debt-oriented funds provide :

- A viable investment opportunity to investors who have a low to medium risk appetite and a short to medium term investment horizon.

- An opportunity to Corporates to access funds at a competitive borrowing cost for investments in infrastructure and technology.

It is apprehended that the said change would weaken the mutual fund industry which in turn would negatively impact the Corporate Bond market. This would, inter alia, result in higher interest rates/yields for borrowers as the market loses depth in the absence of support from mutual funds. Further, the opportunity of a viable return to investors, including the almost 7 million retail investors will get undermined. More so since investments in alternate avenues like Bank Fixed Deposits have been rendered sub-optimal in the scenario of high inflation.

In view of the above, it is recommended that the earlier provision in the Income Tax Law in respect of period of holding of not less than 12 months for debt-oriented mutual funds for the purpose of determining long term capital gain along with the currently applicable rate of long term capital gains tax be continued.

11. **DIVIDEND DISTRIBUTION TAX (DDT) :**

The Finance Act 2014 has changed the methodology of determination of tax payable on dividend distribution by a domestic company and mutual funds. While the DDT rate has been left unchanged, the DDT computation will have to be done after grossing up the dividend with the DDT tax rate. As a consequence of this, the situation of a "*tax on tax*" is getting further aggravated.

Dividend is paid out of post-tax profits, which itself is currently under severe pressure on account of the global economic downturn. Therefore, the above grossing up, which will result in increasing the DDT tax, will impact the dividend pay-out to shareholders and mutual fund subscribers. This reduction in net dividends will bring down the attractiveness of investing in Indian equities and in turn will impact the stock markets. Also, this will have an adverse impact on the divestment plan of the Government and reduce the ability to draw foreign investments that are crucial in financing the deficit. The mutual fund industry will also be impacted due to the lower dividend payouts and future flow of funds will be affected.

Therefore, it is suggested that the earlier methodology of calculation of the DDT based on the net dividend pay-out be continued.

12. **TAXING OF ESOPS IN THE HAND OF THE EMPLOYEES :**

The current Income Tax Law, provides for the inclusion of ESOPs under section 17(2) to be taxed as a "*perquisite*", consequent to the abolition of FBT.

The section states that ESOPs issued free of cost or at concessional rates will be taxed on the date of exercise on the difference between the "*fair market value*" and the amount actually paid by the employee. The "*fair market value*" is to be determined based on stipulated methods which have been separately prescribed by the CBDT.

This suffers from the following drawbacks :

(a) It seeks to tax a notional benefit at a time when the actual gain is not realised by the employee. In fact, it is possible that the actual sale of shares could result in a loss for the employee. Since the perquisite tax paid earlier cannot be set off against the capital loss, the employee suffers a double loss, namely tax outgo and loss on sale of shares.

(b) The question whether the ESOPs are granted at a concessional rate is being determined with reference to the "*fair market value*" on the date of exercise of the options. Technically, this is an incorrect approach. If the ESOPs are issued at the prevailing market price on the date of grant, the issue should be treated as "*non concessional*". This would be in line with the guidelines issued by SEBI. Any subsequent gain accruing to the employee due to favourable market movements by the date of vesting or exercise of option cannot be treated as a "*perquisite*" granted by the employer.

(c) Further, if such subsequent gains are a perquisite in the hands of employers, it would stand to reason that the value equivalent of such a perquisite should have been a deductible expenditure in the hands of the company issuing the ESOP. Since the tax law does not contemplate such a deduction, the taxation of the perquisite would result in double taxation.

(d) Also, from the strictly legal angle, there are a number of differences between ordinary shares and ESOP shares. Therefore, they are not comparable. The taxation principles currently existing, result in discrimination. The market value is also strictly not applicable since there are lock-in periods applicable. A detailed note on these aspects is enclosed (**Annexure 1).**

Since the actual sale of shares will attract capital gains tax, if applicable, it is unnecessary to subject the employee to perquisite tax. In fact, before FBT was imposed on ESOPs, specific provisions existed in the Income Tax Act for exempting the same from perquisites and subjecting it only to capital gains tax

It may be noted that ESOPs have emerged over the years as a critical, motivational and retention tool for companies in a highly competitive market for talent. It is a very effective instrument for encouraging employees to perform and excel and is a win-win proposition for the employers / shareholders on one hand and the employees on the other.

It is suggested that the taxation of ESOPs as perquisite at the time of allotment / exercise should be avoided for the reasons explained above. If at all it is taxed, it should be based on the fair market value i.e. the market price prevailing on the date of grant. Any subsequent appreciation should only be taxed at the time of realization / sale as capital gains.

13. **TAXING OF CONTRIBUTION TO SUPERANNUATION FUND BEYOND SPECIFIED MONETARY LIMITS (CURRENTLY IN EXCESS OF RS.1.50 LAKH) – IN VIOLATION OF SUPREME COURT JUDGEMENT :**

The Finance Act, 2009 had imposed tax on employees in respect of the company's contribution to Superannuation Fund in excess of Rs.1 lac and this limit was increased by the Finance Act. 2016 to Rs.1.50 lakh.

It may be noted that there are various types of superannuation funds. In case of the new pension scheme and similar superannuation funds, the contributions made by the employer vests with the employee and he can transfer it from one employer to another. However, in other cases, contributions made by the employer to a Superannuation Fund do not accrue to the benefit of the employee till such time he retires upon superannuation, when the Fund is used to purchase annuities and/or to pay the commuted pension to the retired employee. Such contributions may or may not result in superannuation benefits to the employees since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Therefore, this should not be taxed as perquisite as per the ratio of decision laid down by the Hon'ble Supreme Court in **CIT vs. L W Russel [2002-TIOL-686-SC-IT]**. Further, the pension payments are subjected to tax at the time of actual receipt by the employee.

As such, it is suggested that contribution to superannuation fund should not be taxed as perquisite.

14. **VALUATION OF COMPANY OWNED ACCOMODATION PROVIDED TO EMPLOYEES** :

As per the current Income Tax Law, company owned accommodation provided to employees is taxable @ 15% of salary in cities having population exceeding 25 lakhs. In other cases, it is taxable @ 10% of salary in cities having population between 10 lakhs and 25 lakhs and 7.5% of salary in other places.

In case of leased / rented accommodation, value of the accommodation is taken at the stipulated percentages or lease rent, whichever is lower.

However, the above method of determination of the perquisite suffers from various inequities. For example, for the same employee staying in the same company owned accommodation, the perquisite will increase with any salary increase.

Again, forthe same company owned accommodation, different employees with different salaries will have different perquisite value.

Also, irrespective of the size/quality of company owned accommodation, the perquisite for a particular employee will be determined as a percentage of salary.

Therefore, it is suggested that in case of company owned accommodation the concept of fair value should be introduced to ensure that the right amount of perquisite is determined for income tax purposes.

15. **SCIENTIFIC RESEARCH EXPENDITURE:**

The income tax law provides for certain tax benefits in respect of scientific research expenditure. In-house R&D is separately incentivized under section 35(2AB) of the Income Tax Act 1961. This specifically requires that the in-house research and development facilitybe approved by the Department of Scientific & Industrial Research (DSIR). The deduction is available @ 200% till FY 2020-21 and thereafter @100% for the following expenditures -

1) Revenue expenditure, and

2) Capital expenditure (not being expenditure in the nature of cost of land and building)

For claiming deduction, there are certain conditions laid down in the Section and in DSIR Guidelines that are required to be fulfilled.

The current issues include the following :

(a) **Negative list of articles/ things specified in the Eleventh Schedule of the Income Tax Act – should be deleted**

Section 35(2AB) specifically lays down that weighted deduction is NOT available for the articles/ things specified in the Eleventh Schedule. Eleventh Schedule, inter-alia, among other things contains various products like beer, wine and other alcoholic spirits, Tobacco and tobacco preparations (such as cigar and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff), Confectionery and chocolates, Cosmetics and toilet preparations, Tooth paste, dental cream, tooth powder and soap etc.

It is highly discriminatory that weighted deduction is not available in respect of the in-house research and development carried out for the above articles/ things. India is a developing market and the need for quality and internationally competitive products cannot be undermined. In fact, in the absence of quality in-house R & D in India, significant expenses are incurred in respect of royalty payments for use of imported technology, packaging/technical specifications etc. Such forex remittances on account of royalty and technical knowhow are putting serious strain on the Current Account Deficit and this needs to be addressed on an urgent basis. Moreover, the menace of contraband products also becomes another area of concern in the country which is a direct fallout of the above problem.

Therefore, companies which are in the business of manufacture/ production of the above products and are incurring expenditure in carrying out in-house research and development should not be denied the benefit of weighted claim, which otherwise would result in excessive payments in foreign exchange for royalty / technical knowhow and poor quality/contraband products flooding the market as explained in the earlier para. In fact, domestic production of international quality products can help not only in saving precious foreign exchange, but also in bringing foreign exchange into the country through exports and royalty earnings. Further, to boost domestic production and empower the domestic companies against big foreign players, it has become imperative to extend the benefit of weighted claim to all manufacturers. ***Therefore, it is suggested that the negative list as given in the Eleventh Schedule be removed in the context of section 35(2AB)***.

(b) **Revenue expenses eligible for weighted claim – scope of expenses to be enlarged :**

DSIR Guidelines (last updated May 2010) has identified various revenue expenses which are not eligible for weighted claim. However, it is the need of hour that the exclusion list be stream-lined and narrowed down. There is no doubt that weighted deduction is intended to be made available only for in-house R&D activities carried out. However, it cannot be denied that there are certain activities, which though forming part of the overall R&D activities, are carried out outside the approved R&D facility. Weighted claim should be available for these activities also. Also, considering the increasing complexities in R&D, there may be foreign consultants involved. However, there is no reason why foreign consultancy expenditure should not be eligible for claim. It is therefore recommended that to encourage greater in-house R&D activity, the ambit of eligible revenue expenses be increased to include –

- Expenditure on outsourced R&D activities
- Lease rent paid for research farms or research labs
- Foreign consultancy expenditure
- Building maintenance, municipal taxes and rental charges
- Clinical trial activities carried out outside the approved facilities
- Contract research expenses

(c) **DSIR Guidelines – Excessively Restrictive**

Among various other conditions, the DSIR Guidelines specifically lay down that -

(i) The manufacturers who wants to lodge weighted claim should enter into an agreement with the DSIR for 'co-operation' in such research and development facility.

The word 'co-operation' shall, inter-alia, mean that the company shall be willing to undertake projects of national importance, as may be assigned to it by the DSIR, on its own, or in association with laboratories of CSIR, ICAR, ICMR, DRDO; DBT, MCIT, M/O Environment, DOD, DAE, Department of Space, Universities, Colleges or any other public funded institution(s). The company would be free to exploit the results of such R&D projects, subject however, to any conditions which may be imposed by Government of India, in view of national security or in public interest.

(ii) Assets acquired and products, if any emanating out of R&D work done in approved facility, shall not be disposed of without approval of the DSIR.

It cannot be denied that such conditions, as above, are very restrictive in nature and instead of promoting in-house R&D, hamper the willingness of corporates to carry out in-house R&D. There is already a condition that the in-house R&D facility should be approved by DSIR. Once the R&D facilities are DSIR approved, there should not be any requirement for entering into a separate agreement with DSIR. In fact, such requirements would do nothing except burdening the corporates with administrative hassles. ***There is an urgent need to relax these stipulations so that in-house R&D activities are encouraged and in-house scientific research gets the necessary tax benefits. This will result in incentivising R & D expenditure for promoting "Make in India" manufacturing.***

16. **DISALLOWANCE OF EXPENSES RELATING TO EXEMPT INCOME UNDER SECTION 14A:**

As per section 14A of the Income Tax Act, 1961, no deduction is allowed in respect of expenditure incurred in relation to exempt income. In the context of the same, the Government has prescribed rule 8D (amended vide notification no.43/2016 dated 2nd June 2016) as per which the disallowance will be determined as below :

(i) The amount of expenditure directly relating to exempt income.
(ii) 1% of the annual average of the monthly averages of the opening and closing value of investments.

The stipulation regarding the disallowance of 1% of the monthly averages of the value of investment is very harsh since it has no relationship with the earning of exempt income. In fact, this could result in adhoc and excessive disallowance and in some instances, there could be cases of the disallowance exceeding the total exempt income. This is even worse when investments are made at the end of the accounting year, say on 31st March. Also, as per current accounting systems, corporates are not required to do any book closing on a monthly basis and therefore this would result in additional work for the sole purpose of determination of disallowance. Moreover, in respect of exempt income from dividends arising out of investment in companies and mutual funds, the payers also pay the dividend distribution tax. Therefore, technically this could not be termed as tax free income in the hands of the recipient and the above disallowance results in double taxation.

Therefore, it is suggested that rule 8D be amended and should be restricted to the following :

- ***Exempt income to exclude dividend income on which dividend distribution tax has already been paid.***
- ***Expenditure directly attributable to earning of exempt income be disallowed.***
- ***Interest expenditure to be disallowed in line with the existing law based on the proportion of average value investments to total assets after excluding the interest expenditure specifically related to the business of the company.***
- ***The disallowance for administrative expenditure should be made by estimating the time of the personal and resources involved for undertaking the activities which result in earning of the exempt income. The aforesaid estimation to be done on a reasonable basis after considering the facts of each case and this should be certified by the Tax Auditor. In case this is not feasible, then the disallowance be restricted to 0.5% of the exempt income.***
- ***The disallowance should not be made for strategic investments which are incurred for gaining a controlling stake in another company/subsidiaries, JVs and associates.***

17. **HOTEL INDUSTRY :**

(i) *Restriction on the adjustment of the section 35AD benefit* : Currently, under section 73A, the benefit of investment in new hotels available under section 35AD, is allowed as a deduction only from the profits of the hotels business. Investment in new hotels requires huge capital outlay with a high gestation period and this restriction under section 73A results in the benefit getting badly deferred with consequential impact on liquidity and future investments. With a view to giving a boost to further investments and growth in the hotels/tourism sector which has a massive untapped potential in India, it is suggested that the adjustment of the section 35AD benefit should be made permissible against the profits of the entire company rather than restricting it to the particular business.

(ii) *Tax Incentives for eco-friendly Hotels* : The need for building eco-friendly hotels cannot be over-emphasized for long term sustenance of the environment. Building of such hotels comes at a much higher cost and therefore some special incentives needs to be considered. Section 35AD does take care to some extent by allowing the deduction of the capital expenditure. However, an additional incentive is required in the form of a weighted deduction of the costs to offset the additional costs incurred.

(iii) *Depreciation and Additional Depreciation : Hotels were eligible for the depreciation allowance of 20% on their building till 31st March, 2002. The depreciation allowance for hotels buildings was, however, scaled down to 10% vide Notification No. 291/2002 dated 27.09.2002.*

Hotel buildings constitute the 'plants' for the hotel industry as their usage is round the clock for 24 hours. The industry has to make very heavy investments in renovation, up-gradation and upkeep of the hotel buildings. Section 32 of the IT Act should therefore be amended to restore the depreciation rate to 20%. The additional depreciation applicable to Plant & Machinery u/s 32 1 (ii a) should also be allowed to hotels which have to make heavy investments in plant and machinery.

(iv) Hotel Charges for long stays are currently subject to TDS(rent) under section 194 I : *Payments made to hotels are not the payment of rent, per se and hence Hotels should be excluded from the purview of Section 1941 for the purpose of Tax Deduction at Source. CBDT may issue appropriate circular in this regard.*

18. **TAX INCENTIVES UNDER SECTION 72A IN RESPECT OF AMALGAMATION OR DEMERGER (TO BE EXTENDED TO ALL BUSINESSES):**

The tax benefits under section 72A in respect of amalgamation or demerger are currently limited to industrial undertakings or a ship, hotel, aircraft or banking. It is suggested that in the current liberalised and buoyant environment where various new sectors are growing at a rapid pace, this should now be extended to all businesses including financial services, entertainment/sports, information technology (IT) and IT enabled services.

Further, the provisions of section 72A should be simplified specially in respect of the conditions applicable for the amalgamating company like losses / depreciation being unabsorbed for at least three years and holding assets on the amalgamation date upto ¾ of the book value of fixed assets held two years prior to the said date.

19. **TAX EXEMPTION FOR SALE OF CARBON CREDITS/WEIGHTED DEDUCTION FOR CERTIFIED INVESTMENTS :**

Carbon Credit is an incentive available to the industries reducing CO2 emission by investing in energy efficient technologies***. As such, it is recommended that tax exemption be given for revenue generated from sale of carbon credits.***

Further the cost of putting additional technology for clean development mechanism is relatively high. ***Therefore, there is a necessity for giving tax incentives by way of weighted deduction for all certified investments in such areas like Leed certified buildings/hotels. This would benefit the nation in terms of creating eco-friendly environment and earning foreign exchange.***

20. **TAX DEDUCTION FOR THE EMPLOYEE REMUNERATION COST INCURRED DUE TO GRANT OF EMPLOYEE STOCK OPTIONS (ESOP) TO THE EMPLOYEES :**

(a) As per the Guidance Note issued by Institute of Chartered Accounts of India ('ICAI'), the SEBI Guidelines and the IndAS the main objective to issue shares under an Employee Stock Option Plan (ESOP) is to remunerate the employee for his services. <u>The SEBI guidelines and the IndAS requires a company to recognise the charge incurred for issue of ESOPs as an employee compensation in the Financial Statements/Books of Account of the Company over the vesting period.</u>

For computing the related employee cost, the IndAS mandates companies to adopt the Fair Value valuation of the share options granted to the employee unless that fair value cannot be estimated reliably. Thus, under the IndAS regime, even if the companies have granted the options at the prevailing market prices on the date of grant, they have to do a fair valuation of the options granted to the employees using option pricing models (which essentially calculates the difference between the exercise/grant price and the expected price of the underlying shares on the date of vesting) and recognise the charge in the profit and loss account over the entire vesting period.

(b) Such share- based payments to employees is construed, both by the employees and the company, as a part of package of the remuneration. There is no difference in two situations viz. (i) when the company issues shares to public at market price and a part of the premium is given to the employees in lieu of their services (ii) when the shares are directly issued to employees at a reduced rate.

(c) Further, it is pertinent to note that under the Income Tax Act too, under section 17(2)(vi) the difference between the fair market value of the ESOPs allotted and exercise price is treated as a perquisite ie. part of salary given to the employees, on which tax is payable by the employees. Hence, income tax itself

cognizes the difference ie value of the share options granted to the employees as part of employee remuneration, taxable in the hands of the employees.

(d) **Thus, it is evident that the legislature contemplates this to be an employee cost ie. a consideration for employment, which entails giving the employees the shares of the company at a particular exercise price and therefore, the same should be treated as an allowable business expenditure u/s 37 of the Income Tax Act.**

(e) **It is an ascertained liability and not a contingent liability, since the employer incurs obligation to compensate the employees over the vesting period, notwithstanding the fact that the exact amount of related cost is quantified only at the time of the exercising the options**. The company becomes liable to issue shares at the time of the exercise of option and it is in lieu of the employees-compensation liability which it incurred over the vesting period to obtain their services. Therefore, the company incurs the liability only during the vesting period, which is neither incurred at the stage of the grant of options nor when such options are exercised.

Reference to the decisions of the Supreme Court in the case of Bharat Earth Movers vs CIT [245 ITR 428] and RotorkRotork Controls India (P) Ltd [314 ITR 62] also indicate that a definite business liability arises in an accounting year which qualifies for deduction even though the liability may have to be quantified and discharged at a future date. Thus, following the decision of the Supreme Court, the employee cost incurred during the vesting period on account of fair valuation of the share options granted to the employees during the year, cannot be treated as a contingent liability and hence should be allowed as a deduction u/s 37 of the Act, as and when it accrues over the vesting period, as per the Guidelines of SEBI and Accounting Standards and Principles.

(f) **Further, the Supreme Court in the case of Woodward Governor India (P) Limited [312 ITR 254] has also held that the term 'expenditure' in certain circumstances can also encompass 'loss' even though no amount is actually paid out.** Following the rationale of this Apex Court decision, the employee cost accruing on account of issue of ESOPs should be treated as a allowable expenditure u/s 37(1) of the Act, since by undertaking to make share-based payments, the company does not pay anything to its employees but incurs obligation of issuing shares at the determined exercise price on a future date(s) in lieu of their services.

(g) **Reliance can be placed on the following decisions which have upheld the allowability of the employee cost incurred on issue of ESOPs to employees as a business deduction during the vesting period-**

(a) Special Bench , ITAT Bangalore, in the case of Biocon Limited v DCIT –[TS 322]
(b) Madras High Court in the case of CIT vs PVP Ventures Limited [211 Taxman 554]
(c) Chennai Tribunal in the case of S.S.I. Ltd vs DCIT [85 TTJ 1049] [211 Taxman 554]
(d) Chandigarh Tribunal in the case of ACIT vs Spray Engineering Devices Limited [53 SOT 70]

<u>Legal issue involved:</u>

a. The issue with respect to deductibility of employee cost incurred for grant of options to employee has been a matter of debate before the Courts/Tribunal. The Income Tax Authorities are not allowing such employee compensation expense as an allowable business expenditure u/s 37 of the Act, inspite of the various judicial precedents, as mentioned above, to the contrary.

b. Further, since the Income tax Law has not expressly specified , there is also a debate on the amount to be allowed as employee compensation expense, the method used for calculating the value of the stock options granted , the year in which the cost should be allowed etc.

c. Without prejudice to the above, it may kindly be noted that deduction for ESOP to employers is provided even by the developed nations:

United States of America

Sec. 83(h) of Internal Revenue Code (IRC) allows the companies deduction for ESOP Expenditure equal to the amount offered to tax by employee in the year it is offered to tax by the employees.

United Kingdom

Part 12, Chapter 2 of the Corporation Tax Act, 2009 allows companies deduction for ESOP expenditure as excess of market value of shares over the amount recovered by the employer in the period when the shares are acquired.

Recommendation

- ***To put an end to the litigations, it is recommended that the CBDT comes out with clear guidelines on the allowability, calculation and treatment of these employee compensation expenditure/cost incurred on account of issue of shares options to employees under ESOP for income tax purposes.***

- ***Under the Ind AS the companies are required to account for the such employee cost for grant of ESOPs under fair value method which is a fair method used internationally to account for such cost. Hence, CBDT should also allow companies to claim deduction for the employee remuneration cost on the basis of fair value method, to ensure less complications and hassles in the calculations and to avoid unnecessary litigation and dispute on this subject***

21. **ALLOWABILITY OF PAYMENT OF PREMIUM OF LEASEHOLD LAND AS A REVENUE EXPENDITURE :**

a. Under the IndAS 16, the upfront premium paid on leasehold land held under operating lease are being treated as prepaid expenses and would need to be charged to the Profit and Loss statement under the head “rentals” on a proportionate basis over the life of the lease period.
Under the current Accounting Standards, these premium payments leasehold land, are charged to the statement of profit and loss account as amortisation of leasehold land on a proportionate basis over the life of the lease period

b. These upfront lumpsum premium lease payments for leasehold landare essential business expenditure and do not generate any capital asset and hence are purely revenue in nature.

c. These are just like payments made under any operating lease to utilise the leased property for the purposes of the business of the lessee and hence should be allowed just like any business expenditure for tax purposes. Further, under the IndAS, these upfront premium paid on leasehold land, held under operating lease are being classified as rentals. Therefore, these expenditures should be treated as tax-deductible expenses.

Recommendation

The CBDT should come out with instructions clarifying that these upfront premium payments for leasehold land, should be allowed for income tax deduction in the year of debit in the statement of Profit and Loss.

22. **TDS :**

(i) **REIMBURSEMENT OF EXPENSES** :

It has been legally established that TDS is not applicable in case of reimbursement of expenses since there is no income involved. However, very often disputes crop up, leading to unnecessary litigation and harassment. Therefore it is necessary to address this problem through a suitable clarification in the Income Tax Law or by way of a CBDT circular.

(ii) **TDS WITHOUT PAN :**

A new section 206AA was introduced in the Finance Act, 2009, under which a penal rate of TDS has been made applicable with effect from 1.4.2010 @20% or higher rate if prescribed, in cases where PAN is not available.

<u>PAN for domestic parties :</u> Section 206AA also necessitates the quoting of PAN in case of all declarations for domestic parties under section 197A. However, this is contradictory to the provisions of section 139A which stipulates that PAN is applicable only in certain cases like those with taxable income etc.
In fact, 197A only covers the issue of declarations in respect of dividend income and interest incomes under sections 194 and 194A in Form 15G and Form 15H. Parties with exempt incomes under the various provisions of the Income Tax Law like those with agricultural income etc. are not eligible to give declarations under section 197A for receiving payments in respect of other TDS provisions like section 194C, 194J etc.. It may be noted that in **Smt. AKowsalyaBai and Others vs. Union of India [346 ITR 156 (2012)],** the Karnataka High Court has held that it should not be necessary for persons whose income is below taxable limits, to obtain PAN. ……..“*Imposing condition on such small depositors to invariably obtain a Permanent Account Number would cause hindrance..*………..”.

It is therefore submitted that the following corrections be incorporated :

- Section 197A be extended for all TDS sections so that a person with say, agricultural income or income below taxable limit and in receipt of any payment under section 194C etc. can give a proper declaration.

- Section 206AA be amended to exclude the quoting of PAN number in cases where the person has ‘nil’ income / exempt income / income below taxable limit.

(iii) **APPLICABILITY OF SECTION 194C TO MANUFACTURING / SUPPLYING PRODUCT BY USING MATERIAL PURCHASED FROM SAME PARTY ONLY IF SUCH MATERIAL PURCHASE IS SUBSTANTIAL :**

In the Finance (No.2) Act, 2009, TDS was made applicable under section 194C in respect of contracts for manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. However, in a large number of instances, it is observed that the material which is purchased from the customer represents a small fraction of the total cost and this provision has created huge operating problems since the transaction may be a principal to principal contract for purchase and sale of goods and the profit margin may be very small. Therefore, it is suggested that the provisions of section 194C be only made applicable in cases where the material purchased from the customer is substantial in nature, i.e., say it exceeds 40% of the total material cost (inclusive of raw materials and packing materials).

(iv) ENHANCEMENT OF LIMITS FOR TDS U/S 194C FOR PAYMENT TO CONTRACTORS :

Currently any payment for contract services rendered which exceeds Rs. 30000 at a time or Rs. 1,00,000 per annum requires the persons responsible for making such payments to deduct tax at source under section 194 C. These limits have been fixed some years ago. The deduction of tax at source on such small amounts involves deployment of relatively large amount of resources in terms of manpower, systems and other costs at the assessee's end without any significant benefits to the revenue. It is recommended that the threshold limit be increased to Rs. 50000 for single payment and Rs. 1,50,000 for aggregate annual limit.

(v) APPLICABILITY OF TDS ON GENUINE PROVISIONS ON ESTIMATE BASIS WITHOUT BILLS :

Currently tax is deductible even in cases where payment is not made and the amount is merely credited in the books of the assessee as provision for expenses or as suspense account or by any other name. Very often, such provisions or credits are made by the assessees to follow accrual system of accounting so that true and fair state of affairs of the business is reflected in the books and to ensure that all revenues and expenses are appropriately matched. This does not necessarily mean liability has crystallized or the amount has become due. Very often exact numbers are not available and the provisions / credits are made based on best estimates available with the assessee. As per the current position, the assessee is required to deduct tax on such provisions even before the bill/invoice has been received. This often leads to excess deduction of tax, disputes with the vendor and extensive reconciliation. Further, this causes great amount of confusion between the assessee and the vendor if the provisioning by the assessee and invoicing by the vendor fall in two different financial years. ***It is therefore recommended that no TDS should be applicable on entries made by assessees which are merely provision for expenses for work completed / services rendered but for which bills have not been received. TDS may be imposed only on such credit entries to the party accounts which are supported by bills / invoices*.**

23. **DOMESTIC TRANSFER PRICING** :

The Budget for 2014 had introduced provisions in respect of Transfer Pricing Audit and documentation for domestic transactions with associated enterprises/related parties. It has been observed that for transactions between domestic companies both of which are profitable, there is no tax implication since the tax rates are virtually the same. Therefore, it is recommended that such transactions between profitable domestic companies which are associated enterprises should be exempt from the requirements of the Transfer Pricing regulations to avoid unnecessary documentation, disputes and litigation.

24. **RETIREMENT FUNDS :**

As per rule 87 of the Income Tax Rules, the employer is permitted to make a total contribution not exceeding 27% of the employee's salary in respect of Provident Fund and Superannuation. Further, as per schedule IV of Part A rule 6 of the Income Tax Act, the employer is permitted to contribute upto 12% of the employee's salary in respect of Recognised Provident Fund. In other words, the Income Tax Law permits contribution upto 15% for Superannuation and 12% for PF.

In the context of the current rates of interest and the high cost of annuities and considering that pensions are in any case taxable in the hands of the employees at the time of receipt, it is suggested that the limit of 15% for Superannuation should be done away with.

In fact, employers should be encouraged to increase the quantum of contributions to ensure a proper annuity / pension for the employees. The law should only stipulate that the annuities should be purchased from recognized and approved Life Insurance agencies. Moreover, the stipulations under section 36(1)(iv) and consequential limits fixed on initial contributions should be totally done away with. In fact, if there are gaps / deficits in the Retirement Funds in terms of the total fund position in relation to the actuarial value, the employer should be under a strict obligation under law to pay up the same for bridging the deficit and thereby avoiding a default.

25. **TAXABILITY ISSUES FOR GRATUITY, LEAVE ENCASHMENT AND OTHER TERMINAL BENEFITS FOR LEGAL HEIRS OF A DECEASED EMPLOYEE :**

There is a lot of confusion in respect of TDS/taxability of various payments like gratuity, leave encashment and other terminal benefits to the legal heirs of a deceased employee. The existing circulars are very old and needs to be updated based on the current Income Tax Law. Detailed note is enclosed (**Annexure 2)**. This matter needs to be clarified urgently.

26. **CONFUSION IN RESPECT OF TDS ON PAYMENT FOR TELEPHONE BILLS (INCLUDING MOBILE BILLS), TELEPHONE BILLS, INTERNET CHARGES, ELECTRICITY CHARGES ETC. CONSEQUENT TO AMENDMENTS IN SECTION 9(1)(VI) EXPLANATIONS 2 AND 6 :**

Consequent to the amendment to the explanations to section 9(1)(vi) of the Income Tax Act in the Budget for 2012, it could be construed that TDS is applicable in respect of payments for telephone bills, mobile bills, internet charges, payment to cable operators, broadband charges, electricity charges and wheeling and transmission charges. However, it should be noted that the said amendment to the definition of "royalty" is ambiguously worded and is inconsistent with the industry understanding as well as in conflict with the established position internationally that the right to use of any service does not result in "royalty" *per se* without the right to use the concerned equipment or process. The characterization of such payments as royalty would be dependent on the terms of use and degree of control over the industrial, scientific or commercial equipment. Indian Courts have consistently maintained this position. Detailed note is enclosed (**Annexure3**). Further, companies like BSNL have given internal instructions that no TDS is applicable for payment of telephone bills. In fact, if TDS deduction is made by the subscriber, then telephone lines are being disconnected. Therefore, it is absolutely necessary for the CBDT to give a detailed circular explaining the applicability of this new explanation 6 to section 9(1)(vi) and specifically confirm that no TDS is applicable for payment of telephone bills including mobile bills, payment of internet charges, payment to cable operators, service providers for viewing television channels, payment of broadband charges, electricity charges, wheeling/transmission charges etc. where the payment is only for the right to use the service without any payment for the right to use/control on the equipment / apparatus.

27. **APPEALS TO CIT APPEALS UNDER SECTION 246A TO INCLUDE INTEREST UNDER SECTION 220(2):**

In the last few years, the list of sections under section 246A has been revised in the context of appeals with CIT(Appeals). However, interest under section 220(2) has been missed out and this is currently creating unnecessary harassment for all assessees.

28. **LONG TERM CAPITAL GAINS – BONDS UNDER SECTION 54EC :**

The Income Tax Law has stipulated a limit of Rs.50 lacs per assessee in respect of the long term capital gains tax saving bond under section 54EC. Currently, huge amounts are required to be deployed in the infrastructure sector and this vehicle could be used for raising such infrastructure development funds. Moreover, the interest income on such bonds is fully taxable. Therefore, it is suggested that this limit should either be removed or substantially increased.

29. **CARRY FORWARD OF EXCESS FOREIGN TAX CREDIT** :

The Income Tax Act allows for set off in respect of foreign taxes paid on overseas income. However, in case of loss/inadequate profits, no set off may be possible. In the current economic scenario of the global economy, business outlook has become extremely uncertain and results have become very volatile. Therefore, it is suggested that assesses be permitted to carry forward (say for five years) such unutilized credit (in USA such relief is granted vide section 904(c) of Federal Tax Act) for adjustment in future years.

30. **REASSESSMENT - SECTION 147/SECTION 148 :**

Nowadays, reopening notices under section 147/section 148 have become a very common occurrence and such notices are being served in large nos. all over the country. It appears that there is no consideration in following the principles on the subject laid down by the Hon'ble Supreme Court and High Courts over the years. Simple audit observations, even on points of law, are frequently being used as grounds for re-opening leading to extreme harassment to all assessees. In fact, the position has become so bad that even for legislations which have become obsolete like Interest Tax (withdrawn in Finance Act, 2001) reopenings are being done for very old years since the relevant law permitted reopenings without any time limit.

Further, the said reopening provisions are being misused in various locations, especially for salaried assessees, where scrutiny assessment is not possible as per the CBDT guidelines and this has become a breeding ground for corruption and harassment.

Therefore, it is suggested that proper stipulations be laid down for any reopening and the period of reopening be also reduced to 3 years from the end of the assessment year.

Proviso to section 147 has been inserted to provide that the Assessing Officer may assess or reassess other than matters which are the subject matter of any appeal, reference or revision. However, in respect of matters which have already been examined at the time of original assessment, the current law as laid down by the various courts categorically stipulates that reassessment of the same cannot be done since it will result in change of opinion. Moreover, it does not make sense to keep on assessing/reassessing the same matter again and again. The annual income tax assessment/reassessment procedure should be normal and routine and should not provide for excessive powers to harass assesses. **Therefore, it is suggested that the new proviso to section 147 should also state that all matters which have been examined in the original assessment should not be reassessed.**

31. **PENALTY UNDER SECTION 271** :

A new sub-section (1B) has been inserted retrospectively from 1st April 1989 to provide that in case of any addition/disallowance in the assessment /reassessment order, the Assessing Officer can give a direction for initiation of penalty proceedings and this shall be deemed to constitute satisfaction for such initiation. It is apprehended that such general power will result in initiation of penalty proceedings in case of any addition/disallowance without justification. This will itself result in arbitrariness, harassment and risk of increased litigation. Moreover, the retrospective amendment will result in opening up a lot of past cases which have already been decided/closed. ***Therefore, it is suggested that this provision may be withdrawn. Even otherwise, it should not be made applicable retrospectively.***

32. **SIGNING OF NOTICES UNDER SECTION 282A** :

The new section 282A has been inserted to provide for issue of any income tax notice or other document without it being signed by the requisite authority. This can result in widespread misuse of powers and harassment. The memorandum has explained that this change is being provided for in the context of computerized generation of notices and other documents.

It is suggested that the computerized notice / document should have a separate control like provision for a digital signature because these are legal / statutory documents and this aspect should specifically be incorporated in

section 282A. In respect of manual notices/documents the section should also record that signatures will be mandatory applicable.

33. **SERVICE OF NOTICES – SECTION 292BB :**

Section 292BB has been enacted to provide that if an assessee has appeared in any proceeding or co-operated in any enquiry in respect of any assessment or reassessment it shall be deemed that notice has been duly served upon him and he cannot take any objection in respect of service of the notice. This provision could also be misused by Income Tax Officials with consequential risk of harassment specially in case of time barred notices. Therefore, it is suggested that this may kindly be withdrawn.

34. **DEDUCTION FOR PERSONAL TAX COMPUTATION :**

The Finance (No.2) Act, 2014 had increased the overall limit to Rs.1.5 lac in respect of deduction under section 80C. In the context of the current inflationary situation, it is suggested that this limit be increased to at least Rs.2.5 lac. This would act as a fillip to investments and also generate greater savings for the tax payer.

35. **LIMIT FOR MEDICAL REIMBURSEMENTS** :

Medical expenses reimbursed by the employer are exempted to the extent of Rs.15,000/- per annum. This limit has remained unchanged from the financial year 1998-99 onwards. Considering the sharp escalation in cost of medicines and medical treatment, it is suggested that this limit be increased to Rs.50,000/-.

36. **MEDICAL REIMBURSEMENTS FOR RETIRED EMPLOYEES :**

Under section 17 of the Income Tax Act, medical reimbursements to employees are exempted from tax in respect of general medical expenditure (upto Rs.15,000 per annum) and expenditure incurred in approved hospitals. However, this tax benefit is not available to retired employees. It is suggested that the provisions of section 17 be amended to include retired employees for the tax benefit on medical reimbursements/hospitalization expenditure in approved hospitals.

37. **LEAVE TRAVEL CONCESSION/ASSISTANCE– TAX RELIEF EVERY YEAR AND REPLACEMENT OF CALENDAR YEAR BY FINANCIAL YEAR :**

As per the current provisions, Leave Travel Concession/Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years. It is suggested that the concept of calendar year should be replaced with financial year (April – March) in line with the other provisions of the Income Tax Law. Moreover, the concerned tax relief should be granted annually and be extended to both domestic and foreign travel, to give a fillip to the Travel and Tourism Industry.

38. **EXEMPTION FOR PAYMENT OF LEAVE ENCASHMENT TO BE RAISED TO RS.10 LAKHS:**

The exemption limit for payment of leave encashment is notified by the CBDT in accordance with the powers given under section 10(10AA). The current limit of Rs. 3 lakhs is very old (since 1998) and needs to be raised substantially with immediate effect. It is suggested that the limit should be raised to Rs.10 lakhs.

39. **OTHER TAX INCENTIVES FOR INDIVIDUALS :**

The Income Tax Law currently provides for various tax exemptions for individuals like transport allowance relief @ Rs.1600/- per month, children education allowance exemption uptoRs.100/- per month upto 2 children, children hostel allowance exemption @ Rs.300/- per month etc. These tax reliefs have not been revised over a long period of time and needs to be suitably enhanced. Otherwise, these benefits should be withdrawn and replaced by a standard deduction for the salaried class to ensure tax simplification.

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THE BENGAL CHAMBER

Annexure 1

ESOP shares vis-à-vis Market Shares

They are not comparable

1. ESOP shares are "issued" by the employer and "subscribed" to by the employee, whereas the shares acquired in the market ("market shares") are "transferred" from one shareholder to another. Consequently, while the market shares are goods, the ESOP shares do not become goods until they are allotted in favour of the subscribing employee.

2. It follows that the ESOP shares are not comparable with the shares that are already being traded. Therefore, it is incorrect to quantify any benefit to the employee with reference to the already trading shares or their so-called market value.

3. Even after allotment of the ESOP shares, the employee is prevented by law or the terms of the grant, from selling the shares during a lock-in period, whereas the shares bought in the market can be sold immediately without any restraint. The legal ability of disposition being one of the essential attributes of "property", the ESOP shares, unlike the market shares, are not property in the hands of the employee even after allotment.

4. When on the date of exercise the shares are subject to a lock-in condition, they cannot be considered to be a benefit; and if it is a not a benefit, it ought not to be fictionally treated as benefit and brought under "perquisites". In ***CIT v. Infosys Technologies Ltd.,(2008) 2 SCC 272*, at page 277**, the Supreme Court held as follows:

   "During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs.165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."

   The Court further, at page 279, held:

   "It is important to bear in mind that if the shares allotted to the employee had no realisable sale value on the day when he exercised his option then there was no cash inflow to the employee. It was not possible for the employee to know the future value of the shares allotted to him on the day he exercises his option."

   It may be borne in mind that in the Infosys case, the Supreme Court dismissed the Government's appeal not only because the ESOP shares were not enumerated under "perquisites" in S. 17 (2), but also because it does not amount to a benefit.

5. For this reason also the ESOP shares and the market shares are not comparable, and the latter cannot afford any basis for determining any benefit that may have accrued to the employee on account of the ESOP shares.

Discrimination

6. When a listed company issues IPO or rights shares at a price less than the market value (or bonus shares), the difference between the issue price and the market price is not taxed. If in such a case the difference does not take the character of income, it cannot be income in the case of ESOP shares too.

7. And, if such difference (in the case of IPO/rights/bonus) does take the character of income, then taxing ESOP share alone lacks any intelligible differentia that can validly explain this classification.

8. If a distinction is suggested on the ground that in the case of ESOP shares the benefit takes the character of income from salaries (which is apparent from treating it as "perquisite") which is not so in the case of market shares, it would be incorrect because such income, especially in the nature of salaries, would flow to the employee only when he realizes a gain upon the sale of the shares and not by mere allotment. Therefore, this is not a meaningful distinction.

Valuation

9. The "market value" is taken as on the date of exercise. But the ESOP shares are allotted after a lapse of time, when the market value may not be the same.

10. Even the market value on the date of allotment would not be relevant because the employee would not be able to realize that "value", being prevented from selling the ESOP shares during the lock-in period.

11. Further, the issue of ESOP shares results in expanding the capital base, and a consequent reduction in the intrinsic value of the existing shares. For this reason also, the alleged benefit flowing from ESOP shares cannot be reckoned with reference to the current value of the already existing market shares.

ANNEXURE 2

TAXABILITY OF GRATUITY , LEAVE ENCASHMENT AND OTHER TERMINATION BENEFITS TO THE LEGAL HEIR(S) OF A DECEASED EMPLOYEE:

(a) **Regarding Leave encashment** –

There are CBDT circulars stating that leave salary paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/her death is not taxable as salary / not taxable. The gists of the 2 circulars are given below :

- Circular No. 35/1/65-IT(B), dated 5-11-1965 states if the legal representative of the deceased is to be taken to be the assessee, then the amount/proposed to be paid is certainly not due to him. It is an ex gratia payment on compassionate grounds in the nature of gift. Thus, the payment is not in the nature of salary.

- Circular No. 309 [F. No. 200/125/79-IT(A-I)], dated 3-7-1981 states this receipt in the hands of the family is not in the nature of one from an employer to an employee. The deceased had no right or interest in this receipt. This payment is only by way of financial benefit to the family of the deceased Government servant, which would not have been due or paid had the Government servant been alive. In view thereof the amount will not be liable to income-tax.

  Based on the above 2 circulars it would seem that CBDT intends to exempt in the hands of the legal heir the leave encashment salary received by the legal heir of a deceased employee.

(b) **Regarding Gratuity** –

- There is a CBDT circular No. 573 dated 21.08.90 which states that a lump-sum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Income-tax Act, 1961**. Infact this circular will cover all other lumpsum termination benefits being paid to the legal heir of a deceased employee, who dies while still in active service.**

- Further, there are 2 caselaws Smt. L.K. Thangammal Vs. Third Income Tax Officer (1 ITD 762 – ITAT Madras) and First Income Tax Officer Vs. Smt. A.A.Talati (31-TTJ-245- ITAT Mumbai) which clearly established the law [before introduction of Section 56(1)(v)] that **gratuity received by the legal heir of a deceased employee is not taxable , even after taking into account the provisions of section 10(10)(iii) of the Act.**

(c) However, Section 56(1) and section 2(24) has been amended w.e.f AY 2005-06 to include gratuitous payments received by an Individual / HUF (any sum of money received not exceeding the prescribed amount without any consideration) with a view to widen the scope of Income. There are certain specific exclusion to such gratuitous receipts but such exclusions do not cover the leave encashment, gratuity or other termination benefits received by the legal heir of any deceased employee in connection with the services rendered by him.

Hence, due to the introduction of Section 56(1)(v)/(vi)/(vii) the leave encashment, gratuity and other termination benefits received by the legal heir is now getting taxable though there were CBDT circular issued [before the introduction of Section 56(1)(v)/(vi)/(vii) of the Act] which had exempted such payments. As the earlier CBDT circulars have not been withdrawn there is a confusion as to whether these payments to legal heir are taxable income in their hands or not.

<u>Since death of an employee creates a lot of financial hardship to the legal heirs and it will be difficult for the legal heirs to calculate and pay taxes on the termination benefits received, hence it is suggested that CBDT should come out with a clear instruction that leave encashment , gratuity or other termination benefits received by the legal heir of a deceased employee is not taxable , even after the introduction of Section 56(1)(v)/(vi)/(vii) of the Act.</u>

ANNEXURE 3

IMPLICATIONS OF THE EXPLANATIONS INSERTED IN THE DEFINITION OF ROYALTY BY THE FINANCE ACT 2012

- As per explanation 2 to Section 9(1)(vi) of the Act, Royalty *inter alia* included within its ambit any lumpsum consideration for

  (a) the use of any patent , invention, model, design, secret formula or process or trademark or similar property.........

- **Explanation 6 to Section 9(1)(iv) has been introduced by Finance Act , 2012 which clarifies that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking , amplification, conversion for down-linking of any signal), cable, optic fibre or by any similar technology, whether or not such process is secret.**

- Based on the above clarificatory explanation introduced by the Finance Act 2012, various transactions **(as listed below)which are actually not in the nature of royalty payments and were earlier not within the ambit of TDS may now come under the purview of Section 194J, based on the wordings of Explanation 6** :

  (a) Payment of Telephone (including mobile) bills

  (b) Payment of Internet charges

  (c) Payment to cable operators, service providers like tata sky, distributors of tata sky, dish TV etc. for viewing the television channels

  (d) Payment of Broadband charges

  (h) Wheeling/ transmission charges paid to the state-electricity grid or private electricity transmission and distribution companies for transmission of electricity of the electricity generated by the windmills installed by private assessees to their factory/units for captive consumption

  (i) Electricity charges

- However, **there should not be any levy of TDS on the above transactions** viz., telephone / mobile charges, internet charges , payment for viewing television channels, electricity charges based on the amendment of Finance Act 2012, since –

  i. **The subscribers/ customers are not getting any right/claim any property in the transmission lines by paying these amounts. The contract between the subscriber and the other party in none of these cases is for using any transmission lines** (say for telephone charges, electricity charges, but it is a contract where the service provider (telecom co., electricity Co., etc.) are suppose to provide for a service by using their own infrastructure of cables, satellites, optic fibre line etc. Since no right is being given in respect of the transmission lines to the subscribers/clients , hence the payment made all the above transaction should not be treated as Royalty and no TDS should be deducted .

ii. The telecom co., electricity co., internet service providers are raising huge resistance against the deduction of Tax at source. BSNL, which is a PSU Company, has clearly circulated a letter wherein they have said that no TDS is applicable on telephone charges and in case tax is deducted by the subscribers/clients then telephone services will be discontinued. Copy of their letter is attached. Further, there is also a letter from CBDT to BSNL, letter no. 275/72/2002 – IT(B) dated 16-2-2004, wherein the CBDT has stated that TDS under section 194J would not be applicable on payment made by subscribers to telecom companies.

iii. There are caselaws delivered prior to the Finance Act 2012 [Skycell Communications Ltd. (251 ITR 53) – Madras High Court] wherein it has been clearly held that services in the nature of a standard facility , provided with the use of highly sophisticated equipment cannot be considered to be a technical service and hence does not attract TDS. Hence, no TDS u/s 194J is applicable on payment for telephone services, internet services etc. Thus, till date the Income Tax Dept had contested that these are payment for technical services and courts have clearly held that such payments are not technical services. Thus, now the department cannot do a volte face and assert that the above listed transactions are royalty payments (since these cannot be technical services in the light of the HC decision) on which TDS u/s 194J will be attracted.

iv. Regarding, wheeling/ transmission charges paid to the state-electricity grid or private electricity transmission and distribution companies for transmission of electricity of the electricity generated by the windmills installed by private assessees to their factory/units for captive consumption , there are specific caselaws by various Tribunals that no TDS u/s 194C or 194J on wheeling and transmission charges paid to State Electricity Transmission Co; Charges not for 'carrying out work' or FTS; Such payment is made pursuant to order of State Authorities constituted under Electricity Act and represents mere reimbursement of cost[TS-511-ITAT-2012(Mum)]

- Since the amendment to explanation 6 has created a lot of confusion as to the application of TDS u/s 194J on payments which are not in the nature of royalty itself**, it is suggested that CBDT comes out with a circular explaining the applicability of this new explanation 6 and specifically exclude payments for telephone (including mobile) bills, payment of Internet charges, Payment to cable operators, service providers for viewing the television channels, Payment of Broadband charges, Electricity charges, Wheeling/ transmission charges paid to the state-electricity grid or private electricity transmission and distribution companies for transmission of electricity of the electricity generated by the windmills installed by private assessees to their factory/units for captive consumption**