The Bengal Chamber

PRE – BUDGET MEMORANDUM FOR THE UNION BUDGET 2012 ON DIRECT TAXES

1. **TAX RATES :**

(a) Corporate Tax Rates :

In the context of the worldwide economic recession, it is suggested that in line with the DTC, the surcharge and education cess be removed in respect of corporates. This will result in generating more surpluses in the hands of companies with consequential impact on investments and growth. This assumes greater importance in the context of the latest estimate of GDP growth rate which is likely to be around 7.5% in 2011-12 as against 8.6% in 2010-11 and the apprehensions on the sharply decelerating industrial growth rate.

(b) Personal Tax Rates :

There is a need for urgent reduction of the personal tax rates because of the high level of inflation in the Indian economy. Suggested tax rate schedule (in line with the DTC) is given below :

Upto Rs. 2 lakhs	Nil
Rs. 2 lakhs to 5 lakhs	10%
Rs. 5 lakhs to Rs. 10 lakhs	20%
Above Rs.10 lakhs	30%

2. **SHORT TERM CAPITAL GAINS TAX – SECTION 111A** :

The rate for short term capital gains tax has been increased from 10% to 15% over the last few years. The lowest income tax slab is at 10% which was earlier in line with the short term capital gains tax rate. The present rate has resulted in a disparity in the said tax structure. For example if an individual has no other income and only short term capital gains of Rs.2 lakhs, he will have to pay tax on Rs.40,000/- @ 15% and not at the lowest slab of 10%. This anomaly needs to be corrected by reducing the short term capital gains tax to 10%. In fact, this will also result in giving a boost to the stock market.

3. **TAXING OF ESOPS** :

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 will be 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).**

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.

4. **TAXING OF CONTRIBUTION TO SUPERANNUATION FUND BEYOND SPECIFIED MONETARY LIMITS (CURRENTLY IN EXCESS OF RS.1 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. This provision was similar to that which was earlier applicable to FBT.

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.

5. **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, for the 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.

6. **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.

7. **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, 2012.

Most manufacturing organizations, especially those in power intensive industries, have been forced to invest substantial capital to meet their energy requirement, as the same is not available adequately from the Grid in the context of the acute power shortfall all over the country.

Therefore, it is recommended that Section 80 IA benefit be extended beyond March, 2012 for at least another 3 years, so that companies can continue to invest capital in power generation with a long term perspective.

8. **DEPRECIATION** :

(a) Depreciation rates :

The tax depreciation rates have been reduced over the last few years and is affecting investments into productive sectors. For instance, the earlier rate of tax depreciation was 25% for plant & machinery and has now been reduced to 15%. In fact, the current tax depreciation rate is even lower than the rate as per the Companies Act on such assets used on double/triple shifts. Therefore, it is recommended that the earlier rates of depreciation should be restored to avoid tremendous hardship to the capital intensive industries.

(b) Additional Depreciation :

Additional depreciation @20% which is applicable on plant & machinery only for the manufacturing sector, on fulfilment of stipulated conditions, should be extended to all asset categories and for all industries. Also, the Additional Depreciation benefit of 20% should be given in all instances irrespective of whether the investment is done before or after 30th September. In other words, it should be an investment linked benefit at a standard rate of 20% irrespective of whether investment has been done for half year or full year. In fact, in the absence of investment allowances, there is a necessity to incentivise investment flows through attractive tax benefits.

9. **LEASED ASSETS** :

Presently there are a lot of uncertainty & litigations surrounding the allowability of depreciation claim by the lessor on finance leases, inspite of there being circulars issued by CBDT clarifying the issues relating to claim of depreciation on leased assets. On top of this, even in few cases, the lease rentals paid by the lesseee to the lessor are not allowed as deductible expenditure.

To avoid litigation, the provisions of section 32 read with section 43(1) and section43(6) should clearly spell out the allowance of depreciation to the lessor at the prescribed rates and subject to fulfillment of certain conditions, in respect of leased assets – under operating base, finance lease etc.

10. **DIVIDEND DISTRIBUTION TAX :**

(a) Rate :

The current rate of dividend distribution tax is 15% plus surcharge 5% and cess 3% (effective rate 16.23%). Alongwith the Corporate Tax Rate of 32.445% (including surcharge and cess) , the incidence of tax on the Corporate Sector is as high as 40%

assuming 50% of the profits are distributed. Moreover, in a number of countries dividend distribution tax is not applicable since it is viewed as double taxation of profits, which itself is a subject of debate and dispute.

Therefore, it is suggested that the Dividend Distribution Tax be brought down to 12% and surcharge and cess be eliminated.

(b) Adjustment at multi - tier levels :

The amendment to section 115-O has now provided for adjustment of dividend received from subsidiary if the subsidiary has paid the dividend distribution tax and the domestic company is not a subsidiary of any other company. Subsidiary company has been defined as one in which the holding company holds more than 50% of the equity share capital. However, in case of multi-tier holdings this benefit is not available. Therefore, necessary amendments need to be introduced to provide for adjustment of dividend distribution tax payments at multi-tier levels. Moreover, very many companies in India which are subsidiaries of foreign companies are not getting this adjustment benefit. This aspect should also be reconsidered.

11. **CORPORATE SOCIAL RESPONSIBILITY COSTS :**

Corporates are currently involved in various areas of social responsibility/community development as part of nation building. Suitable tax incentives should be introduced in respect of such Corporate Social Responsibility Costs to accelerate the process and to ensure that the country can reach the goal of being a developed nation in the near future. It is suggested that a weighted deduction of 150% of the expenditure on community / social development (both capital and revenue) be introduced, specifically covering critical areas like education, health, animal husbandry, water management, womens empowerment, poverty alleviation and rural development. Further, even in cases where a company has its own trust or foundation it should also be eligible for the weighted deduction in respect of expenditure incurred for CSR activities.

12. **HOTEL INDUSTRY** :

(i) Inclusion of Hotels in Schedule XIV of Sec 80 IC : As per Sec 80 IC of the Income Tax Act any undertaking commencing any operation specified in Schedule XIV having undertaken substantial expansion during the period 1/1/2003 to 1/4/2012 to promote eco tourism in the special category states (like Sikkim, Assam, Tripura, Meghalaya, Mizoram, Nagaland, Manipur, Arunachal Pradesh, Uttaranchal and Himachal Pradesh) are exempt from Income Tax for 5 years for promoting eco tourism in the country.

But Schedule XIV of the Act does not include hotels as an eligible operation for taking benefit under this provision. It is evidently clear that the hotels sector is a strong driving force in eco tourism in the country and hence the benefit of this provision should be extended to cover hotels by including it as an eligible activity in Schedule XIV. Also, the benefit should be extended beyond 2012 for at least another three years.

(ii) PAN Number for payments in Hotels / Restaurants : Under Rule 114B, PAN number is required for all payments exceeding Rs.25,000/- in hotels and restaurants. Most parties pay by credit card and it becomes a huge problem to collect PAN number in all instances. It may be noted that credit card companies are separately reporting under rule 114E expenses exceeding Rs.2 lakhs per annum on PAN number basis. Further, the said limit of Rs.25,000/- for hotel/restaurant bills was fixed way back in November 1998. Therefore, it is suggested that the clause may be continued but its applicability may be restricted to hotels and restaurants for only cash payments above Rs.1,00,000/-.

(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) Section 194 I (TDS) : 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.

13. **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.

(a) PAN for foreign parties i.e. non-residents : The explanatory notes to the Finance Bill specifically has stated that this will also apply to non-residents. It may be noted that a large number of foreign remittances relate to import of goods, payment for participation in seminars / conferences and fairs abroad etc. The stipulation regarding PAN for such payments will create unnecessary hurdle to the operations of Corporates and also create huge harassment. Therefore, it is submitted that a clause should be inserted to provide that the requirement of PAN would not be applicable to non-residents in respect of specified cases. Further, in case of foreign companies, in absence of PAN, the applicable TDS is 40% which is a punitive rate and causing excessive hardship to such companies and this should be corrected and brought down to 20%.

(b) PAN for domestic parties : 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 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. Further, in case of foreign companies, in the absence of PAN a standard rate of 20% should be made applicable.

(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. 20000 at a time or Rs. 50000 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. 100000 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 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**.

(vi) APPLICABILITY OF TDS TO BE DETERMINED NET OF SERVICE TAX :

The CBDT has only clarified vide Circular no.4/2008 dated 28/4/2008 that the computation of TDS 'net of service tax' is to be done in respect of section 194-I for rental income. However for TDS under other sections like section 194C, 194J etc. the law has not spelt out whether TDS has to be determined inclusive of service tax or net

of service tax. It is suggested that the provisions of Chapter XVII-B should be made applicable 'net of service tax' since the same represents a tax and not any income.

Further, reimbursement of octroi, works contract tax etc. is currently included for determination of TDS resulting in double burden to the parties since the local tax also goes to the State Government. Therefore, such taxes should also be specifically excluded from TDS computation.

14. **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.

15. **MAT :**

MAT was introduced to bring into the tax net the dividend paying companies enjoying benefits of higher depreciation and other tax exemptions, resulting in nil/ lower taxable income. However, the various tax exemptions and benefits including depreciation rates have been reduced over the years. Consequently, continuance of MAT has become redundant and therefore the said provision, which is giving rise to unnecessary litigation should be abolished or alternatively reduced substantially.

Further, MAT ought to be levied on profits that a corporate can distribute as dividends under the Companies Act. However, over the years, due to various amendments, MAT computation is now resulting in profits greater than the actual book profits that can be distributed as dividend and is therefore against the stated objectives of MAT. For example, provisions for doubtful debts, deferred tax liability etc. are not distributable as dividends but MAT is applicable under the current law. Therefore, it is recommended that if MAT is continued, the various items under section 115JB like explanation 1(h), 1(i), 1(viii) etc. should be removed

Also, there appears to be no rational basis for restricting carry forward of MAT paid to 8 years only. This time limit which has no logical basis should be removed and it should be adjustable against normal income tax in subsequent years.

Further, under the current law, MAT credit balance in the amalgamating company is not available to be carried forward to the amalgamated company. This benefit should be allowed in line with unabsorbed losses and unabsorbed depreciation benefits. Specific amendments for the purpose need to be introduced in section 115JB.

16. **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.

17. RULE 8D OF THE INCOME TAX RULES IN THE CONTEXT OF SECTION 14A FOR DETERMINING EXPENSES DISALLOWABLE IN THE CONTEXT OF EXEMPT INCOME :

CBDT has notified rule 8D for computation of proportionate expenses to be disallowed under section 14A in the context of exempt income. Clause (iii) of sub-rule (2) of rule 8D stipulate that ½% of the average value of investment is disallowable.

This is totally illogical and arbitrary and without any basis. For instance, a shareholder cannot incur ½% of the value of shares as expenses for earning the dividend every year. In fact, there could be instances where such computation would result in expenses being disallowed for an amount more than the income itself. Therefore, it is suggested that this clause should be removed.

18. WEIGHTED DEDUCTION UNDER SECTION 35(2AB) FOR SCIENTIFIC RESEARCH :

The weighted deduction in respect of scientific research will be lapsing on 31st March, 2012 . The country has to invest heavily on R & D to attain and retain the competitive edge in the world markets. It is therefore suggested that the concerned tax benefit should be extended to 31.3.2015.

19. DEDUCTION FOR SECURITIES TRANSACTION TAX :

Prior to assessment year 2009-10, securities transaction tax was allowed as a deduction under section 88E from the income tax in respect of income chargeable under the head 'profits and gains of business or profession'. However, this provision was withdrawn and section 36(1)(xv) was introduced whereby the said tax was made deductible from the business income computation. This provision is illogical and inequitable. Therefore, it is suggested that securities transaction tax be made deductible from income tax as was existing before.

20. 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.

21. **ROYALTY/FEES FOR TECHNICAL SERVICES** :

The requirement for Royalty / Fees for Technical Services (FTS) agreement being approved by the Central Government or being in consonance with the current industrial policy is an age old provision and need to be scrapped. The fact that most foreign royalty/ FTS payments are now under automatic route and subject to maximum caps makes the provision virtually redundant.

22. **INCOME-TAX – WEIGHTED DEDUCTION FOR CROP DEVELOPMENT AND AGRI EXTENSION** :

The only way that farm yields can be improved and brought to international levels is by doing grass-root extension work. Enhancing productivity lies at the root revitalizing Agriculture, together with effective linkages to markets – both domestic and international. In this context, effective agricultural extension services are crucial to enable effective absorption of technology and best practices at farms. In order to ensure widespread reach of effective extension services, the providers of such services and those engaged in crop development activities need to be recognized on par with Research and Development.

Sec.35(2AB) of Income Tax Act permits a weighted deduction of 200% of expenditure on Scientific Research, in-house Research and Development facility in specified industries. This facility should also be extended to expenditure on agri extension and crop development being done by all industries. By this, all companies engaged in extension of services/research will be encouraged to invest in the upgradation of cultivation /agri practices for improved returns to the farmers.

Section 33 A of the Income Tax Act which permits Development Allowance for Tea plantations should also be extended to Crop Development of other cash crops like coffee, tobacco etc. with a weighted deduction of 150%. By this, those engaged in Crop Development / extension services / research will be encouraged to invest in the upgradation of cultivation for improving returns to the farmer and enhancing export competitiveness.

Similarly, assistance given to farmers by the Industry towards modernisation of cultivation practices, e.g. Solar Barns, Seedlings, Irrigation Equipment, should be given weighted deduction @ 200% in the year in which it is incurred.

23. **INCENTIVISING INVESTMENTS IN RESPECT OF AGRICULTURAL INFRASTRUCTURE** :

There is an urgent need to invest heavily in building up of a viable and efficient infrastructure in the agriculture sector in India. This would necessitate building up of proper computerized infrastructural facilities and electronic highways for procurement, dissemination of best agricultural practices, weather information, storage practices etc. as well as offering the best possible price to the farmers. Also, this would result in cutting down intermediaries/middlemen and thereby reduce the transaction costs. In fact, the Government has recently launched the ambitious Bharat Nirman Program for upgrading the rural infrastructure covering roads, irrigation, drinking water, electricity, housing and telecom. The Government has also mentioned that this is an area with significant scope for public/private partnership. Proper tax incentives need to be provided for ensuring that the private Corporate Sector can also be involved in this gigantic developmental effort.

Section 80IA of the Income Tax Act provides for deduction in respect of profits/gains from industrial undertakings engaged in infrastructure development. This covers road, bridge or rail, highway projects, water projects, ports, airports, telecommunication services, industrial parks and power generation. The definition of infrastructure should be extended to include rural infrastructure like :

- Village kiosks housing IT infrastructure like computers, VSATs, Modems, smart cards, projectors, screens etc.
- Support infrastructure like solar-panels, UPS, Batteries etc. at these locations.
- Water harvesting facilities like check dams, wells ponds and other rain harvesting structures.
- Storages including farmer facility center housing training centers, cafeteria, health clinic, pharmacy, bank counters and necessary parking area.
- Green houses and poly houses.

The tax incentives can take the following forms :

i. deduction of proportionate profits for the total value of turnover arising from such computerized infrastructural facilities (in line with the provisions of section 80IA read in conjunction with section 80HHC) for purposes of simplification and avoidance of disputes.

ii. deduction of 150% of the total expenditure incurred, both capital and revenue, for creating such infrastructure (similar to the provisions of section 35).

24. **TRANSFER PRICING FOR INTERNATIONAL TRANSACTIONS** :

As per the Income Tax Act, detailed stipulations are laid down in respect of determination of the arms length price in the context of international transactions with associated enterprises, within the limits of (+) / (-) 5% of the price computed as per the methods prescribed. It is suggested that :

- as per the practice prevalent in various developed countries e.g. USA, it should be sufficient if the arms length price falls within a range of the various comparable prices.

- or else, 15% price flexibility should be provided for against the current 5% flexibility.

In fact, the Finance Act '09 has made certain structural interventions in this area which has worsened the situation for the assessee. This is explained below :

- With respect to the proposed change in the proviso to section 92C(2), the permissible adjustment of +/- 5% to the arithmetic mean of the comparable uncontrollable transactions has been re-worded in a fashion whereby an assessee will be worse off than before. The mathematical example below illustrates this :

Particulars	Assessee's Sale price under TP review	Arithmetical Mean of the Arm's Length Price (ALP) (based on comparable uncontrolled prices	Adjusted ALP after 5% variation	TP Adjustment
Existing proviso	Sale of INR 100	Sale price of INR 125	125 x 0.95 = 118.75	118.75 – 100 = 18.75
Revised proviso (as proposed)	Sale of INR 100	Sale price of INR 125	100 x 1.05 = 105	125 – 100 = 25

The increase in burden as a result of the change in proviso is evident from the TP adjustment column above. Since the proposed proviso also runs contrary to the favourable ITAT decisions on this subject, it is recommended that the proviso be examined afresh.

Presently, there is no guidance/rules regarding the allowability of data accessibility for the purpose of comparability for determining the arm's length price. It is noticed that the Assessing Officer resort to arbitrary selection of data base, which are in the interest of the revenue. For example, ignoring loss making companies to arrive at industry margin or considering data for a particular year ignoring data available for a business cycle of 2-3 years which may be relevant in benchmarking arm's length price of an industry. This leads to unnecessary litigation and cost to the assesses.

Moreover, certain other suggestions in respect of Transfer Pricing are given below :

- The earlier Finance Act had stipulated that the CBDT shall introduce Safe Harbour Rules under section 92 CB. it is important that the proposed rules are put up in the public domain for comments before these are implemented.

- the penalty clause should state "*upto*" instead of "*shall*" under sections 271AA and 271BA since, otherwise it becomes a mandatory penalty.
- advance pricing mechanism should be introduced.
- specialized CIT(Appeals) should be provided for in all the international taxation offices.

25. **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.

It may be noted that currently exclusions are available for compensation received under the Montreal Protocol for ozone depleting substances {proviso ii to section 28(va)}. Similar provisions should be introduced for reduction in greenhouse gases under the Kyoto Protocol.

26. **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.

27**. POWER TO ADJUST UNDER SECTION 143(1**) :

Section 143(1) has been amended to provide for the power to adjust arithmetical errors and incorrect claims if it is apparent from any information in the return. The

Memorandum to the Finance Bill, 2008 states that the said change in section 143(1) has been brought about in the context of centralized processing of returns with the help of computers without any human interface. However, this has not been incorporated in the proposed amendment.

It may be noted that the said power was earlier available under section 143(1)(a) and it was withdrawn on account of widespread harassment and misuse of the said power. Cases where no scrutiny was applicable, were picked up for disallowing various valid deductions/claims and this resulted in harassment and litigation. Therefore, it is suggested that the amended law specifically records that such power to amend under section 143(1) will only be applicable in case of computerized processing of returns in line with the Memorandum Statement.

28. **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 thousands across 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.

29. **AMORTIZATION OF CERTAIN PRELIMINARY EXPENDITURE – SECTION 35D(2)(C) :**

At present issue expenses for public subscription of shares or debentures are covered under the above section. However, with the change to a modern, global and liberalized economy and financial system, many innovative instruments are used (e.g. ECB, FCCB, GDR, ADR etc.) to raise fund. The cost of raising such fund may be covered under the above section with a clear stipulation.

30. DEDUCTION FOR PAYMENTS UNDER VOLUNTARY RETIREMENT SCHEME –SECTION 35DDA :

Under the above section, deduction @ 1/5th of the amount paid to the employees is allowed in respect of payments made to employees under voluntary retirement schemes. Thus, the deduction is allowed over a period of 5 years. This section covers "payment of any sum to an employee at the time of his voluntary retirement." Many companies have structured different schemes to give voluntary retirement to their employees. Some of them are in the nature of monthly pension or payments spread over a few years. Many corporate would like to fund these monthly pension, etc. by purchasing an annuity with LIC/any other insurance company. It is submitted that when the annuity is purchased for covering such payments, deduction @ 1/5th should be allowed under Section 35DDA of the Income Tax Act.

Suggested amendment to Section 35DDA(1) :

"*Where an assessee incurs any expenditure in any previous year by way of payment of any sum to an employee in connection with his voluntary retirement* ***or purchase of an annuity from an insurance company to cover such payments****, in accordance with any scheme or schemes of voluntary retirement, 1/5th of the amount so paid shall be deducted…………"*

31. INCLUSION OF CAPITAL INTENSIVE INDUSTRIES UNDER SECTION 35AD :

Under the provisions of section 35AD, 100% of the capital expenditure is allowed as a deduction in the first year itself in case of certain specified industries which are capital intensive. It is suggested that this provision should be extended to other important industries like paper and steel which are hugely capital intensive and major investments are required in the next few years for ensuring a high GDP growth rate for the country.

32. CHARITABLE PURPOSE – SECTION 2(15) :

As per the first proviso to section 2(15) "charitable purpose" excludes any activity in the nature of any trade, business or commerce or any activity of rendering any service in relation to any trade/business/commerce for a fee, irrespective of the nature or use or application of such activity. This has created lots of operational difficulties for various genuine trusts, which are involved in various charitable and philanthropic activities. While the intention of the legislature is not to hit the genuine trusts carrying on charitable activities, the provisions may be construed differently by the tax authorities. Therefore it is suggested that if such activity is incidental to the main objects and is of a minor nature, then it should continue to be treated as a charitable purpose. For instance, a charitable trust involved in charitable/philanthropic activities in rural areas eg. organizing self-help groups, cattle grazing etc. can organize a small function and the amounts collected by way of advertisements or entry fees should not result in such trust being treated as being involved in business. Accordingly, it is recommended that an explanatory clause be added stating that the ancillary and incidental activities for achieving the main objects of the trust, if it is of a secondary/minor nature, should not constitute any trade, business or commerce.

Moreover, in the context of the principle of mutuality, Chambers of Commerce and Industry Associations should also be excluded from the said proviso since fees / subscriptions are received from members for promotion of their interests and for providing services to them.

In this connection, it may be noted that in the Budget / Finance Act, 2010, a new proviso has been inserted which provides relief to the extent of Rs.10 lakhs. However, this amount is not adequate for larger trusts and therefore it is recommended that the relief should be provided as a percentage of the gross receipts. We recommend 20% or Rs.20 lakhs, whichever is higher.

33. **DIVIDEND FROM FOREIGN COMPANIES SHOULD BE TAXED AT CONCESSIONAL RATE :**

Under section 10(34) read with Section 115-O of the Income Tax Act, dividends distributed by a domestic company are exempt from income tax in the hands of the shareholders. However the companies are required to pay a dividend distribution tax @ 15%.

As India is embarking on a path of globalization whereby we see many of the Indian companies acquiring companies abroad and making investments in those companies, it is necessary to bring such investment at par as far as the dividend exemption is concerned. It is, therefore, submitted that dividends earned in respect of shares acquired in foreign companies be taxed @ 15% in line with the dividend distribution tax on domestic dividends.

34. **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.

Further, the stipulation for penalty does not include the concept of “Mens Rea”. However, as it stands today, the interest that an assessee pays for delayed payment of tax or differential tax determined in the assessment is quasi penal in nature in the sense that the rate of interest is much higher than the rate at which the Government pays to the assessee in case of excess tax collected. Therefore, levy of penalty in addition to interest, without any evidence of malafide on the part of the assessee is unduly harsh. Evidently, the Tax Laws are extremely complex and it is unfair to presume that every default is intentional and was with a view to evade tax. Therefore, it is suggested that the concept of Mens Rea should be introduced in the penalty provisions of the Income Tax Act.

35. **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.

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

Section 292BB has been incorporated 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.

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

The Finance Act, 2006 had expanded the list under section 80C by including the pension fund subscription and bank fixed deposits for 5 years or more. However, the overall limit of Rs.1 lakh has been left unchanged. It is suggested that this limit is increased to at least Rs.2.5 lacs to accommodate for the increased items in the list, specially since standard deduction has also been removed. This would also act as a fillip for boosting investments.

38. **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/-(in line with the DTC).

39. **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.

40. **DEDUCTION FOR HEALTH INSURANCE PREMIUM** :

Deduction is allowed under section 80D in respect of medical insurance premium of an individual or his family to the extent of Rs.15,000/-. In the context of the sharply increasing medical expenses, medical insurance premiums are escalating every year. Also, there is need to increase the penetration ratio of insurance by providing encouragement through tax reliefs for opting for medical insurance. Therefore, it is suggested that the limit be raised to Rs.25,000/-.

41. **SECTION 80L FOR BANK INTEREST ETC**.:

All individuals normally have money in bank accounts which earn interest at a very conservative rate. This interest income, alongwith some other stipulated items like post office deposits, etc. were earlier given the benefit of tax deduction under section 80L to the extent of Rs.12,000/-. This benefit was withdrawn in 2005 and has created unnecessary hardship to individuals alongwith related complications like payment of advance tax, filing of tax returns etc.. Therefore, it is suggested the tax benefit under section 80L should be re-introduced. Also, considering the sharp reduction in the value of money, the limit should be enhanced to Rs.20,000/-.

42. **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.

43. **INTEREST ON HOUSING LOAN – INCREASE OF LIMIT TO RS.2.5 LAKHS UNDER SECTION 24** :

The section 24 of the Income Tax Act provides for deduction of interest on housing loans upto Rs.1.5 lakhs for self occupied property on borrowings done after April 1999 and acquisition / construction completed within 3 years. This limit was introduced by the Finance Act 2001 and therefore, the limit needs to be urgently revised to at least Rs.2.5 lakhs. Moreover, in the context of the time required for completion of large housing projects , it is recommended that the time limit be extended to 5 years.

44. **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.

45. **FRIVOLOUS APPEALS BY REVENUE BEFORE THE TRIBUNAL :**

It has been noted that the Revenue often files frivolous appeals before the Tribunal against the order of Commissioner (Appeals) on any and every issue regardless of the quantum of tax involved and also where the judgment of the Commissioner (Appeals) is based on undisputed facts of the case or covered by earlier Tribunal decisions. It is suggested that a more stringent appeal filing procedure be drawn up (e.g. if covered by earlier Tribunal orders no appeal should be filed, CCITs sanction etc.).

46. **WEALTH TAX** :

Presently Wealth Tax is applicable for companies in respect of motor cars and residential housing property for employees with gross salary upto Rs.5 lacs. These provisions are more than 10 years old and therefore the following are suggested :

- motor cars should be excluded if it is below Rs.15 lacs

- residential housing should also be excluded in respect of employees with gross annual salary below Rs.20 lakhs.

The exemption limit should also be enhanced from the current limit of Rs.30 lakhs to Rs.1 crore (in line with the DTC) in the context of the galloping inflation in the last few years.

Further, for individuals, the exemption in respect of one house property should be enhanced to two properties to give a fillip to the housing sector in the country.

Without prejudice to the above, it may be noted that the amount of revenue collected on account of wealth tax is very meagre currently. As per last year's budget papers the projected revenue was around Rs.500 crores and direct expenditure was Rs.300 crores. Therefore, it appears that there is no purpose served in continuing with this tax especially when one considers the indirect costs incurred in the areas of assessments and appeals by the Income Tax Authorities as well as the large number of litigations involved.

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Annexure

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.