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Supplementary Memorandum Explaining the Official Amendments Moved in the Finance Bill, 2012 AS REFLECTED IN THE FINANCE ACT, 2012

FINANCE ACT, 2012 - PROVISIONS RELATING TO DIRECT TAXES

The Finance Bill, 2012 was introduced in Parliament on 16-3-2012. Certain official amendments have been carried out during the passage of the Bill in Parliament. A gist of the official amendments to the Finance Bill, 2012 as reflected in the Finance Act, 2012 (Act No. 23 of 2012) enacted on 28-5-2012, are as under. The clauses of the Finance Bill, 2012 have been renumbered during the passage of the Finance Act, 2012 in Parliament. The clauses referred to in this document, unless otherwise stated, are those as they appear in the Finance Act, 2012.

Exemption to Prasar Bharati (Broadcasting Corporation of India)

A specific exemption from income tax to the Prasar Bharati (Broadcasting Corporation of India) has been provided by inserting a new clause (*23BBH*) in section 10 of the Act.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

[Clause 5]

General Anti-Avoidance Rule (GAAR)

In the Finance Bill, 2012, as introduced in the Lok Sabha, General Anti-Avoidance Rules (GAAR) were proposed in the Income-tax Act (Act) by way of insertion of a new Chapter X-A. Further, a procedural section (144BA of the Act) was also proposed, providing, *inter alia,* for a GAAR Approving Panel comprising of officers of the rank of Commissioner of Income-tax and above.

GAAR provisions were first proposed in the Direct Taxes Code Bill, 2010 (DTC) introduced in the Parliament in August 2010. The Report of the Parliamentary Standing Committee on Finance on the DTC Bill was received on 9-3-2012 after the finalization of the proposals of the Finance Bill, 2012. After examining the recommendations of the Standing Committee regarding GAAR provisions as proposed in the DTC Bill, the following amendments to the GAAR provisions proposed in the Finance Bill, 2012 have been carried out in the Finance Act, 2012:-

(*i*) The onus on the taxpayer as regards the presumption that obtaining the tax benefit was not the main purpose of the arrangement has been omitted. Thus, the onus of proof will be on the

Revenue for any action to be initiated under GAAR, [Section 96(2) of the Act, as introduced in the Finance Bill, 2012 has therefore been deleted].

(*ii*) To introduce an independent member in the GAAR approving panel, one member of the approving panel would be an officer of the level of Joint Secretary or above from the Ministry of Law.

(*iii*) Any taxpayer (resident or non-resident) can approach the Authority for Advance Ruling (AAR) for a ruling as to whether an arrangement to be undertaken by him is an impermissible avoidance arrangement under the GAAR provisions. The reference can be filed on any date on or after 1-4-2013 to seek an advance ruling regarding an arrangement to be undertaken.

(*iv*) In order to provide more time to both taxpayers and the tax administration to address the issues arising from GAAR provisions so that there is clarity and certainty in the matter, it is proposed to defer the applicability of the GAAR provisions, proposed in Chapter X-A and section 144BA of the Act, by one year so that they would now apply to income chargeable to tax in respect of assessment year 2014-15 and subsequent years.

[Clauses 41, 62, 94 and 95]

Venture Capital Companies (VCC) and Venture Capital Fund (VCF)

Under the provisions of the Act, payment made by a VCC or a VCF to its investors out of income received from a Venture Capital Undertaking (VCU) is exempt from the tax deduction at source (TDS). Also no Dividend Distribution Tax (DDT) or tax on distributed income is levied on payment by the VCC/VCF to the investor. While rationalizing the provisions relating to VCCs and VCFs, such as doing away with sectoral investment restrictions under the Act, it was proposed in the Finance Bill, 2012 (clause 54) to withdraw these exemptions. Considering the representations received and in order to minimize compliance burden, the Finance Act, 2012 continues with the exemption from TDS, DDT and tax on distributed income on the payments made by the VCC or VCF to its investors in respect of the income arising from the investments made by such VCC or VCF in a Venture Capital Undertaking. Consequently, the proposed amendment in Finance Bill, 2012 insofar as it relates to the withdrawal of exemption from TDS, DDT and tax on distributed income is concerned, is withdrawn and the earlier position as provided in the Act continues.

[Clause 57]

Lower withholding at the rate of 5% for external borrowings under ECB or by way of issue of long term infra-bonds

It had been proposed in the Finance Bill, 2012 (by way of insertion of a new section 194LC in the Act) to provide for lower rate of withholding tax at the rate of 5% (instead of 20%) on payment by way of interest paid by an Indian company to a non-resident (including a foreign company) in respect of borrowing made in foreign currency from sources outside India between

1st July, 2012 and 1st July, 2015, under a loan agreement approved by Central Government, if the Indian company was engaged in one of the eight specified businesses. In order to attract low cost borrowings from abroad, this incentive has been extended in the Finance Act, 2012 to all businesses instead of restricting it to the eight specified sectors. Further, this lower rate of withholding tax is proposed to be also available for funds raised in foreign currency outside India by the Indian company through long term infrastructure bonds as approved by the Central Government besides borrowing under a loan agreement.

These amendments will take effect from 1st July, 2012.

[Clause 76]

Concessional rate of taxation on long term capital gain in case of non-resident investors

Currently, under the Income-tax Act, a long term capital gain arising from sale of unlisted securities in the case of Foreign Institutional Investors (FIIs) is taxed at the rate of 10% without giving benefit of indexation or of currency fluctuation. In the case of other non-resident investors, including Private Equity investors, such capital gains are taxable at the rate of 20% with the benefit of currency fluctuation but without indexation. In order to give parity to such non-resident investors, the Finance Act reduces the rate of tax on long term capital gains arising from transfer of unlisted securities from 20% to 10% on the gains computed without giving benefit of currency fluctuations and indexation by amending section 112 of the Income-tax Act.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

Consequential amendments to provide for tax deduction at source have also been made in the First Schedule and will be effective from 1st April, 2012.

[Clause 43 & First Schedule]

Share premium in excess of fair market value to be treated as income

In the Finance Bill, 2012, it had been proposed [section 56(2), as sub-clause [(*viib*)] that in case of a company, not being a company in which the public are substantially interested, which receives, in any previous year, from any person being a resident, any consideration for issue of shares and the consideration received for issue of such shares exceeds the face value of such shares, then the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income tax. An exemption was provided in a case where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a venture capital fund.

(*i*) It has now been further provided that such excess share premium is included in the definition of "income" under sub-clause (*xvi*) of clause (*24*) of section 2.

(*ii*) Considering that the proposed amendment may cause avoidable difficulty to investors who invest in start-ups where the fair market value may not be determined accurately, it is proposed to provide an exemption to any other class of investors as may be notified by the Central Government.

These amendments will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

[Clauses 21, 3]

New deduction in respect of investment in equity shares

It was announced in the Budget Speech for 2012-13 that a new scheme is proposed to encourage flow of savings in financial instruments and improve the depth of domestic capital market. Accordingly, a new clause has been introduced in the Finance Act, 2012 to insert a new section 80CCG in the Income-tax Act. The provision provides for a one-time deduction of 50 per cent of the amount invested in listed equities by a new retail investor, being a resident individual whose annual income is below Rs. 10 lakh. The aggregate deduction shall be subject to a limit of Rs. 25,000 (corresponding to an investment limit of Rs. 50,000) and the investment shall have a lock-in period of 3 years. The modalities of this provision shall be in accordance with a scheme to be notified by the Central Government in this behalf.

This amendment will take effect from 1st April, 2013 and will, accordingly, apply in relation to the assessment year 2013-14 and subsequent assessment years.

[Clause 25]

Recognition to provident funds - Extension of time limit for obtaining exemption from EPFO

Rule 4 (in Part A) of the Fourth Schedule to the Income-tax Act provides for the conditions to be satisfied by a Provident Fund for receiving or retaining recognition under the Income-tax Act. One of the requirements of rule 4 [clause (*ea*)] is that the establishment shall obtain exemption under section 17 of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF & MP Act).

The first proviso to sub-rule (1) of rule 3 (in Part A) of the Fourth Schedule, *inter alia*, specifies that in a case where recognition has been accorded to any provident fund on or before 31st March, 2006, and such provident fund does not satisfy the conditions set out in rule 4 [clause (*ea*)], the recognition to such fund shall be withdrawn if such fund does not satisfy such conditions on or before 31st March, 2012.

In order to provide further time to Employees' Provident Fund Organization (EPFO) to process the applications made by establishments seeking exemption under the EPF & MP Act, the proviso has been amended to extend the time limit from 31st March, 2012 to 31st March, 2013.

This amendment will take effect retrospectively from 1st April, 2012.

[Clause 114]

Tax Collection at Source (TCS) on cash sale of bullion and jewellery

The Finance Bill, 2012, proposed to provide that the seller of bullion or jewellery shall collect tax at source (TCS) at the rate of 1 per cent of sale consideration from every buyer of bullion and jewellery in cash if the sale consideration exceeds Rs. 2 lakh. In order to reduce the compliance burden, the threshold limit for TCS on cash purchase of jewellery has been increased to Rs. 5 lakh from the proposed Rs. 2 lakh. The threshold limit for TCS on cash purchase of bullion is retained at Rs. 2 lakh. Further, it has also been provided that bullion shall not include any coin or any other article weighing 10 grams or less.

This amendment will take effect from 1st July, 2012.

[Clause 81]

TCS on sale of certain minerals

The Finance Bill, 2012, proposed to provide that tax at the rate of 1% shall be collected by the seller from the buyer of the following minerals:

(*a*) coal;

(*b*) lignite; and

(*c*) iron ore.

Under the existing provisions of the sub-section (1A) of section 206C the seller of these minerals is not required to collect tax if the buyer declares that these minerals are to be utilized for the purposes of manufacturing, processing or producing articles or things. As some of these minerals can also be used for generation of power and the existing provisions do not allow the buyer to file a declaration to this effect, the section has been amended to also provide that the seller of these minerals shall not collect tax if the buyer declares that these minerals are to be utilized for the purposes of generation of power.

This amendment will take effect from 1st July, 2012.

[Clause 81]

Minimum Alternate Tax (MAT)

I. Under section 115JB, every company is required to prepare its accounts as per Schedule VI of the Companies Act, 1956. However, as per the provisions of the Companies Act, 1956, certain companies, *e.g* . insurance, banking or electricity companies, are allowed to prepare their profit and loss account in accordance with the provisions specified in their Regulatory Acts. In order to align the provisions of the Income-tax Act with the Companies Act, 1956, the Finance Bill, 2012 proposed to amend section 115JB to provide that in the case of companies which are not required under section 211 of the Companies Act, 1956 to prepare their profit and loss account in accordance with Schedule VI of the Companies Act, 1956, the profit and loss account prepared in accordance with the provisions of their respective Regulatory Acts shall be taken as a basis for computing the book profit for the purpose of section 115JB. This amendment was proposed to be made effective from assessment year beginning on or after 1st April, 2013.

However, as the provisions of section 115JB are applicable to an insurance company or a banking company or an electricity company for prior assessment years also, it has been clarified in the Finance Act by way of an *Explanation* that for the assessment year beginning on or before 1st April 2012, an insurance company or a banking company or an electricity company has an option, for the purpose of MAT, to prepare its profit and loss account either in accordance with the provisions of Schedule VI to the Companies Act, 1956 or in accordance with the provisions of its governing Act.

II. Further, under section 115B of the Act, profits and gains of an insurance company from life insurance business are already subject to tax at a specific rate based on actuarial valuation. It has therefore been provided that the provisions of section 115JB of the Act shall not apply to any income accruing or arising to a company from life insurance business referred to in section 115B. This amendment will take effect retrospectively from 1st April, 2001 and will, accordingly, apply in relation to the assessment year 2001-02 and subsequent assessment years.

[Clause 48]

Rationalisation of TDS Provisions

I. Under the existing provisions of Chapter XVII-B of the Act, tax is required to be deducted (TDS) from certain payments. There are situations where collection of tax by way of TDS may cause genuine hardship to the deductee. In order to reduce the hardship and compliance burden in these cases, it has been provided that no deduction of tax shall be made from such specified payment to such institution, association or body or class of institutions, associations or bodies as may be notified by the Central Government in the Official Gazette.

This amendment will take effect from 1st July, 2012.

[Clause 78]

II. The Finance Bill, 2012 proposed to provide that the intimation generated after processing of TDS statement under sub-section (1) of section 200A shall be deemed as a notice of demand under section 156 of the Act. Consequently, failure to pay the tax specified in the intimation shall attract levy of interest under section 220 of the Act. However, sub-section (1A) of section 201 already contains provisions for levy of interest for non-payment of tax specified in the intimation issued under sub-section (1) of section 200A. It has therefore been further provided that where interest is charged for any period under sub-section (1A) of section 201 on the tax amount specified in the intimation issued under sub-section (1) of section 200A, then, no interest shall be charged under sub-section (2) of section 220 on the same amount for the same period.

This amendment will take effect from 1st July, 2012.

[Clause 84]

Withdrawal of TDS on transfer of certain immovable properties

The Finance Bill, 2012 (clause 73 of the Finance Bill) proposed to provide for deduction of tax at the rate of 1% of the amount paid or payable for transfer of certain immovable properties. The proposed provision of tax deduction on transfer of immovable properties was for collecting tax at first point and also tracking transactions in real estate sector. However, considering the additional compliance burden on the transferee, the proposed provision of tax deduction on transfer of immovable properties has been withdrawn in the Finance Act, 2012 by dropping this clause from the Finance Bill, 2012.

Compulsory filing of income tax returns by residents in relation to assets located outside India

Under section 139 of the Income-tax Act, every resident is required to file a return of income if his income exceeds the maximum amount which is not chargeable to tax. The Finance Bill, 2012 had proposed to make it mandatory for every resident, to file a return of income, if he has assets (including any financial interest in any entity) located outside India or signing authority in any account located outside India, irrespective of the fact whether his income exceeds the exemption limit or not. The intention is to have information available regarding global assets of a resident since the income from such assets is taxable in India.

As a category of residents are called "not ordinarily resident" and the income of a "not ordinarily resident" individual from assets located outside India is not taxable in India, it has been clarified that the provision for compulsory filing of income tax return in relation to assets located outside India would not apply to a person, who is "not ordinarily resident".

This amendment will take effect retrospectively from 1st April, 2012 and will, accordingly apply in relation to assessment year 2012-13 and subsequent assessment years.

[Clause 59]

Securities Transaction Tax (STT) on unlisted equity sold as part of an initial public offer and exemption from long-term capital gains

Securities Transaction Tax (STT) is levied, among others, on sale or purchase of an equity share which is entered through a recognized stock exchange. STT therefore applies to listed securities.

Income arising from long term capital gain on sale of an equity share in a listed company which is chargeable to STT is exempt from tax under section 10(38) of the Income-tax Act.

Through an amendment in the Finance Act, 2012, the benefit of tax exemption of long term capital gains has been extended to an investor who off-loads his shareholding as part of an initial public offer before listing of the company subject to payment of STT at the rate of 0.2 per cent on the transaction. For this purpose, the Finance Bill has been amended so as to provide for levy of STT on the sale of unlisted equity shares under an offer for sale as part of an initial public offer and shares of the company are subsequently listed on the stock exchange.

This amendment will take effect from 1st July, 2012 and will accordingly apply to any transaction made on or after that date.

[Clause 153]

Further clarifications to the Finance Bill, 2012

The following clarifications are with regard to the Memorandum Explaining the Provisions in the Finance Bill, 2012:-

I. A clarificatory amendment was proposed in the Finance Bill, 2012 [clause 63] by inserting the following explanation after sub-section (8) of section 144C, which shall be deemed to have been inserted w.e.f. 1st April, 2009, namely:-

"Explanation- For the removal of doubts, it is hereby declared that the power of the Dispute Resolution Panel to enhance the variation shall include and shall be deemed always to have included the power to consider any matter arising out of the assessment proceedings relating to the draft order, notwithstanding that such matter was raised or not by the eligible assessee."

The date of effectivity of the provision mentioned in clause 63 of the Finance Bill, 2012 and the Notes on Clauses [clause 60] thereof is 1st April, 2009, *i.e* ., the provision would apply to all cases filed before the DRP on or after 1st April, 2009, irrespective of the assessment year. In the Explanatory Memorandum issued with the Finance Bill **["G. Rationalization of Transfer Pricing Provisions** (sub-heading **"Power of the DRP to enhance variations")],** the effectivity has been incorrectly mentioned as applying to assessment year 2009-10 and subsequent years. This being a procedural provision, the correct position is as stated in the Notes on Clauses, *i.e* ., it would apply to any proceeding before the DRP as on 1st April, 2009 and may be read accordingly.

[Clause 63]

II. An amendment was proposed in the Finance Bill, 2012 [clause 77]. It has been explained in the Memorandum Explaining the Provisions in the Finance Bill, 2012 **["E. Rationalization of Tax Deduction at Source (TDS) and Tax Collection at Source (TCS) Provisions"** (sub-heading **"I. Deemed date of payment of tax by the resident payee")].** The word 'payer' has been used instead of the word 'payee' in two instances therein. The relevant extracts may be correctly read as follows:-

(*a*) Para 3:-

"The payer is liable to pay interest under section 201(1A) on the amount of non/short deduction of tax from the date on which such tax was deductible to the date on which the payee has discharged his tax liability directly. As there is no one-to-one correlation between the tax to be deducted by the payer and the tax paid by the payee, there is lack of clarity as to when it can be said that payee has paid the taxes directly. Also, there is no clarity on the issue of the cut-off date, *i.e* . the date on which it can be said that the payee has discharged his tax liability."

(*b*) Para 5:-

"The date of payment of taxes by the resident payee shall be deemed to be the date on which return has been furnished by the payee."

[Clause 79]