KNAV PARTNERS BEYOND BOUNDARIES

BUDGET 2014

IN THIS ISSUE:

This budget has signalled the Government's clear intent to move forward with fast paced reforms to bring India to its earlier growth rate trajectory of 8-9%. The new Government has had just about 1 ½ months to put together a policy statement as significant as the country's budget and they seem to have done a remarkable job.

Some of the key announcements pertain to continuing on the path of fiscal consolidation, manufacturing sector revival, increasing export competitiveness, removing the uncertainties pertaining to tax such as retrospective taxation and introducing investor and entrepreneurial friendly tax and fiscal policies. In summary, this is a strong intent statement to push for growth and economic revival. Outlined below are the specific contours of the NDA Government's economic thrust.

ECONOMY

Economic Indicators:

- The Finance Minister has conveyed the Modi Government's intent to reach a sustainable growth level of 7-8% or about within the next 3-4 years along with macro-economic stabilization.
- The road map for fiscal consolidation is a fiscal deficit of 3.6% for 2015-16 and 3% for 2016-17. For FY 2014-15, the fiscal deficit target is 4.1%.
- Average wholesale price index (WPI) inflation declined in 2013-14 to 6% vis-à-vis 8.9% in 2011-12 and 7.4% in 2012-13.

Goods and Services Tax (GST)

- The Finance Minister has stated that the Government hopes to be able to find a solution in this year for a fair sharing of the GST revenues with the States and approve the legislative scheme which enables the introduction of GST. This will streamline the tax administration, avoid harassment to businesses and result in higher revenue collection, both for the Centre and the States.

Foreign Direct Investment (FDI)

- Currently 26% FDI in defense manufacturing is permitted. The composite cap of foreign exchange is raised to 49%, with full Indian management and control through the FIPB route.
- The composite cap in the Insurance sector is proposed to be increased up to 49% from the current level of 26%, with full Indian management and control, through the FIPB route.
- Requirement of the built up area and capital conditions for FDI for development of smart cities to be reduced from 50,000 square metres to 20,000 square metres and from USD 10 million to USD 5 million respectively.
- The manufacturing units will be allowed to sell its products through retail including E-commerce platforms without any additional approval.

Single Window for Government Services and Promotion of Exports

- Central Government Departments and Ministries to integrate their services with the e-Biz - a single window IT platform - for services on priority by 31 December this year.
- For exponential increase in exports, it is proposed to establish an Export Promotion Mission to bring all stakeholders under one umbrella.

Special Economic Zones

- The Finance Minister provided the Government's commitment to revive the Special Economic Zones (SEZs) and make them effective instruments of industrial production, economic growth, export promotion and employment generation by taking effective steps to operationalize the SEZs, thereby reviving the investors' interest to develop better infrastructure and to effectively and efficiently use the available unutilized land.

Financial Sector Reforms - Capital Market

- Liberalized facility of 5% withholding tax extending to all bonds issued by Indian corporate abroad for all sectors and extend the validity of the scheme to 30.06.2017.
- Liberalize the ADR/GDR regime to allow issuance of depository receipts on all permissible securities.

Adoption of IFRS

- The Government has announced that the adoption of the new Indian Accounting Standards (Ind AS) by Indian companies from financial year 2015-16 voluntarily and from financial year 2016-17 on a **mandatory basis**. This will converge the current Indian accounting standards with the International Financial Reporting Standards (IFRS).

International Trade

- India's share in world exports and imports increased from 0.7% and 0.8% respectively in 2000 to 1.7% and 2.5% respectively in 2013.
- There has also been marked improvement in India's total merchandise trade to GDP ratio from 21.8% in 2000-01 to 44.1% in 2013-14.

DIRECT TAX

IMPACT ON INDIVIDUALS

Personal income Tax rates & exemption:

No change proposed for the tax rate as well as surcharge tax rate for individual. The education cess to continue at 3%.

Personal income tax slab limit proposed to be enhanced to INR 0.25 Mn from existing INR 0.2 Mn for all individual taxpayers below 60 years of age and INR 0.3 Mn from existing INR 0.25 Mn for all Senior citizen tax payers.

Investment under Sec. 80C:

To encourage savings it is proposed to raise the eligible investment deduction limit under 80C from present INR 0.1 Mn to INR 0.15 Mn. Assessee is now free to invest in the eligible investment within the overall celling of INR 0.15 Mn.

Deduction for Housing Loan Interest:

Cost of housing has been appreciated substantially over the past few years, thus it is proposed to increase the limit of deduction allowed on account of interest paid in respect of self -occupied property from INR 0.15 Mn to INR 0.2 Mn.

IMPACT ON BUSINESSES

Tax Rate for Companies:

No change in basic tax rate including Minimum Alternate Tax ("MAT") either for domestic or foreign companies. Education Cess of 3% continues. Also, there is no revision in surcharge of 10% on domestic companies and 5% in foreign companies whose taxable income exceed INR 100 Mn.

Investment allowance for small entrepreneurs:

To incentivize small entrepreneurs an investment allowance at the rate of 15% is proposed to be allowed to a manufacturing company that invests more than INR 250 Mn in any year in new plant and machinery. The benefit shall be available for three years i.e. for investments up to 31st March, 2017. Investment allowance to manufacturing company investing more than INR 1 Bn announced last year to continue in parallel till 31 March, 2015.

Deduction in respect of capital expenditure on specified business:

It is proposed to include business of laying and operating a slurry pipeline for the transportation of iron ore and setting up and operating a semiconductor wafer fabrication manufacturing unit under "specified business" for the purposes of the investment-linked deduction under section 35AD to promote investment in these sectors.

It is also proposed to provide that the date of commencement of operations for availing investment linked deduction in respect of the two new specified businesses shall be on or after 1st April, 2014.

Corporate Social Responsibility:

Under the Companies Act, 2013, companies having:

a) net worth of INR 5 Bn or more; or
b) turnover of INR 10 Bn or more; or
c) a net profit of INR 50 Mn or more during any financial year

are required to spend certain percentage of their profit on activities relating to Corporate Social Responsibility ("CSR").

It is proposed to include business of laying and operating a slurry pipeline for the transportation of iron ore and setting up and operating a semiconductor wafer fabrication manufacturing unit under "specified business" for the purposes of the investment-linked deduction under section 35AD to promote investment in these sectors.

It is also proposed to provide that the date of commencement of operations for availing investment linked

deduction in respect of the two new specified businesses shall be on or after 1st April, 2014.

Dividend and Income Distribution Tax:

Dividend Distribution Tax ("DDT") @ 15% is applied on a net basis, i.e. on the amount paid as dividend after reduction of distribution tax by the company. Similarly, the additional income tax in respect of income distributed by Mutual Funds to its investors is also on a net basis. Both the aforesaid resulted in a lower effective tax rate due to the difference in the base.

Thus, it has been proposed to amend the respective sections so that the income or dividend distributed is grossed up in such a way that any amount paid / distributed by way of dividends or income shall be increased to such amount, which would, after reduction of the tax levied at the applicable rate on such increased amount, would be equal to the net income or dividend distributed.

An illustration explaining the mathematics in the proposed amendment has been mentioned below:

Particulars	**Amount (INR)**
Dividend amount distributed (A)	85
Increase by the amount of tax i.e. (85*0.15)/(1-0.15) (B)	15
Increased amount (C) = (A) + (B)	100
DDT @ 15% (D) = (C) * 15%	15
Dividend distributed	85

*Thus, the effective DDT rate goes up from 16.995% to **19.99%**.*

REITs & InvITs:

- Intend to provide necessary incentives for Real Estate Investment Trusts (REITs) which will have pass through status for the purpose of taxation.
- As an innovation, a modified REITs type structure for infrastructure projects has also been announced as Infrastructure Investment Trusts (InvITs), which would have a similar tax efficient pass through status, for PPP and other infrastructure projects.
- These structures would reduce the pressure on the banking system while also making available fresh equity.
- These two instruments would attract long term finance from foreign and domestic sources including the NRIs.
- To put in place a specific taxation regime for providing a mechanism to tax the income in the hands of such trusts and the taxability of the income distributed by such business trusts in the hands of the unit holders of such trusts.

Concessional rate of tax on overseas borrowing:

In order to incentivise low cost long-term foreign borrowings by Indian companies, it is proposed to amend section 194LC to extend the benefit of this 5% rate of withholding tax to borrowings by way of issue of any long-term bond, and not limited to a long term infrastructure bond.

It is further proposed to extend by two years the period of borrowing for which the said benefit shall be available. The concessional rate of withholding tax will now be available in respect of borrowings made before 1st day of July, 2017.

These amendments will take effect from 1st October, 2014.

Reduction in tax rate on certain dividends received from foreign companies:

To encourage Indian companies to repatriate foreign dividends into the country, it is proposed to amend the Act to extend the benefit of lower rate of taxation without limiting it to a particular assessment year. Thus, such foreign dividends received in financial year 2014-15 and subsequent financial years shall continue to be taxed at the lower rate of 15%.

Authority for Advance Ruling ("AAR") and Settlement Commission:

Currently, an advance ruling can be obtained in respect of the tax liability of a non-resident from the Authority for Advance Rulings. The Finance Minister has now proposed to enable **resident taxpayers** to obtain an advance ruling in respect of their income tax liability above a defined threshold. The Finance Minister has also proposed to strengthen the AAR by constituting additional benches. Further it is also proposed to enlarge the scope of the Income-tax Settlement Commission so that taxpayers may approach the Commission for settlement of disputes. This would continue to be once in a lifetime opportunity for any taxpayer.

Necessary legislative amendments to give effect to the above proposals including those relating to the Authority for Advance Rulings and Income-tax Settlement Commission will be moved in the current session of the Parliament.

Transfer Pricing:

Definition of International Transaction:

The definition of the term International Transaction has been amended and its scope widened to include within its meaning any transaction entered between the enterprise and any person, other than an associated enterprise and where out of a prior agreement, in relation to the relevant transaction between the other person and the associated enterprise, and either the enterprise or the associated enterprise or both of them are non-resident, then such transaction shall be deemed to be an 'international transaction' entered into between two associated enterprises, **whether or not such other person is a non-resident**.

Use of multiple year data:

Currently, only one year data is allowed to be used for comparable analysis with some exceptions. The Finance Minister has proposed to amend the regulations to allow use of multiple year data.

Multiple year data is a better measure of Arms Length rates, as it smoothens out yearly fluctuations and provides a more consistent result.

Determination of Arm's Length Price:

In order to align Transfer Pricing regulations in India with the best available practices, the Finance Minister has proposed to introduce **range concept** for determination of arm's length price. However, the arithmetic mean concept will continue to apply where number of comparable is inadequate. The relevant data is under analysis and appropriate rules will be prescribed.

This is a welcome step, in line with international best practices of interquartile range and provides a much needed respite to assessees in determining the Arms Length Prices or margins.

Capital Gains:

- Clause (viib) in section 47 has been proposed to be inserted to provide that any transfer of a Government Security carrying a periodic payment of interest, outside India through an intermediary dealing in settlement of securities, by a non-resident to another non-resident shall not be considered as transfer for the purpose of charging capital gains
- Compensation received in pursuance of an interim order of the Court, Tribunal or other authority shall be deemed to be income chargeable under the head 'Capital gains' in the previous year in which the final order of such Court, Tribunal or other authority is made.
- Clause (42A) of section 2 has been proposed to be amended so as to provide that an unlisted security and a unit of a mutual fund (other than an equity oriented mutual fund) shall be a short-term capital asset if it is held for not more than thirty-six months.
- The provisions of section 112 has been amended so as to allow the concessional rate of tax of ten per cent on long term capital gain to listed securities (other than unit) and zero coupon bonds.
- It is proposed to insert a new clause (ix) in section 56 to cover the advance received and retained in the

course of negotiations for transfer of a capital asset. Such sum shall be chargeable to tax under income from other sources. Consequently, it is also proposed to amend section 51 to avoid double taxation of the advance received for transfer of capital asset and such amount shall not be deducted from the cost for which the asset acquired or the written down value in computing the cost of acquisition.

- It is proposed to amend section 54F in order to provide relief to individual for investment in residential house property and this is available only if investment is made in one residential house situated in India.
- To remove the ambiguity in case of section 54EC for investment in specified bonds, a proviso is proposed to be inserted to clearly state that investment out of capital gains, during the financial year in which the original asset or assets are transferred and in the subsequent financial year does not exceed INR 5 Mn.

Tax Deduction at Source:

Extension of time limit for depositing withholding tax:

In order to bring the non-residents at par with the residents, it has been proposed that the deductor shall be allowed to claim deduction for payments made to non-residents in the previous year of payment even in case where tax is deducted during the previous year and the same is paid on or before the due date specified for filing of return under section 139(1) of the Act.

Restriction of disallowance of expenses:

In order to reduce undue hardship, it is proposed to restrict the disallowance of expenditure to 30% in case of non-deduction or non-payment of withholding tax on payments made to residents as specified in section 40(a)(ia) of the Act (e.g. royalty, director fees, etc.).

Extension of scope of section 40(a)(ia) of the Act:

To ensure that there is better compliance in respect of payments to residents, the scope of section 40(a)(ia) of the Act has been extended to include all expenditure on which tax is deductible under Chapter XVII-B of the Act.

Correction of TDS statement:

Currently, there does not exist any express provision in the Act for enabling a deductor to file correction statement. In order to bring clarity in the matter relating to filing of correction statement, it is proposed to amend section 200 of the Act to allow the deductor to file correction statements. Consequently, it is also proposed to amend provisions of section 200A of the Act for enabling processing of correction statement filed.These amendments will take effect from 1st October, 2014.

Characterisation of Income in case of Foreign Institutional Investors:

The proposed amendment provides that any security held by the Foreign Institutional Investors ("FII") would be treated as **capital asset** only so that any income arising from transfer of such security would be in the nature of capital gain and not as business income.

Alternate Minimum Tax ("AMT"):

Total income, alongwith the other existing items, to be increased by the deduction claimed u/s 35AD of the Act, net of depreciation allowed u/s 32 for the specified business u/s 35AD of the Act, for the purposes of computing the adjusted total income for discharging the AMT liability.

Estimate of value of assets by Valuation Officer:

It is proposed to substitute the section 142A so as to provide that the Assessing Officer may require the assistance of a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment for the purposes of assessment or reassessment and submit the report to him. The

Assessing Officer may make a reference whether or not he is satisfied about the correctness or completeness of the accounts of the assessee.

Further, it is also proposed to provide that the Valuation Officer shall send a copy of his estimate to the Assessing Officer and the assessee within a period of six months from the end of the month in which the reference is made.

These amendments will take effect from 1st October, 2014.

Income Computation and Disclosure Standards:

The Accounting Standard Committee constituted by Central Board of Direct Taxes has recommended that the provisions of section 145 of the Act may be suitably amended to clarify that the notified AS are not meant for maintenance of books of account but are to be followed for computation of income.

This amendment will take effect and apply from assessment year 2015-16 and subsequent assessment years.

SERVICE TAX

In order to maintain stability in tax regime, no change in normal rate of 12% for Service Tax. Education Cess and Secondary and Higher Education Cess at the rate of 2% and 1% remains.

I. Service tax negative list reviewed:

To broaden the tax base under Service Tax, sale of space or time for advertisements in broadcast media, extended to cover such sales on other segments like online and mobile advertising. Sale of space for advertisements in print media however would remain excluded from service tax. Service provided by radio-taxis brought under service tax.

II. Service tax on service portion in Works Contracts - Rationalization:

* In Rule 2A of the Service Tax Valuation Rules, category 'B' and 'C' of works contracts proposed to be merged into one single category, with service portion as 70%; this change will come into effect from 1st October, 2014.

III. Compliance enhancement:

* Simple interest rates per annum payable under section 75, to vary on the basis of extent of delay in payment of service tax. This will come into force on 1st October, 2014.

Extent of delay	Simple interest rate per annum
Up to six months	18%
From six months and upto one year	24%
More than one year	30%

IV. Service Tax Rules:
[changes to have immediate effect]

* Service provided by a Director to a body corporate to be brought under the reverse charge mechanism; service receiver, who is a body corporate will be the person liable to pay service tax.

* Services provided by Recovery Agents to Banks, Financial Institutions and NBFC to be brought

under the reverse charge mechanism; service receiver will be the person liable to pay service tax.

V. Cenvat Credit:

* Service tax paid under full reverse charge: the condition to pay invoice value to the service provider for availing credit of tax paid, to be omitted ***[change to have immediate effect]***

* Re-credit of Cenvat credit reversed on account of non-receipt of export proceeds within the specified period, to be allowed, if such export proceeds are received within one year from the specified period on the basis of documentary evidence of receipt of payment ***[change to have immediate effect]***

* Time limit for taking credit on input and input services: credit shall be taken within six months from the date of the invoice or challans or other documents specified ***[change to have effect from 1st September, 2014]***

VI. Place of Provision of Services Rules:
[change to have effect from 1st October, 2014]

* Provision for prescribing conditions for determination of place of provision of repair service carried out on temporarily imported goods, to be omitted.

* Intermediary of goods to be given the same treatment as is given to intermediary of services.

* Vessels (excluding yachts) and aircraft to be excluded from Rule 9(d); hiring of vessels or aircrafts, irrespective of whether short term or long term, will be covered by the general rule, which is place of location of the service receiver.

VII. Point of Taxation Rules:
[change to have effect from 1st October, 2014]

* In case of reverse charge services, to bring certainty in the determination of point of taxation, it is proposed to provide that point of taxation will be the payment date or first day after three months from the date of invoice, whichever is earlier. The amended point of taxation will apply to invoices issued after 1st October 2014. A transition rule is proposed to be prescribed.

VIII. Simplification of partial reverse charge mechanism:
[change to have effect from 1st September, 2014]

* In renting of motor vehicle, portion of service tax payable by service provider and service receiver will be 50% each.

CUSTOMS & CENTRAL EXCISE DUTY

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SELECT HIGHLIGHTS:

- *Excise duty on cigarettes hiked for 11% to 72%*
- *To cut excise duty to 6% from 12% on footwear*
- *Basic customs duty on non-fatty acids, glycerine to be reduced*
- *To reduce customs duty of LCDs, LEDs on TV s below 19 inches*
- *Duty on stainless steel products increased*

- *Colour picture tubes to be exempted from customs duty*
- *To reduce excise duty on food processing machinery*
- *To impose customs duty of 10% on certain tele-communication items*

Sincerely,

TEAM KNAV

ABOUT US

PARTNERS BEYOND BOUNDARIES

KNAV is a firm of International Accountants, Tax and Business Advisors.

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