

Tax Bulletin

Budget 2010-11



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Chapter 1 – Budget Highlights

Direct Tax

Individuals and HUFs

- 1. Tax slabs for individuals extended**
- 2. Business assets out of deemed gifts**
- 3. Deduction in respect of investment in long-term infrastructure bonds**

Corporates

- 4. Surcharge decreased from 10 per cent to 7.5 per cent**
- 5. MAT increased from 15 per cent to 18 per cent**
- 6. Formula of computation for Tax holiday for SEZ units made applicable retrospectively from AY 2006-07**
- 7. Investment-linked tax incentives extended for 2 star and above Hotels for any part of India**
- 8. Extension of sunset clause for tax holiday for housing projects**
- 9. Increased in the weighted deduction for in-house research and development and payment made to research organization**
- 10. Rationalization of provisions with regard to allowability of deduction where TDS is applicable in respect of payments made to a resident**

Non-residents

- 11. Source Rule emphatically brought in to nullify the Supreme Court judgement**
- 12. Scope of presumptive taxation for companies engaged in provision of services in relation to prospecting for or exploration or extraction of mineral oil restricted**

Other amendments

- 13. Conversion of company into LLP tax neutral**
- 14. Transfer of shares for without or inadequate consideration exceeding Rs. 50,000 taxable in the hands of a company or a firm at fair market value**
- 15. Threshold limit for tax audit increased**
- 16. Basic limit for applicability of withholding tax increased**
- 17. Rate of interest with regard to non-payment of withholding taxes increased**
- 18. High court may condone the delay in filing of appeals**
- 19. The deductor / collector of tax to continue to furnish TDS / TCS certificates to the deductee / collectee even after April 1, 2010**
- 20. Penalty for non-compliance with tax audit report increased**
- 21. Commissioners empowered to cancel the registration of charitable organization**
- 22. Trade/Business receipts incidental to charitable activities permitted up to Rs. 10,00,000**

Chapter 2 – Income tax

Individuals and HUFs

Other Income – Definition of Property [Section 56]

Amendment	<ul style="list-style-type: none">• The definition of property shall be restricted to cover only capital assets and not stock- in- trade, raw material and consumable stores of any business of the recipient.• The definition of property shall now include bullion.• In order to determine the fair market value of the property as referred in section 56(2), the AO may refer the matter to the valuation officer for the purpose of making an assessment and a re-assessment under the IT Act.• The scope of section 56(2)(vii) shall be restricted in the case of individual or HUF who receives immovable property only without consideration.
Our Comments	<ul style="list-style-type: none">• The provisions of section 56(2)(vii) were introduced as a counter evasion mechanism to prevent laundering of unaccounted income under the garb of gifts, particularly after abolition of the Gift Tax Act. The provisions were intended to extend the tax net to such transactions in kind. The intent being not to tax the transactions entered into in the normal course of business or trade (stock- in- trade, raw material and consumable stores) the profits of which are taxable under specific head of income. Thus, the definition of property shall cover only those assets, which are in the nature of capital assets of the recipient.• We believe that this definition of “property” which is now restricted to “capital assets” would not include movable assets which are in the nature of “personal assets”, other than those specifically excluded from the scope of personal assets given under section 2(14) of the IT Act• Transfer of immovable property for inadequate consideration shall not be covered under section 56(2)(vii).• The amendments shall take effect retrospectively from October 1, 2009 and will apply to transactions undertaken on or after such date.

Deduction for Investment in Infrastructure Bonds (Section 80CCF)

Amendment	<ul style="list-style-type: none">Investment made in long- term infrastructure bonds (as may be notified by the Central Government) during the FY 2010-11 shall be allowed as deduction in computing the income of individuals or HUFs.
Our Comments	<ul style="list-style-type: none">This deduction will be over and above the existing overall limit of tax deduction on savings up to Rs. 1,00,000 under section 80C, 80CCC and 80CCD of the IT Act.

Deduction in respect of contribution to the Central Government Health Scheme (Section 80D)

Amendment	<ul style="list-style-type: none">The deduction granted under section 80D shall be extended to any contribution made to Central Government Health Scheme.
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Computation of profits in case of Special Economic Zone [Section 10AA]

Amendment	<ul style="list-style-type: none">• The formula in respect of computation of deduction under section 10AA shall be effective from AY 2006-07.
Our Comments	<ul style="list-style-type: none">• Finance (No. 2) Act, 2009 made the following amendment in formula for the purpose of computation of deduction under section 10AA: <u>“Profit of the business of the unit” x “export turnover of the unit”</u> “Total Turnover of the business of the undertaking”• The benefit under section 10AA to an undertaking in SEZ was available from AY 2006-07. However, the aforesaid amendment made by the Finance (No. 2) Act, 2009 was made effective only from AY 2010-11. This anomaly has now been rectified by making the amended formula w.e.f. AY 2006-07.

Weighted Deduction on Research and Development [Section 35, 35(2AB)]

Amendment	<ul style="list-style-type: none">• A company, which incurs expenditure (not being expenditure in the nature of cost of any land or building) on scientific research, an approved in-house research and development facility, shall be eligible to claim weighted deduction from 150 per cent to 200 per cent.• Weighted deduction in respect of any sum paid to an approved research association that has the object of undertaking scientific research or to an approved university, college or other institution carrying out scientific research shall be increased from 125 per cent to 175 per cent.• The payments made to approved research association which has object of undertaking research in social science or statistical research shall be covered by the provisions of section 35(1)(iii).
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Investment-linked tax benefit for specified business (Section 35AD)

Amendment	<ul style="list-style-type: none">• The investment –linked tax benefit under section 35AD shall be extended to the business of building and operating a new hotel of two star or above category anywhere in India, which starts operating after April 1, 2010.• One of the conditions for availing the benefit under section 35AD in the case of laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network, is that the specified business “has made not less than one-third of its total pipeline capacity available for use on common carrier by basis by any person other than the assessee or an associated person”. The Petroleum and Natural Gas Regulatory Board has, by regulations, specified a common carrier capacity condition of ‘one-third’ for natural gas pipeline network and ‘one-fourth’ for petroleum product pipeline network. In order to rationalize the existing condition regarding common carrier capacity, the proportion of the total pipeline capacity to be made available for the use on common carrier basis shall be as specified by the said regulation for the purpose of section 35AD(2).• Where deduction under section 35AD is claimed and allowed in respect of the specified business for any assessment year, no deduction shall be allowed under the provisions of Chapter VI-A in relation to such specified business for the same or any other assessment year and vice-versa.
Our Comments	<ul style="list-style-type: none">• Currently benefits of profit-linked deduction under Chapter VI-A of the IT Act are available to specified categories of hotels in certain areas. In view of the high employment potential of this sector and to boost the tourism sector, this investment-linked incentive has been proposed to the hotel sector irrespective of location.• The above amendment seems to be in line with the philosophy of the Government to encourage investment-linked incentives versus profit-linked incentives as proposed in the Direct Tax Code.

MAT related amendments (sections 115JB)

Amendment	<ul style="list-style-type: none">• The rate of MAT shall be increased from 15 per cent to 18 per cent of book profits.
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Disallowance of expenditure on account of non-compliance with TDS provisions [Section 40(a)(ia)]

Amendment	<ul style="list-style-type: none">• No disallowance shall be made, if the tax has been deducted during the previous year and the same has been paid on or before the due date of filing return of income under section 139(1).
Our Comments	<ul style="list-style-type: none">• As per the existing provisions of section 40(a)(ia) in case of payments made to residents on account of interest, commission, brokerage, professional fees, etc., if tax is not withheld, or if after withholding the same is not paid before the end of the previous year, then such expenditure was disallowed for that previous year. The exception to the above was in case of tax deducted in the last month of the previous year, where the time of payment was extended up to the due date of filing of return of income as specified under section 139(1). However, the assessee would get the deduction for such expenditure in the year in which tax is paid.• With a view to streamlining this provision and to be equitable, the section has been amended whereby in all cases where tax has been deducted at anytime during the previous year, the deduction in respect of such expenditure would be allowed as far as the payment of such tax is deposited before the due date of filing of return of income as specified under section 139(1).

Extension of tax holiday for developing and building housing projects [Section 80-IB(10)]

Amendment	<ul style="list-style-type: none">• Tax holiday benefit will be extended for an undertaking from existing four years to five years from the end of the financial year in which the housing project is approved by the local authority. This extension shall be available to those housing projects which are approved on or after April 1, 2005.• Further, the concession has been given to the undertaking by way of increasing the area reserved for shops and other commercial establishments included in the housing projects from '2 percent or 2000 sq. ft. whichever is lower'to'3 per cent of the aggregate built-up area of the project or 5000 sq. ft., whichever is higher'. This benefit shall be available to those housing projects which are approved on or after April 1, 2005, which are pending for completion.
Our Comments	<ul style="list-style-type: none">• Due to the global recession and the resultant slowdown in the housing sector, these amendments are welcome changes.

Non-residents

Income deemed to accrue or arise in India to a non-resident [section 9(1)(v), (vi) and (vii)]

Amendment	<ul style="list-style-type: none">• Income by way of interest, royalty and fees for technical services, which are deemed to accrue or arise in India, shall be included in the total income of a non-resident, whether or not,<ul style="list-style-type: none">◦ such non-resident has a residence or place of business or business connection in India; or◦ such non-resident has rendered services in India.• This amendment shall take effect retrospectively from June 1, 1976.
Our Comments	<ul style="list-style-type: none">• Section 9 provides certain instances where income of a non-resident is deemed to accrue or arise in India. This is more popularly known as ‘source rule’ under the IT Act.• However, the Hon’ble Supreme Court in the case of Ishikawajima-Harima Heavy Industries Limited vs. DIT (288 ITR 408), despite these deeming provisions, held that the non-resident’s income to be taxed in India, the income needs to have a sufficient territorial nexus with India. Further, it held that for establishing such territorial nexus, the services have to be rendered in India as well as utilized in India.• Since the above interpretation was not in accordance with the legislative intent that the situs of rendition of services in India is not relevant as long as the services are utilized in India, the explanation with regard to source rule was inserted in section 9 vide Finance Act, 2007. However, the Karnataka High Court in the case of Jindal Thermal Power Co. Ltd. vs. DCIT (ITA NO. 3021, 3022 to 3025/2005), has held that the aforesaid amendment introduced in section 9 by the Finance Act, 2007 does not do away with the requirement of rendition of services in India for any income to be deemed to accrue or arise to a non-resident in India under section 9.• In order to remove this lacuna the proposed amendment retrospectively from June 1, 1976, states that it is not necessary to perform the services in India, for such services rendered by a non-resident to be taxed in India, as long as the payment for such services is made by a resident or by a non-resident and utilized in India.• This amendment could lead to litigation as it is silent on the territorial nexus of the services being rendered by the non-resident and the Indian state.• Further, the amendment is not clear as regards its applicability on income by way of interest or royalty earned by a non-resident outside India, where there is no nexus between such interest and royalty and the Indian state.

Income of a non-resident providing services or facilities in connection with prospecting for or extraction or production of mineral oil (Section 44BB)

Amendment	<ul style="list-style-type: none">• The provisions of section 44BB shall not apply to the income which is covered by the provisions of section 44DA (Special provision for computing income by way of royalties or fees for technical services in the case of non-resident having fixed place of business / permanent establishment in India).
Our Comments	<ul style="list-style-type: none">• It is proposed that income earned by a non-resident who has a fixed place of business / permanent establishment in India and which is in the nature of providing services or facilities in connection with prospecting for or extraction or production of mineral oil, shall be taxable under the normal principles of taxing business profits under section 44DA of the IT Act.• The proposed amendment tends to take away the benefit of presumptive taxation under section 44BB at 10 per cent of gross receipts from such services earned by a non-resident from India. This amendment nullifies the decision of the AAR in Geofizyka Torun (2009-TIOL-31-ARA-IT). This will increase the compliance burden on the non-resident to maintain books of accounts for determining the taxable income in India.• The proposed amendment seems to restrict the application only to payments received by a non-resident from India and does not cover non-resident to non-resident payment. Therefore, the non-resident performing the above services to another non-resident may still get the benefit of presumptive taxation under section 44BB of the IT Act.

Other amendments

Conversion of a private company or an unlisted public company (company) into a LLP

Amendment	
	<ul style="list-style-type: none">• Transfer of assets on conversion of a company into a LLP in accordance with the provisions of the LLP Act, 2008 shall not be regarded as a transfer for the purposes of capital gain tax, subject to following conditions:<ul style="list-style-type: none">◦ The total sales, turnover or gross receipts in business of the company do not exceed Rs. 60,00,000 in any of the three preceding previous year;◦ The shareholders of the company becomes partners of LLP in the same proportion as their shareholding in the company;◦ No consideration other than share in profit and capital contribution in the LLP arises to partners;◦ The erstwhile shareholders of the company continue to be entitled to receive at least 50 per cent of the profits of the LLP for the period of 5 years from the date of conversion;◦ All assets and liabilities of the company become the assets and liabilities of the LLP; and◦ No amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.• If the above conditions are not complied with, the benefit availed by the erstwhile company, shall be deemed to be the profits and gains of the successor LLP, chargeable to tax for the previous year in which the requirements are not complied with.• The LLP shall be eligible to carry forward and set-off the business loss and unabsorbed depreciation of the erstwhile company.<p>Non compliance of the above conditions shall make the LLP liable to tax for the set-off of losses and unabsorbed depreciation claimed by it.</p>• The written down value of the assets in the books of erstwhile company on the date of conversion shall be deemed to be the cost for the purpose of calculating depreciation in the hands of LLP.• Credit in respect of tax paid by the erstwhile company under section 115JB (MAT) shall lapse in the hands of LLP after conversion.• Expenditure incurred under voluntary retirement scheme under section 35DDA by the company shall be allowed to be amortized in the hands of LLP for the balance period.• The above amendments are effective from April 1, 2011.

Our comments	<ul style="list-style-type: none"> The LLP Act has come into effect in the year 2009 and the LLP Act and related Rules have been notified w.e.f. 1st April, 2009. The LLP Act also allows the conversion of general partnership and private limited companies into LLP. However, the amendment in relation to tax implication of such conversion shall be effective from AY 2011-12. Therefore, the issue would arise whether such conversion prior to this amendment would have exposure under capital gains tax.
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Others

Section	Amendments
56(2)(viiia)	<ul style="list-style-type: none"> The scope of section 56(2) has been extended to cover a firm or a company (other than the company in which the public are substantially interested) which receives from any person any property, being shares of a company (other than the company in which the public are substantially interested) without consideration or inadequate consideration, the aggregate fair market value of which exceeds Rs. 50,000.
2(15)	<ul style="list-style-type: none"> The advancement of any other object of general public utility shall continue to be a “charitable purpose”, if the total receipts from any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business do not exceed Rs. 10,00,000. This amendment shall take effect retrospectively from AY 2009-10.
12AA	<ul style="list-style-type: none"> The Commissioner shall be empowered to cancel the registration obtained by the trust or institution engaged in charitable activities under section 12AA, as stood before the amendment by Finance (No. 2) Act, 1996, if the activities of such trust or institution are found to be non- genuine or not in accordance with the objects for which such trust or institution were established.
44AB	<ul style="list-style-type: none"> The limit of turnover or gross receipts for the purpose of tax audit has been increased from Rs. 40,00,000 and Rs. 10,00,000 to Rs. 60,00,000 and Rs. 15,00,000 respectively.
44AD	<ul style="list-style-type: none"> The threshold limit of total turnover or gross receipts for the purpose of presumptive taxation under section 44AD has been increased from Rs. 40,00,000 to Rs. 60,00,000
80-ID	<ul style="list-style-type: none"> 100 per cent tax holiday as regards to undertaking engaged in the business of hotel or convention centre located in the specified area shall be extended to those hotels or convention centre starting functioning by July 31, 2010 instead of March 31, 2010.

201(1A)	<ul style="list-style-type: none"> • Rate of interest for non-payment of tax after deduction has been increased from 1 per cent per month to 1.5 per cent per month from July 1, 2010.
203	<ul style="list-style-type: none"> • The deductor / collector of tax shall continue to furnish TDS / TCS certificates to the deductee / collectee even after April 1, 2010.
256 / 260A	<ul style="list-style-type: none"> • The High Court may admit the delay in filing of appeal after expiry period of 6 months / 120 days if it is satisfied that there was a sufficient cause for not filing the appeal within such period. • These amendments shall take effect retrospectively from June 1, 1981 and from October 1, 1998 respectively.
271B	<ul style="list-style-type: none"> • The penalty for non-compliance of tax audit under section 44AB has been increased from Rs. 1,00,000 to Rs. 1,50,000

Tax Rates

Income Tax Rates

1.1. For Individuals, Hindu Undivided Families, Association of Persons and Body of Individuals.

Existing		Proposed	
Income (Rs)	Rate (%) [@]	Income (Rs)	Rate (%) [@]
0 -1,60,000 [#]	Nil	0 -1,60,000 [#]	Nil
1,60,001 - 3,00,000	10	1,60,001 - 5,00,000	10
3,00,001 - 5,00,000	20	5,00,001 - 8,00,000	20
5,00,001 and above	30	8,00,001 and above	30

[@] Education cess of 3% is leviable on the amount of income-tax.

[#] The basic exemption limit remains the same at Rs. 1,90,000 in case of resident women below the age of 65 years and Rs. 2,40,000 in case of resident individuals of the age of 65 years or more.

1.2. For Others

Description	Existing Rate* (%)	Proposed Rate ^{\$} (%)
A) Domestic company		
Regular tax	33.99 [@]	33.22 [@]
MAT	16.995(of book profits)	19.931(of book profits)
DDT	16.995	16.609
B) Foreign company		
Regular tax	42.23 [#]	42.23 [#]
C) Firm and LLP^{&}		
Regular tax	30.90	30.90

* Inclusive of surcharge @ of 10% and education cess of 3 %.

^{\$} Inclusive of surcharge @ of 7.5% and education cess of 3 %.

[@] 30.90% where the total income is equal to or less than Rs.10 million.

[#] 41.20% where the total income is equal to or less than Rs.10 million.

TDS Rates

Sr. No.	Section	Nature of Payment	Existing Threshold Limit of Payment (Rs.)	Proposed Threshold Limit of Payment (Rs.)
1	194B	Winnings from lottery or crossword puzzle	5,000	10,000
2	194BB	Winning from horse race	2,500	5,000
3	194C	Payment to contractors	20,000 (for a single transaction)	30,000 (for a single transaction)
			50,000 (for aggregate of transactions during FY)	75,000 (for aggregate of transactions during FY)
4	194D	Insurance Commission	5,000	20,000
5	194H	Commission or Brokerage	2,500	5,000
6	194I	Rent	1,20,000	1,80,000
7	194J	Fees for professional or technical services	20,000	30,000
The above limits will be effective from July 1, 2010				

GLOSSARY OF TERMS

Abbreviation	Meaning
IT Act	Income-tax Act, 1961
HUF	Hindu Undivided Family
w.e.f.	With Effect From
MAT	Minimum Alternate Tax
SEZ	Special Economic Zone
AY	Assessment Year
PY	Previous Year
AO	Assessing Officer
LLP	Limited Liability Partnership
LLP Act	Limited Liability Partnership Act, 2008

Disclaimer

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