Budget 2015

Direct Tax and FEMA implications

RASHMIN SANGHVI & ASSOCIATES

Notes

This is an analysis of only the main Income-tax provisions of the Finance Bill, 2015. Particularly, procedural amendments are not included. To that extent, this is not an exhaustive listing of amendments proposed by the Finance Bill, 2015. The note has considered the provisions of the Finance Bill, 2015 as announced on 28th February 2015.

It provides an academic guidance to the proposals and is for general information. This analysis is not a legal advice. Readers may not take any decision based on this note. This note does not substitute the need to refer to the original bill.

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Dear Sir / Madam,

Budget 2015
Direct Tax and FEMA implications

The Government came out with its second budget after coming to power last year. While there are no big bang reforms, there are several amendments proposed.

Some proposals on Black money are stringent / drastic.

We have discussed some important issues in the attached analysis. We will be glad to discuss the issues with you.

Yours sincerely,

Rashmin Sanghvi and Associates

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CONTENTS

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I. Attack on Black money[1]

1. Black Money

1.1 Pushed by the Supreme Court and own election manifesto, Government has embarked on a multi-pronged attack on black money. Some provisions have been formally proposed in the finance bill. Some are stated in the Finance Minister's speech – to be introduced in the Parliament during current session of the Parliament.

Black money refers to funds on which income-tax has not been paid and which have been hidden from the Government. Funds may be hidden abroad or within India itself. Black money is quite different from Criminal Money. This distinction is important because The Prevention of Money Laundering Act (PMLA), a harsh law applies to criminal money & not just black money.

One cannot deny that even black money creates difficulties and causes harm to the society. It should be dealt with strictly. However punishment should be commensurate with offence. Disproportionately harsh and arbitrary penalties are not justified.

1.2 Finance Minister, in his budget speech has proposed following legal measures:

- A new law to tackle black money abroad. (Only in FM's speech, not part of Finance Bill.)
- Amendments to FEMA law to seize assets. (Part of Finance Bill.)
- Amendments to PMLA to seize assets and make income tax evasion on foreign assets as money laundering offence. (This matter is not included in Finance bill. It is part of FM's speech.)
- Benami Transactions law to tackle black money within India. (Only in FM's speech.)

[1] **The Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015** has been introduced in the Lok Sabha on 20th March 2015. Detailed provisions regarding applicability, consequence and compliance scheme are provided in this Bill. An analysis of this new Bill will be prepared separately. Our analysis above is based on the Budget Speech and must be read in that context.

Let us see the proposals suggested by the Government (as stated in the budget speech and the document - "Key Features of Budget 2015-16.")

2. Proposed New Law on Black Money Held Abroad

2.1 There will be rigorous imprisonment of 10 years for evasion of tax in relation to foreign assets.

- It will be non-compoundable.
- There will be a penalty rate of 300% of tax evaded.
- The offender will not be permitted to approach the Settlement Commission.

2.2 If return of income is filed with **inadequate disclosures**, there will be **rigorous imprisonment of upto 7 years**. Thus a non-disclosure of foreign assets will trigger – even if there is no / minimal income involved.

2.3 Undisclosed income from any foreign assets to be taxable at the maximum marginal rate.

2.4 There will be mandatory filing of return in respect of foreign assets. (This is already there in the present income-tax law.) Date of opening a foreign bank account will be mandatorily required in the return of income. Beneficial owner or beneficiary of foreign assets will be mandatorily required to file return, even if there is no taxable income. Queries are raised: "Should a beneficiary in a discretionary trust abroad disclose any details?" This will depend upon the information required under the Income-tax Rules. We will know when rules are made.

This requirement does not apply to non-residents.

2.5 Entities, banks, financial institutions including individuals (read tax consultants) who abet the tax evasion will be liable for prosecution and penalty.

2.6 Finance Bill has not presented provisions of this new law. Above referred details are from Finance Minister's speech.

3. FEMA: Action against black money held abroad

3.1 Finance bill proposes to insert a new section 37A in FEMA. It provides that if any person holds any foreign exchange, foreign security or any immovable property outside India (foreign assets) in contravention of section 4 of FEMA, **the equivalent value of property in India can be seized**. The Enforcement Officer will first seize the property and then his superior will give an opportunity to explain.

A brief view of the FEMA provision – S.37A.
Compare FEMA with Income-tax:

Sr. No.	Issue	Income-tax Procedure	FEMA Procedure
1.	Officer has reason to believe that an Indian resident has black money abroad.	1.1 Send a notice, hold assessment proceedings, give opportunity to the assessee to establish whether he has complied with the law. 1.2 If the officer decides that there is violation, pass assessment order and raise demand notice. 1.3 If assessee does not pay taxes, start recovery proceedings.	1. No notice, no opportunity of proving – straight away pass an order to seize assets.
2.	If assessee is aggrieved.	Assessee can go in appeal to CIT (A) or Tribunal.	No appeals under FEMA. Only writ petition to High Court.
3.	CIT Appeal Order	CIT (A) will give an opportunity to the assessee and then pass an order on merit.	Competent authority under FEMA – the Enforcement Director will give an opportunity, Consider: what kind of justice one gets in the Enforcement Directorate.

In short, under S. 37A, **no opportunity** is to be given to prove that the accused is actually innocent. Straight away seize assets in India. After seizure, start asking questions. Appellate procedure does not inspire confidence. This proposed section violates fundamental principles of Natural Justice.

3.2 Let us consider the provision in details: Under **Section 4 of FEMA**, an Indian resident cannot hold or sell any assets outside India except as permitted under FEMA. Approach of the Finance Bill is: the moment, a person has assets abroad in violation of section 4; it is **deemed to be black money** & equivalent Indian assets are **liable for seizure**.

Background: Consider a situation where a person is holding assets in a tax haven in violation of FEMA. When Enforcement Directorate wants to seize the foreign assets, the Tax Haven Government and its banks – may not co-operate. In such a situation, the Enforcement director now will have the power to seize Indian assets. And of course, he does not have to prove that he had tried to seize foreign assets. He can straight away seize Indian assets.

This power of seizure under FEMA is in addition to the penal action under Income-tax Act and penal action under FEMA.

3.3 This provision is drastic. It provides that if the Authorised officer has "**reason to believe**" that the foreign asset is "**suspected** to have been held in contravention of FEMA …" the consequences of seizure will follow. This is bad drafting of law. "Reason to Believe" and "Suspicion" do not go together. If the bill is not amended, we can see litigation on this sentence for next twenty years.

Any penal consequence should follow if the contravention is **proved**. One cannot seize property if an officer has mere reason to believe and he just suspects a contravention. Penal consequences should follow only after the contravention is established.

3.4 There are several instances where FEMA rules are not clear at all. And RBI officers are known for changing their views. Now if RBI or the Enforcement Directorate believe that there is a violation, the property will be exposed to seizure.

Illustration - A person has incorporated a company outside India under a bonafide belief that he can invest in such a company. Under **Liberalised Remittance Scheme** (LRS), an individual can incorporate a company outside India without any approval. This is and was always the position. However RBI changed its view without any amendment in the law and said that: "individuals cannot invest in companies outside India under the LRS. Only portfolio investment was allowed". Investors were asked to wind up the foreign companies and apply for Compounding. Subsequently RBI has permitted the investment based on representations subject to various compliance procedures.

As per the proposed S. 37A, the Enforcement director can consider these assets as held in violation of S. 4 of FEMA & seize Indian assets of equivalent value.

3.5 It may be noted that the phrase "**Reason to Believe**" has been considered judicially. It cannot be a mere suspicion by the officer. He must have a valid reason; and the information for the reason should be on his file when he passes the order.

Illustration - In Jain Hawala case the Supreme Court held that entries in a diary of the hawala agent are not a proof of violation of law. It should be independently established that there is a contravention. Will this SC precedent be applicable to HSBC list? It is an issue to be watched.

In the case of HSBC, more than one thousand persons' names have appeared in the lists. Now the authorities have a reason to believe and a suspicion that the persons have violated the law. As far as tax law is concerned, the income-tax officer has to serve the notice, give adequate hearing and follow due process of law. As far as FEMA is concerned, the Enforcement Director can straight away go ahead, attach the bank account and other asset of everyone listed in the HSBC list and seize their assets. After seizure, he can start asking questions.

It is widely known that in the list, there are names of many people who are holding the assets abroad perfectly legally. Even these people can come into trouble.

3.6 After seizing the assets, the authorised officer shall place his order before the **Competent Authority** (Enforcement Director). This authority may confirm the order, or may set aside the order. As judicially held, every order should be a fair and speaking order. If the aggrieved party feels that the Competent Authority's order is unfair, he can file appeal before the High Court.

3.7 It may be noted that this section applies not only to a resident, but also to a non-resident. For example, an Indian resident acquires foreign property in contravention of the FEMA. He then becomes a non-resident. That does not make his foreign property legal as far as FEMA is concerned. If such a person has Indian property, it can be seized.

3.8 Some Technical issues may be considered: Section 4 provides that no Indian shall hold/ own/ transfer any assets outside India – **save as otherwise provided under FEMA.**

Query: An Indian resident has sent abroad $ 1,25,000 under **LRS**. Funds are lying abroad in the form of bank balance, loans and securities. What should he do about these funds? Does he have to make any declarations or file any application?

Answer: Indian residents are officially permitted to remit funds under LRS. Hence these foreign assets will be covered by the phrase "Save as otherwise provided in this Act". Hence there is no violation of S.4. Hence S.37A does not apply. It will be advisable for the person to keep all documentary evidence and make full disclosure in his income-tax return.

3.9 Query: Mr. ABC was a **Non-Resident** of India for twenty years. Some time back he **returned to India** and has become Indian resident. After returning he has not made any declarations with RBI. He has several assets abroad. Is he liable for seizure of assets under S.37A? What action can he take?

Response: Section 6 (4) of FEMA clearly permits Indian resident to hold assets abroad which he had acquired while he was a non-resident. Hence Mr. ABC's holding of foreign assets is not a violation of S.4. Hence S.37A does not apply to Mr. ABC.

Under FEMA, there is no requirement for any declarations.
Under Income-tax, full declaration should be made about all foreign assets held. Pay appropriate Income-tax if payable.

Mr. ABC should also keep sound evidence of having acquired the assets while he was a Non-Resident. The acquisition of assets and the source for the same – income- also should be established.

3.10 Illustration: Round Tripping:

(i) Round Tripping generally means – an Indian assessee transfers his black money abroad. Then in the name of some NRI/ Foreign non-resident he opens an entity in a tax haven. This entity invests the amount in India as white money. This was always illegal under Income-tax Act & under FEMA.

(ii) Several forms of legal Round Tripping were also taking place. Some real life instances: An Indian investor invests in a large foreign company. Say, Tata group acquires Corus, a British Company. Now, if Corus has a subsidiary in India, it would be a legal round tripping.

(iii) People made out several alternative schemes of Round Tripping. Some of them were illegal in substance but claimed as legal in form.

(iv) Then a large Indian group did substantial round tripping – which was in substance clearly wrong.

Suddenly RBI managers declared that all Round Tripping was illegal. They even penalised cases of perfectly legal round tripping.

Such innocent cases may come into trouble U/s. 37A because of RBI's change of mind.

3.11 Foreign Assets held Legally:

For clarification, the following categories of persons would be holding assets abroad legally.

(i) Any Indian resident individual who is holding assets abroad under **Liberalised Remittance Scheme (LRS).**

(ii) Any Indian resident company which is holding assets abroad under **Overseas Direct Investment Scheme (ODI).**

(iii) An Indian resident who has **inherited** foreign assets from a non-resident relative and continues to hold the assets as permitted under Section 6 (4).

(iv) A person was a non-resident. He acquired assets abroad. Thereafter he **returned to India** and became Indian resident. He continues to hold assets abroad as permitted under Section 6 (4) of FEMA.

All these people should be able to prove that they are holding the foreign assets legally before the authorities. Income-tax commissioner/ RBI/ Enforcement Officer - cannot take any penal action without making proper enquiries. However, under proposed Section 37 A, Enforcement Director can straight away seize the assets without asking any questions.

Article 14 of the Constitution guarantees "Equality in Law". It prohibits arbitrary action/ decision by judicial, quasi-judicial and even administrative authorities.

S.37A is clearly an unconstitutional provision and may be struck down by appropriate Court of Law.

4. Prevention of Money Laundering Act (PMLA)

4.1 Under **PMLA**, there appear to be two separate provisions.

One provision is that it is already proposed in the Finance Bill that the **Indian property** of equivalent value of foreign assets **can be seized**. This amendment applies to all offences under PMLA.

Example: A politician derives money from corruption and transfers the same outside India. He launders it and projects it as funds received through clean manner / sources. Indian Government may find it difficult to bring the funds into India. However his Indian funds of equivalent value will be considered as Proceed of Crime. Indian funds can be seized.

4.2 The second provision is - it seems from the budget speech that additionally **offence of tax evasion relating to foreign assets** will be considered as predicate offence.

"Predicate offence" has not been derived. The dictionary meaning is that it is a component of more serious offence. Offence of money laundering is considered as predicate offence. I.e. The main and serious offence (corruption, terrorism, etc.) will be tried under the respective laws. However funds derived from the main offence and **presented as clean money (laundering) is "predicate offence**". It is a money laundering offence.

There could be several reasons for not paying tax. For example, there are differences of interpretation of tax laws. Due to bonafide differences, a person may not pay tax. Or the amount of tax evaded may be small. But if it relates to foreign assets, it may be money laundering offence. Is this fair?

PMLA is a harsh law. It is meant for serious crimes of corruption, terrorism, etc. When the PMLA bill was proposed in 2002, there was a proposal to include income tax evasion under the PMLA. The tax department itself had opposed the same. While tax evasion is not desirable, it is not so serious an offence that it has to be made a PMLA offence.

The manner of dealing of Directorate of Enforcement is well known. Under FERA regime, the Directorate is known to have conducted torture of people, arrests at night, detention, etc. It is not acceptable in a democratic country to have a very harsh law for tax evasion.

5. Harassment:

5.1 Consider these cases:

Jain Hawala Case, Hasan Ali Khan's case and Karim Telgi's Stamp Paper Scandal. In all these cases, influential politicians were named. Despite the best efforts by the Courts, nothing happened to the politicians. In Gujarat, openly, the police officers involved in Godhrakand are protected. In the first year of coming to rule, Government has tried to Jail Teesta Setalvad.

We remember Enforcement Directorate's harassment under FERA.

In this situation if a drastic provision like S.37A of FEMA is passed, one can project the future.

History is being repeated: FERA was an absurd law. Hence people violated the law on a large scale. Politicians, law makers and law administrators violated the law. When Government was failing in enforcing the law, it wanted more and more powers. Ultimately, the law became draconian. It was toothless against politicians and harsh for businessman. When the harassment by Enforcement Directorate crossed all limits, FERA had to be replaced by FEMA.

Now they are proposing S.37A. Draconian law, totally unfit for any democracy. If it is passed, it will be a repeat of FERA.

Hopefully, Parliament will not pass it.
Otherwise, courts may strike it down as unconstitutional.

5.2 It is with this background that we have said – punishment should be commensurate with the offence. When the law is harsh and arbitrary, the powerful people get away. But the people who lack necessary influence suffer. Natural justice is thrown out.

We clarify that tax evasion should be dealt with seriously. However it can be dealt within the existing powers under the law. The existing law has enough powers to deal with tax evasion. There is no need of new law. What is required is efficient & fair administration of law.

5.3 Government will not harass innocent people:

As per media reports, Revenue Secretary Shakti Kanta Das has assured that honest citizens will not be harassed. However, promices by authorities are not adequate. Law itself must incorporate basic procedures ensuring natural justice. CBDT Chairman Ms. Anita Kapur has also said that principles of natural justice will be introduced in the law. We sincerely hope that appropriate amendments will be made in the Finance bill itself before placing the Bill for voting.

Many times, it so happens that the concerned minister gives policy instructions. Then the draftsman in the concerned department drafts the bill. An overzealous officer drafts a harsh provision. The minister does not go through exact wording of entire Finance Bill. And the unintended harsh provision is presented before Parliament. Now the conduct of the Finance Minister will show whether S.37A was an inadvertent error or a deliberate provision.

II. Tax Residence of foreign companies

The Finance Bill proposes to change the residence rules applicable to a foreign company managed from India. While the amendment itself is quite small, it will have a profound impact for tax payers. This note details the changes and its implications.

1. Present position:

Companies are presently considered to be resident of India for tax purposes if they are incorporated in India; or during that year the control and management is situated **"wholly in India"**.

This provision enables Indian residents to set up companies outside India which would be largely controlled from India. Still these would not be considered as resident in India, as a part of the control is outside India. This enables the companies to escape taxation on global income. This is achieved by simply having one or more foreign directors and board meetings outside India.

2. Proposal in Finance Bill:

The Finance Bill proposes to change the residence rules by stating that a company will be considered to be resident in India if:

a) it is incorporated in India; or
b) its **place of effective management**, at **any time** in that year, is **in India**.

Each of the highlighted phrases above has significant implications for foreign companies managed from India.

3. Place of Effective Management:

The proposed amendment provides an explanation that "place of effective management" (POEM) means a place where **key management and commercial decisions** that are **necessary for the conduct of the business** of an **entity as a whole** are, in **substance** made.

3.1 Implications:

Several people in India have formed companies in Dubai, Singapore, Mauritius and other countries for trading operations. Quite a few of such companies are managed from India. All such companies will now be considered Indian Residents.

Once a foreign company is tax resident of India, all the Income-tax Act provisions would apply. The company would need to:

- Submit its world income to tax in India;
- File its tax return in India and disclose its assets;
- Get the accounts tax audited if necessary;
- Comply with the TDS provisions including deduction of taxes from payments made in the foreign country to other non-residents;
- Maintain documentation for Transfer pricing and get Transfer pricing audit done; etc.

3.2 While the Memorandum to the Finance Bill mentions that this provision has been introduced to cover the "shell companies" incorporated by Indians; the proposed amendment is silent on this aspect. Therefore, as the proposed amendment stands, this provision would apply to a shell company; an investment holding company; and a company with substantial business in the country where it is incorporated.

The implications can be quite drastic for such companies.

4. What is POEM?

The POEM concept is in use in many tax laws around the world. The Memorandum to the Finance Bill explaining this provision also states the same. The explanation provided explaining POEM is also taken from the OECD Commentary covering this provision. However, the question is what constitutes "effective management".

4.1 OECD Commentary:

The **OECD Commentary** provides certain factors which can form basis to decide the place of effective management, some of which are:

- where the meetings of its board of directors or equivalent body are usually held;
- where the chief executive officer and other senior executives usually carry on their activities;
- where the senior day-to-day management of the person is carried on;
- where the person's headquarters are located;
- which country's laws govern the legal status of the person;
- where its accounting records are kept; etc.

4.2 Direct Taxes Code Bill:

POEM was sought to be introduced under the **Direct Taxes Code Bill**, 2010 (DTC) too. POEM was defined under the DTC Bill as:

(a) the place where the board of directors of the company or its executive directors, as the case may be, make their decisions;
or

(b) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

4.3 Control and management:

The present law provides that a company will be resident in India if its "control & management" are situated wholly in India during that year.

The concept of control and management has been part of several judicial pronouncements to decide whether a foreign company is resident or not in India. These judicial precedents have largely laid down that control & management would refer to the **"head and brain"**[2] of a company and the de-facto control/management and not the rights to control and manage[3]. Certain decisions have held that the situs of the board of directors of the company should determine the place of control & management of the company[4].

4.4 POEM in tax treaties:

The Memorandum refers to the fact that POEM is an internationally well-accepted concept. It is in fact present in many of India's double tax avoidance agreements. However, this concept is used mainly to resolve the issue of **dual residence of companies and other persons**. For example, a particular company is resident in UK because of its control and management; and at the same time is resident in India because of incorporation. In such cases, recourse is taken to the India-UK double tax avoidance treaty which specifies that the company will be resident in the country where its place of effective management is situated.

There are a few decisions in India on this concept in the treaty context. Some decisions have held that POEM is at the place where the general

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[2] CIT v. Nandlal Gandalal (SC) (40 ITR 1)
[3] CIT v. Bank of China (Calcutta High Court) (154 ITR 617) (1985)
[4] Radha Rani Holdings vs. ADIT (Delhi ITAT) (16 SOT 495)

meeting[5] or the directors' meeting[6] is held. However, it must be noted that these decisions are made on the basis of facts specific to the particular case.

As a contrast, this concept does not find place in the India-USA tax treaty. As per India-US DTA, if a company is resident in both countries, then the DTA does not apply at all to the company. I.e. it loses DTA protection completely.

4.5 The Memorandum to the Finance Bill provides that in due course, a set of **guiding principles** would be issued for the benefit of the taxpayers as well as, tax administration for determining POEM. We need to wait and see what these guidelines mention.

5. "At any time in that year":

The definition states that the company can be resident of India in case the place of effective management is at **any time in that year** in India.

This makes the provision quite stringent. There can be cases where the foreign company is, on incorporation, managed from India for a short while; before the local directors in the foreign country take over the management and operation. However, as per the proposed amendment, such companies would now be considered resident of India for the first tax year as they were effectively managed for a short period from India.

Apart from this, there are concerns that if a foreign company holds one board meeting in India, it will lead to the company being termed Indian resident. However, in our view, this interpretation is not correct. The significance lies in the use of the word "effective" in the rule. The place of effective management would not be a place where solitary decisions are taken during the year.

6. Some issues:

6.1 Tax credit:

If a foreign company becomes resident under the new rules it will be subject to a host of compliances apart from the apparent tax consequences. Further, it will also need to review whether tax credit will be available for taxes paid outside India.

[5] P. No. 9 of 1995 (220 ITR 377) (AAR)
[6] P. No 10 of 1996 (224 ITR 473) AAR

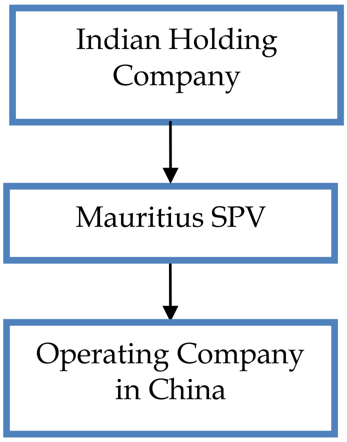
Essentially, it may happen that the foreign company will be termed resident of both India and the country where it is incorporated. If there is a DTAA entered in to by India with that foreign country; the residence of the foreign company will be based on the DTAA provisions. If there is no DTAA, the tax credit will be determined based on whether income was sourced in the foreign country where tax was paid. There will be lot of litigation; and greater clarity will be required from the government on the tax credit rules.

6.2 Transfer pricing applicability:

One of the unintended but beneficial implications can be that international transfer pricing provisions would not apply to transactions between such a company and its parent in India. This is because transfer pricing provisions apply only to transactions between a resident and non-resident; or between two non-residents. As both the parent and subsidiary would now be considered as Indian tax residents, transfer pricing provisions would not apply.

However, the companies would now be subject to domestic transfer pricing provisions; as well as specific pricing rules applicable to all companies in general.

Consider an illustration:



Indian Holding company has invested in an operational company in China through a Mauritius SPV. It is assumed that due to foreign directors and board meetings in Mauritius, the SPV is considered as a resident of Mauritius under the present rules; but its place of effective management is India. Further, the Chinese operational company is resident of China both under the present and proposed rules.

The residence and transfer pricing (TP) implications for all the companies involved under both present and proposed rules will be as under:

Issue	Under Present Rules	Under Proposed Rules
Residence of Mauritius SPV	Mauritius	India
TP rules for transactions between Indian company and Mauritius SPV.	International TP rules will apply.	Domestic TP rules will apply as transaction will now be between two Indian tax residents.
Residence of Chinese operational company	China	China
TP rules for transactions between Mauritius SPV and Chinese Operational company.	No TP rules will apply as transaction is not subject to Indian tax laws	International TP rules will apply as Mauritius SPV will be considered as Indian tax resident.

Please note the above does not take in to consideration issues of dual residence under the treaty; and consequent applicability on transfer pricing rules.

6.3 Foreign transactions:

It must be noted that change in residence of a foreign company to India would not change its residential status under FEMA. The foreign company will still be non-resident for FEMA purposes; and can enter into transactions with other non-residents as per applicable FEMA provisions. The downside will be that each such transaction will now have to be looked from an Indian tax law perspective.

7. Way forward:

In our view, the present position which states that a company will be an Indian resident only if its whole control is in India, is very liberal. It is required to be plugged. However the proposal of the Government goes to the other extreme. Instead of referring to the effective management "at any time during the year", it would have been better to state that company is resident of India if POEM is in India for major portion of the year. That would have been a fair proposal.

Considering the huge amount of implications, management of foreign companies from India must be reviewed thoroughly and corrective steps must be taken immediately.

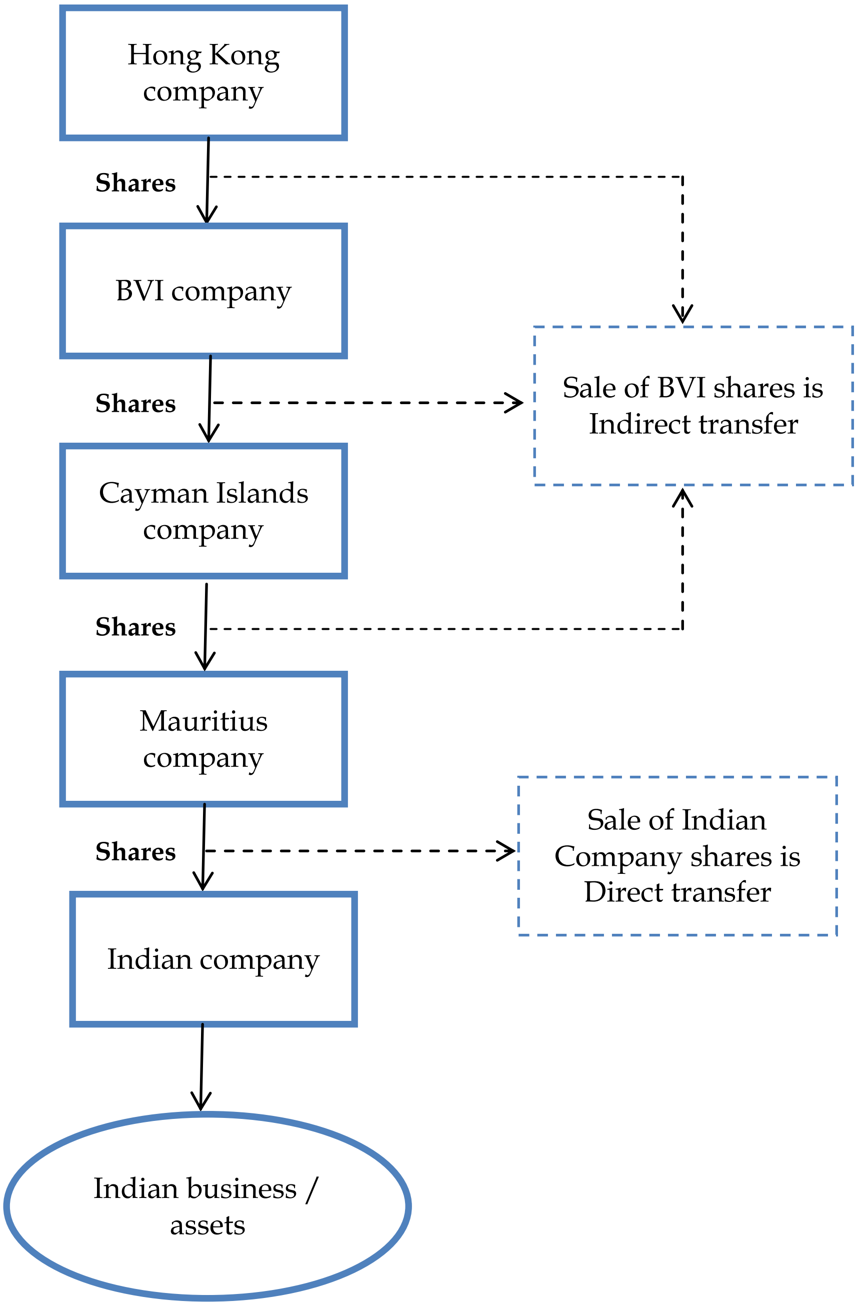
There will be many representations on this change in rule. The final provisions as passed under the Finance Act will need to be checked.

Overall, it must be noted that deciding where the POEM is situated is a very fact-dependent exercise. Therefore, to support the fact that the effective management of a company is in a particular place, proper documentary evidence must be kept. These can be in the form of Board meeting minutes; notices specifying the place of the meeting; place where key board resolutions are signed; place from where board of directors have attended the meeting; day-to-day correspondence; etc.

III. Indirect Transfer Provisions

1. Indirect transfers:

1.1 Indirect transfers refer to selling Indian assets indirectly through a foreign company, instead of selling directly. A simple illustration is given below:



If the Hong Kong company wants to sell its Shareholding in an Indian company to a UK company, it has two options:

(i) Direct Sale: Sell the shares in Indian company held by the Mauritian Company, **OR**

(ii) Indirect Sale: Sell the shares of any foreign company held by another foreign company.

1.2 This issue was brought to the fore in case of Vodafone[7]. Hutch sold shares of its Cayman Island Company with a capital of US$ 1 to Vodafone Netherlands for a consideration of US$ 11 bn. Due to the sale of shares in Cayman Island company, Vodafone acquired substantial stake in the Indian company. The department levied a tax of US$ 2 bn. The company went in appeals and won the case in Supreme Court. However the Government brought about retrospective amendments with sweeping amendments in 2012. The amendments were brought about with effect from 1962 (the date on which the current Income tax Act came into effect). (Our detailed papers on the subject are available on our website.)

Currently the matter is in arbitration.

1.3 The indirect transfer provisions state that if the shares of foreign company which derive their value substantially from Indian assets are transferred, such foreign company's shares are considered to be situated in India. Capital gain on sale of such foreign company's shares is liable to tax in India. The retrospective amendment with very broad coverage resulted in an outcry. Several other transactions which were not intended to be taxed, also got covered in the sweeping net.

2. Several representations were made. A special committee was appointed under the Chairmanship of Dr. Parthasarthi Shome. The committee made several suggestions. Now some of the suggestions are implemented to remove some difficulties. The details are as under:

3. Substantial value:

3.1 The provisions state that if the value of foreign company is derived "substantially" from Indian assets, capital gain will be taxable in India. However the meaning of "substantial" was not given.

3.2 The budget now proposes to explain the meaning "substantial". It states that if the value of Indian assets:

- is more than Rs. 10 crores, AND
- is 50% or more of the value of all assets of the foreign company,

it will be considered as "substantial".

Implications:

All transactions where Indian assets are less than Rs. 10 crores are excluded from these deeming provisions.

[7] Vodafone International Holdings B.V. (341 ITR 1 (SC) [2012])

In larger value transactions also, if the value of Indian assets is less than half of the total assets of the seller, these provisions won't apply.

3.3 Normally the value of Indian assets has to be determined on the date of transfer. However this creates a difficulty. Value cannot be determined on the date the transaction takes place. The sale price and value is determined much before the actual date of transfer.

The provisions now state the **date** when the value has to be considered. It provides that the value of assets has to be considered on the date of **last audited balance sheet** before the date of transfer.

It however further provides that if the **book value** of assets as on the date of transfer has changed by 15% (increased or decreased) compared to the last audited balance sheet date, then the value as on the date of transfer will be considered.

Illustration:

In the chart above, Cayman Island company sells shares of BVI company on 31.10.2014. To determine whether Indian assets are substantial, value of the assets as on 31.3.2014 has to be considered. However if the book value of assets on 31.10.2014 has increased or decreased by 15% compared to book value as on 31.3.2014, then the market value of assets has to be considered on 31.10.2014.

Say value of Indian assets is as under:

Date	Market value	Book value
On 31.3.2014 (last audited balance sheet)	10,000	3,000
On 31.10.2014 (date of transfer)	12,000	4,000

Normally the value as on 31.3.2014 will be considered to determine whether these are substantial (whether these are 50% or more compared to total assets). However as the book value as on 31.10.2014 has increased by more than 15% (increased by 1,000 over the value of 3,000), value as on 31.10.2014 will be considered.

It may be noted that the "value" and the "date" of determination of the value are relevant only to determine whether substantial value is on account of Indian assets. The capital gain will however be determined based on the actual transaction value. Thus the if sale takes place at 14,000, then that will be considered for computing capital gain.

Only if the transfer is between related parties, transfer pricing rules will apply. Then the market value of the assets for the purpose of sale will have to be considered.

The determination of value as on the date of transfer will have difficulties. The price of sale is decided a few months in advance by the board / shareholders. Sale value would consider the value of assets. Companies normally do get a valuation done. It could have been provided that the value as on the date of resolution passed at the board / shareholders may be considered.

3.4 The value of the assets has to be considered on a gross basis i.e. without reducing liabilities. Consider an illustration as under:

Balance Sheet of foreign company

Liabilities	Amount	Assets	Amount
Capital	1,500	Assets in India	4,000
Loan for Indian assets	3,500	Assets outside India	1,000
Total	5,000	Total	5,000

In the above example, if we reduce the loan, the net Indian assets (4,000-3,500 = 500) will be less than 50% of the net assets (1,500). The gross value of Indian assets is more than 50%. Hence it will be considered as substantial. In our view this is logical. At gross level it shows that the foreign company has major interest in India.

4. Proportionate value of consideration:

The existing provisions are such that if the transfer of foreign company's shares is taxable in India, then the entire sale consideration is taxable in India. For example, in the chart above, let us assume that the Mauritian company had its value derived from Indian assets only to the extent of 60% and the remaining 40% was from assets outside India. If Cayman Island company sells shares of Mauritian company to a non-resident, the entire sale consideration of the Mauritian company will be taxable in India. This was not the intention.

Now the budget provides that consideration which is proportionate to the value of Indian assets will be taxable in India. This is a fair provision.

It may be noted in case of companies whose value is based substantially on immovable property in India, several DTAs provide that the entire consideration is taxable in the country of source. Further, the UN Model of 2011 provides for clauses similar to indirect transfer provisions by stating that if the companies own certain percentage of Indian company's shares "directly or indirectly", then the entire sale consideration is taxable in India. Thus the budget provisions are better than the DTA provisions.

5. Minority shareholding:

The existing provisions state that a shareholder is taxable irrespective of the percentage holding. Consider an example. If a shareholder sells 100 shares of Unilever on the stock market and Unilever derives its value substantially from Hindustan Unilever, then gain on those shares is taxable in India!

This was not the intention. Now the budget provides that if the shareholder owns shares or has voting power only upto 5% in the Indian company, transfer of such shares is outside the tax ambit of "indirect transfer" provisions.

6. Mergers (Amalgamations) and demergers of foreign companies which involve indirect transfer:

6.1 There are provisions in the Income-tax Act giving exemptions for mergers and demergers. The provisions apply to transfer of "capital assets" which are transferred in an arrangement of amalgamations and demergers.

In essence, merger / demerger is restructuring of the holding of business. One business may be transferred from one company to another. There may be benefits in future by increased profits, etc. However, the restructuring does not result in any gain to the shareholders per se. To provide clarity, the exemptions have been provided in the law itself.

6.2 In case of mergers and demergers, there are two "transfers". One is by the company which amalgamates into another; or demerges its business (transferor). The other is by the shareholder of such companies. In case of mergers / demergers where the amalgamated company or the resulting company is an Indian company (transferee), exemption in the ITA covers both categories of transfer – for companies and for shareholders.

In case of mergers and demergers between foreign companies where there is an indirect transfer, there was no exemption. Now the budget has proposed that in case of such mergers and demergers, exemption will be available to the companies.

However there is no exemption available to the shareholders of such companies. As with any other exemptions, there are conditions attached. One will have to comply with the conditions.

7. Dividends:

The indirect tax provisions were designed primarily for taxing capital gain. However the language is so wide that even dividends received by non-resident shareholders from foreign companies outside India, will be taxable in India.

Thus in the chart above, dividend declared by Mauritian company to Cayman Island company becomes taxable in India. Similarly dividend declared right up to the ultimate shareholder is taxable in India.

The budget speech mentioned that for clarity on taxation of dividend income, the tax department will come out with a separate circular. The CBDT has issued a circular[8] clarifying that dividend declared and paid by a foreign company outside India in respect of shares which derive their value substantially from assets situated in India would not be taxable in India under the "indirect transfer" provisions. Therefore, the taxation of dividends now stands clarified.

8. Portfolio investors in foreign companies / funds:

Under the existing provisions, portfolio investors are also taxable under indirect transfer provisions. For example, there is an India focused fund outside India. It invests in India. It pays tax as applicable to FIIs. The investor in the fund is also taxable if he sells the units of the fund or receives dividend. The objective was not to tax such investors. This problem remains. However if the investor owns upto 5% of the fund, he will not be taxable as per the budget proposal.

[8] Circular No. 4/2015 dated 26th March 2015.

IV. Other Tax provisions

1. Transfer pricing for domestic transactions – Section 92BA:

1.1 Transfer pricing rules were introduced for domestic transactions from Financial Year 2012-13. The rules and compliance for transfer pricing are onerous. It requires a transfer pricing study, documentation, audit, etc. A limit of Rs. 5 crores was specified below which, transfer pricing rules do not apply.

This limit has been revised to Rs. 20 crores. Thus a person having transactions of less than Rs. 20 crores with related parties does not have to comply with the detailed rules of transfer pricing. This is welcome.

1.2 It however does not mean that one can undertake transactions at any price. Wherever there are related party transactions, the same have to undertaken at market prices. These market prices have to be established to the satisfaction of the tax officer. If the transaction is undertaken at a different price whereby it results in a tax loss to the Government, the tax officer can increase the income.

The relief is that the detailed compliance of maintenance of documents, audit, etc. do not have to undertaken.

1.3 For domestic transactions, generally if it is an expenditure of one person, it is an income of another person. There is no loss of revenue. Only in some circumstances, there could be a tax saving. Hence this limit should have been kept much higher.

2. Tax on Royalties and Fees for Technical Services – Section 115A:

2.1 Non-residents who earn royalties and fees for technical services are taxable @ 25% on gross amount of income (Section 115A). It is proposed to bring down the tax rate to 10%. It is welcome.

2.2 A few years ago, the rate was 30%. It was gradually brought down to 10%. The rate of 10% was comparable to, or lower than the rates in the DTA.

There were however several off shore centres through which the incomes could be routed. Tax could be reduced. These centres would not provide information on persons / companies in their countries. With the intention of getting them to come to the table for signing the DTA, the rate was kept at 25%. This would compel the countries to sign the DTA so that they could get a lower benefit of DTA rate. At the same time, exchange of information article could be signed.

Now India has signed several DTAs and Information Exchange Agreements. Further in the G20 / OECD efforts on tax evasion, a lot of information will be exchanged on automatic basis. This kind of negotiation is not required. Perhaps therefore the rate has been brought down to 10%. It is a favourable provision. Transactions with residents of countries with which India does not have a DTA, will also benefit.

Lowering the tax rate will also reduce compliance burden. Presently to avail lower tax rate as per the DTA, the payee had to furnish Tax Residency Certificate (TRC) from his Government. Now with the rate of 10%, the payee may opt for tax as per Income-tax Act. It will save the trouble of obtaining the TRC.

3. Minimum Alternative Tax – Section 115JB:

3.1 In case of companies, there is a minimum alternative tax (MAT). If the normal income tax is less than 18.5% of book profits, then a minimum of 18.5% of book profits has to be paid as MAT.

In case of projects of engineering, roads, etc., at times several companies bid for the contract jointly. The contract is also awarded jointly. Such arrangements where companies have come together have been held to be an **Association of Persons (AOP)**. Whether such arrangements amount to AOP or not, is a separate issue. That is not discussed here. Assuming that it is an AOP, the implications are as under.

3.2 The AOP is taxable. The companies which are members of AOP are **not taxable on the share of their profit in the AOP**. However under the company law, the share of profit from AOP is included in the book profit of the companies.

This resulted in a situation where the companies had to pay MAT. This was not the intention. Once the AOP pays the tax, the members are not liable to pay the tax. But due to the language of the section, MAT was payable.

It has now been proposed that MAT is not payable on the share of the profit from AOP. Correspondingly, the expenses relating to earning that share of profit is not allowable as a deduction for computing book profit.

This is a welcome provision. It applies from Financial Year 2015-16.

3.3 However does it mean that for the past, MAT is payable? The Government has been saying that they do not want to have retrospective legislation. Even if there is a loophole, it will be plugged from prospective date. As a corollary, any relief or removal of difficulty also applies from prospective date.

We believe that cannot be the intention. MAT on share of profit from AOP amounts to double tax. If apparently, there is an error, the Government can amend the law and clarify that relief will be available even for past years.

At present, it appears that for past years, the companies may have to approach the court of law if they do not wish to pay MAT.

3.4 For FIIs also, MAT has been removed. As per news reports, the department is asking the FIIs to pay MAT for the past years.

4. Measures to curb black money transactions in relation to immovable properties:

4.1 Receipt of advance or repayment of advance for immovable property transactions – Sections 269SS and 269T

Acceptance of loan or repayment of the same above Rs. 20,000/-, can be undertaken only through bank system (cheque or electronic clearing system). This provision is there for the past several years. Any of the above transactions above Rs. 20,000 in cash is liable to penalty of 100% of the loan / repayment of loan.

People have resorted to various ways. For example, for transactions relating to immovable property, there is no restriction on undertaking the transaction in cash. People would accept cash on the basis that it is advance for selling his immovable property. Later, the deal would be cancelled and the money would be repaid. Such a transaction was strictly legal. In reality such a transaction was undertaken to avail a loan.

4.2 It has now been proposed that any transaction pertaining to immovable property exceeding Rs. 20,000 has to be undertaken by cheque, draft or electronic clearing system. The transaction may be for advance or any other purpose. It is not relevant whether the transaction goes through or not. If it is for immovable property, it has to be through bank system.

Similarly repayment also has to be done by banking instruments.

While the section applies to transactions where receipt and repayment of money in cash is involved, even bonafide immovable property transactions will be covered by these sections.

4.3 It should be noted that the section applies to recipients of money – i.e. those who will "receive" advance or who will "repay" the advance. It does not apply to "payers". The reason is that it is recipients who earn income, may show the receipt as loan. People earn cash income and give it to a friend or relative or an agent. Then they take that amount from that agent as loan. Thus the recipient of income enjoys his income without paying tax. Therefore the section applies to recipients.

4.4 The amendment applies not only to builders, but also to individual who is selling his personal property. If the seller declares his sale consideration of the flat fully, pays tax on the same, still the sections apply. Therefore if he has received any sale proceeds in cash, he will liable to penalty. Hence persons who sell any property should consider this provision.

4.5 In our view, the Government has gone overboard. Every time, some abuse of law is sought to be controlled, honest people are put to unnecessary troubles. Government policy is : (i) while giving a relief impose several conditions, (ii) while controlling something, make it open, unlimited control. The object is to avoid cash loans and cash transaction which evades taxes. If the person pays up full tax on the amount received and if no loan is involved, there is no need to provide for harsh provisions.

Already there are provisions such as stamp duty value transactions, PAN details, etc. These are good enough to catch the tax evaders.

4.6 PAN requirement for immovable property transactions:

As a part of measures to curb tax evasion, the Finance Minister in his budget speech has said that PAN will be required to be stated for all transactions of immovable property exceeding Rs. 1 lakh. This requirement will be brought about by way of rules. There is no mention of this in the Finance Bill.

5. General Anti Avoidance Rules (GAAR):

Government had proposed GAAR in the earlier years. The rules were quite strict and wide in their ambit of deeming provisions. Against the strict rules, there was inadequate accountability of the revenue personnel.

Wide deeming provisions are meant for severe violations of large amounts. These are not meant to be used in every suspicion of small violations. However there were no thresholds / no limits prescribed in GAAR.

The Government had earlier postponed the implementation of GAAR rules for 3 years and these were supposed to come into effect from 1st April 2015. The Government has now proposed to defer it by further 2 years. **These will apply from FY 2017-18.**

The memorandum explaining the finance bill has stated that investment made upto 31.3.2017 will be protected by the GAAR. Separate rules will be notified to clarify this issue. Thus investments made upto 31.3.2017 will be protected from GAAR. What is the exact meaning will be better understood once the rules are made. For example, if a non-resident invests through Mauritius for the purpose of saving tax on capital gain. The Mauritian company does not have substance. Does it mean that if the investment is made before 31.3.2017, then capital gain earned by Mauritius company will be protected from GAAR? If yes, many people will set up structures before 31.3.2017. Let us wait for the rules.

6. Furnishing of information relating to payments to non-residents – Section 195(6):

6.1 Section 195 (6) states that - if any person has to make any payment to a non-resident on which tax needs to be deducted; then before making such a payment, information in relation to such payment needs to be furnished to the department. This section applies whether payment is made by a resident or non-resident. In practice, banks asked for the information only when funds were remitted through bank remittances abroad. This provision was inserted by Finance Act, 2008 w.e.f. 1st April, 2008.

6.2 The primary intention behind inserting this provision was to enable the government to keep a track on whether proper deduction of tax is being made while making payments to non-residents. However, the existing provision prescribes furnishing of information only for payments on which tax is deductible. Wherever there is no tax deductible at source, the payments can be made without any furnishing of information[9]. As per the department, this was not the intention.

6.3 To overcome this, the department has come out with an amendment. As per the proposed amendment, information in relation to **all payments**

[9] Practically, many banks are insisting on furnishing of the prescribed information even in cases where no tax is deductible.

made to non-residents, whether taxable in India or not, needs to be furnished to the department in the prescribed manner.

Due to this amendment, all kinds of payments made to a non-residents will get covered. This will have a far reaching effect on the payments which are made to non-residents. The implications of this amendment are envisaged below with the help of some examples:

a. Payments made by importers to non-resident exporters will get covered under this new provision. For all payments that an importer makes, the information in relation to the same needs to be furnished to the department. So far, practically the information was not being insisted by many banks. It was logical also. Out of imports of US$ 750 bn., payments for US$ 500 bn. are for oil and oil products, gold, gems and precious metals. There is normally no tax on the same. Now all such payments will require information to be provided.

b. If an Indian resident goes to a foreign destination for a vacation then each and every payment made by the resident to the foreign non-residents will be covered under this regulation. For example, Mr. X, an Indian resident, who goes on a holiday to USA and makes payment to a US cab driver for a ride from airport to his hotel will be required to furnish this information to the Indian tax department.

c. The section applies to any person making payment to non-residents. Thus payment by one non-resident to another non-resident will be subject to this provision. For example a person resident in UK pays rent for property in India to another UK resident. The information in relation to this transaction will be required to be furnished with the Indian tax department.

6.4 From the above examples it seems that the new provision will have a far reaching implications. Practically, this will become unworkable. The department will have to come out with appropriate clarifications.

6.5 The existing provision under rule 37 BB specifies a list of transactions. If payments are covered in this list, then no information in relation to those payments needs to be furnished. Once the government comes out with proper rules, one will get more clarity as to whether all transactions will be covered under the net of section 195(6) or not.

6.6 There are no penal provisions for not furnishing the information under Section 195(6) currently. The department has now proposed a penalty.. A new section, Section 271-I, has been proposed which provides that if the person responsible for furnishing the information under Section 195(6) does not furnish the information or furnishes inaccurate information, then a penalty of Rs. one lakh rupees may be levied.

6.7 If the amendment is to be interpreted in literal terms, then this will bring a lot of hardship for persons who have regular payments to non-residents. Hopefully the department will come out with proper guidelines, explaining the purpose, intention and the scope of the amendment.

This amendment will take effect from 1st June, 2015.

7. Direct Tax Code:

A new tax law – Direct Tax Code (DTC) was proposed. There had been several representations against the DTC. In essence many of the provisions have been brought about in the existing Income tax Act itself. The DTC has been shelved for good.

8. Residential status of shipping crew – Section 6:

8.1 Residential status of an individual is defined under section 6. The normal rule is as under:

i) A person is resident in India for that year if he stays for more than 181 days in the year.

ii) If the person has stayed in India in the 4 preceding year for 365 days or more, then he will be a resident in that relevant year if he stays for more than 59 days.

Irrespective of his stay in the 4 preceding years, if an "Indian citizen" leaves India as a member of crew of an Indian ship, he will be a resident if he stays in India for more than 181 days.

Thus if an Indian citizen leaves India as a member of Indian ship crew, he will be a non-resident if he stays outside India for more than 182 days.

8.2 There are controversies on the meaning of being "in India" or "outside India". In the case of Mr. Madhukar Vinayak Dhavale (Pune Tribunal), the master of the ship left India as a part of Indian ship crew. When the person crosses the immigration counter, his passport is stamped with the date. As per the passport, his stay outside India was for more than 200 days. However as per the certificate of the shipping company, his stay outside India was just 158 days.

The case does not give the reason for the difference. The reason for the difference could be that – the person may board the ship, however the ship may leave the Indian shores only after a few days. Or the ship may travel to another Indian port before leaving the shores of India.

In such situations should one go by the passport dates or by the facts that was the ship in Indian waters or not.

8.3 A Circular (Number : 586 dated 28.11.1990 - 186 ITR(Stat) 0167) issued by the tax department has clarified that if the ship is outside Indian territorial waters, then it is outside India. (India extends up territorial waters). This circular was not referred to in the above decision. However the fact remains that if the ship is within Indian waters, it is "In India".

8.4 The budget has provided that the manner of determining the number of days within India or outside will be prescribed separately in case of merchant crew. We will have to wait for the guidelines.

8.5 This issue also applies to travel by flight. For example, the immigration counter may stamp the date of departure at 11.30 pm on say 15th June. The flight may depart on 16th June at 12.30 am. Will 16th June be considered as "in India" or "outside India".

Or the flight may depart on 15th June, but will first go from Mumbai to Delhi and then depart from India. Or it could happen that the departure is before 12 mid night, but by the time the Indian air space is crossed, it may be after mid night.

In flights the differences of days are small. In ships the difference in number of says can be large as the ship can be anchored outside the port but within Indian waters for several days at a stretch.

The proposed guidelines will only cover crew of merchant ships and not this travelling by air. Let us wait for guidelines.

V. Deductions for Individuals & HUFs

Overall, the Budget has provided for enhanced deductions for health expenses, pensions and donations in respect of new Government schemes. These are explained below.

1. Deduction in respect of investment in Sukanya Samriddhi Account Scheme [Section 10(11A) and 80C]:

It is proposed to allow deduction under section 80C, in respect of amounts paid or deposited in Sukanya Samriddhi Account Scheme. The deduction is available to an individual for depositing the amount:

(i) for self; or
(ii) for the amount deposited in the name of any girl child of the individual; or
(iii) in the name of any girl child for which the individual is the legal guardian.

All the payments, i.e. the interest and withdrawals from this account will be exempt from tax under section 10(11A). There are certain conditions to deposits under the Sukanya Samriddhi Scheme relating to rate of interest, lock-in period, etc., which should be reviewed before making deposits in such account.

2. Deduction in respect of contribution to certain pension funds [Section 80CCC]:

Under the existing provisions, a deduction is allowed in respect of amount deposited by an individual for any annuity plan of LIC or any other insurer for receiving pension from a fund set up under a pension scheme. This deduction was limited to Rs. 1,00,000. This limit has now been raised to Rs. 1,50,000 and will be applicable in from A.Y. 2016-17.

3. Deduction in respect of contribution to pension scheme of Central Government [Section 80CCD]:

Under the existing provisions of this sub-section, an individual is allowed a deduction of the amount deposited by him in the pension scheme of the Central Government to the extent of:

(i) 10% of salary (in case of employee)
(ii) 10% of Gross Total Income (in any other case)

However, this deduction was limited to Rs. 1,00,000. This limit has now been removed.

Further, deduction is also available for an extra Rs. 50,000 deposited over and above the afore-mentioned limits. Therefore, the revised limits will be:

(i) 10% of salary (in case of employee)
(ii) 10% of Gross Total Income (in any other case)

If the amount deposited is more than the above limits, then the additional amount deposited will be allowed as a deduction to the extent of Rs. 50,000.

4. Deduction in respect of expenditure on health [Section 80D]:

4.1 Currently, Section 80D provides deductions for health insurance premium and payments made towards preventive health check-up by a tax payer for himself, his family (spouse and dependent children) and his parents. The deduction is available to the extent of Rs. 15,000 for self and family; and another Rs. 15,000 for parents. Where the payment is in respect of a senior citizen, the above limits are enhanced to Rs. 20,000.

In the memorandum & the notes to clauses, this limit of Rs. 15,000 is proposed to be raised to Rs. 25,000; and the limit of Rs. 20,000 for senior citizens to Rs. 30,000. However, the Finance Bill is silent on this aspect. It seems that this is an error which will probably be corrected by the time the bill is passed into the Act.

4.2 Further, the Budget now provides that medical expenditure incurred on the health by a very senior citizen (above the age of 80) for himself; or by a tax payer for his parent who is a very senior citizen can also be claimed as a deduction. The deduction is limited to Rs. 30,000 and is available only in cases where no health insurance has been taken for such person.

4.3 Further, the overall limit for the deduction by a tax payer for himself and his family, whether or not above the age of 60 years, is Rs. 30,000. Similarly, deduction for a tax payer for payment in respect of his parents, whether or not above the age of 60 years, is Rs. 30,000. Therefore, theoretically, a tax payer can claim total deduction of Rs. 60,000 for payments in respect of health insurance premiums or medical expenditure.

4.4 While the Finance Bill has mistakenly not increased the limits for Individuals, the limits for HUFs have been increased as mentioned below:

Sr. No.	Amount paid for by member of HUF	Amount of deduction available earlier	Amount of deduction available now
1.	Any member (not being senior citizen)	15,000	25,000
2.	Any member (being senior citizen)	20,000	30,000
3.	For medical expenditure on health of any member (being very senior citizen having no health insurance)	NA	30,000

Overall limit for all the above deductions in aggregate is Rs. 30,000.

These amendments will be applicable from A.Y. 2016-17.

5. Deduction in respect of maintenance including medical treatment of a dependent who is a person with disability [Section 80DD] & Deduction in respect of a person with disability [Section 80U]:

The limit for deductions in respect of the above sections has been raised from Rs. 50,000 to Rs. 75,000. For persons with severe disability, this limit has been raised from Rs. 1,00,000 to Rs. 1,25,000. (Applicable from A.Y. 2016-17).

6. Deduction in respect of medical treatment, etc. [Section 80DDB]:

Under the existing provisions, deduction of Rs. 40,000 (Rs. 60,000 in case of senior citizens) is available for medical treatment of certain chronic and protracted diseases. This limit has been raised from Rs. 60,000 to Rs. 80,000 for very senior citizens.

Earlier a certificate from a specialist working in the Government hospital was required stating that the person was suffering from the specified disease. However, at times, the Government hospitals did not have doctors that specialised in those specified diseases. With the amendment in this section, even a prescription from a specialist is also valid and will entitle an individual to claim the deduction. (Applicable from A.Y. 2016-17).

7. Deduction in respect of donations to certain funds, charitable institutions, etc. [Section 80G]:

7.1 Swachh Bharat Kosh:

An assessee, resident or non-resident, would be entitled to claim 100% deduction in respect of amount donated by him to Swachh Bharat Kosh. Any amount donated on account of Corporate Social Responsibility will not be allowed as a deduction. This provision has been made applicable from 1st April 2015.

7.2 Clean Ganga Fund:

A **resident** assessee would be entitled to claim 100% deduction in respect of amount donated by him to the Clean Ganga fund. Donations made on account of Corporate Social Responsibility will not be covered. This provision has been made applicable from 1st April 2015.

7.3 National Fund for Control of Drug Abuse:

An assessee would be entitled to claim 100% deduction for the donations made by him to this fund on or after 1st April 2016.

VI. Foreign Exchange Management Act

1. The Foreign Exchange Management Act (FEMA) has been amended for the first time since its inception in the year 2000 and that too by the Finance Bill! There are some very important policy amendments which have been brought about by the amendments which are discussed below.

2. Power to regulate Capital Account Transactions:

2.1 The Financial Sector Legislative Reforms Commission (FSLRC) was set up in the year 2013 under the chairmanship of Justice BN Srikrishna to consider all financial sector laws comprehensively. It had suggested changes regarding policy and regulation for foreign exchange capital flows.

It had suggested that power to make rules for **inward capital flows (FDI)** should be with the Government. Rules for outward flows (ODI) could be made by RBI.

The finance bill has proposed even more powers for the Central Government than what has been recommended by the FSLRC.

2.2 Section 6 of FEMA provides that RBI may prescribe rules for Capital Account transactions. Sub-section (3) lists several capital account transactions – inflow of investment, outflow of investment, loans, guarantees, immovable property, etc.

The Finance Bill proposes that RBI will have the powers to prescribe any transactions of capital account transactions <u>involving debt instruments</u>. The Central Government will have the powers to prescribe any transactions of capital account transaction which do not involve debt instruments. The meaning of debt instruments will be determined by the Central Government.

Thus not just for inflow of funds, but even for outflow of funds, RBI will not have any powers. Only the Central Government will have the powers.

The Finance Bill clarifies that the rules issued by RBI will continue till the same are amended.

The Regulatory Powers under FEMA may be broadly considered to be divided as under:

- Current Account Transactions – Section 5 – Already with Central Government.
- Capital Account Transactions – Section 6 – was with RBI.

Now only debt instruments stay with RBI. All other capital account transactions shall be regulated by Central Government.

Thus RBI will have very little powers as far as FEMA is concerned.

2.3 There were differences between RBI and Ministry of Finance regarding foreign inward investment. Some of the differences took several years to get resolved. Even Supreme Court had to comment upon different regulations by Government & by RBI. With powers being centralised with the Central Government, these differences should not be there.

2.4 Administration of Section 3 (Dealing in Foreign Exchange) and Section 7 (Export of goods & services) continue with RBI.

VII. Tax rates

The tax rates have largely been left untouched. There are however some significant changes proposed as under:

1. Wealth tax:

Wealth tax has been abolished. This is very positive. More than the wealth tax, the procedure of getting valuation reports, filing the return, etc. has been saved. Wealth-tax returns were useful as an anti-avoidance measure. An assessee could not just increase his assets/ capital account without declaring the income. Now all information which had to be provided in the wealth tax return, will have to be provided in the Income-tax return. Hence Government's anti-avoidance measure will continue without avoidable harassment.

2. Rates of tax:

To compensate for wealth tax, the **surcharge** has been increased by 2% for incomes above Rupees one crore, on all kinds of assessees. Due to additional surcharge of 2%, all other tax rates for specific purposes like Minimum Alternative Tax, Dividend Distribution tax, etc. will also **increase** marginally. Thus the final rate of tax will be as under:

Person	Income limits	Tax rate (including education cess & surcharge)
Individual, HUF, AOP, BOI, Artificial juridical person	Upto Rs. 1 crore	Maximum rate 30.9%
	Above Rs. 1 crore	Maximum rate 34.6%
Firm and LLP	Upto Rs. 1 crore	30.9%
	Above Rs. 1 crore	34.6%
Indian company	Upto Rs. 1 crore	30.9%
	Above Rs. 1 crore & upto Rs. 10 crores	33.1%
	Above Rs. 10 crores	34.6%
Foreign company	Upto Rs. 1 crore	41.2%
	Above Rs. 1 crore and upto Rs. 10 crores	42.0%
	Above Rs. 10 crores	43.3%

3. Corporate tax:

The Finance Minister has proposed to bring the corporate tax **rate down** to 25% in the next 4 years. It will be combined with removal of tax exemptions. This is the first time that businessman knows what will be the rate of tax 4 years down the line.

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