HIGHLIGHTS OF INDIA’S UNION BUDGET
2018-19

Foreword

The policy announcements in this Budget covered a wide gamut of areas ranging from block-chain to bamboo to the bond market. This is perhaps understandable, given that the general elections are just around the corner.

There are several ambitious policy announcements that, if implemented well, could change the face of the country. It is indeed interesting to note that the Government's longstanding focus on 'ease of doing business' now stands extended to 'ease of living'. Specifically, the National Health Protection Scheme is a landmark initiative towards achieving universal healthcare. There are several other reform initiatives aimed at improving governance, boosting investment, infrastructure and income, especially in the rural areas.

On the tax front, the most important change pertains to the reintroduction of capital gains on listed securities. This is aimed at shoring up revenues to fund important developmental initiatives. The fact that the market has taken this in its stride, speaks volumes about its maturity and vindicates the Finance Minister's bold move. The Government has also lived up to its promise of not levying taxes retrospectively by grandfathering gains upto 31 January 2018.

What India Inc. was expecting, especially in the wake of US headline tax reductions, was an across the board reduction of tax rates. This has not come through, perhaps indicating the need for resource mobilisation in the backdrop of this year's fiscal slippage. Still, the move to extend the 25% rate to MSMEs with a turnover of less than INR 2.50 billion is welcome.

Some key changes in the direct tax regime draw their inspiration from the Base Erosion and Profit Shifting (BEPS) project of the OECD. This includes the expansion of the 'business connection' definition under the Income-tax Act, 1961 ('the Act') to cover certain agency functions as well as digital businesses. These are extremely far-reaching and will have significant impact on foreign companies as well as their Indian customers.

The changes proposed to the Act in respect of companies being restructured under the Insolvency and Bankruptcy Code (IBC) are a step in the right direction and will significantly enhance the efficacy of the IBC process.

On the indirect tax side, while there were a few changes relating to customs duty, there were no major amendments proposed, due to the introduction of the GST in July 2017.

We have in the ensuing pages captured the highlights of the policy announcements and tax proposals in the Budget. We hope you will find this useful.

Dinesh Kanabar

CEO

Key Policy Announcements

- National Health Protection Scheme to be launched to provide medical coverage of INR 500,000 per family per year for 100 million poor and vulnerable families (expected to cover a population of 500 million)
- A unified authority to be established for regulating all financial services in International Financial Service Centres (IFSCs) to be established
- Stamp duty regime in respect of financial securities to be amended in consultation with the States
- Measures to mandate bond market borrowings by large companies being considered
- Gold to be developed as an asset class, and a comprehensive Government policy to be framed
- Overseas Direct Investment (ODI) regulations to be reviewed
- Separate policy for hybrid instruments to be evolved with a view to raising foreign investment, especially for startups and venture capital firms
- Policy and institutional development measures being examined with a view to provide an impetus to the FinTech industry
- Government to explore use of block-chain technology for ushering in the digital economy

Direct Tax Proposals

[slated to be effective from 1 April 2019 (i.e. Assessment Year 2019-2020) unless indicated otherwise]

Tax Rates

Personal tax

- No change in tax slab rates

Corporate tax

- Beneficial tax rate of 25% for domestic companies having a turnover of less than INR 2.50 billion in Financial Year (FY) 2016-17
- Introduction of 4% Health and Education cess replacing existing cess for all taxpayers resulting in a marginal increase in total tax outflows

Deductions

Salaried taxpayers

- Standard deduction of INR 40,000 subsuming existing deduction towards medical re-imbursement (INR 15,000) and transport allowance (INR 19,200). Transport allowance will continue for differently abled persons

Senior citizens

- Deduction for health insurance premiums and medical treatment increased from INR 30,000 to INR 50,000
- Deduction in respect of medical treatment of specified diseases increased by INR 20,000
- Deduction upto INR 50,000 in respect of interest income from deposits with banks, co-operative societies engaged in the business of banking, or post office.

Widened scope of ‘Business Connection’

- The current scope of ‘business connection’ in respect of Agents under the Act to be aligned with the modified Dependent Agent Permanent Establishment (PE) definition under the Multilateral Instrument
- As a result, “business connection” will also include any business activities carried out through a person who, acting on behalf of the non-resident, habitually plays the principal role leading to conclusion of contracts by the non-resident

- Exclusion for activities limited to the purchase of goods removed

Taxability on basis of significant economic presence

- It is clarified that a ‘Significant Economic Presence’ of a non-resident in India will constitute a ‘business connection’

- ‘Significant Economic Presence’ defined to mean:
  - Transactions in respect of any goods, services or property carried out by a non-resident in India including download of data or software in excess of an amount to be prescribed
  - Systematic and continuous soliciting of business activities or engaging in interaction with users (number to be prescribed) in India through digital means

- These provisions will apply irrespective of whether the non-resident has a residence or a place of business in India or renders services in India

- Only so much of income as is attributable to such transactions or activities shall be deemed to accrue or arise in India

- However, tax treaty provisions will continue to apply for non-residents who are entitled to claim treaty benefits

Capital Gains

- Tax on long-term capital gains reintroduced on transfer of:
  - Listed equity shares and units of equity-oriented funds (*held for more than one year*);
  - Units of a Real Estate Investment Trust / Infrastructure Investment Trust (*held for more than three years*)

- Concessional tax rate of 10% proposed on aggregate capital gains exceeding INR 100,000 on sale of such assets. The concessional tax rate will be applicable if :–
  - Securities Transaction Tax (STT) has been paid on both acquisition and transfer of equity share in a company; and
  - STT has been paid on transfer of units of an equity-oriented fund or a business trust.

- Long-term capital gains to be computed without the effect of indexation and foreign exchange fluctuations (for non-residents)

- The cost of acquisition for such long-term capital assets acquired prior to 1 February 2018 shall be the higher of:
  - The actual cost; or
  - The lower of:
    - The fair market value of such asset as on 31 January 2018; or
    - The consideration received upon the transfer of such capital asset

This effectively grandfathers gains based on the fair market value as on 31 January 2018. Proposals do not specifically provide for such relief in respect of 'Foreign Institutional Investors' (FIIs)

- Existing exemption under section 10(38) to continue in respect gains from transfer of long-term capital assets sold before 31 March 2018

- Capital gains exemption on reinvestment in specified bonds under section 54EC restricted to gains arising from the transfer of land or buildings

Dividends

- Loans and advances to certain shareholders and their controlled entities liable to Dividend Distribution Tax (DDT) @ 30% (without grossing up)

- Scope of 'accumulated profits' for the purpose of dividend provisions proposed to be widened to include profits of the amalgamating company (whether capitalized or not)

- Equity oriented funds to discharge 10% tax on distributed income

Taxability of compensation in connection with employment

- Compensation of any nature (capital or revenue) in connection with termination or modification of terms and conditions of an employment contract to be taxed as Income from other sources

Rationalisation of provisions of Income Computation and Disclosure Standard ('ICDS') *(applicable retrospectively from FY 2016-2017)*

- Several provisions proposed to incorporate ICDS in the Act

- Deduction for Marked to Market loss or other expected loss computed in accordance with the provisions of ICDS to be allowed

- Gains or loss arising from foreign exchange fluctions (except transactions relating to imported capital assets) to be computed in accordance with ICDS

- Percentage of Completion Method (POCM) to be applied while computing profits and gains from construction contract

- Profits and gains from service contracts to be determined under POCM except:
    - If the project duration is not more than ninety days [*in which case, Project Completion Method (PCM) will be used*]
    - If the project involves indeterminate number of acts over a specific period of time [in which case, the Straight Line Method (SLM) *will be used]*

For the purpose of application of POCM, PCM and SLM, contract revenue shall include retention money. However, contract costs shall not be reduced by any incidental income such as interest, dividends or capital gains

- Unlisted securities or listed securities (not quoted on a recognised stock exchange) held as inventory to be valued at actual cost initially determined in accordance with ICDS
- In other cases, inventory including securities other than those referred above shall be valued at lower of actual cost or net realizable value computed in accordance with ICDS
- Valuation of inventory to include duty, tax, cess or fee, etc. incurred to bring such goods or services to the place of its location / condition on the valuation date
- Following items to be taxed in the year of receipt:
  - Interest on any compensation or enhanced compensation;
  - Government Grants (including subsidy, cash incentive and duty drawback) if not charged to tax in an earlier year
- A claim for escalation of price in a contract / export incentive will be taxable in the previous year when its realisation is reasonably certain

Taxability of compensation in connection with business

- Compensation of any nature (capital or revenue) in connection with termination or modification of terms and conditions of a contract relating to a business proposed to be taxed as business income

Minimum Alternate Tax (MAT)

- Clarification provided (with retrospective effect from 1 April 2001) that MAT will not apply to a non-resident covered by a presumptive tax regime (viz. oil and gas, shipping, aircraft operations, etc)

Measures for facilitating Insolvency resolution

- In computing MAT for a company against whom a proceeding for corporate insolvency process has been admitted, a deduction will be allowed in respect of the aggregate amount of unabsorbed deprecation and brought forward loss as per books of account (as against the earlier restriction of the lower of the two amounts)
- Provisions of section 79 relating to restrictions on carry forward and set off of losses to not apply in case of a change in shareholding pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016. This is conditional upon the income tax authorities having been afforded a reasonable opportunity of being heard in the insolvency process
- A return of a company under insolvency proceedings must be verified by the Insolvency Resolution Professional appointed by the adjudicating authority

Incentives for employment generation

- The additional deduction of 30% of new employee cost is available for footwear and leather industry in respect of employees who have been employed for 150 days

- Further, the deduction for employment generation will be available even if the new employee fulfils the minimum number of days of employment criteria (240 or 150 days as the case may be) in the subsequent year

Tax benefits for Start-ups *(effective from FY 2017-2018)*

- Tax holiday eligibility for start-ups extended to companies incorporated before 1 April 2021
- Eligibility criteria of turnover restriction of INR 250 million now proposed to be applicable for seven years commencing from the date of incorporation
- Definition of 'eligible business' expanded to provide that benefit would be available *inter alia* to a scalable business model with a high potential of employment generation or wealth creation

Transfer Pricing – Country by Country Report (CbCR) (effective from FY 2017-2018)

- The due date for filing CbCR by an Indian ultimate holding company or an Indian alternate reporting entity to be 31 March of the following accounting year (as against 30 November)
- Indian entity to file CbCR if it is not filed by ultimate parent entity or alternate reporting entity

Transactions between a Holding Company and a Wholly Owned Subsidiary

- Currently, gains arising on transfer of a capital asset between a holding company and a wholly owned subsidiary company or vice-versa are exempt from capital gains tax in the hands of the transferor. However, where transfer of such capital asset is without any consideration or for inadequate consideration, then the difference is taxable as income in the hands of the transferee
- It is proposed that a transfer of capital asset from holding company and its wholly owned subsidiary (or vice versa) for inadequate consideration would not be chargeable to tax in the hands of the recipient/ transferee

Tax based on Stamp Duty value of land and/or building

- Currently, the Stamp Duty value of land and/ or building is considered for determination of taxable income if it is higher than the transaction value. In such a scenario, the tax liability is determined as under:
  - For the Seller, the stamp duty value is deemed to be the 'sale consideration' for calculation of capital gains (if land and/ or building is held as 'capital asset') or business income (if land and/ or building is held other than as capital asset)
  - The difference between the sale consideration and the stamp duty value is chargeable to tax as income from other sources for the Buyer

- It is proposed that the above provisons will not apply in cases where the difference between the stamp duty value and the sale consideration does not exceed 5% of sale consideration

Charitable Trusts and Institutions

- Cash payments exceeding INR 20,000 disallowed for the purpose of computing 'application of income'
- Disallowance of 30% of payments made to residents on failure to withhold applicable taxes

Tax Compliance and Miscellaneous matters

- Permanent Account Number (PAN) mandatory for non-individual entities having financial transactions exceeding INR 250,000 in a financial year
- Principal officers and other specified persons of such non-individual entities also required to obtain PAN
- No deduction available under Chapter VI-A (Heading C) in case of non-filing or delay in filing of tax return
- Scheme for e-assessment proposed. Details to be notified
- No adjustment in summary assessment on account of discrepancy in total income reported vis-à-vis Form 26AS (annual statement of taxes) or Form 16/16A (electronically generated withholding tax certificate). (*effective from FY 2017-18 onwards*)
- No expenditure/loss to be allowed against unexplained income/investments determined by the Assessing Officer
- Increase in penalty for failure to furnish statement of financial transactions/ reportable account as under (*Amendment effective from 1 April 2018*)

Nature of default	Existing Penalty (per day of default)	Proposed Penalty (per day of default)
On failure to furnish the statement of financial transaction or reportable account within the stipulated time	INR 100	INR 500
On failure to furnish the statement of financial transaction or reportable account in response to a notice	INR 500	INR 1,000

- Penalty order issued to an accountant, a merchant banker or registered valuer for furnishing incorrect information in any report or certificate furnished under the provisions of the Act by the Commissioner of Income-tax (Appeals) made appealable to the Income-tax Appellate Tribunal. Amendment effective from 1 April 2018
- Prosecution can lie against companies for non-filing of returns even if no tax is due

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Indirect Tax Proposals

Tariff Rate

To incentivise domestic value addition and to promote the 'Make in India' campaign in certain sectors like food processing, electronics, auto components, footwear and furniture, Customs Duty on various products have been increased. Some of the products are as under:

- Cellular Mobile Phones: from 15% to 20%
- Specified Parts of Motor Vehicles: from 10% to 15%
- Furniture and parts thereof: from 10% to 20%

Customs – Key legislative changes

Social Welfare Surcharge (SWS)

SWS has been imposed on import of goods into India. SWS shall be calculated at the rate of 10% (3% on certain goods) of aggregate duties of Customs on all imported goods in lieu of existing Education cess (2%) and Secondary & Higher Education cess (1%). The said Surcharge shall be non-creditable.

Exemption has been granted from levy of SWS on Integrated Goods and Services Tax (IGST), however, there is no exemption from levy of IGST on SWS.

Road and Infrastructure Cess

Road and Infrastructure Cess has been introduced on import of motor spirit in lieu of Additional Duty of Customs (Road Cess). Similar levy has been introduced under Central Excise.

Customs Act, 1962

- Scope of applicability of Customs Act expanded to cover any offence or contravention committed outside India by any person
- Meaning of 'assessment' substituted with a wider and more comprehensive definition to include tariff classification, valuation, exemptions or concession, origin and any other factor affecting duty, tax or cess
- Meaning of 'Indian customs waters' amended to replace the words 'contiguous zones of India' with 'Exclusive Economic Zone'
- Scope of verification by customs officers expanded beyond self-assessment to all entries of goods made on importation or for exportation
- Provisions of provisional assessment of duty has been extended to export consignments

- Pre-notice consultation facility made available in cases not involving collusion, wilful misstatement, suppression before issue of notice and issuance of supplementary notices.

- Amendment in provisions related to Advance Ruling:
    - The scope of advance rulings has been expanded. An application for an advance ruling can now be made in respect of goods prior to importation or exportation.
    - Similarly, the meaning of 'applicant' for the purposes of an advance ruling has been widened to include any person holding an Importer Exporter Code or exporting any goods to India.
    - The time-frame for issuing an advance ruling has been reduced from six months to three months.
    - Specified customs authorities are empowered to act as Advance Ruling Authority.
    - Provisions made for filing appeal against advance ruling

- Facility of clearance of goods through 'Customs Automated System' to be introduced

- Introduction of 'Electronic Cash Ledger' for making advance deposit of duty, interest, penalty, fees or any other sums payable under the Customs Act

- Rationalization of provisions under the Customs Act to have time bound closures of show cause notices. Subsequently, treating matters as 'deemed to be closed' if the matters are not adjudicated within the time frame.

Customs Tariff Act, 1975

- In case of sale of goods in bonded warehouse, IGST and compensation cess as part of Custom duties is payable on the import price or final sales price, *whichever is higher*.

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