

A COMPLETE ANALYSIS OF THE FINANCE ACT, 2013

PART - V

(Chapter XII, XII-D, XII-DA, XII-E & XII-EA of the IT Act)

Prepared by Advocates of

M/s Subbaraya Aiyar, Padmanabhan & Ramamani (SAPR) Advocates

8. CHAPTER XII – Determination of tax in certain special cases (Tax Rates & Dividend Distribution Tax)

a. Section 115A: Streamlining of tax rate at 25% for non-resident tax payer (other than companies)

Amendment:

In section 115A of the Income-tax Act, in sub-section (1), in clause (b), for sub-clauses (A), (AA), (B) and (BB), the following sub-clauses shall be substituted with effect from the 1st day of April, 2014, namely:—

“(A) the amount of income-tax calculated on the income by way of royalty, if any, included in the total income, at the rate of twenty-five per cent.;

(B) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of twenty-five per cent.; and”.

Analysis:

In respect to section 115A (1) (b) (A), (AA), (B) and (BB), the following sub-clauses shall be substituted with effect from the 1st day of April, 2014, namely:—

“(A) the amount of income-tax calculated on the income by way of royalty, if any, included in the total income, at the rate of twenty-five per cent.;

(B) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of twenty-five per cent.; and”

Section 115A of the Income-tax Act provides for determination of tax in case of a non-resident taxpayer where the total income includes any income by way of Royalty and Fees for technical services (FTS) received under an agreement entered after 31.03.1976 and which are not effectively connected with permanent establishment, if any, of the non-resident in India. The present structure provides taxation at different rates ranging from 30% to 10% depending upon the date of the agreement. In view of the fact that the existing rate of taxation for royalty / fees for technical services is 10%

for current contracts which is lower than most DTAA rates, it is proposed that the tax rate for such income will be increased from 10% to 25%.

[SECTION 27 OF THE FINANCE ACT, 2013]

b. Section 115AD: Tax on Foreign Institutional Investors from securities or capital gains arising from their transfer

Amendment:

The Finance Act 2013 brought about an amendment. In section 115AD of the Income-tax Act, in sub-section (1)(i) the following proviso shall be inserted with effect from the 1st day of April, 2014, namely:—

“Provided that the amount of income-tax calculated on the income by way of interest referred to in section 194LD shall be at the rate of five per cent;”

Analysis:

This provision states that tax on income by way of interest referred to in Sec 194LD will be at the lower rate of 5% and accordingly, tax is deducted only at the rate of 5%.

[SECTION 28 OF THE FINANCE ACT, 2013]

c. Section 115BBD: Extension of beneficial tax rate on dividend income from specified foreign company

Amendment:

In section 115BBD of the Income-tax Act, in sub-section (1), after the words, figures and letters “the 1st day of April, 2013”, the words, figures and letters “or beginning on the 1st day of April, 2014” shall be inserted with effect from the 1st day of April, 2014.

Analysis:

In section 115BBD of the Income-tax Act, in sub-section (1), after the words, figures and letters “the 1st day of April, 2013”, the words, figures and letters “or beginning on the 1st day of April, 2014” shall be inserted with effect from the 1st day of April, 2014

Dividend received by an Indian company from a specified foreign co.(in which it has a holding of 26 per cent or more) are taxed at the rate 15 per cent if such dividend is included in the total income. Lower tax rate was applicable up to AY 2013-2014.This

beneficial tax rate on dividend income from specified foreign company is extended by one year till March 31, 2014 i.e. AY 2014-2015.

[SECTION 29 OF THE FINANCE ACT, 2013]

9. CHAPTER XII-D – Special Provisions relating to tax on distributed profits of domestic companies

Section 115-O: DDT not payable on dividends payable out of dividends received from a foreign company being a subsidiary.

Amendment:

In section 115-O of the Income-tax Act, in sub-section (1A), for clause (i), the following clause shall be substituted with effect from the 1st day of June, 2013, namely:—

“(i) the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,—

(a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or

(b) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend:

Provided that the same amount of dividend shall not be taken into account for reduction more than once;”.

Analysis:

The existing provisions of Section 2(22)(e) provide the definition of dividends for the purposes of the Income-tax Act. Section 115-O provides for levy of Dividend Distribution Tax (DDT) on the company at the time when company distributes, declares or pays any dividend to its shareholders. Consequent to the levy of DDT the amount of dividend received by the shareholders is not included in the total income of the shareholder.

Removal of cascading effect of DDT

By this amendment DDT not payable on dividends payable out of dividends received from a foreign company being a subsidiary. This amendment will take effect from June 1, 2013.

[SECTION 30 OF THE FINANCE ACT, 2013]

10. CHAPTER XII-DA – Special Provisions relating to tax on tax distributed income of domestic company for buy-back of shares.

Sections 115QA to 115QC

Amendment:

After Chapter XII-D of the Income-tax Act, the following Chapter shall be inserted with effect from the 1st day of June, 2013, namely:—

‘CHAPTER XII-DA: SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED INCOME OF DOMESTIC COMPANY FOR BUY-BACK OF SHARES

115QA. (1) Notwithstanding anything contained in any other provision of this Act, in addition to the income-tax chargeable in respect of the total income of a domestic company for any assessment year, any amount of distributed income by the company on buy-back of shares (not being shares listed on a recognised stock exchange) from a shareholder shall be charged to tax and such company shall be liable to pay additional income-tax at the rate of twenty per cent. on the distributed income.

Explanation.—For the purposes of this section,—

(i) “buy-back” means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956;

(ii) “distributed income” means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

(2) Notwithstanding that no income-tax is payable by a domestic company on its total income computed in accordance with the provisions of this Act, the tax on the distributed income under sub-section (1) shall be payable by such company.

(3) The principal officer of the domestic company and the company shall be liable to pay the tax to the credit of the Central Government within fourteen days from the date of payment of any consideration to the shareholder on buy-back of shares referred to in sub-section (1).

(4) The tax on the distributed income by the company shall be treated as the final payment of tax in respect of the said income and no further credit therefor shall be claimed by the company or by any other person in respect of the amount of tax so paid.

(5) No deduction under any other provision of this Act shall be allowed to the company or a shareholder in respect of the income which has been charged to tax under sub-section (1) or the tax thereon.

115QB. Where the principal officer of the domestic company and the company fails to pay the whole or any part of the tax on the distributed income referred to in sub-section

(1) of section 115QA, within the time allowed under sub-section (3) of that section, he or it shall be liable to pay simple interest at the rate of one per cent. for every month or part thereof on the amount of such tax for the period beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

115QC. If any principal officer of a domestic company and the company does not pay tax on distributed income in accordance with the provisions of section 115QA, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.'

Analysis:

Under the existing provisions of the IT Act, income arising to shareholders on account of buy-back of shares is taxable as capital gains in their hands under section 46A. Furthermore, consideration for buy-back has been excluded from the definition of dividend, even under the deeming provisions under section 2(22) of the IT Act and is accordingly not subject to any dividend distribution tax in hands of the company

A company, having distributable reserves, has two options to distribute the same to its shareholders either by declaration and payment of dividends to the shareholders, or by way of purchase of its own shares (i.e. buy back of shares) at a consideration fixed by it. In the first case, the payment by company is subject to DDT and income in the hands of shareholders is exempt. In the second case the income is taxed in the hands of shareholder as capital gains.

Unlisted Companies, as part of tax avoidance scheme, are resorting to buy back of shares instead of payment of dividends in order to avoid payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.

In order to curb such practice it is proposed to amend the Act, by insertion of new Chapter XII-DA, to provide that the consideration paid by the company for purchase of its own unlisted shares which is in excess of the sum received by the company at the time of issue of such shares (distributed income) will be charged to tax and the company would be liable to pay additional income-tax @ 20% of the distributed income paid to the shareholder. The additional income-tax payable by the company shall be the final tax on similar lines as dividend distribution tax. The income arising to the shareholders in respect of such buy back by the company would be exempt where the company is liable to pay the additional income-tax on the buy-back of shares.

The above amendment overrules the decision in **(2012) TaxCorp (INTL) 4300 (AAR)**. The AAR held that the capital gains arising out of the proposed buyback of shares is not taxable in India in view of paragraph 4 of Article 13 of the DTAC between India and Mauritius.

The new provisions sections 115QA, 115QB, and 115QC have been introduced through Chapter XII-DA. The proposed amendment has been made so as to overrule the following decisions:

1) Armstrong world India 349 ITR 303 (AAR)

2) A (2012) 343 ITR 455 / XYZ India (2012) 206 Taxman 631 (AAR)

3) (2012) TaxCorp (INTL) 4300 (AAR)

Any amount of distributed income by a domestic company on account of buyback of shares (not being shares listed on a recognized stock exchange) from a shareholder will be charged tax @ 20%. Such tax shall be payable by the company and consequently the income received will be exempt in the hand of such shareholders. (See amendment in Section 10)

Cases referred:

1) Armstrong world India 349 ITR 303 (AAR)

Amount received on buy back of shares is exempt except when the revenue established it to be a case of avoidance of tax

2) A (2012) 343 ITR 455 / XYZ India (2012) 206 Taxman 631 (AAR)

The proposal of buy-back was a scheme devised for avoidance of tax, a colourable devise for avoiding tax on distributed profits as contemplated in section 115-O of the Act. The arrangement could only be treated as a distribution of profits by a company to its shareholders satisfying the definition of dividend which includes any distribution by a company of accumulated profits to its shareholders.

3) (2012) TaxCorp (INTL) 4300 (AAR)

The capital gains arising out of the proposed buyback of shares is not taxable in India in view of paragraph 4 of Article 13 of the DTAC between India and Mauritius.

[SECTION 31 OF THE FINANCE ACT, 2013]

11. CHAPTER XII-E – Special Provisions relating to tax on distributed income

Section 115R: Additional tax at 5% on any income distributed by a mutual fund under an infrastructure debt fund scheme to a non-resident (not being a company)

Amendment:

In section 115R of the Income-tax Act, in sub-section (2), with effect from the 1st day of June, 2013,—

(a) in clause (ii), for the words “twelve and one-half per cent.”, the words “twenty-five per cent.” shall be substituted;

(b) after sub-clause (iii) and before the proviso, the following proviso shall be inserted, namely:—

“Provided that where any income is distributed by a mutual fund under an infrastructure debt fund scheme to a non-resident (not being a company) or a foreign company, the mutual fund shall be liable to pay additional income-tax at the rate of five per cent. on income so distributed:”;

(c) in the proviso, for the words “Provided that ”, the words “Provided further that” shall be substituted;

(d) for the Explanation, the following Explanation shall be substituted, namely:—

‘Explanation.—For the purposes of this sub-section,—

(i) “administrator” and “specified company” shall have the meanings respectively assigned to them in the Explanation to clause (35) of section 10;

(ii) “infrastructure debt fund scheme” shall have the same meaning as assigned to it in clause (1) of regulation 49L of the Securities and Exchange Board of India (Mutual Funds)

Regulations, 1996 made under the Securities and Exchange Board of India Act, 1992.’

Analysis:

The provision levies additional tax at the rate of 5% on any income which is distributed by a mutual fund under an infrastructure debt fund scheme to a non-resident (not being a company) or a foreign company. And the section also defines “Infrastructure debt fund”.

The amendment doubles the percentage of interest from 12.5% to 25% on the income distributed to any person being an individual or a Hindu undivided family by a fund other than a money market mutual fund or a liquid fund apart from additional 5% on any income which is distributed by a mutual fund under an infrastructure debt fund scheme to a non-resident (not being a company) or a foreign company.

[SECTION 32 OF THE FINANCE ACT, 2013]

12. Chapter XII-EA Special Provisions relating to tax on distributed income by securitization trust

Amendment:

After Chapter XII-E of the Income-tax Act, the following Chapter shall be inserted with effect from the 1st day of June, 2013, namely:—

'CHAPTER XII-EA: SPECIAL PROVISIONS RELATING TO TAX ON DISTRIBUTED INCOME BY SECURITISATION TRUSTS

115TA. (1) Notwithstanding anything contained in any other provisions of the Act, any amount of income distributed by the securitisation trust to its investors shall be chargeable to tax and such securitisation trust shall be liable to pay additional income-tax on such distributed income at the rate of—

(i) twenty-five per cent. on income distributed to any person being an individual or a Hindu undivided family;

(ii) thirty per cent. on income distributed to any other person:

Provided that nothing contained in this sub-section shall apply in respect of any income distributed by the securitisation trust to any person in whose case income, irrespective of its nature and source, is not chargeable to tax under the Act.

(2) The person responsible for making payment of the income distributed by the securitization trust shall be liable to pay tax to the credit of the Central Government within fourteen days from the date of distribution or payment of such income, whichever is earlier.

(3) The person responsible for making payment of the income distributed by the securitization trust shall, on or before the 15th day of September in each year, furnish to the prescribed income-tax authority, a statement in the prescribed form and verified in the prescribed manner, giving the details of the amount of income distributed to investors during the previous year, the tax paid thereon and such other relevant details, as may be prescribed.

(4) No deduction under any other provisions of this Act shall be allowed to the securitisation trust in respect of the income which has been charged to tax under sub-section (1).

115TB. Where the person responsible for making payment of the income distributed by the securitisation trust and the securitisation trust fails to pay the whole or any part of the tax referred to in sub-section (1) of section 115TA, within the time allowed under sub-section (2) of that section, he or it shall be liable to pay simple interest at the rate of one per cent. every month or part thereof on the amount of such tax for the period

beginning on the date immediately after the last date on which such tax was payable and ending with the date on which the tax is actually paid.

115TC. If any person responsible for making payment of the income distributed by the securitisation trust and the securitisation trust does not pay tax, as referred to in sub-section (1) of section 115TA, then, he or it shall be deemed to be an assessee in default in respect of the amount of tax payable by him or it and all the provisions of this Act for the collection and recovery of income-tax shall apply.

Explanation.—For the purposes of this Chapter,—

(a) “investor” means a person who is holder of any securitised debt instrument or securities issued by the securitisation trust;

(b) “securities” means debt securities issued by a Special Purpose Vehicle as referred to in the guidelines on securitisation of standard assets issued by the Reserve Bank of India;

(c) “securitised debt instrument” shall have the same meaning as assigned to it in clause (s) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956;

(d) “securitisation trust” means a trust, being a—

(i) “special purpose distinct entity” as defined in clause (u) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 and the Securities Contracts (Regulation) Act, 1956, and regulated under the said regulations; or

(ii) “Special Purpose Vehicle” as defined in, and regulated by, the guidelines on securitization of standard assets issued by the Reserve Bank of India, which fulfils such conditions, as may be prescribed.’.

Analysis:

“Special purpose distinct entity” means a trust which acquires debt or receivables out of funds mobilized by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set up by the National Housing Bank under the National Housing Bank Act, 1987 (53 of 1987) or by the National Bank for Agriculture and Rural Development under the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);

“Special Purpose Vehicle” means any company, trust, or other entity constituted or established for a specific purpose - (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be;

and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote”.

Enron scandal, where the directors and auditors utilized SPV's to clear the debts off the balance book of Enron lead to the formation of SPV

It provides that on distribution of any income to its investors, the Securitisation Trusts, will be required to pay additional income distribution tax at the rate 25% (plus surcharge of 10% and education cess of 3%) of the distributed income in case the investor is an individual / HUF or at the rate 30% (plus surcharge of 10% and education cess of 3%) of the distributed income in any other case.

The securitisation market has been facing several issues, one of which was lack of special dispensation from taxation of the Trusts created for securitisation. In case where investors were Mutual Funds the Trusts had been generally taking a position that as the income of the Mutual Fund (i.e. beneficiaries) is exempt from payment of tax, the Trust should also not liable to pay any tax in respect of the share of the Mutual Fund.

However, the income tax authorities rejected the above stand of the Trusts and in the last quarter of 2012, slapped demand notices to various Trusts seeking to recover tax from them on behalf of the Mutual Funds in respect of the PTC's issued. The Trusts in turn went back to the Mutual Funds asking them to pay the tax demanded by the income tax authorities in proportion to the PTCs subscribed by them. The income tax authorities also in some cases initiated recovery proceedings directly against the Mutual Funds as they were the beneficiary of the Trusts. The Mutual Funds filed petitions in the High Court, seeking relief from the tax claim given that they are exempt from income tax. The High Court granted an interim stay on the matter until final decision by the appellate authorities.

Firstly, it has been proposed to insert a new section 10 (23DA) providing tax exemptions in respect of the income of the Securitisation Trust earned from the activity of Securitisation.

Secondly, it has been proposed to insert a new Chapter XII-EA, which deals with provisions relating to tax on distributed income by Securitisation Trusts.

However, an exemption from payment of distribution tax has been granted in cases where the income is distributed by Securitisation Trust to any person whose income is not chargeable to tax.

Lastly, it also been proposed to insert a new section 10(35A), providing an exemption to the investors in respect of the income so distributed by the Securitisation Trust. This amendment will be applicable from the FY 2013-14.

As a result, in case where the income is distributed to Mutual Funds, the Securitisation Trusts will not be required to pay any distribution tax in respect of the income distributed to the Mutual Funds.

[SECTION 33 OF THE FINANCE ACT, 2013]