POST BUDGET MEMORANDUM 2018-19

1. CORPORATE TAX RATES :

In the Budget 2016, the Hon'ble Finance Minister had proposed to reduce the rate of Corporate Tax from 30% to 25% over a period, accompanied by rationalization and removal of various tax exemptions and incentives. Phasing out multiple exemptions viz. accelerated depreciation, deductions for Research, 10AA, 35AC, 35 CCD etc. was also initiated.

While the exemptions are being phased out for all class of companies, the benefit of lower rate of corporate tax of 25% is being given only to companies whose total turnover or gross receipts of the previous year 2016-17 does not exceed Rs. 250 crores.

Issues involved

a. While the earlier year's budget laid down a plan for phasing out exemptions, no corresponding plan/roadmap has been indicated for reduction in corporate tax rates for corporates with turnover exceeding Rs.250 crores.
b. In the context of the worldwide economic problems and its consequent effect in India, it is suggested that the corporate tax rate be brought down to 25% for all corporates. This will result in generating more surpluses in the hands of companies with consequential boost to investment and growth and accelerate the GDP growth in India.

Recommendation

It is recommended that Corporate Tax Rate be reduced to 25% for all Corporates and this will definitely result in bringing about greater buoyancy in the overall investment climate in the country.

2. INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS) TO BE WITHDRAWN:

CBDT had earlier notified 10 "Income Computation and Disclosure Standards (ICDS)" which was to be followed at the time of computation of income chargeable to income tax under the head "Profit and gains of business or profession" or " Income from other sources". This was struck down by the Delhi High Court in the case of **Chamber of Tax Consultants vs. Union of India [2017-TIOL-2353-HC-Del-IT],** in respect of the various standards which were reversing the positions decided upon by the Tribunals, High Courts and the Supreme Court. The Budget has now proposed to overturn the said legally established positions by providing for the applicability of the said ICDS with retrospective effect from 1st April, 2016.

Issues involved :

ICDS in its present form is not adding any value and in fact, is bound to create uncertainty and deterrence in the conduct of business in India. It militates against the professed policy of the Government to simplify the taxation system which will consequently impact the "Make in India"

objective as this will create major obstacles to doing business in India. While amendments in the law, guidelines and standards are made with the intent of reducing litigations, it is feared that notification of these ICDS will not achieve this objective. It is apparent that with a huge divergence in the accounting prescribed under IndAS regime, overwriting of the law established through judicial precedents, coinage of new terminologies, there would be an increase in unintended tax litigations.

ICDS is not serving any purpose and will only lead to duplication and wastage of efforts in maintenance of dual set of book keeping, increased complexity, high compliance cost, which is counter-productive to doing business with ease in the country.

Infact, **Justice R.V.Easwar Committee** in its report has rightly made the following observations w.r.t. ICDS:

"Taxpayers are already grappling with regulatory changes of the Companies Act, 2013, Ind-AS and the proposed GST. Industry should be allowed more time to deal with another change of this nature. The Committee understands that the taxpayers feel that many of the provisions of the ICDS are capable of generating a legal debate about which at present there is no clarity.

Further, multiple accounting methods, one for the books of accounts and other for tax purposes, creates confusion, interpretation issues, multiplicity of records and additional compliance burden which may outweigh the gains to be obtained by the application of ICDS. It has also been felt by the Committee that ICDS deals only with the method of accounting and at best it brings timing difference on recognition of expenditure or income as compared to the books of account. ***The Committee therefore feels that a fuller study of the implications of the ICDS is necessary before it is implemented."***

Moreover, all tax return have already been filed for the financial year 2016-17 and the Budget effectively changes the position on a retrospective basis.

Recommendation

Due to the reasons stated above, it is suggested that ICDS be either completely withdrawn or be made applicable only from financial year 2018-19 onwards.

3. CORPORATE SOCIAL RESPONSIBILITY COSTS :

Section 135 of the Companies Act 2013 and The Companies (Corporate Social Responsibility Policy) Rules, 2014 (CSR Rules) as notified make CSR expenditure a statutory requirement for all practical purposes (as per the spirit of the law), in respect of companies falling under the ambit of such regulations. In this connection, it may also be noted that the CSR expenditure under law is in effect calibrated to the average Pre-tax profits (as computed under Section 198 of the Companies Act 2013, akin to managerial

remuneration) earned during the preceding three years and is therefore a charge on profits (just like managerial remuneration) and not an appropriation thereof (which is a shareholder prerogative).
In the Finance (No.2) Act, 2014 it was mentioned that under section 37(1) Explanation 2, all CSR expenditure shall not be deemed to be an expenditure for the purpose of business on the rationale that it is an application of income.

Issues Involved :

It may be noted that every expenditure represents application of income and not an appropriation, if the charge/debit is made before determination of the PBT. In that context, CSR is an item of expenditure similar to any other standard item like rent, repairs and insurance. Moreover, such expenditure which is to be incurred under the new Companies Act and determined @2% of the pre-tax profits, is automatically an expenditure for business purpose even though it may not be incurred in the normal course of business. Also, statutorily sharing the burden with the Government "*in providing social services"* under law cannot be termed as getting subsidy from the Government through the said deduction since it is a statutory expenditure and is not in the nature of any tax or dividend.

In fact, the alternative argument of it not being an expenditure for tax computation purposes is itself not sustainable since it then becomes a "tax" which cannot be introduced under the Companies Act.
The industry therefore expects that such CSR expenditure would be allowed as a deduction under the Income Tax Act and Rules and all the more so, as certain elements of eligible CSR expenditure such as those covered under sections 30 to 36 are fully deductible even under the present tax laws, as explained in the Memorandum.

In fact, the High Level Committee on CSR formed by the Ministry of Corporate Affairs had observed that certain items of CSR are allowable under the Income Tax Act, whereas other items are not allowable and this has resulted in inconsistencies and lack of uniformity in the treatment for tax purposes and this has to be corrected.

Recommendation :

It is therefore recommended that the amendment made under section 37(1), Explanation 2 be dropped and the Income Tax Act expressly stipulate that all expenditure incurred by companies in accordance withSection 135 of the Companies Act 2013 and the CSR Rules be allowed as a deduction under law so as to bring about fairness and uniformity in tax treatment and eliminate potential disputes & litigation that would otherwise arise in this regard.

4. SECTION 80IA BENEFIT – POWER GENERATION :

Under Section 80 IA of the Income Tax Act, deduction in respect of profits and gains from power undertakings (including for captive power generation plants) is available for any ten consecutive assessment years out of fifteen years beginning from the year in which the undertaking generates power. This benefit is available provided the power undertaking begins to generate power at any time before 31st March, 2017.

Issues Involved :

In the current scenario, new power undertakings in the area of solar and other renewable energy sources are becoming critical, especially in the context of protection of the global environment along with the need for generation of adequate power in the present power-starved national economy.

Also, sub-section 12A to section 80IA imposes a restriction on any merged or demerged undertaking for not allowing the benefit of deduction from taxable income after such restructuring. In fact, this benefit is not passed on to the successor of business for the unexpired period after the said restructuring.

Recommendation :

Therefore, the provisions of section 80IA, should be extended till 31st March, 2020, specially in respect of generation of power from renewable sources like solar, wind etc..
Further, the restriction under section 80IA(12A) for mergers / demergers, is extremely unfair and should be deleted, since it adversely affects a lot of corporate restructuring decisions.

5. TAXABILITY OF FAIR MARKET VALUE OF INVENTORY ON CONVERSION INTO CAPITAL ASSET :

Finance Bill 2018 has proposed the amendment of section 28 of the Income Tax Act, 1961 vide clause (via) to include the fair market value of inventory on the date of its conversion into capital asset as the income from business or profession.

Ministry of Corporate Affairs vide G.S.R. 365 (E) dated March 30, 2016 has notified the applicability of Indian Accounting Standards (Ind AS) to NBFC's from April 1, 2018 with comparatives for the periods ending on March 31, 2018. As per IND AS all the investments of the company including those disclosed as stock –in trade as per IGAAP would be required to be disclosed as Current Investment at Fair Value for financial year ended 31st March 2019 .

Issues Involved :

Therefore, as evident from above, for NBFC's, the change in disclosure of certain securities from stock-in-trade to investment w.e.f. 01/04/2018 is a mandatory change in Accounting Standard and not due to change in management intentions with respect to holding of those securities.

The above reclassification of securities into investments as per the requirements of Ind AS on April 1, 2018 may attract the provisions of clause (via) of section 28 of the Act wherein the FMV of the inventory on the date of conversion may be treated as the income from business and profession.

Recommendations

It is recommended that for NBFC's, the conversion of stock-in-trade to investment arising out of change in Accounting standard should be excluded for computing Business income as per section 28 (via) of The Income Tax Act.

6. DEDUCTION IN RESPECT OF EXPENDITURE ON BRAND BUILDING :

In India, there is an over abundance of foreign brands. These range from run-of- the- mill to high-end luxury products. Even for items of daily consumption, the brands consumed by millions of household are predominantly owned by overseas enterprises. Be it baby food, home care, personal care products, tooth pastes, shaving creams, breakfast cereals, tea, coffee, ice creams, confectionary, chocolates, washing machines, laptops, personal computers, refrigerators, mobile phones, televisions, air conditioners, motor cars, etc., the leading brands in the Indian market are the property of foreign enterprises. Every time these products are consumed, value flows out of the country to pay for trademarks used, licenses provided, services consumed and so on.

Until December 16, 2009, the Government had imposed a cap on royalty payments for technological collaboration which was 5% on domestic sales and 8% on exports. Lumpsum royalty payments were capped at US $ 2 million. For use of a brand name, royalty could be paid at upto 1% of sales and 2% of exports. Beyond these levels, approval of the Foreign Investment Promotion Board (FIPB) was required. However, royalty payments have increased sharply since December 2009, when the caps were withdrawn and everything was put under the automatic route. In 2009-10, about US $ 4.44 billion was paid as royalty by Indian companies which was 13% of the Foreign Direct Investment (FDI) inflow into India that year. In 2012-13, Indian companies royalty payments increased to US $ 6.99 billion or 18% of India's FDI inflows that year. These pay-outs have increased 57.43% in the space of four years.

Issues involved :

This unenviable situation is indeed a disheartening reflection of the competitive capabilities of India's home grown brands which are few and far between. However, instead of bemoaning the huge outgo in terms of royalty and other payments, it is much more important to align national and corporate energies to create world class Indian brands. World class brands lend a huge intangible value to products and services enabling them to command a premium and loyalty from consumers. Moreover, successful brands reflect the innovative capacity of their countries and they enrich their national economies. For example, the net sales of Samsung is equivalent to 20% of GDP of South Korea. In fact, a successful global brand is a sustained source of wealth creation. Also, world class brands can contribute increasingly to import substitution, value added exports as well as larger value capture from global markets. In fact, this can transform the country from one dominated by foreign brands to a player of substance in the global arena.

The creation of world class brands demands tremendous staying power with substantial investment commitments over the long run. It requires deep consumer insight, continuous nurturing of R & D, differentiated product development capacity, brand building capability, cutting edge manufacturing and an extensive trade marketing and distribution network. This will also result in job creation and retention of value in the country.

Recommendation :

Therefore, it is vital that the policy environment incentivises the creation of Indian brands. For example, since foreign brands entail a royalty outflow, a similar percentage (say 5%) of turnover of Indian brands should also be admissible as a "standard deduction" for income tax purposes. Moreover, a larger

deduction of say 10% of turnover should be admissible for new brands for the first 10-15 years of their commercial launch. Alternatively, a weighted deduction of 200% of the relevant expenditure on brand building should be allowed as a deduction. This will create a level playing field for domestic enterprises. Moreover, this will help in making the Indian brands globally competitive and thereby control the current account deficit problem on a sustainable basis.

7. **"MAKE IN INDIA" - ENCOURAGING INNOVATION TO DELIVER CORPORATE INITIATIVES FOR LARGER SOCIETAL VALUE CREATION** :

In line with the Hon'ble Prime Minister's call for qualitative and sustainable industrial growth in the form of "Make in India : Zero Defect and Zero Effect", there is a strong need to encourage and incentivise the immense transformational capacity of corporates in innovating business models that can synergistically deliver economic and social value simultaneously.

Issues Involved :

Sustainability in Business Development in its truest sense can only take place when economic growth fosters social equity. Growth must translate into the creation of sustainable livelihoods and replenishment of scarce environmental resources. Limits to future growth will be defined more by vulnerabilities flowing from social inequities, environmental degradation, and climate change than by any other economic factor.

Recommendation :

- Government can support the development of a Responsible Business "Trustmark" Rating System that could be used to convey to the consumer a company's environmental and social performance. An enterprise could be awarded credits by way of "Trustmark Rating", based on an objective evaluation of its triple bottom line performance. An accumulation of such credits could earn the enterprise Trustmark Ratings on a progressive scale. These Ratings could then be displayed on products and services of the company to help consumers make an informed choice.
- Government must consider the provision of a differentiated and preferential set of incentives, fiscal or financial, to companies that demonstrate leadership in sustainability performance. Companies with high "Trustmark" ratings should be provided with incentives like priority fast track clearances, purchase preferences, lower levies of central excise duty for manufacture of "green", eco-friendly products, weighted deduction for the expenditure under the Income Tax Law and so on. This would spur powerful market drivers that will incentivise innovation for larger triple bottom line impact.
- Banks and Financial Institutions could also factor in the Trustmark Ratings in their lending operations providing benefits to more responsible corporations. Going forward, it may even be possible to trade in these "Trustmarks", if a system similar to carbon credits or energy efficiency certificates can be developed so that organisations with surplus credits are able to monetise their efforts.

8. LIMITLESS ROYALTY PAYMENTS – A DRAIN ON THE ECONOMY :

- India is now a global market with free competition by international players in most areas of economic activity.

- International companies are in India to exploit this global market and compete with other international and domestic players.
- To compete effectively, they bring their brands, knowhow, technology and other intellectual property in their own self-interest.
- Hence, incentives in the form of royalty pay-outs by their Indian subsidiaries are neither justified nor required.

Issues Involved :

Payment of royalty by Indian subsidiaries to their overseas parent entities is extremely illogical and injurious to India's current account balance, government exchequer and minority shareholders**.** In the year 2012-13, the pay-out was US$ 7 billion representing 20% of India's annual FDI inflows, and is growing exponentially in the subsequent years.

Recommendation :

It is therefore recommended that such royalty payments should not be permitted. Otherwise, the Income Tax Law should provide for higher quantum of withholding tax.

Indian players seeking access to intellectual property to compete effectively with the international players in the Indian global market should continue to be allowed to pay royalty to unrelated parties on an arm's length basis, without government intervention.

9. **APPLICABILITY OF LONG TERM CAPITAL GAINS TAX U/S 112A FOR ESOPS :**

Finance Bill, 2018 proposes to introduce section 112A to provide for taxability of equity shares or an unit of equity oriented fund or a unit of a business trust @ 10%, provided that Securities Transaction Tax has been paid :

- In respect of equity shares at the time of acquisition and transfer
- In respect of an unit of an equity oriented fund or a unit of business trust, on transfer of such capital asset.

The memorandum also states that under section 112A(4), the Central Government shall notify separately the instances where the applicability of payment of Securities Transaction Tax will not be applicable in respect of the acquisition.

Issue involved:

To protect the exemption for genuine cases where the Securities Transactions Tax could not have been paid like acquisition of share in IPO, ESOPs, FPO, bonus or right issue by a listed company acquisition by non-resident in accordance with FDI policy of the Government etc., the Central Government should notify transfers for which the condition of chargeability to Securities Transactions Tax on acquisition shall not be applicable.

Recommendation:

It is strongly suggested that similar to the existing notification for exemptions in relation to the provisions of section 10(38), which has now been withdrawn, the new notification specifying the transactions on which this amendment will not be applicable must include shares allotted under ESOPs, IPO, FPO, bonus or right issue etc.

10. TAX DEDUCTION FOR THE EMPLOYEE REMUNERATION COST INCURRED DUE TO GRANT OF EMPLOYEE STOCK OPTIONS (ESOP) TO THE EMPLOYEES :

Share- based payments to employees (ESOP) is construed, both by the employees and by the company, as a part of package of the remuneration. There is no difference in two situations viz. (i) when the company issues shares to public at market price and a part of the premium is given to the employees in lieu of their services (ii) when the shares are directly issued to employees at a reduced rate.

Under Ind AS the companies are required to account for the employee cost for grant of ESOPs under fair value method (over the vesting period), which is a fair method used internationally to account for such cost.

Further, it is pertinent to note that under the Income Tax Act too, under section 17(2)(vi) the difference between the fair market value of the ESOPs allotted and exercise price is treated as a perquisite i.e. part of salary given to the employees, on which tax is payable by the employees. Hence, income tax itself cognizes the difference i.e. value of the share options granted to the employees as part of employee remuneration, taxable in the hands of the employees.

The issue with respect to deductibility of employee cost incurred for grant of options to employee has been a matter of debate before the Courts/Tribunal. The Income Tax Authorities are not allowing such employee compensation expense as an allowable business expenditure u/s 37 of the Act, inspite of the various judicial precedents, to the contrary.

Further, since the Income tax Law has not expressly specified , there is also a debate on the amount to be allowed as employee compensation expense, the method used for calculating the value of the stock options granted , the year in which the cost should be allowed etc.

<u>Without prejudice to the above, it may kindly be noted that deduction for ESOP to employers is provided even by the developed nations:</u>

a. <u>United States of America</u>
   Sec. 83(h) of Internal Revenue Code (IRC) allows the companies' deduction for ESOP Expenditure equal to the amount offered to tax by employee in the year it is offered to tax by the employees.
b. <u>United Kingdom</u>
   Part 12, Chapter 2 of the Corporation Tax Act, 2009 allows companies deduction for ESOP expenditure as excess of market value of shares over the amount recovered by the employer in the period when the shares are acquired.

Recommendation :

To put an end to the litigations, it is recommended that there should be clear guidelines on the allowability, calculation and treatment of these employee compensation expenditure/cost incurred on account of issue of shares options to employees under ESOP for income tax purposes. Under the Ind AS the companies are required to account for the employee cost for grant of ESOPs under fair value method (over

the vesting period), which is a fair method used internationally to account for such cost. Hence, the Government should allow companies to claim tax deduction for the employee remuneration cost on the basis of fair value method, to ensure less complications and hassles in the calculations and to avoid unnecessary litigation and dispute on this subject.

11. ALLOWABILITY OF PAYMENT OF PREMIUM OF LEASEHOLD LAND AS A REVENUE EXPENDITURE

a. Under the IndAS 16, the upfront premium paid on leasehold land held under operating lease are being treated as prepaid expenses and would need to be charged to the Profit and Loss statement under the head “rentals” on a proportionate basis over the life of the lease period.
Under the current Accounting Standards, these premium payments leasehold land, are charged to the statement of profit and loss account as amortisation of leasehold land on a proportionate basis over the life of the lease period

b. These upfront lumpsum premium lease payments for leasehold land are essential business expenditure and do not generate any capital asset and hence are purely revenue in nature.

c. These are just like payments made under any operating lease to utilise the leased property for the purposes of the business of the lessee and hence should be allowed just like any business expenditure for tax purposes. Further, under the IndAS, these upfront premium paid on leasehold land, held under operating lease are being classified as rentals. Therefore, these expenditures should be treated as tax-deductible expenses.

Recommendation

The CBDT should come out with instructions clarifying that these upfront premium payments for leasehold land, should be allowed for income tax deduction in the year of debit in the statement of Profit and Loss.

12. TAXABILITY OF EXPORT COMMISSION PAID TO NON-RESIDENT EXPORT AGENTS :

- A non-resident export agent renders export promotion and marketing services outside India and also receives payment for such services outside India. Generally, the services rendered by an export commission agent would restrict to soliciting customers in the foreign location, liaising with the customers, coordination, negotiation and procuring the export orders etc. They do not render any technical services and the payment is only towards the functions and responsibilities that a commission agent is expected to discharge.

- Accordingly, the export commission paid to such non-resident export agents does not accrue or arise/ be received or deemed to accrue or to be received in India and thus are not taxable in India as per Section 5 of the Income Tax Act, 1961 (the Act). Further, the said export commission to non-resident agents cannot be deemed to arise from any business connection in India, as the entire service is carried out outside India and hence it not taxable in India as per Section 9(1)(i) of the Act . Accordingly, no withholding tax u/s 195 applies to such export commission paid to non-resident agents.

- Reliance is also placed on several Court rulings wherein it has been held that export commission paid to non-resident agents for services rendered by the agent outside India are not taxable in India :

  - ***In CIT vs Toshoku Ltd., Guntur and Ors [125 ITR 525 (SC)]*** – The Supreme Court has held that since non-resident taxpayer did not carry on any business operations in India, amounts earned for services rendered outside India could not be deemed to be incomes which had either accrued or arisen in India.

  - **In CIT vs Eon Technology (P) Ltd [(2011) [343 ITR 366 (Delhi)]** – The Delhi High Court has held that when an agent was not rendering any service or performing any activity in India itself, commission income cannot be said to have accrued, arisen to or received by agent in India.

  - **In the case of PanalfaAutolektrik Ltd [(2014) 49 taxmann.com 412 (Delhi)** – The Delhi High Court has held that services rendered by the non-resident cannot be said to be in the nature of 'managerial', 'technical' or 'consultancy' services and hence, the commission cannot be treated as 'fees for technical services'. Thus, the export commission was not taxable in India.

    There are various other judicial precedents wherein it has been held that commission paid to export agents outside India would not be taxable in India and accordingly, no withholding tax would apply on such payments made by Indian assesses:

  - Armayesh Global vs ACIT, [51 SOT 564 (ITAT Mum)]
  - Gujarat Reclaim and Rubber Products Ltd vsAdd.CIT [60 SOT 22 (ITAT Mum)]
  - ITO vs Trident Exports [149 ITD 361 (ITAT Chennai)]
  - DCIT vsDivi's Laboratories Ltd [10 ITR (Trib) 505 (ITAT Hyd)]
  - DCIT vs Transformers & Electricals Kerala Ltd. [35 ITR(T) 440 (ITAT Cochin)]
  - DCIT vs Sandoz (P) Ltd [137 ITD 326 (ITAT Mum)]
  - ACIT vs Farida Shoes (P) Ltd [(2013) 34 taxmann.com 268 (Chennai ITAT)]
  - ACIT vs Model Exims [(2014) 45 taxmann.com 140 (Lucknow ITAT)]
  - IVAX Paper Chemicals Ltd vs Additional CIT [(2014) 44 taxmann.com 173 (Hyd. ITAT)]

Issues Involved:

- The CBDT had issued Circular No 23 dated 23 July 1969 and Circular No. 786 dated 7 February 2000 wherein it was clarified that where the non-resident agent operates outside the country, no part of his income arises in India. Further, since the payment would be remitted directly abroad it cannot be

held to have been received by or on behalf of the agent in India. Such payments were therefore held to be not taxable in India.

- However, CBDT vide Circular No. 7/2009 dated 22.10.2009, withdrew their earlier Circular no. 23 dated 23.07.1969 along with Circular No. 786 dated 07.02.2000.

- **This withdrawal of the circular have led some Assessing Officers to erroneously believe that export commission paid to non-resident export agents are taxable in India and they are arbitrarily disallowing all the export commission expenditures under section 40(a)(i) during assessments on the pretext of non-deduction of tax at source on such export commission , which are legally not taxable in India.**

  This has led to unnecessary harassment of the assessees and has needlessly increased the litigation cost of the assesses.

- It may be worthwhile to point out that the Circular 23/1969 was introduced after a Supreme Court ruling in the case of CIT v. R.D. Aggarwal & Co. [(1965) 56 ITR 20] , as explained in Para 2 of the said circular. **Thus, the position stated in Circular 23/1969 or Circular No. 786 dated 07.02.2000were mere clarifications regarding applicability of the provisions of Section 9 of the Act, and are in no way any alteration to the principals laid down in Section 9 of the Act. Thus, withdrawal of this Circular by the CBDT will not change the provisions of the law which clearly expounds that export commission paid to non-resident are not taxable in India since the export agents have rendered all services outside India (no income accrues or is deemed to accrue in India) and payments have been received by them in their foreign bank accounts (no income is received or is deemed to be received in India).**

Recommendation:

CBDT should come out with a clear clarification that export commission payments to non-resident agents are not taxable in India, in case:

- They render the services entirely outside India
- They receive the payment abroad i.e. do not receive the payment in India.

13. SCIENTIFIC RESEARCH EXPENDITURE:

The income tax law provides for certain tax benefits in respect of scientific research expenditure. In-house R&D is separately incentivized under section 35(2AB) of the Income Tax Act 1961. This specifically requires that the in-house research and development facility be approved by the Department of Scientific & Industrial Research (DSIR). The deduction is available @ 200% till FY 2020-21 and thereafter @100% for the following expenditures -

1) Revenue expenditure, and
2) Capital expenditure (not being expenditure in the nature of cost of land and building)

For claiming deduction, there are certain conditions laid down in the Section and in DSIR Guidelines that are required to be fulfilled.

Issues Involved :

(a) ***First Issue :***

Negative list of articles/ things specified in the Eleventh Schedule of the Income Tax Act – should be deleted

Section 35(2AB) specifically lays down that weighted deduction is NOT available for the articles/ things specified in the Eleventh Schedule. Eleventh Schedule, inter-alia, among other things contains various products like beer, wine and other alcoholic spirits, Tobacco and tobacco preparations (such as cigar and cheroots, cigarettes, biris, smoking mixtures for pipes and cigarettes, chewing tobacco and snuff), Confectionery and chocolates, Cosmetics and toilet preparations, Tooth paste, dental cream, tooth powder and soap etc.

It is highly discriminatory that weighted deduction is not available in respect of the in-house research and development carried out for the above articles/ things. India is a developing market and the need for quality and internationally competitive products cannot be undermined. In fact, in the absence of quality in-house R & D in India, significant expenses are incurred in respect of royalty payments for use of imported technology, packaging/technical specifications etc. Such forex remittances on account of royalty and technical knowhow are putting serious strain on the Current Account Deficit and this needs to be addressed on an urgent basis. Moreover, the menace of contraband products also becomes another area of concern in the country which is a direct fallout of the above problem.

Therefore, companies which are in the business of manufacture/ production of the above products and are incurring expenditure in carrying out in-house research and development should not be denied the benefit of weighted claim, which otherwise would result in excessive payments in foreign exchange for royalty / technical knowhow and poor quality/contraband products flooding the market as explained in the earlier para. In fact, domestic production of international quality products can help not only in saving precious foreign exchange, but also in bringing foreign exchange into the country through exports and royalty earnings. Further, to boost domestic production and empower the domestic companies against big foreign players, it has become imperative to extend the benefit of weighted claim to all manufacturers.

Recommendation :

Therefore, it is suggested that the negative list as given in the Eleventh Schedule be removed in the context of section 35(2AB).

(b) **Second Issue :**

Revenue expenses eligible for weighted claim – scope of expenses to be enlarged :

DSIR Guidelines (last updated May 2010) has identified various revenue expenses which are not eligible for weighted claim. However, it is the need of hour that the exclusion list be stream-lined and narrowed down. There is no doubt that weighted deduction is intended to be made available only for in-house R&D activities carried out. However, it cannot be denied that there are certain activities, which though forming part of the overall R&D activities, are carried out outside the approved R&D facility. Weighted claim should be available for these activities also. Also, considering the increasing complexities in R&D, there may be foreign consultants involved. However, there is no reason why foreign consultancy expenditure should not be eligible for claim.

Recommendation :

It is therefore recommended that to encourage greater in-house R&D activity, the ambit of eligible revenue expenses be increased to include –

- Expenditure on outsourced R&D activities
- Lease rent paid for research farms or research labs
- Foreign consultancy expenditure
- Building maintenance, municipal taxes and rental charges
- Clinical trial activities carried out outside the approved facilities
- Contract research expenses

(c) ***Third Issue -***

***DSIR* Guidelines – Excessively Restrictive**

Among various other conditions, the DSIR Guidelines specifically lay down that -

(i) The manufacturers who wants to lodge weighted claim should enter into an agreement with the DSIR for 'co-operation' in such research and development facility.

The word 'co-operation' shall, inter-alia, mean that the company shall be willing to undertake projects of national importance, as may be assigned to it by the DSIR, on its own, or in association with laboratories of CSIR, ICAR, ICMR, DRDO; DBT, MCIT, M/O Environment, DOD, DAE, Department of Space, Universities, Colleges or any other public funded institution(s). The company would be free to exploit the results of such R&D projects, subject however, to any conditions which may be imposed by Government of India, in view of national security or in public interest.

(ii) Assets acquired and products, if any emanating out of R&D work done in approved facility, shall not bedisposed of without approval of the DSIR.

Recommendation :

It cannot be denied that such conditions, as above, are very restrictive in nature and instead of promoting in-house R&D, hamper the willingness of corporates to carry out in-house R&D. There is already a condition that the in-house R&D facility should be approved by DSIR. Once the R&D facilities are DSIR approved, there should not be any requirement for entering into a separate agreement with DSIR. In fact, such requirements would do nothing except burdening the corporates with administrative hassles. ***There is an urgent need to relax these stipulations so that in-house R&D activities are encouraged and in-house scientific research gets the necessary tax benefits. This will result in incentivising R & D expenditure for promoting "Make in India" manufacturing.***

14. REQUIREMENT TO OBTAIN PAN UNDER SECTION 139A :

Finance Bill, 2018 has proposed an amendment to Section 139A, to provide that every person, not being an individual, which enters into a financial transaction of an amount aggregating to two lakh and fifty thousand rupees or more in a financial year shall be required to apply to the Assessing Officer for allotment of PAN. Further, it is also proposed that the Managing Director, Director, Partner, Trustee, Author, Founder, Karta, chief executive officer, principal officer or office bearer or any person competent to act on behalf of such entities shall also apply to the Assessing Officer for allotment of PAN.

Issues involved:

The amendment proposes a very onerous requirement to obtain PAN. For example, even the non-resident Directors of a company or a person representing the company in any legal case outside India will be required to obtain PAN under this section, who otherwise don't need to obtain PAN.

Further, the term financial transaction has not been defined in the section, which may lead to various ambiguities.

Recommendation:

The requirement should be restricted only to those persons who enter into a financial transaction on behalf of the entity.

In addition, financial transaction needs to be defined in the section.

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