

Finance Act 2011 Tax Highlights

This is a summary of the significant changes brought about in the tax laws by the Finance Act, 2011. The direct tax changes are effective from the financial year commencing on 01 April 2011 unless otherwise specifically stated. Most indirect tax proposals are effective 28 February 2011 unless otherwise stated.

DIRECT TAXES:

Rates of Tax:

- The basic rates of corporate tax remain unchanged for both domestic and foreign companies. However, surcharge for domestic companies has been reduced from 7.5% to 5%. Surcharge on corporate tax for foreign companies has been reduced from 2.5% to 2%.
- Education cess of 3% (includes 1% “secondary & higher education cess”) **across the board** (including on income tax and service tax) continues.
- The Minimum Alternate Tax (MAT) has been increased from 18% to 18.5%.

Company / Tax	Tax rate (inclusive of applicable surcharge and cess)
<u>Domestic Company</u>	
<u>(i) Regular Income-tax</u>	
(a) Where total income is more than Rs.10 million	32.45%
(b) Where the total income is equal to or less than Rs.10 million.	30.90%
<u>(ii) Minimum</u>	

<u>Alternate Tax</u>	
(a) Where total income is more than Rs.10 million	20.01% of book profits
(b) Where the total income is equal to or less than Rs.10 million.	19.06% of book profits
<u>(iii) Dividend Distribution Tax</u>	16.22%
<u>Foreign Company</u>	
<u>(i) Regular Income-tax</u>	
(a) Where total income is more than Rs.10 million	42.02%
(b) Where the total income is equal to or less than Rs.10 million.	41.20%
<u>(ii) Minimum Alternate Tax (MAT)</u>	
(a) Where total income is more than Rs.10 million	19.44% of book profits
(b) Where the total income is equal to or less than Rs.10 million.	19.06% of book profits

- No change in rates of Securities Transaction Tax (“STT”).
- The new personal tax rates are as under :

Taxable income (Rs.)	Tax rate (%)
Up to Rs. 1,80,000*	Nil

1,80,001* to 5,00,000	10
5,00,001 to 8,00,000	20
8,00,001 and above	30

* The threshold limit of basic exemption is Rs. 1,90,000 in the case of resident women below the age of 60 years and Rs. 2,50,000 (earlier Rs. 2,40,000) in the case of resident individuals of the age of 60 years or more but less than 80 years. In case of resident individuals of the age of 80 years or more, the exemption limit is Rs. 5,00,000.

Notes: (i) No surcharge on the total income-tax liability
(ii) Education cess of 2% and an additional secondary & higher education cess of 1% is to be levied on the amount of income tax.

Taxation on income distributed to unit holders

Income received by unit holders from a mutual fund is exempt from tax. The mutual fund (other than equity-oriented mutual funds) will pay income distribution tax as under with effect from 01 June 2011 :

(i) Income distributed by Money market mutual fund or liquid fund to :

- Individual / HUF - 27.038%
- Any other person – 32.445%

(ii) Income distributed by a debt fund other than a Money market mutual fund or liquid fund to :

- Individual / HUF – 13.519%
- Any other person – 32.445%

Deduction for investment in infrastructure :

- Currently a deduction of INR 20,000 from the taxable income of

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individual tax payers is available for investment in long - term infrastructure bonds for the financial year 2010-11. This deduction is provided over and above the limit of Rs. 100,000 under Section 80CCE. The Bill proposes to continue this deduction of Rs. 20,000 towards investment in long- term infrastructure bonds for another year i.e., for the financial year 2011-12.

Contributions to the New Pension System (NPS) :

Under Section 80CCD of the Income Tax Act, an employee is eligible to a deduction from his total income in respect of contribution made to the New Pension Scheme (NPS) by him as well as by his employer on his behalf. However, this contribution was subject to an overall limit of INR 100,000 and thus did not provide the benefit that was intended. Contributions made by employers to NPS is excluded from the limit of INR 100,000 under Section 80CCE. Further, it is also proposed that the employer be allowed a deduction in respect of his contribution to the NPS of an amount being lower of the actual employer contribution to NPS or 10% of employees salary.

Weighted deduction for expenditure on scientific research :

Presently, a weighted deduction of 175% is allowed for any sum paid to a national laboratory or a university or IIT or a specified person for the purpose of scientific research. The weighted deduction has now been enhanced to 200%.

Deduction for capital expenditure for specified business :

Presently, a deduction is allowed for capital expenditure incurred by a taxpayer for the purpose of certain specified business. Now, a deduction for capital expenditure will also be allowed to taxpayers engaged in (i) Developing and building affordable housing projects under a scheme framed by the Central Government or a State Government; (ii) Production of fertilizer in a new plant or in a newly installed capacity in an existing plant in India. The above specified businesses should commence activities on or after 01 April 2011.

Extension of tax holiday sunset clause for the power sector :

Ten year tax holiday will be extended to power sector undertakings which commence operations by 31 March 2012.

Tax holiday sunset clause for undertakings engaged in commercial production of mineral oil :

Presently, a seven year tax holiday is available to undertakings located in any part of India which commence commercial production of mineral oil on or after 01 April 1997. Now, the tax holiday will not be available for blocks licensed under a contract awarded after 31 March 2011 under New Exploration Licensing Policy or in pursuance of any other law.

Minimum Alternate Tax (MAT) and Dividend Distribution Tax (DDT) :

- Presently, income earned by Special Economic Zone (SEZ) developers or units in a SEZ is not considered as part of “book profit” for MAT purposes. Now such income will be considered for computing “book profit” for MAT

purposes. Consequently, income of SEZ developers and units will be subject to MAT.

- Presently, dividend declared by SEZ developers is not subject to DDT. Now, dividends declared by SEZ developers will be subject to DDT with effect from 01 June 2011.

Return of Income :

- Presently, companies are required to file their return of income on or before 30 September. With effect from 01 April 2010, the due date for filing the return of income by companies which are required to submit a Transfer Pricing Report in Form 3CEB of its international transactions, will be 30 November.
- In order to reduce the compliance burden of small taxpayers, the Government will notify any class or classes of persons who will be exempted from filing the return of income on satisfaction of specified conditions. This amendment is effective from 01 June 2011.

Extension of time limit for completion of assessment in case of reference made under exchange of information :

For determination of the statutory limitation period for completion of assessments and reassessments, period commencing from the date on which reference for exchange of information is made by the competent authority under an agreement till the date the information is received by the Commissioner of Income-tax, or a period of six months, whichever is less, is to be excluded. Similar amendment has been proposed for extending the

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time limit for completion of search assessments. The above amendments will take effect from 01 June 2011.

Transfer Pricing :

- Determination of Arm's Length Price (ALP) : Presently, where the difference between the ALP and the Transfer Price (TP) did not exceed 5% of the TP, the TP is deemed to be the ALP. Now, the allowable variation will be such percentage of the TP as the Government may notify.
- Extension of TPO's power - With effect from 01 June 2011 :
 - The TPO's are empowered to examine additional international transactions (which were not formally referred by the tax officer), if identified subsequently in the course of proceedings before him.
 - TPO's have now been granted additional powers of conducting a survey.

Special Measures in respect of transactions involving Notified jurisdictional Area (NJA) :

- Anti avoidance measures are proposed to be introduced to discourage transactions with persons located in countries or territories which do not have effective information exchange arrangements with India.
- The Central Government will be authorized to notify countries or territories outside India as a NJA.
- Any transaction between the taxpayer and a person located

in a NJA will be deemed to be an international transaction subject to TP provisions and all parties to such international transaction would be deemed to be associated enterprises.

- While determining ALP of such international transactions, benefit of allowable variance (currently 5%) will not be available.
- No deduction will be allowed for any expenditure or allowance (including depreciation) arising from such international transactions unless taxpayer maintains such documentation and furnishes such information as may be prescribed.
- No deduction will be allowed for any payment made to a financial institution located in a NJA, unless the taxpayer authorizes Revenue authorities to seek relevant information from the said financial institution.
- Any sum received or credited by the taxpayer from a person located in the NJA will be deemed to be income of the taxpayer, unless the taxpayer satisfactorily explains the source of such money in the hands of such person or in the hands of the beneficial owner located in the NJA.
- Any payment to a person located in a NJA on which tax is deductible, shall be subject to withholding tax, at higher of the following rates :
 - At the rate specified under the Income-tax Act; or
 - At the rates in force; or
 - At the rate of 30%.

The above amendments are proposed to come into effect from 01 June 2011.

Special Provision for taxation of dividends received by Indian company from specified foreign company :

Presently, dividend received by an Indian company from a specified foreign company is taxable at the rate of 30% (plus applicable surcharge and education cess), on a gross basis. Now, such dividend received by an Indian company during the period 01 April 2011 to 31 March 2012 will be taxable @ 15% (plus applicable surcharge and education cess), on a gross basis. Specified foreign company is defined as a foreign company in which the Indian company holds more than 26% of the nominal value of the equity share capital.

Deletion of scheme of DIN for correspondence with tax authorities :

Considering the practical difficulties, i.e. non availability of requisite infrastructure on an all India basis, the provision for scheme of DIN is deleted.

Extension of time limit for recognition of provident funds :

Presently, recognition accorded to provident funds which did not satisfy specified conditions till 31 December 2010 were to be withdrawn. Now an extension will be granted to such provident funds to satisfy the specified conditions by 31 March 2012.

Infrastructure Debt Funds :

The Government of India has proposed to create Special Purpose Vehicle in the

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form of infrastructure debt funds to attract foreign funds for financing infrastructure. The income of such fund is proposed to be exempt from tax and any interest payment received from such notified fund by foreign investors shall be taxable @ 5% on the gross amount of such interest. This provision is effective from 01 June 2011.

Exchange of Information :

Effective 01 June 2011, in order to facilitate prompt collection of information on requests received from tax authorities outside India under the tax treaties, the notified income-tax authorities will have the powers vested in a Civil Court as well as the power to call for information for the purpose of making an enquiry or investigation in respect of any person or class of persons.

Compliance by Liaison Offices :

Effective 1 June 2011, Non-residents having Liaison Office in India with approval from the RBI to submit prescribed annual information statement in respect of their activities to the Tax Authorities within 60 days from the end of the financial year .

Customs Duty :

- Peak rate of BCD unchanged at 10%.
- Basic customs duty rates of 2%, 2.5% and 3% replaced with median rate of 2.5%.

Excise Duty :

- Peak rate of duty maintained at 10%. Basic duty rate increased from 4% to 5% to align with state VAT rates.

- 4% excise duty on a few products has been increased to 5% (such as prepared foodstuffs, paper and articles of paper, textile intermediaries and textile goods, medical equipment, medicaments, etc.
- Duty of 5% levied on specified products which were earlier exempt. Option of payment of excise duty @ 1% on around 130 specified items (without Cenvat Credit) has been provided.

Central Sales Tax (CST) :

No change in CST rate. CST rate (against Form C) of 2% to be continued.

Service Tax :

- Effective service tax rate remains unchanged at 10.3%.
- Service tax will be levied on (i) Services by air conditioned restaurants having license to serve liquor (70% abatement to be prescribed); and (ii) Short term accommodation in hotels / inns / clubs (50% abatement to be prescribed).
- The scope of life insurance services has been expanded to cover all services including in relation to management of investments.
- The scope of legal services includes services provided by individuals to entities and vice versa as well as representation and arbitration services provided to business entities.
- New Valuation Rules for service tax on foreign exchange conversion transactions are effective 1st April, 2011.

- Wef 1st April, 2011, for taxable service providers classified under "Banking and Other Financial Services" category, CENVAT credit utilisation stands restricted to 50%
- Point of Taxation Rules made effective from 1st April, 2011 but with an option for tax payers to determine the point of taxation as the date on which the payment is received, in case of all services that are completed on or before 30th June, 2011 or in regard to which the invoices are issued upto 30th June, 2011.

Goods and Service Tax (GST) :

Parliament has passed the Constitutional Amendment Bill, mandatory for empowering States to tax services in order to enable implementation of the Goods and Service Tax (GST). The date of implementation of GST has not been announced. The IT infrastructure to support GST is being implemented and model laws for Central and State GST are being drafted. Prior to PAN India GST roll out, National Securities Depository Limited is expected to set up a pilot portal in collaboration with 11 states, by June 2011.

Other Key Policy Initiatives :

- The **Direct Taxes Code Bill (DTC)** is under consideration by the Parliamentary Standing Committee and is expected to be effective from 01 April 2012.
- Various Government undertakings will issue tax free bonds of Rs. 300 billion to boost infrastructure

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- development in railways, ports, housing and highways.
- The Government proposes to re-initiate the **reforms in the financial sector**. Towards this end, the Government had set up a financial sector legislative reforms commission in the financial year 2010-2011 to rewrite and streamline the financial sector laws, rules and regulations. The Commission will complete its work in 24 months.
 - The Government will amend The Banking Regulation Act in the context of giving **additional banking licences to private sector players**.
 - The Government will move the following legislations :
 - The Insurance Laws (Amendment) Bill, 2008
 - Life Insurance Corporation (Amendment) Bull 2009
 - Banking Laws Amendment Bill, 2011.
 - In order to liberalise the portfolio investment route, the Government has decided to permit SEBI registered **mutual funds to accept subscriptions from foreign investors** who meet KYC requirements for equity schemes.
 - Foreign Institutional Investors (FII's) **limit for corporate bonds with residual maturity of over 5 years issued by companies in infrastructure sector is raised by an additional limit of USD 20 billion taking the limit to USD 25 billion**.
 - The **Companies Bill** will be introduced in the Lok Sabha during the current session.
 - The Government will introduce a bill to amend the **Indian Stamp Act, 1899**. It will also launch a new scheme to provide assistance to states to modernize their stamp and registration administration and rollout e-stamping in all districts in the next 3 to 5 years.
 - Discussions are concluded on **Tax Information Exchange Agreements** with 11 jurisdictions and 13 Double Tax avoidancxe Agreements.
 - Further liberalization in **Foreign Direct Investment** expected.
 - Significant Progress on **Unique Identification (UID) Project** – 10 lakh Aadhaar numbers to be generated every day from 01 October 2011.

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