

SHREYA CONSULTANCY

The Budget summary, which follows, discusses the salient features of the Finance Bill 2005. The proposals contained in the Finance Bill can be modified by the Parliament before enactment.

INDIA BUDGET 2005

- ✓ Corporate Taxation
- ✓ Personal Taxation
- ✓ Capital Gains
- ✓ NRI Taxation
- ✓ Tax Deduction at Source
- ✓ Service Tax
- ✓ Customs
- ✓ Excise
- ✓ VAT
- ✓ Miscellaneous

This Budget statement is prepared in summary form exclusively for the clients and staff of **SHREYA CONSULTANCY**. It should not be relied upon as a substitute for detailed advice or a basis for formulating business decisions.

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INCOME TAX

CORPORATE TAXATION

Fringe Benefit Tax

❖ It is proposed to introduce a new section 115WA relating to charge of fringe benefit tax which provides that in addition to the income tax charged under the Income-tax Act, an income tax called fringe benefit tax @ 30 % plus surcharge, effectively 33.67 % shall be charged for every financial year commencing from 1st April, 2005 in respect of fringe benefits **provided or deemed** to have been provided by an employer to his employees during the previous year.

❖ “**Fringe benefits**” means-

- a. any privilege, service, facility or amenity, directly or indirectly, provided by an employer to his employees (including former employee or employees) by reason of their employment; or
- b. any **reimbursement**, directly or indirectly, made by the employer to his employees for any purpose;

❖ The fringe benefits shall be deemed to have been provided if the employer has, incurred any expense on or made any such payment as provided under the Act.

❖ The **value** of deemed fringe benefits shall be the aggregate of the following expenses / reimbursements

- a. entertainment - **50%**
- b. festival celebrations - **50%**
- c. gifts - **50%**
- d. use of club facilities - **50%**

- e. provision of hospitality by the employer excluding food or beverages provided to his employees in office or factory - **50%**
- f. maintenance of guest house - **50%**
- g. conference - **50%**
- h. employee welfare - **50%**
- i. use of health club, sports and similar facilities - **50%**
- j. sales promotion including publicity - **50%**
- k. conveyance, tour and travel including foreign travel - **20%**
- l. hotel, boarding and lodging - **20%**
- m. repair, running & maintenance of motorcars including depreciation - **20%**
- n. repair, running & maintenance of aircrafts - **20%**
- o. consumption of fuel - **20%**
- p. use of telephone - **10%**
- q. scholarship to the children of the employees - **100%**
- r. any free or concessional ticket provided by the employer for private journeys of the employees and their family members - **100%**
- s. any contribution by the employer to an approved superannuation fund - **100%**

❖ For the purpose of fringe benefits the privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee.

❖ Effectively only transport facility and canteen has been kept out of the Fringe Benefits Tax

❖ The software industry is generally concerned about the wide sweep on fringe benefits taxation.

❖ Fringe Benefits Tax return has to be filed separately and advance tax has to be paid.

- ❖ Fringe Benefit Tax will not be allowed as a business expenditure.
- ❖ A relook is expected on some of the issues
- ❖ It is expected that the salary structure would become simpler . The employee would spend the money after tax the way he wishes to.

Tax Structure

- ❖ For domestic companies, the corporate income tax rate has been reduced from 35 % to 30 per cent. Surcharge has been increased from 2.5 % to 10 %. Hence, the effective tax rate for domestic companies goes down from 36.6% to 33.67%.
- ❖ In respect of MAT(Minimum Alternative Tax), companies under Section 115JB, the effective tax rate goes up to 0.58% to 8.42 %. However MAT credit would be available.
- ❖ The distribution of dividends by corporates would attract a higher dividend distribution tax of 14.025% an increase of 0.96 %.
- ❖ Withholding tax on technical services to be reduced from 20 per cent to 10 per cent.

Depreciation

- ❖ Rate of depreciation on general Plant & Machinery has been reduced from 25 % to 15 %. But the initial depreciation rate has been increased from 15% to 20%.

Changes in Deduction from Tax Liability

- ❖ It is proposed to remove deduction provided under section 10A allowed to any undertaking, which begins to manufacture or produce articles or things or computer software after 31st March, 2009, in any special economic zone..
- ❖ Terminal date on exemptions given for specific purposes, to be extended, from March 31, 2005 to March 31, 2007 in the following cases:
 - a. Weighted deduction of 150 per cent of expenditure on in-house research and development facilities of companies engaged in the business of biotechnology, pharmaceuticals, electronics, telecommunication, chemicals or any other notified product. ?
 - b. Deduction of profits of new industrial undertakings in Jammu & Kashmir.
 - c. 100 per cent deduction of profits of companies carrying on scientific research and development and approved by the Department of Scientific and Industrial Research.

VRS

- ❖ In case of payment made to employees by a Company in a scheme of voluntary retirement , it is proposed to allow the whole expenditure incurred by the Company in making payment to the employee in connection with his voluntary retirement either in the year of retirement or in any subsequent year, each part payment being entitled to deduction in five equal annual installments beginning from the year in which such part payment is made to the employee. This amendment will take effect retrospectively from 1st April,

2004 and will, accordingly, apply in relation to the assessment year 2004-2005 and subsequent years.

Set-off accumulated losses and unabsorbed depreciation etc

- ❖ New Section 72AA introduced provides for a set-off of carry forward accumulated losses and unabsorbed depreciation where there has been an amalgamation of a **banking company with any other banking institution.**
- ❖ Set-off of carry forward of speculation losses **reduced from eight years to four years.**

PERSONAL TAXATION

Tax Structure

- ❖ The rates of tax in case of every individual or Hindu undivided family or every association of persons or body of individuals, whether incorporated or not, or every artificial juridical person the income-tax exemption limit has been raised to Rs.1,00,000. The new tax brackets and the new rates to be:

Up to Rs.1 lakh	- nil
Rs.1 lakh to Rs.1.5 lakh	- 10 %
Rs.1.5 lakh to Rs.2.5 lakh	- 20 %
Above Rs.2.5 lakh	- 30 %

Impact of Tax rate change

Taxable Income	Existing Tax Liability	New Tax Liability
1 Lac	Nil	Nil
2 Lac	34680	15300
5 Lac	126480	102000
7.5 Lac	202980	178500
10 Lac	307428	255000

- ❖ In the case of **every woman** who is resident in India and is below the age of 65 years during the previous year, the exemption limit shall be raised to Rs. 1,25,000. The new rates of income-tax on total income above Rs. 1,25,000 in such cases will be as under:–

Rs. 1,25,001 to Rs. 1,50,000	- 10 %
Rs.1,50,001 to Rs. 2,50,000	- 20 %
Above Rs. 2,50,000	- 30 %

Impact of Tax rate change

Taxable Income	Existing Tax Liability	New Tax Liability
1.25 Lac	14280	Nil
3 Lac	65280	38250
5 Lac	126480	99450
7.5 Lac	202980	175950
10 Lac	307428	252450

- ❖ In the case of every individual who is resident in India and is of the age of **65** years or more at any time during the previous year, the exemption limit shall be raised to Rs.1,50,000. The new rates of income-tax on total income above Rs.1,50,000 in such cases will be as under:

Rs.1,50,001 to Rs. 2,50,000	- 20 %
Above Rs. 2,50,000	- 30 %

- ❖ The limit for application of surcharge of 10% on Total Income in case of every individual or Hindu undivided family or every association of persons or body of individuals, whether incorporated or not has been raised from Rs.8.5 Lacs to Rs. 10 Lacs

Removal of Deductions

- ❖ Standard Deduction on Salary to be omitted.
- ❖ Deduction U/s 80 E for repayment of Educational Loan restricted to interest payment only. Deduction on payment of principal installment omitted.
- ❖ Section 80L being omitted.
- ❖ The following rebates U/s 88 are proposed to be removed :
 - a. Rebate under Section 88 for investments in LIC, PPF, NSC etc.
 - b. Rebate U/s 88B for Senior Citizens
 - c. Rebate under 88 C for women below the age of 65 years
 - d. Rebate U/s 88D on taxable income below Rs. 1lac.

New Section for Deduction of Investments

- ❖ It is proposed to insert a new section 80C relating to deduction in respect of life insurance premium, deferred annuity, contribution to the provident fund, subscription to certain equity shares or debentures, etc. **Every tax payer** to be allowed a consolidated limit of Rs.1 lakh for savings which will be deducted from the income before tax is calculated.

Banking Cash Transaction Tax

- ❖ The following transaction of withdrawal from a bank in a single day would be subject to a levy of 0.01 % tax, that is INR 10 for every INR 10000
- ❖ A transaction being purchase of a bank draft or bankers cheque or any other financial instrument is also covered.

- ❖ The banking transaction tax paid would be an allowable expenditure.

One-by-Six Scheme Amended

- ❖ Mobile telephone to be removed from the one-in-six criteria for filing income tax returns. Instead, payment for electricity of more than Rs.50,000 per year to be included.

CAPITAL GAINS

Securities Transaction Tax

- ❖ The rates of Securities Transaction Tax have been increased by 33.33% across the board.
- ❖ The rates of the Securities Transaction Tax on non-delivery based transactions hiked to 0.02% from 0.015%.. For delivery based transactions it has gone up from 0.15% to 0.20%. For Futures & Options, the STT has been hiked from 0.01% to 0.0133%.
- ❖ Income Tax Act to be amended to provide that trading in derivatives in specified stock exchanges will not be treated as “speculative transactions” for the purposes of the Income Tax Act.

NRI TAXATION

- ❖ The exemption from tax on interest earned on accounts maintained by Non Resident Indians to continue.

TAX DEDUCTED AT SOURCE

Dematerialization Deferred

- ❖ Dematerialization of TDS certificates deferred. Issue of TDS certificates to continue for one more year.

TDS on freight payments made to Contractors

- ❖ In case of freight payments made to contractors or sub-contractors being an individual and not owning more than two goods carriages at any time during the previous year, not Tax is to be deducted. Such sub-contractor is required, however, to furnish a declaration.

Quarterly returns to file by Banking & Other Companies

It is proposed that any banking company or cooperative society or public company responsible for paying to a resident any income not exceeding five thousand rupees by way of interest (other than interest on securities), U/s 194 A shall prepare quarterly returns for the period ending on the 30th June, the 30th September, the 31st December and the 31st March in each financial year

SERVICE TAX

Exemption

- ❖ Service providers whose aggregate value of taxable services provided during the preceding financial year was upto Rs. 4 lacs, have been exempted from service tax. The proposed exemption scheme would be applicable from 1st April 2005.

- ❖ Exemption has been provided from service tax on business auxiliary service, to a person producing/processing goods, from the inputs received from a manufacturer and sending the resultant product to the same manufacturer for further manufacture of final products, which are cleared on payment of excise duty. The above change will come into effect immediately.

Additional Services Covered

- ❖ Some additional services to be covered such as
 - a. Pipeline transport of goods
 - b. Packaging and mailing services
 - c. Membership fees of Clubs and Associations providing facilities, services or advantages. It does not include associations having objectives which are in the nature of public service and are of a charitable, religious or political nature.
 - d. Commercial or industrial construction service
 - e. Construction of complex, includes construction of a new residential complex having more than 12 residential units and having other facilities like park, lift, common area etc.

AMENDMENTS IN ACT AND RULES

The service tax rules are being amended so as to:

- (a) prescribe that the invoice is to be issued within 14 days from date of completion of provision of service or receipt of payment, whichever is earlier

- (b) prescribe that due date for service tax payment by all service tax assesseees would be 5th of the following month or quarter, as the case may be
- (c) Enable centralized registration of more than one premises
- (d) Prescribe that liability of payment of service tax on business auxiliary services provided by the distributors of mutual funds will be on the recipient of service namely , mutual funds

The above changes will be effective for services rendered on or after 1st April 2005.

Others

- ❖ It has been clarified that ‘Input’ under the head Business Auxiliary Services means all goods or services intended for use by the client.
- ❖ If any service is provided by a **person having a place of business in a foreign country to a person resident in India** such service shall be deemed to be taxable service under Service Tax.
- ❖ Production or processing of goods for or on behalf of clients has become taxable service under the head Business Auxiliary Services.
- ❖ Payments received before or during the provision of taxable services, will be chargeable to service tax.

CUSTOMS

- ❖ To promote investment, customs duties on selected capital goods and parts thereof to be reduced to below 15 per cent, to 10 per cent in some cases and to 5 per cent in some others.
- ❖ Duty on textile machinery and refrigerated vans to be reduced from 20 per cent to 10 per cent.
- ❖ Duties on seven specified machinery used in leather and footwear industry, to be reduced from 20 per cent to 5 per cent; duty on ethyl vinyl acetate (EVA) to be reduced from 20 per cent to 10 per cent.
- ❖ Duty on nine specified machinery used in pharma and biotech sectors to be reduced to 5 per cent.
- ❖ Duties on specified parts of battery-operated road vehicles and for printing presses to be reduced from 20 per cent to 10 per cent.
- ❖ Duties on primary and secondary metals to be reduced from 15 per cent to 10 per cent; industrial raw materials such as catalysts, refractory raw materials, basic plastic materials, molasses and industrial ethyl alcohol to be now liable to a reduced customs duty rate of 10 per cent; duty on lead to be reduced to 5 per cent.
- ❖ Duty on coking coal with high ash content to go down to 5 per cent.
- ❖ Duty on polyester and nylon chips, textile fibres, yarns and intermediates, fabrics, and garments to be reduced from 20 per cent to 15 per cent.
- ❖ Duty to be removed on specified capital goods and all inputs required for the manufacture of Information Technology Agreement (ITA) bound items.

- ❖ A CVD of 4 per cent only to be levied on the imports of ITA bound items and their inputs that attract nil duty; credit for the CVD to be available against payment of excise duty; IT software to be exempt from the proposed CVD.
- ❖ Duty on atmospheric drinking water generators to be reduced from 20 per cent to 5 per cent.
- ❖ Customs duty on crude petroleum to be reduced from 10 per cent to 5 per cent.
- ❖ Customs duty and excise duty to be nil on LPG for domestic consumption and on subsidized kerosene.
- ❖ Customs duty on other petroleum products, including motor spirit (MS) and diesel (HSD) to be reduced from 20 or 15 per cent to 10 per cent; excise duties on petrol and diesel to be fixed as a combination of ad valorem and specific duties.

EXCISE

- ❖ Duty on polyester filament yarn, tyres and air conditioners to be reduced to 16 per cent.
- ❖ Independent texturizers to be given the option to avail the exemption route or pay 8 per cent excise duty with CENVAT credit.
- ❖ **Duty of 2 per cent to be levied on branded jewellery. Any manufacturer's identification mark on his wares, KDM or Hallmark logo or karigar's squiggle would be treated as a 'Brand'.**
- ❖ Duty on mosaic tiles to be levied at 8 per cent and on road tractors for semi trailers of engine capacity exceeding 1800 cc at

16 per cent; agricultural tractors will continue to remain exempt.

- ❖ Surcharge of Re1 per kg on tea and duty of Re1 per kg on refined edible oils and Rs.1.25 per kg on vanaspati to be abolished.
- ❖ Ceiling for SSI exemption based on turnover to be raised from Rs.3 crore per year to Rs.4 crore per year. SSI units to have only two options: either full exemption on the first clearance of Rs.1 crore or normal duty on the first clearance of Rs.1 crore with CENVAT credit.
- ❖ Duty on iron and steel is 16 per cent.
- ❖ Duty on molasses to be increased from Rs.500 per MT to Rs.1000 per MT; duty on cement clinkers to be increased from Rs.250 per MT to Rs.350 per MT as an anti-avoidance measure.
- ❖ In order to raise additional resources for the National Highways Development Project, cess on petrol and diesel to be increased by 50 paise per litre.
- ❖ Specific rate on cigarettes to be raised by about 10 per cent and a surcharge of 10 per cent to be imposed on ad valorem duties on other tobacco products including gutka, chewing tobacco, snuff and pan masala; biris not to be subject to this levy.

VAT

- ❖ All States have agreed to introduce the value added tax (VAT) with effect from April 1, 2005; Central Government to

compensate the States, according to an agreed formula, in the event of any revenue loss.

- ❖ Tax paid on inputs procured from other states will not be eligible for set off.
- ❖ Small traders with a turnover of Rs. 5 lacs will be exempt from VAT.
- ❖ Traders with an annual turnover upto Rs.50 lacs will have the option of a composition scheme.
- ❖ There will exist just two basic rates of 4% and 12.5%, plus a specific category of tax exempted goods and a **special VAT rate of 1% only on gold and silver ornaments.**

MISCELLANEOUS

FINANCIAL SECTOR

Banking

- ❖ Amendments to be introduced to the Banking Regulation Act, to remove the lower and upper bounds to the statutory liquidity ratio (SLR) and provide flexibility to RBI to prescribe prudential norms.
- ❖ To allow banking companies to issue preference shares.
- ❖ To introduce specific provisions to enable the consolidated supervision of banks and their subsidiaries by RBI.
- ❖ Amendments to be introduced to the Reserve Bank of India Act, to remove the limits of the cash reserve ratio (CRR) to facilitate more flexible conduct of monetary policy; and to enable RBI to

lend or borrow securities by way of repo, reverse repo or otherwise.

- ❖ RBI unveils roadmap for presence of foreign banks in India by permitting foreign banks to setup a wholly owned subsidiary or conversion of the existing branches into wholly owned subsidiary.

Capital Market

- ❖ FIIs to be permitted to submit appropriate collateral, in cash or otherwise, as prescribed by SEBI, when trading in derivatives on the domestic market.
- ❖ Definition of 'securities' under the Securities Contracts (Regulation) Act, 1956 to be amended so as to provide a legal framework for trading of securitized debt including mortgage backed debt.
- ❖ A high level Expert Committee on corporate bonds and securitization to be appointed to look into the legal, regulatory, tax and market design issues in the development of the corporate bond market.
- ❖ A one-time exemption from stamp duty on the notional transfer of assets, to be granted to the three stock exchanges that are not yet corporatized.
- ❖ A high powered Expert Committee to be appointed in consultation with RBI, to advise on how to make Mumbai a regional financial centre.
- ❖ SEBI to be asked to permit, in consultation with RBI, mutual funds to introduce Gold Exchange Traded Funds (GETFs) with gold as the underlying asset, in order to enable any household to buy and sell gold in units for as little as Rs.100.

INDUSTRIAL SECTOR

TEXTILES

- ❖ Allocation of Rs.435 crore for the Technology Upgradation Fund (TUF)
- ❖ A 10 per cent capital subsidy scheme to be introduced for the textile processing sector.
- ❖ Cluster development approach to be adopted for the production and marketing of handloom products; 20 clusters to be taken up in the first phase at a cost of Rs.40 crore;
- ❖ Coverage of life insurance scheme for handloom weavers to be enlarged to 20 lakh weavers in two years at a cost of Rs.30 crore per year when fully rolled out;
- ❖ Coverage of the health insurance package for weavers to be increased to 2 lakh weavers at a recurring cost of Rs.30 crore per year.

SUGAR INDUSTRY

- ❖ NABARD, in consultation with State Governments, RBI, banks and financial institutions to work out a scheme for providing a financial package with a moratorium for two years, on both principal and interest, and a schedule of payment having regard to the commercial viability of each unit; interest rate of 2 percentage points below the bank rate to be made applicable to outstanding loans as on October 21, 2004; Indian Banks' Association (IBA) and NABARD to work out a scheme under which factories may renegotiate their past high interest loans.

PHARMACEUTICALS AND BIOTECHNOLOGY

- ❖ Corpus for the research and development fund to be increased in phases.
- ❖ Stable policy environment and incentives to be provided to help the two industries become world leaders.

SMALL AND MEDIUM ENTERPRISES

- ❖ 108 items identified for dereservation.
- ❖ Provision for "Promotion of SSI Schemes" enhanced to Rs.173 crore in 2005-06; units in knowledge-based industries such as pharma, biotech, and IT to be provided equity support through the SME Growth Fund.

FOREIGN TRADE

- ❖ Target of US\$ 150 billion for exports by the year 2008-09 fixed in order to double India's share in world exports to 1.5 per cent.

INFRASTRUCTURE

TELECOMMUNICATIONS

- ❖ A provision of Rs.1,200 crore for Universal Service Obligation (USO) Fund in 2005-06
- ❖ 1,687 subdivisions to get support for rural household telephones
- ❖ BSNL to provide public telephones in the next three years to the remaining 66,822 revenue villages.

NATIONAL HIGHWAY DEVELOPMENT PROJECT

- ❖ NHDP III to be launched in 2005-06 to target selected high density highways not forming part of the Golden Quadrilateral or the North-South and East-West corridors; Rs.1,400 crore provided in 2005-06 to four-lane 4000 kms.
- ❖ A special package for the North Eastern region with allocation of Rs.450 crore.

RURAL ELECTRIFICATION

- ❖ To cover 1.25 lakh villages in five years.
- ❖ Focus to be on deficient States; creation of a rural electricity distribution backbone envisaged, with a 33/11 KV substation in each block and at least one distribution transformer in each village; Rs.1,100 crore provided in 2005-06.

FOREIGN DIRECT INVESTMENT IN REAL ESTATE SECTOR

- ❖ The Cabinet on 24 February 2005 opened the floodgates for foreign investment in the realty sector by allowing 100% FDI through the automatic route. Townships can now be developed over 25 acres compared to 100 acres earlier. FDI has also been opened up for construction and development projects over 50,000 sq mts (12.5 acres) including housing, hotels and resorts, hospitals, commercial premises and educational institutes. The government has however, introduced conditions like \$10 million minimum capitalization for wholly-owned subsidiaries and \$5 million for joint

ventures. Further, foreign investors' funds would be locked in for three years and they would not be allowed to exit without prior FIPB approval. To check speculation, they would not be permitted to sell undeveloped plots. Foreign investors entering into joint ventures would be required to bring in funds within six months of commencement of the company. The projects will also be subject to the building laws and bye-laws of concerned states, municipal and local bodies.