# PRE-BUDGET MEMORANDUM

# 2009

**THE INSTITUTE OF COST AND WORKS ACCOUNTANTS OF INDIA**

**MACRO ECONOMIC ENVIRONMENT & ROLE OF COST & MANAGEMENT ACCOUNTING PROFESSION**

The recent gloom of global economic slowdowns and the failure of corporate governance in Satyam has created threat to the Indian economy and the investors' trust on corporate sector is at Stake. However timely action by the Government by extending several stimulus packages and incentives to create demand and regain confidence of the public & appropriate action by the Government in the Ministry of Corporate Affairs in the case of Satyam have saved the image of the systems and regained the faith of the stake holders.

Despite a political vision, well articulated schemes and adequate funding, many major programmes are not on schedule. And the benefits are not reaching the intended beneficiaries. This trend ought to be reversed through better organization, better transparency, better feedback and better visibility of timely actions through purposeful auditing of social cost and benefit to achieve growth. **The Cost & Management Accounting profession has a major role to play in monitoring timely execution of the Schemes ensuring quality of the work and end use of the funds.**

The main reason for the spiraling prices is to a large extent due to growth of the service sector which account for nearly 54% of the GDP. However, this sector has not been covered under the mechanism of maintenance of cost records and cost audit. In almost all commodities of mass consumption the storage, distribution and selling costs far out weigh the manufacturing costs.

The Government has initiated few timely and innovative steps for sustaining the present growth rate like, considering 2008-09 as the year of consolidation and review of all programmes initiated by the Government in 2004, creation of a National Fund for Transmission and Distribution reform, social security to unorganized sector workers & Monitoring & Evaluation of Central Plan Schemes by independent Research Institutes etc. **The Section 25 Company formed in the name and style of ICWAI Management Accounting Research Foundation through the Center of Excellences established at different part of the Country would be happy to join hands with different Ministries of the Governments in monitoring different schemes in the true letter and spirit to build a develop India.**

The demand for Cost and Management Accounting services inside the country is rising particularly because of the strategic vision/ strategic management focus of Cost and Management Accounting which is increasingly getting enmeshed in Information Technology (IT) systems of today. Accordingly the syllabus of ICWAI has been realigned with IFAC Guidelines (IEG) and SAFA recommendations in line with IFAC from January 1, 2008. ICWAI has signed Memorandum of Understanding with CIMA, London; IMA, United States of America as a step towards Mutual Recognition Agreements recognizing the standard of our professional qualification and competence so that mutual entry in to respective markets can be possible.

Cost consciousness is poorly understood by many including Government Departments, industry and business entities. There is no substitute for effective cost management and continuous improvement. Industry and business must be encouraged to cut their costs voluntarily by tax benefits. The direct taxes should be linked to cost reduction so that industry will get benefit on reduction of prices and it will serve as an impetus for growth.

In India, the importance of competition policy and related regulatory regimes has increased greatly since 1991 when a massive wave of liberalization eliminated many controls on investment, capital market, foreign trade and prices. While regulation has significant relevance in the current economic scenario, cost data fed regulatory issues are also many and worth considering while examining the relevance and usefulness of cost data of companies for tariff fixation/approvals in public utilities like electricity, for ensuring objective subsidy policy, to ensure operational regulation within competitive practices are some of the areas that would require adequate cost audit mechanism as these factors are not addressed in financial reporting mechanism.

In the social sectors like; healthcare and education which are soft infrastructural issues for economic growth, the need for regulation is strongly felt. Strict regulation of the healthcare services is the need of the hour. The fee structures at private healthcare centers need to be formalized and monitored to prevent exploitation of the patients. The National Knowledge Commission has also highlighted that the barriers and quality, cost & content of the higher education needs to be addressed.

In India, methods and techniques of cost accounting and audit of cost accounts can be traced back to pre-independence era when large number of firms was given contracts by the Government of India on cost plus basis. This trend continued on a large scale during World War II that led to the recognition of cost as a distinct concept not only in India but in the industrial economies of the entire world. A phenomenon of cost consciousness started taking shape in the country and the Institute of Cost &

Works Accountants of India was set up in 1944 with the objective of promoting, regulating and developing the profession of Cost & Management accountancy in the Country. The cost accounting mechanism monitor, control and regulate the efficient use of scarce resources and the Cost Accountants are solely and mainly concerned with the internal economy of the industry. policy interventions, administered pricing, social pricing, funding plans, taxation laws, price control environment, transfer pricing, predatory pricing, tariff determination, WTO cases, regulatory framework etc have exerted a major influence in the evolution of cost accounting and assurance practices in various countries of the globe.

In the present economic scenario where Indian economy is characterized by increasingly open markets, presence of national and international competition and the gradual withdrawal of administrative prices, corporate decisions are guided by the competitive situation determined by economic liberalization, globalization and privatization. The present competitive economic environment has made all the organization more cost conscious. From the cost consciousness to a competitive cost structure, the country needs to travel through a road of structured cost practices.

There is general consensus among all stakeholders that cost consciousness is important in all sectors of economy and even more important in non-competitiveness public services. These sectors being users of public money have to emerge stronger along with the growth of economy and therefore there is an urgent need to improve productivity, build competence and reduce wastage and inefficiencies in utilization of scarce resources in these sectors in order to make available public services at reasonable cost. To ensure greater accountability of Government expenditure, improve transparency and uniformity across the sectors, here is a clear need to extend the principle and practices of cost accounting and cost audit to the services and other social sectors and to various government projects and schemes, departmental undertakings and to all government contracts and procurements.

It is the general agreement that all government /public agencies should determine user charges for the utilities and service based on the most efficient costs. These must be produced or generated in a cost effective manner avoiding wastage of scarce natural resources. There should be some co-relation between fees charged and cost incurred for which they should be brought under the ambit of cost accounting principles and cost audit. There is need to move towards user cost based pricing. Subsidies meant for the poor may be decided after being fully aware of the opportunity cost, social factors and the shadow price. Even where cross subsidization is necessary, it should be transparent and made known to the public at large.

After liberalization, as per the report of the National Manufacturing Competitiveness Council of Government of India, the services sector has grown steadily and is accounting for 54% of the GDP compared to 27% of the Industrial Sector including 17% from the manufacturing sector. This has

assumed greater importance after WTO has replaced the concept of GATT to GATIS encompassing vital service activities like Finance, Energy, Health, Education etc. It is imperative that at this stage itself, a system of cost consciousness is created in these sectors so as to maintain efficiency, performance and propriety in their operations to be competitive with larger players entering these sectors from developed countries with greater resources and better efficiency of operations. The introduction of the cost accounting principles in these sectors will lead to Management Principles, apart from determination of cost of operations, by which the quality the quality of the services will improve, leading to higher contribution to the GDP, both by itself and by manufacturing sector to sustain competition.

The IFAC's study paper on "perspectives on Cost Accounting for Governments have suggested that Cost Accounting has a number of important uses in the efficient and effective management of government. It is a valuable tool for the management of general fund organizations as well as for commercial type activity. The use of cost accounting is likely to become even more wide spread than it is today as more successes are reported and the use of accrual accounting spreads. There are a number of approaches that governments in different circumstances can adopt to move progressively to implement cost accounting.

Competitiveness is the common driving factor between the developing and the developed nations. Competitiveness has three dimensions; quality product, cost effectiveness and product is in just-in-time. There is relationship between the core competence and the competitiveness of the country. The strategies are to be worked out the cost of exportable products especially when there is a global economic turbulence and a demand reduction.

**Inventory Valuation**

Inventory plays a vital role in assessing the true profits of the company. Inventory is one of the important constituents of the Current Assets of the Company. Inventory Valuation is reflected in the Balance Sheet based on the certificate issued by the management. Although the choice of technique for closing inventory valuation does not change the economic reality of events that have occurred, but their effect on taxes and retained earnings go a long way in influencing net income and its distribution as return to shareholders. Stock volatility and ratio of stock to earnings indicate the continued vulnerability of the inventory valuation issue towards manipulation.

In this context it may be mentioned here that as per SEBI circular on clause 49, one of the role of the Audit Committee is to review the annual financial statements and major accounting entries involving

estimates based on the exercise of judgment by management before submission to the Board. In almost all the companies, Inventory values are certified by the management.

**It is suggested that immediate instructions may be issued that the value of the closing inventory should be certified by the Cost accountant in Practice so that the authenticated profitability is reported to the stake holders.**

In most financial failures recently reported abroad have a common factor of manipulation of stock and higher drawings from Banks. This leads to liquidity crunch and ultimate bankruptcy. It is suggested that immediate instructions may be issued that the value of the closing inventory should be certified by the Cost Accountant in practice so that the authenticated profitability is reported to the stakeholders

**Corporate Governance**

In the context of the recent financial fraud in the corporate sector it is felt necessary that the existing provisions of financial reporting have not fully met the needs of the stakeholders and there is an urgent need to amend the provisions of Clause 49 to regain the diminishing public confidence in Financial Reporting. It is also observed that almost all the failures are the result of the combined effect of failure in business, failure in governance and failure in reporting. As an entity moves closer to business failure the incentive to distort reporting increases and therefore the chances of reporting failure increases.

**It has been observed that the existing provisions of Clause 49 need following improvement by enabling attention to prevent business failures** and therefore to avoid reoccurrence of such corporate failures in future:

It is observed that management is devoting too much of time in compliance of the various clauses, and do not focus enough on matters such as strategy and building a business. It is suggested by IFAC that governance framework is composed of performance and conformance which together represent value creation, resource utilization and accountability framework of an organization. This result in alignment of business operation and resource utilization with strategic direction and the organization level of risk appetite. **This requires the embedding of a performance review mechanism of resources utilization as a part of the scope of audit committee thus aligning with the thought process of SEBI as well**.

**There is an urgent need to include cost auditing in accounting practices and set up a regulatory body like Accounting Oversight Board to supervise the accounting and auditing practices for which ICWAI has been advocating for quite some time.**

**Cost Audit as a Tool of Enterprise Governance**

India is the first country in the world to introduce **COST AUDIT**. The objective of Cost Audit is not just for administered pricing and deciding on industrial subsidies but also for enabling Indian industry to improve their economic efficiency and compete in today's competitive market in the era of globalization and liberalization. The cost audit report reflects effective utilization of resources like material and labour and also allocates various expenses to different products, which results in working out product wise cost and profitability instead of overall profitability as being reported in the published results today. The reasons for short fall in Profit & Loss in individual product are placed before the Audit Committee with a report from the cost auditor by all listed companies who are covered by Section 209(1)(d) of the Companies Act. The recommendations of SEBI were also on similar lines to the Expert Group constituted by the Ministry of Corporate Affairs recently in this regard. It is also suggested that Input/Output Ratio needs to be worked out for the product to find out the efficiency of resources used and be placed before the Audit Committee. Detail of product-wise Profitability is enclosed as Annexure-II. Cost Audit has a perfect synergy with Enterprise Governance framework conceptualized by IFAC.

The Expert Group constituted by the Ministry of Corporate Affairs to review the Cost Accounting Record Rules, Cost Audit & Cost Accounting Standards have recommended for universal application of Cost Accounting Principles across all sectors of the economy and mandatory audit / certification of cost records by the practicing Cost accountants to make the Industry and service sectors competitive in the Global scenario. It is, therefore, suggested that the principles and practices of Cost Accounting and Cost Audit may be made applicable to all the industries and Cost Audit Report may be made available to the shareholders, which will result in better corporate governance.

**Transfer Pricing**

It may be mentioned here that as per SEBI circular on Clause 49, one of the role of the Audit Committee is to review the disclosure of related party transactions before submitting the statements for board approval. The Explanation to this also talks about related party transactions as defined in the Accounting Standard 18 of ICAI.

Under the present Accounting Standard-18, the Companies have to disclose the related party transactions in the financial results but it does not reveal whether the principle of Arms Length has been followed or not for pricing of their products. An Expert Group to recommend transfer pricing guidelines for companies for pricing of their products in connection with the transactions with related parties was constituted under the Chairmanship of Prof. Verma by the then Ministry of Law, Justice and Company Affairs in the year 2002 and the said group had already submitted its report. In view of the recommendation of the Expert Group **it is suggested that audited financial accounts may contain the**

**report on Transfer pricing of product between related party transactions duly certified by Cost Accountant.**

**Fiscal consolidation:**

There is an urgent need to check the wide fiscal deficit as it is likely to lead to runaway inflation in the event of monetization of deficit or curtailment in social expenditure. Cost Accountants can play a greater role in certifying the end use of funds, in detecting leakage and offering solution in better utilization of funds so that the funds reach the ultimate beneficiaries and thereby effective demand can be revitalized. Expediting tax reforms as suggested by Kelkar Committee, **introduction of uniform GST across the country and simplification of tax payment and return filing norms, can go a long way in curbing tax evasion.** Greater coordinated action with all nations to unearth untaxed money hidden away in tax havens will serve the twin benefits of greater tax revenue and fighting money laundering. Expediting the divestment of ailing PSUs and the process of auction of spectrum allocation for telecom sector can help generate greater revenue for the government.

**Strengthening energy requirements**

India has already been a witness on numerous occasions to the havoc wreaked on the economy due to rising oil prices. Making energy audit mandatory for all manufacturing companies and for all other companies greater oversight over energy conservation policies can encourage energy conservation habit among Indians**. Cost Accountants can help in this regard with their expertise to assess the accurate cost.** India is already a big player in the carbon trading market. Encouragement in the form of fiscal incentives to green projects that are more efficient in consumption of non renewable sources of energy and consequently pollute less, help in tackling the volatility of energy sources. Fiscal sops should be provided to oil refining companies to ensure increasing dependence on domestic sources of oil and they should be accorded special status within the infrastructure sector. At the same time, strategic alliances with oil rich nations can also help assuage energy worries. Encouragement for development of renewable energy sources is also essential.

**Agriculture**

Encouragement to continuous R&D in agriculture is a must to develop high yielding local strains of crops that are more adaptable to local environments. The PDS has to be overhauled. Ensuring remunerative prices to farmers to ensure proper allocation of resources and their protection in the event of bumper harvest while also meeting the food securities concerns of the vast poor of the country should be the most important objective of the PDS. The fixation of minimum support prices should be based on **scientific formula of Cost of production** and should not be guided by political compulsions. The storage and warehousing facilities at FCI godowns should be improved to **prevent spoilage and wastage**. Private partnership should be sought in this area too, since entry of traders is likely to impart greater efficiency in the procurement and distribution of food grain. Enactment of Commodity Warehousing Act will go a long way in helping farmers away from clutches of exploitative middlemen and reduce the transport costs and thereby food costs. The distribution of food grain through fair price shops should be more

effectively monitored to ensure that there is no leakage and the benefit of subsidized food reaches the poor. Export and import of food grain should follow a proper policy rather than being guided by ad hoc or contingency situations. Apart from self-reliance on cereal production, the Government must also endeavour to achieve self-sufficiency in oilseeds and pulses production. Subsidies should consider the cost benefit analysis for which the expertise of cost and management accounting profession has a major role to play.

**Social Infrastructure**

To ensure world class education accessible to all in order to secure the future of Indian youth which constitutes 51% of India's population below 25 years of age there is an immediate need to regulate the secondary, higher, technical and medical education in the Country to ensure reasonable quality, cost and content.

Provision of social security is a challenge for the 80% of India's population working in the unorganized sector with no forms of safety net. Thus creation of a social safety net should be an avowed paternalistic mission of the state. While India has been a pioneer in this regard with the New Pension Scheme, **increasing the coverage of the NPS through greater intermediation, lower cost and affording it tax benefits on par with other social security schemes like PPF will be essential.**

**Infrastructure**

All sectors in infrastructure require independent regulatory authorities for more efficient functioning. **Also an agency should be appointed at national level for monitoring of projects and easy facilitation to cut through the bureaucratic red tapism.**

**(i)** Roads are the lifeline of any vibrant economy. It is necessary to meet the deadlines regarding completion of the National Golden Quadrilateral. **The Viability Gap Funding (VGF) can be increased by the government to attract more private participants for construction of highways.**

**(ii)** Urgent reforms are required in the field of power sector in the form of greater efficiency in generation activities, allowing open access for equitable trading and distribution of power among states, allowing private trading, unbundling of transmission and generation, checking of theft and unauthorized use of electricity etc. Enactment of the Central Electricity Act 2003 is imperative. **In view of the availability of limited fossil fuels more thrust should be given to enhance the power generation through Hydro and non-conventional and nuclear power route. Further, adequate amount should be invested to upgrade the transmission and distribution along with increasing awareness of the consumer to arrest the losses.**

**(iii)** India has tried to replicate the Chinese model of establishing SEZs to raise export level and India's share in world trade. However, SEZs in many places have been facing problems due to faulty land acquisition policies of the government and due to inconsistencies in tax treatment to SEZs vis-à-vis the DTAs and FTAs**. A uniform policy for Land Acquisition needs to be put in place to reduce societal inequality and discord and creation of a land bank can help prevent litigious issues later.**

(iv) With 8-9 million new subscribers being added to the mobile network every month, telecom has truly been the poster boy of Indian infrastructure. The success of this sector is owed to the competition due to presence of many players, which has led to modernized technology, low cost and wider reach among consumers. However, the regulatory failures have impeded the introduction of mobile operator portability (MOP) and the provision of third generation cellular technology (3G), which will support bandwidth hungry applications.

(v) Ports in India are fast losing their monopoly status owing to competition and they are saddled with internal problems like indebtedness and labour issues. **Corporatization and privatization of ports following PPP model is the only way out.** Amendment of major Port Trust Acts is necessary to convert ports into companies. Privatization and modernization of airports too has been on the anvil for long. The process should be expedited.

To monitor timely education of the schemes ensuring quality of the work and end use the funds, **there is an urgent need to introduce the general principles of cost accounting and cost audit in the above sectors including the schemes identified under the Bharat Nirman to augment the rural infrastructure**.

**Price stability**

The price scenario in India faces a very peculiar conundrum. While Wholesale Price Index is at present hovering near zero levels, the Consumer Price Index is in the range of 9-10%. This high CPI could be mainly attributed to high food prices. This is particularly deleterious to the poor (for whom food constitutes the most important item of expenditure) in the absence of any safety net for them. What is perhaps very distressing is that while food prices continue to remain high, mountains of food grains are left rotting in warehouses. Things can get worse once business sentiments improve and oil prices head northward, which will then raise WPI too. The wide variation between the wholesale and retail price indices also makes monetary policy formulation difficult. World-over CPI is the official barometer for guiding monetary policy since it gives larger weight age to food items which impact the masses and lesser weight to manufacturing items. WPI is calculated from the production side and hence tends to give a lop-sided view of consumer price rise. Also CPI is more representative since it also considers services. It is also important to recognize that the low level of WPI is on account of the base effect (the corresponding period in 2008 being a period of high inflation).

**Thus to ensure price stability a few important things would be useful to keep in mind:**

**(i) The government should ensure more efficient food management.**

**(ii) It is important that such a price index be considered that suitably captures the impact on consumers. Thus either the monetary measures should not treat WPI as a benchmark for gauging price rises and consider CPI as the best indicator of inflation or we should move towards adoption of the global practice of comparing prices on a month to month basis rather than the prevailing system of year to year basis.**

**(iii) It is important to examine the cause of inflation-whether demand pull or cost push. Accordingly, the monetary prescription should vary rather than a blanket solution irrespective of the nature of inflation.**

**Monetary Policy**

The reforms of 1991-92 have brought a change in the institutional framework, which resulted in greater deregulation of the banking and financial sector and greater reliance on indirect monetary controls like repo and reverse repo as instruments of affecting liquidity and interest rates, ensuring greater fiscal discipline by passing of the FRBM Act and laying of limits for revenue and fiscal deficit thereof helped curb the fiscal profligacy of the previous period and change in the management of the external sector by the central bank from being restrictive to becoming liberalized and globalised. Thus while most exchange controls have been relaxed, RBI intervenes only to contain extreme exchange rate volatility. Against such a backdrop, questions have always emerged whether RBI true to the needs of a developing nation follow multiple objectives like maintaining growth, price stability, financial stability and exchange stability or should it like other central banks of the world pursue a single objective of influencing growth through monetary policy decisions. A corollary would be whether inflation targeting will be a practical option for RBI to follow.

(i) In a country like India with no perceptible safety net for the poor, managing inflation is undoubtedly important. But sole focus on inflation targeting may take away the flexibility of central banks though it provides a precise method of managing prices.

(ii) The next step would be what should be the tolerable inflation level. The target of RBI should not be zero inflation since it then removes any incentive for producers, leads to misallocation of resources and reduces the central banks' flexibility. Today, the tolerable inflation level should also take into the global inflation rate and the foreign induced supply shocks like oil price spurts before RBI takes any measures to contain inflation. Otherwise there is a danger of 'stagflation'.

iii) As the repeated crises have shown, the importance of monitoring and preventing asset bubbles cannot be overemphasized.

(iii) The process of sterilization as a means of exchange rate management raises questions regarding the prudence of accumulation of large levels of forex reserves. While forex reserves act as insurance in instances of crisis, large accumulation leads to problems of inflation and low yields on these reserves.

(iv) As the recent subprime crisis has shown, financial stability is very much a part of macro stability. Both the South East Asian crisis and the subprime crisis have been averted in India largely to the close supervision of financial institutions by RBI and effective regulation. However, there should not be over regulation that may hamper financial innovation. Also, there is a need of bringing unregulated but highly leveraged entities like hedge funds and less regulated entities like NBFCs into the fold of uniform regulation so that there is no scope of regulatory arbitrage and hence no possibility of systemic risk. Greater coordination with SEBI, IRDA and the like can help plug the existing gaps in the supervisory and regulatory mechanism.

(v) It is necessary to expedite the process of hiving off the public debt function of RBI to enable it to function as an independent monetary authority.

**Financial Sector Reforms**

Financial inclusion, growth and stability should be the three pillars of the reforms process. Creating more efficient and liquid markets, broadening access to finance through and promoting financially inclusive growth, creating a growth friendly regulatory environment, leveling the playing field for all market participants and creating a robust infrastructure for credit are imperative if India is to emerge as the next financial hub of the world.

(i) Calibrated introduction of exchange traded derivatives and securitized products will help in the process of financial innovation and better risk management practices.

(ii) The corporate bond market should be developed so that it can emerge as an alternative source of credit apart from bank credit.

(iii) Greater use of business correspondents and ATMs to increase the reach of banking services to the un banked, who depend on usurious moneylenders should be an important element of the reforms process.

(iv) There should be greater coordination among the regulatory bodies for effective financial supervision covering banks, capital and money markets, insurance, pension and derivatives market.

(v) The thrust of supervision should be on reducing regulatory arbitrage and at the same time encouraging growth and innovation.

(vi) The progress made by India in Information Technology should be harnessed for efficient functioning of this sector.

(vii) The regulatory policies should take into consideration global best practices too. Adoption of international norms in areas of accounting and banking is important for greater global integration and at the same time it should be suited to the economic and financial conditions and compulsions of our country.

(viii) Architecture for collection of credit information is very essential to keep delinquency level low. In this context, greater oversight over credit rating agencies is essential to prevent outbreak of a sub prime type crisis. **Amendment of property rules to favour lenders and encouragement to asset reconstruction companies are essential for a robust credit framework in the country**.

(ix) We should leverage the vast talent of our manpower by providing them with the right balance of incentives and challenges.

**Conclusion**

Demand stimulation is important for the economy bow along with sustainable economic growth. Towards this the companies will need to focus on the bottom of the pyramid instead of always focusing on high end products. When products are designed for the bottom of the pyramid pricing will be certainly an issue and high margins are not sustainable. This will be de-motivating factor for the business. **It is therefore recommended that the GOI in order to focus on the bottom of the pyramid and stimulate companies to design such products exclusively for India should introduce tax concession based on product based profitability. But to avail such concession there should be a procedure for exemption which will notify such products base on application and also lay down the standards for computing product profitability.**

The resultant effect of the global turbulence on the Indian economy will be reduction in the job oriented export sector which contributes close to 20% to the country's GDP and reduction in out sourcing. We need to ignite the minds for new product ideas which are useful not only to the national consumption but also for the export market.

Competitiveness has three dimensions: quality of the product, Cost effectiveness and product in the market just-in-time. The Cost Accountants have a major role to play in working out strategies through which the cost of production of the exportable products could be reduced especially in the prevailing situation of global economic turbulence and a demand reduction.

ICWAI has been pursuing the mission to generate a number of creative leaders from the Cost and Management Accounting profession to guide the industry, Government and the service sectors for effective management of available resources with an endeavour to reduce the cost of all products and services delivered by the Indian Industries and there by making India internationally competitive in all fields.

The decisive verdict in favour of the UPA and continuity of Dr. Manmohan Singh as the Prime Minister is a mandate for a stable Government that could pursue faster economic reforms in the areas of Pensions, Insurance, Banking, Education, Health, Retail, labour reforms and revitalization of Indian economy and the Cost & Management Accounting profession would feel proud enough to be associated with the Government to sustain double digit and inclusive growth and the march towards the path of the Developed India.

## INTRODUCTION

1.1 The Council of the Institute of Cost and Works Accountants of India considers it a privilege to submit a Pre-Budget Memorandum to the Government. The Memorandum contains suggestions for the consideration of the Government while formulating the tax proposals for the year 2009-10.

1.2 Suggestions in the Pre-Budget Memorandum – 2009 in Direct Taxes have been given under the following heads:

I. Suggestions for widening the tax base and increasing the tax revenue.

II. Suggestions to check tax avoidance.

III. Suggestions for rationalization of the provisions of direct tax laws.

1.3 Definition of Accountant u/s 288(2) of the Income Tax Act, 1961

1.4 National Tax Tribunal u/s 2(29D) of the Income Tax Act, 1961

## SUGGESTIONS FOR WIDENING THE TAX BASE AND INCREASING THE TAX REVENUE

**1. Widening the scope of section 44AF**

The scope of section 44AF may be widened to cover all businesses including small scale manufacturing, job workers, dabas, tailors, small restaurants, home delivery out-lets, auto spare servicing, software ancillary units and other small businesses whose sales, turnover or gross receipts are less than Rs. 40 lakhs.

**2. Specified Person:**

Encouraging voluntary compliance – Filing of income-tax return

A provision may be introduced to allow the specified persons to file return of income and pay tax along with interest and such further penal interest as may be thought fit. This will encourage voluntary compliance and at the same time there will be no immunity to these persons from the provisions of law.

**3. Utilisation of PAN and Bank Account Data PAN** and Bank Account data may be cross verified.

## SUGGESTIONS TO CHECK TAX AVOIDANCE

**1. Annual Information Return**

Information to be furnished in the **Annual Information Return u/s 285BA** may appropriately be amended to require information regarding the following financial transactions:

(a) Information regarding tenders/procurements where the value exceeds Rs.10 lakhs. This information may be provided by the concerned organisation.

(b) Sales and purchases of shares exceeding Rs.5 crores respectively in the case of day traders. This information can be filed by the concerned brokers who are dealing with the day traders.

(c) Receipt of donations by trusts or Institutions exceeding Rs.1 lakh. Such information may be filed by the concerned trusts or institutions.

(d) Educational fees paid in excess of Rs.1 lakh per annum. The concerned educational institution should furnish the relevant information to the tax authorities.

**2. Mechanism when the Assessee surrenders income**

Since the Settlement Commission is not having jurisdiction over the past years after the search is conducted by the Tax Department, there should be a suitable mechanism to be drawn for those who have agreed, during the search, to surrender their income to avoid complicated verification under section 142(2A).

**SUGGESTIONS FOR RATIONALISATION OF THE PROVISIONS OF DIRECT-TAX LAWS (INCOME-TAX)**

**1. Person u/s 2(31)** should **include clause (viii)** Limited Liability Partnership.

It is therefore requested that the suitable provisions for the levy of tax on such partnerships be contained in the Finance Bill 2009.

**2. Taxability of Agricultural Income u/s 2(1A)**

(a) A tax rental arrangement should be designed whereby States should pass a resolution under Article 252 of the Constitution authorising the Central Government to impose income tax on agricultural income. The taxes collected by the Centre would however be assigned to the States.

(b) Tax from agricultural income for the purposes of allocation between States will be the difference between the tax on total income (including agricultural income) and the tax on total income net of agricultural income.

(c) Where a taxpayer derives agricultural income from different States, the revenues attributable to a State will be in the ratio of the income derived from a particular State to the total agricultural income.

(d) A separate tax return form should be prescribed for taxpayers deriving income from agriculture.

(e) The definition of Agriculture Income under section 2 (1A) should include the modern concepts of agriculture in the process of cultivation, use of bio-technology process and genetic engineering, which are implemented by various corporate in India.

These recommendations will help mobilise additional resources for the States without the attendant problem of administering the agricultural income Tax.

**3. Income deemed to accrue or arise in India u/s 9(1)(i); Explanation (b)**

An Explanation should be provided to define the activity of "operations which are confined to the purchase of goods in India for the purpose of export" i.e. whether it would include the activity of purchase of customized goods made as per the specification and with the supervision of buyer.

**EXCLUSIONS FROM TOTAL INCOME**

**4. Anomaly in taxation regarding SEZ unit:**

The Income Tax Act 1961 under Section 10 AA contemplates "Special provisions in respect of newly established units in Special Economic Zone". As per this section 10AA (1), 100% of profits derived from the export of such manufactured goods from the SEZ unit

- Is exempted for a period of five consecutive assessment years and
- For the next five consecutive years 50% of such profits will be exempted.
- For the next five consecutive years, 50% of such profits so derived from the SEZ units will be exempted provided a reserve is created as "Special Economic Zone Reinvestment Reserve Account" and utilized for the purpose of business of the Assessee.

In the case of companies having multiple units located both in Domestic Tariff Area ("DTA") as well as in the Special Economic Zone, there is an anomaly under this Section of the Income Tax Act severely impacting the viability of the SEZ unit.

To elaborate, as per this Section, the **deduction** of the SEZ unit has to be calculated as:

$$\text{Profit of the SEZ Unit} \times \frac{\text{Export Sale of SEZ Unit}}{\text{Total Turn Over of the Assessee}}$$

In view of the above, we wish to highlight that the **"Total Turnover of the Assessee"** would include the turnover from other multi-located units of the company and in some cases the units located elsewhere which may have substantial domestic turnover. In view of taking the total turnover as denominator, this will substantially reduce the deduction envisaged from the profits of the export turnover made by the SEZ unit.

In case where a company is having only one SEZ unit it would stand to gain by taking the denominator as the total sales of that SEZ unit only for calculating the exempted profit of the SEZ unit but companies which have multiple units with one or more units located in an SEZ and other units in DTA will be in a disadvantageous position.

**Suggestions:**

**The anomaly in the taxability of profits from SEZ Units needs to be corrected so that companies which have multiple units with one or more units located in an SEZ and other units in DTA also would derive the benefit under this Section.**

**5. "Annual receipts" under section 10(23C)**

It is suggested that "annual receipts" may be clearly defined as income of the hospitals/ educational institutions arising every year but excluding value of donation received in kind by way of shares, other movable assets, land, hospitals/educational equipment, sale consideration received on disposal of land, shares or other movable property etc.

**Further, it may be specifically provided that donations received towards corpus by way of land, shares or other movable assets are excluded from computation of "annual receipts" as prescribed under Rule 2BC of Income Tax Rules.**

**The present limit of Rs.1 crore may also be increased to Rs.5 crores**

**6. Concessional tax treatment to foreign sourced dividend income**

A concessional tax treatment may be accorded to foreign sourced dividend income by subjecting it to tax in India at the same rate (as specified from time to time) as the dividend distribution tax levied on Indian Companies u/s 115-O paying dividends to their shareholders.

**INCOME FROM SALARIES**

**7. Proviso to section 17(2) (iii) and FBT on ESOPs**

It may be clarified that ESOPs would not be taxable as perquisite in all cases.

**8. Section 17(2)(vi)(3) Explanation (B) which states " does not exceed Rs.2 lakhs". This limit of Rs. 2 lakhs should be suitably increased.**

**9. Statutory Exemption limit u/s 10(10), 10(10AA) and 10(10C):**

The limit up to which the gratuity is exempt in case of non-government employees was fixed in the year 1997. The changes in the remuneration pattern

over the years and the rise in price level necessitates that the exemption limit of Rs. 3.50 lakhs should be **revised to Rs.10.00 lakhs**, in line with the limits of exemption with regard to amount received by a person under Government employment.

**Suggestion:**

**The exemption limit for Gratuity, Leave Salary and compensation under Voluntary Retirement scheme should be allowed at par for both Government and Non-Government employees.**

**10. Section 16(i):**

The **standard deduction for salaried employees** had been withdrawn a few years back. This has led to an unnecessary hardship for the salaried employees as they are not able to claim expenses incurred for the purpose of earning their salary. The raised exemption limit would also not be a much help in view of the high Consumer Price Index (CPI).

**It is suggested that the standard deduction be re-introduced to provide some relief to the salaried employees.**

**11. Definition of Salary under Rule 3 of Valuation of Perquisites on Houses**

The definition of Salary is kept very wide and even covers the terminal benefits paid to the retiring Employees. As HRA (Which is similarly taxable in the hands of Employees availing so is calculated and paid on Basic pay, the perquisites in case of allotted residential house to Employees should be taken on the Basic Pay. In case of retiring Employees terminal benefits like leave encashment etc being paid in the last phase of service should be excluded. Similarly on leased accommodation being provided by the company, should be based on the norm of population of the cities as done for company accommodation instead of taking flat 15 % of the total salaries & allowances.

**12. Exemption for Post hospitalization treatment for prescribed medical diseases**

Rule 3A provides exemption of medical Benefits from perquisite value in respect of medical treatment of prescribed diseases or ailments in Hospitals approved by Chief Commissioners. [Proviso to Section 17 (2) (vi)] of I T Act 1961.

Above Rule specifies about the treatment in respect of specified diseases in approved Hospitals but it is silent in respect of treatment of these diseases in the post hospitalization period especially in case of re-imbursement of expenses. Since these diseases require a costly post hospitalized treatment for a longer period, same should specially be included under Rule 3A (as tax free perquisites).

**13. Perquisites taxed in the hands of Employees for medical treatment**

As per clause (v) of proviso to section 17(2) (vi) of Income Tax 1961, sum paid for benefit of Employees or any member of his Family in respect of expenditure actually incurred by the employee on medical treatment (other than that mentioned in clause (i) and (ii) of the proviso in which cases no perquisite arises) is not a perquisite up to a limit of Rs. 15,000/-.

This limit was increased from earlier limit of Rs. 10,000/- to Rs. 15,000/- effective from AY 1998-99. In view of increased cost of medical facilities, above limit needs to be increased suitably at least up to Rs. 50,000/-.

**14. Exemption from the clubbing provisions u/s 64(1A)**

Salary Income of the Parent/Parents of a child/dependent who is mentally retarded should be exempt under section 10 of the Act. In case the Parents derive income from other heads only 50% of the Taxable Income (arrived at after allowing for all the deductions) should be subject to tax.

**15. Interest on Provident Fund Balance**

In case of Companies having Recognized Provident Fund, it is common practice that the employee keeps balance in PF Account even after retirement. As per the

provisions of income tax act, in case of recognized provident fund, the interest on PF balance is exempt only for the period ending with the date of retirement of the employee. Any interest credited in respect of period after retirement on the balance in PF account, the same is not exempt from income tax. However, the interest on PPF and GPF is exempt even in respect of the period after retirement.

**Suggestions**

**The interest on PF balance should be fully exempt irrespective of the fact that the same is given even for the period after retirement.**

**16. Deduction on account of payment of perks tax:**

Payment of Perquisite Tax by Employer should be allowed as deduction to the Company.

**PROFITS AND GAINS FROM BUSINESS OR PROFESSION**

**17. Environment protection related spend** should get weighted deduction in taxable profits computation. But such expenditure should be in line with the management accounting guidelines issued by ICWAI on environment accounting.

**18. Depreciation – Section 32**

At present, Depreciation at special rates are allowed for newly acquired/addition of Assets in relevant year. While normal Depreciation for additional fixed assets is given based on audited Accounts, claim of special rates require a lot of paper works/documentation, like date of ordering, purchase, acquisition, installation, commissioning etc. The department holds a view that the self constructed Assets need to be ***acquired and installed*** in the relevant previous year which is impractical. Therefore, a composite different rate of depreciation clubbing normal depreciation and depreciation at special rates should be allowed in the year of addition of new Assets without insisting on further documentation.

In view of the above, it is **recommended** that the general rate of depreciation for plant and machinery should be reduced to 15 per cent from the existing level of 25 per cent. We also recommend that the rates of depreciation for other blocks of assets must be reviewed along the above lines. Consequently, the depreciation amount charged for tax purposes will be similar to those charged under the Companies Act.

It is further suggested to have a uniform rate of depreciation, which shall replace he rates of depreciation on assets is applicable to both.

It is further suggested that to give a boost to the infrastructure development more particularly for the power sector, accelerated depreciation should be introduced on the power plant. This will be very helpful for fixation of tariffs also.

**19.** **(a) Green Buildings** as certified by authorized agencies should qualify for higher income tax depreciation.

**(b) The Corporates/Organisations which are not contributing towards environmental degradation by restricting the emission of CFCs may be rewarded through fiscal benefits.**

**20.** **Section 36(1) (viia)**

There is differentiation in the tax treatment for Indian and foreign banks resulting in lack of level playing field. The law should be amended to provide for deduction to foreign banks up to 7.5 % of the total income.

**21.** **Treatment of Peripheral Expenditure by PSUs/leading private sector organisations allowed as 100% Business Expenditure for Income Tax purpose.**

Due to increased corporate social responsibility for sustenance of Business, of late the PSUs/other organisations are spending sizeable amount on periphery development of adjacent villages as well as in the State. **Such expenditure on actual basis by PSUs/other organizations should be allowed as business expenditure of revenue nature for income tax calculation purpose.**

***22. Concession for Nano-Technology Industry***

After Information Technology and Biotech Industries, it is necessary now to promote industrial activity in Nano-technology. Therefore, **special deduction for investment in such industry may be introduced.**

**23. Remuneration to Working Partners - Section 40(b)**

There has been a wide spread demand by the professionals that the limits of the remunerations fixed for partners in section 40(b) of the Income-tax Act 1961 should be deleted since the taxability of the partnership firm has been brought at par with the limited companies. This amendment is all the more essential as in case of professional firms all the partners are working partners and there is no concept of a non working partner.

**24. Section 47 – Expansion of scope**

Taking into account the increased globalization of the Indian economy, and consequent holding of Indian assets by many foreign companies, the following transactions in respect of Indian assets should also not be regarded as transfer for the purposes of capital gains under section 47:

(a) amalgamation of a foreign subsidiary with foreign parent company;

(b) transfer by a foreign parent company to a wholly owned foreign subsidiary;

(c) transfer by a wholly owned foreign subsidiary to its foreign parent company;

provided that such transfer does not attract tax on gains in the country in which the transferor company is incorporated.

**We recommend that concessional treatment of long-term capital gains through a reduced schedule rate of tax must be abolished.** In other words, the long-term capital gains would be aggregated with other incomes and subjected to

taxation at the normal rates. Further, since we have recommended the abolition of various saving incentives, we do not consider necessary to allow any exemption for rollover of long-term capital gains.

**25. Ombudsman**

As recommended earlier by various Committees including Kelkar Committee, an institution of Ombudsman may be in the top ten taxpaying cities and all state capitals along the lines of Banking may be set up by the Government at the earliest to tackle the problem of refund of Taxes.

**26. Carry forward of business loss on amalgamation - Section 72A**

The benefit of set-off under Section 72A should be available to the amalgamated company in all amalgamations, and not merely to those specified companies.

**As recommended by the Kelkar Committee on Direct Taxes, the distinction between unabsorbed depreciation and unabsorbed business loss should be removed. In other words unabsorbed depreciation would be merged with business loss and lose its separate identity. Further, business loss would be allowed to be carried forward indefinitely.**

**27. Amendment to section 72A - Carry forward and set-off of losses in amalgamation**

The benefits of continuation of allow ability of brought forward business losses may be allowed to amalgamation of all types of banks.

The scope of section 72A may be expanded to cover all companies in the service sector.

In the light of Cost Accounting Standard 2 on Capacity Determination, which is mandatory, it is suggested that Rule 9(C) may be amended accordingly to include Cost Accountant to certify in Form No. 62, which if obligatory for the amalgamating companies.

**28. Section 80C: Eligible investments entitled for deduction.**

**The maximum limit should be raised to Rs. 2,00,000/- from the existing limit of Rs.1,00,000/-.** The provisions should include item no. 22 as "**principal amount of repayment of loan taken for higher education".**

**29. Section 80 E: Deduction for repayment of loan taken for higher education**

Besides interest on loan taken for higher education, deductible u/s 80E, the principal amount of loan repayment taken for higher education should be allowed u/s 80C.

**30. Section 80-IA**

a) The benefits under Section 80 IA of the Income Tax Act 1961, allows deductions to the undertakings engaged in infrastructure development, operation and maintenance of certain infrastructure facilities such as roads, port, airport, inland waterways, highways, housing, water supply, irrigation, sanitation, navigation Channel under sea etc.

b) Benefits under section 80 IA are also available to undertakings, which are engaged in generation, transmission or distribution of power, but in a restricted manner. In case of power, the benefits are available only to such undertakings, which are engaged in generation, transmission or distribution of power.

The difference in the above two provisions (a & b) is that, in the first case (a), the benefit is available to all undertakings, whereas in the second case (b), the benefits are available to only power generation, transmission and distributions companies and not to the turnkey contractors, who supply, operate or maintain the equipment.

To explain the difference further, the IT deduction under the first category is available to the developers in case of infrastructure projects, even if these projects are owned by the developers or not. That means that the benefit is also

available to the turnkey contractors, who are building or constructing these projects. The results of this benefit are clearly visible in the increased activity in these sectors.

However, similar upsurge of activity is not noticed in the power sector since, as explained above, the benefit is restricted and is not available to the contractors. Due to restrictive wording of the provision, these incentives are available only to the owners of the projects and not extended to developers (turnkey contractors), O&M agencies (who operate or maintain the equipments), as allowed for other infrastructure projects covered under this facility.

This is also clear from the Form No. 10 CCB under Income Tax Rules.

**Suggestions:**

a) **It is suggested that power generation, transmission and distribution business should be added to the list of infrastructure projects appearing under section 80 IA so that similar benefits provided to roads, highway projects, water supply projects, ports, airports etc. are also available to the power sector.**

   It is therefore requested that the benefits currently available only to the Utilities (owners of the projects) may also be provided to the developers and those engaged in operating and maintaining of such projects both in public and private sector.

(b) **The deduction facility under section 80 IA should at least be extended for such projects commissioned till 31st March 2012, keeping in mind the Government's Programme "Electricity for All at affordable cost by year 2012".**

(c) **The provisions of Section 65 (25b) of Finance Act 1994 should be extended to all power projects for availing service tax exclusions under infrastructure facility.**

The country has been facing an acute shortage of funds for infrastructure and power projects. It is therefore suggested that a scheme be introduced whereby the investment in such projects to a certain extent be accepted without any questions. This scheme can always provide some safeguards that investments are not made of the laundered money.

**31.** Definition for Charitable Purpose –section 2(15) of the IT Act.

The definition for charitable purpose has seen a vital change through Finance Act 2008 with a view to limiting the scope of the phrase "Advancement of any other object of general purpose utility", section was amended to the extent that exemption will not be available if it is engaged in the activity in the nature of trade, business or commerce or in an activity of rendering any service in relation to such trade, commerce or business for a fee or cess or any other consideration, irrespective of nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

It may be noticed that the provision is very widely worded and would cover in its ambit institutions which may really deserved to be included among charitable institutions but may have some income for supporting their cause, good enough to come under this mischievous provision. The Finance Bill should cover such institution by a suitable amendment under the Income Tax Act.

***32. Restoration of Section 80-O***

India has started witnessing an opening up for the services sector. It has created opportunities for Indian professionals like, Company Secretaries, Chartered Accountants, Cost Accountants and Engineers etc. to export professional services. India needs to launch frontal attack in order to capture professional service markets in other parts of the world while Indian market is likely to be opened to multi-national firms. India possesses avalanche of professional and services talent and Mode 4 of the GATS is likely to be the most popular Mode for export for Indian professional services. But it is necessary to boost Indian professional

services' market survey and market penetration abilities. Therefore, various Income Tax concessions are a call of the day for Indian professional services. One measure would be to restore 50% deduction that was available on export of professional services to the extent of convertible foreign currency brought in through such exports.

***33. 100% EOU for Professionals***

It is further essential that 100% EOU concept be brought in the arena of professional services. 100% EOUs for Cost Accounting services, Company Secretarial Services, Chartered Accountant services, knowledge based services, etc., may be created with relevant Income tax and Indirect tax benefits to such EOUs on the same lines as an STP unit. This would enable such professionals to form partnerships or open proprietary EOUs with a thrust on export market. No part of the services rendered by such EOUs be allowed to be rendered in the domestic market.

***34. Special deduction for Micro lending/ micro finance***

In order to help banks and financial institutions give micro credit/ finance to the rural poor, particularly women, without any requirement of any co-lateral security, for engaging in income generating activities, it is necessary to give income tax deduction for income from micro credit activities of banks and financial institutions or other financing agencies. This will help in reducing poverty levels in rural India.

**35. Entitlement to avail DTA benefit - Section 90**

The term "liable to tax" should be defined in Act (in section 90 and 91) to say that there should be tax laws in force in the other State, which provide for taxation of such person (i.e. being a "taxable subject" in that country), irrespective that such tax laws fully or partly exempt such person from charge of tax on any income in any manner.

**36. Foreign tax credit to permanent establishments of foreign branches Section 91**

The Act should contain enabling provisions allowing credit to a foreign company / its PE for taxes paid in other countries on incomes received by it from a third country and taxable in India. This provision can be beneficially used in the absence of such treaty or such provision in the Treaty.

**37. Procedure for granting tax credit available under DTA - Section 91**

Suitable amendment may be made in the Act requiring that rules in this regard may be prescribed. CBDT may, in its turn, formulate appropriate rules to provide the necessary documentation in connection with the claim and grant of credit for foreign tax paid by Indian companies.

**TRANSFER PRICING**

**38.** In case of transfer pricing computation under Section 92C of the Income Tax Act, 1961 the following methods are prescribed:

a) Comparable uncontrolled price method
b) Resale price method
c) Cost plus method
d) Profit split method
e) Transactional net margin method
f) Such other method as may be prescribed by CBDT.

Of the five methods prescribed so far, all the methods under serial nos. (c) and (d) are cost based and the computation will be possible only with the application of the cost accounting principles. In case of determination of transfer price, the application of Cost Accounting Standards 1 to 4 issued by ICWAI has been made compulsory by the Competition Commission in their draft regulation. CBEC has long back made the CAS 1 to 4 mandatory for compliance in connection with valuation under Central Excise laws. Keeping in view the correct revenue

assessment under Income Tax Laws as well as to facilitate the transfer pricing audit by the department, the Section 92C should be amended in such a manner that the adoption of Cost Accounting Standards as stated above are made mandatory and the transfer price so derived should be authenticated by a competent professional.

**39. Applicability of Transfer Pricing Regulations**

Applicability of transfer pricing regulations in respect of transactions like loans/ royalties/ technical collaborations entailing less than arm's length consideration

Where any services/goods/property are provided at concessional or NIL value by a foreign company to the Indian company, it should be provided that the foreign company would not be taxed (if the foreign company is taxable in India in respect of the transaction) on the basis of arm's length price. It is also suggested that such transactions should be specifically excluded from the ambit of the legislation.

**MINIMUM ALTERNATE TAX (MAT)**

**40. Deduction of depreciation or loss**

The explanation that depreciation does not include loss should be deleted and brought forward loss as per books should be allowed to be deducted.

**41. Section 44AB / 115JB**

It may be clarified that provisions relating to

(i) tax audit report under section 44AB;

(ii) MAT under section 115JB;

(iii) Transfer Pricing

should apply only to the payer and not to the recipient of presumptive income under section 115A/DTAs except that they shall be subject to such provisions where the Assessee is taxable on net-basis.

**42. Scope of Exemption from MAT**

It may be clarified that the exemption from MAT to a "developer" is available in respect of income arising from an undertaking or enterprise engaged in

(a) developing a SEZ,

(b) developing and operating a SEZ and

(c) developing, operating and maintaining a SEZ.

**43. Section 115JB (6)**

It may be clarified that the relevant income of entrepreneur or developer mentioned in section 115JB (6) shall be excluded while computing book profit under explanation to section 115JB (2).

**44. Long Term Capital Gains**

It may be provided that MAT paying Corporate Assesses who are hit by the amendment in section 115JB would be entitled to the credit of STT as tax paid.

**45. Section 115JB – Deferred Tax (MAT)**

There is a doubt whether debit to profit and loss account of deferred tax is liable to be added back, whether as part of "income –tax paid or payable and the provision therefore" or "as amount or amounts set aside to provisions made for meeting liabilities other than ascertained liabilities".

This issue may be suitably clarified.

Presently the Income Tax Act prescribes a procedure for getting a certificate in Form No. 29B by an Accountant as defined in section 288 of the Income Tax Act in respect of the working of the MAT as per the Income Tax Act. A Cost Accountant is eligible to practice and appear before the Tax Authorities. The Tax Auditors are to be appointed by the Management / Board of Directors. There are number of

corporates in India who engages the Cost Accountant to handle their tax cases upto the stage of the ITAT. It is therefore suggested that the suitable amendments should be brought into the legislation to include the Cost Accountants also to certify the Form 29B in respect of certifying the MAT working under the Income Tax Act.

## CORPORATE DIVIDEND TAX AND DEEMED DIVIDEND UNDER SECTION 2(22)(e)

**46. Bringing tax on deemed dividend under section 2(22) (e) on par with the Corporate Dividend Tax**

In order to bring parity between the various items of deemed dividend mentioned in section 2(22) it is suggested that dividend chargeable in the hands of the beneficial shareholders under section 2(22)(e) should also be charged at the rate of 15%.

**47. Section 115-O - Dividend Distribution Tax**

- Section 115-O (6) may be amended to provide the mechanism for computation of dividend which will be exempt from dividend distribution tax.

- The dividend distribution tax has been raised from 10% to 15% over the years. It is suggested that with a view to increase the liquidity of the companies and also enable the companies to distribute higher amount of dividend in view of the recent melt down in the market, the rate of such tax should be brought down to the original levy of 10%.

## FRINGE BENEFIT TAX

**48. (a) Fringe Benefit TAX (FBT) on Scholarship (50%)**

Scholarship has been brought under the ambit of FBT under 50% categories. Scholarships granted to meet the cost of Education, is exempted under section 10(16). Scholarship is given to the students who excel in their education for further pursuing higher education. This is also in line with the national policy of encouraging education. Misuse of exemption of such scholarship could be alternatively avoided by fixing a ceiling limit per student u/s 10(16) say Rs. 500 to Rs. 1000/- pm. Any sum paid beyond the provided ceiling limit may be brought under the purview of FBT. This is felt essential to ensure that genuine meritorious

students do not get deprived and only abnormal scholarship beyond the ceiling limit can be construed as tax avoidance and can be brought under ambit of FBT.

**(b) The following expenditure should not be subjected to Fringe Benefit Tax:**

- Expenditure on hospital and medical treatment of employees including reimbursement.
- Expenditure on townships maintained by the company.
- Expenditure on tours, travel including hotel accommodation in India.

**49. Deduction under Chapter VIA, for Contribution towards "Space Research" & "Aviation".**

Space Research is an upcoming area where Indian Scientists have an edge. The Government may consider specific tax benefits for Institute/s to be set up in private sector.

Aviation industry in India is facing acute shortage of qualified pilots. Therefore, the Institutes'/Corporates in private sector providing training to trainees for obtaining commercial pilot licence could be considered for similar tax benefits.

**50. Depreciation on Motor Cars**

Depreciation for purposes of FBT should be the depreciation on the individual assets subject to FBT and computed as per accounting standards.

## ASSESSMENT PROCEDURES

**51. E-filing v. Explanation to section 139(9)**

Provisions of the Act and the rules need amendment in view of the objectives of e-filing, particularly the ones referring to the defective return in Explanation to section 139(9).

**52. Reopening of Assessment**

Income Tax Act at present provides for re-opening of assessment even in such cases where the regular assessment has been completed. Further, even after completion of reopened assessment, the assessing officer can again reopen the already reopened assessment. Hence, there is no limit in reopening of assessment.

**Suggestions:**

Provision should be made in the income tax act so that where the assessment has already been completed u/s 143(3), reopening of assessment should be allowed only once.

**53. Additions in reopened Assessments**

As per the present practice in the income tax assessment relating to reopened assessments, the assessing officer takes permission for reopening of the assessment on the issue in respect of which the income has escaped assessment. However, while completed the reopened assessment the assessing officer makes additions for other items for which permission has not been taken. Further, additions are also made in respect of items which have already been considered and added to the taxable income by the assessing officer in the regular assessment.

**Suggestions:**

Amendment in the Income Tax Act is requested to provide for:

- The additions should be made only in respect of item of income/expenditure which has escaped assessment, for which the approval has been taken for reopening of the assessment.
- The item of income/expenditure which has already been considered in original assessment, should not be again reconsidered for further additions.

**54. Disallowance of Prior Period Expenditure**

At present if a company accounts for prior period expenditure and income, the assessing officer disallows the prior period expenditure. However, prior period income is taxed in the year in which it is accounted. So there is a different treatment for prior period expenditure and prior period income. It is normal practice in companies, that where the expenditure/income of earlier years comes to the notice of the company, the same is accounted in the year in which the same is known to the company.

**Suggestions:**

Amendment in the Income Tax Act is requested to be made for prior period expenditure as follows:

- Prior period expenditure should not be disallowed.
- If an item is treated as prior period and disallowed, the assessing officer should specify the year in which the same is allowable. Necessary amendment should be made to enable the assessing officer to reopen the assessment for earlier years on this issue only so that deduction can be given in that year.

**55. Disallowance of adjustments made due to change in Accounting Policy**

It is a normal practice in companies to change the accounting policy to bring in line with the standards issued by the Institute of Chartered Accountants of India. Wherever such changes are made and there is reduction in profit, the assessing officer adds the amount by which the profit has reduced. This is not justified since the change in accounting policy does not mean that the profit is underestimated. Further, whenever there is an increase in profit due to change in accounting policy, the same treatment is not given by the assessing officer.

**Suggestions:**

Whenever there is reduction in profit due to change in accounting policy and the accounting policy has been consistently followed in subsequent years, no addition should be made in the taxable income.

**56. The need for withdrawing section 145A in view of Accounting Standard 2 (Revised) - Valuation of Inventories becoming mandatory**

The complicated computation required for complying with the provisions of section 145A will not generate any extra revenue as the impact of section 145A is revenue neutral. Hence section 145A needs to be deleted.

**57. Section 154**

It may be clarified in section 154 itself (not withstanding Board Circular to the effect) that as long as the Assessee had made the application within the time of 4 years, restriction of time limit would not apply and amendments under the section can be made even after the period of 4 years.

Also, an option may be provided to the Assessee to appeal against the failure of the Assessing Officer.

Suitable mechanism may be put in place in the law to facilitate filing of appeal for the reasons explained in the suggestion in the context of section 154(8).

**58. Non-speaking Orders**

The Act may contain a procedure requiring the Assessing Officer:

(i) to state all the facts as brought on record by the assessee;

(ii) to give notice to the assessee of specific additions intended to be made and to allow reasonable time to meet his case.

(iii) to list all the case laws cited by the assessee in support of his case and giving reason(s) for not following it;

(iv) to state reason(s) for allowing lesser time to gather facts where such an application by the assessee is rejected.

This will save avoidable burden on appellate authorities.

## DEDUCTION OF TAX AT SOURCE

**59. TDS from provisions/liability created in the accounts:**

As per the provisions relating to deduction of tax at source, the Assessee is required to deduct tax even on the amount for which provisions has been made or liability has been created in the accounts. Normally, the provision in the accounts is made on estimated basis. The actual liability may differ from the amount provided in the accounts.

**Suggestions:**

Hence in the referred cases as above, the TDS should be deducted only at the time when the amount becomes due/payable.

**60. Section 192**

Section 192 may be amended to specifically provide that credit for foreign taxes on the salary is allowable to be set-off for computing the TDS obligation there under. As a safe guard, the certificate of accountant may be required in all such cases.

**61. Section 192 read with section 80G**

Section 192 was amended to allow the employer to net off, loss from house property to avoid the paper work relating to refund claims on account of interest on housing loans. Considering the above, similar amendment should be made to specifically allow the employer to consider all donations eligible for deductions under section 80G.

**62. Section 194-I v. section 194J on payment for equipment on hire**

The scope of tax deductible under respective sections may be clarified so far as they relate to payment for use of equipment.

**63. Withholding on Long Term Lease**

It may be clarified that lump sum payments for long term lease would not be covered within the ambit of section 194-I.

**64. Sections 10(13A), 80GG read with section 194-I**

The deduction under section 80GG has been specifically provided for furnished accommodation also. Also, tax under section 194-I is to be deducted (by specified persons) from any amount paid for use of any furniture and fittings.

Benefit under section 10(13A) should be specifically extended to include any payment made for the use of any furniture or fittings by the assessee.

**65. Section 194J**

The tax deduction at source from professional fee had been raised from 5% to 10%. This also has brought in untold difficulties for the professionals as the same has led to the decrease in cash flow of the professional firms. It is therefore suggested that the rate of deduction be brought to the earlier level of 5%.

**66. Incentive to the Tax Deductor**

The tax deductor may be given a credit of 5% of the tax deducted and remitted by him to the credit of the Central Government.

**APPEALS**

**67. Power to stay demand to be given to CIT (Appeals)**

A specific provision may be enacted in the Income-tax Act to give power to stay demand of tax to the Commissioner (Appeals).

**PROMOTING INDIA AS A FAVORABLE 'HOLDING COMPANY' DESTINATION**

**68. Underlying Tax Credit**

A mechanism, known as the allowance of underlying tax credit for the stream of dividend income may be adopted. In this scheme, credit is given by the country where the parent company is a resident, not only for the tax withheld at source on the dividend payout by the overseas subsidiary but also in respect of the tax suffered on distributable profits.

**Underlying tax credit = Gross Dividend / Distributable Profits x Actual Tax Paid on those profits.**

The underlying tax credit may be computed, in the case of an Indian parent company receiving dividend from more than one tax jurisdiction, by aggregating the gross dividend, distributable profits and actual taxes suffered on those profits in all such jurisdiction.

This would give an incentive for the flow of funds to the parent Indian company and it would also make them more competitive. Larger availability of funds may generate increased investments by these Indian companies and a source of more taxes for the country.

It can be provided that the underlying tax credit would be granted on dividends paid by a company provided at least 10% of its shares are held by an Indian company.

**69. Redressal Mechanisms – MAP and AAR (Administrative Reforms)**

It is suggested as follows: -

a. The administrative guidelines in respect of MAP (including stay on tax demands during their pendency) should be formulated in a clearer manner and communicated to the taxpayers.

b. Efforts should be made to reduce the time in resolving disputes in consultation with the other treaty partner countries.

The Authority for Advance Rulings has only one bench stationed at Delhi.

More benches of AAR may be constituted at any other place where the volume of work so justifies.

**70. Net of tax arrangements – Section 248**

The net effect of the amendment in section 248 is that in 'subject to tax' contracts, once the tax is deducted by the person making the payment, he shall not be eligible to file appeal against the said deduction, even though he does not agree with the Department's order for deducting tax at source. In such cases, the only option left will be for the recipient to file the return of income and claim refund. This may be addressed.

**WEALTH TAX ACT**

**71. Definition of House as per Wealth Tax Act.**

As per section 2 (ea) (i) (I) of the Wealth Tax Act, a House meant exclusively for the residential purpose and which is allotted by a Company to an Employee, Officer or Director of such Company whose gross annual salary is less than Rs. 5 lakhs shall not be treated as Asset. **This limit needs to be revised accordingly to keep it at par with the level of Salaries in present days.**

**72. Withdrawal of Education Cess & Surcharge:**

The **Education Cess & Surcharge** were introduced quite a few years back and they have outlived their utility. It is requested that the same be withdrawn.

***73. Inclusion of "Cost Accountants in Practice" in the definition of the term, "Accountant" given under Explanation to Section 288(2) of Income-tax Act, 1961***

A Cost Accountant in Practice is allowed to act as an Authorised Representative before the various authorities like, Company Law Board, Customs, Excise, Service Tax Appellate Tribunal, Securities Appellate Tribunal etc.

Since Cost Accountants are appearing before Income Tax Appellate Tribunal and Commissionerates, etc. therefore, it is required that they should be treated at par with other professionals like, Chartered Accountants etc. and be allowed to practise in the area of Income-tax. Cost Accountants, like Advocates and Chartered Accountants are governed by Code of Conduct enforced by a statutory professional body. Hence, they owe a bounden duty to render ethical and high standard services.

Your Honour may kindly consider the suggestion and give due recognition to the Cost Accountants by including them in the definition of the term **"Accountant"** given under Explanation to sub-section (2) of section 288 of the Income-tax Act, 1961.

A separate Memorandum in this regard is being submitted to the Honourable Minister of Finance, Government of India for favourable consideration.

**74. Advance Ruling (Chapter XIXB), Explanation to Section 245N (5)**

Advance Rulings involve valuation which is a domain of an expert. It is recommended Cost Accountants who are trained professionals having this expertise, should be included as an "Authorised Representative" by amending Sec.288 (2) of the Income Tax Act, 1961.

**NATIONAL TAX TRIBUNAL**

**75.** In the National Tax Tribunal Act, 2005, as amended in 2007, we request that section 13 of the said Act may be amended by inclusion of the words, "Cost Accountants in Practice" to act as an authorized representative according due recognition to cost accountants in Practice along with other professionals by inserting the words, "cost accountants", after the words, "one or more chartered accountants or" and before the words, "legal practitioners" in Sub-section (1).

Also, the definition of the term "Cost Accountant" be included in the Explanation by inserting a new clause (b) as given below and the proposed clause (b) be re-named as clause (c)—

*(b) a cost accountant within the meaning of the Cost and Works Accountants Act, 1959 (23 of 1959); or*

Cost Accountants in practice are authorized to appear and represent cases in, inter alia, Income Tax Appellate Tribunal, Customs, Excise and Service Tax Appellate Tribunals apart from appearing before the lower tax authorities in direct taxes, indirect taxes and service tax matters. Barring them to appear before National Tax Tribunal does a great injustice to Cost Accountants.

## CENTRAL EXCISE

### 1. Valuation

In numerous Central excise cases relating to the dispute over valuation, the Tribunal as well as the Supreme Court had directed that the valuation aspect for those specific matters, be verified for proper settlement. Therefore, it is suggested that the cases relating to valuation dispute should be brought under the purview of Section 14A of the Central Excise Act for verification before preferring appeal by the aggrieved party. This will minimize both the time and cost involved in prolonging the litigation process.

### 2. Capacity Determination

Government of India has notified for compulsory submission of Annual Installed Capacity Statement in form ER-7 by all assesses.

The Institute of Cost and Works Accountants of India has already formulated the Cost Accounting Standard-2, i.e. the Cost Accounting Standard on Capacity Determination. It is suggested that CAS-2 be made mandatory in line with CAS-4 i.e. Cost of Production for Captive Consumption which has already been made mandatory by CBEC. This will facilitate declaration of proper capacities and help revenue authorities to monitor actual utilization of capacities.

### 3. Ascertainment of principal inputs in compliance with Rule 9A of the CENVAT Credit Rules, 2004.

For submission of Form ER-5 and ER-6 involving the desired particulars about principal inputs, ascertainment of correct raw-material cost is essential. Unless total raw material cost is correctly ascertained, the value of each individual inputs used whether constitutes more than 10% of the raw material or not, cannot be measured.

Moreover, since ER-5 and ER-6 recognizes the relationship between inputs and outputs, the correct consumption of inputs for related outputs are required to be

correctly accounted for. In order to safeguard the revenue, detect any irregularities and evasion, CAS-7 i.e. Cost Accounting Standard on Material Cost issued by the ICWAI be made mandatory in line with CAS-4 i.e. Cost of Production for Captive Consumption which has already been made mandatory by CBEC.

**4. Large Tax Payer Units:**

Large Tax payer units have been given major concessions in respect of removal of inputs and capital goods without payment of duty and transfer of **CENVAT** credit. Removal of inputs and capital goods on which **CENVAT** credit has been taken, can take place under a simple transfer challan or invoice by sender unit to its other registered premises. The recipient unit enjoys the benefit of **CENVAT** credit as if the duty has been paid by the recipient unit itself. **This facility may be extended to the units paying more than 3 crores from PLA and all such transfers be brought under the preview of Section 14AA of the Central Excise Act for proper accounting and monitoring.**

**5. Merit rate of Excise Duty for Power Generation, Transmission & Distribution Equipments**

We appreciate the Govt. initiative to reduce the earlier general rate of Central excise to 14% and its recent further cut by 4%.

**Suggestions:**

Since the electrical industry supplies equipments for infrastructure Development of the country, till the time a uniform GST is implemented, 8% merit rate of Excise Duty should be imposed on all products supplied to Power generation, Transmission & Distribution projects. This will lead to reduction of project cost thereby enabling execution of more such projects within the available resources. Finally, this would also lead to lowering of the cost of electricity.

**6. General Excise Duty on clearance of Excisable Goods:**

Presently with effect from 24.02.2009, As per Notification No.4/2009-CE dt.24.02.2009, The General Excise Duty on clearance of Excisable Goods is payable @ 8 % adv. The manufacturers of Final Excisable Goods and providers of output taxable services are entitled to avail **CENVAT** Credit on inputs, input services and capital goods. The provisions in respect of availment and utilization of CENVAT credit have been detailed in CENVAT Credit Rules, 2004.

As per Rule 6 (1) of the CENVAT Credit Rules, 2004 , the CENVAT credit shall not be allowed on such quantity of input or input service which is used in the manufacture of [exempted goods or for provision of exempted services,] except in the circumstances mentioned in sub-rule (2).

As per Rule 6(2) of the CENVAT Credit Rules 2004 , a manufacturer of excisable and exempted goods and provider of taxable and exempted services is required to maintain separate accounts receipt, consumption and inventory of input and input service meant for use in the manufacture of dutiable final products or in providing output service and the quantity of input meant for use in the manufacture of exempted goods or services and take CENVAT credit only on that quantity of input or input service which is intended for use in the manufacture of dutiable goods or in providing output service on which service tax is payable

As per Rule 6(3) of the CENVAT Credit Rules 2004, the manufacturer of goods or the provider of output service, opting not to maintain separate accounts, has to pay amount equal to ten per cent of value of the exempted goods and the provider of output service has to pay an amount equal to eight per cent of value of the exempted services; as per Rule 6(3)(ii) of the CENVAT Credit Rules, 2004 (CCR-2004).

It is suggested that Rule 6(3) (ii) of CENVAT Credit Rules, 2004 be amended to make the payment of amount under exemption notification by a self declaration in a prescribed format duly certified by an independent professional recognized under Central Excise Act.

**7. Rule 6(5) of CENVAT Credit Rules,2004**

Rule 6(5) of CENVAT Credit Rules, 2004 permits manufacturer of excisable and exempted goods and provider of taxable and exempted services to avail CENVAT credit on certain input services, even though these services are common for manufacture of excisable and exempted goods and provision of taxable and exempted services. Generally the services covered in rule 6(5) are such that the utilization of the same cannot be segregated for various excisable and exempted activities. Certain more services also fall in the same category. It is suggested that Rule 6(5) of the CENVAT Credit Rules, 2004 be amended to include following services in its scope.

1. Advertising Agency's Services (section 65 (105) (e))
2. Business Auxiliary Service (section 65 (105) (zzb))
3. Business Support Service (section 65 (105) (zzzq))
4. Practicing CA Service (section 65 (105) (s))
5. Practicing CS Service (section 65 (105) (u))
6. Practicing CWA Service (section 65 (105) (t))
7. Registrar to an issue (section 65 (105) (zzzi))
8. Rent – a – cab operator services (section 65 (105) (o))
9. Renting of Immovable property (section 65 (105) (zzzz))
10. Tour Operator's service (section 65 (105) (n))
11. Works Contract Service (section 65 (105) (zzzza))
12. Information Technology (IT) Software services (section 65 (105) (zzzze))

The proposed amended Rule is given below.

*(5) Notwithstanding anything contained in sub-rules (1), (2) and (3), credit of the whole of service tax paid on taxable service as specified in sub-clause(e) (g),(n)(o) (p), (q), (r), (s)(t)(u)(v), (w), (za), (zm), (zp), (zy)(zzb), (zzd), (zzg), (zzh), (zzi), (zzk), (zzq)(zzzi) (zzr)(zzzq)(zzzz)(zzzza)and (zzzze) of clause (105) of section 65 of the Finance Act shall be allowed unless such*

*service is used exclusively in or in relation to the manufacture of exempted goods or providing exempted services.*

**8. Insertion of Section 14AB**.

**It is suggested that in order to have proper assessment and reconciliation with the periodic returns filed by the assessees an annual audited return be prescribed.**

Proposed Section is as follows-

(1) Every Person filing periodical return or statement under this Act or Rules made there under shall get its returns or statements audited by a professional as specified U/s 14A of the Central Excise Act, at such intervals and subject to such norms as may be specified in this behalf by the Government.

(2) Failure to submit the return shall be treated as failure to submit the returns or the statements, as the case may be and shall attract penalty as may be prescribed.

(3) The provisions of sub section (1) shall have effect notwithstanding that the accounts or returns or statements of the persons aforesaid have been audited under any other law for the time being in force or otherwise.

## CUSTOMS LAW

***(A) Amendment of regulation 6(a) of the Customs House Agents Licensing Regulations, 2004***

We suggest that Clause (a) to regulation 6 be amended by adding the word, "Cost Accountant" as an expert for better administration and to bring equity in recognition of experts.

**(B) Statement regarding the actual use of the imported materials**

Under rule 7 (b) of Notification 36/96 it is prescribed that the importer has to maintain a simple account indicating the quantity and value of goods imported, the quantity of imported goods consumed for the intended purpose, and the quantity remaining in stock, bill of entry wise and shall produce the said account as and when required by the concerned authority.

**It is suggested that the statement so required be kept ready with the assessees under certification by an independent professional. This shall facilitate timely and proper compliance.**

**(C) End use Certificate**

The present procedure involving certification of essential items by Central Excise authorities is very time consuming.

The items covered under notification No.25/99 are such that they can be effectively used only in the manufacture of the related end product. On many occasions, similar certificates will be required at Sea Customs and Air Customs. This will result in the delay in clearance of materials. The end result will be stock out position.

Therefore, self certification / Chartered Engineer's certification regarding the essentiality of the raw materials should be accepted.

**(D) Consignment Stock**

Suppliers or their authorized agents with Central Excise registration may be allowed to open Consignment Stock facility within the manufacturers' facility / near the place of import.

**(E) Structure of inverted custom duty on key inputs like: coal tar pitch, aluminium fluoride, carbon electrode paste furnace oil, synthetic flocculants, cryolite bath, carbon blocks & caustic soda**

The present duty structure for Aluminium industry is inverse in nature. While present custom duty on Aluminium metal is @ 5% ad valorem, custom duty on key inputs are higher than 5%.For instance, Custom Duty on inputs like CT Pitch **(Ch.2708.10 @ 10%)**, Aluminium Fluoride **(Ch.2826.12 @ 10%),** Carbon Electrode Paste **(Ch. 3801.3 @ 10%)** Furnace Oil **(Ch.2710.11 @ 10%)** Synthetic Flocculants **(Ch.3901.90 @ 10%)**, Cryolite bath **(Ch.2826.3 @ 10%**), Carbon Blocks **(Ch.8545 @ 7.5%)** and Caustic Soda, **(Ch.2815 @ 10%)** etc.

**Suggestion**

This situation of duty inversion needs to be re-structured by lowering duties on these inputs or by increase in the import duty rate of Aluminum Metal.

**(F) Anti dumping duty on caustic soda imported from any origin.**

Caustic Soda is a major input for production of Alumina and this single Input cost comes to 20-22% of total cost of production. The designated authority in Commerce ministry has recommended imposition of anti dumping duty on all imports of Caustic soda from China & Korea (major producers). Even though caustic soda has application in various fields like pulp & paper, news print, yarn, staple fiber, detergents, soaps, drugs & pharmaceuticals, it has got maximum application in Alumina. Considering limited indigenous production of caustic soda, custom duty was reduced to 10% in 2007-08 Budgets from 12.5%. Due to imposition of anti dumping duty, the producer of Alumina shall be severely affected.

Above anti dumping duty has been imposed based on representation of indigenous manufacturers of caustic soda and probably there is no contest by the exporting countries due to negligible import by Indian industry. As a result, due to imposition of Anti-dumping duty Aluminium industry in general shall suffer from high price.

**Suggestion**

There is need for immediate review & withdrawal of Anti-dumping duty on Caustic Soda, which is the major raw material for production of Alumina.

## SERVICE TAX

Service Tax introduced in the year 1994 has emerged as a major source of revenue for the Central Government.

In the budget of 2008-09 and interim budget of 2009-10, Government has introduced many important changes. Coverage of tax has been expanded to include many new services. At the same time scope of many services has been either widened or suitably clarified. There are important changes in legislative provisions concerning the administration of tax. Likewise CENVAT Rules have also been amended to introduce a new scheme of proportionate credit availment.

### *(A)* Transactions/ Services subject to VAT and Service Tax

There are a number of transactions, which are deemed to be sale under the Constitution of and subject to levy of VAT, whereas same transactions are being treated as a taxable service in India subject to service tax, e.g., comprehensive repair and maintenance services, construction services, intellectual property services, catering services, etc. This leads to double taxation in respect of the same transaction and it needs to be addressed in order to avoid the cascading effect of tax and reduce the transaction cost, as at present these two taxes cannot be set off against each other. The present situation with regard to such services could well be appreciated from the following instance:

**Situation**

- Mere license of brands (without transfer) is subjected to both sales tax by the State and service tax by the Union.

**Suggestion**

- Government should discuss issues with States in line with Supreme Court's Larger Bench judgment in ***BSNL vs. UOI (2006) 3STT 245(SC)*** and double taxation at Central and State levels should be avoided for all such transactions. Taxation of licensing in intellectual property rights by way of

sales tax and then again by the Union by way of service tax amounts to double taxation and increase in cost.

**(B) Grouping of Taxable Services**

There are many taxable services, which are similar in nature or provided by same person but have been classified separately. Therefore, similar services need to be clubbed together to avoid classification disputes, purpose of uniformity as well as to make it tax payer friendly, so that it is easy to file return etc. Last year, the Government has already initiated this by grouping telecommunication related services. However, there are some other instances also, which need consideration:

1. Insurance Related Services
    - i. General Insurance Services
    - ii. Life Insurance Services and
    - iii. Insurance Auxiliary Services
2. Traveling Services
    - i. Air Travel Agent Services
    - ii. Tour Operator Services
    - iii. Rent a Cab Services
    - iv. Rail Travel Agent Services
    - v. Travel Agent Services
    - vi. International Air Travel Services and
    - vii. Transport of Person by Cruise Ship Services
3. Transport Services
    - i. Transport of Goods by Air Services
    - ii. Transport of Goods by Road Services
    - iii. Transport of Goods through Pipeline Services and
    - iv. Transport of Goods in a Container by Rail Services

4. Consultancy Services

   i. Consulting Engineer Services

   ii. Architect Services

   iii. Management Consultant Services

   iv. Chartered Accountant Services

   v. Cost Accountant Services

   vi. Company Secretary Services and

   vii. Scientific and Technical Consultant Services

5. Convention, Mandap Keeper, Dry-cleaning, etc. Services may be grouped under one category say, Hotel Services.

6. Photography, Video Tape Production, Sound Recording Services, etc.

**(C) Other matters**

**1. Exemption of service tax on port services.**

It is an established law that all goods meant for export are excluded from the scope of levy of any tax or duty. Accordingly, export cargo handling services exempted from payment of service tax. But the department is taking a stand that port services covers all service in relation to goods and vessels and therefore, such services are more specific to port and attract service tax.

**Suggestion**

Since, any goods meant for export is excluded from levy of tax or duty, accordingly, the port services relating to export cargo should be exempted from payment of service tax**.**

**2. Installation and Commissioning Services:**

The installation and commissioning services were brought under tax net with effect from01/07/2003. The scope was extended by covering erection within the ambit with effect from 10/09/2004. On the same day, commercial and industrial construction

services were also brought under tax net. From 01/06/2007, a new category was introduced under works contract service. These three services are extensively used in setting up of the power projects.

In respect of commercial and industrial construction service, Section 65 (25b) specifically excludes services provided in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams. Similarly, the section 65(105)(zzzza), under works contract service, excludes the services rendered in respect of roads, airports, railways, transport terminals, bridges, tunnels and dams. In addition to the above statutory provisions, notification no. 16/2005 ST, dated 07/06/2005, exempts construction services in respect of port or other port from the whole of service tax leviable thereon under section 66 of the Finance Act, 1994. Further, notification no. 17/2005 ST, dated 07/06/2005, exempts the activities of site formation and clearance, excavation and earthmoving and demolition and such other similar activities provided to any person by any other person in the course of construction of roads, airports, railways, transport terminals, bridges, tunnels, dams, ports or other ports, from the whole of service tax leviable.

The Government has given special emphasis to the power development programme during the 11th and 12th plan periods. It is unfortunate that, in spite of power projects being of national importance and considering an ever increasing demand-supply gap, similar benefits have not been extended to the power sector at par with other infrastructure businesses stated above.

**Suggestions:**

a) It is suggested that power generation, transmission and distribution business should be added to the list of infrastructure projects appearing under section 80 IA so that similar benefits provided to roads, highway projects, water supply projects, ports, airports etc. are also available to the power sector.

   It is therefore proposed that the benefits currently available only to the Utilities (owners of the projects) may also be extended to the developers and those

engaged in operating and maintaining of such projects both in public and private sector.

(b) The deduction facility under section 80 IA should at least be extended for such projects commissioned till 31st March 2012, keeping in mind the Government's Programme "Electricity for All at affordable cost by year 2012".

(c) The provisions of Section 65 (25b) of Finance Act 1994 should be extended to all power projects for availing service tax exclusions under infrastructure facility.

**3. Development of merchant power plants:**

All additions to generating capacity are to be welcomed. There is a direct correlation (nearly 1:1) between generating capacity addition and the country's GDP growth, as brought out in the Integrated Energy Policy. The entire capacity addition cannot come from the State Projects alone, nor from mega coal plants and nuclear plants. Private investment is a must, so also load centre based, non-coal/nuclear decentralized generation. However, the prevailing duty & tax structure in India prevents such private merchant power plants from getting a credit or offset of duty & tax paid on input costs, both capital side as also on fuel and operational expenses. This imposes a heavy financial burden on the price of electricity generated at such merchant power plants that use fuels such as liquid fuels (furnace oil, residual fuel oils etc) or natural gas. The impact of such taxes and duties, on project cost and operating costs, together can be as high as 80 paise per kWh, an unaffordable and unnecessary tax/duty loading by any standards.

**Suggestions:**

It is suggested that the Govt. should evolve a mechanism whereby such duty & tax loading be eliminated on generated electricity, a commodity that is becoming increasingly in focus for development of the economy.

**4. Valuation of Taxable Services**

Consequent upon inter-sectoral adjustment of CENVAT credit and in the cases of composite contract for ascertainment of correct quantum of service components and goods components, the section 14A of the Central Excise Act be extended to the field of service tax. This will avoid, reduce the disputes over valuation in service tax cases and will enable savings of time and cost for both the assessee and Revenue.

**5. CENVAT Credit**

The cases relating to the dispute over use, availment and utilization of CENVAT credit which are under the process of litigation, be brought under a similar provision as under section 14AA of Central Excise Act before preferring further appeal by the aggrieved party.

This will minimize both the time and cost involved in prolonging the litigation process.

**GENERAL SUGGESTION**

**(1) Abatement**

With effect from 1st March 2006, there is a significant change in the policy whereby a service provider claiming the abatement is not allowed to take the Cenvat Credit benefit even for the service tax he is paying to the sub-contractor. This change has affected both the industry as well as the consumer adversely and transaction cost has increased because of the tax paid at many stages without any Cenvat benefit. This also appears to be against the overall policy of the Government and the Cenvat Scheme, therefore, this policy needs to be reviewed and credit of service tax paid to sub-contractor or other input services may be allowed to the assessee availing the abatement benefit.

**(2) Complexity in the Definitions under Service Tax Law**

There are many taxable services, which have been defined in such a manner that it leads to different interpretations and there is no certainty about the coverage and scope of the taxable services, which has led to the disputes like goods transport services are treated as courier services because there is a delivery of goods at the door of customer. Even though both services apparently appear to be different but the definitions of both the taxable services is as such which can be interpreted in such a manner that a goods transport service can be treated as a courier service. Similarly, a cargo handling service includes packing & unpacking, loading & unloading of a cargo, whereas in case of goods transport services, loading and unloading is an incidental part but sometimes the same have been treated as part of cargo handling services. Not to be mentioned, there is a total confusion about the coverage and scope of auxiliary services and business support services. Therefore, there is a need to review the definition of all the taxable services to define the same in a more logical way, to bring clarity about the coverage and the scope of taxable services.

**(3) E-payment of Taxes**

To avoid the confusion, the scheme of e-payment should clearly spelt out whether the payment of tax criterion is applicable after taking into account the Cenvat Credit or before and whether the payment of all branches separately registered will be clubbed together.

**(4) Time of Tax Payment**

All assessees under service tax have been allowed only 5 days to make the service tax payment and moreover for the month of March also, no extension time is permitted for making the payment. These provisions are very harsh for the small tax-payers, those who are not having the computerized system as well as not enough manpower. At least for the tax-payers whose tax liability is not more than a certain amount say Rs.1 lac per month or Rs.10 lacs in a year, the relaxation should be given for making the payment from 5 days to 15 days.

**(5) Revision of Returns**

To avoid the dispute, the specific provision need to be inserted under what circumstances and within what time an assessee is allowed to revise his return. Every taxation law permits the assessee on a bonafide ground to rectify his own mistake and even the service tax law was having the provisions prior to the 16th October 1998. Specific provisions in this regard will bring the certainty and of course will avoid the disputes.

6. There is a provision in CENVAT credit rules which allows the full CENVAT credit on Capital Goods purchased when it is used both for manufacture of both dutiable & non-dutiable goods. This provision is widely misused by the assessees. For example, suppose an assessee manufacture goods worth Rs.1 crore but Rs.80 lakhs worth is non-dutiable, allowing full credit to such assessee is not justified. To avoid such occurrences of misuse, this provision can be extended only to those assessees whose dutiable turnover is more than 50% of the total turnover. In case their dutiable turnover is less than 50% of their total turnover, capital CENVAT utilization can be restricted to some %, say, 25%.

7. As per the existing provisions of the law, audit of an assessee is done by both Internal Audit wing of the Commissionerates as well as by C&AG. This is unwanted as both are government agencies; there should be co-ordination between them so that only one agency audits the assessee during a year.

8. There should be more systematic use of Desk Review and Section 14A & 14AA audits, which provide an independent assessment of the revenue generation for indirect taxes.

9. Value addition criterion as mentioned in the notification for region-based exemption needs to be certified by practicing cost accountants, since it has been seen that more refund is granted without proper verification of value addition norms.

**SPECIAL ECONOMIC ZONE**

1. Developer, co-developer and units, their contractors and sub-contractors are permitted to procure duty-free imported goods and duty-free indigenous goods. The supplies of indigenous goods are also entitled for export incentives like DEPB/DRAWBACK/DEFIA and advance authorization. At present, 3 months average requirement is approved by the unit approval committee headed by development commissioner based on chartered engineer's certificate and consumption report is required to be certified by independent chartered engineer. The present practice needs to be changed for approval based on the chartered engineer's certificate and required to be certified jointly by chartered engineer and cost accountant. Since specified exclusive officer and authorized officer have not been posted in each of the SEZ, there are high probabilities of transferring the duty free materials in DTA in absence of such certification,. Moreover it requires the skill set and uniformity can be checked and this needs to be done immediately otherwise black ships in SEZ will mis-utilize the scheme and good scheme of SEZ may be withdrawn due to high risk of evasion.

2. SEZ units are not required to submit consumption report and also not subjected for consumption within the SION norms and therefore the parallel provisions at par with EOU with respect to be brought in and such consumption report and input output norms required to be certified by independent cost accountants.

3. SEZ units are subjected for payment of service tax and thereafter apply for refund. This causes the additional cost and additional transaction time. Therefore, services rendered to the SEZ to be treated at par with export of services and should be exempted, which is line with the Sec 51 of the SEZ Act.

4. Services provided by SEZ units are subjected to be taxed whereas it should be treated at par with import of services and the service tax are required to be recovered based on reverse charge basis.

5. Whenever SEZ Developer, co-developer and units, their contractors and sub-contractors are returning the material or disposing of the surplus material in DTA, they are required to pay only duty forgone amount. However, there is no mechanism to check the same and therefore periodical returns to be introduced which needs to be certified by independent cost accountants.

## GOODS AND SERVICE TAX

GST is "a further significant improvement – the next logical step -towards a comprehensive indirect tax reforms in the country". It can pave the way for modernization of tax administration -making it simpler and transparent – and significant enhancement in voluntary compliance.

However, the benefits of GST are critically dependent on a neutral and rational design of the whole structure. The issues require much research and analysis, deft balancing of conflicting interests of various stakeholders, and full political commitment for a fundamental reform of the system.

The introduction of GST from April, 2010 with taking care of the difficulties faced in administering the VAT in India, the Process of Indirect Tax Reforms initiated by the Central Government during last few years will be achieved to a great extent.

ICWAI can offer major contribution in the formulation of the policy document, smooth implementation and administration of GST in association with the Government to augment the interest of the Revenue.