

## **Changes made in Finance (Bill) No. 2, 2014 as passed by the Lok Sabha**

The Lok Sabha on Thursday, the 24th of July, 2014 approved of certain changes made in the Finance (Bill) No. 2, 2014. The Finance Bill as approved by the Lok Sabha has clarified certain doubts on the taxability of unlisted shares and units of Mutual Funds during the transition period between April 1, 2014 and July 10, 2014 and has introduced new provisions to give effect to the statement given by the Hon'ble Finance Minister on the floor of the house. Mr. Arun Jaitley in his budget speech given on July 10, 2014 in the Parliament had said as under:

*“I propose to enable resident taxpayers to obtain an advance ruling in respect of their income tax liability above a defined threshold. I also propose to strengthen the Authority for Advance Rulings by constituting additional benches. I further propose to enlarge the scope of the Income-tax Settlement Commission so that taxpayers may approach the Commission for settlement of disputes.”*

The list of changes made in the Finance Bill are as under:

- 1) Unlisted securities and units of MF transferred between 01-04-14 and 10-07-14 shall be deemed to be long-term capital assets, if held for more than 12 months.
- 2) Long-term Capital Gains on Units of Mutual Funds transferred between 01-04-14 and 10-07-14 shall be taxable at 10% without indexation.
- 3) A third proviso has been inserted in Section 92C to provide that where more than one price is determined by the most appropriate method, the arm's length price shall be computed in such manner as may be prescribed. Accordingly, the provisions of first and second proviso (arithmetic mean and tolerable range) shall not apply.
- 4) Taxpayers can approach Settlement Commission even for pending re-assessment cases.
- 5) Resident taxpayers can approach Authority for Advance Ruling.
- 6) Changes are aimed at strengthening Authority for Advance Ruling.

A Brief of the changes made is given hereafter:-

### **1. Unlisted securities and units of MF transferred between 1-4-2014 and 10-7-2014 shall be deemed to be long-term capital assets, if held for more than 12 months:**

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It is proposed that unlisted shares and units of a mutual fund (other than Equity oriented mutual fund) shall be categorized as long-term capital assets only if they are held for more than 36 months.

The existing provision requires holding them for a period of more than 12 months so as to categorize them as long-term capital assets.

So, only a security listed on stock exchange as well as units of equity oriented fund held by an assessee for more than twelve months shall be considered as 'long-term capital assets'.

The Finance Bill, 2014 as passed by the Lok Sabha has inserted a new proviso in section 2(42A) to provide that the unlisted shares and units of a Mutual Fund shall continue to be deemed to be long-term capital assets if they have been transferred during the period from April 1, 2014 to July 10, 2014 after holding them for a period of more than 12 months (instead of more than 36 months). This proviso shall be inserted w.e.f. April 1, 2015.

## **2. LTCG on Mutual Fund Units transferred between 1-4-2014 and 10-7-2014 shall be taxable at 10% without indexation:**

Long-term Capital Gains on mutual funds (other than equity oriented mutual funds) are proposed to be taxed at the rate of 20%. Accordingly, option to pay tax at the rate of 10% (without indexation) would not be available in case of long-term capital gain arising from sale of such units.

However, the Finance Bill, 2014 as passed by the Lok Sabha provides that the benefit of the proviso shall continue to be available for the long-term capital assets, being units of Mutual Funds, transferred between April 1, 2014 and July 10, 2014. Thus, the assessee shall have an option to pay tax at lower of following rates if units of Mutual Funds are transferred between the said periods:

- a. At 10% of capital gains as computed after reducing the cost of acquisition without indexation
- b. At 20% of capital gains as computed after reducing the indexed cost of acquisition

The Finance Bill, 2014 provided that the amendments to section 112 will take effect from Financial Year 2014-15. This raised doubts among investors regarding the retrospective effect of the provision to tax the units of Mutual Funds (other than equity oriented mutual funds) redeemed during period April 1, 2014 to July 10, 2014. Thus, a proviso has been inserted for the transitional period to allow benefits of concessional tax rates during the aforesaid period.

## **3. Determination of Arm's Length Price when more than one price is determined by most appropriate method:**

Under the existing TP regulations, where more than one price is determined by most appropriate method, the arithmetic mean of all such prices is taken for determination of arm's length price with a tolerable range of +/- 3% or +/- 1%, as the case may be.

The application of this methodology has been one of the reasons for TP litigations among taxpayers and revenue. Thus, to address this issue, Finance Minister in his budget speech proposed use of range for determination of arm's length price, where adequate number of comparables are available in the benchmarking set. However, the Finance Bill as presented in the House on July 10, 2014 did not include any clause to address this issue.

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Accordingly, the Finance Bill as approved by Lok Sabha has inserted a third proviso in section 92C to provide that where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction shall be computed in such manner as may be prescribed. With introduction of the new mechanism the provisions of first and second proviso (arithmetic mean and tolerable range) shall not apply. This proviso shall be inserted w.e.f. April 1, 2015.

#### **4. Taxpayers can approach Settlement Commission even for pending re-assessment cases:**

As per section 245C of the Act, an assessee may apply to Settlement Commission for settlement of cases at any stage of a case relating to him. The term 'case' as per section 245A(b) shall mean any proceeding for assessment which may be pending before an Assessing Officer on the date on which application is made before Settlement Commission.

Before June 1, 2007 an assessee was allowed to apply for settlement of cases even when the proceedings for re-assessment were pending before the Assessing Officer. Subsequently, Finance Act, 2007 restricted the scope of the provisions by providing that an assessee shall not be allowed to make the application before the Commission during the pendency of reassessment proceedings or during pendency of proceedings of making fresh assessment where original assessment was set aside.

Finance Act, 2007 inserted a proviso for the purpose of section 245A(b) to provide that proceedings for reassessment or fresh assessment where original assessment was set aside shall not be deemed to a proceeding pending before the Assessing Officer. Consequently, a taxpayer was not able to file an application for settlement of cases in cases where reassessment was pending before the Assessing Officer. Effectively, the scope of the term 'case' for which an application could be made was curtailed by the Finance Act, 2007.

The Finance Minister during his budget speech has proposed to enlarge the scope of the Income-tax Settlement Commission so that taxpayers could approach the Commission for settlement of disputes. Accordingly, the Finance Bill, 2014 as passed by Lok Sabha has deleted the proviso which restricted the scope of the term 'case' to the pending assessment cases only. Such amendment would reinstate the existing position wherein an assessee can apply for settlement of even those cases which are pending for re-assessment proceedings. The changes in the provisions shall take effect from October 1, 2014.

Similar changes have been made in Wealth-tax Act as well for settlement of cases.

#### **5. Resident taxpayers can approach Authority for Advance Ruling:**

As per the existing provisions of section 245N(a), the term 'Advance Ruling' shall mean:

- (a) A determination of any question of law or fact arising out of a transaction which has been undertaken or is proposed to be undertaken by a non-resident applicant;
- (b) A determination of any question of law or fact by the Authority in relation to tax liability of a non-resident arising out of a transaction which has been undertaken or is proposed to be undertaken by a resident applicant with such non-resident;
- (c) A determination or decision by the Authority in respect of an issue relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal

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and such determination or decision;

- (d) A determination or decision by the Authority, whether or not an arrangement, which is proposed to be undertaken by any person, being a resident or a non-resident, is an impermissible avoidance arrangement as referred to in Chapter X-A (GAAR) or not (applicable from 1-4-2015).

Currently, an advance ruling can be obtained for determining the tax liability of a non-resident. This facility is not available to resident taxpayers, except Public Sector Undertakings. Thus, the Finance Minister proposed, in his budget speech to extend the scope of advance ruling so as to enable resident taxpayers to obtain an advance ruling in respect of their income-tax liability above a defined threshold.

Accordingly, section 245N(a) is amended to provided that the term 'Advance Ruling' shall mean a determination by the authority in relation to the tax liability of a resident applicant arising out of a transaction undertaken or proposed to be undertaken by him. Further, the meaning of the applicant has been amended so that the Central Government may notify the class of resident persons for the purpose of obtaining the advance ruling.

## **6. Changes aiming at strengthening Authority for Advance Rulings ('AAR')**

The Finance Minister, Sh. Arun Jaitley, in his budget speech had said that additional benches of AAR would be constituted for strengthening the AAR. Thus, following amendments have been made to the Finance Bill as approved by the Lok Sabha under section 245-O in order to strengthen the AAR:

- a. **Increase the strength of members of AAR:** The existing provision provides that the AAR would only consist of three members, namely, a Chairman, an officer of Indian Revenue Service and an officer of Indian Legal Service. The amendment provides for additional appointment of Vice-Chairmen as member of AAR. Further, Central Government has been empowered to appoint such number of Vice-Chairmen, revenue members and law members as it deems fit.
- b. **Eligibility criteria for appointment of members of AAR:**
- (i) **Chairman:** As per the existing provision a person who is a retired judge of the Supreme Court can be appointed as Chairman. The Finance Bill, 2014 as passed by the Lok Sabha provides that only a person who has been a judge of the Supreme Court would be eligible for appointment as Chairman.
  - (ii) **Vice-Chairman:** It is provided in the Finance Bill, 2014 as passed by the Lok Sabha that a person, who has been a Judge of a High Court, can be appointed as a Vice-Chairman.
  - (iii) **Member of IRS:** The existing provision provides that an officer of IRS who is qualified to be a member of CBDT is eligible for appointment as member of AAR. The new provision provides that a revenue member from IRS, who is a Principal Chief Commissioner or Principal Director General or Chief Commissioner or Director General of Income-tax is eligible for appointment as member of AAR.
  - (iv) **Member of Indian Legal Service:** The existing provision provides that an officer of Indian legal service, who is or is qualified to be an additional Secretary to the Government of India, is eligible for appointment as member of AAR. The new provision provides that a law member from IRS, who is an Additional Secretary to the

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Government of India, is eligible for appointment as member of AAR.

- (v) **Additional benches of AAR:** The existing provision does not provide for constitution of benches of AAR at various locations. It merely provides that office of AAR shall be located in Delhi. The amended provisions provides as under:
- The office of AAR shall be located in Delhi and its benches shall be located at such places as Central Government may specify.
  - Further, benches of AAR have been given authority to exercise power and functions of AAR and it has been further provided that such benches would consist of Chairman or the Vice-Chairman and one revenue member and one law member.

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