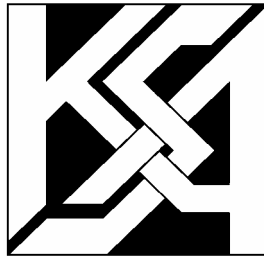


UNION BUDGET 2006 – AN OVERVIEW



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① INTRODUCTION

The Hon'ble Finance Minister, Shri P. Chidambaram presented the Union Budget for the Financial Year 2006-07 and the Finance Bill, 2006 before the Parliament (Lok Sabha) on 28th February 2006. This is the third budget of the United Progressive Alliance (UPA) Government since it assumed power in India in May 2004. As expected, the economic objectives laid down in the National Common Minimum Programme (NCMP) of the UPA Government continue to provide the foundation in formulating this budget.

In keeping with the thrust areas of NCMP, the budget has focused on agriculture, employment promotion, investment growth, and infrastructure augmentation such as power generation, ports, airports and rural roads. Accordingly, major budgetary allocations have been made for eight flagship programmes of the UPA government, namely,

- ❖ Sarva Siksha Abhiyan
- ❖ Mid-Day Meal Scheme
- ❖ Rajiv Gandhi Drinking Water Mission
- ❖ Total Sanitation Campaign
- ❖ National Rural Health Mission
- ❖ Integrated Child Development Services
- ❖ National Rural Employment Guarantee Scheme
- ❖ Jawaharlal Nehru National Urban Renewal Mission

In a robust demonstration of its nascent strength, the Indian economy is projected to grow at 8.1 % in the current year 2005-06 as against the growth rate of 7.5% for the previous year. Although, the inflation in most parts of the world showed a rising tendency on account of rising global crude oil prices, in India, inflation declined from 5.7% on April 2, 2005 to a low of 3.3% on August 27, 2005. However, inflation saw a rise post August 27, 2005 but prices have remained at comfortable levels with the WPI-inflation at 4.1% on February 4, 2006 vis-à-vis 5.0% on February 5, 2005.

The growth of the Indian economy is very well reflected in the remarkable buoyancy of the capital market. Recently, the Bombay Stock Exchange Index (BSE Sensex) crossed the unprecedented barrier of 10000 and continues to be maintained above that level. Foreign investors have shown a keen interest in Indian Capital Market, which is manifest in the growing inflow of funds entering the capital market.



According to the Economic Survey for 2005-06 presented by the Finance Minister, the growth trend for the last three years appears to indicate the beginning of a new phase of cyclical upswing in the economy from 2003-04. The initial momentum to this new phase of expansion, in 2003-04, was provided by agriculture, though in later years performance of this sector remained subdued. In contrast, industry and services have continued to expand steadily. These sectors have acted as the twin engines propelling overall growth of the economy. The industrial resurgence is manifest in the projected step up in its growth to 9% in the current year, which is driven by robust performances from manufacturing and construction sectors. The services sector growth continued to be broad-based. Among the three sub-sectors of services, 'trade, hotels, transport and communication services' continued to lead by growing at a double digit rate. Growth in financial services also maintained the momentum with progressive maturing of Indian financial markets and the ongoing construction boom. It is remarkable that this growth has been achieved despite the impact of extraordinary natural calamities suffered during the last year.

The budget estimate of the fiscal deficit for the fiscal year 2006 – 07 stands at 3.8 % of GDP as against 4.3 % as per the revised estimate for the fiscal year 2005 – 06. In absolute terms, the total fiscal deficit is estimated at Rs.1,48,686/- crores (US \$ 33.79 billion) for the year 2006 – 07.

This booklet is meant to apprise our esteemed clients of the important budget proposals mainly in the field of direct taxes while an attempt has been made to cover indirect taxes also. We offer a broad outline of the major proposals.

+The changes proposed in the Finance Bill on direct taxes become effective from the Assessment Year (A.Y.) 2007 – 08, i.e. the financial year beginning on 1st April 2006, unless otherwise stated.



② BUDGET HIGHLIGHTS

Direct Taxes

- ✓ No change in personal tax rates / slabs or rates of surcharge and education cess
- ✓ No change in corporate tax rates and rates of surcharge and education cess except increase in MAT from 7.5% to 10%
- ✓ Securities Transaction Tax (STT) increased by 25%, across the board for all transactions.
- ✓ 1/6 Scheme of filing income tax returns abolished
- ✓ Term deposit of 5 years or more with a Scheduled Bank to qualify for deduction u/s. 80C
- ✓ Limit of Rs.10,000/- for contribution to Pension Funds u/s. 80 CCC raised to Rs.1,00,000/-
- ✓ Fringe Benefits – Reliefs and Exemptions:
 - Value of Fringe Benefits reduced to 5% in respect of –
 - Tours and Travel
 - Hospitality, Use of Hotel, Boarding & Lodging facilities in the case of Shipping Industry and Airline Companies
 - Expenses now exempt from FBT –
 - Fees paid to Brand Ambassador and Celebrity Endorsement
 - Distribution of free samples of medicines or medical equipments to doctors
 - Employers contribution to Superannuation Fund upto Rs. 1,00,000/- per employee.
- ✓ Anonymous donations to charitable trusts/institutions other than religious trust/institutions will now be taxed at 33.6%
- ✓ Long Term Capital Gains from Securities and depreciation on revaluation of assets will now be included in Book Profits u/s. 115JB
- ✓ Assessing Officer can now compute proportionate expenses incurred for earning exempt income as per prescribed guidelines



- ✓ Tax holiday u/s 80 IA for Industrial Parks set up up to 31/3/2009 and for Power Projects becoming operational by 31/3/2010.
- ✓ Income of Co-operative Banks will now be chargeable to tax
- ✓ Exemption u/s. 10(23G) for income from investment in infrastructure projects removed
- ✓ Close-ended equity oriented Mutual Funds now exempt from dividend distribution tax
- ✓ Investments in Nabard, NHB, Sidbi bonds no longer eligible for exemption from LTCGs; only NHAH and REC Bonds will be eligible
- ✓ Issue of PAN suo moto by Income Tax Authorities,
- ✓ To widen the tax net, disclosure of PAN made mandatory for more transactions to be specified in due course.
- ✓ Scheme for Filing of tax returns through 'Tax Pre-parers'

Indirect Taxes

- ✓ Peak rate of Customs Duty for non-agricultural products reduced from 15% to 12.5%.
- ✓ Special additional duty of customs of 4% now extended to cover all imported goods – agricultural as well as non-agricultural imports, jewelery being 1%
- ✓ Customs Duty on alloy steel and primary and non-secondary non-ferrous metals reduced to 7.5%
- ✓ Import duty on steel melting scrap restored to 5% at par with primary steel
- ✓ Customs duty on mineral products reduced to 5% with a few exceptions
- ✓ Customs duty on ores and concentrates reduced to 2%
- ✓ Customs Duty on Refractories and inputs for refractories reduced to 7.5%
- ✓ Excise duty on small cars reduced to 16%
- ✓ Concessions from Customs Duty to specified vital drugs – exemption from excise duty and CVD
- ✓ Customs Duty on Vanaspati increased to 80%



- ✓ Duty on Packaging machines reduced to 5%
- ✓ Duty rates on clearances by EOU to DTA at 25% of basic customs duty plus excise duty on like products
- ✓ Concessional Project rate of 10% to pipeline projects for transportation of natural gas, crude petroleum and petroleum products
- ✓ Excise duty on aerated drinks reduced to 16%
- ✓ Packaged Software to attract excise duty of 8%
- ✓ Computers to attract duty of 12%
- ✓ LPG (domestic) to be included in the list of 'Declared Goods' under CST
- ✓ Excise Duty on Cigarettes increased by 5%
- ✓ Excise Duty on all man-made fibre yarn and filament yarn reduced to 8% and import duty reduced to 10%
- ✓ DVD Drives, Flash Drives and Combo Drives fully exempt from excise duty
- ✓ Decrease in Excise Duty for certain food items
- ✓ Decrease in Excise Duty on specified printing, writing and packing paper to 12 %
- ✓ Excise Duty of 16% imposed on Set Top Boxes

Service Tax

- ✓ Goods and Services Tax (GST) to be introduced by April 2010
- ✓ Increase in Service tax rate from 10% to 12%
- ✓ Service Tax Net widened - New Services included and scope of existing services widened
- ✓ Relief for Leasing and Hire Purchase Industry
- ✓ Withdrawal of Exemption to certain services
- ✓ Transport of passengers embarking on international journey by air other than economy class to attract Service Tax
- ✓ Credit card, debit card, charge card or other payment card related services chargeable to Service Tax



③ DIRECT TAX PROPOSALS

3.1 TAX RATES:

There is no change in the tax rate structure for any class of assesseees. Accordingly, the tax rates prescribed for the assessment year 2006-07 would continue to apply for the assessment year 2007-08 also.

The rates of income tax for individuals, Hindu Undivided Families (HUF's), Association of Persons (AOPs), etc., for the financial year 2006 – 2007, relevant to the assessment year 2007 – 2008 are as follows:

EXISTING		PROPOSED	
Income Slab (Rs.)	Rates applicable for FY 2005 – 06 (AY 2006-07)	Income Slab (Rs.)	Rates proposed for FY 2006 – 2007 (AY 2007-08)
Upto 1,00,000 *	NIL	Upto 1,00,000 *	NIL
1,00,001*- 1,50,000	10 %*	1,00,001*- 1,50,000	10 % *
1,50,001* - 2,50,000	20 %	1,50,001*- 2,50,000	20 %
Above 2,50,000 **	30 %	Above 2,50,000 **	30 %

*In the case of a resident woman below 65 years of age at any time during the previous year, for the figures Rs. 1,00,000 and Rs. 1,00,001; the figures Rs. 1,35,000 and Rs. 1,35,001 shall be respectively substituted. In the case of a resident individual of the age of 65 years or more at any time during the previous year, the rate of 10 % shall be read as NIL; the figure of Rs. 1,50,001 shall be substituted with Rs.1,85,001/-.

**Persons in this slab having income-exceeding Rs. 10,00,000 would be required to pay 10 % surcharge on the total income tax payable.

Note: Education cess @ 2 % on surcharge and income tax continues to be levied in proposed rate structure.

In the case of domestic companies, the tax rate would continue to be 30% with surcharge at 10 % of the tax. Further, the education cess of 2 % on tax and surcharge will also continue to be charged for the FY 2006 – 07. Thus, the effective corporate tax rate would continue to be 33.66 % as in the previous year.

The tax rate under Minimum Alternative Tax (MAT) is proposed to be increased from 7.5% to 10% of the Book-profit. After considering the impact of surcharge and education cess, the effective rate of MAT for financial year 2006-07 works out to 11.22% as against 8.415% in the financial year 2005-06.



There is no change in the rate of Dividend Distribution Tax, which is 12.5%, the effective rate being 14.025% after considering surcharge and education cess.

For foreign companies, there is no change in the income tax rate, which is presently 40%. The surcharge on income tax would continue to be 2.5 % with further education cess of 2 % of tax and surcharge as in the FY 2005 – 06. Thus, the effective tax rate works out to 41.82% (unless a special rate is provided for specific kind of income either in the domestic law or in the relevant tax treaties).

In the case of firms, the tax rate continues to be 30 %. The rate of surcharge continued to be 10 %; while the education cess continues @ 2 % on tax payable inclusive of surcharge. The effective tax rate in the case of firms works out to 33.66 % as in the previous year.

In the case of co – operative societies and local authorities, there has been no change in the rates of income tax. These entities will not be liable to surcharge as in the last year.

3.2 NEW TAX INCENTIVES AND RELIEFS:

a. Rationalization of Fringe Benefit Tax (FBT):

Finance Act, 2005 had introduced FBT in the last fiscal year as an additional tax. There were number of representations from different quarters to abolish this levy since it has resulted in uncertainties regarding its administration, besides the burden of additional tax. The Finance Minister, in his budget speech, has reiterated the justification for levy of FBT on the principles of horizontal and vertical equity. However, the following concessions have been proposed for FBT:

- i. *Contribution to Superannuation Fund:* - Currently, contribution made by an employer to an approved superannuation fund is subject to FBT without any threshold exemption limit. It is now proposed that only such contribution, which is in excess of Rs. 100,000/- per employee, will attract FBT.
- ii. *Free Medicine Samples:* - Expenditure on distribution of free samples of medicines or of medical equipment, to doctors will no longer attract FBT.
- iii. *Payment to Brand Ambassadors:* - Expenditure by way of payment to any brand ambassadors for sales promotion will also not attract FBT.
- iv. *Expenditure on tour and travel* – It is now proposed to include 5% of the expenditure on tour and travel (including foreign travel) in the taxable fringe benefit instead of 20% at present.



- v. *Transport subsidy/allowance* or any facility provided by the employer to his employees for journeys by the employees from their residence to the place of work and back will no longer be subject to FBT.
- vi. *Expenditure on hospitality* - In the case of assessee engaged in the business of airline and shipping, only 5% of the expenditure on provision of hospitality, including provision of food or beverages, and for use of hotel, boarding and lodging facilities will now be subject to FBT instead of 20% at present.

b. Extension of Relief Under Section 80 IA:

Under the existing provisions, the tax holiday under section 80 IA is available to an undertaking that develops, develops and operates or maintains and operates an industrial park, which is notified by the Central Government on or before 31st March 2006. It is now proposed to extend the period up to 31st March 2009. Similarly, the tax holiday is available to certain power plants provided they begin to operate on or before 31st March 2006. This time frame is proposed to be extended to 31st March 2010.

This is a welcome measure since it will go a long way in attracting additional investments in the power sector that will, to some extent, tide over the scarcity of power.

c. Dividend Distribution Tax (DDT) - Close Ended Equity Oriented Funds Exempted:

Presently, open ended equity oriented funds referred to u/s 10(23D) of the Income tax Act 1961, are not required to pay DDT u/s 115 R. It is now proposed to extend this benefit to all equity-oriented funds irrespective of whether they are open ended or close ended. However, in order to be considered as an equity-oriented fund, it is now necessary that more than 65% (as against the present 50%) of the total proceeds of such fund are invested in equity shares in domestic companies.

d. Term Deposit With Scheduled Bank – Covered u/s 80 C:

Section 80C provides for a deduction from total income up to Rs.100,000/- in certain cases, if investment is made in certain specified schemes / financial products. It is now proposed that term deposit with tenure of not less than 5 years kept with a scheduled bank will also qualify for this deduction. This measure is likely to benefit scheduled banks in mobilising long-term deposits.



e. Limit u/s Section 80 CCC enhanced:

Contribution to certain pension funds up to maximum of Rs.10,000/- qualify for a deduction in computing total income of an individual. The limit is now proposed to be enhanced to Rs.100,000/-. However, it is important to note that the existing overall limit of Rs.100,000/- for the aggregate deductions u/s. 80C, 80CCC and 80CCD remains unchanged. Therefore, on an aggregate basis, there is no additional benefit, though an individual may now invest more in pension funds u/s.80 CCC in preference to other instruments covered u/s 80C.

3.3 ADDITIONAL TAX BURDEN:

a. *Minimum Alternate Tax (MAT): Amendments*

Section 115JB of the Income tax Act 1961 provides for levy of MAT @ 7.5% of the book profit to be computed under that section where the tax payable under the normal provisions of the Act is less than MAT.

In the Finance Bill, 2006 the following three amendments are proposed in section 115JB that will result in additional tax burden:

- i. Firstly, the tax rate is increased from 7.5% to 10% of the book profit;
- ii. Secondly, the long term capital gains arising from transfer of shares / units which are exempt u/s 10(38), will now form part of the book profit; and
- iii. Thirdly, depreciation on revaluation of assets, which is debited to the profit and loss account, will have to be added back in computing the book profit.

However, the credit available under section 115JAA can now be carried forward and allowed up to a period of seven assessment years instead of five. Further, while computing interest u/s 234A/B/C, the credit allowable under section 115JAA will be reduced in computing the tax base subjected to interest.

b. *Taxation of Co-operative Banks:*

Under the existing law profits and gains arising from banking business of a co-operative bank is not taxable since the same is fully deductible u/s 80 P. It is now proposed to amend section 80P by inserting new sub-section (4), whereby this benefit is proposed to be denied to a co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank. Consequent to this amendment, section 2(24) is also proposed to be amended by inserting a new sub-clause (vii) whereby the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members is brought within the purview of the definition of "income". It appears that this amendment is proposed in the statute to counter the possible argument by the co-operative banks that the income arising from the business transacted with the members is not liable to tax on the ground of mutuality.



The stated underlying rationale for the proposed amendment is that the co-operative banks compete with other commercial banks, and therefore, they should not enjoy any special tax treatment. However, it appears that the government has overlooked the fundamental objectives of the co-operative movement. Unlike commercial banks, a co-operative bank, being an important vehicle of the co-operative movement, is not formed with the objective of making profit as its fundamental objective, though in the course of its business, it may eventually earn profit. It is for this very reason, and also to provide fillip to the co-operative movement, the tax benefits were conferred all these years. It is felt that the proposed levy will significantly affect the co-operative banking sector, and will have its adverse impact on the overall co-operative movement.

c. *Tax On Anonymous Donations:*

A new section 115BBC is proposed to be inserted to provide that any anonymous donations received by certain charitable trusts or institutions referred to in section 11 and 12, or by a hospital, a university, an educational institution or any other institution referred to in section 10(23C), will be subjected to tax @30%. However, this provision will not apply to any trust or institution created or established wholly for religious purposes. Consequently, the Bill also seeks to amend section 13 by inserting a new sub-section (7) to provide that in respect of these anonymous donations no exemption will be available to these trusts or institutions under section 11. Similar amendment denying exemption in respect of such anonymous donations is also proposed in section 10(23C). Anonymous donation is defined as any voluntary contribution referred to in section 2(24)(ia), where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the donor and such other particulars as may be prescribed.

d. *Amendment in Section 43B:*

Under section 43B certain expenditure is allowed on actual payment thereof. One of such items is interest on any loan or borrowing from any public financial institution or state financial corporation or a state industrial investment corporation. Many a times such institutions reschedule the repayment of loan including the interest payable, which is often converted into a separate loan, usually referred to in banking parlance as funding of interest, where a borrower is unable to fulfill his obligations of repayment. In such an event, the issue that arises as to whether such funding of interest could be considered to be an actual payment of interest so as to qualify for deduction u/s 43B in the year of funding. It is now proposed to insert a new Explanation 3C, as a clarificatory amendment, with retrospective effect from 1st April 1989 to provide that conversion of interest payable into a loan or a borrowing shall not be deemed to be actual payment of such interest. Similar amendments are also proposed by way of another Explanation 3D, also with retrospective effect from 1st April 1997, in the case of interest payable on any loans or advances from a scheduled bank.



The proposed amendment appears to be quite unreasonable and harsh particularly because it is retrospective in its effect. Funding of interest is usually made where the borrower is unable to meet his financial obligations due to adverse financial position. The impact of the proposed amendments that too with retrospective effect would inflict additional tax burden on such borrowers, who are already suffering. Further, it is important to note that consequent to the proposed amendment, there does not appear to be any consequential provision enabling the assessee to claim a deduction on payment of the funded liability of interest. In the absence of any specific provision, it is most likely that the department may take a view that payment of instalment in respect of the funded interest is not allowable as it could be viewed as discharge of a loan liability, and not payment of interest *per se*. In that event, the assessee could suffer a permanent disallowance of interest, which obviously could never be the intention of section 43B. Therefore, there appears to be a strong case for reconsideration of the proposed amendment.

e. Increase in the rates of Security Transaction Tax (STT):

The rates of the Securities Transaction Tax (STT) are proposed to be increased by 25% across the board w.e.f. 1st June 2006 in respect of all categories of transactions covered by STT. The comparative rates of STT are given below:

Type of Security transaction	Existing rate	New rate
Delivery based purchase of equity shares in a company or a unit of an equity oriented fund – tax to be paid by the buyer.	0.1 %	0.125%
Delivery based purchase of equity shares in a company or a unit of an equity oriented fund – tax to be paid by the seller	0.1 %	0.125%
Non- Delivery based purchase of equity shares in a company or a unit of an equity oriented fund – tax to be paid by the seller	0.02 %	0.025%
Derivative trading	0.0133 %	0.017%
Sale of units of an equity oriented fund to the mutual fund.	0.2 %	0.25%

f. Omission of Section 10(23G):

Under the existing provisions contained in section 10(23G), any income by way of dividend, interest or long term capital gains of an Infrastructure Capital Fund or an Infrastructure Capital Company or a Co-operative Bank from investments made on or after 1st June 1998 by way of shares or long term finance in certain approved businesses, is exempt. It is now proposed to remove this exemption on the ground that the tax rate as well as the cost of borrowing of funds have since come down, and further, dividend distributed by domestic companies are exempt u/s 10(34) and long term capital gains from transactions subject to security transaction tax are also exempt u/s 10(38). Though in view of the exemptions provided for in case of the dividend income and long term capital gains, the exemption under section 10(23G)



might have lost its relevance; nonetheless, the interest income earned by the Infrastructure Capital Fund / Company or a Co-operative Bank would be subject to tax in view of the proposed amendment.

The proposed amendment appears to be unfair and unreasonable as it is also applicable to the interest income arising from the existing transactions where the interest rates might have been negotiated keeping in view the tax exemption. Such unilateral adverse amendment will significantly affect the confidence of investors in government policies, and hamper the canalisation of funds towards the much needed infrastructure projects.

3.4 CHANGES IN TAX PROCEDURES

a. Amendment in section 14A:

Section 14A provides for disallowance of expenditure incurred by the assessee in relation to income which is exempt from tax. The computation of expenditure attributable to exempt income poses practical difficulties leading to litigation. It is now proposed that the assessing officer can determine the disallowable expenditure in accordance with such method as may be prescribed, if he, having regard to the accounts of the assessee, is not satisfied with the correctness of the assessee's claim in respect of such expenditure. This provision shall also apply even if an assessee claims that he has not incurred any expenditure in relation to the exempt income. The real impact of this proposed amendment could be gauged once the Board prescribes the method of computation. One can only hope that such method would be rational, reasonable and fair.

b. Amendment in Section 10 B:

In order to claim exemption under section 10B, it will now be necessary to submit the income tax return within the time prescribed u/s 139(1). In other words, any delay in filing the return of income by the assessee would deprive him of the tax holiday for the relevant assessment year even if he is otherwise eligible for the same.

Similar provisions have also been proposed in new section 80AC in relation to tax holiday allowable u/s 80 IA, section 80 IAB, section 80 IB and section 80 IC. It would, therefore, be imperative for those assessee claiming tax holiday under these sections to submit their tax return in time.



c. *Abolition of One-by-Six scheme:*

A person fulfilling any one of the six criteria notified under the proviso to section 139(1) is required to submit the return of income notwithstanding the fact that he does not have any taxable income. This scheme is popularly known as “One-by-Six” scheme. It is now proposed to omit this provision from the statute.

d. *Curtailment of period for completion of assessment:*

Under the existing provisions of section 153, assessment can be completed within a period of two years from the end of the relevant assessment year. From the assessment year 2004-2005, it is now proposed to curtail this period by three months. Thus, the assessment for AY 2004-2005 will now have to be completed on or before 31st December 2006.

In the case of reassessment under section 147, the same could be completed under the existing law within a period of one year from the end of the financial year in which notice u/s 148 has been served. It is now proposed to reduce the period of one year to nine months in all cases where the notice u/s 148 has been served after 31st March 2005.

e. *Amendment to Section 148:*

A Special Bench of the Income Tax Appellate Tribunal has recently given a ruling that a notice issued u/s 143(2) is invalid if it is served beyond 12 months from the end of the month in which a return is filed by the assessee in response to notice u/s 148. Accordingly, the assessment order passed u/s 147 in pursuance of such a belated notice was held to be illegal and bad in law. In order to overcome this ruling, it is now proposed to amend section 148, to provide with retrospective effect that even if a notice u/s 143(2) has been served beyond the said period of 12 months but before the expiry of the time limit for making the assessment / reassessment, every such notice shall be deemed to be a valid notice. This amendment will be applicable to those cases where returns have been furnished during the period 1st October 1991 to 30th September 2005 in response to a notice u/s 148.

f. *Amendment to Section 206 - Annual Return for Tax Deduction at source not required to be filed:*

From the financial year 2005-2006, it is now proposed to dispense with the requirement of filing the annual returns in respect of tax deduction at source. This is consequent to the provision requiring the submission of quarterly returns for tax deduction at source.



g. Amendment to Section 234 A / 234 B / 234 C

Interest u/s 234A is levied where the return of income is filed beyond the due date. Currently, the base amount on which such interest is levied is calculated after reducing from the tax determined u/s 143(1) / 143(3), the amount of advance tax paid and any tax deducted or collected at source. It is now proposed that besides the advance tax paid and TDS / TCS, relief of tax allowed u/s 90 / 90A / 91 on account of tax paid in a foreign country and tax credit allowed to be set off under section 115JAA will also be reduced in arriving at the base amount on which interest is leviable. Similar amendments are also proposed in section 234B and 234C. This amendment will set at rest the ongoing litigation in this respect.



④ **INDIRECT TAX PROPOSALS**

4.1 CUSTOM DUTIES

4.1.1 *Special Additional Duty of Customs:*

Budget 2005 had imposed a special additional duty of customs @ 4% u/s. 3(5) of Customs Tariff Act, 1975 on ITA (Information Technology Agreement) bound items and on specified inputs/raw materials used for manufacture of electronics/information technology items. This additional duty of customs has now been extended to cover all imported goods – agricultural as well as non-agricultural imports at 4% and jewellery will attract a lower rate of 1%.

However, the following imports have been exempted from this special additional duty of customs –

- Goods which are fully exempt from VAT;
- Goods which are exempted both from basic and CV duty;
- Petroleum crude, kerosene for PDS, LPG for domestic supply, petrol, diesel, coal, coke and petroleum gases and fuel of Chapter 27;
- Goods for export promotion schemes under which imports are allowed at zero duty;
- Passenger baggage;
- Fertilizers and inputs for fertilizers;
- Newsprint, glazed newsprint, wood-pulp for newsprint;
- DTA clearances of EOUs/EHTP/STP/SEZ Units provided such goods are not exempt from sales tax/VAT;
- Gold concentrate;
- Gold, silver, rough and cut diamonds, precious metals, precious and semi-precious stones (Chapter 71);
- Imports by EOUs and units in the EHTPs/STPs or SEZs;
- Ships for breaking up;
- Non-mega power projects, transmission and distribution projects and high voltage transmission.



4.1.2 Customs Duty Reduced:

- Peak rate of customs duty on non-agricultural products – from 15% to 12.5%.
- Ad valorem component of customs duty on textiles fabrics and garments – from 15% to 12.5%

Metals and their Inputs:

- On primary and semi-finished forms of metals like alloy steel, aluminum, copper Zinc, Ashes and residues of copper and zinc, tin, base metals of Chapter 81, Calcined alumina – from 10% to 7.5%
- On mineral ores and concentrates – from 5% to 2%
- On ferro alloys – from 10% to 7.5%

Minerals:

- On mineral products of Chapter 25, except for cement, marble, granite and asbestos – from 15% to 5%

Refractories & Inputs for refractories:

- On Refractories and inputs for refractories - from 10% to 7.5%

Chemicals and Petrochemicals:

- On basic inorganic chemicals falling under heading 2801 to 2805 – from 15% to 10%
- On organic Chemicals falling under headings 2901 to 2904 with the exception of chloromethanes and trichloroethylene – from 10% to 5%
- On menthol – from 15% to 10%
- On styrene, ethylene dichloride and vinyl chloride monomer – from 5% to 2%
- On catalyst of heading 3815 – from 10% to 7.5%.
- On Ethyl Vinyl Acetate – from 10% to 5%
- On Polymers of Ethylene, Polymers and copolymers of Propylene, Polymers and copolymers of Styrene and Polymers of Vinyl Chloride – from 10% to 5%
- On Naphtha for manufacture of specified polymers – from 5% to Nil



Agriculture:

- On Atlantic salmon – from 30% to 10%

Textiles:

- On manmade fibres, filaments, yarns and spun yarns – from 15% to 10%
- On DMT, PTA, MEG and Caprolactum – from 15% to 10%
- On Paraxylene – from 5% to 2%
- On specified textile machinery and parts for manufacture of such machinery – from 15% to 10%

Information Technology:

- On MP3 players and MPEG 4 players – from 15% to 5%

Petroleum:

- On Naptha and petroleum coke – from 10% to 5%

Health:

- On 10 anti-AIDS drugs, 14 anti-cancer drugs, 4 specified drugs (including bulk drugs for their manufacture), and 2 specified diagnostic kits and 1 equipment – to 5%. These drugs will also be exempt from excise duty and countervailing duty.

Miscellaneous:

- On non-edible grade oils having free Fatty Acid content of above 20% used for manufacture of soaps, industrial fatty acids and fatty alcohols – from 15% to 12.5%
- On Vinyl acetate monomer, Butyl rubber, 2-Vinyl pyridine, Metallurgical grade silicon, Borax/boric acid, Potassium Chloride – from 15% to 10%
- On Crude Glycerine – from 30% to 12.5%
- On Cullet (broken glass), parts of pen under heading 9608, Phenol/acetone for manufacture of bisphenol – A, Packaging machinery falling under 8422 30 00 and 8422 40 00 – from 15% to 5%



- On Hearing aid – from 5% to Nil
- On Bisphenol-A and Epichlorohydrin for the manufacture of Epoxy Resin – from 10% to 5%

4.1.3 Customs Duty Imposed/Increased:

Metals & their Inputs:

- 5% duty imposed – on iron and steel melting scrap

Agriculture:

Duty increased –

- on honey from 30% to 60%
- on vanaspati, bakery shortening, inter-esterified, re-esterified, elaidinised fats, margarine and similar boiled, oxidized, dehydrated, sulphurised, blown, polymerized or modified preparations of edible grade, falling under headings 1516, 1517 or 1518 – from 30% to 80%

4.1.4 Exemptions – withdrawn:

Customs duty exemptions/concessions have been withdrawn on the following items:

- Subbed polyester base for the manufacture of medical or industrial X-ray films and graphic art films;
- Saddle tree
- Parts of outboard motors imported by specified agencies;
- Spare parts for maintenance of textile machinery;
- Video cassettes and Video tapes imported by Television Center of AIR or by M/s. Electronic Trade and Technology Development Corporation Ltd., or by others;
- Food preparations containing flour, meal, starch etc., in a specified proportion meant for infant use and put up for retail sale;
- Food products (excluding alcoholic preparations) imported by hotels/tourism industry in terms of licences issued under 1997-2002 Exim Policy;
- Plant, machinery, equipment imported for setting up of Currency Note / Bank Note Press at Salbony, Mysore, Nasik and Devas;



- Exemption from CVD on gold concentrate. This exemption will continue by way of excise duty exemption;
- Specified goods for manufacture of capital goods for setting up of a unit with an investment of Rs. 5 crore.

4.1.5 Others:

- Concessional rate of 5% on nickel and articles of nickel has been restricted to goods falling under Chapter 75
- Concessional rate of 5% customs duty plus Nil CVD presently available to specified plantation machinery upto 30.04.2006, has been extended by one more year.
- Customs duty on Set Top Boxes, whether or not covered under ITA (Information Technology Agreement), has been unified at Nil customs duty plus 16% CV D plus 4% special additional duty of customs..
- CVD u/s. 3(3) of the Customs Tariff Act has been withdrawn on computers consequent to imposition of excise duty at 12% on computers.
- Customs duty on natural gas including propane and butanes, has been unified at 5%
- A unified rate of 10% customs duty has been prescribed for glass frit and all other glass under tariff item 3207 40 00
- Pipeline projects for transportation of crude oil, petroleum products and natural gas has been notified as project imports under Heading 9801

4.2 CENTRAL EXCISE:

4.2.1. Relief Measures:

A. Excise Duty reduced:

- On aerated drinks from 24% to 16% (Abatement from Retail Sale Price (RSP) has been consequently reduced from 45% to 42.5%)
- On cars with length not exceeding 4 metres and engine capacity not exceeding 1200 cc for petrol cars and 1500 cc for diesel cars from 24 to 16%
- On Heat resistant latex rubber thread, LPG gas stove of value exceeding Rs. 2,000 per unit; Compact fluorescent lamps*; footwear of retail sale price between Rs. 250 and Rs. 750 per pair* – from 16% to 8%

(* Abatement from RSP has been consequently reduced from 40% to 37%)



- On specified printing, writing and packing paper from 16% to 12 %
- From 16% to Nil on –
 - Condensed milk;
 - Ice-cream;
 - Pectic substances, pectinates and pectates, pectin esterase;
 - Yeast;
 - Pasta, whether or not cooked or stuffed or other wise prepared;
 - Storage devices namely DVD drives, Flash drives and Combo drives;
- Processed meat, fish and poultry products from 8% to Nil;
- From 16% to 8% on –
 - Ready to eat packaged food and instant mixes*
 - Texturised vegetable protein (soya bar);
 - Man-made fibres and filament yarns;
 - MP3 players and MPEG 4 players
- Duty on clearances of goods to DTA from EOU, STP, EHTP, etc., has been changed from 50% of the aggregate of customs duty to 25% of the basic customs duty plus excise duty payable on like goods.

(* Abatement from RSP has been consequently reduced from 40% to 37%)

B. Excise Duty fully exempted:

- On paddy de-husking, rice rubber roles;
- Nuclear grade sodium produced by Heavy Water Board for supply to Kalpakkam Nuclear Power Plant
- Drawing inks
- Quebracho and Chestnut extracts;
- Gold concentrate for refining



4.2.2 Excise Duty Imposed:

- Duty of 8% with CENVAT credit imposed on –
 - Goggles;
 - Articles of wood;
 - Registers, account books, order books, receipt books, letter pads, memorandum pads, diaries, binders, folders, file covers etc., excluding notebooks and exercise books;
 - Paper labels;
 - Paper pulp moulded trays;
 - Articles of mica;
 - Goods containing atleast 25% by weight of fly ash/phospho gypsum;
 - Roofing tiles;
 - Raw tanned or dressed fur skins;
 - Portable receivers for calling, alerting or paging;
 - Henna powder not mixed with any other ingredients;
 - 100% wood free plain or pre-laminated particle or fibre board, made from sugarcane bagasse or other agro-waste; parts of walking sticks, seat sticks, whips, riding-crops and the like;
 - parts of drawing and mathematical instruments;
 - frames and mountings for spectacles, goggles or the like of value below Rs. 500 per piece;
- Duty of 16% imposed on –
 - Umbrellas, sun umbrellas and their parts;
 - Food preparations intended for free distribution subject to end use certification;
 - Soap manufactured under a scheme for sale of Janata soap;
 - Strips and tapes of polypropylene used in factory of its production in the manufacture of polypropylene ropes;
 - parts and components of motor vehicles transferred to a sister unit for manufacture goods falling under chapter 87;



- goods other than electrical stampings and laminations, bearings and winding wires supplied for the manufacture of PD pumps for handling water;
- specified goods meant for display in any fair or any exhibition in India;
- parts of table ware, kitchen ware and other household articles of iron and steel, copper, aluminium;
- railway track machines;
- sulphur(2503 00 10) sulphur falling under this tariff item for fertilizers will be exempt;
- mixture of graphite and clay for manufacture of pencil and pencil leads;
- aluminium ferrules for manufacture of pencils; tobacco used for smoking through hookah or 'chilam'

(Note : In all these cases, exemption upto Rs. One crore would be available under the General Small Scale Industries (SSI) Exemption Scheme)

- Duty of 12% imposed on Computers
- Duty of 8% imposed on package software on electronic media
- Duty of 16% imposed on set top boxes not covered under the Information Technology Agreement

4.2.3 Excise Duty Increased:

- From 8% to 16% on Mosaic tiles; Glass Ware; Lay flat tubing; Cigarette filter rods.
- The rate of compounded levy on Stainless Steel patti/pattas has been increased from Rs. 15,000 per machine to Rs. 30,000/- per machine.
- Cess leviable on domestic petroleum crude oil under the Oil Industry (Development) Act 1974 has been increased from Rs.1,800/- per ton to Rs.2,500/- per ton.

4.3 SERVICE TAX:

4.3.1 Tax Rate:

The Finance Minister has proposed to introduce a National level Goods and Services Tax (GST) by 1st April, 2010. The foundation of GST is that goods and services attract the same rate of tax. Hence, to progressively converge the service tax rate and



the CENVAT rate, the service tax rate is proposed to be increased from 10 % to 12%. The increase will be applicable from the date of enactment of the Finance Bill, 2006.

4.3.2 New Services under the tax net:

Service Tax is being imposed on the following new services :

- i. Service provided by a Registrar to an Issue;
- ii. Service provided by a Share Transfer Agent;
- iii. Automated Teller Machine (ATM) operations, maintenance or management;
- iv. Service provided by a recovery agent;
- v. Sale of space or time for advertisement other than in print media;
- vi. Sponsorship services provided to any body corporate or firm other than sponsorship of sports event;
- vii. Transport of passengers embarking on international journey by air other than economy class;
- viii. Transport of goods in containers by rail by any person other than Government Railway
- ix. Business Support Services;
- x. Auctioneer's services, other than auction of property under the directions or orders of Court of Law or auction by the Central Government;
- xi. Public Relations Service;
- xii. Ship Management Service;
- xiii. Internet Telephony Service;
- xiv. Transport of persons by cruise ship;
- xv. Credit card, debit card, charge card or other payment card related services;

The above services will get covered from a date to be notified after the enactment of the Finance Bill, 2006.

4.3.3 Scope of Existing Services expanded/clarified:

- i. Substituting the references to 'Commercial Concern' in seventeen taxable services with 'person', the Budget has expanded the scope of the service providers.



- ii. Banking and other financial services, to include –
 - a. transfer of money through different modes by any person;
 - b. services provided as banker to an issue;
- iii. Management Consultancy Service to specifically include consultancy in different areas of management;
- iv. General insurance service to include service provided to a policy holder or any person by an insurer, including re-insurer;
- v. Life insurance service to include service provided to a policy holder or any person by an insurer, including re-insurer;
- vi. Insurance auxiliary service concerning general insurance business, to include service provided to a policy holder or any person by an insurer, including re-insurer;
- vii. Insurance auxiliary service concerning life insurance business, to include service provided to a policy holder or any person by an insurer, including re-insurer;
- viii. Maintenance or repair service to be renamed as “Management, maintenance or repair” service, and to include management of moveable property;
- ix. Erection, commissioning or installation service to include erection, commissioning or installation of structures, whether or not pre-fabricated;
- x. Consulting Engineer service, to include engineering consultancy services provided by any firm or body corporate;
- xi. Business auxiliary service to include computerised data processing;
- xii. Technical testing and analysis service, to clarify that it –
 - a. includes clinical testing of drugs and formulation; and
 - b. excludes testing or analysis for the purpose of determination of the nature of diseased condition, identification of a disease, prevention of any disease or any disorder in human beings or animals.

The above changes will be effective from a date to be notified after the enactment of the Finance Bill, 2006.



4.3.4 Withdrawal of exemptions:

The following service tax exemptions are being withdrawn:

- i. The exemptions in relation to general insurance where –
 - a. Premium is received from re-insurance both domestic and overseas;
 - b. All business for which premium is booked outside India;
- ii. Exemption for services other than accounting, auditing and statutory certification services provided by practicing Chartered Accountant, Company Secretary or Cost Accountant in his/her professional capacity;
- iii. Exemption for taxable services provided by a Call Centre or a Medical Transcription Centre;
- iv. Exemption for taxable service provided in relation to Enterprise Resource Planning (ERP) software system provided by a management consultant in connection with the management of any organisation;
- v. Exemption for catering services provided on a railway train by an outdoor caterer;
- vi. Exemption for catering services provided within the premises of an academic institution or medical establishment by an outdoor caterer.

The above changes will be effective from 1st March, 2006.

4.3.5 Exemption From Service tax:

The following services will be exempt from Service tax:

- i. Financial leasing services including equipment leasing and hire-purchase, on that portion of the taxable value comprising of 90% of an amount representing as interest i.e. the difference between the installment paid towards repayment of the lease amount and the principal;
- ii. Testing and analysis services provided in relation to water quality testing by Government owned State and District level laboratories;
- iii. All taxable services provided by the Reserve Bank of India.

The above exemptions will come into effect from 1st March, 2006.



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