

Tax Hotline

April 27, 2001

THE INDIAN UNION BUDGET 2001 - 2002

The Indian Finance Minister, Mr. Yashwant Sinha, tabled the Union budget for the financial year 2001 - 02 ("the **Budget**") before the Lower House of Parliament on Wednesday, April 25, 2001. The Budget was passed by the Lower House with some pertinent modifications and, somewhat predictably, was a more populist version of the Finance Bill 2001 ("the **Bill**"), which was announced earlier in February this year. The actual text of the Budget is still to come in; however the first information has been more positive than not.

For instance, Indian export companies have been given further latitude as to the proportion of export deduction available to them from the financial year 2001 - 02 upto 2004 - 05. Under the relevant section of the Indian Income-tax Act, 1961 ("the **Act**"), i.e. under Section 80HHC, the aforesaid export companies will now be progressively taxed on 30%, 50%, 70% and 100% of their profits respectively upto 2004 - 05, instead of the previous scale of 40%, 60%, 80% and 100% respectively.

The Finance Minister has exempted from tax, the transfer of assets under schemes of de-mutualization and corporatization of the Indian stock exchanges.

Another cause to bring out the bubbly is the continued availability of the tax benefits under the software export license held by a privately-held Indian export company even after its shareholding pattern has substantially changed (Section 10A and 10B of the Act). The provisions mooted by the Bill had permitted only those software export companies in which the public is substantially interested, to continue availing of the aforesaid tax benefits despite a change in the pattern of shareholding beyond 49% of the total paid up equity share capital. With the passing of the budget, it appears that this tax benefit will now be available to private companies in the software sector even after corporate restructuring.

However, the Budget has corrected the drafting error in the Bill concerning the levy of capital gains tax in the hands of unit-holders upon redemption of units to the Unit Trust of India or any other mutual fund. The Bill had set the Indian fund industry aglow with the promise of exemption of income accruing to unit holders upon the redemption of their units, in addition to the halving of dividend distribution tax from the erstwhile 20% to 10%.

As far as the introduction of transfer pricing provisions in India is concerned, the Finance Minister has explicitly stated that these provisions would apply to transactions entered into between a head office and the branch of an entity. In addition, it is clarified that an adjustment made to the transfer price in the case of one enterprise shall not, by itself, form the basis of a consequential adjustment in the case of the other enterprise.

The information technology industry will benefit from the addition of thirty-two (32) specified items in the list of machines and equipment that are allowed to be imported at a low rate of 5% basic customs duty.

Funds, which have been enjoying exemptions under Section 10(23C) of the Act, have been put on par with charitable institutions under Section 11 of the Act as far as the accumulation of their income is concerned. These funds will be permitted to accumulate upto 25% of their income without any time limit.

The domestic telecom industry will breathe a sigh of relief; the Finance Minister has ensured that customs duty on telecom parts and components will be reduced from 15% to 5%, to keep in line with the diminished customs duty on telecom equipment from 25% to 15%. This reduction from 15% to 5% has precluded the possibility of loss of production to the domestic segment.

In addition, an increase in the amount of standard deductions available to the salaried class, some sops on deductions for interest income, and an additional import duty on automobiles, which will be over and above the basic customs duty, has ensured that the Union budget retains its populist flavor. The Budget now awaits the approval of the Upper House of Parliament and the President of India.

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