CHAPTER - FIVE
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TAX INCENTIVES FOR NRIs INDUSTRIAL VENTUREES

5.1 INTRODUCTION

Fiscal Policy is that part of Government economic policy which deals with taxation, expenditure, borrowings and the management of pupil debt in an economic. The importance of fiscal policy has greatly increased in modern times. In an under-development country like India, fiscal policy is more and more being used as a means as a means to step up the rate of economic growth. Fiscal policy primarily concerns itself with the flow of funds in the economy.

Taxation has a very important role in fiscal policy. Taxation policy and investment Policy for NRIs were first introduced in 1970. In 1973 R. N. Malhotra Committee was appointed to examine foreign exchange remittance into India with its tax implications. In 1981, the Economic Administration and Reforms Commission headed by Shri L.K. Jha was also asked to review taxation policy for Non-Resident Indians. Facilities for presentation of 1982-83 budget. Jalan Committee
was appointed to review the non-residents investment and consequent concession were announced in 1983-84.

It is recognised that the tax laws do not always have as their sole objective, raising the revenue. Although fiscal needs of the Government are of obvious importance, other considerations do exist like political, economic, social etc. However, in the process, the tax laws become so complex that they lose the different purposes. In this connection, it would be interesting to know the observations of US Treasury-Indian Tax Convention, :

"..........The tax from which exemption is granted should be a genuine part of the country's tax structure and not a tax created for the purpose of providing an exemption from it."1

In India, incentives, allowances and concessions are granted to various types of industrial and trading activities. Some of these incentives are available only to the resident Indians and resident Indian Companies, whereas certain incentives and exemptions are available to non-residents. A detailed discussion on the same follows:

5.2 SCHEME OF DIRECT TAXATION IN INDIA

The Direct Tax legislation comprises of the Income Tax Act, 1961(ITA), and the wealth Tax Act, 1957 (WTA). The Direct Tax legislation undergoes changes through the Finance Act passed in parliament every year and, at times through and Amending Act, between two Finance Acts. The Finance Act forms part of the Budget exercise which is presented at end of February each year.

5.3 TAXATION OF NON RESIDENT INDIANS

The fiscal policy, provision of various taxation laws, special schemes and arrangements relating to the non resident Indians are discussed in detail as under:
5.3.1 AGREEMENTS FOR DOUBLE TAX AVOIDANCE

The need for agreement for double tax avoidance arise because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status, etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. In such a case, the possibilities are as under:

1. The two countries have an Agreement for Double Tax Avoidance, in which case the possibilities are:
   
   (a) The income is taxed only in one country.
   
   (b) The income is exempt in both countries.
   
   (c) The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

2. The two countries do not have an agreement for double Tax Avoidance between them. In such a case, the domestic law of the country will apply. Generally the domestic law contains provisions which are similar to those explained in para 1.2.1 (c) above. In the case of India, the provision of section 91 of the Income -Tax Act will apply, which are similar to those explained in above. The CBDT has clarified vide circular No. 333 2nd April, 1982 that in case of a conflict in the provisions of the agreement for double tax avoidance and the income Tax Act, the provisions contained in the agreement for double tax avoidance will prevail – text of circular is given as Annexure 10A.

3. The list of countries with which India has agreement for double tax avoidance includes, inter alia, Australia, Austria, Bangladesh, Belgium, Brazil, Canada, Czechoslovakia, Denmark, Finland, France, Germany, Great Britain, Greece,
Hungary, Indonesia, Italy, Japan, Kenya, Korea, Libyan Arab Jamahiriya, Malaysia, Mauritius, Nepal, Netherlands, New Zealand, Norway, Poland, Romania, Russia, Singapore, Spain, Sri Lanka, Sweden, Syria, Tanzania, Thailand, UAR, USA and Zambia etc.

4. Earlier, a controversy existed as to the position, whether the rates prescribed by and Agreement for double taxation Avoidance or the provisions contained in an agreement for Double Taxation Avoidance would apply, even if the domestic law i.e. the Income Tax Act, 1961, contained more beneficial provision. Fortunately, section 90(2) has been inserted by the finance Act, 1991, with retrospective effect from assessment year 1972-73, clarifying that either the domestic law or the Agreement for Double Taxation Avoidance, whichever is more beneficial to the assessee, will apply.

5.3.2 SCHEME UNDER INCOME TAX LAW

**Scheme of Taxability**

The scheme of taxability in India is linked to the person's residential status and the scope of his total income. A person's residential status would determine the scope of total income falling within the net of Indian taxation. By scope of total income is meant the territorial extent to which the law can extend its arm to bring a person within the tax net. This is intricately connected with residential status and has been explained subsequently.

However, it may not be out of place here to mention the scope of total income as contemplated by section 5 of Income Tax Act, which is:

(i) Income received or deemed to be received in India.

(ii) Income which accrues or arises as is deemed to acre or arise to him in India.
(iii) Income which accrues or arises to him outside India.

A Non-resident would not be liable to tax in India in respect of (iii) above, he would however, be liable to tax on income is deemed to accrue or arise to him in India and thus, the concept of deemed accrual would be very important from the point of view of a non-resident.

**Income deemed to accrue or arise in India**

Section 9 of the income tax Act contains various categories of income which are deemed to accrue or arise in India. The fiction created by this section is aimed at roping in income accruing outside India within the net of Indian Taxation. An important situation where income is deemed to accrue or arise in India is whether the income accrues or arises from any "business connection" or from any property situated in India. There is no statutory definition of "business connection" and thus, whether there exists any "business connection" or not will depend on the facts in each case. However, it has been judicially held that "business connection" implies a real and intimate relationship between the trading activity carried on outside India and the same is carried on outside India. For example, and agent of a non-resident and having an arm’s length dealing with him will not constitute a business connection with the non-resident.

Salaries earned in India i.e. payable for services rendered in India, as also dividend paid for an Indian company, is considered as income deemed to accrue or arise in India.

Interest, royalty and fees for technical services paid by and Indian resident is also deemed to accrue and arise in India.

**Taxation of royalties for technical services**

The taxability of royalty and "fees for technical services" (FTS) – jointly referred to as technology transfer fees (TTF) is governed by the provisions of sec 9 the scope of chargeability of non resident Indians
under India Tax Laws extends to income which falls under any of the following heads/categories

❖ Received in India
❖ Deemed to be received in India
❖ Accruing or arising in India
❖ Deemed to accrue or arise in India

The relevant sections are Sections 9(1)(vi) and 9(1)(vii), which provide that technology transfer fees payable by the Government or and Indian resident to a foreign enterprise (including a company), would be deemed to accrue or arise in India and would, therefore, be liable to Indian taxation in the assessment of the recipient.

Where the foreign company receiving the technology transfer fees from India belongs to a country with which India has an agreement for avoidance of double taxation, the normal rules of Indian taxation do not apply and the taxability or otherwise of technology transfer fees would be governed by the provisions of the agreement for avoidance of double taxation.

The position can, therefore, be summarised as follows:

❖ Where the payment is received by a foreign company with which India does not have any agreement for avoidance of double taxation, royalty and FTS would be liable to tax in India as per section 9.

❖ Where the receipt is a foreign company of country with which India has an agreement for avoidance of double taxation the taxability would depend on the provision of the agreement for avoidance of double taxation.
Royalty has been defined in the Explanation to section 9 (1) (vi) as follows:

For the purpose of this clause 'royalty means consideration including any lump sum consideration out excluding any consideration which would be the income of the of the recipient chargeable under the head 'capital gains' for :-

(a) The transfer of all or any rights (including the granting of licence) in respect of a patent, invention, model design secret formula or process or trade or similar property:

(b) The imparting of any information concerning the working of or the use of a patent invention model design secret formula or process or trade mark or similar property:

(c) The use of any patent invention model design secret formula or process or trade mark or similar property:

(d) The importing of any information concerning technical industrial commercial or scientific knowledge experience or skill:

(e) The transfer of all any rights (including the granting of a licence in respect of any copyright literary artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting but not including consideration for the sale distribution or exhibition of cinematographic films or

(f) The rendering of any services in connection with the activities referred to in sub-clauses (a) to (e).'

An interesting aspect in regard to the term 'royalty arises here. Normally this term is understood in the context of a recurring payment but as per the definition in section 9 (1) (vi), it is clear that lump sum technical transfer fees are artificially included in the definition of 'royalty'. In other words, the terms 'royalty' included not
only the type of payment as understood in the normal sense, but also lump sum technical transfer fees and accordingly, the definition of ‘fees technical services’ has been considerably diluted in the context of the domestic Indian tax law.

‘Fees for technical services’ has been defined in Explanation 2 to section 9(1) of the Income Tax Act, 1961 as under:

For the purpose of this clause, ‘fees for technical service’ means any consideration (including any lump sum consideration) for rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personal) but does not include consideration for any construction, assembly, mining like project by the recipient or consideration which would be the income of the recipient chargeable under the head ‘Salaries.’

The same definition of ‘Fees for technical services’ does not exist in many of the agreement for avoidance of double taxation.

Scope of chargeability of Technology Transfer Fee, where no agreement for avoidance of double taxation is as per section 9 (1) (vi) and 9 (1) (vii) being relevant to royalty and FTS, respectively. Basically, the ‘source rule’ is followed and accordingly, royalty paid by an Indian enterprise will be liable to taxation in India.

Section 9 (1) (vi) provides that the following income by way of royalty shall be deemed to accrue or arise in India:

‘(vi) Income by way of royalty payable by –

(a) the Government; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India; or.
A person who is a non-resident where the royalty is payable in respect of any right property or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India.

It would be seen that clauses (a) and (b) above basically deal with the rule and only in exceptional cases, where the royalty paid by an Indian enterprise is for the foreign business of an Indian enterprise would the royalty not be taxable in India in the hands of the foreign enterprise.

A situation prevails for FTS and the words of Sec. 9(1)(vii) are for all practical purposes, identical with the terminology used in Sec 9(1)(vi).

Any foreign companies into net of tax agreements with Indian concerns, in which case the foreign company is relieved from Indian Tax liability. In such cases the scope of chargeability does not directly affect the foreign company or the NRIs but the provisions of Sec. 10(6A) of the Income Tax Act that in case of net of tax royalty and FTS payments no grossing up would be done of the tax if X Ltd. (India) has entered into an agreement to pay to collaborator of a country with which India does not have an agreement for avoidance of double taxation.

5.3.3. TAX INCENTIVES TO TRADE & INDUSTRY IN INDIA.

The NRIs may make investments in India either directly in individual capacity or through a foreign company incorporated outside India at the country of their abode. Therefore the matters pertaining to incentives to trade & industry need to be considered in both the condition.
FOREIGN COMPANIES:

Foreign Companies are generally required to operate through joint venture companies to be incorporated in India. Since a company which is unincorporated in India is deemed to be a resident in India, joint venture companies will be entitled to all the incentives available to the resident companies even if they are wholly or substantially owned by a foreign company. However, a foreign company may apply to the Central Board of Direct Taxes seeking declaration for itself under section 2(17) of the Income Tax Act, 1961. The incentives and allowances granted by the Income Tax Act are subject to an overall limit to the effect that the total amount of incentives/deductions cannot exceed 70 percent of the total income in one single year.

The various Tax Planning aspects, Allowance and Exemptions allowed to the NRIs and Foreign companies and other procedural provisions are briefly explained hereunder. (It is pertinent to mention that there are numerous provisions relating to tax incentives and concessions, but detailed explanation of each of them is considered neither desirable nor appropriate for the sake of brevity. However, all such provisions have been duly listed and discussed keeping in mind their importance and relevance.)

1. Some Tax Planning Aspects in Income Tax

Some important aspects related in income tax planning and tax schematic are discussed briefly as follows:

(A) Where should the new industry be located?

Many factors affect location of a business. The following tax incentives are available under the Act, which must be given due consideration in taking such decisions:

1. Incentives are available under Sec 10A in the case of newly established industrial undertaking in FTZs i.e. Tax holiday.
2. under Sec. 10B in the case of newly established 100% EOU-Tax Holiday of 10 years beginning with the assessment year relevant to previous year in which the undertaking begins to manufacture or produce articles/things.

(B) **What should be manufactured or which business can be taken up**

Several incentives are available under the Income Tax Act which are directly co-related to the nature of business. A broad list of some of the incentives, deductions, and special provisions in respect of specified business are as follows:

- Incentives for Units set up in free Trade Zone under sec. 10A
- Incentives for 100% Export Oriented Units under Sec. 10B
- Concessions for Investment Deposit A/C under Sec. 33AB
- Concessions for Site Restoration Fund under Sec 33ABA
- Deduction in respect of Reserve for shipping business under Sec 33AC
- Deduction in respect of Reserve for shipping business under Sec 33AC
- Deduction in respect of Amortisation of certain preliminary expenses under Sec 35D
- Deduction in expenses on prosperity for minerals under Sec. 35E
- Special Reserve created for financial corporation under Sec. 35 (1) (viii)
- Special provisions in the case of mineral oil business under Sec 42 & 44BB
- Special provisions in civil construction in case of mineral oils business under Sec 44AD

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• Special provisions regarding plying, hiring, leasing of goods and carriage of Mineral Oils under Sec 44 AE.

• Special provisions for computing income by way of royalties etc, in case of non residents Sec. 44DA²

• Special provisions for computing profits & gains of restaurants,

• Special provisions for computing profits & gains of shipping business under Sec 44B

• Special provisions for computing profits & gains of operation of aircraft under Sec 44BBA

• Special provisions for computing profits & gains of turnkey power project under Sec 44BBB

• Special provisions for computing profits & gains of royalty income of foreign companies under Sec 44D

• Special provisions for computing profits & gains of Housing project aided by world bank under Sec. HHBA

• Special provisions for computing profits & gain of Export business under Sec. 80 HHC

• Special provisions for computing profits & gains of earning in convertible foreign exchange under Sec. 80HHE

• Special provisions for computing profits & gains of Newly Set up Industrial undertaking under Sec. 80IA

• Special provisions for computing profits & gains of collecting and processing of biodegradable waste under Sec. 80JJA

• Special provisions for computing profits & gains of employment of new workmen under Sec. 80JJAA

• Special provisions for computing profits & gains of Royalty from certain foreign enterprises under Sec. 80O etc. etc.

² Inserted by the Finance Act, 2003, w.e.f. 04.04.2004

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(C) What should be the Form of Organisation?

Among other consideration tax incentive plans play important role, while selecting a suitable form of organisation for a new business. **Partnership** firm is beneficial if taxable income is less than Rs. 1,50,000 but if the Income is more than 1,50,000 it is advisable to have the business set up in a limited company form, which can be either a **Private Limited Company** or a **Public Limited Company**. Such decision can be taken after considering the aspect of size of business and capital investment etc. The company form of organisation is also better in view of limited liability, perpetual entity and ease of exit or change of ownership etc.

(D) What should be the Capital Structure?

When setting up a business, the planning of capital structure is also important aspect in tax planning as it always has a very long term impact in the business. The tax planner should properly balance risk, costs, control and tax consideration in deciding capital structure of the business. A suitable mix of equity and debt is necessary to balance cost of funds and also minimise the tax incidence on the profits of the business.

Under **Tax Laws**, dividend on shares is now not tax deductible, while interest paid on borrowed capital is allowed as deduction under Sec. 36 (1) (iii). Cost of raising financing through borrowing is deductible in the year in which it is incurred. Cost of issue of shares is also allowed as deduction by amortisation over a period of 10 years under Sec. 35D. Moreover, a company has to pay 10% tax on the dividend distributed by it to its shareholders after 1st June, 1997 under Sec 115O.

2. **Special Provisions w.r.t Depreciation Allowance**

In terms of the provisions of Sec 32 of the Income Tax Act, 1961, an industrial under is allowed depreciation allowance on its
building, plant and machinery, furniture and fixtures etc, being tangible assets and knowhow patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature being intangible assets acquired on or after 1998. The Scheme of depreciation allowance has been based on block assessment and according to different rates of depreciation prescribed, there can be 15 blocks of assets as under:

(a) Building - 4 blocks (5%, 10%, 20%, & 100%)
(b) Plant & Machinery - 7 blocks (10%, 20%, 25%, 40%, 50%, 60% & 100%)
(c) Furniture & Fixtures - 2 Blocks (10% & 15%)
(d) Intangible Assets - 1 Block of 25%

An important incentive built in to the 'block of assets' concepts is that no tax is leviable on profit earned on sale of old assets, to the extent the same is replaced by new assets in the same block.

Earlier the depreciation allowance was in the following forms, which has now been discontinued.

a. Normal Depreciation Allowance
b. Initial Depreciation Allowance
c. Extra Shift Depreciation
d. Additional Depreciation
e. Terminal Depreciation

A Scheme of Investment Allowance, which was introduced in place of Development Rebate in 1986 has since been discontinued now.

3. Special Provisions w.r.t. Tea Development Account

Where an assesses carrying on business of growing and manufacturing tea in India has, during the previous year, deposited
with the National Bank for Agriculture and Rural Development (NABARD) any amount or amounts in an account maintained by the assessee with that bank in accordance with the special account scheme by the Tea Board, the assessee is allowed under the new section 33 AB of the Income-tax Act, a deduction of—

a. a sum equal to the amount or the aggregate of the amounts so deposited during the previous year, or

b. a sum equal to twenty per cent of the profits of such business, whichever is less.

When the amount standing to the credit of the assessee in the special account is utilised by the assessee for the purposes of the business referred to in sub-section (1) in accordance with the scheme—

a. for acquiring any asset being building, machinery, plant or furniture, the actual cost of such asset be reduced by the amount so utilised;

b. for incurring any expenditure for the purposes of such business, such expenditure shall be reduced by the amount so utilised and the resultant sum, if any, shall be taken into account for the purposes of the Act,

Where any amount, standing to the credit of the assessee in the special account, which is released during any previous year by the NABARD for being utilised by the assessee for the purposes of the business referred to in sub-section (1) in accordance with the scheme is not so utilised, either wholly or in part, within that previous year, the whole of such amount or, as the case may be, part thereof which is not so utilised shall be deemed to be profits and gains of business and accordingly chargeable to income-tax as the income of the previous year. This deduction is available form the assessment year 1986-87.
4. **Special Provisions w.r.t. Expenditure on Scientific Research**

To encourage scientific research activities in India, section 35 of the Income-tax Act provides for deduction in respect of expenditure on scientific research (even for capital assets to the extent of 100 per cent of the cost of asset except expenditure on acquisition of land) in the following manner:

- Any expenditure whether capital or revenue laid out or expended on scientific research related to the business carried on by the assessee.

- Any sum paid to an approved scientific research institution which has as its object the undertaking of scientific research or to a university, college or other institution to be used for scientific research, whether related to the business of the assessee or not.

- Any sum paid to an approved university, college or other institution to be used for research in social science or statistical research related to the class of business carried on by the assessee.

Any sum paid to a National Laboratory or universities or any India Institute of Technology with a specific direction that the said sum shall be used for scientific research undertaken under a programmes approved by the prescribed authority, then the assess shall be allowed a deduction of 125% of the sum paid w.e.f. 1st October, 1996

5. **Special Provisions w.r.t. Expenditure on Acquisition of Patent Rights etc.**

The payments made for the right to use patents of copyrights would be allowable as revenue expenditure. However, where the price is paid for the purchase of copyrights or patent right and a capital asset is acquired upto 31-3-98, the write off is allowed as consolidated
revenue expenditure by spreading it over a period of fourteen years in terms of section 35A of the Income-tax Act.

6. **Special Provisions w.r.t. Expenditure on Know how**

Under section 35AB of the Income-tax Act, if in any previous year the assessee has paid any lump sum consideration for acquiring any know how for the purpose of his business up to 31.3.98, one-sixth of the amounts so paid can be deducted in computing the profits and gains of the business for that previous year, and the balance amount is allowed to be deducted in equal installments for each of the five immediately succeeding previous years. If the know-how is developed in a approved laboratory, university or institution up to 31.3.98, one-third of the said lump sum consideration paid in the previous year by the assessee, can be deducted in computing the profits and gains of the business for that year, and the balance amount is allowed to be deducted in equal instalments for each of the two immediately succeeding previous years.

7. **Special Provisions w.r.t. Conservation of Natural Resources**

Under section 35CCB of the Income-tax Act where an assessee incurs any expenditure by way of contribution of any sum to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources, the assessee would be entitled to deduction of whole of such expenditure as business deduction.

8. **Special Provisions w.r.t. Amortisation of Certain Preliminary expenses**

Under the Income-tax Act all the expenditure connected with business incurred after the setting up of the business are allowable a business deduction. However, under section 35D of the Income-tax Act, certain expenditure, though incurred prior to the commencement of the business of or even after the commencement of the business in
connection with the extension of industrial undertaking which may otherwise be disallowable on the ground that it is of a capital nature, is allowed as business expenditure of ten successive years beginning with the previous year in which the business commences. In each of these ten years an amount equal to one-tenth of such expenditure is allowed. The expenditure so incurred should be in connection with either preparation of feasibility or a project report or for conduction market survey or for any engineering services relating to the business of the assessee or for formation of company or for setting up the business and for other incidental charges, etc.

9. **Special Provisions w.r.t. Expenditure on Prospecting etc. for Certain Minerals.**

Certain minerals like aluminum ore, coal lignite, gypsum, iron ore, other precious metals, silver, zinc, etc., are listed in the seventh schedule to the Income-tax Act. Where the assessee who is resident in India is engaged in the operations relating to the prospecting for or extraction or production for any such mineral, incurs expenditure specified below, he shall be allowed, under section 35E of the Income-tax Act, for each one of the relevant previous years, a deduction of an amount equal to one-tenth of the amount of such expenditure. The expenditure eligible for the deduction is that incurred by the assessee at any time during the year of commercial production and any one or more of the four years immediately preceding that year, wholly and exclusively on any operations relating to prospecting for any mineral or groups of associated minerals specified in the said Seventh Schedule or to the development of mine or other natural deposit. The section thus grants deduction in respect of expenditure which may otherwise be disallowable on the ground that it is of capital nature or has been incurred prior to the setting up of the business.
10. **Special Provisions w.r.t. Exchange Fluctuations**

After the devaluation of the Indian rupee on June 6, 1966, section 43A was introduced to counteract the effect of devaluation in certain cases. The section applies where the assessee acquires any asset from abroad for the purposes of his business or profession and, in consequence of change in the rate of exchange, there is an increase or reduction in the liability of the assessee.

By virtue of this section the liability so increased is allowed to be added to the cost of the related asset and if the liability is reduced, the cost is accordingly reduced for the purposes of various allowances in the Income-tax Act like depreciation, investment allowance, etc.

11. **Special Provisions w.r.t. Profits from New Industrial Undertakings an Backward Areas**

Under section 80HH of the Income-tax Act, the profits and gains derived by the assessee from industrial undertaking or a hotel which is set up in the backward area is eligible for a deduction of an amount equal to 20 per cent of such profits and gains. This benefit is given for the development of the backward areas. For this purpose, it is necessary that the business is not formed by transfer of old plant and machinery and that it should employ at least 10 workers in manufacturing process which is carried on with the aid of power or employs 20 or more workers in a manufacturing process carried our with out the aid of power. In case of a hotel, the condition of the minimum number of workers is not laid down but the hotel is required to be approved by the Central Government. The industrial undertaking deriving benefit under this section will not be eligible for deduction in respect of profits and gains from newly established small-scale industrial undertakings under section 80HHA.
12. Special Provisions w.r.t. Profits from Small scale Undertakings

The profits and gains of small-scale industrial undertakings are eligible for deduction under action 80HHA of the Income-tax Act of an amount equal to 20 per cent of such profits and gains. Such an industrial undertaking should not have been formed by the transfer of a new business or old machinery or plant and it should employ ten or more workers in the manufacturing process carried on with the aid of power or twenty or more workers in the manufacturing process carried on without the aid of power. The industry which is eligible for deduction under this section will not be eligible for deduction in respect of profits and gains from newly established industrial undertaking in backward areas under section 80HH. A small-scale industry is one in which investment in plant and machinery does not exceed Rs. 3.5 million.

13. Special Provisions w.r.t. Profits from Projects Abroad

Section 80HHB grants deduction in respect of profits and gains from projects undertaken outside India. Under this section where the gross total. Income of resident assessee includes any profits and gains derived from the business of—

A. the execution of a foreign project undertaken by the assessee in pursuance of a contract entered into by him; or

B. the execution of any work undertaken by him and forming part of the foreign project undertaken by any other person in pursuance of a contract entered into by such other person with the Government of a foreign state or any statutory or any other public authority or agency in a foreign state or a foreign enterprise.
A deduction of an amount equal to 50 per cent of such profits and gains from the total income is allowed. There are a few conditions attached to this incentive. These are:

❖ The consideration for the execution of such project should be payable in convertible foreign exchange, i.e. currency of all the foreign countries except Nepal and Bhutan.

❖ The foreign project should be a project of civil construction outside India or for the assembly or installation of any machinery or plant outside India. Further, the Central Board of Direct Taxes may prescribe any other type of work which may be considered as foreign project.

❖ The assessee should maintain separate books of account.

❖ An amount equal to 50 per cent of profits and gains should be respect of which deduction under this section is to be allowed and credited to an account called 'Foreign Projects Reserve Account' which should be used by the assessee during the period of five years next following for the purposes of his business other than for distribution by was of dividends or profits.

❖ An amount equal to 50 per cent of the profits and gains of foreign projects should be brought by the assessee in convertible foreign exchange in India within six months front the end of the previous year in respect of which deduction under this section is to be allowed.


Section 80HHC of the Income –tax Act grants deduction in respect of profits retained for export business with effect from assessment year 1983. The scheme was amended from time to time. Presently the section provides that where an assessee being an Indian
company or a person (other than a company) resident in India is engaged in the business of export out of India of any goods or merchandise except (i) mineral oil, and (ii) minerals and ores, there shall be allowed, in computing the total income, a deduction of profits derived by the assessee from the export of such goods or merchandise.

15. Special Provisions w.r.t. Profits from New Industrial Undertakings

Till the assessment year 1984-85 under section 80M of the Income-tax Act, deduction, in respect of inter-corporate dividends, was allowed of an amount equal to –

A. 100 per cent in respect of income by way of dividends from a company which is engaged exclusively in the manufacture or production of certain high priority items listed in the Ninth Schedule to the Income-tax Act (these items, amongst others, include industrial and agricultural machinery, earthmoving machinery, ships, tyres and tubes, paper, pulp and newsprint, cement, industrial explosives, basic drugs, electronic components, etc); and

B. 60 per cent in respect of income by way of dividends from companies engaged in all the activities except in (a) above.

From the assessment year 1985-86, deduction was allowed at uniform rate of 60 per cent for all inter-corporate dividends. However, w.e.f. Assessment year 1998-99, entire income of dividend is exempted from tax this section 80M has since been omitted.


There are some special provision relating to certain incomes of non resident Indians laid down under sec. 115I of the Income Tax Act. These provisions have been examined hereunder:
(A) Special provisions relating to concessions & Incentives

Income Tax Act, 1961 provides for various special concessions and incentives exclusively for NRIs, a brief list of such provisions is given below:

1. Interest to non residents under Sec. 10 (4) & 4B
2. Salary to Non-residents Under Sec 10(6)
3. Technical Fees received by notified companies etc. under Sec 10(6C)
4. Fees received by NRI Consultants under Sec 10 (8A) & (8B)
5. Interest Exemption under 10(15)
6. Air Craft Lease Rent under Sec 10(15A)
7. Shipping Profits of Non Residents under Sec 44B
8. Income of Foreign Airlines under Sec 44BBA
9. Profits of Business of Civil Constructions under Sec 44BBB
10. Tax Paid on Behalf of Non residents under Sec 10(6A) & (6B)

(B) Special provisions relating to Procedures and computations etc.

The following provisions are relevant in this regard:

115C : DEFINITIONS

Non-resident Indian means an individual being a citizen of India or a person of Indian origin who is not a resident.

It should be noted that:
A) A person is deemed to be of India Origin if he or either of his parents or either of his grandparents was born in undivided India.

B) As per Sec 6: An individual will be resident in any previous year, if:

   a) he is a citizen of India, who leaves India during the previous year for the purposes of employment outside India or as a member of crew of an Indian ship and is in India in that previous year for a period of 182 days or more or

   b) he is a citizen of India or a person of India origin who being outside India comes on a visit to India in any previous year and is in India for a period of 182 days or more in that previous year, or

   c) in any other case:

C) in any other case:

   (i) is in India for a period of 182 days or more in that previous year, or

   (ii) having within the four years immediately preceding that previous year been in India for a period amounting to 365 days or more in aggregate and is in India for a period of 60 days or more in that previous year.

SPECIFIED ASSETS:

Specified assets means any of the following assets:

(i) Shares in an Indian Company whether public limited or private limited.

(ii) Debentures issued by a public limited Indian company

(iii) Deposits in a public limited Indian Company

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(iv) Any security of the Central Government.

(v) Any other asset which the central government may notify (however, no assets have since been notified by the Central Government.)

**CONVERTIBLE FOREIGN EXCHANGE:**

Convertible Foreign Exchange means the foreign exchange which is treated as convertible by RBI

**FOREIGN EXCHANGE ASSETS:**

Foreign Exchange Assets means any specified assets which the assessee has acquired or purchased with or subscribed to in convertible exchange.

**INVESTMENT INCOME (II):**

Investment Income means any income derived from a foreign exchange assets other than dividends on shares referred to in sec 115-0

**LONG TERM CAPITAL GAINS (LTCG):**

Long, Term capital Gains mean income chargeable under the head capital gains relating to a foreign

**115D : COMPUTATION OF TOTAL INCOME**

The provisions are important in respect of computation of the total income in case of NRIs:

(A) No deduction in respect of any expenditure or allowance shall be allowed under any provisions of the Income Tax Act in computing the investment income.

(B) Where Gross Total Income includes only Investment Income and/or Long Term Capital Gains the first proviso shall apply, but the second proviso shall not apply for computation of long term capital gains

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Where Gross Total Income does include Investment Income or Long Term Capital Gains and other incomes Sec 48 shall not apply for computation of long term capital gains, although the first proviso to sec 48 shall apply

**115E : COMPUTATION OF INCOME TAX**

Where the total income of an assessee, being a non resident Indian includes:

(a) any investment income, or

(b) income by way of long term capital gains, then, the tax payable by him shall be the aggregate of:

(i) the amount of income tax calculated on the investment income referred to in clause (4), if any, included in the total income, at the rate of 20%

(ii) the amount of income tax calculated on the income by way of long term capital gains referred to in clause (b), if an, included in the total income, at the rate of 0.15

(iii) the amount of income tax with which he would have been chargeable had his total income been reduced by the amount of income referred to in clauses (a) and (b)

**Sec 115F : Capital gains on transfer of foreign exchange assets not to be charged in certain cases**:

Where a NRI has transferred a long term foreign exchange asset and has within a period of 5 months after the date such transfer invested the net consideration in any "specified Assets" or in NSCs VI or VII issue then,

(a) if the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of the capital gains shall not be charged to tax under section 45;
(b) if the cost of the new asset is less than the new consideration in respect of the original asset, the following shall not be charged to tax under sec. 45:

Capital Gains* Cost of acquisition of new asset Net consideration

Here net consideration means the consideration from transfer less expenditure in connection with transfer.

It should be noted that where the new asset is transferred or converted into money within a period of 3 years from the date of its acquisition, the amount of capital gains arising from the transfer of original asset not charged to tax earlier, shall be deemed to be the income under the head "capital gains" relating to long term capital assets. The same shall be charged to tax in the previous year in which new assets is transferred or converted into money.

115 G: Return of Income not to be filled in certain cases

An NRI is required to furnish the return of income if:

(a) Total income consists of only investment income and/or on term capital gains, and

(b) Tax at source has been deducted from such income.

115 H: Benefit under the Chapter available in certain cases after the assessee becomes resident.

Where a person who is a NRI in any previous year becomes assessable as a resident in any subsequent year, then he may furnish a declaration in writing along with the return of income under sec 139 for the year in which he is so assessable.

The declaration shall be to the effect that the provision of this chapter shall continue to apply to him in respect of the investment
income derived from foreign exchange assets (other than shares in Indian company)

It he does so, the provisions of this chapter shall continue to apply to him in relation to such income for the assessment year and every subsequent assessment year until the transfer of conversion into money of such asset.

Sec 115 I Discretion to elect application of above provisions

It is provided that an NRI may elect not to be governed by the provisions of this chapter for any assessment year by furnishing his return of income for that assessment year under sec. 139 and declaring therein that the provisions of this chapter shall not apply to him for that assessment year.

5.3.4 SCHEME UNDER WEALTH TAX LAWS

Wealth tax is charged for every assessment year in respect of net wealth on the valuation date of every individual including non-residents. The assessment year connotes the same meaning as for income-tax purposes i.e, from 1st April to 31st March immediately after the valuations date, valuations date is 31st March immediately preceding the assessment year.

Assesees for the purpose of wealth tax are also categorized as under.

(i) Resident

(ii) Resident but not ordinarily resident in India

(iii) Non-residents

The general provisions regarding procedure of assessment and filling of returns etc. are on the same lines as for income-tax discussed earlier in this chapter.

Net Wealth:

Wealth tax is levied on net wealth which in other words is 'taxable wealth'. It represents excess of assets "belonging to" the assessee
including deemed assets) over debts. Certain assets are exempted and do not form the part of the net wealth.

**Net Wealth vis a vis Residential status**

Generally, value of all assets, wherever located, is to be included in the net wealth. However, in case of foreign citizens, non-resident persons, not ordinarily residents and non-resident companies, following are not be included in the net wealth:

(a) assets located outside India, and

(b) assets located outside India, income from which is exempt u/s 10 of the Income-tax Act.

Similarly, debts located outside India are also not deductible under Sec. 6 of the Wealth Tax Act.

The question as to where the asset is located is essentially one of fact and will have to be decided in the light of evidence. The following instructions are issued for general guidance:

(a) Tangible immovable property is situated in India if the property lies in India

(b) Rights or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise lies in India.

(c) Rights or interest (otherwise than by way of security) in or over tangible movable property are located in India if such property is located in India, or if it is transit to India.

(d) Debts, secured or unsecured (other than those dealt with below, are located in India, if they are contracted to be repaid in India or, if the debtor is residing in India.
(c) Money kept in a bank account in the form of deposits or otherwise are located in India if the branch of the bank at which the account is kept is situated in India.

(f) Securities issued by the Central Government or a State Government or a municipality or other local authority in India are located in India unless they are inscribed for payment outside India.

(g) Shares, stock, debentures stock in a company are located at the place where the company is incorporated.

(h) Ships or aircraft are located in India if they are registered in India.

(i) Copyright or licence to use any copyrighted material, patent, trade mark or design is located in India if the rights arising there from are exercisable in India.

(j) Patents, trade-marks and designs are located in India if they are registered in India.

(k) Rights or cause of action ex delict to not included in any of the items mentioned above are situated in India if they are enforceable in India.

It is not possible to give an exhaustive list of assets and the principles to be applied in determining the location of all such assets. For assets which are not covered by the above items, the location has to be fixed having regard to the nature of the assets.

**ASSETS**:

The 'Assets' include property of every description, movable or immovable including every species of an estate, real and personal and everything which one person can own, acquire or hold or enjoy or transfer to another.
The following have, however, been excluded from the scope of assets for wealth-tax purposes:

(i) Agricultural land and growing crops (including fruits or trees); grass or standing trees on such land.

(ii) Any building owned or occupied by a cultivator of or receiver of rent or revenue out of agricultural land if the building is on or in immediate vicinity of the land, and is required and used as a dwelling house or store house or and out house.

(iii) Animals.

(iv) A right to receive an annuity in any case where the terms and conditions relating thereto preclude the commutation of any portion thereof into a lump sum grant and is not purchased by the assessee or by any person in pursuance of contract with him.

(v) Any interest in property, available to an assessee for a period not exceeding six years from the date such interest vests in assessee.

**ASSETS MUST "BELONG TO" THE ASSESSEE**

As stated above, assets belonging to the assessee are be induced in his net wealth. The expression 'belonging to' includes ownership and rightful possession but not mere possession unaccompanied unaccompanied by right to property. For instance, assets held by a trustee in trust for the beneficiary do not belong to' the trustee in his individual capacity.

Ownership may be way of control, possession or enjoyment of property. But all the three attributes need not necessarily be present to make the property belonging to the assessee.

However, the following persons are deemed as owner of immovable properties for wealth-tax purposes:
(i) A member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or associations as the case may be.

(ii) A person who has taken possession of any building under an agreement to sell (which is not registered) with the vendor and paid consideration or willing to perform his part of the contract.

(iii) A person who acquires any right (excluding any rights by way of lease from month to month or for a period not exceeding one year) with respect to any building by virtue of any transaction as is referred to in section 269 UA(f).

EXEMPTIONS AND DEDUCTIONS

Important exemption and deduction in respect of non-resident persons as contained in Section 5 have been discussed hereunder.

Following assets shall not form part of net wealth, subject to the limits without any monetary limit.

1. Interest in H.U.F.
2. Residential Units
3. Patent or Copyright
4. Right in Insurance Policy
5. Right in Annuity
6. Right to receive pension
7. Value of Household Goods
8. Agricultural Tools and Equipment's
9. Outstanding Fees of Lawyers etc.
10. Instruments and apparatus of Scientific Research
11. Works of Art etc.
12. Drawing, Painting etc.
13. 6.5% Gold Bond, 1977
15. Foreign Exchange Assets
16. 7% Capital Investment Bonds
17. Relief Bonds
18. Debentures of public sector company
19. NRI Bonds 1988 of State Bank of India notified u/s 10(15) (iid) of Income Tax Act
20. Amount of Provident Funds for the Salaried Employees
21. Amount of Public Provident Funds
22. Shares held by a Company
23. National Saving Scheme
24. Jeevan Dhara/Jeevan Akshay
25. Deposit Scheme of Retirement Benefits
26. Deposit in Co-operative Housing Society
27. Building used for Employees Residence
28. Value of Assets brought by erstwhile non-resident persons
29. Equity Shares Owned by non-residents
30. Exemption in case of non-residents

ASSETS EXEMPT UPTO AN INDIVIDUAL LIMIT

The following assets are exempt subject to certain Limits:

❖ **Personal Conveyance**: One or more conveyance (such as motor car or other mechanically propelled vehicles,
aircraft and boat) upto aggregate value of Rs. 75,000 as per Sec. 5(1) (viii)

**Tools and Instruments of Professionals**: upto a limit of Rs. 50,000. As per Sec. 5(1) (x)

**ASSETS EXEMPT UPTO AGGREGATE LIMIT OF RS. 5,00,000**

The aggregate value of following assets up to a value of Rs. 5,00,000 is exempt in computation of net wealth.

<table>
<thead>
<tr>
<th>Nature of Assets</th>
<th>Sections</th>
</tr>
</thead>
<tbody>
<tr>
<td>A One house or part of house belonging to the assesssee</td>
<td>5(1)(iv)</td>
</tr>
<tr>
<td>B Deposit under following schemes-3 year/5 year fixed deposit in State Bank of India of its subsidiary or Post Office, 1/2/3/5 year Post Office Time Deposit, 5 year Post Office Recurring Deposit</td>
<td>5(1)(xv)</td>
</tr>
<tr>
<td>C Deposit in Post Office Saving Banks</td>
<td>5(1) (xvi)</td>
</tr>
<tr>
<td>D Deposit in 10 years Treasury Saving Deposit Certificate, 15 years Annuity Certificate, Post Office Cash Certificate, National Saving Certificate VI &amp; VII issue</td>
<td>5(1) (xvi)</td>
</tr>
<tr>
<td>E 12 Year National Defence Certificates</td>
<td>5(1)(xvi)</td>
</tr>
<tr>
<td>F 5 year National Development Bonds</td>
<td>5(1)(xvi)</td>
</tr>
<tr>
<td>G Debentures issued by public sector company on or after 1.6.1988 as specified by the Government</td>
<td>5(1)(xvii)</td>
</tr>
<tr>
<td>H Central and State Govt. Security other than security referred to in clause (xvi) of Sec. 5(1), i.e. items C to F</td>
<td>5(1) (xxii)</td>
</tr>
<tr>
<td>I Investment in shares in any Indian company other than referred to in clause (xxa) of Sec. 5(1). See item No. 22</td>
<td>5(1) (xxiii)</td>
</tr>
<tr>
<td>J</td>
<td>Debentures of Any Co-operative Society, Co-operative Land Mortgage Bank, A Co-operative Land Development Bank or any other institution and authority notified by Government.</td>
</tr>
<tr>
<td>K</td>
<td>Unit of a Mutual fund Specified under clause (23D) of Section 10 of the Income Tax Act i.e. SBI Mutual Fund, Canbank Mutual Fund, LIC Mutual Fund, Indian Bank Mutual Fund, PNB Mutual Fund, BOI Mutual Fund &amp; GIC Mutual Fund</td>
</tr>
<tr>
<td>L</td>
<td>Units in Unit Trust of India</td>
</tr>
<tr>
<td>M</td>
<td>Deposit under National Deposit Scheme</td>
</tr>
<tr>
<td>N</td>
<td>Deposit under Banking Company including Co-operative Land Development Bank including deposits in savings/current account or fixed/term deposits with Nationalised and Scheduled Banks)</td>
</tr>
<tr>
<td>O</td>
<td>Deposit with a Financial Corporation engaged in providing long term finance for Industrial Development in India or with a Public Company engaged in Providing long term finance for construction or purchase of houses in India for residential purposes.</td>
</tr>
<tr>
<td>P</td>
<td>Deposit with the Industrial Development Bank of India</td>
</tr>
<tr>
<td>Q</td>
<td>Deposit with authority dealing in housing accommodation or planning, development or improvement of Cities, Towns &amp; Village</td>
</tr>
<tr>
<td>R</td>
<td>Deposits made with National Housing Bank</td>
</tr>
<tr>
<td>S</td>
<td>Shares in any Co-operative Society</td>
</tr>
<tr>
<td>T</td>
<td>Deposits with a Co-operative Society</td>
</tr>
<tr>
<td>U</td>
<td>Value of assets forming part of an industrial under taking belonging to the assessee (other than land and building or any right therein)</td>
</tr>
<tr>
<td>V</td>
<td>Value of assets (other than land building or any right therein) forming part of an industrial undertaking belonging to the firm or association of persons in which the assessee is a partner or member</td>
</tr>
</tbody>
</table>
It may be noted that:

- Deposits under National Deposit Scheme will be entitled to a separate exemption of Rs. 25,000 in addition to overall financial exemption of Rs. 5 lakhs.

- The minimum holding period for claiming exemption of deposits of assets is six months prior to the valuation date except in the case of one house or a part of the house.

- Deposit under National Deposit Scheme, assets (other than land and building) forming part of an industrial undertaking, value of the interest of a partner or member in the assets forming part of an Industrial undertaking belonging to a firm or an AOP. If the assessee sells any exempted assets (other than shares or securities held by him as stock in trade) and acquires within 60 days from the date of sale, another asset exempt under Section 5, the period of holding previous asset shall be included for computing period of six months.

- Where a debt is secured on, or has been incurred in relation to any asset referred to in items A to V above, then exemption u/s 5(1A) shall be allowed first in respect of such assets and thereafter against other assets.

- Where the assessee is a partner of a firm or member of an AOP, and such or AOP owns any asset which is exempt u/s 5(1), then while calculating his interest in the firm or AOP exemption shall be allowed to him to the extent of his proportionate share in such asset(s).

VALUATION OF ASSETS:

The value of assets is to be computed in accordance with section 7 and Schedule III to the Act. Wherever rules provide, the valuation of such asset is to be computed in terms of rule which is
binding. The rules provide for valuation of almost all types of assets such as immovable property, quoted and unquoted shares/debentures, interest in firm, business assets, life interest, jewellery, etc. value of other assets is to be fixed at the market value as on the valuation date.

OBLIGATIONS TO FILE RETURN:

Undermentioned persons are liable to file Wealth Tax Return:

1. Every Individual, Association of persons, Body of trustees, Hindu Undivided Family, (other than specified); having net wealth exceeding Rs. 2.5 lakhs on the valuation date.

2. Hindu Undivided Family, Which has atleast one member assessable to wealth tax and having a net wealth exceeding Rs. 1.5 lakhs

3. Every company, not being a company in which the public are substantially interested.

4. Any person to whom a notice has been served for furnishing a return by Assessing Officer.

5.4 EXPORT INCENTIVES

Exports are given top priority in India, as India needs regular inflow of foreign exchange of non-borrowing category to meet its growing import requirements due to developmental needs, which affects the balance of trade adversely. For this purpose several export incentives are given to encourage and support export activities and also to help the Indian exporters competing in the International market. Such encouragements are common to all countries.

Export incentives in India can be categoriesed into:

(a) Indegenous inputs without payment of excise duty,

(b) No excise duty on the final product,

(c) Import of goods without payment of custom duty,
(d) No export duty on the export of final product

(e) Bank finance at concessional rates

(f) Exemption from income tax or a tax holiday

(g) Exemption from sales Tax and other local taxes

(h) Special Import licence import of goods, which are otherwise not permitted.

The concessions are given in a package form for the units established in the Export Processing Zones and to the hundred percent Export Oriented units. Similar packages are also given to the units set up in the Technology Parks for electronic hardwares and computer softwares.

The concessions so given are in the nature of:

(i) Tax holiday for a period ranging for, 3 to 15 years in various respects depending on the type of good and the location,

(ii) Deferment of Tax Levy for designated period of 3 to 8 years and thereafter realization in phased manner,

(iii) Non-levy of duty, whether custom duty of excise duty at all, in case of specified exports and imports for the designated units,

(iv) Duty drawback i.e. seeking refund of duty or adjustment thereof in the payment of duty on other account after completion of export,

(v) Specialised Incentives for achievement of exports and targets etc where some quota system is prevalent as in case of garments export.

The incentives, deductions and exemptions given to such earnings in Income Tax Act have already been discussed in the foregoing paragraphs.
In nutshell the Government has framed out numerous incentive schemes for NRIs on one form or the other. Several incentives are also available to them depending on the nature of the project, location of the project, form of the business organisation or entity, nature of the project, form of the business organisation or entity, nature of product they propose to manufacture, their participation in the export and commitment to earning of foreign exchange for the country by such project.

5.5 TAX HAVENS

Tax haven has been coined as business terminology. Haven means a place of shelter and safety. Therefore, tax haven would mean a shelter, albeit, a tax shelter\(^3\). Basically it is a foreign country with tax legislation specially designed to attract the formation of branches, companies and subsidiaries of parent companies based in heavily taxed industrial nations. However, there should be some interaction between the two such countries for a tax heaven operation. This interaction may be explicit (as in the case of reciprocal treaty) or implicit. In this context, morality is not considered an absolute, but a concept which, like the tax laws, themselves Certain tax heavens are best suited for certain specified enterprise more than the other. For instance, Hong Kong may be viable in many case for manufacturing enterprise. Many tax heavens are flag-of-convenience nations or territories, allowing foreign ship owners to register under tax haven flag to avoid taxes, economic restrictions, and the various rules and regulations of their own nations. Such countries in prominence are Liberia and Panama, besides, Bahamas, Bermuda, Cyprus, Isle of Man, Malta, Mauritius etc.

Tax havens may be with no income tax like Bermuda, Bahamas and Cayman Islands. Tax havens may have income tax but no tax on foreign source income like Hong Kong, Gibraltar, Jersey, Liberia, Isle of Man, Guernesey, Cyprus and Maina etc. There are certain tax

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havens with special legislation for regional offices of foreign companies like, Philippines, Jordan, Greece and Tunisia etc. There are also a few tax havens for some special purposes like. The Netherlands for holding companies, Austria for international holding companies, Luxembourg for large holding companies, etc.

Most of the Tax Havens are islands or archipelago societies. Foreign invasion in most of these countries have resulted in ethnically mixed populations, native peoples and white immigrants from Europe and America. They have almost no racial friction and are peaceful and non-violent. The planning for tax through Tax Havens needs careful consideration as these are in the eyes of tax collectors for suspicion. However, the concept and opportunity can be well utilised.