

HR & Tax Alert



Quality In Everything We Do

India – Highlights of the India Budget 2005 proposals

March 2005

Executive summary

The Indian Finance Minister presented the Union Budget 2005 in Parliament on 28 February 2005.

The proposed changes include a change in the personal income tax 'slabs' (bands), the abolition of the standard deduction and amendments to the personal tax rebate provisions. Along with these measures come provisions designed to ensure that employers pay taxes on "fringe benefits" along with some measures for controlling tax evasion.

The objective of this Alert is to set out some of the proposals which impact employers, employees and individual income earners, especially salary earners. The Alert also includes proposals dealing with employer compliance and proposals affecting individuals in their capacity as employees. The provisions of the Budget are proposals only and will not acquire legal status until they are approved by both Houses of the Parliament and receive the assent of the President of India. Once approved, unless otherwise stated, the provisions will generally apply with respect to the Financial Year 2005-06 i.e. with effect from 1 April 2005.

Budget Proposals

Rates of Income Tax

The Budget has proposed a change in the tax 'slabs' (bands) for individual tax payers. The minimum tax exemption limit for male individuals who are not senior citizens has been raised from Rs 50,000 to Rs 100,000 (for women and senior citizens, this limit has been increased to Rs 125,000 and Rs 150,000 respectively). (As at 1 March 2005 1US\$ is equal to 43.70Rs). A comparison between the existing and the proposed personal income tax schedule is tabularised below –

Income 'slabs' (bands)	Current rates	New Income 'slabs' (bands)	Proposed Rates
Up to Rs 50,000	Nil	Up to Rs 100,000	Nil
Rs 50,001 to Rs 60,000	10%	Rs 100,001 to Rs 150,000	10%
Rs 60,001 to Rs 150,000	20%	Rs 150,001 to Rs 250,000	20%
Above Rs 150,000	30%	Above Rs 250,000	30%

Furthermore, the Budget proposals include a 10% surcharge that will be applicable when the total income of the individual exceeds Rs 1,000,000 compared to the current level of Rs 850,000. An additional charge known as an 'Education Cess' of 2% of total tax liability (including surcharge) would continue to be payable by all taxpayers. Hence, the maximum tax rate for individuals would remain at 33.66%.

Fringe Benefit Tax

At present, there is no concept of fringe benefit tax in India. All cash and benefits in kind provided to employees are taxed in accordance with prescribed rules. In addition to these existing rules, a proposal has been made to introduce a Fringe Benefit Tax ("FBT") payable by the employer. This would apply to expenses incurred in respect of employee welfare and other similar payments which cannot be attributed to a particular employee but which may have an element of personal benefit. The proposed list of such items includes entertainment, use of club facilities, guest house, domestic and foreign travel expenses, hotel and lodging expenses and contributions by an employer towards a superannuation fund.

The proposed rate for the FBT is 30% (plus applicable surcharge and 'education cess') on the value of the fringe benefits and this will be payable by the employer over and above the normal corporate tax if any. Specific regulations have been proposed for calculating the value of the fringe benefits. Any employer who is liable to pay FBT, will be required to pay the tax in advance during the financial year and provide a fringe benefits tax return by the prescribed due date. Penal provisions have also been specified in case of non-compliance. The FBT paid by the employer is not deductible for corporate tax purpose.

The draft provisions are very loosely worded and have a wide application. They do not clarify whether FBT applies to foreign employers or to employees who are on short stay or business trips to India and who are not subject to income tax in India. However, it is expected that the Government will clarify such matters soon. Many business forums and chambers of commerce have demanded a roll-back of the FBT provisions.

Standard Deduction

Currently, employees are eligible for a standard deduction on their salary income. It is proposed that this will be abolished.

Withdrawal of Tax Rebates

It has been proposed in the budget that the tax rebates currently available on specific investments made during the relevant tax year be replaced with an income-based deduction of up to Rs 100,000 for all individual taxpayers. The investments eligible for the proposed deduction are similar to those that were entitled to the rebate. Further, it is proposed that the rebates currently available to senior citizens and women in employment be withdrawn.

Exemption/Deduction on Interest income

It is proposed that the deduction currently available to individual tax payers on interest income earned from bank interest and specified securities be withdrawn. However, the budget proposes to maintain the tax exemption available on interest earned on Non-resident external (NRE) accounts and foreign currency deposits.

Banking Cash Transaction Tax

A new levy has been proposed as a measure for determining possible tax evasion. This will be called "banking cash transaction tax" and it will operate as 0.1% on cash withdrawals or purchases of bankers drafts, or similar, of Rs 10,000 or more per individual per day. This tax would be collected by the banks which now have the onus to deduct the tax, deposit the amount on time and to file periodic returns. Penal provisions for non-compliance have also been proposed.

Extension of date for the new TDS certificate procedure

To facilitate the new procedure for the Tax Deduction at Source ('TDS') certificates, whereby the certificates will be available in electronic format only, it was provided in the last budget that there would be no requirement for issuing the TDS certificates and filing the certificates along with the personal income tax return from 1 April 2005. Since the new system of tax accounting is gradually stabilising, it has now been proposed to extend the application of the current

method of issuing TDS certificates in paper format to tax year 2005-06 and to defer the new procedure to 1 April 2006.

Next steps

Employers should ensure that they are aware of these

proposals which could impact their India mobility program as well as Indian employment costs.

Ernst and Young will continue to track the progress of these proposals and issue an Alert when the proposals acquire the force of law.

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