AMENDMENTS MADE BY FINANCE ACT, 2018 AT A GLANCE

INCOME-TAX

Section	*Effective date of amendments*	*Nature of amendment*	*Effect of amendment*
1	*2*	*3*	*4*
2(22)	***1-4-2018***	Explanation 2A *inserted*	Clause (*22*) of section 2 provides the definition of the term "dividend". *Explanation 2* to clause (*22*) clarifies the expression "accumulated profits" for the purposes of clause (*22*). Instances have come to light whereby companies are resorting to abusive arrangements in order to escape liability of paying tax on distributed profits. Under such arrangements, companies with large accumulated profits adopt the amalgamation route to reduce capital and circumvent the provisions of sub-clause (*d*) of clause (*22*) of section 2. With a view to preventing such abusive arrangements and similar other abusive arrangements, a new *Explanation 2A* is inserted in clause (*22*) of section 2 to widen the scope of the term 'accumulated profits' so as to provide that in the case of an amalgamated company, 'accumulated profits', whether capitalized or not, or losses as the case may be, shall be increased by the accumulated profits of the amalgamating company, whether capitalized or not on the date of amalgamation.
2(24)	***1-4-2019***	*Sub-clauses* (xiia) *and* (xviib) *shall be inserted*	Clause (*24*) of section 2 defines the expression "income". Section 45 *inter alia,* provides that capital gains arising from a conversion of capital asset into stock-in-trade shall be chargeable to tax. However, in cases where the stock in trade is converted into, or treated as, capital asset, the existing law does not provide for its taxability.

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			In order to provide symmetrical treatment and discourage the practice of deferring the tax payment by converting the inventory into capital asset, clause (*24*) of section 2 shall be amended by inserting new sub-clause (*xiia*) in clause (*24*) so as to include the fair market value of inventory referred to in *clause* (*via*) of section 28, also within the definition of income. Further, new sub-clause (*xviib*) shall be inserted in clause (*24*) so as to include any compensation or other payment referred to in clause (*xi*) of sub-section (2) of section 56, also within the definition of income.
2(42A)	***1-4-2019***	*Sub-clause (*ba*) shall be inserted in clause (*i*) of* Explanation 1 *and certain words shall be substituted in* Explanation 4	*Clause* (*42A*) of section (2), *inter alia,* provides for determination of period for which the capital asset is held by the assessee. Section 45 *inter alia,* provides that capital gains arising from a conversion of capital asset into stock-in-trade shall be chargeable to tax. However, in cases where the stock in trade is converted into, or treated as, capital asset, the existing law does not provide for its taxability. In order to provide symmetrical treatment and discourage the practice of deferring the tax payment by converting the inventory into capital asset, clause (*42A*) of section 2 shall be amended by inserting new sub-clause (*ba*) in clause (*i*) of *Explanation 1* of clause (*42A*) so as to provide that in case inventory is converted into or treated as a capital asset under the newly inserted clause (*via*) of section 28, the period shall be reckoned from the date of its conversion or the treatment. *Explanation 4* shall be amended to provides that 'equity oriented mutual fund' will have the same meaning as assigned to it in section 112A.
9	***1-4-2019***	*Clause (*a*) of* Explanation 2 *to section 9(1) (i) shall be substituted;* Explanation 2A *shall be inserted in clause (i) of sub-section (1) of section 9*	Under the existing provisions of *Explanation 2* to clause (*i*) of sub-section (1) of section 9, "business connection" includes business activities carried on by non-resident through dependent agents. The scope of "business connection" under the Act is similar to the provisions relating to Dependent Agent Permanent Establishment (DAPE) in India's Double Taxation Avoidance Agreements (DTAAs). In terms of the DAPE rules in tax treaties, if any person acting on behalf of the non-resident, is habitually authorised to conclude contracts for the non-resident, then such agent would constitute a PE in the source

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			country. However, in many cases, with a view to avoid establishing a permanent establishment (PE) under Article 5(5) of the DTAA, the person acting on the behalf of the non-resident, negotiates the contract but does not conclude the contract. Further, under paragraph 4 of Article 5 of the DTAAs, a PE is deemed not to exist when a place of business is engaged solely in certain activities such as maintenance of stocks of goods for storage, display, delivery or processing, purchasing of goods or merchandise, collection of information. This exclusion applies only when these activities are preparatory or auxiliary in relation to the business as a whole. OECD under BEPS Action Plan 7 reviewed the definition of 'PE' with a view to preventing avoidance of payment of tax by circumventing the existing PE definition by way of commissionaire arrangements or fragmentation of business activities. In order to tackle such tax avoidance scheme, the BEPS Action plan 7 recommended modifications to paragraph (5) of Article 5 to provide that an agent would include not only a person who habitually concludes contracts on behalf of the non-resident, but also a person who habitually plays a principal role leading to the conclusion of contracts. Similarly Action Plan 7 also recommends the introduction of an anti fragmentation rule as per paragraph 4.1 of Article 5 of OECD Model tax Conventions, 2017 so as to prevent the tax payer from resorting to fragmentation of functions which are otherwise a whole activity in order to avail the benefit of exemption under paragraph 4 of Article 5 of DTAAs. Further, with a view to preventing base erosion and profit shifting, the recommendations under BEPS Action Plan 7 have now been included in Article 12 of Multilateral Convention to Implement Tax Treaty Related Measures (MLI), to which India is also a signatory. Consequently, these provisions will automatically modify India's bilateral tax treaties covered by MLI, where treaty partner has also opted for Article 12. As a result , the DAPE provisions in Article 5(5) of India's tax treaties, as modified by MLI, shall become wider in scope than the current provisions in *Explanation 2* to section 9(1)(*i*). Similarly, the anti-fragmentation rule introduced as per paragraph 4.1 of Article 5 of the OECD Model Tax Conventions, 2017 has narrowed the scope of the exception under

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			Article 5(4), thereby expanding the scope of PE in DTAA *vis-a-vis* domestic provisions contained in *Explanation 2* to section 9(1)(*i*). In effect, the relevant provisions in the DTAAs are wider in scope than the domestic law. However, sub-section (2) of section 90 provides that the provisions of the domestic law would prevail over corresponding provisions in the DTAAs, to the extent they are beneficial. Since, in the instant situations, the provisions of the domestic law being narrower in scope are more beneficial than the provisions in the DTAAs, as modified by MLI, such wider provisions in the DTAAs are ineffective. In view of the above, the provision of section 9 shall be amended so as to align them with the provisions in the DTAA as modified by MLI so as to make the provisions in the treaty effective. Accordingly, clause (*i*) of sub-section (1) of section 9 shall be amended to provide that "business connection" shall also include any business activities carried through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident and the contracts are— (*i*) in the name of the non-resident; or (*ii*) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that the non-resident has the right to use; or (*iii*) for the provision of services by that non-resident. Explanation 2A *to section 9* - Normally both the residence and source countries claim the right to taxation. Taxation of business profits on the basis of economic allegiance has always been the underlying basis of existing international taxation rules. Economists gave primacy to the economic allegiance rather than physical location and made it clear that physical presence was important only to the extent it represented the economic location. Ordinarily, as per the allegiance of taxing rules under Article 7 of DTAAs, business profit of an enterprise is taxable in the country in which the taxpayer is a resident. If an enterprise