

About New Direct Tax Code 2009

Friends as we know, Finance Minister Pranab Mukherjee on August 10 released the New Draft Direct Tax Code. The draft, which is expected to radically change the tax structure, will now be open for discussion after which it will take the form of law. The finance minister had in his budget promised to deliver a new code within 45 days and has kept to his promise.

Unveiling the new code, Home Minister P Chidambaram, with the finance minister by his side, said he was confident that new code, when passed by the Parliament, will be a huge improvement on the existing law. "It is a brand new code written from scratch. It is not an amendment but a replacement of the Income Tax, 1961," he said, adding that it would promote entrepreneurship and the thrust would be on "regulated free markets".

Proposed changes

The draft proposes to bring all direct tax laws under one umbrella, the finance minister said, adding that it would eliminate the scope of litigation. "The new draft code has simplified capital tax gains and laws on for non-profit organizations, savings instrument," he said. The new code was aimed at removing distortions in the tax structure, he added.

The code proposes to exempt the general tax payer from paying income tax if his income is Rs 1,60,000 in a year.

He would pay just zero tax till an income of Rs 1,60,000 per year. From income above Rs 1,60,000 till Rs 10 lakh (Rs 1 million), he will pay a tax of 10 per cent.

For income above Rs 10,00,000, but less than Rs 25,00,000 (Rs 2.5 million), he will pay tax of Rs 84,000 plus 20 per cent of the amount over Rs 10,00,000.

For income above Rs 25,00,000, he will pay Rs 3,84,000 plus 30 per cent of the amount by which the total income exceeds Rs 25,00,000.

Currently, the general income tax payer does not pay tax till Rs 1,60,000 of income in a year. However, he pays 10 per cent tax on income between Rs 1,60,000 and Rs 3 lakh, 20 per cent between Rs 3 lakh and Rs 5 lakh (Rs 500,000) and 30 per cent beyond Rs 5 lakh.

While the code proposes abolition of the controversial STT, it also suggests reintroduction of tax on long term capital gains on securities trading.

Major Highlights of Direct Tax Code 2009:

Income Tax

Change in nomenclature: A unified financial year term replaces assessment year and previous year

Rise in tax slabs: The 10 per cent tax bracket raised up to Rs 10 lakh, 20 per between Rs 10 and 25 lakh and 30 per cent for over Rs 25 lakh.

Salary perks as part of income: Would include perks like house rent, leave travel allowance, medical imbursement

Gratuity on change of jobs: Will be tax-exempt on change of jobs only if it is invested in a retirement fund

Income from ordinary source: Would include income from employment, house property, business and so on.

Income from special source: Would include capital gains on equity and equity oriented funds, income of any other nature

Wealth Tax and 80 C

Wealth limit: Increased substantially from Rs 30 lakh to Rs 50 crore. Will not apply to private discretionary trusts

Rate of taxation: Reduced from 1 per cent to 0.25 per cent

More instruments: Will include equity, mutual fund units purchased and fixed deposit investments

80C limit: From Rs 1 lakh at present to Rs 3 lakh for a hindu undivided family (HUF) or individual

Less instruments in 80C: Equity-link savings scheme and 5-year fixed deposit will not be included

Definition of higher education expanded under 80C: Higher education will now include graduation and post graduation studies and the tuition fees will be exempt

Insurance

Medical insurance: Existing exemptions retained for individuals, senior citizens and the handicapped

Tax-free: Pure life insurance and policies whose premiums less than 5 per cent of sum assured, even on bonuses

Exempt-Exempt-Tax (EET): New tax regime for all provident funds, superannuation funds, life insurance and New Pension Scheme (NPS). These investment to be taxed on withdrawal

Grandfathering Clause: Withdrawal of any amount invested in retirement and superannuation schemes as on March 31, 2011 will not be taxed

Relief on rollover: The rollover of money withdrawn from one account of the permitted saving to another will not be treated as withdrawal.

Housing

Housing Deduction: The deduction of Rs 1.5 lakh for housing loan interest payment removed for a self-occupied residence

Gross Rent Calculation: The gross rent for calculating income tax will be based either on the rent that the house owner has contracted or on the presumptive rent, whichever is higher.

Presumptive Value: Presumptive rent to be considered as actual rent or 6 per cent of the rateable value of a property fixed by local authorities, or 6 per cent of the cost of buying or building the property

Joint Ownership: If two people own the house, the tax will be levied based on the proportion of their ownership

Rent Deductions Capped: The deduction from gross rent for any repair work or municipal taxes is capped at 20 per cent from the earlier 30 per cent

Capital Gains

Distinction Scrapped: The distinction between short- and long-term capital gains tax scrapped

Indexation benefit: One year cap remains to avail indexation benefits. The same applied for house sold after one year

Rate of Capital Gains: The rate of capital gains tax as per income slab of the person

Equity Investment: Investors will not enjoy zero tax on equity held for over one year

Dividend: Dividends paid out on equity investment are fully tax exempt

Exceptions: Capital gains will not apply to transfer of assets on partition of Hindu undivided family, gifts, transfer under an irrevocable trust, of any investment asset, other than sweat equity share

- ü The code seeks to consolidate all direct taxes i.e. Income Tax, DDT, FBT & Wealth Tax under a single umbrella.
- ü The regulatory function of the taxing statute has been withdrawn. This is being labelled as a great simplification measure.
- ü Under the code all rates of taxes are proposed to be prescribed in the First to the fourth Schedule to the code itself thereby obviating the need for an Annual Finance Bill. The changes in the rates will be done through appropriate amendments to the Schedules.
- ü The Code has provided a comprehensive definition of income. It includes all accrual and receipts of revenue and capital nature unless otherwise specified. It is important to note in this regard that agricultural income has been excluded from the scope of this code.
- ü The separate concept of “Previous Year” and “Assessment Year” will be replaced by a unified concept of “Financial Year”
- ü Unabsorbed business losses shall be allowed to be carried forward indefinitely.
- ü **Classification of source of Income (Section 12)**

For the purpose of computation of total income of any person for any financial year, income from all sources shall be classified under the following :

- ❖ **Income from Special Sources**
- ❖ Items listed in the Table in Rule 3 of the First Schedule shall be considered as income from special sources
- ❖ **Income from Ordinary Sources**
- ❖ All income accruing from a source other than the special sources, shall be classified under the following heads of income
 - Income from Employment
 - Income from House Property
 - Income from Business
 - Capital Gain
 - Income from Residuary Sources

- ü **Income from House Property** – No deduction for taxes or interest will be allowed in case of a self-occupied property.
- ü The earlier limit of Rs. 1,50,000/- on account of interest on capital borrowed for the purpose of acquiring constructing repairing renewing or reconstructing the property has been withdrawn. As per the code any amount of interest paid in this regard shall be admissible.
- ü **Income from Business** – profit on sale of business capital assets and undertaking under a slump sale will no longer be treated as capital gain. They will be treated as genuine business income.
- ü Income by way of interest earned by the assessee other than financial institutions shall now be treated as “Income from Residuary Sources”.
- ü Business expenditure has been classified into 3 mutually exclusive categories:
 - ❖ Operating Expenditure
 - ❖ Permitted Financial Charges
 - ❖ Capital Allowances
- ü Depreciation on business capital assets will now include expenses amortised.
- ü In order to curb the growing cases of asset stripping and loss manipulation the code proposes that loss on sale of business capital assets will be treated as intangible assets and depreciation will be allowed at the same rate applicable to the relevant block of assets. Thereby, only a fraction of loss shall be allowable every year.
- ü **Income from Capital Gains** – The present distinction on the basis of the length of holding of the asset between short-term capital asset and long-term capital asset will be eliminated.
- ü The Securities Transaction Tax (STT) will be abolished.
- ü The base date for determining the cost of acquisition of asset has now been shifted from 01-04-1981 to 01-04-2000.
- ü It has been held time and again by various judicial authorities that where the cost of acquisition of capital asset is indeterminable, the machinery provisions for computing capital gains fail. In this regard, the code now proposes a new provision wherein if the cost of acquisition of an investment is not determinable or ascertainable for any reason, the cost of acquisition shall be deemed to be ‘NIL’.
- ü **Income from Residuary Sources** – Any amount exceeding Rs. 20,000/- taken or accepted or repaid as loan or deposit otherwise than by account payee cheque or draft shall now be treated as “Income from Residuary Source.

ü **Incentive for Savings** – The code now proposes a new method of taxation of savings i.e EET (Exempt-Exempt-Taxation). Under this method the contributions to savings intermediary are exempt from tax, the accumulation/accretion is also exempt from tax and only withdrawals from such account would be taxed. The aggregate amount of deduction admissible under this scheme shall be limited to Rs. 3,00,000/-.

ü **Tax Holiday for certain business**:-The new code substitutes profit linked incentive by a new scheme as the profit linked incentive is regressive in nature. Under the new scheme a person would be allowed to recover all capital and revenue expenditure (except expenditure on land, goodwill and financial instrument) and he would be liable to income tax on all profits made thereafter.

ü **Liability under Minimum Alternate Tax (MAT)**: a radical change has been proposed under the scheme of MAT. The code provides for MAT calculated with reference to the “Value of the Gross Assets” and not according to the existing book profit method. The rate of MAT as proposed is 2 percent of the value of the gross assets. The same shall be 0.25 percent in case of banking companies.

ü **Set off MAT credit**: – Under the code it has been proposed that MAT will be a final tax and hence it would not be allowed to be carried forward for claiming tax credit in subsequent years.

ü **Wealth Tax** :- The Individual and HUF has been included under the purview of wealth tax. Further, the exemption limit for them has been fixed at Rs. 50 crores. Rate has been fixed at 0.25%.

ü Income Tax Authorities shall now also include Transfer Pricing officer.

ü Due date of filing of return in case of companies proposed to be 31st August.

ü The time limit for filing revised return will be limited to 21 months from the end of the relevant financial year.

ü Under the code, the time limit for filing an appeal before higher forum i.e CIT(A), ITAT , shall be thirty days from the date of receipt of the order.

ü **Income Escaping Assessment** :- A case can be reopened under the code for the following reasons :

- ❖ If computation has not been made in accordance with decision rendered by the appellate authority
- ❖ Computation has not been made in accordance with the direction contained in Circulars, instructions issued by the CBDT.
- ❖ Any objection has been raised regarding the computation by the C&AG.

ü The time limit has been increased from existing 4 years to 7 years from end of the Financial Year.

ü The notice of reassessment must contain in writing the reason for reopening the case.

ü **Penalty Provisions**:- A person who wilfully under reports his tax liability shall be liable to penalty not less than and upto twice the amount of tax payable. No income tax authority has power to waive the penalty

ü **Specific Anti Abuse Rules** : The general anti avoidance rules will further supported by anti avoidance rules to deal with the following circumstances:-

- ❖ Payment of associated persons in respect of expenditure
- ❖ International transaction not at arm length
- ❖ Transaction resulting in transfer of income to non resident;
- ❖ Avoidance of tax in certain transaction in securities

Briefly, the salient features of the code are as under:

(a) Single Code for direct taxes: All the direct taxes have been brought under a single code and compliance procedures unified. This will eventually pave the way for a single unified taxpayer reporting system.

(b) Use of simple language: With the expansion of the economy, the number of taxpayers can be expected to increase significantly. The bulk of these taxpayers will be small paying moderate amounts of tax. Therefore, it is necessary to keep the cost of compliance low by facilitating voluntary compliance by them.

This is sought to be achieved, inter alia, by using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law. Each sub-section is a short sentence intended to convey only one point. All directions and mandates, to the extent possible, have been conveyed in active voice.

Similarly, the provisos and explanations have been eliminated since they are incomprehensible to non-experts. The various conditions embedded in a provision have also been nested. More importantly, keeping in view the fact that a tax law is essentially a commercial law, extensive use of formulae and tables has been made.

(c) Reducing the scope for litigation: Wherever possible, an attempt has been made to avoid ambiguity in the provisions that invariably give rise to rival interpretations. The objective is that the tax administrator and the tax payer are ad idem on the provisions of the law and the assessment results in a finality to the tax liability of the tax payer. To further this objective, power has also been delegated to the Central Government/Board to avoid protracted litigation on procedural issues.

(d) Flexibility: The structure of the statute has been developed in a manner which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, to the extent

possible, the essential and general principles have been reflected in the statute and the matters of detail are contained in the rules/Schedules.

(e) To ensure that the law can be reflected in a Form: For most taxpayers, particularly the small and marginal category, the tax law is what is reflected in the Form. Therefore, the A-10 structure of the tax law has been designed so that it is capable of being logically reproduced in a Form.

(f) Consolidation of provisions: In order to enable a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated. Further, the various provisions have also been rearranged to make it consistent with the general scheme of the Act.

(g) Elimination of regulatory functions: Traditionally, the taxing statute has also been used as a regulatory tool. However, with regulatory authorities being established in various sectors of the economy, the regulatory function of the taxing statute has been withdrawn. This has significantly contributed to the simplification exercise.

(h) Providing stability: At present, the rates of taxes are stipulated in the Finance Act of the relevant year. Therefore, there is a certain degree of uncertainty and instability in the prevailing rates of taxes. Under the code, all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the code itself thereby obviating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

Rates of income-tax	
I) In the case of every individual, other than women and senior citizens:	
(1) Where the total income does not exceed Rs 1,60,000	Nil
(2) Where the total income exceeds Rs 1,60,000, but does not exceed Rs 10,00,000	10 per cent of the amount by which the total income exceeds Rs 1,60,000
(3) Where the total income exceeds Rs 10,00,000 but does not exceed Rs 25,00,000	Rs 84,000 plus 20 per cent of the amount by which the total income exceeds Rs 10,00,000
(4) Where the total income exceeds Rs 25,00,000	Rs 3,84,000 plus 30 per cent of the amount by which the total income exceeds Rs 25,00,000
II) In the case of women below the age of 65 years at any time during the financial year:	
(1) Where the total income does not exceed Rs 1,90,000	Nil
(2) Where the total income exceeds Rs 1,90,000 but does not exceed Rs 10,00,000	10 per cent of the amount by which the total income exceeds Rs 1,90,000
(3) Where the total income exceeds Rs 10,00,000, but does not exceed Rs 25,00,000	Rs 81,000 plus 20 per cent of the amount by which the total income exceeds Rs 10,00,000
(4) Where the total income exceeds Rs 25,00,000	Rs 3,81,000 plus 30 per cent of the amount by which the total income exceeds Rs 25,00,000
III) In the case of senior citizens:	
(1) Where the total income does not exceed Rs 2,40,000	Nil
(2) Where the total income exceeds Rs 2,40,000 but does not exceed Rs 10,00,000	10 per cent of the amount by which the total income exceeds Rs 2,40,000
(3) Where the total income exceeds Rs 10,00,000 but does not exceed Rs 25,00,000	Rs.76,000 plus 20 per cent of the amount by which the total income exceeds Rs 10,00,000
(4) Where the total income exceeds Rs 25,00,000	Rs 3,76,000 plus 30 per cent of the amount by which the total income exceeds Rs 25,00,000

