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Draft Direct Tax Code Bill – 2009

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- The Current law – Income-tax Act, 1961
- Almost five decades old
  - Over 5000 amendments – seriously mutilated!
- New Code in the making for four years.
- Will be applicable from April 1, 2011 if passed.
- The proposed Direct Tax Code is a combination of major tax relief and removal of most tax-exempted benefits. It is expected to usher in a new tax regime of transparency and greater compliance.

OBJECT/SCOPE

- ***<u>Concept of Assessment Year done away with : Replaced with Financial year (as stated in</u> Discussion Paper of New Code said change will not impact the existing system of TDS; Advance Tax; Self Assessment Tax etc and is aimed to reduce confusion in compliance and administration)***

New Concept of Tax base

- 275.**“tax bases”** means-
- (a) income or total income, as the case may be, in relation to income-tax;
- (b) net wealth in relation to wealth-tax;
- (c) dividend distributed in relation to dividend distribution tax; and
- (d) the income or total income, net wealth, or dividend distributed referred to in sub-clauses (a) to (c) of any other person in respect of which the assessee is assessable under this Code

The Code is not an attempt to amend the Income Tax Act, 1961; ***nor is it an attempt to "improve" upon the present Act.*** *In drafting the Code, the Central Board of Direct Taxes(the Board) has, to the extent possible, started on a clean drafting slate.* ***Some assumptions which have held the ground for many years have been discarded****. Principles that have gained international acceptance have been adopted. The best practices in the world have been studied and incorporated. Tax policies that would promote growth with equity have been reflected in the new provisions.* ***Hence, while reading the Code, it would be advisable to do so without any preconceived notions and, as far as possible, without comparing the provisions with the corresponding provisions of the Income Tax Act, 1961 (Para 1.7)***

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.

Revenue's Objective in Discussion Paper towards Business Taxation

*There are two models for computation of income under this head. The first is the model where the taxable income is equal to **business profits with specified adjustments**. However, this model does not provide for items of receipts which form part of business profit and deductions to be made therefrom. **As a result, there are frequent disputes about taxability of receipts and deductions for expenses. The second model is the income-expenses model which is now followed in countries like U.S.A., Canada, Australia and most Asian countries. The computation of income from business under the Code will be based on the income-expenses model where the taxable income under this head will be equal to gross income minus allowable deductions. To the extent possible, the items of receipts and deductions for expenses are enumerated to reduce the scope for litigation***

Each business unit is separate

Section 28 of the DTC provides that for purpose of computing the 'income from business' the income from each business will be computed separately;

- DTC introduces a provision whereby each unit of the taxpayer's business shall be deemed to be distinct and separate from another unit.
- As a result it seems that all the provisions of computation of profits will apply separately to each such unit;

Each business unit is separate

- The taxpayer might therefore be required to maintain separate books of accounts for each such unit and get the same audited as per Section 83 and 84 of the DTC corresponding to Section 44AA and 44AB of the IT Act.
- The proposed section will cast a more burdensome duty on the taxpayer to comply with the extra documentation requirement.

Rise in the Income Slabs

- While retaining the basic exemption limits at Rs 1.6 lakh (for individuals), Rs 1.9 lakh (for women) and Rs 2.4 lakh (for the retired), the slabs have been hiked substantially.
- The 10 % tax bracket raised up to Rs 10 lakh, 20 % between Rs 10 and 25 lakh and 30 % for over Rs 25 lakh.

MAT original Draft DTC

- The DTC has proposed a Minimum Alternate Tax (MAT) on companies calculated with reference to the "value of gross assets". The rate of MAT will be 0.25 per cent of the value of gross assets in the case of banking companies and 2 per cent of the value of gross assets in the case of all other companies.
- Problems____________
  - all companies to pay tax even if they are *loss making companies* or operating in a cyclical downturn.
  - not reasonable to apply this for *newly set up infrastructure companies* which have long gestation periods.
  - Assuming the same net income as a percentage of gross assets for all taxpayers is not practical

Problems________MAT As per Draft DTC

- The inclusion of *“capital works in progress”* which is not used in the business and does not contribute in revenue generation would distort the asset based tax.
- The proposed MAT does not allow for any *carry forward* .

Revised proposals

- Considering the above critics, it has been proposed that MAT will be computed according to Book Profit rather than gross assets. However, it is not clear that credit will be given for MAT paid or not.

Tax treatment of savings – Exempt Exempt Tax (EET) v/s Exempt Exempt Exempt (EEE) basis

- Most countries that follow the EET method of taxation of savings also have a *social security system* in place for all their citizens.
- it is proposed to provide the EEE method of taxation for Government Provident Fund (GPF), Public Provident Fund (PPF) and Recognized Provident Funds (RPFs) and the pension scheme administered by Pension Fund Regulatory and Development Authority. Approved pure life insurance products and annuity schemes will also be subject to EEE method of tax treatment.

Income and Treatment

- **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

Taxation of income from employment - Retirement benefits and perquisites

- Deductions under EET regime will be allowed if savings are invested in a separate account "retirement benefits account".
- Retirements benefits such as leave salary, annuity, pension, and gratuity will be fully taxable.
- Medical perquisite will also be fully taxable.
- Revised proposals
- On receipt of various critics from various stakeholders govt. decided to- Withdraw the Retirement Benefits Account scheme.
- Exempt withdrawal of retirement benefits from tax subject to certain limits.
- Perquisites in relation to medical facilities/reimbursement provided by an employer to its employees shall be valued as per the existing law with appropriate enhancement of monetary limits.

Wealth Tax

- **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

wealth tax

- DTC provides that wealth tax will be levied on all assets including *productive assets*. This has been criticized on the ground that taxation of productive assets will be against the basic line of charging of wealth tax. Therefore revised code proposed to tax only unproductive asset.
- Again the threshold limit of Rs.50 crores was argued to be too high hence it was decided by govt. to calibrate it in the context of overall tax rates.

Income from House property

- **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

loan interest payment for a self-occupied residence

- Considering the oppositions raised against this aspect it was decided to continue deduction up to Rs.1.5 lacs. In the revised draft

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

Revised proposal

- Capital gains arising from transfer of an investment asset, being equity shares of a company listed on a recognized stock exchange or units of an equity oriented fund, which are held for more than one year, shall be computed after allowing a *deduction at a specified percentage* of capital gains without any indexation. This adjusted capital gain will be included in the total income of the taxpayer and will be taxed at the applicable rate. The loss arising on transfer of such asset held for more than one year will be scaled down in a similar manner.
- Income arising on purchase and sale of securities by an FII shall be deemed to be income chargeable under the head “capital gains”. This would simplify the system of taxation, bring certainty, eliminate litigation and is easy to administer.
- The capital gains arising to FIIs shall *not be subjected to TDS* and they will be required to pay tax by way of advance tax on such gains as is the existing practice.
- STT is proposed to be calibrated based on the revised taxation regime for capital gains and flow of funds to the capital market.

Agriculture land and Income

- Urban Agriculture Land is a capital asset and sale of such land purchased one year before should have been used in last 2 years for agriculture.
- Rollover relief available if invested in another agri land.
- However no tax on agriculture income being state subject.

Unexplained Income in New Code

- New Section 56(2)(l)

any amount found credited in the books of an person maintained for the financial year, if-

*(i) the person offers no explanation about the **nature and source** thereof; or*

*(ii) the person offers an explanation but **fails to substantiate the explanation**; or*

(iii) the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory;

- Earlier section 68
- Cash credits Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Income-tax Officer, satisfactory, the sum so credited may be charged to income-tax as the income of the assessee of that previous year".

Unexplained Income in New Code

- New Section 56(2)(m)

the value of any investment *made by the person in the financial year to the extent for which,-*

(i) the person offers no explanation about the ***nature and source of the investments; or***

(ii) the person offers an explanation but ***fails to substantiate the explanation****; Or*

(iii) the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory;

- Earlier section 69/69B
- Unexplained investments. Where in the financial year immediately preceding the assessment year the assessee has made investments which are not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of the investments or the explanation offered by him is not, in the opinion of the Income-tax Officer, satisfactory, the value of the investments may be deemed to be the income of the assessee of such financial year".

Unexplained Income in New Code

- New Section 56(2)(N)

the value of any money, bullion, jewellery or other valuable article owned by the person to the extent for which,-
(i) the person offers no explanation about the *nature and source of acquisition of the money, bullion, jewellery or other valuable article; or*
(ii) the person offers an explanation but fails to substantiate the explanation; or
(iii) the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory;

- Earlier section 69A

Where in any financial year the assessee is found to be the owner of any money, bullion, jewellery or other valuable article and such money, bullion, jewellery or valuable article is not recorded in the books of account, if any, maintained by him for any source of income, and the assessee offers no explanation about the nature and source of acquisition of the money, bullion, jewellery or other valuable article, or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the money and the value of the bullion, jewellery or other valuable article may be deemed to be the income of the assessee for such financial year

Sec 80C now Renamed 66

- **80C limit**: From Rs 1 lakh at present to Rs 3 lakh for a hindu undivided family (HUF) or individual Sec 66
- **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 section 67
- **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

Deductions for Donations sec 72 ie. of 80G of the Act.

- 125% of the amount of money actually paid Any scientific research association or National Laboratory or Any university, college or other institution engaged in carrying on scientific research, statistical research or research in social science.
- 100%
- 50%

Books

- Every person shall keep and maintain books of account and other documents
- (a) any person carrying on legal, medical, engineering, architectural profession or profession of accountancy, technical consultancy, interior decoration or any other profession as is notified by the Board in the Official Gazette;

  (b) any other person carrying on business, if,-

  (i) his income from the business exceeds two lakh rupees;

  (ii) his total turnover or gross receipts, as the case may be, in the business exceeds ten lakh rupees in any one of the three financial years immediately preceding the relevant financial year;

TaxAudit and NGO's Tax audit

- Tax Audit limits same as earlier there is no change.

Only In case of presumptive tax it is now 1 crore.

- For NGO's it obtains a report of audit in prescribed form from an accountant before due date of filing of the return in respect of,-

(A) the accounts of business, if any, carried on by it in accordance with the provisions of section 84; and

(B) its accounts relating to the permitted welfare activities in a case where the gross receipts referred to in section 89 exceeds one lakh fifty thousand rupees;

CHARGE OF BRANCH PROFITS TAX

- Every foreign company shall be liable to branch profits tax, at the rate of 15% on total income for the financial year as reduced by the amount of income tax thereon.

104 Disallowance of expenditure having regard to fair market value

A person shall not be allowed a deduction under this Code in respect of so much of the expenditure, whether capital or revenue in nature, as is considered by the Assessing Officer to be excessive or unreasonable if,-

(a) the payment in respect of the expenditure has been, or is to be, made to any associated person; and

(b) the expenditure is excessive, or unreasonable, having regard to,-

- (i) the fair market value of the goods, services or facilities for which the payment is made;
- (ii) the legitimate needs of the business of the person; or
- (iii) the benefit derived by, or accruing to, the person there from.

Arm’s Length Advance pricing

- The amount of any income, or expense, arising from an international transaction shall be determined having regard to the arm's length price.

  The Board, with the approval of the Central Government, may enter into an *advance pricing agreement* with any person in respect of the arm’s length price in relation to an international transaction which may be entered into by that person on the basis of the prescribed method being the most appropriate method.

Advance pricing & Reporting of International transaction

Such Agreement shall be valid for such financial years as specified in the agreement which in no case shall exceed five consecutive financial years.

- **Reporting of international transaction**

149.(1) Every person who has entered into an international transaction during the financial year shall furnish a report of the transaction to the Transfer Pricing Officer on or before the due date.

(2) The report referred to in sub-section (1) shall be obtained from an accountant in the prescribed form duly signed and verified in the prescribed manner by such accountant.

Sec 150 Tax Return Preparer

- The Board may, without prejudice to the provisions of section 148, frame a Tax Return Preparer Scheme so as to allow a Tax Return Preparer to prepare and furnish the return of tax bases of any specified class of persons.
- Every Tax Return Preparer shall affix his signature on the return so prepared by him.

162 Assessment

(3) The Assessing Officer shall, regardless of anything to the contrary contained in this Act, in the first instance, forward a draft of the proposed order of assessment (hereinafter in this section referred to as the draft order) to the assessee if he proposes to make any variation in the income or loss returned which is prejudicial to the interest of such assessee.

(4) On receipt of the draft order, the assessee shall, within thirty days of the receipt by him of the draft order,-

(a) file his acceptance of the variations to the Assessing Officer; or

(b) file his objections, if any, to such variation to,-

(i) the Dispute Resolution Panel; and

(ii) the Assessing Officer.

162 Assessment

(5) The Assessing Officer shall complete the assessment on the basis of the draft order,

if- (a) the assessee intimates to the Assessing Officer the acceptance of the variation; or

(b) no objections are received within the period specified in sub-section(2).

(6) The Assessing Officer shall, notwithstanding anything contained in section 146, pass the assessment order under sub-section (3) within one month from the end of the month in which,-

(a) the acceptance is received; or

(b) the period of filing of objections under sub-section (2) expires.

(7) Upon receipt of the directions issued under sub-section (5), the Assessing Officer shall, in conformity with the directions, complete the assessment within one month from the end of the month in which the direction is received notwithstanding anything to the contrary contained in section 146.

GENERAL ANTI-AVOIDANCE RULE (GAAR)

The code has inserted the concept of GAAR whereby commissioner will be given power to investigate in a case where a taxpayer has entered into an arrangement, the main purpose of which is to obtain a tax benefit and such arrangement is entered or carried on in a manner not normally employed for bona-fide business purposes

1. or is not at arm's length
2. or abuses the provisions of the DTC
3. or lacks economic substance.

Revised GAAR

- The following safeguards are proposed for invoking GAAR provisions:-
  - The Central Board of Direct Taxes will issue guidelines to provide for the circumstances under which GAAR may be invoked.
  - GAAR provisions will be invoked only in respect of an arrangement where tax avoidance is beyond a specified threshold limit.
  - The forum of Dispute Resolution Panel (DRP) would be available where GAAR provisions are invoked.

Please send Your Critical Comments to FM

Thanks