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DIRECT TAX CODE

[1] Introduction ::

The Direct Tax Code (DTC) bill was unveiled by honourable finance minister to sought to revamp and simplify the direct tax low and its administration in the country through several radical changes. The tax code which the government had planned to enact and implement from next year onward with suitable changes if required envisaged meaningful reduction in the tax rates while simultaneously being revenue neutral for the government. It has sought to bring all direct taxes under one code for providing single tax reporting system. It has also been stated that the new code is drafted by taking into account the internationally accepted principles of public finance and best practices to make it at par with the international practices and not merely to replace the existing Income Tax Act, 1961.

[2] Meaning and Features of DTC Bill ::

The Present Income Tax Act was enacted in 1961 to replace the earlier Act which had been legislated in 1922, before independence. About 50 years have been clasped since the enactment of present Income Tax Act. At the time of presenting the Union Budget for 2005-06 the Government had announced its intention to introduce a revised and simplified Income Tax Bill. Subsequently, the Government under took a work on drafting a Direct Tax code to replace the existing Income Tax Act, 1961 and the Wealth Tax Act, 1957.

Hon'ble Finance Minister Shri Pranab Mukherjee(Now President) during his speech in the Parliament on 6th July 2009 had promised to bring about structural changes in direct taxes by releasing the new Direct Tax Code (DTC). Keeping with his promise, the Finance Minister released the draft Direct Tax Code along with a discussion paper on 12th August 2009 for public debate.

Direct Tax Code is to improve the efficiency and equity of the Indian tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base. The attempt is to simplify the language, remove ambiguity, provide stability and adopt best international practices. The code seeks to consolidate all direct taxes I.e. Income Tax, DDT, FBT & Wealth Tax under a single umbrella.

[2.1] Features of Direct Tax Code Bill is as follows ::

1. The regulatory function of the taxing statute has been withdrawn. This is being labelled as a great simplification measure.
2. 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.
3. 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.
4. The separate concept of "Previous Year" and "Assessment Year" will be replaced by a unified concept of "Financial Year"
5. Unabsorbed business shall be allowed to be carried forward indefinitely.
6. Classification of source of Income.

[2.2] Taxable Income and computation of Income(With Reference to DTC) ::

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:

a. Income from Special Sources

b. Income from Ordinary Sources

All income accruing from a source other than the special sources shall be classified under of income.

- Income from Employment
- Income from House Property
- Income from Business
- Capital Gain
- Income from Residuary Sources

It is explained as follows:-

- Income from House Property –No deduction for taxes or interest will be allowed in case of a self –occupied property.
- The earliest limit of Rs 1, 50,000/- on account of interest on capital on capital borrowed for the purpose of acquiring constructing repairing renewing or reconstructing. As per the code any amount of interest paid in this regard shall be admissible.
- 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.
- Income by way of interest earned by the assesses other than financial institutions shall now be treated as "Income from Residuary Sources".
- Business expenditure has been classified into 3 mutually exclusive categories:
  1. Operating Expenditure
  2. Permitted Financial Charges
  3. Capital Allowances
- Depreciation on business capital assets will now include expenses amortized.
- 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.
- The Securities Transaction Tax (STT) will be abolished.
- The base date for determining the cost of acquisition of asset has now been shifted from 01-04-1981 to 01-04-2000
- 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.
- 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/-.
- Tax Holiday For Certain Business:- The New Code Substitutes 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.
- 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.
- Set off MAT credit :- Under the code In 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.

[2.2.1] Rate of Income Tax ::

• In case of women the basis exemption limit raised to Rs.1,90,000/- and for senior citizen to Rs.2,40,000/-

1. It has been proposed that the tax Rate of companies shall be reduced to 25 percent.
2. 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%.

3. Income tax Authorities shall now also include Transfer pricing officer.
4. Due date of filing of return in case of companies proposed to be 31st August.
5. The time limit for filing revised return will be limited to 21 months from the end of the relevant financial year.
6. 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.
7. 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.
8. The time limit has been increased from existing 4 years to 7 years from end of the financial Year.
9. The notice of reassessment must contain in writing the reason for reopening the case.
10. Penalty Provisions:- A person who wilfully under reports his tax liability shall be liable to penalty not less than and up to twice the amount of tax payable. No income tax authority has power to waive the penalty
11. 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
12. Value of Gross Assets:- Value of Gross assets shall be computed in accordance with the formula A+B+C-D-E
    - A= The value of the gross block of fixed assets of the co. as on the close for the financial year
    - B= The value of the capital work in progress of the co. as on the close for the financial year
    - C= Book value of all the assets of the company as on the close of the FY
    - D= Accumulated depreciation on the value of the Gross block claimed up to the last day of the of the relevant financial year
    - E= The amount of debit balance of profit and loss account if included in the amount "C"

[3] Objective of Direct Tax Code ::

The Codes seeks to consolidate and amend the law relating to direct taxes, that is, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax, so as to enable to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase in the tax-GDP ratio. Another objective is to reduce the scope for dispute and minimize litigation.

[4] Salient Features ::

The following are the salient features of the Code :-

a. Single code for direct taxes;
b. Use of simple language – as to convey with clarity the intent, scope and amplitude of the provisions of law;
c. Reducing the scope of litigation – by avoiding ambiguity in the provisions so that the taxpayer and tax administration are ad idem on the provisions and the assessment results in a finality;
d. Flexibility – by reflecting the general principles in the statute and leaving the matter of details to rules, Schedules so that change in the structure of grooving economy are accommodated without resorting to frequent amendments;
e. Elimination of regulatory functions – by withdrawing the regulatory function of the taxing statute; Providing stability – by prescribing the rates of taxes in the Schedule of the Code instead of being done annually in the Finance Act.

[5] Impact OF DTC on Common People in India ::

The DTC will be effective from 1st April, 2011. Common people are not at all interested regarding amendments, alteration, modification and introduction of various provisions of Minister –in –Charge and socio –economic requirements, they are future and plan their income appropriation to get maximum benefit. The draft DTC which is a document containing changes in exemptions, tax slab etc, This will perhaps be a big change in the five decades old Income Tax Act. As per the proposal, the new tax slab would be : 0% tax for income less than Rs.1.6 lac 10% tax for income from Rs.1.6 lac to10 lac 20% tax for income from Rs 10 lac to 25 lac and 30% tax for income more then Rs25 lac.

For Female, second slab begins from Rs 1.90 lac and for Senior Citizen it begins from 2.40 lac.

The new tax slab is really amazing because almost 98% of Indian will then pay 10% or less tax because income of majority of people is below 10 lac. In planning and framing an ideal Income Tax Structure of a welfare state likes ours the objectives are to give relief to the maximum possible extent to the lower and middle income group taxpayers and check certain black money at one hand and to enable the Government to increase collection of tax revenue for development works.

As a result, the Government may face shortage of finance and have to borrow fund at a higher rate of interest from the financial institutions or others. By the existing system of Provident Fund not only the common people are benefited but also the Government is equally benefited.

[6] Impact of Direct Tax Code in International Taxation ::
The code in it's present form shall invariably affect adversely all the foreign investors, foreign companies intended to take part and accelerate the economic growth of the nation. Significant impacts that are expected are enumerated herein below:

[6.1] Tax Residency and Income deemed to accrue or a rise in India ::
Under the proposed Code income arising out of direct or indirect transfer of a capital asset situated in India will now be deemed to accrue in India and subject to tax. Under the present law, income arising from the indirect transfer of a capital asset was out of the preview of income deemed to accrue in India.

[6.2] Tax Impact of Royalty & Technical Know-how fees in Cross Border Transaction ::
Newly introduced definitions of 'royalty' and 'fees' for technical services as provided by the Direct Taxes Code and their impact is explained below. This introduces new definitions of 'royalty' and fees for technical services. These will have direct impact on the tax liability of non-residents receiving payments from Indian payees. Mere have been discussed implications of these definitions.

Royalty ::

Royalty is defined in para 240 of section 284 of the Code, as under:
"284 (240) 'Royalty' means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head 'Capital gains') for -

a. The transfer of all or any rights (including the granting of a license) in respect of a patent, invention, process, trade mark of similar property;
b. The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula, process, trade mark or similar property;
c. the use of any patent, invention, model, design, secret formula, process, trade mark or similar property;
d. the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience of skill;

[7] Impact on foreign companies taxation ::

The Code proposes to tax corporate profits at a reduced rate but the benefit of this largesse is sought to be curtailed by doing away with slew of exemptions and deductions proposed earlier. The Code also proposes to bring in Minimum Alternate Tax ('MAT') on a corporation based on the value of its assets as per a formula prescribed, irrespective of its profits (as opposed to its current form based on the book profits of a corporation). This tax cannot be carried forward for credit against future tax liabilities (as the present law permits). This in effect discriminates against the manufacturing sector vis-à-vis the service sector and also amounts to a back door wealth (capital) tax. Whether foreign companies/branches will be subjected to this MAT remains to be seen.

[7.1] Cross border merger & acquisition-tax impact ::

Mergers of an Indian company into a foreign company are also not made tax neutral under the code. Based on the above, the unkindest cut for foreign investors are provisions relating to cross border capital gains whereon Withholding Tax ('WHT') at the high rate is attracted. In such cases, it is unlikely that the residence jurisdiction of such a taxpayer would allow credit for this WHT if the local capital gains tax is at lower rate (or even worse if it is nil).

Another feature potentially impacting capital markets is the decision to treat mutual fund: employee benefit funds and trusts on a pas through basis for taxation purpose where the income is taxed in the hands of the ultimate recipient. However, in the absence of detailed provisions relating to the method of such pass through, the impact on the ultimate investors in such mutual funds and venture capital funds is ascertainable.

[8] Conclusion ::

The conclusions of above discussion are as under :

1. The biggest advantage for the individual tax payers is that tax slab is just 10% for the income group of Rs. 1,60,000 to Rs, 10,00,000. This will be beneficial to middle class people. Because previously this 10% was charged for the group up to Rs. 5,00,000 and from Rs. 5,00,000 to Rs. 10,00,000 the charge was 20%. So now the class whose income is between Rs. 5,00,000 to Rs. 10,00,000 will be able to save 10% of their total income.
2. The taxable salary will bell go high. It will be because of inclusion off all other perks and benefit in addition to basic salary will be included in taxable income. But it is the fact that at the last individual will be able to save some more as compared to previously.
3. Due to implementation of STT, the investors who have recently started taking interest in investing in securities will be demoralized.
4. DTC has imposed tax on maturity value of life insurance policies, PPF and GDF. This will affect negatively to the saving mentality of middle class people.
5. The tax exemption on interest paid on home loans have been proposed to be withdrawn. It will disappoint to the lower middle people in taking housing loans.
6. Reduction in corporate tax @ 8% (including surcharge) will give benefit to companies. But on the other hand it is seem that the reduction is high. It will reduce the government income at all.
7. The basis of computing MAT has been changed from book profit to gross assets. Further credit of MAT will not be available and discontinuance of the provisions to carry forward mat are negative points for companies availing MAT.
8. Depreciation on machinery has been proposed to reduce to 15%. This will give negative impact to companies availing the benefits of high rates of depreciation.

From the above brief discussion, it can be concluded that the proposed Direct Tax Code bill will bring certain definite advantages and disadvantages for both individual and corporate tax payers.

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