

REVISED PROPOSALS AS PER DISCUSSION PAPER ON DIRECT TAXES CODE

1. MINIMUM ALTERNATE TAX (MAT) □ GROSS ASSETS VIS-À-VIS BOOK PROFIT

Existing Provision:

- MAT is be computed at the rate of 19.93% on the Book Profit □ (for A.Y. 2011-12)
- Further, MAT credit is allowable for the period of 10 Assessment Years.

Direct Taxes Code (DTC)

Initial Proposal:

- MAT shall be computed at the rate of 2 % of the 'value of gross assets'.
- Tax credit will not be available for the future years.

Recommendations:

- Hardship on loss making companies and the newly set up businesses.
- An asset based MAT model does not have a proximate linkage with a particular years income or turnover.

Revised Proposal:

- Computation of MAT on Book Profits has been retained.
- However, neither the effective tax rate nor the tax credit for the future years has been specified.

2. TAXATION OF INCOME FROM HOUSE PROPERTY

Existing Provision:

- Gross Annual value is higher of the following:
 - (i) Reasonable expected rent of the property;
 - (ii) Actual rent received or receivable during the year.

- 30% of the Net Annual value is available as deduction towards repairs and maintenance expense.
- Deduction on account of interest on capital borrowed for self occupied property is available up to a ceiling of Rs. 1.5 lakhs.

Direct Taxes Code

Initial Proposal:

- Gross rent shall be higher of the following:
 - (i) Amount of contractual rent for the financial year;
 - (ii) Presumptive rent calculated at 6% per annum of the rateable value fixed by the local authority. If no rateable value has been fixed, 6% shall be calculated with reference to the cost of construction or acquisition of the property.
- Deduction at the rate of 20% towards repairs and maintenance.
- In case of self occupied property, no deduction shall be allowed on account of interest payable on capital borrowed for the purpose of acquiring, constructing the property.

Recommendations:

- Determination of notional rent on presumptive basis will always be subject matter of dispute between the assessee and the assessing officer.
- In order to promote investment in housing, the deduction for the interest on capital borrowed for acquisition or construction of a self occupied house property, should be retained.

Revised Proposal:

- Gross rent will not be computed at a presumptive rate of six per cent of the rateable value or cost of construction/acquisition.
- In the case of the property which is not let out by an individual or an HUF, deduction on account of interest on capital borrowed for acquisition or construction of house property shall be allowed subject to a ceiling of Rs. 1.5 lakhs.

3. TAXATION OF CAPITAL GAINS

Existing Provision:

- There is a distinction between the short term and long term capital asset.
- Long and short term capital asset is segregated on basis of 'period of holding' and period of holding is computed from the date of acquisition of the capital asset till the preceding date of its transfer.
- Long term capital gain arising other than from sale of listed shares or equity oriented units is taxable at the rate of 20% while short term capital gain is taxed as per the normal slab rate.
- Long term capital gain arising on sale of listed shares or equity oriented units is exempt and the short term capital gain is subject to tax at the rate of 15%.

Direct Taxes Code

Initial Proposal:

- Distinction between 'Short Term Capital Assets' and 'Long Term Capital Assets' eliminated.
- The phrase 'Investment Asset' has been used in place of 'Capital Asset', wherein investment asset means any capital asset which is 'not a business capital asset'.
- Capital gains to be taxed as ordinary income in the case of residents & at the rate of 30% in the case of non-residents.
- The base year for the purpose of indexation for the capital assets transferred after one year from the end of the financial year in which acquired, shall be shifted from 01.04.1981 to 01.04.2000.
- Securities Transaction Tax to be abolished.

Recommendations:

- The tax rate of 30 % on capital gains in the hands of non-residents is very high as in the case of listed equity shares they are currently being taxed at nil rate if held for more than one year.
- Major disputes persist whether the income earned by Foreign Institutional Investors (FIIs) from transactions in the capital market should be characterized as business income or as capital gains.

Revised Proposal:

- Investment Asset has been segregated into two segments:

- a) Investment asset held for 'more than one year' from the end of financial year in which the asset is acquired &
 - b) Investment asset held for 'less than one year' from the end of financial year in which the asset is acquired.
- Capital gains to be taxed as ordinary income at rates applicable to the tax payer whether resident or non-resident.

(A) Investment Asset held for more than one year from the end of financial year in which the asset was acquired	
Investment Asset being Listed Equity Shares or Units of Equity oriented fund	<ul style="list-style-type: none"> • Capital Gain shall be computed after allowing <u>deduction with certain specified percentage which will to be notified later</u> • The loss arising on transfer of such asset shall also be scaled down on similar lines. • Benefit of Indexation shall not be available • Appropriate transition regime shall be provided from shift of the current Nil tax scheme. It has also been clarified that investors holding long term shares till 31st March 2011 will not be subject to the long term capital gain tax and stock prices as on 1st April 2011 will be the new base price for computing capital gains tax.
Other Investment Asset	<ul style="list-style-type: none"> • Benefit of indexation shall be available. However, the base rate for determining the cost of acquisition will shifted from 1.4.1981 to 1.4.2000 • Unrealized gain between 1.4.1981 and 1.4.2000 will not be liable tax • The proposal to introduce Capital Gain Saving Scheme dropped.

(B) Investment Asset held for less than one year from the end of financial year in which the asset was acquired

- Capital gain shall be computed without any specified deduction or indexation
- Capital gain shall be charged as per the applicable rate to the taxpayer

- The income arising on purchase and sale of securities by the FII's shall be deemed to be income chargeable under the head capital gains. The capital gains arising to FIIs shall not be subjected to withholding tax however FII's will be required to pay tax by way of Advance Tax on such capital gains.
- Security Transaction Tax is proposed to be retained.

4. TAXATION OF NON-PROFIT ORGANISATIONS (NPO's)

Existing Provision:

- The phrase 'charitable purpose' is used to define the activities to be pursued by the non-profit organizations.

Direct Taxes Code

Initial Proposal:

- Fresh registration of NPO's after introduction of DTC.
- Only cash system of accounting is stipulated for NPO's.
- The phrase 'permitted welfare activity' has been used instead of 'charitable purpose' in order to emphasize the charitable intent.
- Income of NPOs shall be taxable @ 15%.

Recommendations:

- Getting a fresh registration certificate under the DTC would increase in the compliance cost for NPO's and also substantially increase the workload of the income-tax department.
- The option of choosing either cash or accrual systems should be allowed.
- The Status of religious and partly religious & partly charitable institutions not clear.

Revised Proposal:

- NPO's already registered under the Income-tax Act, 1961 would not be required to apply for fresh registration under the DTC, however, some additional information to be provided to Income Tax Authorities.
- The phrase 'charitable purpose' will be retained in place of 'permitted welfare activity'.
- Only cash system of accounting has to be followed.
- Donation of 'public religious institutions' will be exempt from tax subject to fulfillment of certain conditions. However donation to these institutions will not be entitled for any deduction in the hands of the donor.
- 'Partly religious and partly charitable institutions' will also be treated as NPOs and the income from the public religious activity shall be exempt subject to fulfillment of certain conditions.
- Income from charitable activities will be liable to tax.

5. SPECIAL ECONOMIC ZONES □ TAXATION OF EXISTING UNITS

Existing Provision:

- Tax benefit is available to the units operating in the SEZs and the developer of the SEZs.

Direct Taxes Code

Initial Proposal:

- Profit linked deductions were made available to developers of Special Economic Zones (SEZs) in the DTC for their unexpired period under the Income Tax Act. However, such benefit was not extended to the units operating in SEZ.

Revised Proposal:

- Existing Units operating in SEZs shall also be entitled for the profit linked incentive for the unexpired period of tax holiday.

6. CONCEPT OF RESIDENCE IN THE CASE OF A COMPANY INCORPORATED OUTSIDE INDIA

Existing Provision:

- A Foreign company is considered as resident in India only if the control and management of its affairs are 'wholly situated' in India.

Direct Taxes Code

Initial Proposal:

- A Foreign company will be treated as resident in India if, at any time in the financial year, the control and management of its affairs is situated 'wholly or partly' in India.

Recommendations:

- The word 'partly' sets a very low threshold for regarding a foreign company as a resident in India.
- It would adversely impact the foreign direct investment in India.

Revised Proposal:

- A Foreign company will be treated as resident in India if its 'place of effective management' is situated in India. The term 'place of effective management of the company' means:
 - (i) The place where the board of directors of the company or its executive directors, as the case may be, make their decisions; or
 - (ii) In a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.
- Concept of 'Controlled Foreign Corporation' has been introduced so as to tax the passive income earned by a foreign company, controlled directly or indirectly by Indian residents, if such income is not distributed to shareholders which results in a deferral of taxes. Such income will now be deemed to have been distributed. Consequently, such income would be taxable in India in the hands of resident shareholders as dividend received from the foreign company.

7. DOUBLE TAXATION AVOIDANCE AGREEMENT (DTAA) VIS-À-VIS DOMESTIC LAW

Existing Provision:

- The provision between the domestic law and relevant DTAA, the one which is more beneficial to the taxpayer shall prevail.

Direct Taxes Code

Initial Proposal:

- The DTC provides that neither a DTAA nor the Code shall have a preferential status. In the case of a conflict between the provisions of a treaty and the provisions of the Code, the one that is later in point of time shall prevail.

Recommendations:

- The DTAAs cannot be renotified unilaterally so all existing DTAAs would become redundant.

Revised Proposal:

- The domestic law or the relevant DTAA, whichever is more beneficial to the taxpayer will be applied.
- A concept of 'limited treaty override' is being introduced whereby a treaty will prevail unless the following provisions are invoked:
 - (i) General Anti Avoidance Rule ('GAAR')
 - (ii) Controlled Foreign Corporation ('CFC') Regulations
 - (iii) Branch profits tax is levied
- It is clarified that this limited treaty override would not deprive a tax payer of any intended benefits available under an applicable tax treaty.

8. WEALTH TAX

Existing Provision:

- It is payable only by an individual, Hindu undivided family, and company.
- It is charged at the rate of 1% of the amount by which net wealth exceeds Rs. 30 Lacs.
- Wealth-tax is levied only on un-productive Assets.

Direct Taxes Code

Initial Proposal:

- Wealth tax will be payable by an individual, HUF and private discretionary trusts.
- It will be charged at the rate of 0.25% if the net wealth exceeds Rs. 50 crores.
- Financial Assets (being the productive assets) were also included under the definition of Net Assets.

Revised Proposal:

- Wealth tax will be payable by all the categories of taxpayers except Non-profit organization.
- It will be payable only on the non-productive assets as is the present case
- The threshold limits and the rates will be notified later.

9. GENERAL ANTI-AVOIDANCE RULES (GARR)

Existing Provision:

- No such provision exists.

Direct Taxes Code

Initial Proposal:

- It was proposed in order to eliminate the harmful effects of tax avoidance on the tax base.
- The following conditions were prescribed under which GAAR could be invoked to disregard any arrangement or a transaction:
 - (i) Transaction not at arm's length
 - (ii) Transaction represents misuse or abuse by the tax payer
 - (iii) Transaction lacks commercial substance
 - (iv) Transaction is entered or carried on in a manner not normally employed for bonafide business purpose.

Recommendations:

- Commissioners of income-tax (CIT) were given wide and unfettered powers to question any 'transaction' or 'arrangement' resulting in reduced taxation if they consider such transaction as 'impermissible'.
- No distinction between tax mitigation and tax avoidance as any arrangement to obtain a tax benefit may be considered as an impermissible avoidance arrangement.

Revised Proposal:

The following safeguards are also proposed for invoking GAAR provisions:-

- (i) The Central Board of Direct Taxes will issue guidelines to provide for the circumstances under which GAAR may be invoked.
- (ii) GAAR provisions will be invoked only in respect of specific arrangements where tax avoidance is beyond a specified threshold limit.
- (iii) The forum of Dispute Resolution Panel (DRP) would be available where GAAR provisions are invoked.

10. TAX TREATMENT OF SAVINGS □ EXEMPT EXEMPT TAX (EET) VIS-À-VIS EXEMPT EXEMPT EXEMPT (EEE) BASIS

Existing Provision:

- The concept of EEE is followed on the permitted savings such as such as approved Provident Funds, approved Superannuation Funds, Life insurers, New Pension Trust..

Direct Taxes Code

Initial Proposal:

The concept of EET was proposed wherein:

- (i) the contributions towards certain savings are deductible from income (E)
- (ii) the accumulation/accretions are exempt till such time as they remain invested (E)
- (iii) subsequently, all withdrawals at any time are subject to tax at the applicable marginal rate of tax (T)

Recommendations:

- EET method of taxation is generally prevalent in countries having a social security system. In absence of the same in India, it would be unfair on people who need funds at the time of retirement to meet out various family obligations.

Revised Proposal:

- It is proposed to provide the EEE method of taxation on specified savings such as Government Provident Fund (GPF), Public Provident Fund (PPF), Recognised Provident Funds (RPFs) approved Pension scheme, approved pure life insurance products and annuity schemes.
- For other instruments, EET regime will apply. However, investments made before commencements of DTC which currently enjoy EEE method of taxation would continue to be so eligible for the remaining duration of the investment

11. TAXATION OF INCOME FROM EMPLOYMENT □ RETIREMENT BENEFITS AND PERQUISITES

Direct Taxes Code

Initial Proposal:

- The value of retirement benefits shall be fully taxable without any exemption limit.
- The value of rent free or concessional, accommodation in case of government employee shall be computed in the same manner as is presently determined in the case of employees in the private sector.
- Medical facilities and reimbursements shall be fully taxable.
- An employer's contribution to an approved provident fund, superannuation fund and New Pension Scheme within the limits prescribed considered as salary in the hands of the employee.

Revised Proposal:

- The retirement benefits shall be exempt subject to certain monetary limits.
- Medical facilities / reimbursement provided by an employer to employees be valued as per existing law.
- Perquisite value of rent free accommodation shall not be on market value.
- An employer's contribution to an approved provident fund, superannuation fund and New Pension Scheme within the limits prescribed shall not be considered as salary in the hands of the employee.