# Significant changes in the proposed Direct Taxes Code, 2013

The Income-tax Act was passed in 1961 and has been amended every year through the Finance Act. The Wealth-tax Act was passed in 1957 and has also been amended many times. Numerous amendments have rendered the two Acts incomprehensible to the average taxpayers. Besides, there have been several policy changes due to change in economic environment, complexity in the market, increasing sophistication of commerce, and development of information technology. There has also been a multitude of judgments (at times conflicting) rendered by the courts at different levels. This necessitated drafting of a Code to consolidate and amend the law relating to all direct taxes. Accordingly, a draft Code along with a concept paper was released on 12th August, 2009 inviting suggestions from the public. The Code sought to consolidate and amend the law relating to all direct taxes so as to establish an economically efficient, effective and equitable direct tax system which would facilitate voluntary compliance and also reduce the scope for disputes and minimize litigation.

Having considered the suggestions received from various stake holders a revised discussion paper was released on 15th June, 2010. Thereafter, taking into account the suggestions which were accepted by the Government, the Direct Taxes Code Bill, 2010 was introduced in the Lok Sabha on 30th August, 2010. The Bill was referred to the Standing Committee on Finance (SCF) on 9th September, 2010 for examination and report thereon. The SCF presented its report to the Speaker, Lok Sabha in March, 2012. The report contains general recommendations in Part-I and deals with specific clause wise recommendations in Part-II. A large number of recommendations of the SCF along with other suggestions which were forwarded at the examination stage have been accepted by the Government. Further, the Kelkar Committee in its report on 'Road Map for fiscal consolidation' submitted to the Government in September, 2012 made the following observations on the Bill:-

"The Direct Taxes Code Bill, 2010 which intends to revamp the law relating to direct taxes is likely to result in considerable unacceptable losses on a continuing basis. Given the low tax-GDP ratio and the existing fiscal crisis, there is absolutely no fiscal space for such large revenue loss. Therefore, the Direct Taxes Code Bill, 2010 should be comprehensively reviewed before it is enacted into law for implementation."

Since the Direct Taxes Code Bill, 2010 was introduced in the Parliament, amendments were carried out in the Income-tax Act, 1961 and the Wealth-tax Act, 1957 through Finance Acts, 2011, 2012 & 2013. These amendments were consistent with the policy laid down in the DTC Bill, 2010. Incorporating these amendments in the DTC Bill, 2010 would require a large number of official amendments making the Bill incomprehensible and the legislative process cumbersome. Hence, it was decided to revise the Direct Taxes Code incorporating all the amendments and presenting it as a fresh Bill. Accordingly, a new revised Direct Taxes Code was drafted.

**Recommendations of SCF which are proposed to be accepted**

Out of 190 recommendations made by the SCF, 153 are proposed to be accepted wholly or with partial modifications. In addition to the recommendations forming part of the report, 61 suggestions forwarded by the SCF at the discussion stage have also been accepted for incorporation in the revised Code. Some of the recommendations of the SCF which are proposed to be accepted are as under:-

(i) Simplicity and comprehensibility of both structure and content thereby making the statute more user friendly.
(ii) Ensuring tax buoyancy by tapping high capacity/income and evasion prone segments.
(iii) Re-orienting departmental resources towards high-capacity as well as avoidance/evasion prone categories/sectors.
(iv) Modernisation and computerisation of all tax operations; equipping the department with men and material to carry out the tasks assigned.
(v) Moderation in tax rates for individual taxpayers with emphasis on voluntary compliance.
(vi) Deductions for individual taxpayers to be focused on long term needs like social security.
(vii) The age for senior citizens may be relaxed from 65 years to 60 years.
(viii) Area base incentives may be considered on investment linked basis. However, the general principle should be that all incomes and profits are to be taxed and exemptions, if any, should be treated as a dynamic variable, by ensuring that each exemption serves an economic purpose.
(ix) Smooth transition to investment linked incentives with focused coverage.
(x) Maintaining uniformity in 'grandfathering' provisions so that the available benefits for different categories under the existing Income-tax Act are phased out in a uniform and non-discriminatory manner ensuring smooth transition to DTC provisions.
(xi) The definition of the term 'place of effective management' for the purposes of determination of residency of companies may be modified as the definition in the DTC Bill, 2010 is not very clear and provides room for uncertainty.
(xii) Clause 5(1)(d) read with Clause 5(4)(g) and Clause 5(6) of DTC Bill, 2010 seek to tax income of a non-resident arising from indirect transfer of capital assets situated in India. The Committee recommended that exemption should be provided for transfer of small share holdings as application of these provisions in such cases will cause hardship.
(xiii) For the purposes of taxation of income under the head 'Income from house property' a distinction should be made between commercial and non-commercial renting of properties. The concept of unrealised rent should also be built in as is the position under the existing Income-tax Act.
(xiv) For the purposes of deduction in respect of interest on loan taken for self occupied house property, the loan given by the employer should also qualify for this concession.

(xv) Tax neutrality may be provided on conversion of a partnership firm under the Partnership Act, 1932 into a limited liability partnership or a company.

(xvi) Where compensation is received on compulsory acquisition of an investment asset, the period for acquiring the new asset for the purpose of relief from capital gains should be reckoned from the date of receipt of such compensation.

(xvii) With a view to provide smooth transition from IT Act to Direct Taxes Code, provision be made for treatment of losses remaining to be carried forward and set off as per the provisions of the existing Income-tax Act on the date on which DTC comes into effect.

(xviii) The non-profit organisation may be given an option to adopt either the cash system or accrual system of accounting for computing their income under the Code.

(xix) The Income-tax Act provides for carry forward of tax paid on book profit (MAT credit). A provision may be made in the DTC Bill for carry forward of unutilised MAT credit under the IT Act, on the date on which the DTC comes into force.

(xx) The General Anti Avoidance Rules may be reviewed to bring more clarity and precision to the scope of the provisions. The onus of proof should rest on the tax authority invoking GAAR. The constitution of the panel approving GAAR should be reviewed. The taxpayers may also be permitted to obtain an advance ruling to determine whether a transaction would attract GAAR.

**Recommendations of the SCF which have not been incorporated in the proposed DTC, 2013**

The recommendations of the SCF which were not in harmony with the broad taxation policy of the Government have not been incorporated in the revised Code. Some of the main recommendations of the SCF which have not been incorporated in the revised Code are mentioned below along with the reasons for their non-acceptance:-

- ***Tax slab for Personal Income Tax (PIT):*** *SCF has recommended revised tax slabs as (a) 0-3 lakhs – Nil; (b) 3-10 lakh – 10%; (c) 10-20 lakh – 20%; (d) beyond 20 lakh – 30%*: The recommendation is not acceptable as it will result in huge revenue loss. The total revenue loss on account of recommended changes in PIT slabs and removal of cess works out to Rs. 60,000 crore approximately.

- ***The rate of tax for life insurance companies may be kept at 15% instead of the proposed 30%*****:** Under the Income-tax Act, tax on a life insurance company is levied at the rate of 12.5% of the surplus generated in the profit and loss account of the company based on actuarial valuation. In the Code, the tax base for a Life Insurance Company is limited to the surplus generated for the company in the shareholders account while the surplus determined in the policyholders' account (technical account) is not taxable. Therefore, rate of tax on such companies is aligned with that applicable to other companies, that is 30 per cent.

- ***Exemption limit to be linked to the consumer price index***: It is not practicable to link exemption limit to the consumer price index for a number of reasons. First, it is not clear why the Consumer Price Index should be the base and not the Wholesale Price Index. Further complications may arise if the base of the index or the commodity basket changes. Second, it would lead to changes which are not multiples of whole numbers. Third, indexing the slabs to inflation index is not a comprehensive approach as the slab structure is dependent on a number of factors including other reliefs given to a taxpayer, potential revenue loss to the Government, number of taxpayers who would go out of the tax net etc.

- **Abolition of *Securities Transaction Tax (STT)*:** The recommendation is not acceptable as STT is required to regulate day trading. Further, the rate of STT has already been reduced significantly by Finance Act, 2013.

- ***Levy of Dividend Distribution Tax on policy holder's investments may negatively impact the insurance industry*:** With a view to provide parity in treatment of insurance products and mutual fund products, the Code proposes to levy Income Distribution Tax on equity linked insurance products on the lines of equity oriented mutual funds. For a life insurance company, only the surplus determined in the shareholder account would be taxed. This will benefit the policy holders as it would leave more money in the policy holder's account. Further, in respect of life insurance products, that is, where the premium paid or payable for any of the years does not exceed 10% of the capital sum assured, any amount including bonus will not be subjected to tax. Besides, pure life insurance products are also outside the tax ambit.

- ***Deduction for CSR expenditure in backward regions and districts:*** The CSR expenditure cannot be allowed as a business deduction as it is an application of income. Allowing deduction for CSR expenditure would imply that the government would be contributing one third of this expenditure as revenue foregone.

**<u>Other significant changes in the Code</u>**

Taking into account, the report of the SCF and the amendments carried out in the Income-tax Act, 1961 and the Wealth-tax Act, 1957 which are consistent with the policy laid down in the Bill, the revised Code has been drafted. While drafting the revised Code, a comprehensive review of the provisions of DTC Bill, 2010 was also carried out in the light of the observations made by the Kelkar Committee in its report on 'Road Map for fiscal consolidation'. Some of the other changes in the revised Code, which are based on a comprehensive review of the DTC Bill, 2010 and reflect the broad policy of the Government, are as under:-

- ***Taxation of 'Income from house property':*** The income from a house property, which is not used for business or commercial purposes, will be taxed under the head 'income from house property'. The income from house property shall be the gross rent as reduced by the specified deductions. The gross rent shall be higher of the contractual rent or the presumptive rent. The presumptive rent shall be the annual value or rental value (without giving any deduction) fixed by the local authority for the purposes of levy of property tax. In a case where no such value is fixed by the local authority, the presumptive rent shall be the amount for which the property might reasonably be expected to be let from year to year.

- ***Change in base of Wealth-tax:*** The DTC Bill, 2010 captured only unproductive assets for levy of wealth-tax. This substantially reduced the base for wealth-tax. To keep the base wide, the revised Code captures all assets for wealth-tax, whether physical or financial, thereby removing the distinction between physical and financial assets, which discriminated against those taxpayers who are conservative and put their money in physical assets. Wealth-tax is proposed to be levied on individuals, HUFs and private discretionary trusts at the rate of 0.25%. The threshold for levy of wealth-tax in the case of individual and HUF shall be Rs.50 crores.

- ***Additional tax @10 per cent on recipient of dividend (liable to Dividend Distribution Tax) exceeding one crore rupees:*** Under the Income-tax Act as well as in the DTC Bill, 2010, the dividend distribution tax is to be levied at the rate of 15%. This favours high net worth taxpayers who pay only a fraction of their earnings as tax on their investments in the capital market. The draft DTC proposes to remove this anomaly by levy of 10% additional tax on the resident recipient if the total dividend in his hand exceeds Rs.1 crore.

- ***Rationalisation of provisions related to non-profit organisations:*** The provisions for taxation of non-profit organisations (NPO) has been rationalised by taxing their surplus at a concessional rate of 15%, allowing basic exemption limit of Rs.1 lakh and permitting all capital expenditure as a revenue outgoing. The draft Code does not provide for specific modes of investments. An NPO would be free to make its investments, other than the limited prohibited modes of investments. Consequently, specific deduction for accumulation and the provision for carry forward of deficit are proposed to be removed.

- ***Settlement Commission:*** Settlement Commission has not achieved the intended purpose of early settlement of cases and additional revenue realisation. At the same time, the backlog of cases has reduced the efficacy of search and survey actions. Accordingly, the draft Code does not provide for the machinery of Settlement Commission.

- ***Weighted deduction for scientific research:*** DTC Bill, 2010 provides for weighted deduction of 175% to the donor on any donation made by it to the specified institutions to be utilised by them in scientific research. Weighted deduction of 200% is also provided for in-house scientific research. Since, the weighted deduction reduces the actual expenditure on research and there is significant potential for its misuse, the revised Code provides for weighted deduction of 150% for in-house scientific research and 125% to the donor on any donation made by it to the specified institutions.

- *35 per cent tax rate for individual/ HUF having income exceeding Rs. 10 crore:* With a view to maintain overall progressivity in levy of income-tax, the revised Code provides for a fourth slab for individuals, HUFs and artificial juridical persons. In their case if the total income exceeds Rs.10 crore, it is proposed to be taxed at the rate of 35%.

- **Ring-fencing of losses from business availing investment linked incentive:** The policy of the Government has been to broaden the tax base and the strategy for broadening the base essentially comprises of three elements (i) to minimize exemptions as they erode the tax base (ii) to reduce the number of ambiguities in the law, and (iii) checking of erosion of tax base through tax evasion. Accordingly, the profit linked and area based deductions were replaced by investment linked deductions for businesses specified in the Eleventh, Twelfth and Thirteenth Schedules of the DTC Bill, 2010. The basic principle of investment linked incentive is that the taxes are payable by a business after it recoups its capital investment. However, to protect the tax base it is necessary to ring fence losses from such businesses, otherwise profits of even the existing businesses can be potentially wiped out. Accordingly, the revised Code provides for ring fencing of losses from specified businesses. However, in the case of business re-organisation, where there is unabsorbed loss in the years preceeding the re-organisation, such loss will be allowed to the successor in respect of such business.

- *Taxation of indirect transfer of assets:* The DTC Bill, 2010 provides for a 50% threshold of global assets to be located in India for taxation of income from indirect transfer in India. This threshold is too high. There could be a situation that a company has 33.33% assets in three countries but it will not get taxed anywhere. Accordingly, the revised Code provides for a threshold of 20% of global assets to be located in India for taxation of income from indirect transfer in India. Besides, exemption is provided for transfer of small share holdings (upto 5%) outside India.

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