

## DIRECT TAX CODE 2010

The DTC Bill, 2010 introduced in the Parliament is proposed to be made effective from 1 April 2012. While some onerous provisions from the first draft of the DTC have been rightly dropped after representations, several proposals in the DTC are still likely to compel the corporate to rethink their existing structures and mode of conducting business.

For example, the DTC proposes to tax transfer of shares of a foreign company, on the basis that there is a transfer of a capital asset situated in India, if the fair value of the assets situated in India constitute at least 50 percent of the assets directly or indirectly held by the foreign company.

Further, an overseas company with a place of effective management in India will now be treated as a tax resident in India and would be consequently liable to tax in India on its global income.

Introduction of CFC rules would result in taxing income of certain overseas subsidiaries in the hands of their Indian owners, even before such income is distributed.

Other provisions of interest to India Inc. relate to APA and the GAAR. The former is a very welcome step and will go a long way in minimizing the transfer pricing disputes. However, the wide-sweep of the GAAR has been retained, despite the many representations made to the government in this regard. One hopes that in practice though, it will be applied judiciously.

Another key provision deals with the continuation of tax holidays to units in SEZs. In a welcome move, much to the delight of India's exporters, the Bill provides that units in SEZs that commence operations on or before 31 March 2014 are to be entitled to a grandfathering of profit-linked tax deductions.

However, units in SEZs will not be exempt from MAT, a move which dampens the attractiveness of SEZs.

It's heartening to note that the long term capital gains on sale of listed shares continue to be tax exempt and short term capital gains on the sale of such shares will be taxed at half the applicable rates. Gains on sale of other assets (including unlisted shares) are to be taxed fully, subject to indexation benefits.

Overall, the calibration of tax rates, which was hinted at in the revised discussion paper has been carried through with the Corporate tax rate proposed at 30 percent instead of the earlier rate of 25 percent and individual tax slabs being considerably less generous as compared to those which had earlier raised euphoric hopes of low personal taxation in India.

India Inc. has long advocated its preference for a modern, stable and simple tax regime. Whether the DTC meets these criteria is something that will be undoubtedly debated as one analyses the fine print.

However, it is the tax administration's implementation that will determine the long-term impact of the new tax regime.

The following paragraphs give an overview of the proposals in the DTC. We trust you would find these useful.

## General provisions

The DTC 2010 would come into force on 1 April 2012, if enacted

The concept of previous year replaced with a new concept of financial year which inter alia means a period of 12 months commencing from the 1st day of April

Income has been proposed to be classified into two broad groups:

Income from Ordinary Sources and Income from Special Sources

Income from Ordinary Sources refers to:

- Income from employment
- Income from house property
- Income from business
- Capital gains
- Income from residuary sources.

Income from Special Sources to include :

specified income of non-residents, winning from lotteries, horse races, etc. However, if such income is attributable to the PE of the non-resident it would not be considered as Special Source income. Accordingly, such income would be liable to tax on net income basis

Losses arising from Ordinary Sources to be eligible for set off or carry forward and set-off against income only from ordinary sources without any time limit.

Similar treatment would apply for set off and carry forward of losses from Special Sources. Loss arising from speculative business, losses under the head capital gains, and losses from the activity of owning and maintaining horse race to be set off only against such income in the same or succeeding financial years

In case of delayed filing of return of income for any particular year, only losses pertaining to that year would now not be allowed to be carried forward for set off in future years.

## Corporate tax

Under the first draft of the DTC, it was proposed that a company shall pay tax on its gross assets at the rate of 2 percent (0.25 percent in case of banking companies) if the tax liability under provisions of the DTC is less than the tax on gross assets. The revised draft of the DTC reintroduces profit-based MAT. The rate has been increased from 18 percent to 20 percent.

- Computation of book profits broadly similar to that under the Act

- DTC does not specifically provide for credit of MAT paid under the Act
- MAT now applicable to SEZ developers and SEZ units
- SEZ developers now subject to DDT similar to SEZ units.
- Security Transaction Tax to continue
- Deduction for DDT paid by subsidiary available against the DDT liability of the holding company

Tax rates for Coporates	Esisting Rate	As per DTC
Income Tax Indian Company	30 %	30 %
MAT	18 %	20%
Dividend Distribution tax	15 %	15 %
Income distributed by mutual fund to unit holders of equity oriented funds	N.A.	5 %
Income distributed by life insurance companies to policy holders of equity oriented life insurance schemes	N.A.	5 %

### Business income

- Income of distinct and separate businesses i.e. where there is no inter-lacing and inter dependence Of business as stipulated is to be computed separately.

### Income

- The ambit of business income has been widened to cover:

- Profit on transfer, demolition, destruction or discardment of any business capital asset which need to be determined as under:

Type of Asset	Formula	Summary
Business Asset forming part of block of asset	$A-(B+C)$	<p>A = the amount accrued or received in respect of asset which is transferred/discarded/destroyed /destruced, along with the scrap</p> <p>B = written down value at beginning of year</p> <p>C = Actual cost of assets acquired during the year</p>

Business asset not falling in above	A-B	<p>A = the amount accrued or received in respect of asset which is transferred/discarded/destroyed /destructured, along with the scrap</p> <p>B = Actual cost of the asset</p>
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## Expenses

- The tax depreciation regime stipulates (key changes in depreciation rates are given in the Annexure)
  - Depreciation to lessee in case of a finance lease and payments for lease rent to be treated as payment towards principal and interest
  - Many new Block of Assets/categories introduced such as rails, scientific research assets, family planning assets, etc
  - Allowance of depreciation even where all the assets in the block of asset are demolished, destroyed, discarded or transferred
- Initial depreciation shall not be allowed if the asset
  - is installed in any office premises or any residential accommodation including a guest house
  - is in nature of any office appliance
- Disallowance of expenditure for non-withholding of tax or non-payment of tax would not be applicable if such tax is paid on or before the due date of filing of return of income. Further, if tax is paid after the due date of filing of return of income for such year, such expenditure would be allowed in the financial year in which the tax is paid
- **Rate of deduction for scientific research and development allowance increased to 200 percent**
- Interest on capital borrowed or debt incurred payable to any financial institution to be allowed as a deduction in the financial year in which the amount is actually paid or in which the liability has accrued, whichever is later

## International Tax :

Category	Existing Rate	As per DTC
<b>Foreign Company</b>	<b>40 %</b>	<b>30 % . Additional branch profits tax of 15 percent (on post tax income) for income attributable directly or indirectly to permanent establishments of foreign companies in India</b>



Chartered Accountants

A foreign company is considered to be a resident in India if its place of effective management at any time in the year is in India

Place of effective management is defined as (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.

Any other person is considered to be a resident in India if its place of control and management at any time in the year is situated wholly or partly in India

The rule that the provisions of domestic law or treaties, whichever are more beneficial shall apply has been restored. Except where provisions relating to (a) GAAR, (b) levy of Branch Profits Tax, or (c) CFC shall apply

Income shall be deemed to accrue in India, if it accrues, whether directly or indirectly, through or from the transfer, of a capital asset situated in India.

Income from transfer of share or interest in a foreign company by a nonresident outside India will not be deemed to accrue in India if the fair market value of the assets owned (directly or indirectly) by that company does not exceed 50 percent of the fair market value of the total assets owned by that company.

Further, it is provided that proportionate gains would be taxable in India where any income is deemed to accrue to a non-resident by way of transfer of share or interest in a foreign company.

PE defined in the same way as in treaties and includes one day Service PE, (substantial) equipment PE and insurance agent PE.

Insurance premium including reinsurance premium payable in respect of insurance covering any risk in India included in the definition of 'income deemed to accrue or arise in India'

Income in the nature of insurance premium, interest, royalty, FTS and transportation charges would be deemed to accrue in India whether or not the payment is made in India or services are rendered in India or the non-resident has a residence or place of business or any business connection in India or the income has accrued in India

Definition of interest has been widened to include any service fee or other charges in respect of the money borrowed or debt incurred or in respect of any credit facility which has not been utilized

Interest is deemed to accrue in India if paid by a non-resident in respect of business carried out in India or for earning any income from any source in India. However, such interest will not be deemed to accrue in India if such interest is not claimed as a deduction by the non-resident from his income chargeable to tax in India.

Royalty/FTS/Interest,etc. attributable to the PE of a non-resident in India is taxable on net basis

Dividend paid by a domestic company is deemed to accrue in India. As domestic company is defined as a company resident in India, this would include foreign companies which are deemed to be resident in India

In relation to availability of FTC, it has been clarified that:

- (i) FTC to be available to a person resident in India; and
- (ii) FTC to be restricted to the amount of Indian income tax payable on (a) income taxed outside India and (b) total income of the assessee.

The Central Government may prescribe methods for computing the foreign tax credit, the manner of claiming credit and such other particulars as are necessary for the relief or avoidance of double taxation

Income of FIIs from transfer of any security will be taxable as capital gains

For non-residents, head office expenditure to be restricted to one-half percent of the total sales, turnover or gross receipts.

## Tax incentives

The DTC substitutes profit-linked incentives with investment based incentives wherein capital expenditure incurred for specified businesses will be allowed as a deductible expenditure. However, certain profit-linked tax incentives under the Act are grandfathered in the DTC.

The investment-linked incentives will apply to the following businesses:

- Generation, transmission or distribution of power
- Developing or operating and maintaining any infrastructure facility
- Operating and maintaining a hospital in a specified area
- Processing, preservation and packaging of fruits and vegetables
- Laying and operating of a cross country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of the network
- Setting up and operating a cold chain facility
- Setting up and operating a warehousing facility for the storage of agricultural produce
- Exploration and production of mineral or natural gas
- SEZ Developers and units established in SEZ
- Building and operating a new hotel of two-star or above category commencing operations on or after 1 April 2010
- Building and operating a new hospital with at least 100 beds commencing operations on or after 1 April 2010
- Developing and building a housing project under slum redevelopment or rehabilitation scheme commencing operations on or after 1 April 2010.

## Special Economic Zones

SEZ Developers and even units established in SEZ engaged in the business of manufacture or production of article or things or providing of services would be eligible for tax incentives.

Grandfathering of profit-linked incentives under the Act to continue for SEZ developers notified on or before 31 March 2012. In case of SEZ units, grandfathering extended for units commencing operations on or before 31 March 2014

Eligible expenditure for investment based tax incentive not to include:

- Expenditure on purchase, lease or rental of land or land rights
- Negative profit for any financial year preceding the relevant financial year.

## Capital gains

- Definition of ‘capital assets’ has been replaced with the term ‘Investment Asset’. Investment Asset does not include business assets like self generated assets, right to manufacture and other capital asset connected with business.
- Further, Investment Asset is defined to include any securities held by Foreign Institutional Investors and any undertaking or division of a business
- Additional deductions over and above the actual/indexed cost of acquisition/improvement have been provided in computing capital gains for various Investment Assets depending on their nature and holding period viz:
  - On transfer of equity shares or equity-oriented mutual funds which have been held for more than one year and where STT has been paid on the transfer, a deduction equal to 100 percent of the capital gains
  - On transfer of equity shares or equity-oriented mutual funds which have been held for less than one year and where STT has been paid on the transfer, a deduction equal to 50 percent of the capital gains.
- The earlier DTC draft did not provide for any such deduction and also proposed doing away with STT.
- Fair market value substitution date and the indexation base date is proposed to be 1 April 2000
- In respect of exemption on transfer of Investment Assets from holding company to WOS and vice versa, the proposed lock in period for holding-100 percent subsidiary relationship, is now capped at eight years. It further provides that the transferee should not convert the investment asset into stock in trade. In case these conditions are breached, the gains would be taxable in year of breach. Under the earlier DTC draft, conversion of the investment asset into stock in trade was taxable in the year of sale of asset.

- If the cost of acquisition/cost of improvement of an asset is not determinable by the tax payer, then such cost shall be taken as nil and capital gains to be computed.

Capital Gains Savings Scheme provided in the earlier DTC draft, for rollover of capital gains, has been done away with.

The cost of acquisition with respect to various modes of acquisition of shares has been provided in the Seventeenth Schedule.

## Transfer pricing provisions

Provisions relating to Advance Pricing Agreement (APA) mechanism have been introduced. The CBDT with the approval of the Central Government may enter into an agreement with the tax payer, specifying the manner in which the arm's length price is to be determined in relation to an international transaction. The said agreement will be valid for a maximum period of five consecutive financial years unless there is a change in law or facts. The agreement will be binding on the tax payer and the CIT and the income tax authorities below him.

The scope of the term 'associated enterprise' has once again been brought in line with the scope as existing under the Act, and the stringent conditions proposed by the earlier draft of DTC have been removed.

However, following additional criteria have been introduced

- Provision of services (directly or indirectly) to another enterprise or person specified by it, if the amount payable and other terms relating thereto are influenced by such other enterprise
- If any of the enterprises to the transaction are situated in any specific or distinct location which may be prescribed

Report of International Transactions certified by a Chartered Accountant to be lodged directly with the Transfer Pricing Officer instead of the AO. However, the proposal of selecting cases for scrutiny by the Transfer Pricing Officer based on risk management strategy framed by the CBDT as contained in the DTC 2009, has been done away with. Instead, the AO shall make a reference to the Transfer Pricing Officer for determination of arm's length price which is in line with the position as contained in existing provisions of the Act.

Transfer Pricing Officer will have the power to determine the arm's length price after due verification; however, such determination will not be subject to the specific conditions as contained presently in the Act. Further, the requirement of issuance of show cause notice by the Transfer Pricing Officer before proposing variation to the arm's length price determined by the taxpayer has been done away with.

## Personal Taxation

1. Basic threshold limit proposed to be increased to INR 250,000 for resident senior citizens and to INR 200,000 for other individuals including resident women.
2. Peak rate of 30 percent applicable to income exceeding INR 1 million vis-à-vis INR 2.5 million proposed earlier.

3. Definition of Residency and Scope of Income:
4. The category of 'Not Ordinarily Resident' abolished and only two categories of taxpayers proposed viz. residents and non-residents. The additional condition of 729 days retained only to ascertain taxability of overseas income.
5. A citizen of India or person of Indian origin living outside India and visiting India will trigger residency by staying in India for more than 59 days visa vis more than 181 days proposed earlier.

### Income from Employment

- Employment income proposed to be computed as the gross salary due, paid or allowed less the aggregate of the specified deductions
- Exemptions such as house rent allowance, leave encashment and medical reimbursements have been retained. The exemption for medical reimbursements increased to INR 50,000. An allowance to meet personal expenses has been introduced. Leave travel concession and non-monetary perquisite have been done away with.
- Receipts under the Voluntary Retirement Scheme, Gratuity and Commuted Pension deductible from employment income subject to limits without the condition to make any prescribed investments.
- Employer contributions to approved Provident Fund, approved Superannuation Fund or any other approved fund to be deductible to the extent of prescribed limits as against aggregate proposed cap of INR 300,000 prescribed earlier.
- Withholding tax on salaries is now proposed to be a part of the overall consolidated withholding tax provisions on all payments.
- Tax to be withheld on payment/credit.

### Income from House Property :

- Gross rent to be calculated on the basis of actual rent received or receivable and not on presumptive basis (higher of contractual rent or presumptive rate of 6 percent of rateable value/construction/acquisition cost as proposed earlier).
- Interest on housing loan on self occupied property now available upto INR 150,000 as a deduction from gross total income. Further, interest relating to period prior to financial year in which the property has been acquired or constructed deductible in five equal instalments.
- Deduction for repairs and maintenance to be 20 percent of the gross rent

- If shares of owners of property are not definite and ascertainable, such persons to be assessed as an association of persons in respect of such property.
- Property used as hospital, hotel, convention centre or cold storage and forming part of SEZ, income from which is computed under the head 'income from business' not to be included under income from house property as against all types of property occupied for business as proposed earlier.
- The deduction for service tax on payment basis has now been withdrawn.
- The arrears of rent to be taxable in the year of receipt irrespective of ownership of property at that time with deduction for repairs and maintenance at 20 percent of such arrears.

### EEE for Savings Scheme

- All long-term retiral savings schemes moved to EEE regime as against Exempt-Exempt-Tax proposed earlier
- Deduction in respect of investment in approved funds such as Provident Fund, Superannuation Fund or Pension fund reduced to INR 100,000 from INR 300,000. Further, any withdrawal there from now not taxable which exemption was earlier confined only to accumulated balance as on 31 March 2011.
- Receipts under a life insurance policy on death/maturity exempt from tax
- Receipts of surrender value from life insurance policy and distributions from equity linked insurance policies exempt subject to prescribed conditions.

### Other Deductions :

1. An aggregate deduction stipulated of INR 50,000 towards life insurance premium, health insurance premium and tuition fees for two children
2. Deduction to a person with disability and for medical treatment and maintenance of a dependent person with disability stipulated subject to prescribed conditions.
3. Deductions in respect of contributions or donations to certain funds or nonprofit organisations proposed.
4. An individual not receiving house rent allowance allowed deduction towards payment of rent upto a maximum limit of INR 2,000 per month, subject to prescribed conditions.
5. The deduction for interest paid on loans for higher education for a period of eight years to be restored.

## Wealth tax

Every person, other than a NPO, liable to pay wealth-tax at the rate of 1 percent on net wealth exceeding INR 10 million which is a much lower threshold as compared to the earlier proposed threshold of INR 500 million

The specified assets for computing 'net wealth' have been retained in line with existing taxable assets, with additional items as under:

- Archaeological collections, drawings, paintings, sculptures or any other work of art
- Watches with a value in excess of INR 50,000
- Bank deposits outside India, in case of individuals and HUFs, and in the case of other persons, any such deposit not recorded in the books of account
- Any interest in a foreign trust or any other body located outside India (whether incorporated or not) other than a foreign company
- Any equity or preference shares held by a resident in a CFC
- Cash in hand in excess of INR 200,000 in the case of an individual and HUF.

## Return of income and assessment

- The due date for filing the return of income for non-corporate taxpayers is 30 June of the year following the financial year and for other assesses is 31 August
- Belated/revised return can be filed within 24 months from the end of the financial year. In the draft DTC released in 2009, the due date for belated/revised returns was 21 months from the end of the financial year. The revised provision is in line with the current tax law.
- Time period for furnishing a return in response to a notice pursuant to non filing of a return reduced to 14 days.
- A acknowledgement to be issued on receipt of each return of tax bases and initial processing to be completed within 12 months from the month in which the return is filed.
- Reference to procedure for selection of cases for scrutiny assessments in line with risk management strategy as proposed in the draft DTC released in 2009 dropped in the revised DTC.
- Time limit for making an application for rectification of mistake in an order/intimation has been increased to four years from the end of the financial year in which the order/intimation is passed.
- Assessment to be completed within 21 months from the end of the financial year in which the return was 'due' (33 months in respect of the cases referred to transfer pricing officer).
- The time limit for issue of notice for selection of cases for scrutiny has been extended to six months from the end of the financial year in which the return is furnished.

- Assessment of taxes after search and seizure operations to be treated as tax base escaped assessment and would be subject to re-opening.
- A taxpayer failing to pay due tax/interest on self assessment before filing of return to be treated as assessee in default.
- Threshold limits for tax audit revised as under:
  - gross receipts exceeding INR 25 lacs for person carrying on profession
  - total turnover or gross receipts exceeding INR 1 crore for person carrying on business.
- In case of change in officer or jurisdiction, the succeeding officer has to continue any proceedings from where the earlier officer has concluded the proceedings. This is likely to reduce the hardships to the taxpayers in case of change in officers.
- Disallowance of expenditure for non-withholding of tax or non-payment of tax would not be applicable if such tax is paid on or before the due date of filing of return of income. Further, if tax is paid after the due date of filing of return of income for such year, such expenditure would be allowed in the financial year in which the tax is paid.

### Income from residuary sources

The following items over specified threshold included as income from residuary sources:

- Receipt of money and any specified property (shares, securities, jewellery, etc.), not being an immovable property, for inadequate or without consideration by an individual or a Hindu undivided family
- Receipt of immovable property without consideration by an individual or a Hindu undivided family
- Receipt of shares of a closely held company for inadequate consideration or without consideration by a firm or a company.

## Schedules to DTC

First	Rates of tax
Second	Rates of other taxes (MAT, DDT, Wealth Tax, etc.)
Third	Rates of tax deduction at source for residents
Fourth	Rates of tax deduction at source for non-residents
Fifth	Procedure for recovery of tax
Sixth	List of exempt income
Seventh	Persons not liable to tax
Eighth	Profits of life insurance business
Ninth	Computation of income from Special Source
Tenth	Computation of profits of business of operating qualifying ships
Eleventh	Computation of profits of business of mineral oil and natural gas
Twelfth	Computation of profits of Special Economic Zone Developers and Units
Thirteenth	List of specified businesses notified by the Central Government
Fourteenth	Computation of income subject to presumptive taxation
Fifteenth	Depreciation schedule
Sixteenth	Deduction for contributions and donations to specified persons
Seventeenth	Determination of cost of acquisition of investment assets acquired by specified modes
Eighteenth	List of minerals and groups of associated minerals
Nineteenth	Approved provident fund, superannuation fund and gratuity fund
Twentieth	Computation of income attributable to controlled foreign companies
Twenty-first	Orders appealable before CIT (Appeals)
Twenty-second	Deferred revenue expenditure allowance

## Glossary of Terms

AO	Assessing Officer
AOP	Association of Persons
APA	Advanced Pricing Agreement
BOI	Body of Individuals
CBDT	Central Board of Direct Taxes
CFC	Controlled Foreign Company
CIT	Commissioner of Income tax
DDT	Dividend Distribution tax
DRP	Dispute Resolution Panel
DTAA	Double Tax Avoidance Agreement
DTC	Direct Taxes Code
EEE	Exempt-Exempt-Exempt
FTS	Fees for Technical Services
FII	Foreign Institutional Investors
FTS	Foreign Tax Credit
GAAP	Generally Accepted Accounting Principles
GAAR	General Anti Avoidance Rules
IFRS	International Financial Reporting Standards
MAT	Minimum Alternate Tax
NPO	Non Profit Organisations
PE	Permanent Establishment
SEZ	Special Economic Zone
STT	Securities Transaction Tax
The Act	The Income-tax Act, 1961
VCU	Venture Capital Undertaking
WOS	Wholly Owned Subsidiary