DIRECT TAX CODE

-Presented by Taxmen

INTRODUCTION

- Replace the existing Income Tax Act, 1961.
- Consolidate the law relating to all direct taxes
- Establish an economic, effective and equitable direct tax system
- Achieve voluntary compliance.
- Reduce the scope for disputes and minimize litigation.
- Stabilise the tax regime.
- Pave the way for a single unified taxpayer reporting system.
- Eventually help increase the tax-GDP ratio

NEED FOR DTC

- IT Act, 1961 is almost 48 years old, without much change.
- Difficulty in understanding tax laws.
- Burst of litigation, swamping tribunals and courts.
- Too many sections, sub-sections, provisos and explanations.
- Head spin for the general tax payer to decipher the act.

The regime so far

- First draft bill of DTC released by GOI for public comments on 12/8/2009 (DTC 2009).
- Discussion paper released in 2009 with bill.
- Revised Discussion Paper released in August 2010.
- DTC 2010 introduced in the Parliament in August 2010.
- Standing Committee on Finance (SCF), submitted its report to the Parliament on 9/3/2012.
- Khelkar Committee Report of September 2012 suggested a comprehensive review of DTC.
- Revised version of DTC (DTC 2013) released on 31/3/2014.

Salient Features

- Single Code for direct taxes
- Use of simple language
- Reducing the scope for litigation
- Flexibility
- Ensure that the law can be reflected in a Form
- Consolidation of provisions
- Elimination of regulatory functions
- Providing stability

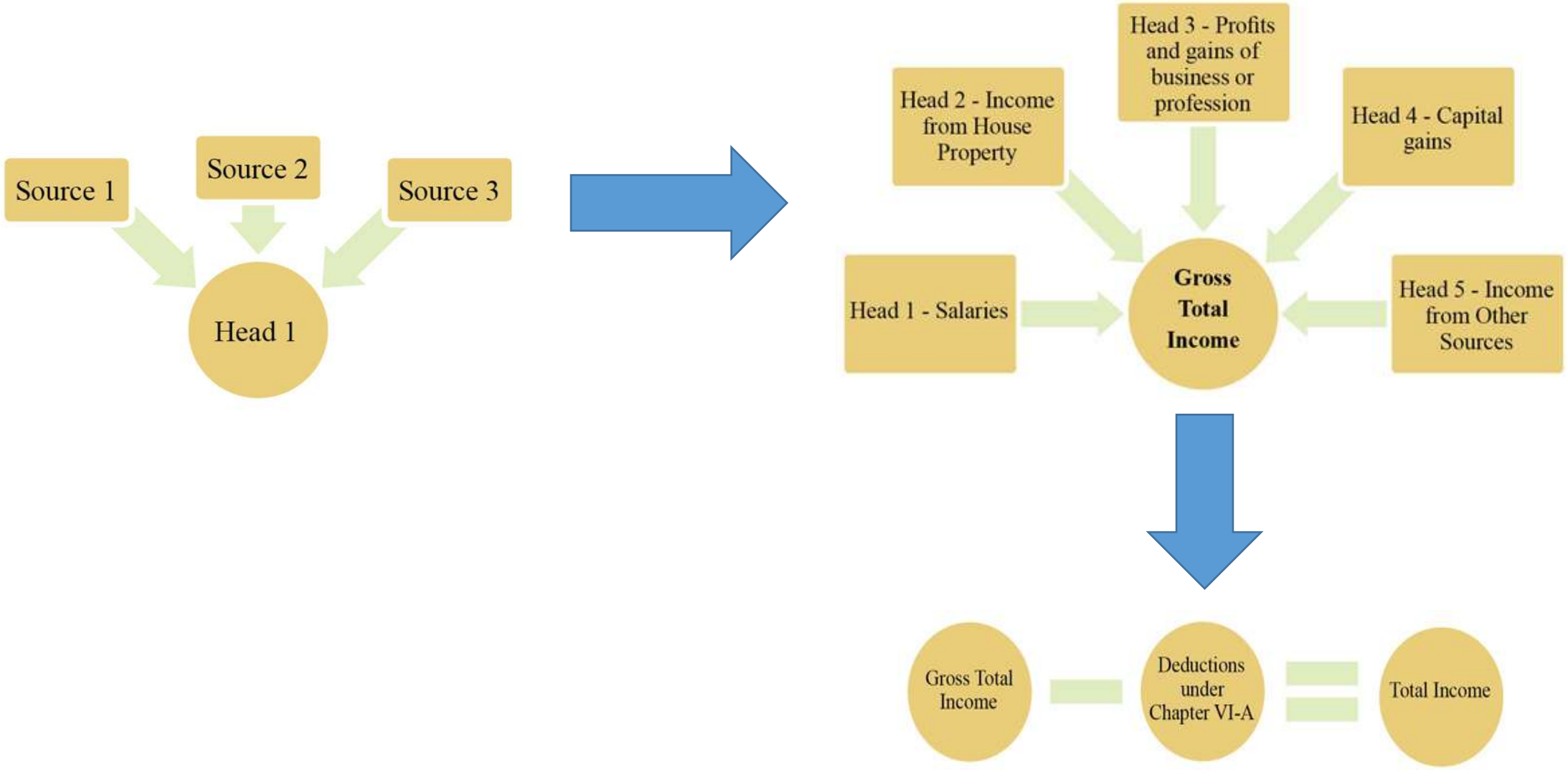
Highlights of DTC

- Proposal to levy dividend distribution tax at 15%.
- Exemption for investment in approved funds proposed at Rs.150,000 annually, against Rs.120,000 currently.
- Proposed bill has 319 sections and 22 schedules.
- Mutual Funds/ULIP dropped from 80C deductions, income to be subject to tax @ 5%.
- Fringe benefit tax to be charged to the employee rather than the employer.
- Political contribution of up to 5% of gross total income eligible for deduction.

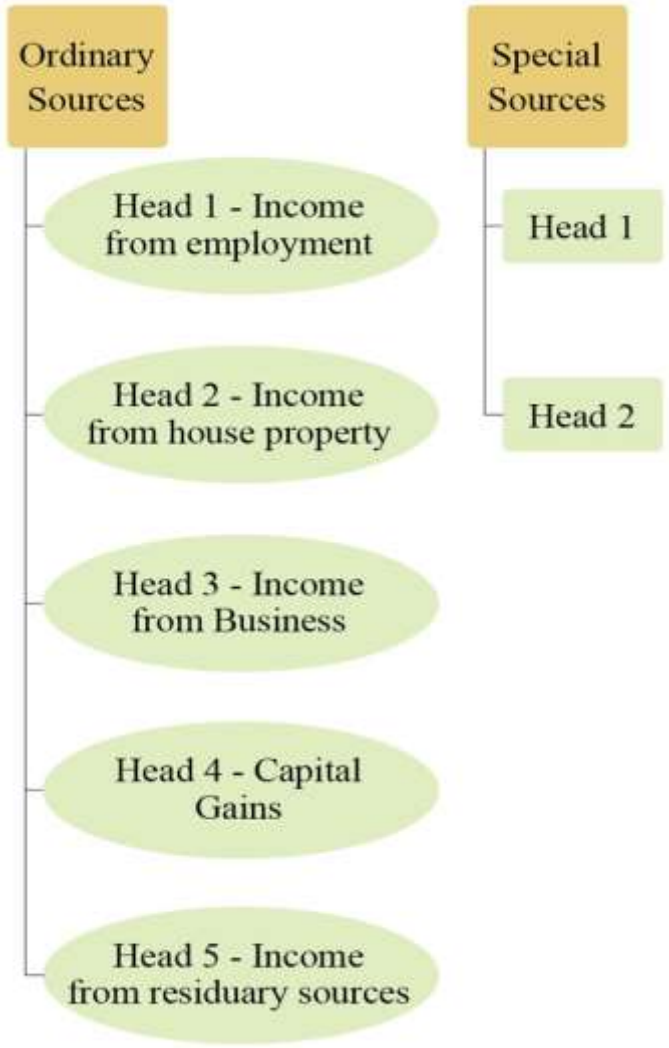
Concepts Introduced

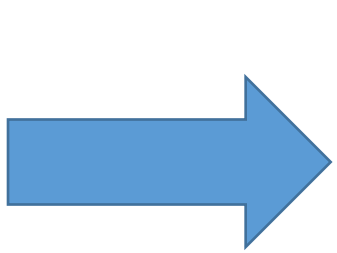
- DTC 2013 proposes to introduce:
- General Anti Avoidance Rules (GAAR),
- Taxation of Controlled Foreign Companies (CFC),
- Place of Effective Management (POEM) rule
- Expanded source rules for taxation of royalty, fees for technical services (FTS) and interest.

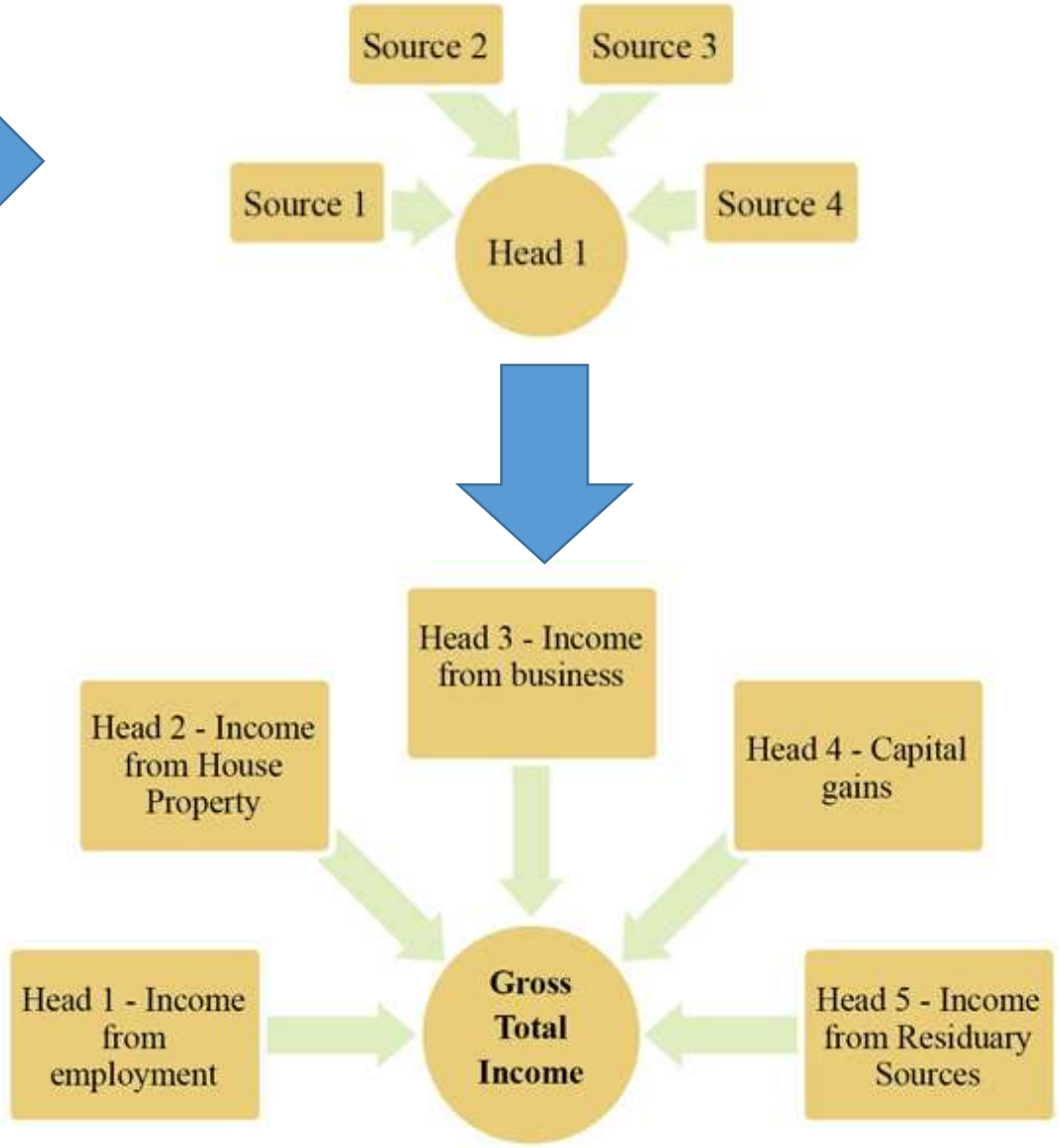
OLD STRUCTURE:



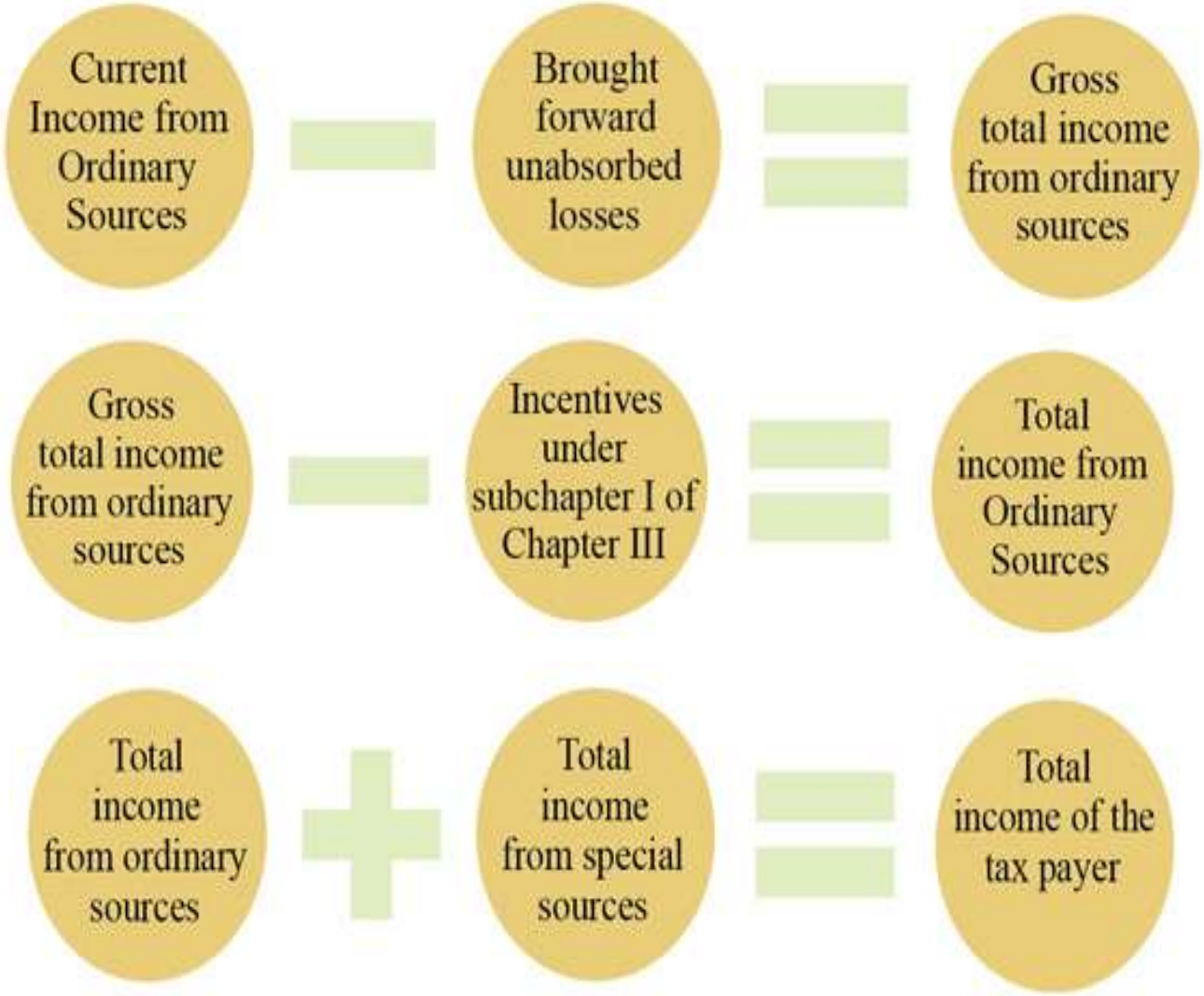
NEW STRUCTURE:







NEW STRUCTURE continued



- <u>INCOME TAX ACT, 1961</u>
- COMPOSITION:

  This Act has two legislature i.e. Income Tax Act, 1961 & Wealth Tax Act, 1957.
- RESIDENTIAL STATUS:

  It is applicable to three kinds of residential status i.e. ‘Residential’, ‘Non Resident’ and ‘Resident but not Ordinarily Resident.
- FILLING YEAR:

  There are ‘previous year’ and ‘assessment year’.

- <u>DIRECT TAX CODE</u>
- COMPOSITION:

  Single Code was drafted for the Income Tax Act, 1961 & Wealth Tax Act, 1957.
- RESIDENTIAL STATUS:

  In “Resident but not ordinarily resident” has been done away with.

- FILLING YEAR:

  To eliminate confusion only ‘Financial Year’ will prevail.

- TAX SLAB:

  Individual tax rates in Income Tax Law (ITL) are as follows

  10%- from Rs.2,50,000 to Rs.5,00,000

  20%- from Rs.5,00,001 to Rs.10,00,000

  30%- from Rs.10,00,001 and above

- MAT APPLICABILITY:

  MAT rate is 18.5%. MAT credit can be availed for 10 years

- TAX SLAB:

  Individual tax rates proposed in Direct tax code (DTC).

  10%- from Rs.300000 to Rs.10,00,000

  20%- from Rs.1000001 to Rs.2000000

  30%- from Rs.2000001 and above

- MAT APPLICABILITY:

  MAT rate is 20 %. Credit for MAT is proposed for 15 years.

- TAX INCENTIVES:

  Tax incentives were based on location or on export turnover upto a specified period. Further capital investment were not allowed to amortized.

- TAX INCENTIVES:

  Export and Area/profit based exemption to be discontinued without affecting currently enjoying such incentive. Under the DTC, all capital investment and revenue expenditure (except land, goodwill and financial instruments) allowed to be amortized indefinitely and the period of such amortization will be called as ‘Tax Holiday’.

- Best judgment assessment under section 144 of ITA, a best judgment assessment is allowed in cases where there is a failure to file a return or failure to comply with the terms of certain notices etc. Under the DTC, in addition to the existing requirements, a best judgment assessment can also be made if the assessee fails to follow regularly the prescribed method of accounting or if the Assessing Officer is not satisfied with the correctness or completeness of the accounts of the assessee.
- Under DTC income has been proposed to be classified into two broad groups: Income from Ordinary Sources and Income from Special Sources
- In corporate tax rate, the tax rate of foreign company in ITA is 40 % whereas

  in DTC the tax rate of foreign company is 30 %.
- The capital gains chapter applies to investment assets. All security transactions of Foreign Institutional Investors (FIIs) are classified as investment assets. Also, in respect of assets acquired prior to 1 April 2000, appreciation in value until 1 April 2000 is excluded from the taxable net. DTC 2013 continues to provide tax neutrality to transactions of amalgamation and demerger subject to compliance of specified conditions. DTC 2013 has modified the definition of business reorganization (BR) to accommodate BRs involving NRs as well,4 subject to compliance of other prescribed conditions.

- Under the ITL, any asset is considered long term if it is held for more than 36 months, except in the case of shares and listed securities for which the relevant holding period is 12 months.
- GENERAL ANTI AVOIDANCE RULES (GAAR)

  GAAR contains a broad set of provisions which have the effect of invalidating an arrangement under certain circumstances. The Tax Authority, in such cases, is granted wide powers to adjust the taxpayer's assessment. GAAR applies to transactions which are "impermissible avoidance arrangement". The proposed GAAR provisions under DTC 2013 are in line with the Income Tax Act with a few modifications. DTC 2013 proposes to expand the definition of "connected person" to include company carrying on business or profession in which the holding company has substantial interest. Under the Income Tax Act, the entire arrangement may be declared as impermissible arrangement even if a part of the arrangement is impermissible arrangement. The Standing Committee on Finance had proposed that it needs to be clarified only that part of the arrangement would be invoked which is proved as "impermissible". However, the same has not been accepted in DTC 2013.

- Levy of Branch Profit Tax

  Under DTC 2013, every foreign company, in addition to income tax payable, is liable to pay branch profit tax at the rate of 15 per cent in respect if branch profits of a financial year. As compared to the provisions of the Income Tax Act, DTC 2013 reduces corporate income tax rate for foreign companies from 40 per cent to 30 percent, which is line with the tax rate of domestic companies. However, branch profit tax is levied additionally. Branch profit tax is levied on income attributable, directly or indirectly, to the Permanent Establishment (PE) or an immovable property situated in India as reduced by the amount of income tax payable on such attributable income. Branch profit tax is applicable irrespective of the tax treaty.

- Controlled Foreign Company (CFC)

  CFC regulations basically focus on taxing the undistributed profits of a foreign company which is situated in a low tax jurisdiction but is controlled by the residents. It is developed to eliminate the artificial deferral of resident taxes on foreign source incomes. Though CFC rules are presently absent in the ITL, they were introduced for the first time in DTC 2010.

- Availment of tax treaty benefit

  The tax treaty related provisions under DTC 2013 are in line with the provisions of the Income Tax Act. The beneficial provisions of the tax treaty would prevail over the Act. However, beneficial provisions of the tax treaty may not apply where GAAR, branch profit tax and Controlled Foreign Company (CFC) related provisions are invoked. DTC 2013 provides that liability of foreign company on account of branch profit tax can not be treated as discriminatory.

Opportunities for a Company Secretary

- Tax Audit currently allowed to be conducted only by a CA.
- Proposed DTC 2013 to allow Tax Audit by CSs' and Cost Accountants.
- Clause 88 of Proposed DTC – who has to be audited? Who audits?
- "Accountant" defined in Clause 320(2) includes Chartered Accountants , Company Secretaries , Cost Accountants and any person having such qualifications as the Board may prescribe, for the purposes specified in this behalf.

Chapter XX: Interpretations and Constructions

Clause 320 :

(2) “accountant” means a chartered accountant within the meaning of the Chartered Accountants Act, 1949 and who holds a valid certificate of practice under sub-section (1) of section 6 of that Act, and shall include-

(i) a company secretary within the meaning of the Company Secretaries Act, 1980 ;

(ii) a cost accountant within the meaning of the Cost and Works Accountants Act, 1959 ; or

(iii) any person having such qualifications as the Board may prescribe, for the purposes specified in this behalf.

- Only a CA to appear before a Tax Tribunal according to National Tax Tribunal Act, 2005.
- A CS in practice could not appear before the Tribunal.
- A CS in practice could only be a consultant to his client in income tax matters.
- A CS in practice could not conduct any audit.
- A CS in practice may file returns on behalf of the assessee.
- Tax Audits to be conducted only by CAs’.

- Purview of term "accountant" extended to include a CS .
- Persons entering into international transactions or specified domestic transactions, to get books audited by an "accountant".
- "Accountant" to conduct audit of books of accounts and tax audit of NPOs'.
- Audit report also to be obtained from "accountant".
- Companies to which clause 103 applies to obtain a report from an "accountant" .
- Special audit under clause 162 to be conducted by an "accountant" under the directions of the assessing officer.
- Purview of term "authorized representative" extended to include an "accountant".

MAJOR CORPORATE RESTRUCTURING AND DIRECT TAX CODE

- As per the provisions of Direct Tax Code the income or deemed income resulted from transfer of any investment asset shall be liable to tax as per the provisions of capital gains.
- Income arising from transfer of any investment asset by a company to its subsidiary company will not be considered as capital gains subject to certain conditions
- Income arising from transfer of any investment asset by a subsidiary company to the holding company will not be considered as capital gains subject to certain conditions
- In above 2 points the income arising from transfer will be taxable under the capital gains if before the expiry of period of eight years from the date of transfer the parent company ceases to hold the whole of the share capital of the subsidiary company or the investment asset is converted by the transferee into or is treated as its business trading asset.

- Income arising from transfer of any investment asset under a scheme of business re-organisation will not be taxable under the head capital gains if all the assets and liabilities of amalgamating company become the assets and shareholders of 75% or more in value of the amalgamating co. will become shareholders of amalgamated co.
- In case of demerger

  all the assets and liabilities of the undertaking become the assets and liabilities of the resulting co.

  assets and liabilities are transferred at values appearing in books of account.

  the transfer of the undertaking is on going concern basis

- Income arising from transfer of any investment asset, being shares held in an Indian company, by an amalgamating foreign company to the amalgamated foreign company will not be taxable.
- Income arising from transfer of any investment asset, by a banking company to a banking institution will not amount to capital gains if the transfer is effected under a scheme of amalgamation, sanctioned and brought into force by the Central Government under sub-section (7) of section 45 of the Banking Regulation Act, 1949;
- Income arising from transfer of shares of an amalgamating company by a shareholder under a scheme of business re-organisation will not be taxable.
- Income arising from transfer of any investment asset by a sole proprietary concern to a company will not be taxable.

- Income arising from transfer of any investment asset by a private company or unlisted public company to a limited liability partnership or any transfer of a share held in the company by a shareholder as a result of conversion of the company into a limited liability partnership will not be taxable

CASE STUDY


Vodafone PLC, London
Vodafone, Netherland
Capital gain tax not paid
INCOME TAX DEPARTMENT
Bought CGP for Rs. 55,000 crore
Hutchinson HongKong
CGP investment Holding, Cayman Islands owned 67% of Hutch Essar India
vodafone bought this to control this
Hutch Essar India
mrunal.org
2007

CONCLUSION

The revised provisions in DTC 2013 are aligned with the Income Tax Law provisions or are a response to the recommendations of the SCF. Provisions such as lowering the threshold to 20% for trigger of indirect transfer, and making the active test (a condition for the trigger of CFC provisions) stringent, could cause concerns. It is important to note that DTC 2013 is presently a draft version which can be implemented only after it is presented before the Indian Parliament and is thereafter approved after debate. The code will make the tax laws much more efficient and more assessee friendly.

THANK YOU!