




ASSOCHAM 

Direct Tax Code 2009



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Backdrop

- Current law – Income-tax Act, 1961
- Almost five decades old
- Over 5000 amendments
- New Code in the making for four years

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Stated Objectives

- Simplicity
- Minimising litigation
- Widening the tax base
- Eliminating exemptions

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Topics

- Basis of Taxation
- Scope of Total Income
- Computation of Total Income
- General Rules Relating to Computation
- Business Income
- Capital Gains
- Set-off and Carry Forward of Losses
- Business Reorganisations

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Commencement

- Applicability – Financial year 1st April 2011
 - Confusing indications for earlier applicability

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Basis of taxation

Basis of Taxation

- Income, in general, to include all accruals and receipts of revenue and capital nature unless otherwise specified
- Exemptions, if any, made on consideration of:
 - Positive externalities
 - Encouraging human development & reducing risk
 - Equity
 - Reducing compliance & administrative burden

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Scope of total income

Scope of Total Income

- Residence based taxation for residents – to be taxed on worldwide income
- Source based taxation for non-residents – to be taxed only in respect of accruals & receipts in India (including *deemed* accruals & receipts)
- Change in residency test for individuals – concept of *not ordinarily resident* eliminated
- Change in residency test for foreign companies
- Incomes exempt from tax listed in Sixth Schedule

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Computation of total income

Computation of Total Income

- Ordinary sources (A)
 - Income from employment
 - Income from house property
 - Income from business
 - Capital gains
 - Income from residuary sources

- Special sources (B)
 - Investment income/Royalty/FTS of *non-residents*
 - Specified income of *non-resident* sportsman (not Indian citizen)
 - Guarantee money earned by *non-resident* sports association
 - Winnings from lottery/crossword puzzle/race/betting/any other game

- Total Income = A + B

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General rules
relating to
computation

Expenditure not to be allowed

- Any expenditure attributable to income which does not form part of total income
- Expenditure incurred for any prohibited purpose
- Provision for unascertained liability
- Any expenditure where source of funds is unexplained
- Any expenditure incurred by a *non-resident* in respect of:
 - Royalty
 - FTS
 - Income liable to tax at special rates

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Disallowance of payments for default in TDS

- No deduction for any payment in respect of which tax not deducted at source *or* TDS not deposited
- Deduction to be allowed in year of payment
- Exceptions:
 - Tax deducted during last quarter of FY and paid before “due date” of filing return will be allowed as deduction
 - Payment made more than 2 years after end of FY in which tax was deducted, will not be allowed as deduction

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Business income

Taxation of resident companies

	Existing (%)*	Proposed (%)*
Corporate tax	30	25
Dividend Distribution Tax	15	15
MAT	15	2 / 0.25 on assets
Capital gains tax	varying	25

* Surcharge and cess as per the relevant Finance Act

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Business Income...

- Income from separate businesses to be computed separately
- Income from businesses eligible for incentives to be computed separately

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...Business Income...

- Sweeping amendments to the scope of taxable profits
 - any amount receivable from or in connection with business included
- Taxable profits to now include:
 - Relief in respect of any liability in the nature of loan, deposit, etc
 - Amount receivable on cessation / termination of any business agreement
- Profit on sale of business capital assets or on slump sale
 - taxed as business income and not capital gains

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...Business Income...

- Deductions allowable only under three classes:
 - Operating expenditure
 - Permitted Finance Charges
 - Capital Allowances
- Losses incidental to business – selectively covered

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Deferred revenue expenditure

- Specific Deferred revenue expenditure eligible for capital allowance

Block of Assets	Depreciation Rate (%)
Non-compete fees	25
Premium on obtaining assets on lease / rent	25
VRS expenditure	25
Business re-organisation expenditure	25
Expenditure on prospecting mineral or development of mine / other natural deposit of any mineral	15

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Capital Allowances

- Broadly similar to depreciation and similar allowances
- 150% weighted deduction for in-house scientific R&D expenditure; extended to all industries
- Loss upon sale of entire block of assets to be ignored
 - Depreciation on block to continue
- Lessee eligible to claim capital allowance in case of finance lease

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Minimum Alternative Tax (MAT)

- Payable on 'value of gross assets' and not on 'book profits'
- Tax Rate
 - Banking companies – 0.25%
 - Other companies – 2%
- No credit allowed in subsequent years
- Multiple level taxation – holding-subsidary structures

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Dividend Distribution Tax

- DDT extended to all “dividends”?
- Dividend distributed to specified pass-through entities exempt from DDT
- DDT exemption for SEZ developers discontinued
- Dividends specifically excluded from DDT – whether exemption available in the hands of recipient?

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Tax incentives...

- Profit-based tax incentives sought to be discontinued
- Expenditure / Investment-based incentive scheme introduced
- Infrastructure Projects including development of Special Economic Zones (SEZ) under new scheme
- Export-based Incentives such as for units in Software Technology Parks or SEZs to be discontinued
- Selective grandfathering

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...Tax incentives

- Eligible businesses entitled to following additional deductions:
 - Expenditure on purchase, lease or rental of land or land rights
 - Capital expenditure on most assets
 - Expenditure incurred before commencement of business
- Each eligible business to be treated as separate business

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Grandfathering of existing incentives

- Following incentives continued under the Code:
 - Sec 80-IA – Profits from Infrastructure business
 - Sec 80-IAB – Profits earned by SEZ developer
 - Sec 80-IB – Profits from various businesses covered therein
 - Sec 80-IC – Profits from undertakings in special category States
 - Sec 80-ID – Profits from business of hotels / convention centres in specified areas
 - Sec 80-IE – Profits from undertakings in the North-East
 - Sec 80JJA – Profits from business of collecting and processing bio-degradable waste
- No specific provisions for grandfathering of SEZ units eligible for tax holiday under section 10AA

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Capital gains

Capital Gains...

- Distinction between long-term and short-term gains removed
- Capital gains taxable at normal rates
- Gains on transfer of business capital assets taxable as business income
- Other capital assets referred to as 'Investment Assets'
- Securities Transaction Tax proposed to be abolished

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...Capital Gains

- Indexation available only for assets held for one full financial year
- Indexation benefit now available for bonds and debentures
- Indexation benefit now available to non-residents
 - Adjustment for exchange fluctuation no longer available
- Substitution of cost by fair market value
 - Base date shifted from 1.4.1981 to 1.4.2000
- Cost of acquisition of asset deemed to be “nil” if not determinable

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Roll-over provisions for capital gains...

- Roll-over available for re-investment of sale proceeds
- Roll-over available only to individuals/HUFs
- Investment to be made in new asset within
 - one year before or
 - three years from the end of the financial year in which transfer took place
- If new asset not acquired before the end of the financial year
 - Sale proceeds to be deposited in Capital Gains Deposit Scheme

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...Roll-over provisions for capital gains

- Qualifying new assets:
 - Agricultural land – in case of gain on transfer of agricultural land
 - Residential house – in case of gain on transfer of any asset
 - Deposit in Capital Gains Saving Scheme (CGSS) – in case of gain on transfer of any asset
- Any withdrawal from CGSS is liable to tax under the head income from residuary sources in the year of withdrawal

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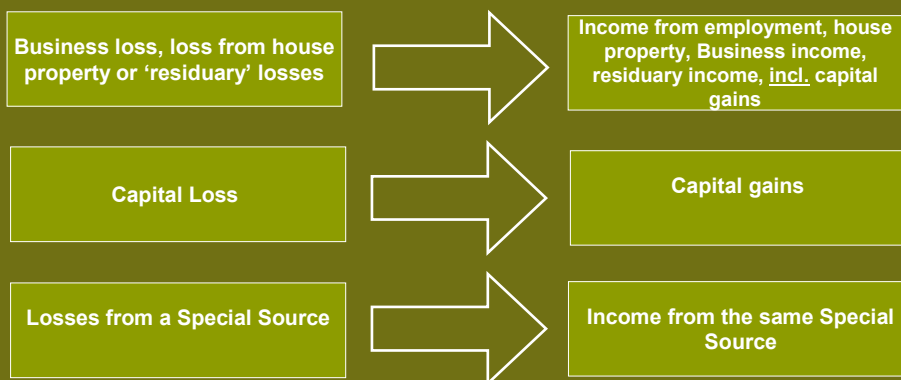
Set-off and carry forward of losses

Set-off and carry forward of losses ...

- No distinction between long term and short term capital losses
- Capital losses not to be set off against any other income
- Loss of a specified business / special source allowable only against subsequent years' profits of the same business / source
- Losses allowed to be carried forward indefinitely
- Entire losses including previous years' losses lapse if return not filed by due date

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... Set-off and carry forward of losses ...



- Set-off in same or subsequent years

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... Set-off and carry forward of losses

- Losses of closely held companies to lapse on change in controlling interest, as now
- No distinction between unabsorbed depreciation and loss
- Capital losses may be carried forward even after change in ownership
- Discussion paper talks of ring-fencing losses from speculative business - no corresponding provisions in Code

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Business
re-organisations

Business Reorganisation

Scope	<ul style="list-style-type: none"> • Restricted to mergers between residents only <ul style="list-style-type: none"> – Cross border mergers?
Carry forward of Losses	<ul style="list-style-type: none"> • Now available to all businesses i.e. not restricted to industrial undertakings, banks etc. • Business continuity conditions retained for successor • Pre-merger conditions removed • Violations to trigger reversal of loss set-off in respective years
Capital gains exemption	<ul style="list-style-type: none"> • Stipulated only for Investment assets?

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Business Reorganisation - Demerger

Scope	<ul style="list-style-type: none"> • Restricted between residents only
Consideration	<ul style="list-style-type: none"> • Resulting company to issue only “equity shares”
Carry forward of Losses	<ul style="list-style-type: none"> • Now ‘test of continuity of business’ as in mergers applicable <ul style="list-style-type: none"> – Continuity of business and non-disposal of fixed assets for 5 years • Violations to trigger reversal of loss set-of in respective years
Capital gains exemption	<ul style="list-style-type: none"> • Stipulated only for Investment assets?

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Slump Sale

Taxability

- Consideration less 'Net Worth' - Taxable as Business Income

Net Worth

- Mode of computation to be prescribed

Actual Cost for buyer

- Uncertain (cost to previous owner or actual purchase price?)

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Transfers between Holding and Subsidiary

Shareholding lock-in

- Proposed to be Indefinite
 - Earlier was 8 years
 - Grandfathering ??

Conversion to stock-in-trade

- Proposed to be taxed if converted at any time
 - Earlier not taxable after 8 years

Capital gains exemption

- Restricted to investment assets
- Business capital assets and slump sale – whether exempt ?

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Other important provisions

Indirect Transfers

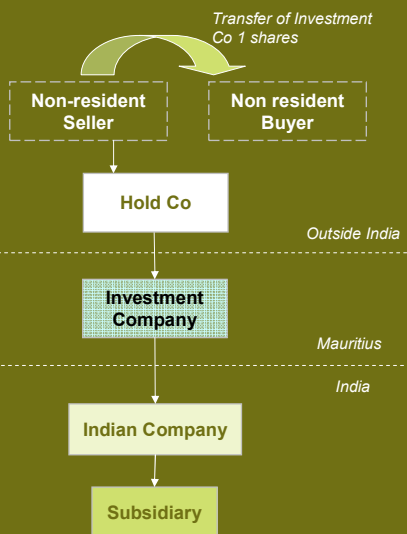
- Income deemed to accrue in India
*Section 5 – “The income shall be deemed to accrue in India, if it accrues, whether directly or indirectly, through or from:-
(d) the transfer, directly or indirectly, of a capital asset situate in India”*

Withholding tax

- Resident deductee @ 10% - On gross sales consideration?
- Non-resident deductee @ 30% - on capital gains

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Transfers outside India



- Offshore divestment of HoldCo with underlying asset in India exposed to tax
 - Vodafone type transfers taxed

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