New Direct Tax Code Bill, 2009 with our Immediate Comments – Aug 14, 2009

NEW DIRECT TAX CODE BILL, 2009 WITH OUR IMMEDIATE COMMENTS

By S Sivakumar, CA

The Finance Minister has taken a bold step by announcing the new Direct Tax Code, which is expected to be made applicable from April 1, 2011. We must heartily congratulate the FM and his team for bringing out this new Code, which would definitely make life simpler for the tax payer. To attempt to change a law which has been in vogue for over 100 years, in indeed a bold attempt.

In a lighter vein, I must admit, that the new Code would substantially reduce the professional opportunities for tax consultants and would also significantly reduce the very process of tax collection by the Department, as the whole law would look much much simpler.

The main basis for taxation under the Code would be based on the residential status of the assessee and would not depend on the sources of his income. Thus, there is a proposed shift to residence based taxation from source based taxation.

There is a generic shift to lower tax rates and individuals would be the largest beneficiaries. Profit based incentives available to corporates are proposed to be systematically eliminated in the new Code, which has proposed a shift to an expenditure based incentive scheme. Large infrastructure projects including developers of Special Economic Zones will now move away from a deduction /exemption based on their profits, to a deduction based on revenue and capital expenditure from gross receipts.

It would look like, its curtains for the tax holiday for 100% Export Oriented Units including the STP Units, beyond April 1, 2011.An initial reading of the Code suggests that the existing provisions contained in Section 10AA for SEZ Developers and Units, might either be discontinued or may included in the 'grandfathering' proposals which are yet to be specified. One indeed hopes that the existing SEZ Developers and Units, who have

set up their facilities on the basis of the availability of tax holiday under the existing Section 10AA of the Income tax Act, are not penalized under the new Direct Tax Code.

The individual taxpayers would move to a "Exempt-Exempt-Taxable" model, where the tax exemptions would be available at the time of contributions and accruals, but would be taxable at the time of withdrawals.

Some of the other welcome proposals contained in the Code include the rationalisation of wealth taxprovisions, benefit of indefinite carry forward of losses and the introduction of Advance Pricing Agreements (APAs) under Transfer Pricing Rules.

However, the proposal to override the provisions of the Double Tax Avoidance Agreements could spell a lot of trouble for corporates having international transactions.

Here are some of the specific proposals contained in the Direct Tax Code Bill with our specific

comments:

 Tax law in simple and easy to understand language.

 The new Income Taxes Code to be applicable from 1st April, 2011.

 Personal Income tax rates slashed substantially.

o Upto 10 lacs (less existing basic exemption limit) : 10%

o Next 15 lacs : 20%

o Over 25 lacs : 30%

(Our comments : A lot of exemptions and deductions available for individuals have been streamlined.

However, individuals would pay significantly lesser taxes, which is highly welcome. At last, some tangible benefit is being proposed for individual tax payers and the salaries employees would stand to gain the most)

 All Companies to pay tax @ 25%.

(Our comments : This signals a significant reduction in the corporate tax rate, which is presently at 33%, inclusive of surcharge). MAT @ 2% of gross assets. Even loss making companies to pay MAT.

(Our comments : This would distinguish between services companies and manufacturing/realty companies, where, investments in fixed assets are significantly higher. Even loss making companies would be required to pay MAT, which defies logic. The services sector, which employees much lesser gross assets to generate revenues, would stand to gain, as contrasted to the manufacturing and realty sectors, which employ assets to a very large extent. The step to levy MAT even on companies which do not make profits, is highly retrograde). No provision for MAT credit.

(Our comments : This is highly retrograde given the fact that even loss making companies would now be paying MAT and would never be able to adjust the MAT paid).

• Dividend distribution tax to continue @ 15% of dividend. Foreign companies also to pay 15% of branch profit tax.

(Our comments : The retention of the DDT at 15% looks unfair, compared to the reduction of the corporate tax rate to 25%. A DDT rate of 10% would have been more appropriate).

• Firms to continue to pay tax @ 30%.

(Our comments : The retention of the tax for firms @ 30% looks unjustified, given the fact that the tax rates for corporates and individuals are getting significantly reduced). • No cess or surcharge in any case.• Agricultural income continues to be included in taxable income only for rate purposes. • Wealth tax exemption limit raised to 50 crores. To include financial assets like shares. • Limit of savings increased from 1 lac to 3 lacs.

• Savings to be taxed at the time of maturity under the EET system. Savings before 1-4-2011 not taxable.

• Law made stricter for defaulters and non-filers. • The new law to apply in place of existing direct tax avoidance agreements with other countries. • Losses allowed to be carried forward indefinitely.

(Our comments : It is good that assesses would be able to carry forward losses indefinitely).

• TDS to be deposited in the year of deduction. For last quarter, TDS can be deposited till due date of filing ITR. If TDS not deposited within 2 years from end of year of deduction, expenditure shall be disallowed. • TDS rates reduced in some cases like payment to contractors and rent of machinery to 1%.

• Due dates of filing income tax returns :

o Companies and other audit cases : Aug. 31

o Others : June 30

(Our comments : It might be extremely difficult for companies to file IT returns by August 31. One does not understand what is sought to be achieved by this move) • Revised return or belated return can be filed within 21 months from the end of the financial year • Valuation of perquisites like rent free accommodation to be same in case of all employees whether in government or private sector.

 Gratuity to be exempt only if invested in a retirement fund. No deduction of interest upto Rs. 1.50 lacs for self occupied properties.

(Our comments : This will act as a major dampener for the Residential Realty Sector as well for individuals who have taken housing loans. Under the present dispensation, individuals can claim the deduction of interest paid on self occupied properties including flats, which is now proposed to be removed. The housing realty sector is bound to get affected due to this proposal).

 Standard deduction from Gross Income from house property reduced from 30% to 20%.

(Our comments : Looks unjustified and would result in more taxes to be paid by assesses taxable under 'Income from House Property' No distinction between short term and long term capital gains. All capital gains to be taxed at normal rates.

(Our comments : As per the proposal, both long term and short term capital gains would get taxed at the rate applicable to normal profits. Read with the proposal to abolish exemptions under Section 54 and its sub sections which include exemption in respect of capital gains arising on sale of listed securities, residential properties, etc., this new proposal could mean that a lot of tax would now need to paid on transfer of capital gains of all assets including houses, shares in listed companies, etc. There seems little justification in proposing to levy income tax on capital gains at rates that are applicable to business profits). 2000 to be base year for indexation in case of capital gains.

 Security Transaction Tax to be abolished

(Our comments : Good step which should increase volumes in the stock exchanges). Exemptions u/s 54 etc. from capital gains abolished.

(Our comments : This new proposal looks very unfair given the fact that, exemptions that are available in respect of sale of shares in listed companies, residential properties, etc. will now get abolished. The new proposal would dampen the enthusiasm of investors in stock markets).

 For business, profit linked incentives removed. Only revenue and capital expenditure shall be allowed to be amortised. The remaining profit shall be taxable.

(Our comments : A reading of the Code with the Sections and Schedules suggests that the tax exemptions for 100% Export Oriented Units may be withdrawn with effect from the financial year 2011-12. This move could come as a great dampener for the 100% Export Oriented Units including Software Technology Park units.

- Area based incentives also removed. Existing business concerns not affected.

(Our comments : It remains to be seen as to how existing companies, who have set up industrial undertakings in backward/remote areas would continue to avail of the tax xemption).

- Limit of turnover for presumptive taxation raised to 1 cr