

COMMENTARY
ON
REVISED DISCUSSION PAPER
ON
THE DIRECT TAXES CODE, 2010

Introduction

The Direct Taxes Code Bill, 2009 (DTC) was released for public comments along with a discussion paper on 12th August 2009. Subsequently, a revised discussion paper on DTC has been released on 20th June 2010, seeking comments from public within 30th June 2010. The DTC will come into force from 1 April 2011. The DTC has 285 Sections and 18 Schedules as against 298 Sections and 14 Schedules in the existing Income Tax Law (ITL).

The original DTC had broadly retained the scheme of the existing ITL, but, under a modified structure, intended to lend simplicity, flexibility and stability to the taxation system and also to reduce the scope for ambiguity and litigation.

The DTC had proposed to consolidate direct taxes under a common tax code. It had also proposed to substitute Minimum Alternate Tax (MAT) on companies (which is currently income-based) by a tax on 'gross assets'. The other major changes includes dispensing with the concept of assessment year, lowering of tax rates, substituting income-linked incentives with investment-linked incentives, treating business assets gains as part of business income, unlimited carry-forward of losses, introduction of far-reaching General Anti Avoidance Rules (GAAR) and rationalization of provisions relating to penalties. Further, the DTC provided that, neither the DTC nor the Tax Treaties entered into between the Government of India (GOI) and the Government of a foreign country shall have a preferential status and that a subsequent law can override prior law. The DTC also proposed to introduce an Advanced Pricing Agreement (APA) regime and to modify the test of residency for companies by treating a foreign company as a resident in India based on existence of partial

control and management and to levy a Branch Profit Tax (BPT) on foreign companies.

On receipt of public comments on first draft on DTC, the Central Govt. has released the revised discussion paper containing eleven major issues to redress some of the grievances of the various stakeholders. The eleven issues are : –

- i. Minimum Alternate Tax (MAT) – Gross assets vis-à-vis book profit.
- ii. Tax treatment of savings – Exempt Exempt Tax (EET) vis-à-vis Exempt Exempt Exempt (EEE) basis.
- iii. Taxation of income from employment – Retirement benefits and perquisites.
- iv. Taxation of income from house property.
- v. Taxation of capital gains.
- vi. Taxation of non-profit organisations.
- vii. Special Economic Zones – Taxation of existing units.
- viii. Concept of Residence in the case of a company incorporated outside India.
- ix. Double Taxation Avoidance Agreement (DTAA) vis-à-vis domestic law.
- x. Wealth Tax.
- xi. General Anti Avoidance Rule (GAAR).

An effort has been made to summarise the key proposals of the DTC as modified in the revised discussion paper along with our views on such proposals. These are discussed in the subsequent pages.

1. **Tax Rates**

The First and Second Schedules of DTC proposed the indicative rates of Income Tax and other taxes which are summarised in the following table :-

Status of the taxpayer	Tax rates as per the ITL		Tax rates proposed in the DTC	
	Individual	Up to INR 160,000*	NIL	Up to INR 160,000*
INR 160,000 to 300,000		10%	INR 160,000 to 1,000,000	10%
INR 300,000 to 500,000		20%	INR 1,000,000 to INR 2,500,000	20%
Above INR 500,000		30%	Above INR 2,500,000	30%
* INR 190,000 for women taxpayers and INR 240,000 for senior citizens				
Domestic Company	30%		25%	
Foreign Company	40%		25%	
Branch Profit Tax	Not Applicable		15%	
Firm	30%		30%	
Wealth Tax	1% for net wealth in excess of INR 3 Million		0.25% for net wealth in excess of INR 500 Million (No threshold for private discretionary trusts)	

In the revised discussion paper on DTC it has been proposed that the indicative tax slabs and tax rates and monetary limits for exemptions and deductions originally proposed in the DTC will be calibrated at the time of finalisation of DTC to neutralise the effect in revenue that may arise as a result of reduction in tax base.

It is also proposed in the revised DTC that the threshold limit and rate for Wealth Tax will be suitably calibrated in the context of overall tax rates.

Comments

- With the introduction of concept of Limited Liability Partnership (LLP) which is treated at par with other partnership firm for income tax purpose, there is no reason as to why the rate of tax for LLP including other partnership firm should not be at par with rate of tax applicable for companies @ 25%.

2. **Taxation of Companies**

- Companies will be taxed at a flat rate of 25% as against the current rate of 30% (excluding surcharge and cess).
- Dividends distributed by domestic companies would continue to be subjected to Dividend Distribution Tax (DDT) at the rate of 15%. The dividends which are subjected to levy of DDT will continue to be exempt from tax in the hands of the recipient.
- The DTC released in August 2009, had proposed to substitute Minimum Alternative Tax (MAT) based on “Gross Asset” in place of computation of tax on “Book Profit” of the Company. The revised discussion paper on DTC now proposes to reinstate the existing system to compute MAT with reference to “Book Profit”. The revised DTC also proposes to make appropriate changes in respect of MAT credit while finalising DTC.

Comments

- The main object of introducing MAT on book profit was harmonisation of profit base for distribution of dividend as per Companies Act with the profit on which tax is payable. As per Section 115JB of the ITC, loss shall not include depreciation whereas as per proviso (b) to Section 205(1) of Companies Act, the word ‘loss’ includes depreciation. There is no reason to give the word ‘loss’ as used in Section 205, a different meaning from the one in which it is ordinarily understood, solely because it has to be read with existing provision which is proposed to be incorporated in DTC.

Accordingly, entire accumulated loss as per books of accounts of the Company should be allowed to be set off against 'Book Profit' instead of exercising provision for deduction of brought forward loss or unabsorbed depreciation, whichever is less as per books of accounts.

- Considering the fact that capital gain arises out of transfer of capital assets which is a nonrecurring activity and also the fact that capital gains arising out of 'Business Restructuring' is exempted, income from transactions in all investment assets which will be charged to 'Capital Gains' should be ignored for the purpose of computation of 'Book Profits'.

3. Scope of Total Income

- The DTC proposed to continue with the present system of combination of residence-based taxation and source-based taxation. It also seeks to continue to apply residence-based taxation to residents i.e. global taxation and source-based taxation to non-residents.
- Originally, the DTC proposed to modify the test for determining the residence of a company by providing that the existence of "partial control and management" would result in residence in India. The revised discussion paper on DTC has now proposed that a foreign firm would be treated as resident only if its "place of effective management" (PEM) is in India. The test of residency of a foreign firm will be determined on the following criteria –
 - (i) Whether the Board of Directors function from India, or
 - (ii) Whether the major strategic and commercial decisions are taken from India.
- It is also proposed in the revised DTC to introduce the concept of "Controlled Foreign Corporation "(CFC) to bring under the tax net

deferrals resulting from non-distribution of passive incomes earned by foreign companies being controlled directly or indirectly by a resident in India. Consequently, undistributed income would be taxable in India in the hands of resident shareholders as dividend received from foreign company.

- The principles relating to source of income are also proposed to be modified to cover even income arising from indirect transfer of capital asset/s situated in India, as deemed to accrue or arise in India and also to clarify that rendering of services in India is not essential for taxing service income.
- The DTC seeks to replace the present dual concept of 'Previous Year' and 'Assessment Year' with the unified concept of 'Financial Year'.

Comments

- PEM is defined in the draft DTC as the place where the Board of Directors take decisions or in a case where the Board of Directors routinely approve decisions of executive directors or officers, the place where such executive directors or officers perform their functions. It appears that the reference is to operational management. However, the definition could have the potential of being subject to varying interpretations e.g. in situations where the facts reflect decision-making at different places. There are still some loopholes in the definition of PEM. Such a loose definition could hamper foreign investment in India as even a single Board Meeting could make the firm an Indian resident and lead to steep hike in their tax liability.
- The revised paper does not throw light on what would be the conditions and threshold limits for attracting the CFC provision.
- It is important to bear in mind that there will be many situations when dividend may not be declared at all to the holding company, either due to losses at the operating company level or because

funds are required for expansion. In these situations, the tax liability in India should not arise even under the CFC regime.

- It would be genuine hardship on the part of the resident shareholders who will be forced to pay tax on undistributed income of CFC without having received cash flow.
- The words 'indirect transfer of capital asset situated in India' should be excluded from the deeming provision of income accrued in India to avoid undue hardship in genuine business transactions. Any tax evasion scheme or arrangement would stand covered under General Anti-Avoidance Rules proposed to be incorporated in DTC.

4. Computation of Total Income

- The DTC seeks to classify incomes into 2 categories viz. 'Special Sources' and 'Ordinary Sources'. The special sources (specified in a separate Schedule) generally reflect items like Royalty, Fees for Technical Services (FTS), investment income etc. All other sources of income will be ordinary sources. Special sources would be subject to tax on the gross amount.
- The total income of the taxpayer for a financial year will be the aggregate of 'Total Income from ordinary sources' and 'Total Income from special sources'.
- The income from ordinary sources are classified under the following heads of income :-
 - A. Income from Employment
 - B. Income from House Property
 - C. Income from Business
 - D. Capital Gains
 - E. Income from Residuary Sources.

5. **Income from Employment**

“Income from employment” will be gross salary as reduced by the aggregate amount of permissible deductions. “Gross Salary” is defined to include the value of perquisites, profits in lieu of salary, amount received on voluntary retirement or termination, leave salary, gratuity and any amenity, pension or any commutation thereof, contributions made by the employer to an approved superannuation fund, provident fund, life insurance and new pension fund.

“Permissible deductions” from gross salary includes Profession tax, certain allowances subject to prescribed limits, retirement benefits such as payment towards VRS, gratuity, commutation of pension provided such retirement benefits are deposited in Retirement Benefit Accounts.

The DTC originally proposed to introduce Exempt-Exempt-Tax (EET) method of taxation of contribution made towards certain retirement benefits under which contribution and annual accumulation into the Fund are not taxed but withdrawal from the Fund is taxed.

The revised discussion paper on DTC now proposes : –

- (1) There will be no tax on withdrawal from Government Provident Fund (GPF), Public Provident Fund (PPF), Recognised Provident Funds (RPFs), approved Pension Scheme, approved pure Life Insurance Products and Annuity Schemes. In other words, the existing system of Exempt-Exempt-Exempt (EEE) in respect of withdrawal of such fund shall continue to be retained.
- (2) Contribution to approved superannuation fund, receipt under VRS, commutation of pension, gratuity and encashment of leave on superannuation will continue to be exempted subject to certain limits. There is no need to deposit such amount in Retirement Benefit Account.

- (3) The method of valuation of perquisites including rent free or concessional accommodation provided to the employees of Government and others will be appropriately provided in rules.
- (4) Perquisites in relation to medical facilities/reimbursement provided by the employer shall be valued as per existing law with appropriate enhancement of monetary limits.

Comments

- The limit of Rs.3 lakhs includes only contribution to P.F., LIP, Superannuation Fund and new Pension Trust. However, investment in Mutual Fund, Senior Citizen Savings Scheme, Post Office Schemes – NSC, etc. which are presently permitted are excluded. Exclusion of such investments as eligible investments will be cause of concern for Individual and HUF assesseees.
- Clause 284(210) of DTC interestingly does not require that the security underlying Employee Stock Option Plan or Scheme or Sweat Equity should be allotted or transferred to an employee free of cost or at a concessional rate .This is an anomaly which would require to be rectified when the DTC is finalised.

6. Income from House Property

The DTC originally proposed to compute the income from house property on gross rent which will be higher of (i) contractual rent or (ii) presumptive rent. The presumptive rent will be calculated @ 6% p.a. on rateable value fixed by any local authority and where no rateable value has been fixed @ 6% p.a. on cost of construction.

The deductions in respect of property taxes, standard deduction towards repairs and maintenance (reduced from 30% of annual value allowed under the ITL to 20% of gross rent under the DTC) and interest expenditure will be allowed from the gross rent. However, no deduction for interest expenditure will be permitted in respect of self-occupied property. Income from house property shall be computed under this

head notwithstanding that the letting, if any, of the property is in the nature of trade, commerce or business.

The revised discussion paper on DTC, now proposes: –

- (i) In the case of let out house property, gross rent will be the amount of rent received or receivable and the concept of presumptive rent will be discarded.
- (ii) In the case of house property not let out, gross rent will be taken at nil and no deduction for taxes, interest, etc. will be allowed.

However, interest on borrowed capital for acquisition of one house property subject to a ceiling of Rs.1.50 lakh will be allowed in the hands of an Individual or HUF. The overall ceiling of deduction for savings will be enhanced accordingly.

Comments

- The basis of taxability should not be the nature of income but the source of income. It is, therefore, suggested that in case of SEZ developers, business centres, serviced apartments, letting out of a factory along with all its business assets which are inseparable, it should be treated as business income instead of income from house property.
- Unrealised rent and vacancy allowance for the period for which the house is not let out are not deductible under DTC. This will cause hardship to the assessee.
- There is no express provision in the DTC as is presently available in ITL regarding deduction of interest on borrowed capital for the period prior to the financial year in which the property is acquired or constructed in five equal instalments. This anomaly will cause hardship to individual assessee.

7. Income from business

An important change proposed by the DTC under this head of income is that every business will constitute a separate source of income, necessitating separate computation of income for each business.

The framework proposed by the DTC for taxation of business income is as follows:

- i) All assets will be classified into business assets and investment assets. The business assets will be further classified into business trading assets and business capital assets.
- ii) The income from transactions in all business assets will be taxed under the head 'Income from Business' while the income from transactions in all investment assets will be taxed under the head 'Capital Gains'.
- iii) The profits from business will be computed by deducting business expenditure from gross earnings of the business.
- iv) The gross earnings will ordinarily include all accruals and receipts derived from or connected with business assets, whether trading or capital.
- v) Business expenditure will be classified into 3 mutually exclusive categories (i) Operating expenditure (ii) Permitted financial charges (iii) Capital allowances.
- vi) The benefit of weighted deduction at 150% for any expenditure (both revenue and capital) incurred on in-house scientific research and development by a company is proposed to be extended to (i) cost of building (ii) all industries (not restricted to manufacturing).
- vii) As a distinctive for asset stripping and loss manipulation, the DTC proposes that loss on sale of business capital assets will be treated as an intangible asset on which depreciation will be allowed at the rates applicable to the relevant block of assets,

which will effectively result in allowance of such loss on amortized basis.

Comments

- Computation of income from each business separately is not going to serve any purpose excepting additional burden on the assessee towards cost of compliance in as much as tax is payable on the net result of all the business under the head “Income from Business”. However, income from specified business and speculative business in any case, are to be separately computed.
- Gross earning among others includes :-
 - (i) Remission of drawback or refund of tax, duty, cess – u/s 31(2)(vii) of DTC.
 - (ii) Remission or cessation of loan, deposit, advance, etc. – u/s 31(2)(xiii) of DTC.
 - (iii) Advance, Security Deposit on long term leasing or transfer – u/s 31(2)(xxi) of DTC.
 - (iv) Reimbursement of any expenditure – u/s 31(2)(xxii) of DTC.

As regards item no. (i) & (ii), the inclusion in gross earnings should be restricted to amount earlier allowed as a deduction u/s 33 of DTC, otherwise it would result in a tax on capital receipts as part of gross earnings. As regards item no. (iii), inclusion of advance, security deposit in gross earnings is tantamount to taxing a continuing liability as deemed receipt, which would adversely impact the viability of leasing business carried on in a bona fide manner. As regards item no. (iv), it should be restricted to reimbursement of business expenditure allowed as a deduction u/s 32 of DTC.

- Deduction for operating expenditure towards –
 - (i) Rent – u/s 33(ii) of DTC
 - (ii) Expenses on payment basis – 33(xxxvii), (xxxviii), (xxxix) & (xi) of DTC

should be allowed on accrual basis or in accordance with the method of accounting adopted by the assessee. Similarly, permanent disallowance of expenditure u/s 18(3)(b) of DTC for non-deposit of TDS within 2 years should be deleted.
- Expenditure which is revenue in nature and incurred in ordinary course of business should be allowed as deductible expenses. Incidental expenses towards raising funds by issue of debentures, bonds and share-capital as well as interest charges on borrowed fund should be unconditionally allowed as deductible permitted finance charges u/s 34(2) and (3) of DTC.
- Allowance for initial depreciation of 20% of the actual cost of assets u/s 37 of DTC should not be linked to installation and use of assets in the same financial year since there may be cases where installation of an asset and its use may not occur in the same financial year. Further, terminal allowance u/s 38 of DTC should be allowed to all block of asset and should not be restricted to only block of asset where rate of depreciation is zero.

8. Income from Capital Gains

The DTC originally proposed that: –

- a) The income from transactions in all investment assets i.e. other than business assets, will be taxed under the head 'capital gains'.
- b) The present distinction between short-term investment asset and long-term investment asset on the basis of length of holding of the asset, will be eliminated except that, for assets transferred

after a year of holding, the indexation benefit will be available in the computation of capital gains.

- c) Like business losses, capital losses will also be allowed to be carried forward for an indefinite period.
- d) The Securities Transaction Tax (STT) will be abolished and, consequently, exemption presently enjoyed on long-term capital gains derived from transfer of equity shares and units of equity-oriented mutual funds, will no longer be available.
- e) The base date for determining cost of acquisition under the ITL i.e. 1st April 1981 will be shifted to 1st April 2000. As a result, appreciation in value of the asset till 1st April 2000 will not be liable to tax.
- f) A new Capital Gains Savings Scheme will be framed by the Central Govt. Capital Gains deposited under this scheme will not be subject to tax till the withdrawal from such scheme.
- g) Where cost is not determinable for any reason, the cost of acquisition and cost of improvement will be deemed to be as "NIL".
- h) The benefit of 'rollover' i.e. exemption of capital gains for reinvestment of the sale consideration or capital gains in specified modes, will be restricted to limited circumstances.
- i) The capital gains will be subjected to tax at the rate of 30% in the case of non-residents and in the case of residents at the applicable marginal rate.

The revised discussion paper on DTC now proposes that: –

- (i) Income under the head "Capital Gains" will be considered as income from ordinary sources in case of all taxpayers including non-residents. It will be taxed at the rate applicable to that taxpayer.

- (ii) Capital asset held for more than a period of one year from the end of financial year in which asset is acquired will be treated as “long-term capital asset”. Capital asset held for less than one year from the end of financial year in which asset is acquired will be termed as short term capital asset.
- (iii) Capital gain arising from transfer of any short term investment asset will be computed without any specified deduction or indexation. The entire short term capital gain will be included in total income and be charged to tax at the rate applicable to that taxpayer.
- (iv) Capital gains arising from transfer of a long-term investment asset being listed equity shares or units of an equity oriented fund will be computed after allowing a deduction at a specified percentage of capital gains without any indexation. This adjusted capital gain will be included in total income and be taxed at the applicable rate. The loss arising from transfer of a long-term investment asset will be scaled down in a similar manner. The specified rate of deduction for computing adjusted capital gain will be finalised in the context of overall tax rates.
- (v) For taxation of capital gains arising from transfer of long-term investment asset (other than listed equity shares and units of equity oriented funds), the base date for determining the cost of acquisition will now be shifted from 1.4.1981 to 1.4.2000. The cost of acquisition of asset shall be allowed to be raised at market price as on 1.4.2000. The capital gains will be computed after allowing indexation on this raised base. Capital gains on such assets will be included in total income and be taxed at the applicable rate.
- (vi) It proposes to discontinue the Capital Gains Savings Scheme.
- (vii) Securities Transaction Tax (STT) has been proposed to be re-introduced which the first draft had sought to abolish.

(viii) Income arising on purchase and sale of securities by a Foreign Institutional Investor (FII) shall be deemed to be income chargeable under the head “Capital Gains”. However, capital gains arising to FII shall not be subjected to TDS and they will be required to pay tax by way of advance tax on such gains as is the existing practice.

Comments

- Section 45 of the DTC does not include the following “transfer” in the list of “exempted transfer”:
 - (a) Transfer of land of Sick Industrial Company under a scheme where the company is managed by its workers’ cooperative.
 - (b) Transfer of capital asset in a transaction of reverse mortgage under a scheme made and notified by Central Government.

The above transfer should also be exempt from Capital Gains Tax and therefore should be included under Section 45 of DTC.

- The Government proposes to redefine long-term capital gains and stretch the holding period from 12 months to as much as 23 months to qualify for a lower of tax (by way of deduction at a specified percentage from the long-term capital gain or benefit for indexation). This is completely different from the situation today wherein long-term capital gains is calculated from the date of acquisition. The proposed change in period of holding will cause undue restriction on the investors in terms of holding investments for longer period than the current position to qualify and reap the tax benefit.
- The capital gains tax proposed in the revised DTC discussion paper will act as a drag on equity investments and stock markets in general.

- The first draft had proposed to impose a 30% Capital Gains Tax (as against concessional rate of 10% for long-term and 15% for short-term) on FII which is one of the main investors in the stock market. The revised draft has not changed the rate even though the Finance Ministry had received several representations to create a special tax regime to attract investments from them. FII will consider the 30% Capital Gain Tax proposal an additional burden for them.

9. Income from Residuary Services

All income other than the income required to be included under the “Special Source” and the income from employment, house property, business, capital gains shall be computed under the income from Residuary Sources.

DTC proposes to tax any amount received as loan or deposit otherwise than by an account payee cheque or draft from any person if the aggregate amount exceeds Rs.20,000/-.

Comments

- Tax on cash deposits with bank will cause undue hardship to banks and will be against the principle of natural justice. It will also defeat the very purpose of bringing the unaccounted money into banking system.

10. Tax incentives

- The DTC seeks to replace profit-based tax holiday incentives with investment-based incentives. The taxpayer will be allowed to recover all capital and revenue expenditure (except land, goodwill and financial instrument). The period consumed in recovering all capital and revenue expenditure will be the period of tax holiday.
- Current profit-linked incentives and area-based exemptions in the ITL will be grandfathered.

- It has now been proposed in the revised discussion paper on DTC to allow profit linked deductions to units already operating in SEZ for the unexpired period.

Comments

- Proposal to grandfather tax holiday for existing SEZ units is a right move. However, it needs to be seen whether grandfathering shall apply to all units existing until the date of commencement of the code or not. It is important to clarify the drafting error on the original code which suggested March 31, 2010 as the terminal date for grandfathering SEZ unit tax incentives.

11. Business reorganization

- The DTC recognizes that business reorganizations should ordinarily be tax neutral.
- Similar provisions in the ITR for ensuring tax neutrality of business reorganizations, in the form of amalgamation, demerger, corporatization of firms / proprietary concerns, to continue in the DTC.
- The successor entity will be entitled to the benefit of accumulated losses of the predecessors, upon fulfilment of certain conditions.

Comments

- The definition of “Business Reorganisation” should be broadened to include reorganisation of business of
 - (a) two or more residents,
 - (b) resident(s) and non-resident(s) and
 - (c) non-residentsinvolving an amalgamation or merger.

- It should be clarified that provisions of Indian Companies Act would not be applicable to amalgamation of two or more foreign companies.
- Period of holding of shares received on amalgamation should be clarified.
- Specific exemption should be granted for transfer by an Indian resident of shares held in a foreign company on amalgamation of such foreign company with another foreign company.

12. Taxation of Non-Profit Organisation (NPO)

The DTC originally provides that the total income of a NPO shall be computed applying the cash system of accounting. The income of an NPO is the aggregate of the income from permitted welfare activities and any income arising from transfer of any investment asset not being a financial asset. Income from permitted welfare activities is computed by reducing the outgoings in relation to the activities from the gross receipts from the permitted welfare activities. The First Schedule provides that the whole of the total income so computed would be subject to tax at the rate of 15%. However, if the NPO is carrying out any business operations which are not incidental to the permitted welfare activities, then the entire activities (except activity for the advancement of any other object of general public utility) will be taxed at the rate of 30%. It is mandatory for NPOs to register with Income Tax Department.

The revised DTC now proposes that –

- (i) NPOs already registered under the Income Tax Act 1961, need not be required to apply for fresh registration.
- (ii) Income from public religious institutions will be exempt from tax subject to fulfilment of certain conditions. Donations to these institutions will not be eligible for deduction in the hands of donor.

- (iii) Partly religious and partly charitable institutions will also be treated as NPOs if they are registered under the DTC. Their income from public religious activity will be exempt subject to fulfilment of certain conditions.
- (iv) Up to 15% of the surplus or 10% of gross receipts, whichever is higher will be allowed to be carried forward to be used within three years from the end of the relevant financial year.
- (v) Donations by an NPO out of its accumulated surplus to another NPO will not be considered as application for the charitable purpose.
- (vi) The definition of “Charitable Purpose” under the existing Income Tax Act 1961 will be retained in place of “Permitted Welfare Activities”
- (vii) A basic exemption limit will be provided and the surplus in excess of such limit will be subject to tax.
- (viii) The Central Government shall be empowered to notify any non-profit organisation of public importance as an exempt entity.

Comments

- The proposal to define a tax exemption threshold limit for non-profit organisation is a welcome move.
- The provisions of the DTC should allow reduction of outgoings from Capital Gain derived from the transfer of a capital asset.
- A trade association registered under Section 25 of the Companies Act 1956, should not be excluded from the purview of Section 96(b).
- The principle of mutuality should be respected by the DTC. Members contributing to an association for the common benefit of all members should not be subject to tax.

13. **Anti-Abuse provisions**

Transfer Pricing

- The Central Government will be empowered to formulate a scheme for introducing Advanced Pricing Agreement (APA) with taxpayers in relation to International APA with taxpayers for determining the arm's length price in relation to International Transactions (ITS).
- Under the DTC, a taxpayer will need to report specified ITS directly to the Transfer Pricing officer (TPO) as against the current practice of reporting to the Assessing Officer (AO). The TPO will determine Arm's Length Price based on which the AO will assess the income of the taxpayer.
- The DTC also proposes to widen the scope of the definition of 'Associated Enterprises' by fixing the threshold at 10% holding as against 26% under the ITL.

Comments

- Introduction of APA is a welcome step in order to provide certainty to the taxpayer in respect of its tax liability from the international transaction it proposes to enter into. However, the proposed scheme of APA should have clarity on the following aspects :-
 - (i) Requirement of Central Government's approval on a onetime basis to formulate a scheme or a case-to-case basis for each and every APA.
 - (ii) Taxpayer's power to make suo-moto adjustment to the price determined (after applying methodology prescribed in the transfer pricing regulations of DTC) in order to arrive at arm's length price under APA.
 - (iii) Validity of APA where there is change in facts based on which APA has been entered into by the taxpayers.
 - (iv) Nature of APA i.e. unilateral, bilateral or multilateral.

- (v) Assurance in confidentiality of information submitted by the taxpayer from field audit and third parties.

14. General Anti Avoidance Rules (GAAR)

- The DTC proposes to introduce GAAR to serve as a deterrent against tax evasion and avoidance and to dissuade taxpayers from violating tax equity, by use of legal constructions or transactions.
- Commissioner of Income Tax (CIT) will be empowered to invoke GAAR and to declare an arrangement as an Impermissible Avoidance Arrangement (IAA) if it is entered into for obtaining a tax benefit like round-tripping, transaction through an intermediary, self-cancelling transactions, etc.
- The onus will be on the taxpayer to prove that obtaining a tax benefit was not the main purpose of the avoidance arrangement.
- The CIT can determine the tax consequences for an impermissible avoidance arrangement i.e. the CIT may disregard the arrangement, any party involved, any accommodating parties involved or reallocate / recharacterize the income or transaction or disregard the entire arrangement as if it had not been entered into. The CIT may also disregard the provisions of the tax treaty.
- The revised discussion paper on DTC now proposes to introduce certain safeguards. These are –
 - (i) CBDT will issue guidelines to provide for the circumstances under which GAAR may be invoked.
 - (ii) GAAR provisions will be invoked only in respect of arrangement where tax avoidance is beyond a specified threshold limit.
 - (iii) The forum of Dispute Resolution Panel (DPR) would be available where GAAR provisions are invoked.

Comments

- While anti avoidance provisions are welcome, there appears to be a lot of subjectivity in the current provisions which could lead to harassment to taxpayers. Therefore, GAAR should be made applicable only in special circumstances which should be objectively defined and objective tests should be laid down for treating any arrangement as an IAA.
- The four conditions laid down in the definition of IAA should be made cumulative for any arrangement to be treated as an IAA.
- The test of commercial expediency and determination as to whether the transaction is properly entered into as a part of legitimate commercial undertaking would rejuvenate and merit consideration while addressing implementation of a GAAR.
- The parameters stipulated for the application of GAAR still remaining subjective in nature, requiring further consideration and strengthening in order to avoid opening of the floodgates of litigation.

15. Relief from Double Taxation

DTC originally proposed –

- Similar to the existing ITL, the Central Government will be empowered to enter into a tax treaty for relief from double taxation and for exchange of information.
- Neither the DTC nor the tax treaty will have a preferential status and in case of a conflict between the two, the latter in point of time shall prevail.

The revised discussion paper on DTC now proposes to restore the existing law to provide that between the domestic law and relevant DTAA, the one which is more beneficial to the taxpayer shall apply. But this beneficial provision will be introduced with rider that domestic law will override the treaty provisions in circumstances where (i) General Anti Avoidance Rules (GAAR), or (ii) Controlled Foreign Corporation (CFC)

provisions are invoked or (iii) where foreign companies are paying branch profit tax.

Comments

- The DTC should retain the time tested provision prescribed under the existing ITL [Section 90(2)], namely allowing the assessee to choose between the provision of DTC and the Treaty provision, whichever is more beneficial without any rider.
- Alternatively, the revised provisions ought to be made applicable only in respect of new DTAA negotiated after the DTC comes into force.

16. Branch Profit Tax

Section 100 of the DTC provides that every foreign company shall be liable to Branch Profit Tax, at the rates specified in Paragraph C of the Second Schedule on its 'Branch Profits'. The prescribed rate is 15 % on the branch profits. It is provided that 'Branch Profits' shall be the total income for the financial year as reduced by the amount of income tax thereon.

Comments

Although it appears that branch profits tax will be levied on Foreign Companies only if it has a Branch in India, this intention is not coming out clearly from the definition of 'Branch Profit' which is ambiguous.

Further it is not clear whether branch profit tax will be applicable even to an unregistered branch, say a permanent establishment under DTC in India.

17. Tax Deduction at Source

Section 195 of DTC read with Third and Fourth Schedule requires deduction of tax on specified payments to resident and non-resident

payees. The rates prescribed for tax deduction on payment of “any other income”, which is a residuary provision are provided as under:

Payment to resident	- 10%
Payment to non-resident	- 35%

The scope of residuary provision is very wide and will include all payments which are currently not subject to deduction. For example, even payment for sale of goods or for purchase of machinery from a resident will get covered under this provision and tax will have to be deducted before making the payment. Similarly, problems will be faced while making payments solely towards sale of goods, etc. to non-residents which are currently not subject to withholding tax. Further, DTC provides for withholding tax on the whole of other income @ 35% without clarifying that withholding tax should be applied only if the income is chargeable to tax in India. Since there is no reference in Section 195 and the Fourth Schedule to the rates prescribed under the tax treaty, in all cases tax will have to be deducted at the rates prescribed under the Fourth Schedule even if the treaty provisions are applicable

Comments

- In respect of payment to residents, Entry No.14 in the Third Schedule prescribing the TDS rate on “Any Other Income” should be deleted.
- In respect of payment to non-resident DTC should provide for
 - (i) consideration of rates prescribed under treaty for the purpose of withholding tax in cases where tax treaty can be applied and
 - (ii) withholding tax only where specified payments are “chargeable to tax”.

18. Tax on net wealth

DTC originally proposed –

- To provide for levy of wealth tax on the high net worth entities viz. individuals, Hindu Undivided Families and private discretionary trusts. Companies were proposed to be excluded from the scope of taxable entities.
- To reintroduce the regime of wealth tax provisions as prevalent prior to changes brought in the year 1992, by providing for levy of wealth tax on all assets, including financial assets, except for certain specified assets.
- To increase the threshold to INR 500 million from the present threshold limit of INR 3 million. Further, the rate of wealth tax would be reduced from the current rate of 1% to 0.25% on the net wealth exceeding the threshold.

It is now proposed in revised DTC that Wealth Tax will be levied only on “Unproductive Assets” on the same basis as provided in the Wealth Tax Act 1957. Non-profit organisation will be excluded from levy of Wealth Tax. All other taxpayers including companies will be liable to pay Wealth Tax. It is also proposed that the threshold limit and rate of tax will be suitably finalised in the context of overall tax rates.

Comments

- Tax on wealth due to value addition by way of inflation should be avoided. The proposal for valuation of “assets at cost or market price whichever is lower” may be applied for valuation of all unproductive assets to eliminate the inflationary effect on the value of assets.

19. Penalties

The DTC proposes to elaborate, define and explain circumstances in which penalties can be levied. The basic condition for levy of penalty would be wilful under-reporting of the tax base.

Primarily, failure to file tax return by the due date and assessment of the tax base at an amount higher than the amount disclosed in the tax return i.e. variances, shall be presumed to be wilful under-reporting of the tax base.

20. Comments

The DTC marks a new era in the Indian tax scenario after more than 50 years of operation of the current ITL.

The approach of the Government of India (GOI) to release a draft of the DTC for public comments, before introducing it in the Parliament, is commendable. This allows the stakeholders sufficient time to evaluate the impact of the new law before it is brought into force and also to provide its comments for the consideration of the GOI.

Business community would need to watch the developments and actively engage with the GOI for presenting its points of view. At the same time, it would be important to assess the impact that some of the proposals could have on current structures and business models.