An Overview Direct Tax Code in India

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Abstract:
Taxes are sometimes referred to as direct taxes or indirect taxes. The meaning of these terms can vary in different contexts, which can sometimes lead to confusion. An economic definition, by Atkinson, states that "... direct taxes may be adjusted to the individual characteristics of the taxpayer, whereas indirect taxes are levied on transactions irrespective of the circumstances of buyer or seller." (A.B. Atkinson, Optimal Taxation and the Direct Versus Indirect Tax Controversy, 10 Can. J. Econ. 590, 592 (1977)). According to this definition, for example, income tax is "direct", and sales tax is "indirect". In law, the terms may have different meanings. In U.S. constitutional law, for instance, direct taxes refer to poll taxes and property taxes, which are based on simple existence or ownership. Indirect taxes are imposed on events, rights, privileges, and activities. Thus, a tax on the sale of property would be considered an indirect tax, whereas the tax on simply owning the property itself would be a direct tax.

Keywords: *Direct tax code, Property, Taxation*

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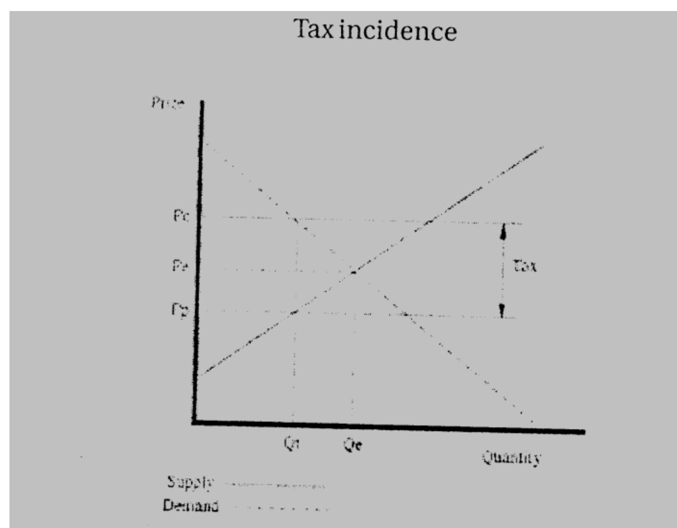
1. Introduction

Taxes are also imposed by many sub national entities. Taxes consist of direct tax or indirect tax, and may be paid in money or as its labour equivalent (often but not always unpaid labour). A tax may be defined as a "pecuniary burden laid upon individuals or property owners to support the government a payment exacted by legislative authority" A tax "is not a voluntary payment or donation, but an enforced contribution, exacted pursuant to legislative authority" and is "any contribution imposed by government whether under the name of toll, tribute, tallage, gabel, impost, duty, custom, excise,etc. The legal definition and the economic definition of taxes differ in that economists do not consider many transfers to governments to be taxes. For example, some transfers to the public sector are comparable to prices. Examples include tuition at public universities and fees for utilities provided by local governments. Governments also obtain resources by creating money (e.g., printing bills and minting coins), through voluntary gifts (e.g., contributions to public universities and museums), by imposing penalties (e.g., traffic fines), by borrowing, and by confiscating wealth. From the view of bsidy, aid, supply, or other name."

Taxes are sometimes referred to as direct taxes or indirect taxes. The meaning of these terms can vary in different contexts, which can sometimes lead to confusion. An economic definition, by Atkinson, states that" ... direct taxes may be adjusted to the individual characteristics of the taxpayer, whereas indirect taxes are levied on transactions irrespective of the circumstances of buyer or seller." (A. B. Atkinson, Optimal Taxation and the Direct Versus Indirect Tax Controversy, 10 Can. J. Econ. 590, 592 (1977)). According to this definition, for example, income tax is "direct", and sales tax is "indirect". In law, the terms may have different meanings. In U.S. constitutional law, for instance, direct taxes refer to poll taxes and property taxes, which are based on simple existence or ownership. Indirect taxes are imposed on events, rights, privileges, and activities. Thus, a tax on the sale of property would be considered an indirect tax, whereas the tax on simply owning the property itself

would be a direct tax. The distinction between direct and indirect taxation can be subtle, but can be important under the law.

2. Tax incidence



Law establishes from whom a tax is collected. In many countries, taxes are imposed on business (such as corporate taxes or portions of payroll taxes). However, who ultimately pays the tax (the tax "burden ") is determined by the marketplace as taxes become embedded into production costs. Depending on how quantities supplied and demanded vary with price (the" elasticities" of supply and demand), a tax can be absorbed by the seller (in the form of lower pre-tax prices), or by the buyer (in the form of higher post - tax prices). If the elasticity of supply is low, more of the tax will be paid by the supplier. If the elasticity of demand is low, more will be paid by the customer. And contrariwise for the cases where those elasticities are high. If the seller is a competitive firm, the tax burden flows back to the factors of production depending on the elasticities thereof; this includes workers (in the form of lower wages), capital investors (in the form of loss to shareholders), landowners (in the form of lower rents) and entrepreneurs (in the form of lower wages of superintendence). The Indian finance minister recently presented in parliament the proposed Direct Tax Code (DTC) that eases fears of double taxation and updates the corporate tax rates for foreign companies. Nair & Co. provides a quick look at what the revised DTC-that aims replace India's 50-year-old Income tax law and create a system that simplifies the tax structure- has in store for the multinationals. The original discussion paper was issued in August 2009 and the revised paper was released in June 2010

3. India Direct Tax Code: Relief from Double Taxation: In a major relief to the tax payers, the DTC reinstates the current well established principle _ the provisions of domestic law or Double Taxation Avoidance Agreement (DTAA), whichever is more beneficial to the tax payer should prevail. However this principle will not be applicable in certain conditions including:

- When the General Anti Avoidance Rule is invoked.
- When Controlled Foreign Corporation provisions are invoked.
- When branch profits tax is levied.

The latest measure comes after stakeholders raised several arguments against the provisions in the original discussion paper that in the event of a conflict between the provisions of a tax treaty and the provisions of the DTC, the "later in time" doctrine would apply.

4. India Direct Tax Code: Corporate Tax

The corporate tax rate for both domestic and foreign companies is proposed at 30%, higher than the 25% tax proposed in the original discussion paper. Also, it has been proposed to lift the surcharge &

cess on corporate tax, thereby bringing the effective corporate tax rate to 30% from the present highest rate of about 33.2% for domestic companies and about 42% for foreign companies, including the present surcharge and cess. The DTC also proposes a new branch profit distribution tax of 15%. This will be over and above the tax rate of 30% proposed for the foreign companies.

5. India Direct Tax Code: Residency for Foreign Companies

The original discussion paper specified a foreign company to be a resident in India if the management and control of its affairs are either "wholly" or "partly" situated in India at anytime during the financial year. The inclusion of the word "partly" led to much ambiguity and outcry by businesses and stakeholders that the residency test was not in tune with international concepts like place of" effective" or" central" control and management. The DTC introduced in the parliament now proposes that the "place of effective management" be used as the test for determining whether a foreign company is resident in India.

The "Place of effective management" is defined as:

- The place where the board of directors of a company or its executive directors make their decisions; or
- If the board of directors routinely approves 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.

6. India Direct Tax Code: General Anti-Avoidance Rule (GAAR)

The Direct Tax Code has introduced a General Anti-Avoidance Rule (GAAR), in line with the proposals of the discussion papers, to deal with instances where a taxpayer enters into an arrangement to obtain a tax benefit and

- The arrangement is in a manner not normally employed for genuine business purposes.
- The arrangement is not at arm's length .
- The arrangement abuses the Direct Tax Code .
- The arrangement lacks commercial substance.

Stakeholders argued against the proposals in the discussion papers; stating

- The proposed GAAR is sweeping in nature allowing it be used in a potentially arbitrary manner.
- The proposed GAAR does not distinguish between tax mitigation and tax avoidance i.e, any arrangement to obtain a mere tax benefit could be deemed to as avoidance.

Despite the protests, the Indian government has not changed GAAR but clarified that not every arrangement that would mitigate tax liability would be classified as an avoidance agreement and it has proposed that the Central Board of Direct Taxes will issue guidelines to provide for such circumstances and thresholds under which GAAR could be invoked. In addition, the government also clarified that the Dispute Resolution Panel would be made available when the GAAR is invoked against a taxpayer.

7. India Direct Tax Code: Minimum Alternate Tax (MAT)

In a very positive measure the DTC rolled back the proposed asset based Minimum Alternate Tax, which will now be applicable on "book profits" and not on the "gross assets". Gross asset base MAT was proposed by the original discussion paper in 2009, which proposed the MAT to be imposed at a rate of 2% of gross assets and also shifted the base for computing the MAT from book profits to the "value of gross assets”. Offsetting the good news of withdrawal of the proposed minimum alternate tax (MAT) on gross assets, It is proposed to raise the MAT on book profits to 20% from the current 18%. However, it may be noted that the highest MAT rate including the surcharge and cess is presently 19.93%.

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8. India Direct Tax Code: Special Economic Zone (SEZ)

The DTC has also cancelled the proposal of the original discussion paper about scrapping the tax benefit to units in SEZs. The tax benefits for units established in SEZs on or before March 31,2014 will continue to get the tax benefits prevailing under the current income tax law.

9. Individual Income Tax slabs to be increased

The DTC bill looks to increase the existing income tax slabs, effectively reducing the applicable tax rates to individuals. However, the proposed revision in the slabs is a watered down version of the one proposed in the original DTC draft. In fact, the improvement in effective tax rates is marginal. An individual earning Rs30lakh salary per annum pays an effective tax rate of 25.1 % currently. Under the new bill, this person would have to pay an effective rate of24.3% compared to the 17.8% effective rate under the original DTC draft. The increase in tax slabs, even though marginal, is a positive for domestic consumption driven sectors like FMCG, consumer goods, etc.

Exhibit 1: Direct Tax Code Bill: Key previsions

Category	Existing Act	Original DTC Discussion paper	DTC Bill 2010
Corporate Tax Rate	30%	25%	30%
Surcharge on Corporate Tax	3.22 %	0 %	0%
MAT	19.93% of Adj. Book profit	2% of Gross Assets(0.25% of Bank)	20% of Adj. Book Profit
Mat Credit	10 years	Nil	15 yeas
Securities Transaction Tax	0.25% Max	0%	0.25 % max
Tax Regime on retirement saving schemes	Exempt-exempt-Exempt	Exempt-Exempt-Tax	Exempt-exempt-Exempt
Investment related dedication limit	1,00,000	3,00,000	1,00,000
Dedication on interest on Home loans	1,50,000	0	1,00,000
Tax receipt from life insurance policy	nil	Marginal Rate	Nil

Source : DTC Bill, Angel Research

Exhibit 2: Tax Slabs for Personal Income Tax

Tax Rate	Existing Act Applicable Income Slab (Rs)	Original DTC Discussion paper	DTC Bill 2010
Nil	1,60,000	1,60,000	2,00,000
10%	1,60,000 – 5,00,000	1,60,000 – 10,00,000	2,00,000 – 5,00,000
20%	5,00,000 - 8,00,000	10,00,000- 25,00,000	5,00,000– 10,00,000
30%	> 8,00,000	> 25,00,000	>10,00,000

Source : DTC Bill, Angel Research

The bill also provides for deduction of insurance premium and tuition fees from taxable income up to a maximum of Rs50,000. As per the current regulations, deduction on insurance premium is a part of Rs l00,000 deduction allowed under Section 80c. Reimbursement limit on medical expenses has been raised from Rs 15,000 to Rs 50,000 per annum. We believe that this would provide more disposable income in the hands of individual tax-payers and therefore a positive for domestic consumption led stories. Individuals would incur 1 % wealth tax in case their assets are over Rs l cr.

10. Long-term Capital Gains on equities to remain tax-free

The draft paper on DTC had recommended that distinction between short- and long-term capital gains be dispensed with and all capital gains be taxed at the marginal tax rate. However, the DTC bill has revoked this proposal and seeks to keep the tax rate on long-term capital gains far equity transactions as Nil. Tax rate on short - term capital gains for equity transactions would be half the applicable rates, as against a flat 15% currently. For companies, however, short-term capital gains tax rate stands at 30%. The proposal to keep long-term capital gains tax free is, in our opinion, an improvement over the earlier draft, as it provides an incentive for long-term investments over short - term gains.

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