



India – Direct Tax Code 2009



Vinod Kothari

vinod@vinodkothari.com



Roadmap to introduction

- Discussion paper in August 2009
- Direct Tax Code Bill presented
- Finance Minister in Budget Speech 2010 says DTC will be implemented from the next year

Highlights of the DTC



- Composite law, consolidating
 - Income tax
 - This includes gift tax on the recipient
 - Wealth tax
 - MAT does not remain; however tax based on gross assets of companies introduced
 - Branch profits tax in case of foreign companies
- Broad scheme of taxability largely remains the same:
 - Tax on global income in case of residents
 - Indian income in case of non-residents
- Dividend distribution tax stays

Merits of DTC over the earlier law

- Sections have been cleaned up, serialised, instead of the earlier numbers like 80QQA and 115JJA
- Opportunity to introduce certain new concepts and definitions

Heads of income



- **Income from ordinary sources**

- Income from employment
- Income from house property
- Income from business or profession
- Capital gains
- Residuary incomes

- **Income from special sources**

- Certain India-connected incomes in case of non-residents
- Winnings from lotteries etc in case of residents

Expenditure not allowed – sec 17// 18

- Sec 56 (2) (o) deals with expenses for which explanation is not satisfactory
- This is treated as deemed income, and disallowed as expense
 - Not double taxation, but taxed as income
- Also, current provisions about expenditure where TDS not deducted get strengthened
 - The benefit of deduction gets permanently lost if TDS not paid within 2 years



Income from employment

- Largely the scheme is the same as under existing law
- The word “salary” defined



Income from house property

- Income from house property defined as
 - Contractual rent or
 - Presumptive rent, whichever is higher
- Presumptive rent shall be 6% of the value determined by local authority, or where no such value fixed, cost of construction/acquisition
- This would mean income from all properties taxable unless
 - Property used for business
 - Property not ready for use
 - One house for self use
- In case of self-use properties
 - Very confusing provision in sec. 25 (5) – any other benefit derived by the owner



Income from business

- Detailed provisions defining what is separate business
 - these provisions affect provisions dealing with set off of inter-business losses
- Deeming provisions if the location of the business is physically in a different place
 - Strictly, this would mean every unit of a business is a separate business
- Deemed incomes
 - Interesting additions such as security deposit or other advance for long term lease of a business or interest in a business
 - Payments made in cash [current sec 40A (3), 1961 Act] taken as income instead of disallowed expense

Deductions against business income

- Broad classification into 3 classes
 - Operating expenses
 - Financial expenses
 - Capital allowances
- Operating exps – sec 33
 - Besides condition of laying out “wholly and exclusively for the business”, law makes a big blunder of listing out exps that are allowable
 - Hence, by default, anything that does not fall under the list is not an allowable expense
 - Huge effort and litigation will go in interpretation of the clauses of the section to find out whether a particular exp falls within the list or not
 - Surprisingly enough, after listing out 42 items, the 43rd item is – any other expense

Financial charges – sec 34

- Apart from cost of money borrowed or trade credit etc., proportionate discount on issue or premium on redemption of bonds is specifically made allowable
- Unfortunately, interest on debt incurred for capital assets not allowable as exps until the asset put to use – sec. 34 (2) (a) (ii)
 - Interest required to be capitalised
 - Contrary to accounting rules
- Exps on bond issuance also not allowable
- Payment of interest to “permitted financial institutions” is allowable only on cash basis
 - Interest converted into loan deemed not to have been paid

depreciation



- Partial ownership of an asset specifically permitted for depreciation purposes
- In case of financial leases, lessee to claim depreciation
- Unlike existing provisions, block value to continue to give depreciation even if the block has ceased to exist – in this case terminal depreciation (not short term capital loss)
 - Likewise, profit on sale of depreciation assets treated as business profit and not capital gain
- Depreciation
 - Initial depreciation – 20%, halved if the asset is used for less than 180 days
 - Allowed in case of plant and machinery
 - Allowed only to actual user; not applicable in case of leasing
 - Normal
 - Terminal – where block has ceased to exist or block value is zero

Capital gains



- Gains on transfer of any “investment asset” will be capital gains
 - Business capital assets are not investment assets; their gains/losses will be a part of business income
- Distinction between long term and short term capital gains seemingly is going away for the purpose of set off
- However, inflation indexing is permitted for any capital asset more than 1 year from the end of the financial year in which it is acquired



Income from residual sources

- Every other income falls under this head
- Specific inclusions for the following:
 - Unexplained incomes or investments also taken as residual income
 - Loans taken in cash exceeding Rs 20000
 - Self generated assets – generic provision as against only specified assets as of now
 - All gifts other than those from relatives, marital gifts, testamentary gifts or in contemplation of death

Carry forward of profits for closely held companies

- Benefit of carry forward of losses not allowed in case of closely held companies unless at least 51% of voting power remains in the hands of the same persons

A decorative graphic consisting of two rows of circles. The top row has two circles: a solid light purple one on the left and an outlined light purple one on the right. The bottom row has three circles: a solid light purple one on the left, an outlined light purple one in the middle, and a solid light purple one on the right.

Wealth tax

- 0.25% wealth tax proposed on gross assets of a company, if exceeding Rs 50 crores

Fair value based disallowance provisions

- Sec 104 introduces a disallowance provision, to disallow either capital or revenue expense
 - If payment made to associated person
 - Even if payment is not made to associated person
 - If unreasonable or excessive based on fair market value
 - Based on legitimate needs of the business of the person
 - Benefit derived therefrom
- In other words, in case of every expense, the onus of proportionality and reasonability thrown on the tax payer

General anti avoidance provision – sec 112

- This is a general anti avoidance rule (GAAR)
- Transactions can be disregarded, steps may be combined, or transactions may be recharacterized to find if they are impermissible avoidance transactions
- Several rules have been laid out on powers of tax officers
- Impermissible avoidance transaction:
 - creates rights, or obligations, which would not normally be created between persons dealing at arm's length;
 - results, directly or indirectly, in the misuse, or abuse, of the provisions of the Code;
 - lacks commercial substance, in whole or in part; or
 - is entered into, or carried out, by means, or in a manner, which would not normally be employed for bonafide purposes;
- Sec. 114 contains a deeming provision, throwing the entire onus on the tax payer to prove
 - Everything is avoidance, unless proved that tax benefit was not the purpose of the transaction