Partners:

Rashmin C. Sanghvi

Naresh A. Ajwani

Rutvik R. Sanghvi

Rashmin Sanghvi & Associates

Chartered Accountants

109, 1st floor, Arun Chambers, Tardeo Road, Mumbai - 400 034, India.

☎ :(+91 22) 2351 1878, 2352 5694 • Fax: 2351 5275

Website: www.rashminsanghvi.com • E-mail: rashmin@rashminsanghvi.com

Dear Sir/Madam, 9th September, 2009

Direct Taxes Code Bill (DTC)

Income-tax Department has presented a draft of the **Direct Taxes Code (DTC)** Bill along with a Discussion Paper on the same. These are placed on our website. They are also on the Finance Ministry's website at:

http://finmin.nic.in/DTCode/index.html

We had an opportunity to meet & discuss with Joint Secretaries, Taxes & Planning section of the Central Board of Direct Taxes (CBDT) - who have been the chief architects of the DTC. They have clarified several issues. In this brief note, we are stating the clarifications. Hence this note is a combination of the DTC provisions and oral clarifications from the draftsmen. However, this is our personal note & cannot be considered as Government's clarifications.

CBDT has invited suggestions from all concerned. If any one has any reservation, doubt or criticism, he/she can write to the CBDT on the following e-mail address. They have promised to consider all suggestions.

directtaxescode-rev@nic.in

Time plan for the implementation of the Bill is given below in paragraph 8.

Important modifications suggested in the Code are:

1. Tax Rates:

All corporate **tax rates** are reduced to **25%** at the highest level. Even **foreign companies** will be treated **at par** for tax rates. Indian companies will, in addition, pay **Dividend Distribution Tax** (DDT) @ 15%. To bring foreign companies at par, if they have branches/permanent establishments in India, they will now pay a **Branch Profits Tax** (BPT) @ 15%. Corporate tax rate and DDT/BPT together will add upto **36.25%.** This is considerable relief for foreign company tax rate of 42. 23%.

For individuals, for income upto Rs. 25,00,000, income-tax will be only Rs. 3, 84,000. Beyond Rs. 25,00,000, the maximum tax rate will be 30%.

All these rates are without surcharge & education cess.

2. Concept:

DTC is drafted with a long term vision. It is an attempt to **simplify the law** by reducing tax rates & minimising all tax exemptions/deductions. Impact on Government revenues of both together may be to set off each other. Over all, for the Government, because of DTC, tax revenue may neither increase nor reduce. However, for assessees, there may be significant implications – for some, tax reductions; and for others, tax increases.

The **language** of the law is simplified. All "provisos" and "explanations" have been removed. Now it is an easy flow, user friendly language. Department's target is to simplify to such an extent that simple software should be good enough to find out whether an income is taxable or not.

It is clarified that the DTC is **not an amendment** of existing Income-tax Act (ITA). DTC is **conceptually different** from ITA. Though of course, there will be several common provisions.

DTC is not just Income-tax. DTC brings all direct taxes under its net. In certain cases, it provides for tax on the basis other than Income. For example, MAT will be levied on Gross assets. Wealth tax is also levied through this Code.

3. GAAR:

In India, so far there were no **General Anti Avoidance Rules**. DTC proposes to introduce the same. GAAR will be applicable to tax avoidance attempts within India as well as under International taxation. GAAR will override Double Tax Avoidance Treaty (Treaty). **Treaty abuse** will not be permitted.

It is declared that in India, for direct tax purposes, **"Substance will Override Form".** Any arrangement which is found to be primarily meant for tax avoidance can be ignored by the tax department. For example, **treaty shopping** will not be permitted. Supreme Court decision in the **Azadi Bachao** Andolan case will stand overridden. Similarly, tax avoidance by splitting contracts for supply & installation into **offshore & onshore** supplies will be scrutinised in depth. (This provision has already been introduced in law.)

While treaties that are abused will be overridden, on the whole, Government of India will abide by all the international treaties that she has signed. India is committed to the **Vienna Convention** that provides for implementation of a treaty in "**Good Faith**". However, if the other country to the treaty does not implement the treaty in Good Faith, elaborate provisions have been made to enable tax department to take care.

Tax Avoidance through tax haven companies - for example in Hutchison Essar - **Vodafone** case will not be permitted.

4. Residents Liable to tax on Global Income

It is a settled principle of law that an **Indian resident is liable to Indian tax on his global income.** In Supreme Court decision in **Chettiar's** case it was held that if the resident has paid tax abroad on his foreign income, he cannot again be taxed in India. This decision is proposed to be overridden. Hence once an Indian resident has earned income any where in the world, the same shall be liable to tax in India. This principle will apply irrespective of the fact that the assessee has paid any tax abroad. The taxes paid abroad will be available as relief against their Indian taxes.

5. Non-Residents Liable to Indian Tax on Indian Income:

It is also a settled principle of law that a Non-resident is liable to Indian tax on his income form Indian sources. "Source" is not defined in the Act or in any Treaty. In all models of Treaties, Non-Residents are permitted to be taxed on "Fees for Technical Services", "Royalty", "Interest", "Dividend" etc. "Passive Incomes" based on payments borne by/paid by residents of the Country Of Source (COS).

Supreme Court decision in **Ishikawajima** case probably meant as under: If a non-Resident has **source of income** outside India, it cannot be taxed in India. Even if the treaty permits it, Government of India has no jurisdiction to tax it. Thus, if a Non-Resident Company earns Fees for Technical Services (FTS) from an Indian resident, but the services are rendered outside India, the fees cannot be taxed by India. This decision is sought to be overridden.

Once a provision in DTC as well as treaty permits certain tax, such tax shall be levied irrespective of the location of source of income.

6. Offshore Companies:

While specific **"Controlled Foreign Companies"** (CFC) rules are not proposed, definition of the **Residential Status** is proposed to be so modified that all companies & trusts etc. controlled from India will be taxable in India. This will have repercussions far wider than CFC rules. And compensatory "Underlying Tax Credit" is not proposed. This provision will certainly need several modifications to be "Just & Fair".

7. MAT:

Companies having taxable income less than book profits are liable to MAT under section 115JB. There is considerable controversy under this provision. DTC proposes to replace the MAT based on profits by an Asset based tax. The new MAT will be 2% of the gross book value of all assets held by the Company without deducting liabilities. A company will be liable to pay either its normal tax or MAT which ever is higher.

This can raise considerable problems for loss making companies & infrastructure companies. Department has interesting arguments in favour of the MAT. We will present the same in our detailed note.

8. Time Plan:

Please note that this is a draft of the Bill. It will go through several modifications before it becomes the law.

The proposed action plan is as under: By 10th September, 2009 department wants to receive all representations from all interested parties. Then, the department will review all the representations received. In October & November, 2009 these representations will be considered and DTC will be revised in consultation with the Law Ministry.

In the last week of December, 2009 the finalised bill will be presented before the Parliament. Thereafter this bill may be referred to a Select Committee or the Standing Committee of the Parliament. This committee may again invite representations from all concerned. Hence people will have a further time upto May or June, 2010 to make further representations.

Thereafter the Parliament may consider and pass the bill, hopefully by August, 2010. A process for drafting the rules under the Direct Taxes Code will start. Entire code with rules will be available to the people long before 1st April, 2011.

The DTC will be applicable to all incomes earned on and after 1st April, 2011.

This is a brief explanation of several issues that arise out of the DTC. We are preparing a more detailed note analysing the DTC. We will place the same on our website and send the link to you.

In case, you need any clarification on the subject, please contact us.

With Best Regards,

For Rashmin Sanghvi & Associates
Partners

Rashmin, Naresh & Rutvik.

Note: This is a brief note on a vast subject. This is only for quick information for our clients & friends interested in the subject. This note should not be considered as an advice. No action may be taken or omitted based on this summary.