DIRECT TAX CODE IN INDIA: IMPACT AND STRATEGIES

Ms. Parul Mittal*

ABSTRACT

The draft of direct tax bill is introduced as a bill of parliament. Direct Tax code is a draft bill to change Income tax act 1961. It is originally proposed to be applicable from 01.04.2012. But it is unlikely to happen so and it is proposed to come in effect from 01.04.2013. The Direct Taxes Code (DTC) is said to replace the existing Indian Income Tax Act, 1961.This code is the combination of the relief from major tax liabilities and as well as removal of many tax exemption benefits. The aim of code is to eliminate the distortions in tax structure. (It also introduced moderate level of tax liabilities as well as expands the basis for taxation.)The code for direct taxation also covers tax compliance and simplification of litigations regarding the tax liabilities. The objective of this paper is to analyze the impact of DTC on different issues (factors). Throughout this study, we also give emphasis on the major highlights of DTC in India. This paper studies the concept of DTC and its evaluation.

* Assistant Professor, Department of Management, Indira Gandhi P.G. Regional Center, Mirpur, Rewari-123401(Hr.).

INTRODUCTION

DTC is proposed to remove most of the categories of exempted income. Equity Mutual Funds (ELSS), Term deposits, NSC (National Savings certificates), Unit Linked Insurance Plans (ULIPs), Long term infrastructures bonds, house loan principal repayment, stamp duty and registration fees on purchase of house property will lose tax benefits.

The Parliamentary panel on Direct Taxes Code in its report tabled in LokSabha today has suggested raising the income tax exemption limit to Rs 3 lakhs. The report of Standing Committee on Finance, which scrutinized the Direct Taxes Code (DTC) Bill, will pave the way for discussions and adoption of DTC by Parliament. DTC will replace the Income Tax Act, 1961. The Standing Committee also suggested that 10% tax will be levied on taxable income between Rs 3-10 lakhs, 20% between Rs 10-20 lakhs and 30% on over Rs 20 lakhs. At present, 10% tax is levied on income between Rs 1.8-Rs 5 lakhs, 20% on income between Rs 5-8 lakh and 30% above Rs 8 lakhs. The DTC is to proposed income tax exemption limit at Rs 2 lakhs, 10% tax for income between Rs 2-5 lakhs, 20% for Rs 5-10 lakhs and 30% above Rs 10 lakhs. The proposed Direct Tax Code is a combination of major tax relief and removal of most tax-exempted benefits. It is expected to usher in a new tax regime of transparency and greater compliance.

SALIENT FEATURES

1. Only half of Short-term capital gains will be taxed.

2. Surcharge and education cess will be abolishing.

3. for incomes arising out of House Property: Deductions for Rent and Maintenance would be reduced from 30% to 20% of the Gross Rent. Also all interest paid on house loan for a rented house is deductible from rent.

4. Tax exemption on Education loan to continue.

5. Tax exemption on LTA (leave travel allowance) will abolish.

6. Taxation of Capital gains from property sale: For sale within one year, gain is to be added to taxable salary.

7. Tax on dividends: Dividends will attract 5% tax.

8. Medical reimbursement: Max. Limit for medical reimbursements has been increased to rupees 50,000 per year from current level of rupees 15,000 limit.

IN GENERAL

Earlier Income Tax Act and Wealth Tax Act (Covering Income Tax, TDS, DDT, FBT and Wealth taxes) expected to abolish and single code of Tax, DTC in place. Concept of Assessment year and previous year has been abolished. Only the "Financial Year" terminology exists. Only status of "Non Resident" and "Resident of India" exits. The other status of "resident, but not ordinarily resident" goes away. Earlier the terminology of assesses was meant for the person who is paying tax and/or, who is liable for proceeding under the Act. Now it has been added with 2 more definitions namely a person, whom the amount is refundable, and/or, who voluntarily files tax return irrespective of tax liability. This helps any person to file his returns and maintain the record of tax return filing.

No changes in the system of Advance Tax, Self Assessment Tax and also TDS. Amendment of TDS goes in line with earlier Notification 31/2009 which speaks of Form 17/UTN/etc. In TDS, a new return, if found required, will be introduced for Non TDS payments. Government assessed is covered in Direct Tax Code. Even though they are not liable for Income Tax / Wealth Tax, Government Assesses are required to comply with provision of TDS and TCS.

WHY INDIA NEED DIRECT TAX CODE

There are several reasons behind the need of DTC as follows:

- Provides stabilities in direct tax rates
- Increase tax to GDP ratio
- Corporate tax 30%(no surcharge and cess)
- Wealth tax "cut off" increased

DTC bill has had its share of criticism post its proposal which has eventually been the reason for delay in applicability of it. Direct Tax Code was first meant to be applicable from 1st April, 2012 will now finally apply from 1st April, 2013. The Direct Taxes Code Bill which was introduced in

Parliament last year proposes to replace the 50-year old Income Tax Act. Our Finance Minister Mr. Pranab Mukherjee has given several statements in the current year assuring of DTC going on roll from the beginning of the financial year 2012-13. Before finalizing, the draft was put to several invited memoranda containing views/suggestions from various Individuals/Experts/institutions/Organizations interested in the bill. The Memoranda that was submitted to the Committee would form part of the records of the Committee and would be treated as 'confidential' and would enjoy privileges of the Committee. Because of the changes that are proposed to be brought with DTC coming into operations, Individuals, companies, HUF/AOP/BOI are set to get certain tax benefits and also some tax norms will get stringent.

Major Deductions applicable under Tax Incentives for an individual:

1. Investments through PFRDA approved agencies (Max of 3 Lakhs)
2. Payment of tuition fees
3. Medical treatment
4. Health insurance
5. Donations
6. Interest on loan taken for higher education
7. Maintenance of a disabled dependant
8. Interest income on Govt. bonds

Deductions from Salaries:

1. Allowed are only, PT, Transport Allowance (limit prescribed) and special allowances given exclusively to meet duties (to the extent actually incurred).
2. Also deduction is allowed for PF as tax incentives.
3. And last, deductions are allowed for Voluntary retirement, Gratuity on retirement and pension received.
4. No deductions on HRA, Medical reimbursements, etc, etc.
5. Employer part of PF paid will be exempted from tax as Tax Incentives under EET methodology (to employees).

House Property:

1. No deduction for Housing loan repayment of Self-Occupying property. This includes interest as well as part of principal.
2. Only Let out properties are considered and the Gross rent and specified deductions are taken with simple calculations.

Residuary Sources (Other Sources):

1. (Earlier things follow almost.
2. Any amount exceeding 20,000 taken / accepted / repaid as loan or deposit, otherwise by an account payee cheque/draft shall be added to the income.)

Computation of total Income

Incomes are broadly divided into 2 sources, namely Special Sources and Ordinary Sources.

- **Special sources** are given no deduction and what is earned is taxed directly (generally at a lower rate).
- **Ordinary sources** are divided into further categories, namely:

I. Income from employment.
II. Income from House Property
III. Income from Business
IV. Capital gains
V. Income from Residuary Sources (Similar to other sources, with some minuses)

The 5 categories of Ordinary sources can have multiple sources under each head (E.g.: Multiple employer, Multiple Business, Multiple Properties, etc). The income will be computed in 2 step procedure for each head: (Calculate for each source under each head of Income. Aggregate the total under each head and arrive a total profit or loss under such head. Then aggregate all the 5 heads and arrive the figure of "**Current Income from Ordinary Sources**". Then this value has to be aggregated with "**unabsorbed losses** as of immediate preceding financial year". Such aggregated income will be treated as "**Gross Total income from Ordinary Sources**".

If such result is negative, then Gross Total Income will be **NIL** and value will be treated as "**Unabsorbed current loss from ordinary sources**". Such Gross Total Income will be further reduced by incentives similar to deductions. The resultant amount will be **'Total income from ordinary sources'**.

IMPACT OF DIRECT TAX CODE:

- **Impact on Tax Liability (Income Slab)**

DTC has redefined the Tax Slabs which brought smile on the face of salaried class as Income tax exemption limit is now proposed at Rs2 lakhs per annum, up from Rs1.6 lakh. Following tax slab has been applied under the new direct tax regime.

Income	Tax rate
Up to Rs 2,00,000	No tax
Between 2,00,000 to 5,00,000	10% of the amount by which the total income exceeds 2,00,000
Between 5,00,000 to 10,00,000	30,000 + 20% of the amount by which the total income exceeds 5,00,000
More than 10,00,000	1,30,000 + 30% of the amount by which the total income exceeds 10,00,000

According to new proposal Tax burden at highest level came down by Rs 41,040 annually. This generates some more disposable income for people falling under different tax slab. For senior citizens (65+), there will be no tax on income up to 2, 50,000. Earlier exemption limit was 2, 40,000.

Exemptions

Exemption for investment in approved funds and insurance schemes is nownat Rs 1.5 lakh annually. Earlier it was Rs 1.2 lakh annually.

- **Deduction of 1 lakh under 80C**

The DTC maintained the existing deduction of Rs1 lakh under 80C but DTC removes most of the categories of exempted income like ULIPs, ELSS funds, NSC, Infrastructure bonds, and term

deposits. Additionally Tax deduction in principal part of the housing loan under 80C is also removed. The instruments available for tax saving purpose will be:

- ✓ New pension system (NPS)
- ✓ Provident fund (EPF and PPF)
- ✓ Superannuation fund

- **Deduction of 50,000**

There will be another 50,000 deduction which will be allowed for the following:

- ✓ Pure Life Insurance where the sum assured is 20 times the annual premium.
- ✓ Health insurance, Med claim Policies
- ✓ Tuition fee (up to 2 child's)

Impact on PPF

With implementation of DTC, PPF will come under the EET (exempt, exempt, tax) regime. Under the EET model proposed by the DTC, contributions to PPF would be taxed at the time of withdrawal. However, balance accumulated or investments made till 31 March 2011 and the interest they earn will not be taxed. Hence only new contributions made on or after the commencement of the code will be subject to tax. There are various reasons for investing in PPF i.e. good investment, flexibility & convenience, tax benefits, extension after 16 years etc. Hence it is still good to start an investment in PPF and it would be great if we can invest the maximum during year to make the most before DTC is implemented.

Impact on Individual

The Tax Code will raise income tax slabs significantly, lowering the tax burden on individuals. The draft proposed exempting the general tax payer from paying tax for income up to Rs 1.60 lakhs a year. According to the proposal, a tax payer will pay at the rate of 10 per cent for income above Rs 1.60 lakhs and up to Rs 10 lakhs, at 20 per cent on income between Rs 10 lakhs and Rs 25 lakhs and at 30 per cent for income beyond Rs 25 lakhs. At present, while the basic exemption limit remains at Rs 1.60 lakhs a year, the limit for tax slabs are much lower — one

pays 10 per cent tax on income ranging between Rs 1.60 lakh and Rs 3 lakhs, 20 per cent between Rs 3 lakhs and Rs 5 lakhs and 30 per cent beyond Rs 5 lakhs.

Thus, for an individual with taxable income of Rs 10 lakh a year tax payment will drop from Rs 1.68 lakhs to Rs 51,000, a net annual saving of Rs 1.17 lakhs. The exemption limit for women and senior citizens will continue to be Rs 1.90 lakhs and Rs 2.40 lakhs, respectively.

- **Impact on MAT**

The Tax Code will also change the calculation of minimum alternate tax (MAT) payable by corporate. MAT will now be levied at 2 per cent of the value of gross assets of a firm in case of all companies except for banks which will pay tax at 0.25 per cent. This shift in MAT from book profits to gross assets is aimed at encouraging optimal utilization and increased efficiency of assets. But Ernst & Young Partner- Tax & Regulatory Services, Sudhir Kapadia feels that this proposal seems to run counter to the objective of encouraging of capital investments for productive growth. Vasal of KPMG also of the view those changes in MAT rule will cause hardship to loss making companies as they will have to pay tax on assets.

- **Impact on Wealth Tax**

The proposed Tax Code can sought to make major changes in wealth tax calculations and rates. The threshold limit for wealth tax will be raised to Rs 50 crores from the present Rs 30 lakhs and the tax rate is reduced from 1 per cent to 0.25 per cent. But, in a smart move, to expand the scope of taxation the Tax Code included financial assets like shares, corporate bonds, fixed deposits, etc in wealth tax. The valuation of these assets will be done at cost or at market price, whichever is lower. In case of capital gains tax too, the Tax Code proposed some sweeping changes. It has done away with the present system of short-term and long-term capital gain tax, and replaced it with a uniform structure and gains will be taxed at the marginal tax rate as applicable to the tax payer. The implications of these changes are clear: The period of holding has no bearing on the tax payable and bigger investors will be taxed at higher rates than the smaller ones.

- **Impact on Mutual Funds**

It is important to clarify what the DTC means when it says "any income which accrues to them". Mutual funds can only pay dividends out of equalized and realized profits so the need to mention

accruals seems out of place and needs to be remedied lest it results in chaotic accounting requirements for mutual funds and confusion for investors. Therefore, whilst the dividend from corporate will be subjected to DDT as now, the dividends paid by Mutual funds it seems will be taxed as there seems to be no mention of DDT to be recovered by mutual funds. This also seems to hold true for debt funds as the DTC does not make any distinction between debt and equity funds.

Impact on Capital Gains

DTC proposal may change the perspective of short and long term capital gains. Only half of Short-term capital gains will be taxed. According to DTC proposal income from capital gains will be categorized as income from normal sources for all tax payers and hence will be taxed as per the individual's tax slab. DTC also proposes indexation base year change from 1-Apr-81 to 1-Apr-2000.

- Short term capital gain on stocks: As per DTC only half of short term gain will be added to your taxable income and taxed as per the category you fall into.
- Long term capital gain on stocks: Holdings sold after a year will come under long term capital gains and not taxed.
- Short term capital gain on property sale: The gain will be added to the taxable salary and taxed as per your category/slab.
- Long term capital gain on property sale: The gain, after indexation, will be added to your salary and taxed as per your tax slab. Earlier, the tax on long term capital gain on property sale was flat 20%.

Impact on Corporate

The rate of tax for corporate tax payers shall be 30 percent (inclusive of surcharge and cess). Carry forward of losses shall be allowed without any time limit. Due date of filing the tax return shall be 31st August following the financial year, replacing 30th September. The rate of CDT will be 15%.

Impact on Investment Strategy

The world of investments is about the future. It is about planning for tax-adjusted returns for future years. As investors do their maths of investments today, they have to keep in mind that the income tax map is set for a substantial change in April, 2012. The new tax codes will have an impact on most investment avenues such as insurance policies, home loans, PPF, mutual funds and stocks. Many tax exemptions in existence today will no longer be valid as the government slowly migrates from the exempt-exempt-exempt (EEE) regime to a simpler and straighter forward tax structure.

- **Impact on Insurance**

The DTC will have a significant impact on insurance as it applied to existing policies too. According to the code, any amount you receive at maturity from an insurance policy (including bonus) will be taxed. However, this rule will not apply to policies where premium paid in a year is less than five percent of sum assured each year and the policy is kept till maturity. The DTC aims to nudge policyholders to take a long term view on investments. To be eligible for tax deduction under DTC, a policy should have a life cover of at least 20 times the annual premium.

- **Impact on Tax Evasion**

Like Honey bee sucks nectar from each flower & does not leave any impact on that, in this way new tax code will promote tax revenue & lessen tax evasion.

- **Impact on Income Inequalities**

Greater tax revenue will be more utilized for uplifting poor provided lesser corruption & more education is there; hence will have negative effect on income inequalities.

SOME HIGHLIGHTS OF DIRECT TAX CODE:

- Common threshold Income Tax exemption limit for men and women proposed at Rs. 2 lakhs per annum (proposed), up from Rs. 1.8 lakh
- 10 per cent tax on annual income between Rs. 2-5 lakhs, 20 per cent on between Rs. 5-10 lakhs 30 per cent for above Rs. 10 lakhs
- Tax burden at highest level came down by Rs. 41,040 annually
- Proposal to raise tax exemption for senior citizens to Rs. 2.5 lakhs from Rs. 2.4 lakhs currently.

- Corporate Tax to remain at 30 per cent but without surcharge and cess.
- MAT to be 20 per cent of book profit, up from 18.5 per cent.
- Proposal to levy dividend distribution tax at 15 per cent.
- Exemption for investment in approved funds and insurance schemes proposed at Rs. 1.5 lakhs annually, against Rs. 1.2 lakhs currently
- Bill has 319 sections and 22 schedules against 298 sections and 14 schedules in existing IT Act.
- DTC replaced archaic Income Tax Act.
- However, many provisions in Income Tax Act are also a part of DTC as well.
- Fringe benefits tax will be charged to the employee rather than the employer.
- Tax proposals for 2012-13 mark progress in the direction of movement towards DTC and GST.
- DTC rates proposed to be introduced for personal income tax.
- Exemption limit for the general category of individual taxpayers proposed to be enhanced from Rs 1, 80,000 to Rs 2, 00,000 giving tax relief of Rs 2,000.

EVALUATION OF DTC

Direct Tax Code: The gains and the pains

PERSONAL TAXATION

- Maintains tax exemption at Rs 1.60 lakh income a year
- 10 per cent tax on income of Rs 1.6-10 lakh
- 20 per cent tax on income over Rs 10 lakh up to Rs 25 lakh
- 30 per cent tax on income beyond Rs 25 lakh
- All perks and allowances will be added to income for taxation
- Savings up to Rs 3 lakh will be exempted from income for taxation
- Withdrawals from PF, PPF etc will be taxed
- Wealth tax limit raised to Rs 50 crore from Rs 30 lakh
- Financial securities like shares brought under wealth tax

CORPORATE TAXATION

- Corporate Tax rate to be 25 pc against 30 pc
- Abolition of Securities Transaction Tax
- Re-introduction of long-term capital gains tax
- No distinction between short and long term capital gain tax
- Amalgamation and de-mergers to be tax neutral
- Business losses can carried forward till fully adjusted
- MAT will be on gross assets as against book profit
- Area-based incentives will be replaced with incentives on investment
- Punishment for defaulters will be more severe

CONCLUSION

DTC proposals regarding NRI's taxation seems to be slightly harsh. For NRI's, if we stay in India for at least 60 days and earn money, we will be taxed. The limit earlier was 182 days. Thus it appears that new tax bill implemented from 1st April 2013 has some good news and some bad news. This will have a positive effect on the work and consumption/savings rates. The tax base increased as the tax rate is simple to understand .These rates will have greater revenue potential. But the cost of collection tax still remains to be examined.

It seemed the reforms proposed in new direct tax code shall have great positive implication for India's outlook and made the most of tax system, as part of efforts to cancel revenue deficit and lower fiscal deficit to less than 3.0 percent of GDP. DTC doesn't provide any extra benefit to women. Women giving men tough fight seems to be a reality as per DTC. DTC proposed to levy dividend distribution tax at 15%. Thus, DTC aims to replace the archaic Income Tax Act and simplify the whole direct tax regime in the country. The Code aims to reduce tax rate which seems

to be a very positive and progressive initiative from the government side. Moreover, the implementation of the proposed fiscal reforms will reduce both tax evasion and costs of compliance, and eliminate most of the distorted behavior coming from tax avoidance. These tax reforms are largely in response to the massive reforms enacted in the UK and the US in the 1980's. Therefore, this bill will introduce a total departure from multiple tax brackets and high rates of tax prior to reforms. Thus in market oriented economy like us it is expected that the tax structure brought forward by this bill reduce conspicuous consumption and make it difficult for people to evade and avoid tax, and thus will promote horizontal equity.

In short, DTC will have a direct impact on tax saving and calculations. With the implementation of DTC, government encourages savings and contributed to infrastructural development.

REFERENCES

- http://www.ey.com/IN/en/Services/Tax/Direct-Tax-Code, Direct Tax Code | DTC India 2012 | Deciphering DTC - Ernst & Young - India
- http://www.thehindubusinessline.com/features/mentor/, Business Line: Features / Mentor
- http://www.business-standard.com/india/news/dtc/s-impactindia-inc/406668/, DTC's impact on India Inc
- http://www.pankajbatra.com/india/new-direct-tax-code-dtc-highlights/,Direct tax code highlights
- http://en.wikipedia.org/wiki/Direct_Taxes_Code
- http://www.ninemilliondollars.com/2012/01/direct-tax-code-dtc-2012-features-and-when-will-it-be-implemented/
- http://www.pankajbatra.com/india/new-direct-tax-code-dtc-highlights/
- http://www.kpmg.com. KPMG 2012, direct tax Code 2012 .highlights.
- India: Direct Tax Code 2012 review and analysis Stock market review .com

- Meade, J E 1978. The Structure and Reform of Direct Taxation, London: George Allen and Unwin.
- M. Govinda Rao* Tax Reform in India : Achievements and Challenges, Asia pacific Development Journal Vol. 7, No. 2, December 2000
- Peter, M V & Kerr, 12001. "The influence of tax mix and tax policy on savings and capital formation in developing economies: A Survey," Asia Pacific Development /0Hma/, UNESCAP,8 (l).
- Vinay.k.shrivastav, Direct tax code: strategic issue, Indian journal of accounting, Vol. xlii, October 2011, pg. 66-70.
- www.saraltaxoffice.com/articles/direct-tax-code-highlights.php
- www.icofp.org/asset/jan/impact_of_direct_tax_code.pdf