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DIRECT TAXES CODE – AN OVERVIEW

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ABSTRACT

The Income Tax Act 1961 has become very complex and virtually unintelligible to the common man by virtue of a complicated structure, numerous amendments, frequent policy changes and a multitude of judgments that gave varying interpretations to already undecipherable provisions. This complexity has not only increased the cost of compliance for the average tax payer, but also made it costly for the administration to collect tax. Lastly, the tax base has been eroded significantly due to an increasing number of exemptions and horizontal inequity. Direct Taxes Code is completely new, simplified taxes code which replaces the Income Tax Act1961 and also gives moderate relief to tax payers, reduce unnecessary exemptions and improve compliance thus improving collections. The tax payers themselves can compute and file Income Tax Returns without the help of experts. This paper highlights the overview of the Direct Taxes Code in a nutshell.

KEYWORDS
Direct Taxes Code, Income Tax Act, Tax exemption, Exemption limit.

INTRODUCTION
Taxes are compulsory payments which citizens in a country are required by law to make to the government for defraying the cost of providing public goods and financing transfer payments. Therefore, they have to be financed from taxes. This immediately raises the question of the basis of allocating the costs i.e. the basis of determining the distribution of tax payments.Now, the Direct Taxes Code - 2009 is a Draft proposal to replace the 51 year old Income Tax Act- 1961 (from the date it completes 51 years as on 1.04.2012) which has been cumbrous by so many sections and provisions which in most cases are not understood by the ordinary tax payers who, to avoid any complicacy and mistakes in the calculation of tax and submission of Tax Return, take help of experts incurring thousands of money for this purpose. The Philosophy behind such replacement is to make the Direct Taxes Code very easy and simple so that tax payers themselves can, without help of experts compute and file Income Tax Returns. In planning and framing an ideal Income Tax Structure of a welfare state like ours the objectives are to give relief to the maximum possible extent to the lower and middle income group taxpayers and check creation of black money at one hand and to enable the Government to increase collection of tax revenue for development works on the other.New Direct Taxes Code which has been announced by the Finance Minister Pranab Mukherjee, which will be replaced by the current Income Tax Structure from the Financial Year 2012-2013.The Income Tax Act was passed in 1961 and has been amended every year through the Finance Acts. The Act deals with income tax. Dividend Distribution Tax was included in the Act by inserting Chapter XIID with effect from June 1, 1997. Fringe Benefit Tax was included in the Act by inserting Chapter XIIH with effect from April 1, 2006. Wealth Tax is administered through the Wealth Tax Act, 1957.

Tax administrators, chartered accountants and tax payers have raised concerns about the complex structure of the Income Tax Act. In particular, the numerous amendments have rendered the Act incomprehensible to the average tax payer. Besides, there have been frequent policy changes due to changing economic environment, complexity in the market, increasing sophistication of commerce, development of information technology and attempts to minimize tax avoidance. The problem has been further compounded by a multitude of judgements (very often, conflicting) rendered by the courts at different levels. Any complex tax legislation increases the cost of compliance as well as administration. Given that the cost of compliance is essentially regressive in nature, this undermines the equity of the tax system. Similarly, high cost of administration is wasteful. Over the last twenty five years, the marginal tax rates have been steadily lowered and the rate structure rationalized to reflect the best international practices. Any further rationalization of the tax rates may not be feasible without corresponding increase in the tax base. Broadening of the base is important to enhance revenue productivity of the tax system and to improve its horizontal equity. The strategy for broadening the base essentially comprises of three elements. The first is to minimize exemptions. For many decades, the tax base has been eroded through a steadily escalating range of exemptions. The removal of these exemptions will have three consequences: (i) It will result in a higher tax-GDP ratio; (ii) It will enhance GDP growth, since tax exemptions and deductions distort allocative efficiency; and (iii) It will improve equity (both horizontal and vertical), reduce compliance costs, lower administrative burdens, and discourage corruption. The second element of the strategy relates to the problem of ambiguity in the law which facilitates tax avoidance. Therefore, it is necessary to undertake a periodic exercise of rewriting the Tax Code in the light of new trends in interpretation by the judiciary, aggressive tax planning by taxpayers, and new opportunities for reducing compliance cost through massive induction of technology and public private partnership. The third element of the strategy relates to checking of erosion of the tax base through tax evasion. The Direct Taxes Code (hereafter referred to as the 'Code') is designed to reflect this strategy. The Code is not an attempt to amend the Income Tax Act, 1961; nor is it an attempt to "improve" upon the present Act. In drafting the Code, the Central Board of Direct Taxes (the Board) has, to the extent possible, started on a clean drafting slate. Some assumptions which have held the ground for many years have been discarded. Principles that have gained international acceptance have been adopted. The best practices in the world have been studied and incorporated. Tax policies that would promote growth with equity have been reflected in the new provisions. Hence, while reading the Code, it would be advisable to do so without any preconceived notions and, as far as possible, without comparing the provisions with the corresponding provisions of the Income Tax Act, 1961.

WHAT IS THE "DIRECT TAXES CODE"?
Income tax in India is governed by the age-old Income Tax Act, drafted in 1961. A lot of things have changed since then. No doubt, many things have been implemented by modifying the IT Act from time to time. But this has been a patch-work. And like any patch work, it has made the IT Act very complicated. Thus, the IT Act today is very difficult to interpret, and has resulted in many disputes and court cases. The "New Direct taxes code" is something that would ultimately replace the Income Tax Act, 1961. It would contain provisions of income tax as well as some other direct taxes, like the wealth tax. So, here are the changes proposed in the "New Direct taxes code". The Direct taxes code (DTC) is governed by the Direct taxes code Bill 2010. It is a direct amendment to the current law, Income-Tax Act 1961. The DTC has proposed more than 5,000 amendments to the current five-decade-old Act.

WHY NEED THE DIRECT TAXES CODE (DTC)?

As part of its financial reforms process, the government wanted to modernise and upgrade its direct tax laws i.e. the Income Tax Act and the Wealth Tax and bring them more in line with current times. DTC is expected to widen tax base, give moderate relief to tax payers, reduce unnecessary exemptions, and improve compliance thus improving collections. It also seeks to address new realities like operations of foreign companies in Indian markets, foreign institutional investors. For example, capital gains tax would be imposed on acquisitions made overseas if the acquired company holds over 50 percent assets in Indian company. This would affect companies like Vodafone Group for its acquisition of a 67 percent stake in Hutchison Essar from Hong Kong`s Hutchison Telecommunications International Ltd. The government has also clarified those foreign companies, which were regarded as 'resident of India' if their control and management were wholly situated in India, will now be considered 'resident' if the "place of effective management" is in India. DTC replaces the archaic Income Tax Act, 1961 and Wealth Tax Act, 1957. It will come into effect from April 01, 2012. First return of income under its norms will be filed after March 31, 2013.

OBJECTIVE

The Direct taxes code (DTC) seeks to consolidate and amend the law relating to all direct taxes, namely, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio. Another objective is to reduce the scope for disputes and minimize litigation.

It is designed to provide stability in the tax regime as it is based on well accepted principles of taxation and best international practices. It will eventually pave the way for a single unified taxpayer reporting system.

- Making the whole process simpler
- Minimizing litigation
- Broadening tax base
- Eliminating tax exemptions.

SALIENT FEATURES OF THE CODE

1. The Code seeks to consolidate and amend the law relating to all direct taxes, that is, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio. Another objective is to reduce the scope for disputes and minimize litigation.

2. Briefly, the salient features of the Code are as under

(a) Single Code for direct taxes: All the direct taxes have been brought under a single Code and compliance procedures unified. This will eventually pave the way for a single unified taxpayer reporting system.

(b) Use of simple language: With the expansion of the economy, the number of taxpayers can be expected to increase significantly. The bulk of these taxpayers will be small paying moderate amounts of tax. Therefore, it is necessary to keep the cost of compliance low by facilitating voluntary compliance by them. This is sought to be achieved, inter alia, by using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law. Each sub-section is a short sentence intended to convey only one point. All directions and mandates, to the extent possible, have been conveyed in active voice. Similarly, the provisos and explanations have been eliminated since they are incomprehensible to non-experts. The various conditions embedded in a provision have also been nested. More importantly, keeping in view the fact that a tax law is essentially a commercial law, extensive use of formulae and tables has been made.

(c) Reducing the scope for litigation: Wherever possible, an attempt has been made to avoid ambiguity in the provisions that invariably give rise to rival interpretations. The objective is that the tax administrator and the tax payer are ad idem on the provisions of the law and the assessment results in a finality to the tax liability of the tax payer. To further this objective, power has also been delegated to the Central Government/Board to avoid protracted litigation on procedural issues.

(d) Flexibility: The structure of the statute has been developed in a manner which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, to the extent possible, the essential and general principles have been reflected in the statute and the matters of detail are contained in the rules/Schedules.

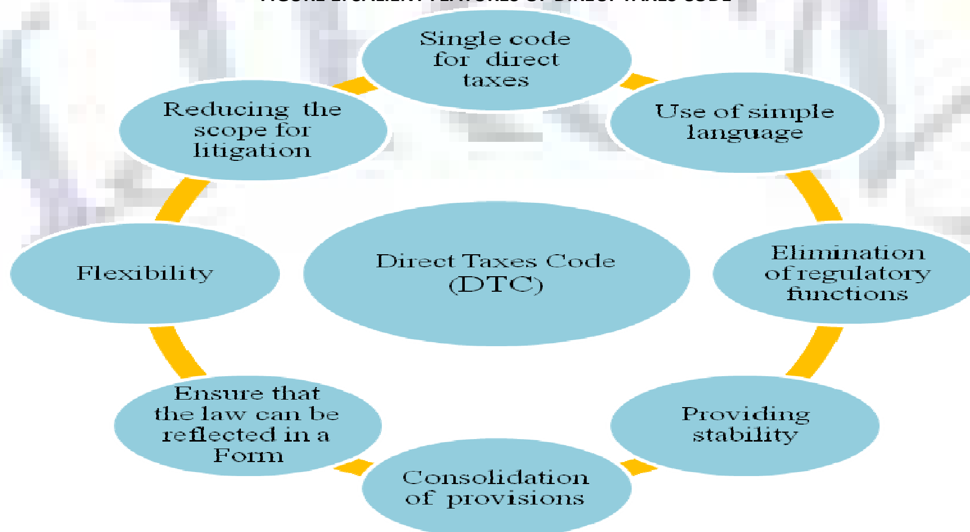
(e) To ensure that the law can be reflected in a Form: For most taxpayers, particularly the small and marginal category, the tax law is what is reflected in the Form. Therefore, the A-10 structure of the tax law has been designed so that it is capable of being logically reproduced in a Form.

(f) Consolidation of provisions: In order to enable a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated. Further, the various provisions have also been rearranged to make it consistent with the general scheme of the Act.

(g) Elimination of regulatory functions: Traditionally, the taxing statute has also been used as a regulatory tool. However, with regulatory authorities being established in various sectors of the economy, the regulatory function of the taxing statute has been withdrawn. This has significantly contributed to the simplification exercise.

(h) Providing stability: At present, the rates of taxes are stipulated in the Finance Act of the relevant year. Therefore, there is a certain degree of uncertainty and instability in the prevailing rates of taxes. Under the Code, all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself thereby obviating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate amendments.

FIGURE 1: SALIENT FEATURES OF DIRECT TAXES CODE



A BRIEF OF THE DTC HIGHLIGHT

Highlights of the New Direct taxes code are listed below:

- All Direct Taxes are integrated as a single Act.
- This Code structure will be effective from April 1, 2012
- It contains 16 Chapters, 285 Sections and 18 schedules.
- Previous year and Assessment year concept will be removed.
- Tax audit ceiling will remain the same.
- Corporate tax rate is proposed at 25 percent.
- MAT at the rate of 2 per cent of Gross Assets.
- No Surcharge and cess will be levied.
- Dividend Distribution Tax will be at 15 percent.
- Foreign Companies Branch office are liable to pay at 15 percent.
- Wealth tax rate @ 0.25 percent above 50 crores.
- TDS rates are maintained as it is.
- Advance Tax due dates and installments remains the same.
- Provisions similar to Section 14A and Rule 8D remains.
- VRS Gratuity and commuted pensions, taxable if not invested in approved savings, will be taxable on withdrawals.
- Government and Non-Government Taxation Difference removed.
- Standard deduction of 30% of NAV now made to 20% of Gross Net.
- Housing Loan Interest for Self Occupied house disallowed.
- Business Expenditure classified into three groups.
- Share Profit will be as usual, STT to be abolished.
- Capital Gains reinvestment will be allowed for one residential house and in Agricultural land.
- No carry forward of MAT credit.
- Limits on remuneration and interest to partners removed.
- Returns to be processed within one year, otherwise no demand notice can be raised.
- Tuition fees for children will be allowed to Individuals and HUF.
- Savings limit eligible for deduction increased to Rs. 3 lakhs from the current Rs. 1 lakh.
- Deductions like 80D, 80DD, 80DDE, 80U, 80E, 80 GG retained.
- Deductions for Co-operative societies, copyright royalties, patents are retained.
- Composite letting (with infrastructure) included in IFHP.

HIGHLIGHTS IN GENERAL

Earlier Income Tax Act and Wealth tax Act (Covering Income Tax, TDS, DDT, FBT and Wealth taxes) are abolished and single code of Tax, DTC in place.

1. Concept of Assessment year and previous year is abolished. Only the "Financial Year" terminology exists.
2. Only status of "Non Resident" and "Resident of India" exits. The other status of "resident but not ordinarily resident" goes away.
3. Earlier the terminology of Assessee 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.
   i. This helps any person to file his returns and maintain the record of tax return filing.
4. 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.
   i. In TDS, a new return, if found required, will be introduced for Non TDS payments.
5. Government Assessees is covered in Direct Tax Code. Even though they are not liable for Income Tax / Wealth Tax, Government Assessees are required to comply with provision of TDS and TCS. (Current act was not covered with Government Assessees).

NEW TAX RATES: (For Ordinary source of income)

Slab	Income Between	Tax rate
1	0 - 2 Lakhs	0%
2	2 Lakhs to 5 Lakhs	10%
3	5 Lakhs to 10 Lakhs	20%
4	Above 10 Lakhs	30%

Source: Ministry of Finance

For Female, no special provision and for Senior citizen it begins from 2.50 Lakhs Companies tax rate changed from 30% to 25%.

NEW DUE DATES FOR TAX RETURNS

Sl No	Type	Date	First filing (under DTC)
1	Non-Business / Non-Corporate	30th June	30/06/2012
2	Others	31st August	31/08/2012

TAX INCENTIVES

1. Earlier terms Deductions under Chapter VI A will be treated as Tax incentives.
2. 80C gets a major hit by introduction of EET methodology (Exempt - Exempt - Tax). The investment is Exempted when invested. The investment is Exempted till it is remained invested. The investment is Taxed when it is withdrawn.

a. Also, investments are considered only of those invested through savings intermediaries approved by PFRDA (Pension Fund Regulatory and Development Authority).
   i. Such savings intermediaries may in turn invest in ELSS mutual funds, government securities, Public sector securities, etc.
   ii. Such investments are also exempted to the maximum of Rs. 3 Lakhs.

b. All such savings will be governed directly by government by an appointed depository (an independent agency).

c. Other than this, Tuition fees for children will be allowed as deductions.

d. No maximum limits for this, as savings are charged once they are withdrawn.

3. Medical treatment, higher education loan interest, donation and rent paid by self-employed individual are deductible.
4. New provision comes for Handicapped individuals to get deductions upto 75,000.

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.
5. Employer part of PF paid will be exempt from tax as Tax Incentives under EET methodology (to employees).

HOUSE PROPERTY

- No deduction for Housing loan repayment of Self-Occupying property. This includes interest as well as part of principal.
- 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

1. Incomes are broadly divided into 2 sources, namely Special Sources and Ordinary Sources.
2. Special sources are given no deduction and what is earned is taxed directly (generally at a lower rate).
3. Ordinary sources are divided into further categories, namely:

a. Income from employment.
b. Income from House Property
c. Income from Business
d. Capital gains
e. Income from Residuary Sources (Similar to other sources, with some minuses)

ORDINARY SOURCES

1. The five categories of Ordinary sources can have multiple sources under each head (Eg: Multiple employer, Multiple Business, Multiple Properties, etc).
2. The income will be computed in two step procedure for each head:

a. Calculate for each source under each head of Income.
b. Aggregate the total under each head and arrive a total profit or loss under such head.

3. Then aggregate all the five heads and arrive the figure of "Current Income from Ordinary Sources".
4. 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".

a. If such result is negative, then Gross Total Income will be NIL and value will be treated as "Unabsorbed current loss from ordinary sources".

5. Such Gross Total Income will be further reduced by incentives similar to earlier Chapter VI (A) deductions. The resultant amount will be 'Total income from ordinary sources'.

SPECIAL SOURCES

1. This includes incomes like:
    a. Any assessee
        i. On income by way of winnings from
            - Any lottery or crossword puzzle
            - Race, including horse race (not being the income from the activity of owning and maintaining race horses)
            - Card game or any other game or gambling or betting.
    b. Non-resident
        i. On investment income by way of Interest, dividends on which distribution tax has not been paid, capital gains, any other investment income
        ii. On income by way of royalty or fees for technical services
    c. Non-resident sportsman who is not a citizen of India
        i. On income by way of participation in India in any games, advertisement or contribution of articles relating to any game or sport in newspapers, magazines or journals in India
    d. Non-resident sports association or institution
        i. On income by way of guarantee money in relation to any games or sports played in India.
2. The income on such way will be aggregated "Current Income from Ordinary Sources".
3. 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 Special Sources".
    a. If such result is negative, then Gross Total Income will be NIL and value will be treated as "Unabsorbed current loss from Special sources".
4. Such Gross Total Income will be calculated separately and adjusted will losses. Then the resulting values will be aggregated and the resultant amount will be 'Total income from Special sources'.

TOTAL INCOME

1. 'Total income from ordinary sources' + 'Total income from Special sources' = Total Income.
2. The losses can be carried forward for any number of financial years, with year on year adjustment system.
3. Loss under Capital Gains and Loss under Speculative business are ring-fenced and can be adjusted only against respective heads.

CONCLUSION

It is difficult to draw any firm conclusions about the DTC at this point of time. DTC has integrated all Direct Taxes as a single Act. The aim of the DTC is to simplify tax legislation minimize litigation, broaden tax base and eliminate tax exemptions in part to attract foreign business and investment. Although India is one of the fastest growing economies in the world, it still needs substantial investment before it becomes a fully developed economic power. Keeping that in

mind, the government will need to ensure the provisions of the DTC are implemented effectively and successfully to safeguard the country's long term ambitions.The Direct Taxes Code change in the whole taxation system of India. The new tax code aims to make the system more efficient and easy for tax payers, with simplified rules and regulations. It is a step towards replacing the five decade old Income Tax Act of India. DTC will surely help in the growth of our economy because the tax rate has been reduced for person who earns upto ten lakhs. This reduction in tax may motivate them to contribute their money in the development of the economy, like establishing business frims, building hotels etc., which play major role in the growth of economy.

ABBREVIATIONS

DTC- Direct taxes Code
EET- Exempt Exempt Tax
MAT- Maximum Alternate Tax
TDS- Tax Deducted at Source
CBDT- Central Board for Direct Taxes
UTN- unique tax reference number
TCS- Tax Collected at Source
ELSS- Equity Linked Saving Schemes Mutual Fund

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