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By Speed Post

Shri Pranab Mukherjee
Hon'ble Minister of Finance
Government of India
Central Secretariat, North Block
New Delhi - 110 001

Respected Sir,

On behalf of Calcutta Chamber of Commerce, we have pleasure in forwarding for your kind consideration a Memorandum giving our suggestions and comments on 'Draft Direct Tax Code Bill 2009", which may be of help in the preparation of the Final Draft.

With regards,

Yours sincerely,

S.K. Agrawal

Sushil Kr. Agrawal

Encl. As stated.

<u>Direct Tax Code Bill 2009</u>

Issues on Direct Tax Code for inclusion in joint proposal/presentation to the Hon'ble Finance Minister and also for interaction session with Hon'ble Union Finance Minister.

<u>Chapter II</u>

<u>Para 1</u> : Provision for liability to pay IT under clause 2(7) read with clause 284 sub-clause 274 requires clarification, since it includes surcharge, cess. It is understood that there would be no surcharge or cess under the DTC regime. Therefore, there is need of clarification for the same.

<u>Para 1.2</u> : **Residence in India**: A non Indian company would be treated as resident in India, if the place of control and management, at any time in the year, **is situated even partly** in India [(clause 4(3) (B)]. Such provision would have adverse impact on foreign company with no Indian branches, since holding of one board meeting in India would convert such foreign company an Indian resident company, as in one board meeting it can take decision on management and control of business in India. But this is not the object of the DTC.

<u>Chapter III COMPUTATION OF TOTAL INCOME</u>

<u>A- GENERAL</u>

<u>Para 2A.1 :</u> For the purpose of deduction for expenditure, the term unascertained liability has been used for restriction of allowing deduction- clause 17(1).
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- This term has not been defined in the code
- Where it means liability incurred or not
- Where it means quantification not ascertained
- In case of warranties and guarantee on sale of various goods manufacturer/seller has to provide estimated liability to be incurred in subsequent years and such liability is required to be deducted in the year of sale and can not be allowed as deduction in any of the subsequent year.

Para 2A.2: The proposed clause of DTC has disregarded mandatory Accounting Standard- (AS-4) events occurring after balance sheet date, which are compulsorily followed by all the companies under Sec.212 of the Companies Act.

<u>Para 2A.3</u> : Disallowance of expenditure for TDS defaults is draconian in nature. There is no doubt that compliance of TDS provisions has to be ensured and defaulters should be punished but total disallowances of expenditure exceed the limits of punishment. However, the deterrent provisions should be there under the TDS chapter in place of disallowance provisions under this chapter.

Moreover the restriction of deposit on TDS amount for allowability of the disallowed amount in the subsequent year has been restricted to two years, whereas such restriction does not appear in the current statute, presumably because of the reason that the assessee is at times unaware of its liability of TDS and can rectify its mistake once it is pointed via assessment order.

Therefore, it is suggested that even if our first proposal is not accepted by the Government and the liability provisions are retained, the provision for allowability of expenditure should be modified to deposit of TDS within a period of at least two years from the date of receipt of the assessment order.

Para 2A.4 : The restriction on allowance of deduction for expenditure in para 17(2) of DTC is stated. It is suggested that a clause should be included similar to Sec 37 of the current statute, which should provide – where specific deduction provisions are not applicable to any expenditure not being in the nature of capital expenditure or personal expenses of the assessee, laid out wholly or exclusively for the purpose of business or provision shall be allowed in computing the income.

C- INCOME FROM HOUSE PROPERTY

Para 2C.1 : As per the DTC Bill, long term lease tenure is 12 years or more, and in such cases security deposit/advance rent would be taxed as income. This proposal is deterrent to the growth of house building sector. It should be removed.

Para 2C.2 : Where the house property is let out with plant or machinery and the same is not separable, the income would be taxed under the head house property, whereas under the current statute such income is being assessed under the head income from other sources. The change of head has repercussion on deductible expenditure, which are spent wholly and exclusively for the purpose of letting out. On the contrary, under the head income from house property expenditures are allowed on a percentage of the gross rent only, whereas on actual such expenditures could not be more. Thus it amounts to taxing of unearned income.

Para 2C.3 : The presumptive deduction under the current statute is 30% of net rent and under the proposed law it is 20% of the gross rent. It is proposed that present presumptive deduction should continue under DTC.

Para 2C.4 : Housing sector growth in India is dependent to a great extent on purchase of self occupied property by assessees. The allowable deduction of interest on loan for acquiring of sale occupied property up to a sum of Rs.1.5 lac would no longer be available under DTC. Such proposal would have an adverse impact on the housing sector, as well as on medium income group Indian citizens.

Para 2C.5: Section 25(1) of the new Code provides that "gross rent" in respect of a property shall be the higher of the amount of contractual rent and presumptive rent for the financial year. Further, it has been stated that "presumptive rent" shall be 6 per cent of the ratable value fixed by any local authority in respect of the property or 6 percent of the cost of construction or acquisition of the property, if no such value has been fixed by the local authority.

We suggest that the actual rent should be taxed instead of presumptive rent. The computation of income on the said "presumptive rent" method is likely to adversely affect those owners/ landlords whose tenants are old and the rent amount is moderate. In those cases, if the actual rent is lower than presumptive rent, then considering the higher amount will not be justified and one will be required to pay tax on notional income, which he has not actually earned.

Para 2C.6 : A large number of companies are presently assessed on rental income received from house properties under the head income from business or provision under current statute. But according to the provision to the DTC Bill, such income would no longer be assessed under the business head but under the head of income from house property. The present system should be allowed to continue under DTC.

D- INCOME FROM BUSINESS

Para 2D.1 : Deeming provision has been ascertained in the DTC clause 29(2) where the business or unit is located physically apart from the other unit. Since intra head adjustments are allowed, what purpose would be served by deeming separate business for computation of taxable income is not known; rather it is a strange provision. It is likely to add confusion and complications, rather than simplification, which is the main thrust of the government in bringing DTC.

Para 2D.2: Capital receipts have been defined as gross earnings, clause 31(2)(xi) on account of slump sale; amount of reduction, remission or cessation of any liability by way of loan, deposit, advance or trade credit (such inclusion is quite distinct from Sec 41(1) of current statute), since under the new provision irrespective of the fact where the principal amount of loan is reduced or any expenditure which was not allowed as deduction in earlier year(s) would be included in the gross earnings of business. Both such inclusions in Gross earnings are highly objectionable. In this case, definition clause 234 of DTC clause 284 is relevant.

Para 2D.3:

In the computation of business income, the operating expenditure not to be allowed as an expenditure u/s 33(4) of the new Code includes any expenditure incurred by a person on advertisement in any souvenir, brochure, tract, pamphlet or the like published by a political party.

We feel it should be allowed.

Even political donations are allowed 100 per cent deduction. So there is no logic for disallowance.

E- CAPITAL GAINS

Para 2E.1: Direct Tax Code has abolished distinction between short term and long term capital gains. Capital Gains, irrespective of period of holding of the assets that has been sold are to be included in taxable income, subject to certain permitted deductions. However, tax slabs and rates are far more benevolent than under the current statute.

Para 2E.2: The term ‘net consideration’ has not been defined. The definition is a must.

<u>Para 2E.3</u>: Formula for calculation of tax free amount of capital gain should be related to the amount of capital gain rather than the amount of net consideration received on sale. To illustrate: net consideration received on sale of a long term house property is Rs.20 lac and capital gain thereof is Rs.8 lac. Under the DTC, the reinvestment amount should be full valued of net consideration i.e. 20 lac as per this example. On the contrary, under the current statute, the entire amount of the capital gain would be tax exempted (of the said example) since the new investment is not less than the gains. Further the conditions for exemption are restrictive in nature as compared to current statute. For example, exemption is available to the assessee if the assessee is holding one more house other than the reinvested house (presumably where the purchase precedes the sale). But under the DTC, the assessee should not own any other house (other than the reinvested house). Section restrictive condition in the Bill in the period allowed for re-purchase of house has been reduced from the current statute in the DTC Bill. It is proposed that the time for the investment should not be reduced in the Bill.

<u>Para 2E.4</u>: As per present provisions, transfer of capital assets in a scheme of reverse mortgage is not considered as taxable transfer. Such exemption is not provided in the new code. As a result, the transfer of capital assets in case of reverse mortgage may be treated as taxable capital gain.

Reverse mortgage may be included in the list of items provided in section 45 so that it shall not be included in the computation of capital gains.

This will ensure benefit to the senior citizens and provide them security in the old age.

<u>F- RESIDUARY SOURCES (OTHER SOURCES)</u>

<u>Para 2F.1:</u> Section 48 and section 56(2)(h) of draft code provides for charging capital gains tax on transfer of immovable assets by the investors on the basis of stamp duty valuation. Further, stamp duty valuation is defined as the value adopted or assessed or assessable i.e. the value which the stamp valuation authority would have adopted if it were referred for the purpose of stamp duty.

The Government may rather re-enact the provisions of pre-emptive purchase of immovable property exceeding a specified amount of say Rs. 1 crore or more, by Central Government. Such scheme will spare the purchasers of smaller flats from unnecessary tax burden. In any case, even if the proposed system is adopted, flats or properties of certain measurement, say upto 1000 sq. ft. built up area or those costing upto Rs. 25 Lakhs may be kept outside the purview of the provisions of section 48 of the new Code.

Valuation made for stamp duty does not reflect the consistency and it is not based on the real value. It is rather adhoc. No inspection takes place. There are no qualified engineers in the office of Registrar to make proper valuation. The said basis imposes tax on the notional basis and not on the basis of real income.

Para 2F.2: While serial No11 of the Sixth Schedule of the New Code which deals with "income not to be included in the total income" gives specific reference to accumulated balance outstanding as on 31-03-2011 in Employees Approved Provident Fund and any accretion there to, it is silent with respect to PPF and other insurance or superannuation schemes. Why this discrimination among existing Provident funds and other long term saving schemes? While the Government's discussion paper on the new code [paragraph 12-7] states this exemption will be available to GPF, PPF,RPF and EPF, the same is not to be found in the sixth schedule of the new code and it states only about EPF.

H- TAX INCENTIVES

Para 2H.1 : **Tax Incentives (Deduction) – EET**

The code proposes to usher in EET regime. Contribution to retirement benefit funds will be tax deductible (exempt), the accruals during the tenure of the scheme will not be taxable (exempt). However, tax will have to be paid on any withdrawal (tax), there will be grand fathering for PF accumulations up to March 31st, 2011. However clarity is needed on the tax treatment of withdrawal of interest on such accumulations arising after that date. There is a paradigm shift from exemption of retirement benefits to tax deferral. One is not sure whether this provision can be implemented especially in the case of withdrawal from the Provident fund. The regime needs to be properly set up. The tax payer should get appropriate credit for tax withheld from the income. Past experience from similar scheme like NSS was not pleasant.

Para 2H.2 : Under EET regime, as per the draft provisions, receipt of life insurance maturity money by legal heir would be liable to tax and tax liability on person other than the assessee, who made deposits, is highly objectionable. Moreover it would be anti insurance sector measure.

Para 2H.3: Under the current statute, an assessee is not in taxation net even if the assessee deposits insurance premium in excess of present limit of Rs.1 lac for deduction and he receives insurance maturity value. But under the proposed provisions, the assessee would be taxed on two occasions, firstly when he deposits insurance premium in excess of Rs.3 lacs (limit for deduction proposed), since it would be taxed income on deposit and secondly he would be taxed at the time of withdrawal. This will provide as disincentive for the growth of insurance sector.

Para 2H.4 : Under the proposed law, employers contribution on PF would be taxed in the hands of employee on maturity, which is totally tax free under the current statute. Such provision would be affecting almost all salaried taxpayers.

Para 2H.5 : A person being an individual shall be allowed a deduction in respect of any amount actually paid by him in the financial year by way of interest on loan taken by him from any financial institution for the purpose of
a) pursuing his higher education, or
b) higher education of his relatives.

A person being an individual shall be allowed a deduction in respect of any amount actually paid by him in the financial year by way of interest on loan taken by him from any financial institution or bank or any approved non profit organization.

The motive behind this deduction is to encourage the spread of education and therefore the deduction should also cover the loans taken from the banks and non profit organizations covered by sixteenth schedule of the code.

Para 2H.6 : The deduction under this section shall not be allowed in respect of any amount of money paid to any person referred to in sub-section (1) if
a) the amount is laid out or expended during the financial year for any religious activity or
b) any activity of the donee is intended for or actually benefits any particular caste, not being a Schedule Caste or Schedule Tribe.

This provision should be omitted.

Once a donor makes any donation to a non profit organization which has been approved by the prescribed authority, he does not have any control or right over the donee's affairs. Hence, it would be unjustified to penalise a bonafide donor for the lapses committed by the donee subsequent to the donation is made. Instead, monitoring of such non-profit organizations be strengthened.

CHAPTER – IV – NON PROFIT ORGANISATIONS

Para 3: Summary of suggestions for this chapter are:

(i) The concept of a charitable or religious society or a charitable and religious society should be retained, as also the concept of income applied for charitable or religious purpose.

(ii) A certain percentage of their income (15-20%) should be allowed to be retained for general and running expenses.

(iii) (a) They should be allowed to accumulate funds for their objects for a period up to 5 years. This should be treated as income applied for charitable or religious purposes.

(b) They should also be allowed to a form a "corpus fund" out of their income, which corpus would be subject to the same conditions as corpus formed out of donations and this should not be treated as income, but like donation by others for corpus.

(iv) Educational institutions and hospitals per se should be exempted from tax if they are wholly or substantially financed by Government or if their gross receipts do not exceed a specific limit (say Rs.2 crores) and included in the Seventh Schedule.

(v) Religious societies, the benefit of which is not restricted to private religious purpose, should be eligible for tax exemption, even if they are not registered under the Central or State legislation for regulation of religious endowments or trusts.

(vi) Capital expenditure should be allowed as outgoing even if it is not in an investment asset, e.g., works of public utility; or buildings for educational institutions; hospitals; pilgrim houses, etc.

(vii) Tax exemption should continue to be granted to charitable and religious societies in existence before passing of the new legislation. Any new regime should apply to societies and trusts formed after coming into force of the new legislation.

(viii) Government grants should be excluded from gross receipts. They are subject to their own conditions.

CHAPTER – V & SECOND SCHEDULE (MAT)
Para 4:

Tax on gross assets on banking companies @ 0.25% and in case of any other company @ 2%

(a) Present system of charging tax on the basis of MAT on the companies may be retained.

(b) Alternatively, we suggest that all exemptions and deductions in aggregate should be pegged at 70% of gross total income and therefore such assessees will be compulsorily paying tax on the balance 30% of GTI. In this system, there will be hardly any room for grudge and loss making companies will be spared from unnecessary burden. In that case, we also suggest that wealth tax on companies may be continued subject to the new exemption limit.

(c) Without prejudice to our suggestion above, we state that no provision has been made for reduction of liabilities and debts owed by the company in computing the gross assets. We suggest that even if the Government continues with the model of charging MAT on the value of gross assets, all liabilities including debts owed by the company should be allowed to be reduced from the value of gross assets.

(d) MAT credit carry forward will not be allowed in the new regime. The non-availability of MAT credit will result in MAT being a permanent cash outflow. Presently, it is permitted to be carried forward for 10 years. Thus we suggest that MAT credit carry forward should be allowed.

In our view, charging of tax @ 2% of value of gross assets for companies (other than banking companies) is not proper, as firstly, it is not logical to assume profit on the basis of value of assets and secondly, if this process is followed many loss making companies will be adversely hit. The profitability or business results depend on so many factors in today's competitive world. As a result of the proposed asset based tax, the loss making companies will also be required to pay tax. Instead, present system of MAT is more logical and may be retained under the new Code.

CHAPTER –IX – SPECIAL PROVISIONS TO PREVENT EVASION

Para 5 : We feel that under the garb of general anti evasions rule (clause 112 of DTC), CITs are being provided with wide ranging & excessive powers which would disregard genuine business transaction.

The unbridled power given needs to be reviewed and toned down so that the CIT is not allowed to disregard the genuine business transactions. The provision of treating/deeming connected persons as one and the same person under sub clause (c) and (e) of section 112(1) is totally uncalled for. The power to recharacterise equity and debt as also to recharacterise revenue and capital expenditure under sub clause (g) of section 112(1) are not desirable.

The change suggested will prevent the taxpayers from suffering from undue hardships.

CHAPTER – X

TAX ADMINISTRATION & PROCEDURE

Para 6.1 : Clause 166 of the Code contains the provisions relating to re-opening of assessments**.**

Following suggestions are made in this regard -

(a) It seems that no time limit has been prescribed for the reopening of assessments in cases other than search cases. A time limit of four years may be prescribed.

(b) Prescribed time limit for search cases is seven years, which may be reduced to four years.

(c) The provision of reopening of assessments in the case of any other person in search cases be resorted to only if any material is seized or is obtained in pursuance to the requisition u/s 140 suggesting undisclosed income of that "other person".

(d) Re-opening should not be done on the basis of a decision rendered by the Appellate Tribunal, NTT and High court in the case of a person other than the assessee since such decisions do not attain finality until an order is passed by the Supreme Court.

Para 6.2:

Under clause 166, very wide powers are proposed to be given to the AO to reopen the assessment within 7 years. At present the AO cannot reopen the assessment if all particulars have been disclosed at the time of the assessment or on change of opinion. This concept is now proposed to be given up. The powers given to the AO, under the Code include power to reopen under following circumstances also-

(a) if there is a decision prejudicial to the assessee by ITAT, National Tax Tribunal, High Court or Supreme Court in the case of the assessee or any other person either under the income tax Act, or under the Code or under any other law.

(b) If original assessment is not in accordance with any other direction, instruction or circular issued by CBDT.

(c) if there is any audit objection by Comptroller and Auditor General of India.

With these unlimited powers, the assessment will not be finalised for number of years and it may lead to harassment of the honest assesses and may lead to unethical practice.

Para 6.3: Section 167(6) of the Code provides that applications for rectifications of mistakes apparent from record shall be decided within a period of six months failing which an order shall be deemed to have been made rejecting such application.

It is suggested that the provision be modified to ensure the automatic allowance of application in case the order is not passed within the stipulated period. And at the same time the erring officers should be asked to explain their dereliction of their duty.

The proposed provision does not reflect judicious approach and rather puts premium on the inefficiency of the departmental officials. It will provide incentive to not to act.

Para 6.4 : Provision of Section 194(8) provides for the circumstances for the revision of orders prejudicial to the revenue.

SLP granted by the Supreme Court should not be made the basis for the exercise of revisionary jurisdiction of the Commissioner. SLP granted is the prima facie view of the Supreme Court and not the final view. Changes suggested would reduce the hardship of the taxpayers and unnecessary litigation.

Para 6.5: Condonation of delay in filing of appeal by CIT(bill) and ITAT has been restricted to one year after the expiry of 30-60 days time limit allowed for filing [(refer clause 184(5) and 188(6) of DTC].

Para 6.6: The revision of orders by CIT as clause 194 order relating to appeal pending before higher authority can be revised by the CIT as per clause 194(8) of DTC, which provides Provision of Section 194(8) provides for the circumstances for the revision of orders prejudicial to the revenue.

Further, SLP granted by the Supreme Court should not be made the basis for the exercise of revisionary jurisdiction of the Commissioner. SLP granted is the prima facie view of the Supreme Court and not the final view.

Changes suggested would reduce the hardship of the taxpayers and unnecessary litigation.

<u>Para 6.7</u>: Appeal

All orders of the Assessing officer should be made appealable to CIT(A) and all orders of commissioner/Chief Commissioner must be made appealable to Tribunal. Similarly all orders passed with approval of Commissioner (rather than only of the Chief Commissioner as proposed) must be made appealable to Tribunal. Considerable litigation has taken place to decide whether a particular order is appealable or not.

<u>Para 6.8</u>: Appeal to High Court

Section 260A of the Income tax Act 1961, provides an appeal to High court, whereas the new Code does not make any such provision to file an appeal to High Court. Clause 192 of the Code provides an appeal to National Tax Tribunal. The constitutional validity of National Tax Tribunal is still pending before the Apex Court, and as the pendency has been reduced considerably before various High courts and Tribunal, whether the country really needs a National tax Tribunal is itself debatable. Hence, it would be appropriate if a provision is made for filing an appeal to High Court.

<u>Para 6.9</u>: Power of Revision

Clause 194 gives very wide power to the Commissioner to revise the order passed by the Assessing officer. At present, the assessee can file an appeal to the Tribunal against the order of Commissioner. However, no provision is made to file an appeal to the Tribunal against an order of revision by the Commissioner under Clause 194. The assessee has no option but to file a writ against the order of Commissioner and this will increase the litigation. It would be very appropriate to provide for provision for an appeal to the Tribunal against such an order.

Section 264 of the Income Tax provides that an assessee can approach to the Commissioner for revision of order passed by subordinate authorities under certain circumstances. However, the Direct tax Code does not provide for any such provision for approaching to the Commissioner. It is very essential to have provision similar to section 264 in the code to render justice to the assessee.

<u>CHAPTER –XIII - PROSECUTION</u>

<u>Para 8:</u>

Section 245(1) of the draft code provides for Presumption of existence of a culpable mental state on the part of the accused person in a prosecution case under the Code.

In a prosecution case, the existence of culpable mental state should be proved by the revenue. A person should be prosecuted only on willful violation of the provisions of the Act and the burden of proof should be on the revenue.

It is the duty of the prosecution to prove such guilt. The deeming provisions of culpable mental state are totally improper and against the settled law. It is surprising that the accused will be burdened to prove a negative fact i.e. that he was not guilty. In a democracy, where rule of law is to prevail such provisions should not be enacted.

CHAPTER –XV – GENERAL

Para 9.1 : Deemed service of notice clause 264 (2) and (3):

DTC has provided for deemed service of notice on 5th day after the day on which a notice is sent by post or by courier service. For failure of postal department and courier service providers the assessee may have to suffer due to such proposal. Moreover sub cl (3) provisions are more draconian in nature which states that regardless of the fact that the notice etc has not been actually received by the person, the notice would still be deemed to have been served on the assessee. Thus the said proposal would legalize all settled issues on failure to follow Principals of natural justice as applicable to taxation laws.

OTHERS:
1. Accountability.

What is missing in the Code is provision relating to accountability. e.g. when a refund due to the assessee is not granted within the time specified under the Act, the assessee may have to file an appeal and pursue the remedy. No questions will be asked to the Officer why no refund is granted. Similarly, the Officer may make huge addition knowing well that the said additions will be deleted by the appellate authorities still no question will be asked to the Officer as to why he has made such an addition. We therefore are of the opinion that the accountability provision should have been introduced as recommended by Dr Raja Chelliah in his committee report. (1992) 197 ITR 257 (ST).

2. Tax Services

The approach of the tax officials must be changed from 'tax collection' to 'tax service', which aspect is conspicuously missing in the Code. The Government should have stated in the preamble that as they are relying on voluntary compliance of the assessee based on a certificate of Chartered Accountant. The attitude of the tax officials must be changed from 'tax collection' to 'tax services'.

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