CALCUTTA CHAMBER OF COMMERCE

SUGGESTIONS ON

THE DIRECT TAXES CODE BILL 2010

INDEX

Suggestions on

Direct Tax Code Bill 2010

1) Introduction

It has been endeavor of the Union Government and desire of several Chambers **to achieve the goal of simplification and rationalization of direct taxes** while introducing new legislation and amendments to the existing legislation. If the government really desire to simplify the tax law, one has to look at the recommendations of various Committees set up (so far) by the government including Task Force on Direct Taxes (Dr. Kelkar Committee), Tax Reform Committee (Dr. Raja J. Chelliah) and a committee of experts should be formed at present date to discuss the provisions of the Bill thread bare. And such committee should travel all parts of the country, interact with judiciary, members of tribunal, tax professionals, tax officials, tax payers and experts in Information Technology and thereafter the new Code should be introduced in the Parliament for enactment. It is our earnest request to the Standing Committee on Finance of Parliament for considering these aspects before submission of its report to the Parliament.

2) Accountability

2.1) At present Assessing Officer can freely over assess the taxable quantum, raise tax demands (high pitch demand) without causing reasonable grounds and yet remain unaffected, concerned over the high pitch demands in their zeal to fulfill their targets, whereby the assesses are the most sufferer. There are innumerable reports where assessing officer recommend to the Commissioner/Collector in more than 90% of cases, where first appellate authority had deleted additional demand made in the taxable amount and did not sustained the additional demand, had referred the second appeal to the tribunal. As such officers do not loose anything even if the tribunal rules against their action. Dr. Raja J Chelliah Committee had recommended in its report, Para 5.9-(1992)197 ITR 257 (St.), that the assessing officer should be made accountable for their actions by being blamed for raising demands which are not uphold by the tribunal.

The DTC Bill had not addressed accountability of officers issue at all. We strongly suggest that accountability provision should be introduced in the DTC Bill.

The complexities introduced in place of simplification are dealt separately hereinafter.

2.2) **Introduction of Performance Judgment Mechanism (Accountability)**

We would like to stress upon the need of accountability regarding allocation of budgetary expenditure and actual funds under each head. The resources of funds are scare and requirements of funds are more because of developmental activities including infrastructure. The need of hour is optimum use of limited resources of funds. It requires plugging the loopholes and leakage of revenue generation and tracking of utilization and distribution of fund.

In the budgetary exercise future prospect and budgetary allocations are discussed at length and there is no scope of comparison of budgetary allocation of previous period with actual utilization and use of such budgetary allocations. There should be major thrust on performance along with future prospect. To judge the performance there is a greater need of **accountability**, which will require the information to Indian citizen about the budgetary allocation, made and actual amount spent under each budgetary heads. Similarly there is a scope of optimum use of limited resources of fund. It may be achieved by blocking the leakage of fund in the course of utilization and distribution.

3) **New Tax Policy vs. Policy on Investment and Policies to boost Growth:**

Following the opening up of Indian economy, foreign investment had grown exponentially, contributing greatly to India's economic growth besides higher growth of domestic savings and investments. India still need significant amount of foreign investments for its future growth. Towards achieving this goal the introduction of DTC should play positive role, which would attract quality foreign investment in order to spore investment and boost growth. Following adjustment are required to achieve this target.

a) Maximum tax rate should be moderately reduced to 25% from 30%.
b) A concept of a residential status of a company, permanent establishment and royalties have been the subject of prolong litigation, resulting in uncertainty in tax regime in India.
c) The introduction of General Anti Avoidance Rule (GAAR) under the DTC Bill exaggerate the existing problem, as GAAR confers vast powers on the tax authorities in this regard or recharacterise transactions perceived to be avoidance transactions. There is high probability of increased tax uncertainties in future.

4) Indian Investment Abroad

Investment made by Indian companies in global market provide opportunity to Indian company to compete globally and provide access to new markets leading to growth in production resulting growth of GDP and overall tax limit. There is hardly any incentive to Indian industry and business for assisting Indian economic policy to achieve this goal. Rather the new rule of residential status as per DTC Bill, could bring overseas subsidiaries of Indian companies as Indian resident company, resulting increased the tax burden of Indian business houses as compared to business houses of other developed countries of the world causing absence of level playing field.

5) Absence of Long Term Tax Policy in the Bill

The lack of certainty in Indian tax regime and frequent tax litigations are major hurdles faced by Indian and foreign investors in India. Frequent legislative amendments do not serve the desired goal and often provide reasons for completing judiciary pronouncement and litigations.

6) **Some of the specific clauses of the Bill required considerations, which are summarized hereunder:**

6.1) Clause 4(3) – residents in India – a company:

Sec 6(3) of the present act provide that a company shall be resident in India, if the control and management of the company is situated only in India. But in the Bill clause 4(3) provides if

company's control of effective management, **at any time in the year** is situated in India. Clause 314(192) of the Bill defines the term place of effective management. The present law is settled by virtue of a number of Apex Court's and High Courts' decision. There is no need of unsettling the law by introducing new terms other than the present law, which would cause hindrance to the economic growth of the country.

6.2) **<u>General Anti Avoidance Rule (GAAR)</u>**

Through this concept wide powers are proposed to be given to the Commissioners. It provides for arrangement entered into by a person as "**an impermissible avoidance arrangement**". The manner in which the new provision would be applied will be prescribed by notification. It would be presumed that the tax payer had entered into the arrangement for the main purpose of obtaining tax benefit unless otherwise proved by the tax payers. It is implied that GAAR provisions shall overwrite all other provisions of the law including double taxation avoidance agreement with several countries.

So far we have understood and the Apex Court had held that tax planning is permissible and tax avoidance is not valid. But the proposed provision of GAAR would override all such Supreme Court decisions, if enacted in present form.

6.3) **<u>Clause-18</u>** : Expenditure not to be allowed as deduction in respect of exempt income under Sixth Schedule. Sec. 14A read with Rule 8D had caused large number of litigations. Such litigations are likely to be continued in large numbers because of provisions of clause 18 of DTC Bill. Following suggestions are, therefore, made for reducing the litigation while keeping the intention of the legislature :

a) Unless there is an excess between earning of exempted income and expenditure incurred by the assessee in relation to such income. No disallowance should be made.
b) Disallowance if at all made under any prescribed rule should not be more than the actual income claimed to be exempted. (At present because of the formula prescribed in rule 8D, disallowances made by the assessing officers had far exceeded the income exempt from tax).
c) The principle of disallowance the expenditure incurred by the assessee in relation to exempt income is acceptable but the mode of its implementation and bring indirect expenditure into the network of disallowances is contrary to the said principle.
d) The term used in the clause 18 is expenditure, **attributable to income** which is not included in total income under the Sixth Schedule as against the same the term used in the present Act is expenditure incurred by the assessee in **relation to income**.

There are several Supreme Court and High Court decisions which had elaborated upon the terms used for "in respect of" / "in relation to", under the present Act - Sec. 14A. But "attributable to", a new term had been used under clause 18 of the Bill. The term "attributable to" would be much wider than the term "in respect of" and "in relation to".

It appears that the DTC Bill desires to increase the number of litigations between the tax payers and tax department through insertion of such terms in the DTC Bill.

6.4) Clause 7 of the Bill – <u>Employer Contribution to different fund -deemed income of the Employee.</u>

Under the present Act employer contribution to PF and ESI etc. are not considered as income under the head salary of employees. But clause 6 of the DTC Bill provide contrary to the same and said that such contribution made by an employer to the account of employee would be deemed to be income received by the employee during the Financial Year. It is highly controversial and non-acceptable charging provision under the DTC Bill which would effect adversely a large number of tax payers in India.

6.5) <u>Taxation of Charitable Trusts/Institution (Non-profit organizations – NPOs)</u>

Chapter IV of the Bill contained the special provisions relating to computation of total income of NPOs.

- NPOs should not loose exemption if one portion of its activity is considered as business activity along with several major philanthropic activities carried out by such organization. Rather business income portion of the activities should be taxed at marginal rate.

- Clause 103 of the Bill in its present form does not produce the desired result of simplification of law. 1st and 2nd proviso to Sec 3(3) of the present act conveyed the intention of the legislature, but clause vi of 103(b) clause of the Bill requires redrafting accordingly.

It is suggested that the said clause vi may be substituted as under.

"103(b)(vi) ***advancement of any other object of general public utility,***
Provided that where advancement of any object of general public utility involves the carrying on of any activity in the nature of trade, commerce or business or any activity of rendering any service in relation thereto, for a cess, fee or any other consideration(irrespective of nature of use, application or retention of the income from such activity), not being an activity referred to in Sec 93(1)(c), the income from business exceeding Rupees 10 lakhs shall be taxed at Maximum Marginal Rate."

Similarly clause 102 of the Bill may be amended- substituted as per following suggestions:

"102. Notwithstanding anything contained in chapter IV any person shall be liable to tax at maximum marginal rate on the specified income for the relevant assessment year as under:-

(1) On the business income even when the person:-

(a) holds any business under trust, notwithstanding any specific direction that -

(i) the business shall form part of the corpus of such person; or
(ii) *the income from the business shall be applied only for charitable activity;*

(b) on the income in respect of which the person fails to comply with the conditions specified in section 97;

(c) on the entire income for the relevant year if it ceases to be a non-profit organization at any time during the financial year, irrespective of registration granted under sub-section (4) of section 98;

(d) on the business income if it is not a business incidental to charitable activity.

(2) Without prejudice to sub-section (1), the non-profit organization which ceases to be so due to conversion, merger or dissolution as referred to in sub-section (1) of section 101 shall be liable to income-tax in respect of its net worth in accordance with that section.

(3) The total income of any person falling under clauses (a), (b), (c) or clause (d) of sub section 1 shall be computed in accordance with the provisions of this code."

The above suggestions will simplify the tax provisions and protect the NPOs from the scope of litigations.

- The present Act provides concessions to trust/institution created or formed before the commencement of 1961 Act and it exempted them from the provisions of inactive category provisions of Sec 13 of the present Act. Thus they are entitled to exemption from taxation. However, such privilege have not been mentioned under clause 97 read with clause 314(169) of the Bill, which corresponds to Sec 13 of the present Act. It requires modifications.

It is observed that the benefits available to organizations created before 1st April 1962 for benefit of any religious community have been omitted in the Bill. Such omission has far reaching consequences for trusts/institutions/organizations (created before 1st April 1962) which presently continue to enjoy tax exemption under the present Act. Since there is neither any declaration nor intention of the Government Legislature for withdrawing tax exemption for such organization, we are confident that this suggestion would be accepted by the Standing Committee on Finance.

The Bill is silent about the trust/institution, partly religious and partly charitable organizations. Discussion Paper on DTC 2009 contained a provision relating to partly religious and partly charitable institutions. It was provided that in case the trust deed/memorandum of the institutions contains a clause specifying the application of its gross receipts in the pre-determined ratio between charitable and religious activities the trust would be entitled to exemption in respect of the income from public religious activities. The income from charitable activities of the trust would be governed by the provisions as applicable to NPOs.

- Clause 93(1)(b) provide for inclusion of rent received from a property held by NPO in the gross receipts from a charitable activity. Clause 94 provides for amount of taxing for the purpose of computation of income but clause (a) excludes any capital expenditure for any receipts referred to Sec 93. It means that under the Bill capital expenditure would not be

treated as application of the trust income. This provision is highly contrary to the basic root of the charities law as prevailing in India so far. It has been held by several courts and supported by present Act that when the income of a trust is spent for construction or acquisition of assets for the purpose of carrying of the charitable activity of the trust/institution, it is treated

as application of trust income. It is, therefore, suggested that the provision containing *"not being capital expenditure"* as contained in clause 94(a) should be omitted.

- Repayment of loan taken by NPOs for application of fund towards charitable activities should be considered as the application of trust income, as is being considered under present law.

- Clause 94(f) provides for accumulation of income to the extent of 15% of total income or 10% of the gross receipts whichever is higher. Clause 95 of the Bill further provides that such accumulation shall be treated as income of the NPO, if it is not invested or deposited the mode specified in clause 95. It is suggested that there is no justification of reducing accumulation allowed upto 15 % of trust income and the present period of 5 years to 3 years in clause 94(f)(i) & (ii). It should be 15% of trust income and not less than 5 years as per the present Act.

- There is no specific mention about deduction of administrative expenditure in different sub-clause 94. It is suggested that in order to simplify the law and to avoid litigation, specific provision should be inserted in clause 94 for allowing the same as an amount of outgoing for the purpose of computation of total income.

- The present benefit of investment out of capital gains U/s 11(1A) of the present Act is missing in the DTC Bill provisions. It is suggested that the present benefit given to NPO as per Sec 11(1A) may be retained by specific sub-clause in clause 93(d) of the Bill.

6.6) Clause 159 and 163 – Reopening of assessment and search and seizure.

The reopening of assessment and regulation pertaining to the search and seizure matters are incorporated in clauses 159 and 163.

As per the new provision if the Assessing Officer has a reason to believe that any tax base chargeable to tax has escaped the assessment for the relevant assessment year, he can reopen the assessment. He only has to record the reasons in writing. The scope of deemed escaped assessment is widened to include the cases where for eg. (i) Computation or assessment has not made in accordance with any order, direction, instruction or circular issued by the Board. (ii) Any objection has been raised by the Comptroller and Auditor General of India to the effect that the assessment has not been made in accordance with the provisions of Income Tax Act. Concept of change of opinion is done away with. As per present sections 147 to 152, 153A to 153C, Assessing Officer may assess or reassess such income other than the income involving matters which are subject to any appeal, reference or revision; such restrictions are not there in the proposed Code. For issue of notice the period is extended from the present six years to seven financial years immediately preceding the financial year in which the search and seizure has been carried out or material has been obtained. If the present code becomes an Act, there cannot be any finality to the assessment though the assessing officer might have

applied his mind and passed the speaking order. It is desired that the present provision of law may be retained.

6.7) Clauses 179(3) (b) – Power of CIT(A), 183(7) – Power of Tribunal, Clause 192(6)(b) – Power of Commissioner

As per the new code Appellate authorities have no power to condone the delay beyond one year. There may be delay due to mistake of tax consultant, or due to any other genuine reason at ax payers' end. As there is no power to condone the delay, the assessee may have to approach the High Court by way of writ. Whereas under present law there are no such restrictions, but if the CIT (A), CIT or Tribunal is satisfied, they may condone the delay. It is suggested that present provisions of law may be retained in this matter.

6.8) Clause 181 – Power of CIT(A)

Clause 181 provides for extending the power of the CIT(A) while disposing an appeal to consider and decide on any matter which has not been considered by the AO. No such power is there under the present income tax Act under section 251.

6.9) Clause 182 (6) – Chief justice of High Court to head the Income Tax Appellate Tribunal.

As per clause 182(6), the Central Government may appoint a person who is or has been a Chief Justice of High Court to be the President of the Appellate Tribunal. Under the present Income Tax Act the President of ITAT is selected amongst the Sr. vice president and Vice presidents on merit by a committee inter alia consisting of senior most judge of Supreme Court, and the system is working satisfactorily. At present the Income Tax appellate Tribunal has benches in 27 Cities having sanctioned strength of 126 members.

It may be noted that most of the other Tribunals are constituted of retired employees and Judges who are appointed for fixed tenure ranging from 3 to five years and even the Benches are in not more than three places, hence other Tribunals cannot be compared with the Income Tax Appellate Tribunal. Normally a Member is selected as President after serving more than 20 Years in the Tribunal. As a Member he has to undergo transfer at least once in four years. When a person is selected as a president he is fully aware of functioning of various benches of Tribunal, knowledge and integrity of each and every member which makes him to discharge his duties more efficiently. Bringing an outsider, may affect the functioning of Tribunal. For the last 69 years the Government was satisfied with the functioning of Tribunal and there is no reason to bring an outsider to head the Institution, unless there are advantages to be gained by appointing a sitting or retired Chief Justice of High court. The legislature has not given any one reason how the institution will be benefited by bringing a retired Chief Justice to head the institution. Further, as the order of Tribunal is subject to challenge before the High Court, according to me it will lower the status of Chief Justice of the High Court. I am of the opinion that as the present system is working satisfactorily there is no need to bring an outsider to head the institution.

6.10) Clause 186(5) – Constitution of Special Bench

As per the clause 186 (5), the President shall on a reference received from the Board for disposal of any particular case, constitute a Special Bench consisting of Five members or more. The wording "shall" means whenever the reference is received from the Board the President shall constitute a special Bench. It may lead to interfering with the judicial functioning of the President. As the law stands today, the president may constitute a special Bench considering the importance of law involved and not on a particular case at the sweet will of the Board.

6.11) Clause 257 – Authority for Advance Ruling and Dispute Resolution

As per the qualification fixed for appointing vice Chairperson is concerned, even the ITAT members who has completed more than 7 years of service may be considered as eligible for the appointment as vice chairperson and members who have completed 5 years of service may be considered as eligible for appointment as members of authority for Advance Ruling and Dispute Resolution. By Qualification and experience the members of the ITAT are most suited as members of Authority for Advance Ruling and Dispute Resolution.

6.12) Clause 234 – Penalty- Bar of limitation for imposing penalty

Section 275(IA)(a) of the present Act, specifically state that no order of imposing or enhancing or reducing or cancellation of penalty or dropping the proceedings for imposition of penalty shall be passed (a) unless the assessee has been heard or has been given reasonable opportunity being heard.

However, clause (a) is missing in proposed clause 234. It may be desired that old provision may be retained.

6.13) Clause 268(3) – Settlement Commission – Qualification for Members

As per the proposed clause the Chairperson, Vice chairperson and other members, shall be appointed by the Central Government from amongst the officers of the Indian Revenue service who have served for last twenty years in the service including at least five years in the rank of Commissioner or above.

As per section 245B (3) of the Income Tax Act 1961, the members can be appointed from "amongst persons of integrity and outstanding ability having special knowledge of and experience in problems relating to direct taxes and business accounts."

Federation has made representation to Government from time to time to appoint at least few professionals from the field of law and accountancy which will benefit the institution. Federation once thought of filing the PIL why no professionals have been invited to join the settlement commission. As per the Direct taxes code only departmental officials can be appointed, only qualification is number of years of service and the requirement of men of integrity and outstanding ability. Such a good provision has been given a go by without any reason. An ideal settlement commission should consist of a member from the department, one from the legal field and one from the field of accountancy.

6.14) Prosecution

1. In many of the sections of the present Income Tax Act, there was no minimum fine prescribed. Now as per the code, the minimum fine is Rs 50000. Judge has no discretion to reduce the minimum fine.

2. **Clause 252 – Prosecution to be at instance of Chief Commissioner or Commissioner**. Section 279(1A) of the Income Tax 1961 provided that "A person shall not be proceeded against for an offence under section 276C or section 277 in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable on him under clause (iii) of section 271 has been reduced or waived by an order under section 273A., Where as such a good provision is omitted in the code.

3. **Clauses 243 and 244 – Willfully Failure to furnish statements, reports etc. and willful failure to comply with direction under this code**.

Two new clauses have been introduced, as per clause 243 if a person willfully fails to produce or cause to be produced ,on or before the date specified in any notice served on him under sub clause 2 of clause 150 (Notices for enquiry before assessment) such accounts and documents as referred to in the notice, he shall be punishable with rigorous imprisonment for a term which may extend to one year or with fine equal to a sum calculated at rate which shall not be less than fifty rupees or more than one hundred rupees for every day during which the default continues or with both. Similar punishment is also prescribed as per clause 244 for failure to comply with the direction as per clause 151(1). (Special audit)

6.15) Clause 314 (215) – Remission or cessation of any liability.

As per clause 314 it includes remission/ cessation of any liability, by virtue of there being no transaction with the creditor during the period of five years from the end of the financial year in which the last transaction took place.

That means any credit in the book beyond five years will be treated as income of the assessee, whether the assessee may be disputing or some litigation may be pending.

6.16) Recovery and attachment-. Mode of Recovery-Gift held to be Invalid – Fifth Schedule. Rule 3(2).

In fifth Schedule, provision of rule 3(2), has permitted the TRO to challenge transfer to spouse, or minor child, otherwise than for adequate consideration. However there is no time limit provided as to how far back the transfer can be challenged. There has to be time limit to be fixed. It may be reasonable to fix one year prior to arising of tax liability by passing of order by Assessing Officer. Further the expression "inadequate consideration" will be a matter of debate and appeal.

Further, if transfer is to a minor child and he attains the majority then it should not be permitted to be challenged.

It may be noted that similar provision was not there in second schedule Rule 4 of the Income Tax Act, 1961.

6.17) Clauses 112 – 114 – Wealth Tax

All assessees are covered other than a nonprofit organization. At present only few assets are covered, however the proposed code proposes to add tax also on following specified assets.

– Archaeological collections, Drawings, sculptures or any other work of Art.
– Watch having value in excess of Rs 50000/-.
– Interest in foreign trust or any other body located outside India (Whether incorporated or not) other than a foreign company.
– Equity or preference shares held by a resident in a CFC.
– Cash in hand in excess of ` 2,00,000/- in case of an individual.
– Bank deposits outside India, in case of individuals and HUFs, and in the case of other persons, any such deposit not recorded in the books of account.

7) **Other proposals for inclusion in DTC Bill:**

i) **Tax Rates**

a) The need to keep tax rates and Laws under certain norms has been emphasized by political philosophers and economic analysts from time immemorial. The DTC had proposed to introduce considerable novelty into tax regime which includes reduction in corporate tax and personal tax rates and slabs. Such proposal would give a new direction to taxation system. At present there are little bit of uncertainty. As announced by Hon'ble Finance Minister, the effective corporate tax rate stands at 20.6%. With profit linked incentives being phased out, corporate tax payment based on MAT are likely to come down sharply and once companies start paying tax at normal rate over MAT rate, effective tax rate would be close to 25%. Considering this background the government should introduce simplified Tax Code and bring corporate tax rate to 25%. Past experience had shown that revenues had gone up whenever tax rates were reduced. The proposed tax slab and rates in the DTC is undoubtedly a bold move. If it is implemented, it would result in greater tax compliance to bring an increasing proportion of the economy into the tax net. It will leave more money in the hands of individuals and other tax payers for savings and consumption which would lead to more investments and generation of more demand. India had already experienced in recent past that consumption demand had been an engine of growth for Indian economy.

b) If tax rates proposed in DTC is not mentioned in the proposed Bill, some of the exemptions and deductions should be kept in the proposed Bill, as discussed hereunder:

i) The senior citizens age should be brought down from 65 – 60 years in order to give relief to retired persons and as prevalent in other fields like Govt. service retirement age, Railways fare relief to sr. citizens etc.

ii) No reduction had been provided under the DTC for employees receiving House Rent Allowance for self employed people similar to Sec .10(13A) and Sec.80GG of the present Act.

iii) In case of salaried assessee, u/s 89 where arrear or advance salary is received, LTC U/s 10(15) retrenchment compensation, U/s 10(10B) encashment of unutilized Earn Leave on retirement, U/s 10(10AA)

iv) To boost the investment in new industries of the new specified areas, following proposals of the present Act which are missing in the DTC Draft and Revised Draft should be included in the proposed DTC Bill.

80IC – Undertakings in certain special category states.
80ID – Hotels and convention center in specified area.
80IE – Undertakings in North Eastern states.
80JJA – Business of collecting and processing of bio-degradable waste.
80JJAA – Employment of new work men.

c) Power of Central Government for introducing schemes for submission of E-filing of tax returns provided in Sec.139C, 139D are missing from DTC Bill. Since the E-filing returns are utilized by tax payers to a great extent and the government is permitting the scheme such power should be retained in the proposed DTC Bill specifically.

International Financial Reporting System (IFRS) is going to be introduced in a phased manner in the Indian economy scenario or the financial year including on and from 1st April 2011. In this matter Ministry of Corporate Affairs had also issued guideline for convergence of present accounting standard with IFRS. The provision of DTC Bill should be compatible to IFRS for smooth implementation of accounting standards as well as DTC on and from 1st April 2011.

ii) **AGE LIMIT AND NIL TAX SLAB ETC. FOR SENIOR CITIZENS**

The Government had provided tax advantages to senior citizens. Following the government retirement age and retirement age prevailing in professionally managed corporate sector, it is proposed to reduce the threshold age for tax exemption purposes from 65 years to 60 years. With the proposed reduction, senior citizens would be able to avail of large tax benefits on instruments like the Senior Citizens Savings Schemes on the bank deposits.

Moreover al the National Insurance Companies and other insurance companies had increased premiums on medical insurance payments in recent past.

Suggestion

It is suggested that, considering the increase in cost of living and medical treatment, the basic limit of exemption for senior citizens should be increased from Rs.2,25,000/- to Rs.4,50,000/- and for deduction U/s 80D for Medical Insurance Premium, the limit should be increased from Rs.15,000/- to Rs.35,000/-.