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Direct Tax Reform In India- An Analysis of Direct Tax Code 2011

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Abstract: *This paper attempts to evaluate direct tax code 2011 and its impact on the individual tax payers. The study aims at identifying the differences between the present income tax act 1961 and the direct tax code 2011. A new tax code that overhauls the present Income tax act 1961, which was very complicated on account of innumerable amendments, has been overdue. The direct tax codes intends to moderate tax rates and simplify the tax laws and is meant to provide stability to tax regime as it is based on accepted principles of taxation and best international practices. Moderation of rates will result in increased tax compliance and thereby increase in revenue collections. The Direct Tax Code aims for a flexible structure so that, in the long run, there may not be a necessity to bring frequent amendments in the tax laws to take care of the changes in growing economy. The main objectives of the Direct Tax Code is to improve efficiency and equity of the system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expending the tax base. This paper makes an attempt to provide an in-depth analysis about the significant amendments that has been proposed in the Direct Tax Code with particular emphasis on personal taxation and taxation on common man and to see how it will affect all. This paper aims to make an exploratory study of the new direct tax code, focusing on its highlights.*

Keyword: *DTC, NPO, Residuary, Employment, House property, Capital Gain.*

Introduction

Economic development is measured in terms of increase in per capita real income. In order to attain it, the rate of investment in both public and private sectors should be accelerated. In the absence of foreign assistance, an investment has to be financed by domestic savings. Then, it should be such that households pay the tax by curtailing their consumption expenditure. Similarly corporate savings should not be adversely affected. Lastly it should fetch increasingly larger amount of tax revenue to the government. Simultaneous attainment of all these may be in conflict and the structure should be design as to reconcile them as far as possible and this is largely achieved by heavy reliance on indirect taxes. Growth oriented tax policy cannot neglect its impact in a mixed economy on the private sector. Every effort should be made to develop a tax structure which besides fetching large revenue to the public exchequer provides incentives to private saving and investment. Direct tax Code 2011 cleared by Cabinet is a turning point in Indian taxation system as it is going to bid a final good bye to the 50 years old Income tax act, 1961 as well as the Wealth tax act 1957. Direct tax Code 2011 will be effective from April 1, 2012. Direct tax code was unveiled in August 2009; the government received more than 1600 representation on Direct tax Code. The Direct tax Code 2010 was tabled in the Lok Sabha on 30th august 2010. Indian income tax law had become to much complicate owing to the innumerable amendments, the DTC was a brave attempt to do away all these complications. After clearance from the Parliamentary Standing committee the bill was passed. Proposed bill has 319 sections and 22 schedules against 298 sections and 14 schedules in existing IT Act. The main objective of introducing DTC was to bring all direct taxes under one code for providing a single Tax reporting system. The Direct Tax Code was drafted after taking into account the principles of public finance which are internationally accepted and the best practices in order to make it at par with international practices so that it does not become a mere replacement of the existing Income Tax Act, 1961.

Justification Of The Study

The attempt to broaden the tax base by doing away with several exemptions and preferences in the new code are truly welcome and they can help in reworking the strategy towards achieving fiscal consolidation. The direct tax code seeks to consolidate and amend the law relating to all direct taxes, that is, income tax, dividend distribution tax and wealth tax so as to establish an economically efficient, effective and equitable

direct tax system which will facilitate voluntary compliance and help to increase the tax GDP ratio, and reduce the scope for disputes and minimize litigation.

Review Of Literature

In the opinion of Rajan (June 2010)The original DTC draft had proposed the EET method of taxation for savings, where the contributions made by an individual, along with accumulations/accretions thereto, would be exempt only till one remained invested. However, withdrawals at any time would be subject to taxation at the marginal rate. This would result in the amount withdrawn or amount received under whatever circumstances being brought into the computation of total income of the assessee, and then being taxed at the marginal rate (according to the applicable tax slab).

In the views of M Govinda Rao & R Kavita Rao(september2009) working under the assumption that rationale for providing tax preferences to the non profit sector remains unchanged, and given the fact that the surplus in any NPO does not accrue to any individual, there is a continuing need to support such institutions.

In the view of T.N Pandey (2009) , the most discipline class of tax payers i.e. the salaried employees are proposed to be given the hardest hit by the DTC. Regretfully such tax payers who keep on contributing regularly to the union exchequer by way of tax deduction at source and who by and large pay their taxes honestly, are being given raw deal in the matter of taxation of their income from employment.

In the opinion of Ajay Shrivastava(2011) The DTC, which the government plans to enact and put into practice , envisages meaningful reduction in the tax rates while will be simultaneous revenue neutral for the Government. It aims to achieve this by increasing the tax base and rationalizing the countless tax incentives prevalent under the current law.

Zajo Joseph(2011), viewed that with the introduction of the STT, certain additional concessions on the tax treatment of capital gains were given. In the proposed DTC, it is proposed to reintroduce the tax on capital gains. Hence it is argued that since the concessional treatment of capital gains is partly withdrawn, the STT should be scrapped.

Viral Dholakia (June 2010) viewed that on the proposal on the capital gains, the government intends to do away with the distinction between the short-term and long-term capital gains in a bid to bring simplicity in the taxation of capital gains. The discussion paper recommends that the capital gains of the tax payer will be added to their total income. Thus, the tax liability of the assessee, on account of income from the sale

of capital assets, would be in line with their income slabs. The capital gains will be considered as income from ordinary sources. Now, this move will definitely hinder the long term savings. Currently, investments in stock market assets and equity-oriented mutual funds which are held for more than 1 year are considered as long-term capital assets and are not taxable. Whereas income from short-term investments that are held for less than 12 months from the date of acquiring such assets are taxable at rate of 15%.The phasing-out of distinction between short-term and long-term capital assets may not provide incentive to an investor to hold their equity assets for a longer duration, if their actual investments are yielding capital gains over a shorter period of time frame. They may be tempted to book gains more frequently as and when available and take home the profits that are accruing, irrespective of the time period.

Objective Of The Study

This study fulfils the following objectives:

(i). To analyze the various reviews and recommendations made by tax reform committees.

(ii).To make a comparative study of the Income Tax Act 1961 Vs Direct Tax Code 2011.

(iii).To review the main objectives of Direct Tax Code 2011.

(iv).To give suggestions on the basis of findings of the study.

Methodology

Some secondary data have been obtained from journals; reports of the national survey and various publication. The information thus obtained was analyzed, interpreted and tabulated. This research study is explanatory in nature. Though the study is comprehensive yet there is scope for further research.

Analysis of Direct Tax Code in India

The Bill proposes to increase the exemption limit for individuals from Rs 1.6 lakhs to Rs 2 lakhs. Accordingly, the slabs have also been reworked. Those with a taxable income of Rs 2-5 lakhs will be taxed at 10 per cent; those in the Rs 5-10 lakhs bracket will have to pay 20 per cent; while taxable income of over Rs 10 lakhs will attract a 30 per cent levy. Senior citizens are in for some relief, but 'gender equality' has meant that the additional exemption limit so far available to women taxpayers will be withdrawn once DTC comes into effect. The new provisions under the Direct Tax Code are as follows.

Income	Tax Rates
Upto Rs.200000	Nil
Between Rs. 2 lakh – Rs. 5 lakh	10%
Between Rs. 5 lakh – Rs. 10 lakh	20%
Income over Rs. 10 lakh	30%

Table 1: The new provisions under the Direct Tax Code

Corporate tax has been kept at 30%. The limit for exemptions for salaried people is Rs. 2 lakh including resident women, while that for senior citizens is Rs. 2.5 lakh. Under the DTC Bill, the annual deduction has been raised to Rs. 1.5 lakh. The Government has also proposed to restore back the taxation of retirement savings, in the nature of provident fund contributions and pure life insurance and annuity products, to the Exempt-Exempt-Exempt scheme from the earlier proposition of Exempt-Exempt Tax scheme. Wealth tax under the provisions of initial DTC, was required to be paid only on wealth in excess of Rs. 50 crores at a tax rate of 0.25% but on all assets including financial assets i.e. investments in shares. Under the current tax regime, wealth tax is required to be paid @ 1% on wealth in excess of Rs.30 lakhs.

Currently under the Act, no tax is required to be paid on securities held for more than a year from the date of acquisition and sold on the stock exchange on which securities transaction tax is paid. In addition to this, for securities held for less than one year, the tax liability is restricted to 15%. However, under the DTC, there has been some relief granted to the tax payers by providing for a specified percentage deduction from income / indexation benefit depending on the nature of security on assets held for long term. However, in case of short-term assets, there is no relaxation to the taxpayer and tax will be required to pay as in case of any other ordinary income.

Income Tax Act 1961	Direct Tax Code 2011
Income Tax Act 1961 was very complicated on account of innumerable amendments made all most every year.	The direct tax codes intends to moderate tax rates and simplify the tax laws and is meant to provide stability to tax regime.
Incorporation of various exemptions and preferences has resulted in higher compliances cost.	Litigations and disputes are expected to be reduced through the implementation of Direct Tax Code 2011.
The procedural issues relating to personal income taxation under Income Tax Act 1961 was very complicated.	The procedural issues relating to personal income taxation are also expected to simplify a lot.
Under Income Tax Act 1961, the tax rates were higher and tax base was low.	The direct tax code intends to achieve higher tax base with low tax rates.

Table 2 : Income Tax Act 1961 Vs Direct Tax Code 2011

Significant Changes In Direct Tax Codes

The basic objective of tax reform is to limit the plethora of exemptions and broaden the tax base which is required to face the current fiscal challenges before the country. Keeping such challenges in mind the direct tax codes intends to moderate tax rates and simplify the tax laws and is meant to provide stability to tax regime as it is based on accepted principles of taxation and best international practices. Under direct tax codes incomes have been bifurcated into Ordinary Sources and Special Sources.

Ordinary Sources		Special Sources
Employment		Winning From Lotteries,Games,etc
House Property	**Income**	Non resident Income
Business		
Capital Gain		
Residuary		

Table 3: Sources of income

A. Employment

The following amounts shall not be included in 'Salary' subject to specified limits.

a) An employer's contribution to an approved provident fund, Super Annuation Fund and New Pension Scheme.

b) Retirement Benefits
c) Gratuity
d) Voluntary Retirement Scheme
e) Commutation of Pension linked to gratuity and
f) Encashment of leave on superannuation.
g) Medical facilities / reimbursement provided by an employer to employees be valued as per existing law.
h) Perquisite value of rent free accommodation shall not be on market value.

B. Income From House Property

a) Self occupied Property shall be valued at Rs. NIL. However, interest upto Rs. 1.5 lakh on borrowed capital will be allowed.

b) In case of let out property, gross rent will be the amount of rent received or receivable.

c) Gross rent will not be computed at a presumptive rate of 6% of rate able value or cost of construction / acquisition.

C. Capital Gains

a) Income under the head 'Capital Gains' will be considered as Income from ordinary sources in case of all tax payers including non-residents. It will be taxed at the rate applicable to that tax payers.

b) Capital Asset held for a period of more than one year from the end of the financial year in which asset is acquired.

A) Listed equity shares or units of an equity oriented fund, capital gains shall be computed after allowing a deduction at a specified percentage of capital gains without any indexation. Similarly, loss arising on transfer of such asset will be scaled down in a similar manner.

B) Other assets:-

i) Base date is shifted to April 01, 2000 instead of April 01, 1981.

ii) The capital gains on such assets shall be computed after allowing indexation on this raised base.

c) Income arising on purchase and sale of securities by an FII shall be deemed to be income chargeable under the head 'capital gains'. No TDS on such income, however, they will have to pay advance tax.

D. Non-Profit Organization (NPO)

a) NPO registered under the Income-tax Act, 1961 would not be required to apply for fresh registration under the DTC.

b) NPO may not able to spend the entire receipts during the financial year itself, may be allowed to carry forward upto 15% of the surplus or 10% of gross receipts, whichever is higher, to be used within three years from the end of the relevant financial year.

c) A basic exemption limit will be provided and the surplus in excess of such limit will be subject to tax.

d) The phrase 'charitable purpose' will be retained in place of 'permitted welfare activity'.

e) It is proposed to retain the cash system of accounting.

f) The Central Government shall be empowered to notify any non-profit organization of public importance as an exempt entity.

g) The income of a public religious institution shall be exempt subject to fulfillment of certain conditions. Donation to these institutions will not be eligible for any deduction in the hands of donor.

h) Partly religious and partly charitable institutions will be treated as NPO if they are registered under this code. Their income from public religious activity will be exempt subject to the fulfillment of certain conditions.

E. Special Economic Zone(SEZ) – Taxation of existing unit

As a policy, it has been decided not to extend the scope or the period of profit linked deductions. However, specific provisions for protecting such deduction for the unexpired period have been provided in DTC in case of SEZ developers. Similar provision to protect profit linked deductions of units already operating in SEZ shall be incorporated.

F. Concept of residence in the case of a company incorporated outside India

a) Foreign company will be treated as resident in India, if its 'place of effective management' is situated in India.

G. Double Taxation Avoidance Agreement(DTAA) vs. Direct Tax Code(DTC)

a) Between the domestic law and relevant DTAA, whichever is more beneficial to the tax payer shall apply. However, DTAA will not have preferential status over the domestic law in the following circumstances: -

- When GAAR(General Anti Avoidance Rule) is invoked,
- When Branch Profit tax is levied.

H. Wealth Tax

Specified 'unproductive assets' will be subject to Wealth Tax. It will be payable by all tax payers except non-profit organizations.

I. General Anti Avoidance Rule (GAAR)

The provisions would apply, if any one of the following conditions is met:-

a) It is not at arms length,

b) It represents misuse or abuse of the provisions of the code,

c) It lacks commercial substance,

d) It is entered or carried on in a manner not normally employed for bonafide business purposes.

Effect Of DTC On Insurance

DTC will have significant impact on insurance sector as well. Under DTC, a policy should give life cover of at least 20 times the annual premium, to be eligible for tax deduction. In absence of such condition one will not get any tax deduction on the premium and even the income from the policy will be taxable. Right now income received from insurance policies is free. So it should be made sure that if one looks for tax deduction on insurance plan, one should buy a policy which offers a bigger cover. This is possible only if term plan is for duration of 20-25 years. Tax deduction limit for life insurance will get reduced from present Rs 1 lakh a year to Rs 50,000 an year. This annual limit of 50,000 will include the amount paid for tuition fees of children as well as medical insurance for self and parents. So an insurance policy with a large premium, around 80,000 – 1 lakh will fetch maximum tax deduction of only Rs 50,000.The DTC will also nudge policyholders to take long term view on investments. Premature withdrawals from ULIPs will be taxed, so one has think twice before deciding on an insurance policy.

Impact Of DTC On Tax Saving Of Individual Male (Non Senior Citizens)

As per the present slab of tax (Assessment year 2011-2012) on individual male (Non Senior Citizens) an individual is suppose to pay Rs. 158620 tax on an income of Rs. 1000000 whereas on the other hand, if DTC is followed the person shall be liable to pay Rs. 133900 on the same income thereby making a tax saving of Rs.24720.

Income Tax Act (Assessment Year 2011-2012)				Direct Tax Code		
First	Rs. 160000		Nil	First	Rs. 200000	Nil
Next	Rs. 340000	@ 10%	Rs.34000	Next	Rs. 300000 @ 10%	Rs.30000
Next	Rs. 300000	@ 20%	Rs.60000	Next	Rs. 500000 @ 20%	Rs.100000
Next	Rs.200000	@ 30%	Rs.60000			**Rs.130000**
			Rs.154000	**Add:** Education Cess @ 3%		Rs.3900
Add: Education Cess @ 3%			Rs.4620	**Total**	**Tax**	**Payable**
Total Tax Payable			**Rs.158620**	**Rs.133900**		

Table-4

Highlights Of The Direct Taxes Code Bill

- Income tax exemption limit proposed at Rs. 2 lakh per annum, up from Rs. 1.6 lakh
- 10 per cent tax on annual income between Rs. 2-5 lakh, 20 per cent on between Rs. 5-10 lakh, 30 per cent for above Rs. 10 lakh
- Tax burden at highest level will come down by Rs. 41,040 annually
- Proposal to raise tax exemption for senior citizens to Rs. 2.5 lakh from Rs. 2.4 lakh currently
- No mention about tax exemption to women in proposed bill
- 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 per cent and MAT will be calculated with reference to 'book profit' and not on the basis of 'value of gross assets'.
- Proposal to levy dividend distribution tax at 15 per cent
- Exemption for investment in approved funds and insurance schemes proposed at Rs. 1.5 lakh annually, against Rs. 1.2 lakh currently
- Proposed bill has 319 sections and 22 schedules against 298 sections and 14 schedules in existing IT Act
- Once enacted, DTC will replace archaic Income Tax Act.

Conclusion

The proposed changes in the tax brackets will rob the exchequer of the benefits of a larger tax base and is likely to result in significant revenue loss to the exchequer. If, indeed, the special interest groups prevail in keeping the exemptions and preferences unchanged while the tax rate is reduced, there will be a huge loss of revenue. The important question is whether the country can afford this at the time when the need of the hour is to return to the part of fiscal consolidation. The provisions concerning taxation of salaried employees as contain in the code show that the entire scheme of taxation of income from salaries was to be changed in the manner mentioned in the code resulting in almost complete somersault of the present position. The proposed Wealth tax is likely to be a mere token and it is not likely either to generate any significant revenue or improve equity in the tax system. It makes no sense to have an exemption limit as high as Rs 50 crores and levy the tax at .25% on the wealth above that. The code does not recognize the good work done by many of the NPO's over the years in providing various services which the government cannot, and its attempt to prevent misuse, ends up reducing a conceptual argument for not taxing these organizations into a tax preference.

Suggestions

On the basis of the present study, the following suggestions have been made:

- There is a need to make efforts to bring majority of India's population under tax net.
- The ministry of Finance should follow such a policy by which genuine tax payers should be encouraged and defaulters should be panelized with heavy penalties.
- All transaction in real estate and purchase of costly consumer and producer goods must be taxed for the purpose of income tax at market rate at the time of transaction so that the growth of the black economy should be curved to a reasonable extent.
- In order to check evasion the government needs to establish its credibility regarding its own integrity before exhorting persons to pay their taxes correctly.
- The deduction on the interest on house loan was not there in the earlier draft but in the revised draft again this benefit has been given under pressure. A large chunk of black economy is in the real estate sector and moreover, over dose of finance in the housing sector is also putting inflationary pressure on the overall economy of India.
- Tax slabs should be reduced to two only and maximum tax rate should not be more than 20% so that maximum people should be motivated to pay taxes voluntarily rather than forced one.
- The DTC needs to be supplemented with Unique Identity Card project so that a comprehensive data base of potential tax payers can be worked out.

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