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Direct Tax Code 2009

Corporate Tax

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Agenda

- ❑ Objectives behind the code
- ❑ Salient Features
- ❑ Income from Business
 - Minimum Alternate Tax (MAT)
 - Dividend Distribution Tax (DDT)
 - Treatment of losses
 - Tax deducted at Source (TDS)
 - Significant Procedural Changes

Objectives behind the Code

- Income-tax Act, 1961 almost five decades old
- Over 5000 amendments
- Eliminating distortion in tax structure
- Moderate levels of taxation
- Broadening the tax base
- Simple language to remove ambiguity
- Reduce cost of compliance and administration

Salient features

- Consolidation of provisions to enable better understanding of tax legislation
- Use of tables / formulas and elimination of provisos / explanations
- Attempt made to avoid ambiguity in the provisions that give rise to contrary interpretations
- Powers delegated to Central Government / CBDT to avoid protracted litigation on procedural issues
- Providing stability – Tax rates prescribed in the code obviating need for annual Finance Bill

Overview of Corporate tax rates

| | Existing (%)* | Proposed (%)* |
|---------------------------|---------------|--------------------|
| Corporate tax | 30/ 40 | 25 |
| MAT | 15 | 2 / 0.25 on assets |
| Dividend Distribution Tax | 15 | 15 |
| Capital gains tax | Nil/ 10/ 20 | 25/30 |
| Branch profits tax (NR) | - | 15 |
| Interest (NR) | 20 | 20 |
| Royalty/ FTS (NR) | 10 | 20 |

- Surcharge and cess as per the relevant Finance Act
- Most treaties provide WHT for interest/ royalty/ FTS @ 10%

Change in residency rules for foreign companies

| | Provision | Implication |
|----------|---|---|
| Current | Foreign companies resident in India only if controlled and managed <u>wholly</u> in India during the year | Non-India income not liable to tax in India |
| Proposed | Threshold lowered to wholly <u>or partly</u> managed and controlled from India <u>at any time during the year</u> | Non-India income exposed to Indian tax |

Income from Business

- Income from each business to be computed separately (section 28)
- Assets classified into business assets (trading and capital) and investment assets.
- The computation of income under this head is based on income-expense model:

| | | |
|--|------------|------------|
| Gross Earnings (section 31) | | XXX |
| Less: Business Expenditure (section 32) | | |
| - Operating Expenditure (section 33) | XXX | |
| - Permitted Finance charges (section 34) | XXX | |
| - Capital allowances (section 35) | <u>XXX</u> | <u>XXX</u> |
| Taxable Income from Business | | XXX |

Business Income - Gross Earnings

➤ The Gross earnings (Section 31)

- Any amount receivable from or in connection with the business
- Value of any benefits or perquisite receivable from or in connection with the business
- Value of the closing inventory

Business Income - Gross Earnings

➤ **Gross earnings includes:**

- Profits from sale of business capital assets OR any consideration on slump sale – business income
- Reimbursement of any expenditure incurred.
- Relief in the nature of any liability in the nature of loan, deposit, advances etc.
- Receivables on cessation or termination of any business agreement
- Subsidy receipts (other than to meet cost of business capital assets)
- Advance, security deposit or otherwise from long term leasing of business assets or interest in business asset

➤ **Gross earnings excludes:**

- Interest income (other than permitted financial institutions)
- Income from letting of property (land and building)

Business Expenditure – Deductions

- Business expenditure incurred wholly and exclusively for the purpose of business (section 32) -
 - (i) Operating expenditure (Section 33)
 - (ii) Permitted finance charges (Section 34)
 - (iii) Capital allowances (Section 35)

Business Income – Deductions....

- (i) **Operating expenditure (Section 33)** – expenditure wholly and exclusively for the purposes of business
- Rent paid for premises occupied and used
 - Expenditure for maintenance of computer software or hardware
 - Expenditure for business reorganization, dissolution or liquidation
 - Expenditure for safeguarding the goodwill of the person necessarily to be preserved for his business
 - Losses incidental to business is selectively covered
 - Key disallowances for e.g. personal expenses, unascertained liabilities, any rate or tax, dividend etc.
 - Certain expenditure for e.g. tax, bonus, leave encashment etc. on payment or accrual whichever is later

Business Income – Deductions....

(ii) Permitted finance charges (Section 34)

- Interest on capital borrowed or interest paid to trade creditors
- Proportionate amount of Discount or premium on bond or debentures
- Incidental financial charges allowed other than for issue of debentures, bonds or share-capital.
- Interest on capital borrowed for acquisition of capital asset **not** allowed [section 34(2) (a)]
 - Prior to the date of commencement for new business
 - Prior to the date when asset is first put to use in other cases

Business Income - Deductions....

(iii) Capital allowances (Section 35)

- Depreciation on business capital assets
 - Initial Depreciation (akin to additional depreciation)
 - Terminal allowances
 - Scientific research and development allowance
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- Depreciation to be allowed on the business capital assets – whether or not the deduction has been claimed.
 - Powers granted to AO to restrict deduction having regard to use of asset

Business Income - Deductions....

➤ **Capital allowances (Section 35)....**

- Broadly similar to depreciation and similar allowances
- New Block of assets / categories introduced such as Rails, Scientific research assets, Family planning assets.
- 150% weighted deduction for in-house scientific R&D expenditure; extended to all industries
- Loss upon sale of entire block of assets to be ignored- Depreciation on block to continue
- Lessee eligible to claim capital allowance in case of finance lease

Business Income - Deductions....

➤ Capital allowances (Section 35)....

Deferred revenue expenditure – specific expenditure eligible for capital allowance

| Block of Assets | Depreciation Rate (%) |
|--|-----------------------|
| Non-compete fees | 25 |
| Premium on obtaining assets on lease/rent | 25 |
| VRS expenditure | 25 |
| Business re-organisation expenditure | 25 |
| Expenditure on prospecting mineral or development of mine/other natural deposit of any mineral | 15 |

Grandfathering of existing incentives

- **Following incentives continued under the Code:**
 - Sec 80-IA – Profits from Infrastructure business
 - Sec 80-IAB – Profits earned by SEZ developer
 - Sec 80-IB – Profits from various businesses covered therein
 - Sec 80-IC – Profits from undertakings in the North-East
- **No specific provisions for grandfathering of SEZ units eligible for tax holiday under section 10AA**

Minimum Alternative Tax ('MAT')

- Payable on 'value of gross assets' and not on 'book profits'
- Tax rate
 - Banking companies – 0.25%
 - Other companies – 2%
- No credit allowed in subsequent years
- Multiple level taxation – holding-subsidiary structures

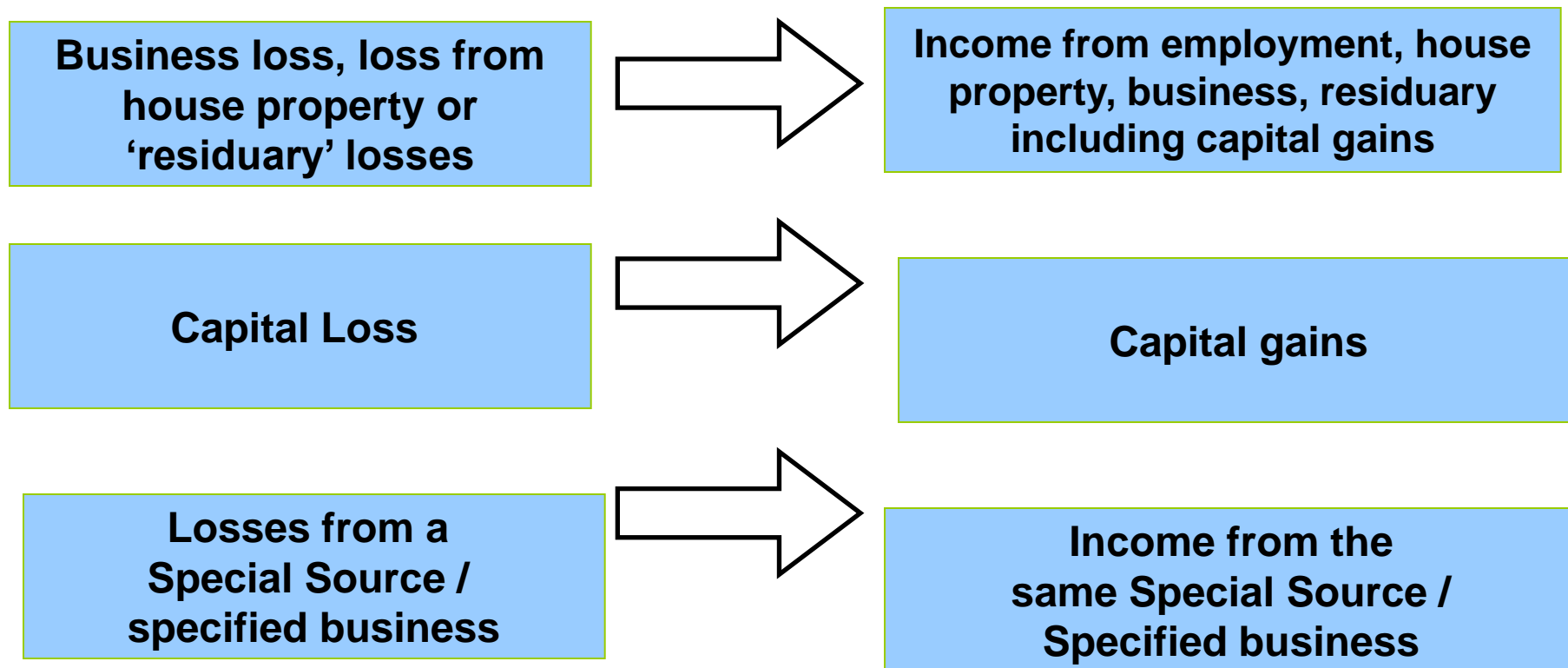
Dividend Distribution Tax ('DDT')

- DDT extended to all “dividends”?
- Dividend distributed to specified pass-through entities exempt from DDT
- DDT exemption for SEZ developers discontinued

Carry forward of losses

- No distinction between long term and short term capital losses
- Capital losses not to be set off against any other income
- Loss of a specified business/special source allowable
 - Only against subsequent years' profits
 - Of the same business/source
- Losses allowed to be carried forward indefinitely
- Entire losses including previous years' losses lapse if return not filed by due date

Set-off and Carry forward of losses



- Set-off in same or subsequent years
- Discussion paper talks of ring-fencing losses from speculative business - no corresponding provisions in Code

Tax Deduction at Source (TDS)

- TDS on payments for purchase of goods?
- No ability to seek lower rate of TDS?
- No time limit for completion of TDS assessment
 - Time limits were recently introduced
- TDS on capital gains
 - From payments to residents @ 10%
 - From payments to non-residents, including FIIs @ 30%

Significant procedural changes

- Current safeguards against reopening of assessments done away with
- Scope of “rectification” significantly widened
- New dispute resolution procedure extended to residents in all cases involving a dispute above Rs. 25 lacs

Thank You