



# Interactive Session on Direct Taxes Code Bill, 2009

Individual Taxation and Capital Gains

# Contents

- ❑ Philosophy and Strategy
- ❑ Scope of Total Income
- ❑ Residence in India
- ❑ Rates of Tax
- ❑ Income from Employment
- ❑ Taxation of perquisites
- ❑ Employment based deductions
- ❑ Savings based deductions
- ❑ Other deductions
- ❑ Withholding tax (TDS) on salary
- ❑ Income from House Property
- ❑ Capital Gains
- ❑ Wealth-Tax



# Philosophy and strategy

---

## ▶ **Philosophy**

- ▶ Use of **simple language** to ensure clarity.
- ▶ **Reduction in scope for litigation** by avoiding ambiguity in provisions.
- ▶ **Use of flexible structure** to accommodate changes in the growing economy without resorting to frequent amendments.
- ▶ **Form based law** - Incorporate a design which can be logically reproduced in a Form.
- ▶ **Consolidate and rearrange** various provisions to make them consistent with the general scheme of the Act.

## ▶ **Strategy**

- ▶ **Expand tax base** by adopting a comprehensive definition of income by including all accruals and receipts of revenue and capital nature unless otherwise specified.
- ▶ **Remove tax exemptions** to achieve equity, reduce compliance cost, lower administrative burden, discourage corruption.
- ▶ **Liberalize tax rates** -expected to yield existing level of revenues with the revised comprehensive tax base.
- ▶ **Provide limited exemptions** on the consideration of positive externalities, encouraging human development and reducing risk, equity, and reducing compliance and administrative burden.
- ▶ **Provide exceptions**, essentially in the nature of deferrals, with a view to mitigating the problem of liquidity.

# Scope of total income

▶ No change

	In India		Outside India	
	Income accrued / deemed to accrue	Income received	Income accrued / deemed to accrue	Income received
Resident	✓	✓	✓*	✓*
Non-Resident	✓	✓	✗	✗

\*Subject to exception in case of “new” residents (see next slide)

# Residence in India

## ▶ Residential Status

- ▶ No change in the test for qualifying as a resident or non-resident.
- ▶ The term 'not ordinary resident' has been done away with but concept remains.
- ▶ Income accrued, deemed to accrue or received outside India is not considered taxable in the year the individual ceases to be a non-resident and the immediately succeeding year provided the individual was a non-resident in 9 immediately preceding years.
- ▶ The present 730 days test has been done away with.
- ▶ For globally mobile employees especially foreign nationals working in India, the present 3-4 years window for excluding foreign source income will be reduced to two years.

# Rates of Tax

## Tax Rates

## Impact

Income Slab	Existing Rates	Proposed Rates	Income (Rs.)	Current tax (Rs.)	Proposed tax (Rs.)	Savings (Rs.)	Savings (%)
Upto Rs.1,60,000*	Nil	Nil	1,50,000	Nil	Nil	-	-
Rs.1,60,000 to 3,00,000	10%	10%	3,00,000	14,420	14,000	420	3%
Rs.3,00,000 to 5,00,000	20%		5,00,000	55,620	34,000	21,620	39%
Rs.5,00,000 to 10,00,000	30%		7,50,000	1,32,870	59,000	73,870	56%
Rs.10,00,000 to 25,00,000	30%	20%	10,00,000	2,10,120	84,000	1,26,120	60%
Above Rs. 25,00,000	30%	30%	20,00,000	5,19,120	2,84,000	2,35,120	45%

\*Higher limits for working women and senior citizens

# Rates of Tax

- ▶ No change in minimum threshold, possibly to preserve tax base
- ▶ Tax base may actually expand due to removal of many exemptions/ deductions
- ▶ Tax benefit skewed in favor of higher income groups
- ▶ Of the approximate 31 million non-corporate tax payers, over 90% report income of upto Rs.200,000 and only about 3% report income over Rs.1 million
- ▶ To maintain vertical equity, strong case to shift slabs significantly upwards

# Income from employment

---

- ▶ Employer defined to mean an entity which controls and directs the individual under express or implied employment contract and is obligated to pay compensation to him (concept of economic employer)
  
- ▶ Payments / benefits now fully taxable:
  - ▶ Leave encashment
  - ▶ HRA
  - ▶ Entertainment allowance
  - ▶ Special allowances
  - ▶ LTC / LTA
  - ▶ Medical facilities and reimbursements

# Income from employment

---

- ▶ Tax exemption replaced with tax deferral in case of commuted pension, gratuity and VRS compensation subject to deposit of amount in Retirement Benefit Account (RBA)
- ▶ Taxes, if borne by employer, will be subject to grossing up. Concept of “non-monetary perquisites” done away with
- ▶ Employee share plans to be taxed upon exercise. Valuation norms to be prescribed. (*No change*) (*Term “sweat equity” loosely used to mean all types of share plans*)

# Taxation of perquisites

---

- ▶ Defined as-
- ▶ Value of any accommodation (*to be prescribed*)
  - ▶ *Expected to cover both company leased and HRA*
- ▶ Payment for life insurance or annuity
- ▶ Employer contribution to PF, SAF, NPS
- ▶ Value of sweat equity shares
- ▶ Discharge of any obligation of the employee (*to be prescribed*)
- ▶ Any other amenity, facility etc. (*to be prescribed*)

# Employment based deductions

---

- ▶ Profession tax (*no change*)
- ▶ Transport allowance (*limits to be prescribed*)
- ▶ Any special allowance or benefit granted to meet official expenses to the extent of expenses actually incurred (*to be prescribed*)
- ▶ VRS compensation, gratuity and pension (subject to deposit in the Retirement Benefit A/c)
  - ▶ Withdrawals will be taxed
  - ▶ Scheme of retirement benefit to be prescribed

# Savings based deductions

---

- ▶ All savings instruments transitioned to EET basis
  - ▶ Tax exemption on accumulations in “approved” PF as on 31<sup>st</sup> March 2011 and (future) accretions thereon to be preserved
    - ▶ Approval to be granted by PFRDA. What about funds already in existence?
    - ▶ Does this include PPF?
  
- ▶ Overall limit of Rs.300,000 per annum paid to any “permitted savings intermediaries”
  - ▶ Approved provident fund
  - ▶ Approved superannuation fund
  - ▶ Life insurance
  - ▶ New Pension System (NPS)
  
- ▶ Roll over on purchase of annuity plan will be tax free
- ▶ Employer contributions to PF, SAF to be included in the limit?

# Other deductions

---

- ▶ Tuition fees for children
  - ▶ For maximum of two children
  - ▶ Educational institution should be situated within India
  - ▶ Covered under the overall limit of Rs 300,000 per annum for savings instruments
- ▶ Interest on education loan
- ▶ Health insurance premium, treatment of prescribed diseases, maintenance of a disabled dependent

# Tax withholding (TDS) on salary

---

- ▶ Liability to withhold tax is on the employer (*no change*)
- ▶ Appears to require taxes to be withheld on payment or credit (“deemed payment” vs. “paid”)
- ▶ Where salary is payable to a non-resident, in the absence of any specific provision, residuary rate of 35% may become applicable under the Fourth Schedule
- ▶ No provisions to address dual employment / successive employment / split salary situations
- ▶ Loss from house property, if any, cannot be factored into the computation
- ▶ Other income to be ignored

# Income from House Property

Particulars	Existing Provision	Proposed
Tax base	Annual value is the basis for taxation. Rent realized and fair market value form the basis for determining annual value.	Gross rent is the basis for taxation. Contractual rent and presumptive rent* form the basis for determining gross rent. *6% of (a) ratable value, or (b) cost of construction or acquisition, if no ratable value is fixed.
Standard deduction	30% of Gross Annual Value	20% of Gross Rent
Interest on borrowed capital	<ul style="list-style-type: none"> <li>▶ Allowed upto Rs. 150,000 or Rs. 30,000 for self occupied property.</li> <li>▶ Allowed without limit for let-out properties.</li> </ul>	<ul style="list-style-type: none"> <li>▶ No deduction available for self occupied property.</li> <li>▶ Allowed without limit for let-out property.</li> </ul>
Deduction for interest paid on loan during the pre-construction or pre-acquisition period	Allowable in 5 installments.	Apparently not allowed.

# Capital Gains

Particulars	Existing Provision	Proposed
Personal effects and rural agricultural land	Not liable to capital gains	Not liable to capital gains
<b>Distinction</b> between short-term and long-term capital asset	Distinct tax treatment and rate.	No distinction
<b>Base date for indexation</b> and substitution of FMV to determine cost of acquisition	1 April 1981	1 April 2000
<b>Set-off and carry forward</b> of short term and long term capital gains	Subject to restrictions	All capital gains can be set-off against each other and resultant loss can be carried forward
Capital assets eligible for <b>indexation</b>	Any capital asset held for more than 36 months (12 months in certain cases) immediately preceding date of its transfer	Any capital asset held for at least one year from the end of FY in which it is acquired

# Capital Gains - deductions

Rollover Deduction	Existing Provision	Proposed
On transfer of residential house	Available on purchase of residential house u/s 54.	Ambiguity on availability of deduction on purchase of residential house upon transfer of a residential house.
On transfer of urban agricultural land	Available on purchase of agricultural land u/s 54B.	Available on purchase of agricultural land
On transfer of any long-term asset /investment asset held for more than one year, not being residential house	Available on purchase of residential house u/s 54F	Available on purchase of residential house
On transfer of any long-term asset /investment asset held for more than one year (residual provision)	Available on purchase of NHAI or RECL bonds u/s 54EC	Available on deposit in Capital Gains Savings Scheme A/c (CGSS). Any withdrawal will be taxed as Income from Residuary Sources.

# Wealth Tax

Particulars	Existing Provision	Proposed
Scope of Wealth Tax	Applicable to Individuals, HUFs and Companies.	Applicable to Individuals, HUFs and Private Discretionary Trusts.
Threshold Limit	Wealth tax payable on net wealth in excess of Rs. 30 lakhs.	Wealth tax payable on net wealth in excess of Rs. 50 crores.
Rate of tax	1% of net wealth in excess of Rs. 30 lakhs	0.25% of net wealth in excess of Rs. 50 crores
Assets	Inclusive definition of assets – assets to include motor car jewellery, urban land etc.	Assets mean <u>all</u> assets including financial assets and deemed assets

# Overall conclusions

---

- ▶ Some level of simplification achieved
- ▶ Widening of tax slabs, though welcome, may not deliver benefits evenly to all income groups
- ▶ Move towards EET may severely impact persons in the last 5-10 years of their careers
- ▶ Imposition of Rs.3 lakh limit could lead to problem of segregation to avoid double taxation
- ▶ Parity of tax treatment between private and government employees may adversely affect government employees who have significant perks and less of cash salary
- ▶ Lack of horizontal equity between self-occupied and rented house may encourage malpractices

# Overall conclusions

---

- ▶ Taxation of employee share plans needs to be more comprehensively stated, taking into consideration the cross border movement of employees and various types of plans. Deferment of tax to actual liquidity event is recommended
  
- ▶ Items that may be additionally considered
  - ▶ Need to eliminate receipt based taxation. Impedes free flow of capital and earnings
  - ▶ Standard deduction based on number of dependents (subject to upper limits). This will enable better alignment with “capacity to pay”
  - ▶ Parity between contributions to Indian social security schemes and overseas schemes in consonance with Social Security Agreements signed by India
  - ▶ Employer should be permitted to adjust estimated foreign tax credits while computing TDS on salary

---

---

# Questions?



**Thank You**

 **ERNST & YOUNG**  
*Quality In Everything We Do*

 **AMCHAM**  
I N D I A