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TAX REVAMP IN INDIA - REAL OR DISGUISED?

The Government of India introduced a new Direct Taxes Code (DTC) that seeks to simplify the tax regime in India. This article discusses the implications of tax proposals of DTC. The main focus of the new Code is on tax evasion by making a simple change from book profits to value of assets. Hence, though the revamp is the need of the hour which is aimed at widening the tax net, yet implementation would be the key to make it real.

INTRODUCTION

1. The Government of India introduced a new Direct Tax Code that seeks to simplify the tax regime in India. This was a much awaited proposal as the old and outdated current taxes are calculated on the basis of the Income-tax Act, 1961 with many amendments which are difficult to understand. This is making calculations difficult while it's hitting the overall growth given that direct taxes account for major source of income. Hence, this new Code would replace the existing income tax laws.

MAIN PROPOSALS OF THE NEW CODE

2. The main proposals of the new Code are as follows :

- Income-tax rates slash
- Most exemptions to go
- Interest on savings to be taxed
- Personal Income-tax slab rate hiked
- To raise deduction limits for savings up to Rs. 3,00,000
- Corporate Tax: Down from 30 per cent to 25 per cent
- Wealth tax to be levied on wealth above Rs. 50 crore
- Fringe Benefit Tax to be levied at the hands of employees

The new Code proposes to increase tax slabs, which means more residual income at the hands of a common man. However, interest on savings is going to be taxed and fringe benefit tax would be levied at the hands of employees. Further, the Code proposes to keep a common platform for all income generated out of stock market investments. The current distinction between short-term and long-term capital gains is proposed to be abolished and, which effectively would mean tax on all capital gains at applicable tax rate. At present, the long-term capital gains tax is *Nil* on equity transactions on which STT is paid and 20 per cent on all other assets, while the short-term capital gains tax rate is 10 per cent on equity transactions on which STT is paid and 30 per cent on other assets.

PROPOSED TAX SLABS

3. Following are the proposed tax slabs - Personal Income Tax :

Total Income	*Tax Rate (%)*
Up to Rs. 1,60,000 *(Rs. 1,90,000 for women and Rs. 2,40,000 for senior citizens)*	*Nil*
Rs. 160,000 - Rs. 10,00,000	10
Rs. 10,00,000 - Rs. 25,00,000	20
Above Rs. 25,00,000	30

TAXING SAVINGS - MIXED

4. The tax deduction limit at present at Rs. 1 lakh would be raised to Rs. 3 lakhs. However, following changes would move negative sentiment :

- interest paid on home loans is proposed to be withdrawn
- tax on savings such as PPF, insurance, etc., at the time of withdrawal
- retirement benefits such as gratuity will be tax-free only if deposited in specified benefit schemes

CORPORATE TAX RATE REDUCTION - AIMED AT WIDENING TAX NET

5. The current income-tax of rate 33 per cent including surcharge on corporate sector is proposed to be reduced to 25 per cent. The overall effort and the kicker is to rationalize and make taxes uniform for all companies, irrespective of whether they are Indian or foreign owned. This would reduce the burden and paper work by a substantial margin, especially for foreign companies.

An unclear suggestion which requires more inputs from the Government is the ideas of charging foreign companies an additional tax called branch profits tax at the rate of 15 per cent of the branch profits.

Our following analysis shows that out of the BSE-500 companies which represent around 80 per cent of the overall market cap, there are 153 cos. paying effective tax rate of 40.8 per cent including deferred, wealth and FBT taxes.

BSE-500 Companies Fig. in Rs. Crs

Items	*PBT*	*Total Tax*	*Corpn. Tax*	*Eff. tax rate*	*Defered Tax*	*Wealth Tax*	*Agricultural Tax*	*FBT*	*Other Misc. Tax*	*Avg. effec.*	*No. of cos.*
Cos. where effec. tax rate>33.3%	134,642	50,050	45,274	33.6	4,030	18	-	720	8	40.8	153
Cos. where effec. tax rate is btwn. 0%-33.3%	204,541	43.047	36,930	18.1	5,106	22	-	923	6	20.7	312
Loss making but taxes still paid	(7,707)	236	.36	(0.5)	126	2	-	73	-	(5.9)	35

Source : CMIE

The second positive is on the business losses that will be allowed to be carried forward indefinitely as against 8 years at present. However, since it would impact the exchequer coffers, the reduction in income-tax which is aimed at a gradual increase in tax base would be offset by :

- Withdrawal of tax incentives on exports, infrastructure and area based holidays
- The allowable depreciation rate on plant and machinery is also proposed to be brought down to 15 per cent

Following are some investment-based incentives :

- Revenue and capital expenditure on scientific research and development: deduction to the extent of 150 per cent of the expenditure will be allowed to all companies
- Under the new provisions, tax liability will accrue in various specified infrastructure sectors only after 100 per cent of the capital expenditure is recovered, allowing these companies to postpone the tax liability. Following are sectors :
    - Generation, transmission and distribution of power
    - Specified infrastructure projects
    - Hospitals
    - Food processing, packaging, cold storage, agricultural warehouse
    - Oil and Gas
    - SEZ

Once the Code is implemented, both domestic and foreign companies would be paying tax at a low rate of 25 per cent as against 33.99 per cent and 42.23 per cent, respectively, at present (inclusive of surcharge and education cess). While domestic companies would pay 15 per cent tax on the dividends that they actually distribute, foreign companies would be required to pay a 'branch profit tax' at the same rate whether or not they remit profits outside the country.

Dividend distribution tax which at present is charged at the hands of the company will continue at the rate of 15 per cent of the amount declared as dividend.

MAT - IS IT REALLY NEGATIVE?

6. The new Code suggests a rate of 0.25 per cent of the value of gross assets for banking companies and 2 per cent for all other companies. A very striking aspect of the new Code's suggestions is that the MTA will be a final tax and it will not be allowed to be carried forward for tax credit in subsequent years.

Hence, with the above, there would be a shift from book profits to value of gross assets. The basis of computing would be on gross assets = Value of Gross Fixed Assets + Capital work-in-progress + Book value of all other assets - Accumulated depreciation - Debit balance in profit and loss account.

This aspect on the move is looking at the logic of a minimum RoI that the company would earn. However, the more clearer picture is to keep a check on the tax evasion. Many corporates have been using loopholes in tax such as inflated invoices (over-invoicing) to officially avail higher depreciation thus reducing overall tax to be paid, *i.e.*, if an actual asset is costing Rs. 100 crs., it is billed at say Rs. 150 crs. and, thus, the depreciation availed is on Rs. 150 crs., which reduces the taxes. This difference of Rs. 50 crs. is actually never paid and, hence, the tax saved is money earned, which is routed through tax heavens back into the company as promoter's capital.

Hence, while the actual aim is to look at tax evasion, companies suffering genuine losses or lower RoI stand to lose.

7. SECTORAL IMPACT

Sector	*Key Discussions*	*Its Impact on the sector*
Agriculture - Mild positive	- Reduction in the Corporate Tax rate - Introduction of long-term capital gain tax long-tax - Decrease in the depreciation rate for Plant & Machinery to 15 per cent - As per current regulations, SEZ profits are 100 per cent exempt for the first five years, then 50 per cent for the next 5 years, and again 50 per cent for the next five years, subject to re-investment.	The corp. rate reduction would be off-set by lower tax shield. No mention of SEZ benefits continuation since boost to set-up SEZ's in agriculture would enable export sales rise. So far the sector is only dependant on domestic sales
Automobiles - Mild Positive	- Cut in corporate tax rate - Changes in Personal Income-tax slabs - The allowed rate of depreciation on Plant & Machinery has also been cut to 15 per cent - Minimum Alternate Tax (MAT) will be 2 per cent of the value of gross assets (15 per cent of Book Profit at present).	- Rising disposable income would boost auto sales - Companies going for higher capex stand to lose due to reduced depreciation on plant & machinery. This would be off-set against lower corp. tax rate. - High capex planned by Auto Majors such as Tata Motors, Bajaj Auto, M&M would stand to lose due to MAT. State-wide (area based) exemptions clarity is yet to come.
Banks - Positive	- Increase in Tax incentive limit on savings from Rs. 1 to 3 lakhs, but tax on such savings at the time of eventual withdrawal - Reduction in Corporate Tax rate to 25 per cent and MAT at 0.25 per cent of Gross Assets - Withdrawal of a tax exemption on interest paid up to Rs. 1.5 lakhs on home loans	- The trend on focusing on savings would boost savings and current account deposits for banks which the banks have been writing for long. Such deposits reduce the overall cost of deposits for banks. - Few banks to be hit due to MAT while stands positive on reduced corporate tax rate

Sector	*Key Discussions*	*Its Impact on the sector*
	- Provision for NPAs allowable up to 1 per cent of Aggregate Average Advances as against 7.5 per cent of Total Income and 10 per cent of Rural Advances at present.	- Bank subsidiaries in MF's and Insurance to be hit due to tax on eventual withdrawal to make investments in financial instruments
Infra - Neutral	- Reduction in corp. tax rate - MAT	- Reduction in corp. tax rate is positive - Negative for companies having presence in BOT space and claiming MAT credit.
Housing & Real Estate	(*a*) Interest on the housing loan borrowed for acquiring, construction, etc., (*b*) Repayment of principal of loan amount taken for acquiring, constructing, etc., a housing property. (*c*) Deduction for Repairs & Maintenance Following are the deductions from Capital Gains - if invested in Property or deposited in a Savings Scheme : **Deduction # 1** Capital Gain from: Any investment Asset and Investment in Residential house : **Deduction # 2** Capital Gain on Any investment Asset and Investment in Deposit in an account maintained under the Capital Gains Savings Scheme	(*a*) Currently, the interest paid by an assessee on the self-occupied property is allowed as a deduction from the taxable income to the extent of Rs. 1,50,000. But in the new Tax Code, this is not available (*b*) Now the re-payment of the principal amount is allowed as a deduction under section 80C (within the overall limit of Rs. 1,00,000). But this benefit has been removed under the new Tax Code (*c*) Now the assessee can claim a deduction of 30 per cent of the Annual Value, if the house is let out for tent. In the new Tax Code, 20 per cent on the Gross Rent is allowed as deduction **Conditions to be met on deduction 1** (*i*) The assessee does *not own any residential house*, other than the new investment asset, on the date of transfer of the original investment asset; and (*ii*) The origi-

Sector	*Key Discussions*	*Its Impact on the sector*
		nal investment asset was acquired prior to one year before the beginning of the financial year in which the transfer of the asset took place. So, if you have 2 residential houses and sell one and invest in a new residential house, you will not be eligible for the benefit. **Conditions to be met on deduction 2** (*i*) The original investment asset was acquired prior to one year before the beginning of the financial year in which the transfer of asset took place; and (*ii*) The deposit is made within a period of sixty days from the date of transfer of the original investment asset.
Power - Neutral	- Reduction in corp. tax rate & MAT - Reduction in rates of Depreciation on Plant & Machinery to 15 per cent	- Negative for companies such as CESC availing MAT credit, but since RoI on power projects is capped, not much impact would be seen - Companies availing higher rate of depreciation would stand to lose due to reduction in rates to 15 per cent for plant and machinery
Pharmaceutical - Negative	- Corp. tax rate reduction and MAT - Export-based incentive under Section 10 to be eliminated.	- Non-availability of MAT credit and exports to be hit which have been providing cushion to pharma companies. Reduction in corp. tax rate benefit would be off-set by non-availability of MAT credit. Hit on export incentives is 'major' negative

Sector	*Key Discussions*	*Its Impact on the sector*
Software - Neutral	- MAT - Reduction in corp. tax rate	- Many companies in IT & ITES have low tax rate and companies claiming MAT credit would be impacted negatively - Exemptions for SEZ which currently fall under section 10AA are the focus area for most IT companies and they are shifting most of their incremental business due to sunset clause for the STPI scheme. Removal of this exemption would negatively impact

Sectors which stand to gain due to reduction in corporate tax rate to 25 per cent as they are falling in higher tax bracket are capital goods, cement, hotels and metals.

INTERNATIONAL TAXATION

8. Over and above the corporate tax, foreign companies having operations in India will have to pay 15 per cent Branch Profit Tax (BPT), irrespective of the fact that whether they are repatriating funds or not.

Another major shift in the Code is approach towards tax avoidance. The enactment of General Anti Avoidance Rules (GAAR) in the new code puts burden of proof on the taxpayer to establish that availing tax benefits was not the main purpose of the transaction. The power of invoking GAAR has been vested with the Commissioners. Further, as per the provisions of DTC, all non-profit making organisations and all charitable trusts are now subject to tax payment of 15 per cent.

Cross-border acquisitions of Indian companies: The new Code would give more powers to the Income-tax Department in foreign deals: Foreign firms that acquired Indian companies have argued that Indian tax authorities have no *locus standi* over transactions that took place outside India between two overseas parties. The Indian tax regime has also reinforced its position on such issues by stipulating that the Tax Code overrides the Double Taxation Avoidance Agreements (DTAA) it has signed with other countries. The Code states that in a situation, wherein domestic law is amended subsequent to the signing of a treaty, the subsequent amendment will prevail over the treaty.

CONCLUSION

9. There is lot of hue and cry on MAT being negative, despite the positives on personal tax slabs and reduction in corporate tax rate. The main focus of the new Code is on tax evasion by making a simple change from book profits to value of assets.

Hence, though the revamp is the need of the hour which is aimed at widening the tax net, yet implementation would be the key to make it real.