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New DIRECT TAXES CODE in INDIA -A Review

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Direct Taxes Code Bill, 2010

- **The Bill proposes to amend and consolidate following existing direct tax laws:-**
  - **Income-tax Act, 1961**
  - **Wealth-tax Act, 1957**

No Gift -tax, Inheritance-tax in India

Direct Taxed Code (DTC): Present Status

- **Year 2005 - process to rewrite direct tax laws initiated.**
- **Aug, 2009 - a draft of Direct Taxes Code along with a discussion paper was released.**
- **June 2010 - a revised discussion paper was released.**
- **Aug, 2010 - DTC Bill, 2010 was introduced in the Parliament.**
- **At present, the DTC Bill is before the Parliamentary Standing Committee (PSC) on Finance.**
- **The DTC Bill, 2010, as amended based on the recommendations of the PSC, will be taken for consideration by the Parliament**
- **New Code scheduled to be effective from 1st April, 2012.**

DTC: Structural changes

- Income Tax Act, 1961 and the Wealth Tax Act, 1957 consolidated into a single legislation .
- Simple language, extensive use of tables, formulas
- Rationalized structure.
- Profit linked tax incentives replaced by investment linked incentives.
- Direct tax rates are part of the Code instead of annual Finance Acts – no need to be part of secret annual budgetary exercise.

Direct Taxes Code – Key features

- General Anti-Avoidance Rule (GAAR)
- Controlled Foreign Company Rules (CFC)
- Advance Pricing Agreements (APA)
- Residence of Companies - “place of effective management” criterion
- Introduction of branch profit tax on foreign companies

DTC: General Anti-Avoidance Rule

- **Impermissible Avoidance Arrangement**
  - **Where main purpose is to obtain tax benefit and it**
    - **Creates rights or obligations which would not normally be created between persons dealing at arm's length**

or

- **Results in misuse or abuse of the provisions of the Code**

or

- **Lacks commercial substance, in whole or in part**

or

- **Carried out in a manner which would not normally be employed for bona-fide purposes**

Consequences of GAAR

- Commissioner may declare any arrangement as impermissible avoidance arrangement and consequently he may,-
  - disregard any part or the whole arrangement
  - re-characterise the transactions
  - deny the tax benefit obtained.

GAAR : Issues

- **Why GAAR, and why not SAAR?**
- **Unfettered powers to Revenue Department?**
- **Why treaty overide?**
- **GAAR *vis-à-vis* LOB clause in a tax treaty?**
- **Retrospective operation of GAAR?**
- **Why the presumption against the taxpayer?**
- **Advance Ruling available?**

Controlled Foreign Company (CFC)

- A company incorporated abroad
- It is controlled or managed, directly or indirectly, by residents in India.
- Nature of income – predominantly passive
- Not a listed company
- Low tax jurisdiction -tax paid by such company in its jurisdiction is less than 50% of corresponding Indian tax; and
- Annual income of the company is more than Rs 25 lakhs (about $50,000).

Consequence of CFC

- Post tax income of the CFC shall be attributed to residents in India in proportion to their shareholding.
- Such attributable income shall be deemed to have been distributed as dividends and taxable as income in the same year.
- Deduction allowed if such income is actually received in subsequent year.
- Reporting requirement: interest in any foreign entity including CFC will be required to be disclosed.

CFC: Issues

- Why CFC now (may affect India Inc's investment abroad)?
- Should determination of low tax jurisdiction be based on simple effective rate of taxation?
- Why to include base companies?
- Why to attribute entire income instead of passive income only?
- How to attribute CFC income in case of multi-tier structure?

Advance Pricing Agreements

- The Government may enter into an agreement with a tax payer
  - to specify the manner in which arm's length price can be determined
  - in relation to an international transaction
- APA may be valid upto five years
- Manner of determination may be any of the methods prescribed with adjustments or variations

APA - Issues

- Unilateral and Bi-lateral APAs
- Constitution of authority to negotiate APA – whether professionals/experts to be involved
- Type of cases to be covered
- Time period for finalization of APA
- Revision of APA if significant changes take place.

Residence of a Company

<u>Current law</u>:

- A company is defined as resident in India if
  - It is incorporated in India, or
  - <u>whole</u> of control and management is situated in India during the year
- Definition is too narrow
- Scope of taxation in domestic law is narrower than treaty law which provides the criteria of "place of effective management".

Residence of a Company

<u>Proposal under DTC</u>:

- **A company is defined as resident in India if**
  - **It is incorporated in India, or**
  - **It’s place of effective management at any time during the year is situated in India**
- **“place of effective management” is defined as a place where:**
  - **Board of Directors make their decisions, or**
  - **the executive directors perform their duties, in case the Board routinely approves the decisions.**

Residence: Issues

- Why should a company incorporated abroad be treated as Resident in India?
- Will one Board meeting of a company incorporated abroad make it a resident in India?
- Why can’t the definition of “place of effective management” be more specific?
- What does happen when residence of a company incorporated abroad changes from resident to non-resident?

Branch Profit Tax on a Foreign Company

<u>Current law</u>:

- Taxation of Domestic company
  - On its income @ 30% plus Surcharge and Edu Cess
  - Dividend Distribution tax @ 15% (plus surcharge and cess) on post tax profits distributed
- Taxation of Foreign company
  - On its income @ 40% plus Surcharge and Cess
  - No such Dividend Distribution tax

Branch Profit Tax on a Foreign Company

Proposal under DTC:

- **Taxation of Domestic company**
  - On its income @ 30%
  - Dividend Distribution tax @ 15% on post tax profits distributed
- **Taxation of Foreign company**
  - On its income @ 30%
  - Additional tax by way of branch profit tax
    - @15% on total income
    - On total income minus normal tax payable
    - Only in case of income attributable to permanent establishment in India or immovable property.

Branch Profit Tax : Issues

- What is the need for introducing BPT when the current system is working well?
- Why treaty override provisions provided in respect of levy of BPT?
- Is BPT leviable in a case where there is a PE under domestic law but not under the tax treaty?
- Why is the BPT levied in the year of income , and not in the year of repatriation of post tax income?

Thanks