

## Direct Taxes Code 2013

3 April 2014



### Background

Recently, the Finance Minister has released the Direct Taxes Code, 2013 (DTC 2013) for public discussion/comments. The first version of DTC was introduced in August 2009 when Government unveiled the DTC along with a discussion paper to replace the Income-tax Act, 1961 (the Act) and the Wealth Tax Act, 1957. In June 2010, the Government released the revised discussion paper incorporating several changes to address concerns over some major issues arising therefrom.

In August 2010, the Government tabled a revised version in the form of DTC 2010 in the Lok Sabha which was then referred to the Standing Committee on Finance (SCF) for its review and comments. The Standing Committee after deliberating with the recommendation given by various stakeholders submitted their report to the Parliament on 9 March 2012.

Thereafter, in September 2012, Kelkar Committee in its report on 'Road Map for Fiscal Consolidation' suggested a comprehensive review of DTC. Hence, Government decided to revise the DTC after considering suggestions given by SCF and present the revised version in the parliament.

As per news reports, out of 190 recommendations made by SCF, 153 are proposed to be accepted wholly or in part. Some of the key recommendations accepted include exemption to taxation of income from indirect transfer for shareholders having small shareholdings (upto 5 per cent), modification in definition of place of effective management, broad based General Anti-avoidance Rules (GAAR), etc. The following paragraphs give an overview of the provisions of DTC 2013. We trust you would find these useful.

### International Tax

#### ***Indirect transfer of shares of an Indian company***

DTC 2013 has provided that an asset or a capital asset, being any share or interest in a company or entity registered outside India shall be deemed to be situated in India, if the share or interest derives, directly or indirectly, its value substantially from the assets (whether tangible or intangible) located in India.

The share or interest shall be deemed to derive its value substantially from the assets (whether tangible or intangible) located in India, if on the specified date, the value of such assets:

- Exceeds the amount as may be prescribed; or
- Represents at least twenty per cent of the Fair Market Value (FMV) of all the assets owned by the company or entity, as the case may be.

DTC 2010 provided for a 50 per cent threshold of global assets to be located in India for taxation of income from indirect transfer in India. Based on the recommendation of SCF, that the threshold was too high, the DTC 2013 now provides for a threshold of 20 per cent of global assets to be located in India for taxation of income from indirect transfer in India.

DTC 2013 proposes to exempt small shareholder who does not hold the right of management or control exceeding 5 per cent directly or indirectly and on satisfaction of certain prescribed condition. This was also recommended by SCF. However, recommendations related to exemption on transfer of listed shares outside India and overseas intra-group restructuring are not accepted.

SCF had also recommended that the criteria for computing the FMV of the assets could be applied on a particular date instead of any time during the 12 months preceding the transfer. This recommendation is accepted in DTC 2013 which provided the definition of 'specified date' as the date on which accounting period of company /entity whose share/interest is transferred ends and which immediately precedes the date of transfer of the asset share/interest in the company.

### ***Place of effective management***

DTC 2013 has provided that a foreign company is considered to be a resident in India if its Place of Effective Management (POEM) at any time in the year is in India. POEM has been defined to mean the place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are in substance made. However, under the Act, foreign company is treated as resident in India only when its place of control and management of its affairs is situated wholly in India.

The definition of POEM has been changed from earlier version of DTC. This change is in line with the SCF's recommendation that that term 'executive directors', and 'officers' may be removed from the definition of POEM and the definition should be more objective and in line with internationally accepted standards.

Accordingly, a foreign company having POEM in India will be treated as a tax resident in India and would be consequently liable to be taxed in India on its global income.

### ***Widening of source rules***

The scope of 'royalty' under the Act has been extended retrospectively with effect from 1 June 1976. These provisions have been proposed to be introduced under DTC 2013. In addition to that, DTC 2013 further expanded the scope of royalty to include consideration for the use or right to use transmission by satellite, cable, optic fibre or similar technology, use or right to use ship or aircraft, transfer of all or any rights (including the granting of a license) in respect of live coverage of any event and cinematographic films or work on films, tapes or any other means of reproduction.

Further, the Act provides for taxation of interest payable by the non-resident in respect of any debt incurred and used for the purpose of business carried on by the non-resident in India. DTC 2013 expanded the scope of this provision to include interest payable by the non-resident in respect of any debt incurred and used for the purpose of earning any income from any source in India. Thus, interest paid, though not claimed as deduction in India, would still be taxable by virtue of the extended source rule.

### ***Availment of tax treaty benefit***

The tax treaty related provisions under DTC 2013 are in line with the provisions of the Act. The beneficial provisions of the tax treaty would prevail over the Act. However, beneficial provisions of the tax treaty may not apply where GAAR, branch profit tax and Controlled Foreign Company (CFC) related provisions are invoked. DTC 2013 provides that liability of foreign company on account of branch profit tax cannot be treated as discriminatory.

Under DTC 2013, the taxpayer can claim tax treaty benefit only if it obtains Tax Residency Certificate (TRC) from the specified authority of the foreign territory. Further, such taxpayer also needs to obtain other documents and information, as may be prescribed. The Indian Government is empowered to issue notification defining terms which are not defined under DTC 2013 or the tax treaty and the same meaning will be deemed to take effect from the date when the concerned tax treaty came into force.

### ***Levy of branch profit tax***

Under DTC 2013, every foreign company, in addition to income-tax payable, is liable to pay branch profit tax at the rate of 15 per cent in respect of branch profits of

a financial year. As compared to the provisions of the Act, DTC 2013 reduces corporate income-tax rate for foreign companies from 40 per cent to 30 per cent, which is in line with the tax rate of domestic companies. However, branch profit tax is levied additionally.

Branch profit tax is levied on income attributable, directly or indirectly, to the Permanent Establishment (PE) or an immovable property situated in India, as reduced by the amount of income-tax payable on such attributable income. Branch profit tax is applicable irrespective of the tax treaty. Accordingly, the effective tax rate for a foreign company would be 40.5 per cent on income attributable to its Indian PE.

## General Anti-Avoidance Rules

Provisions of GAAR were originally introduced in DTC 2009. Subsequently, GAAR has been included in the Act with certain modifications. GAAR applies to transaction which are 'impermissible avoidance arrangement'. The proposed GAAR provisions under DTC 2013 are in line with the Act with a few modifications.

DTC 2013 proposes to expand the definition of 'connected person' to include company carrying on business or profession in which the holding company has substantial interest.

Under the Act, the entire arrangement may be declared as impermissible arrangement even if a part of arrangement is impermissible arrangement. The SCF had proposed that it needs to be clarified only that part of the arrangement would be invoked which is proved as 'impermissible'. However, the same has not been accepted in DTC 2013.

The Standing Committee had recommended that the onus of proof should rest on the tax authority invoking GAAR. However, DTC 2013 proposes to rest the onus of proof on the taxpayers.

## Controlled Foreign Company

CFC provisions were first introduced in DTC 2010 to limit artificial deferral of tax by using offshore low taxed entities. It enables to tax the income of foreign companies situated in low tax jurisdiction but are controlled by the resident entities. The CFC provisions are as follows:

- The total income of a resident taxpayer to include income attributable to a CFC, which is defined to mean a foreign company:

- which is a resident of a 'territory with lower rate of taxation' (i.e. where taxes paid are less than 50 per cent of taxes on such profits as computed under DTC);
- whose shares are not listed on any stock exchange recognised by such territory;
- which is individually or collectively controlled by persons resident in India (through capital, voting power, income, assets, dominant influence, decisive influence, etc.); and
- which is not engaged in active trade or business (i.e. it is not engaged in commercial, industrial, financial undertakings through employees/personnel) and more than 25<sup>1</sup> per cent of its income comprises passive income (dividend, interest, etc.)

The above provisions continue to be in line with DTC 2010, except the following:

- DTC 2013 provides that in computing the rate of tax in the foreign jurisdiction, for the purpose of determining coverage under the CFC regime, the credit of foreign taxes paid by the foreign entity shall be included in taxes paid.
- It lowers the threshold of 'passive income' proportion of the foreign company, to 25 per cent of its income (from 50 per cent in DTC 2010).
- It includes a provision empowering the Central Government to notify a country or specified territory outside India as not being 'a territory with lower rate of taxation' having regard to tax rates and tax exemptions prevailing therein.

The specified income of CFC shall be treated as 'Nil' if it is negative or less than INR 2.5 million.

DTC 2013 provides that no adjustment shall be made to the income attributable to CFC on account of transfer pricing adjustment in respect of the international transaction between Indian resident entity and CFC.

Dividend received in a subsequent year from a foreign company to whom provisions of CFC apply, will be reduced from the total income to the extent it has been taxed as CFC attributable income in any preceding financial year.

---

<sup>1</sup> DTC 2010 provided that if more than 50 per cent of its income is comprising of passive income then CFC provision will apply.

## Corporate Tax

### **Computation of income from business**

DTC 2013 has proposed that certain businesses for e.g. as covered under section 80-IA, 80-IB, 80-IC (certain specified undertakings) etc of the Act shall be treated as distinct and separate business and its income shall be computed separately. SCF recommendations have not been accepted in this regard.

The profits from any business, other than Specified businesses whose income is dealt by the relevant schedules, shall be the gross earnings from the business as reduced by the amount of business expenditure incurred.

Gross earnings are listed in detail in DTC 2013 and include accruals and receipts connected with business. Key inclusions are as follows:

- Amount received on cessation, termination or forfeiture of any agreement entered into in the course of business.
- Consideration for transfer of carbon credits.
- Profits on transfer of business capital assets.
- Any amount accrued or received as advance or security deposit from a long-term lease or transfer of a business asset.
- Outstanding stagnant balance of creditor for more than five years, except where recovery suit/arbitration is pending or where beneficiary is a sick industrial company.

Business expenditure in DTC 2013 is broadly classified into the following three mutually exclusive categories: (a) Operating expenditure, (b) Permitted financial charges, (c) Capital allowances. There is a detailed listing of qualifying operating expenditure which also includes a residuary clause to cover any other expenditure if it is laid out or expended wholly for the business purpose and is not capital in nature.

DTC 2013 clarifies that a person who has acquired the assets on a finance lease will be deemed to be the owner of the asset.

DTC 2013 has reduced the weighted deduction for scientific research and development allowance from 200 per cent to 150 per cent. However, unlike DTC 2010 which allowed deduction to all the companies, DTC 2013 allows deduction only to the company engaged in the business of biotechnology or in the business of manufacture or production of any article or thing, not being an article or thing specified in Fourteenth Schedule.

### **Deduction for corporate social responsibility related expenditure**

Under the Companies Act, 2013, any specified company should mandatorily spend 2 per cent of their net profits in every financial year on CSR activities. DTC 2010 and the Act do not include specific provisions for allowability of the expenditure incurred on CSR activities.

Accordingly, the Committee had recommended that tax deduction for CSR expenditure in backward regions and districts may be provided to encourage more CSR activities in places where it is required.

However, the DTC 2013 does not provide for allowability of CSR expenditure. The website of the Income-tax department<sup>2</sup> provides a rationale that the CSR expenditure cannot be allowed as a business deduction as it is an application of income. Further, allowing deduction for CSR expenditure would imply that the government would be contributing one third of this expenditure, as revenue foregone.

### **Minimum alternate tax**

DTC 2013 proposes to levy MAT at the rate of 18.5 per cent as against the earlier rate of 20 per cent provided under DTC 2010. MAT is levied if the tax liability under the regular provisions is lower than 18.5 per cent of the book profits (after prescribed additions/deletions). The provisions of MAT are applicable to Insurance, Banking and Electricity companies as well. However, income from life insurance business is not covered under the MAT provisions of DTC 2013.

The carry forward of MAT credit is allowed for 10 years under DTC 2013 as compared to 15 years prescribed in DTC 2010.

DTC also allows carry forward of MAT paid under the provisions of Act. This is in line with SCF's recommendations.

### **Alternate minimum tax**

DTC 2013 proposes to introduce the provisions of Alternate Minimum Tax (AMT) applicable to a firm in line with the existing provisions under the Act. AMT is levied at the rate of 18.5 per cent if the tax liability under the regular provisions is less than the 18.5 per cent of the adjusted total income.

<sup>2</sup> [www.incometaxindia.gov.in](http://www.incometaxindia.gov.in)

The adjustments relate to various investments and deductions as allowed in the computation of the normal income.

The carry forward for AMT is allowed for a period of 10 years. DTC 2013 also allows carry forward of AMT paid under the provisions of Act. This is in line with SCF's recommendations.

## **Tax on dividend received in excess of INR 10 million**

DTC 2013 proposes to introduce an additional levy of 10 per cent on the resident shareholder if the total amount of dividend received exceeds INR 10 million. Under the current provisions of the Act, once a domestic company has paid Dividend Distribution Tax (DDT) at the rate of 15 per cent, no tax is further required to be paid by a shareholder on such dividend received.

This dividend income subject to an additional levy of 10 per cent above falls under the category of 'special source' of income and no deduction of expenditure is allowed to be set-off against such income. The additional tax is to be paid by the resident shareholder over and above the DDT paid by the distributing company.

## **Income distribution tax on Mutual Funds, Securitisation Trusts and Insurance companies**

DTC 2013 proposes to cast an obligation on the non-equity oriented mutual funds and Securitisation Trusts to pay tax on the distribution of income at the following rates:

- 25 per cent where the payment is made to an individual/Hindu Undivided Family (HUF); and
- 30 per cent where the payment is made to any other person.

Correspondingly, the income is not taxable in the hands of recipient unit holders of mutual fund; therefore, there is no need to withhold tax.

In case of Securitisation Trusts, no distribution tax is required to be paid where the payment is made to any person who is not liable to tax. The provisions pertaining to taxation of Securitisation Trusts in DTC 2013 are in line with the provisions of the Act.

DTC 2013 proposes that income distribution by the life insurers to the policy holders will attract distribution tax at following rates:

- In case of an approved equity oriented insurance scheme at the rate of 5 per cent; and
- In case of scheme other than an approved equity oriented insurance scheme at the rate of 25 per cent if the payment is made to an individual/HUF and at the rate of 30 per cent if the payment is made to any other person.

Any income received from a life insurer on which the distribution tax has been paid by the life insurer is not taxable in the hands of the policy holder.

Income arising under a life insurance policy is not taxable where the amount is received on completion of the original period of contract of insurance and the premium paid or payable in any of the year does not exceed 10 per cent of the capital sum assured.

Tax is not required to be deducted in case of payment of income by life insurers to policy holders under any scheme.

SCF had recommended that the capital sum assured should be at least 10 times of the annual premium as a pre-condition for granting tax exemption in relation to the proceeds / benefits of the life insurance policies. The recommendations of SCF about capital sum assured being at least 10 times of the annual premium has been accepted.

## **Capital Gains**

DTC makes a distinction between 'investment assets' and 'business assets' and provides that gains arising from the transfer of 'investment assets' are taxable under the head 'capital gains'.

DTC 2013 has proposed that 'investment asset' has been amended to include any self-generated capital asset in the course of business and any security held by a qualified foreign investor.

In line with the recent introduction of certain provisions<sup>3</sup> of the Act, the scope of transfer of 'investment asset' is widened to include the disposing of an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding the fact that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

In line with the certain other provisions<sup>4</sup> of the Act, DTC 2013 has proposed exemption for income arising on transfer of any 'investment asset' by a firm to a company as a result of succession by a company in the business carried on by the firm subject to certain conditions. SCF had recommended exemption for income arising on succession of a firm by a company as well as on transfer of asset by a firm to a company. DTC 2013 has been amended in relation to transfer of assets but not in relation to succession.

It is proposed that in respect of assets acquired prior to 1 April 2000, appreciation in value till 1 April 2000 is kept out of the taxable net.

While DTC 2013 continues with exempting specified transfers, it has made provisions only for substitution of cost base, while not including specific provision providing the benefit of holding period of the transferor.

Under the Act, there is litigation as to whether indexation benefit may be availed by a successor when asset is acquired under gift, inheritance, succession, etc. DTC 2013 is more specific permitting benefit of indexation from the year of acquisition of asset by the previous owner.

Under the DTC 2013 for all assets other than listed securities, the applicable threshold for the asset to turn long-term is 1 year reckoned from the end of the financial year in which asset is acquired. The asset may, therefore, turn long term if held for a period of 1 year 1 day to close to two years depending on the date of acquisition of the asset.

Benefit of indexation in respect of long term capital gain may be claimed by all taxpayers. Individuals and HUF may also be entitled to the benefit of roll over exemption. Long term capital gain is however, taxed at normal rate (as against concessional tax rate in the Act)

It is proposed that in case of non-resident, any income arising from transfer of an investment asset, being a security purchased in foreign currency shall be computed in foreign currency and reconverted to Indian rupees.

Further where the full value of consideration of an 'investment asset' is not ascertainable or cannot be determined, then FMV of the said 'investment asset' on the date of transfer would be deemed to be the full value of consideration.

DTC 2013 has also proposed that 'Cost of Acquisition' of an 'investment asset' acquired on dissolution of an unincorporated body or on distribution of any asset on the liquidation of a company shall be the fair market value or the stamp duty value, as the case may be, on the date of distribution of the asset. SCF recommendation is accepted in this regard.

DTC 2013 has proposed that 'Cost of Acquisition' of an 'investment asset' acquired through any of the prescribed modes of acquisition, shall be the full value of consideration for such acquisition. The SCF had recommended that in cases of exempt transactions which are subsequently taxed on account of non-compliance of conditions, the cost in the hands of the transferee should be the full value of consideration. Though the recommendation was in relation to those transactions which are subsequently taxed, condition of being taxed has been skipped, and replacement of higher cost is allowed to all the transactions.

DTC 2013 has proposed that 'Cost of Acquisition' should include prescribed expenditure incidental to purchase, if borne by the person. In this relation, the SCF recommendations have been accepted. This a restrictive provision, till now all such expenditure were allowed.

DTC 2013 has proposed that the specified deemed income, taxable as capital gains, shall be deemed to be the income of the successor, if the predecessor ceases to exist in the financial year in which the transfer is taxable. SCF recommendation is accepted in this regard.

DTC 2013 has proposed that for computation of indexed cost of acquisition / improvement, the benefit of period of holding by the previous owner, in case of transfer by special modes, should be provided and thereby increasing such indexed cost. SCF recommendation is accepted in this regard.

<sup>3</sup> Explanation 2 to Section 2(47) of the Act

<sup>4</sup> Section 47(xiii) of the Act

DTC 2013 has proposed that any amount by way of advance, security deposit or of similar nature received and retained on account of negotiations for transfer of whole or part of, or any interest in, any 'investment asset' is made as gross residuary income.

DTC 2013 has proposed that in case of compulsory acquisition, the period for acquiring new asset or the period for depositing the amount for claiming rollover benefit, shall be reckoned from the date of receipt of the compensation. SCF recommendation is accepted in this regard.

DTC 2013 proposes an exemption from capital gains tax arising on conversion of an Indian branch of a foreign bank into a subsidiary company.

#### **The following recommendations of the Standing Committee have not been accepted:**

- For the purposes of determining the cost of an 'investment asset' received on retirement by a participant from an unincorporated body, the FMV on the date of distribution to be considered as cost of acquisition.
- The security held by Foreign Institutional Investors (FII) should not be included in the definition of 'investment asset'.

### **Conversion of partnership firm into LLP/Company**

Presently, conversion of a partnership firm into a Limited Liability Partnership (LLP) or a company is exempt from tax under the Act on fulfillment of certain conditions. There was no clarity on this aspect in the earlier version of DTC. The Committee had recommended that tax neutrality may be provided on conversion of a partnership firm into a LLP or a company.

DTC 2013 has provided that transfer of any investment asset by a firm to company as a result of conversion of the firm into LLP/company in accordance with the provisions of relevant Act shall be exempt if specified conditions are satisfied.

### **Residuary Income**

DTC 2013 proposes to tax the amount of voluntary contribution received by a person, other than an individual or a HUF or a non-profit organisation, by including it in the gross residuary income. Further it proposes to include any income of a resident attributable to CFC as a residuary income.

DTC 2013 also proposes to include any amount received as advance, security deposit or otherwise, from the long-term leasing of any interest in any investment asset, etc. as the residuary income.

### **Carry forward and set-off of losses**

Losses brought forward under the head, income from house property, income from business or profession, income from speculation business and income from activity of owning and maintaining race horses under the Act shall be set-off and carried forward against the income computed under DTC 2013 in a prescribed manner.

Losses brought forward under the head capital gains (whether short term or long term) under the Act shall be set-off and carried forward against the income computed under the head capital gains in DTC 2013 upto 8 financial years. SCF's recommendation on carried forward capital loss is accepted.

In respect of losses incurred in subsequent years, DTC 2013 provides intra-source and intra-head set-off of loss from ordinary sources for an unlimited period. However, speculative loss, capital loss, loss from activity owning and maintaining of horses, tonnage tax scheme, etc. can be carried forward for limited period. There are special rules which regulate losses incurred in investment linked tax holiday activities.

Loss incurred by the predecessor/transferor entity can be carried forward by successor entity in case of business reorganisation of residents (amalgamation and demerger), corporatisation of non-corporate entities and conversion into LLP, etc. provided the predecessor was in the business for at least 3 years and the successor satisfies the continuity of the business test by continuing the business of the predecessor for 5 years. Further specific provisions on quantification of loss to be transferred on demerger have been proposed in DTC 2013.

### **Collection and recovery of tax**

DTC 2013 requires a person to deduct tax on the specified payments to a non-resident at the appropriate rate. However, for the payments which are not specified, an amount paid is to be deducted only if it is chargeable to tax. Under the Act, payments to non-resident which are chargeable to tax are subject to deduction of tax at source. SCF had recommended to bring these provisions in line with the Act which has not been accepted.

Under DTC 2013, a person shall not be called upon to pay tax himself to the extent tax is deductible and has been so deducted from payment made to him. This is in accordance with the recommendations made by SCF.

The provisions similar to those under the Act with respect to prescribing of time limit for passing an order for default in deducting/collecting taxes at source, higher deduction of tax for non-furnishing of Permanent Account Number (PAN), higher deduction of tax for transactions with persons located in Notified Jurisdictional Area, issue of lower/nil tax deduction certificate by Assessing Officer, non-deduction of tax on certain payments on furnishing of declaration, etc. are now proposed under DTC 2013.

In line with the Act, the payments made to a non-resident of a country with which India has entered into a tax treaty, and where the tax treaty provides for a lower rate of tax, then such lower rate is to be adopted for deduction of tax. The concern raised due to the language of DTC 2010 as regards time for deduction of tax has been clarified in DTC 2013 by deeming a specified payment to be made, if such payment has been made by credit to the account of the payee or any other account, whether called suspense or by any other name. The change is in line with the recommendation made by SCF.

DTC 2013 proposes a significant amendment to allow an employer to consider any other income of the employee while deducting tax under the head 'income from employment', provided the income does not have the effect of reducing the tax deductible on income under the head 'Income from employment'.

A threshold has been proposed for non-deduction of tax in respect of the following payments:

- Royalty, fees for professional/ technical service and non-compete fees paid to residents - INR 30,000
- Consideration paid for transfer of immovable property - INR 500,000
- Interest received on time deposits by senior citizens – INR 20,000

DTC 2010 requires every seller, who is receiving an amount in cash for sale of bullion or jewellery to collect 1 per cent of sale consideration from the buyer subject to a prescribed ceiling.

SCF recommended definitions of various terms such as commission, brokerage, rent, professional service, etc. The same have been accepted under the DTC 2013.

### The rates for deduction of tax proposed under DTC 2013 are as follows:

Interest (other than specified interest)	20%
Specified Interest (interest to FII or QFI between 1 June 2013 and 1 June 2015, interest on monies borrowed in foreign currency, interest on infrastructure debt fund payable to a non-resident)	5%
Dividend other than dividends subject to DDT	20%
Royalty or Fees for Technical Services (FTS)	25%
Winning from lottery, or crossword puzzle or card game or any other game of gambling or betting	30%
Winning from race, including horse race	30%
Payment to non-resident sports person and by way of guarantee money to a non-resident sports association or institution in relation to any game or sport played in India	10%
Payment to non-resident entertainer in respect of his performance in India	10%
Payment by way of insurance including reinsurance	20%
Any other sum, if chargeable to tax	30%

### Computation of total income

Under DTC 2013, income is broadly classified into two categories for computing total income i.e. 'ordinary sources' and 'special sources'.

The income classified under 'ordinary sources' is in line with the Act viz. income from employment, house property, business income, capital gains and residuary sources. However, the income from special sources includes investment income, royalty/FTS, etc. Accordingly, total income of taxpayer is an aggregate of total income from 'ordinary source' and 'special source'.



DTC 2013 proposes to expand the scope of 'special source' income so as to include within its ambit the value of investments; value of bullion jewellery, other valuable article or money owned; amount credited in books; amount of expenditure incurred if one of the following conditions is satisfied viz. there is no explanation; an explanation is offered but there is a failure to substantiate the same; or the explanation offered is not to the satisfaction of the AO.

## Transfer Pricing

On the Transfer Pricing front, DTC 2013 has not been significantly amended vis-à-vis DTC 2010. Consequential amendments in relation to international transactions, Specified Domestic Transactions (SDT), tolerance band, safe harbor, Advance Pricing Agreements (APA), etc. have been proposed to be in line with the existing provisions of the Act.

One of the significant change is an expansion in the definition of 'associated enterprise' to include 'associated persons' in respect of SDT (i.e. persons covered under Section 40A(2)(b) of the Act). In the absence of profit linked deductions under DTC 2013, SDT is not applicable in respect of transactions under profit linked deductions. However, DTC 2013 is silent as regards grandfathered profit linked deductions.

As compared to elaborate definition of 'intangible property' under the Act, DTC 2013 has provided a shorter and inclusive definition of this term.

A few recommendations made by SCF on APA that it is to be concluded in a time bound manner and it should be a part of the tax treaties have not been accepted in DTC 2013.

## Tax on income received from Venture Capital Company and Venture Capital Fund

The provisions relating to taxability of income of Venture Capital Fund (VCF) or Venture Capital Company (VCC) under DTC 2013 have been aligned with the following provisions of the Act:

- Only Securities and Exchange Board of India (SEBI) registered Category I Alternate Investment Fund (AIF), sub category VCF and existing VCFs/VCCs registered under the SEBI VCF regulations are per se eligible for the automatic tax pass through.

- The tax pass through is available only in respect of income from venture capital undertakings (VCU). Sectoral restrictions have been dispensed with and the definition of VCU has been made in line with the definition of VCU under the respective SEBI regulations.
- Income of the qualifying AIF/VCF/VCC will be subject to tax in the hands of investors on an accrual basis irrespective of actual distribution thereof by the qualifying AIF/VCF/VCC to the investors.

The Act provides for a withholding tax exemption on income paid by qualifying AIF/VCF/VCC to its investors. However, such withholding tax exemption is not provided for in DTC 2013 (nor was such an exemption present in DTC 2010).

## Wealth Tax Provisions

Under the Wealth Tax Act, 1957, tax is payable in respect of the net wealth on the corresponding valuation date by every individual, HUF and Company. The wealth tax is levied at the rate of 1 per cent of the amount by which the net wealth exceeds INR 3 million. Further, the wealth tax is levied with reference to only certain specified assets subject to certain exemptions.

Under DTC 2013, every individual, HUF and private discretionary trust, will be liable to pay tax on the net wealth on the valuation date of a financial year. It also provides a list of assets which are not subject to wealth tax. The proposed asset base is very wide compared to the present Wealth-tax Act. DTC 2013 captures all assets, physical or financial (including listed and unlisted shares), for wealth tax as against only unproductive assets captured in DTC 2010. Non-residents, foreign citizens and foreign companies may not be required to pay wealth tax in respect of assets situated outside India. Further, valuation rules may be prescribed for determining the value of net wealth.

Individuals, HUF's and private discretionary trusts are subject to wealth tax at rate of 0.25 per cent. Further, in case of individuals and HUF threshold limit is prescribed as INR 500 million. However, DTC 2010 had provided for threshold limit of INR 10 million and tax rate of 1 per cent of net wealth exceeding that limit.

## Our comments

DTC 2013 includes some of the key recommendations of SCF and also tries to align with the provisions of the Act. Despite acceptance of many of the recommendations given by SCF, several clauses of DTC 2013 may compel taxpayers to rethink on their existing structures and mode of conducting business/transactions. These clauses include reduction in threshold of value of assets in India as a percentage of global assets to 20 per cent for taxation of income from indirect transfer, no reduction in individual tax rates, levy of additional taxes on dividends exceeding INR 10 million, no deduction on CSR expenditure, absence of machinery for settlement commission, higher tax rate of 35 per cent for taxable income above INR 100 million, etc.

The current DTC's fate will depend on the policies and priorities of the next government. Therefore, one would have to wait for the formation of the next government post-general election and whether DTC would be on their business agenda. However, the DTC 2013 does provide the taxpayers with valuable insights into the immemerging trends in the policies and thought processes of the tax collectors.



[www.kpmg.com/in](http://www.kpmg.com/in)

**Ahmedabad**

Commerce House V, 9th Floor, 902  
& 903, Near Vodafone  
House, Corporate Road,  
Prahlad Nagar,  
Ahmedabad – 380 051  
Tel: +91 79 4040 2200  
Fax: +91 79 4040 2244

**Bangalore**

Maruthi Info-Tech Centre  
11-12/1, Inner Ring Road  
Koramangala, Bangalore 560 071  
Tel: +91 80 3980 6000  
Fax: +91 80 3980 6999

**Chandigarh**

SCO 22-23 (1st Floor)  
Sector 8C, Madhya Marg  
Chandigarh 160 009  
Tel: +91 172 393 5777/781  
Fax: +91 172 393 5780

**Chennai**

No.10, Mahatma Gandhi Road  
Nungambakkam  
Chennai 600 034  
Tel: +91 44 3914 5000  
Fax: +91 44 3914 5999

**Delhi**

Building No.10, 8th Floor  
DLF Cyber City, Phase II  
Gurgaon, Haryana 122 002  
Tel: +91 124 307 4000  
Fax: +91 124 254 9101

**Hyderabad**

8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad 500 034  
Tel: +91 40 3046 5000  
Fax: +91 40 3046 5299

**Kochi**

4/F, Palal Towers  
M. G. Road, Ravipuram,  
Kochi 682 016  
Tel: +91 484 302 7000  
Fax: +91 484 302 7001

**Kolkata**

Infinity Benchmark, Plot No. G-1  
10th Floor, Block – EP & GP,  
Sector V Salt Lake City,  
Kolkata 700 091  
Tel: +91 33 44034000  
Fax: +91 33 44034199

**Mumbai**

Lodha Excelus, Apollo Mills  
N. M. Joshi Marg  
Mahalaxmi, Mumbai 400 011  
Tel: +91 22 3989 6000  
Fax: +91 22 3983 6000

**Pune**

703, Godrej Castlemaine  
Bund Garden  
Pune 411 001  
Tel: +91 20 3050 4000  
Fax: +91 20 3050 4010

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks of KPMG International Cooperative (“KPMG International”), a Swiss entity.