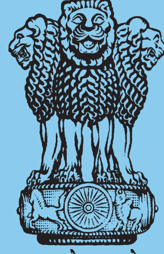

सत्यमेव जयते

In my Speech to Parliament on the 6th July, 2009 while presenting the Union Budget for 2009-10, I had stated that tax reform is a process and not an event. I had also promised to pursue structural changes in direct taxes by releasing the new Direct Tax Code within the next 45 days for public debate. I am happy to be able to fulfil this promise by releasing the draft Direct Taxes Code along with a Discussion Paper today.

The thrust of the Code is to improve the efficiency and equity of our tax system by eliminating distortions in the tax structure, introducing moderate levels of taxation and expanding the tax base. The attempt is to simplify the language to enable better comprehension and remove ambiguity to foster voluntary compliance. The new Code is designed to provide stability in the tax regime as it is based on well accepted principles of taxation and best international practices. It will eventually pave the way for a single unified taxpayer reporting system. It will specially meet the aspirations of our young and professionally mobile population.

I invite all members of the public to go through this draft and share their valuable suggestions with us. I am sure through our collective effort, we will be able to build a consensus and finalise this Draft Code so that we can present it to Parliament in the Winter Session, 2009 for enacting a Direct Tax Code for the 21st Century which will be compatible with the needs of a fast developing economy.

PRANAB MUKHERJEE

FINANCE MINISTER

12th AUGUST, 2009
NEW DELHI

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1.1 The Income Tax Act was passed in 1961 and has been amended every year through the Finance Acts. The Act deals with income tax. Dividend Distribution Tax was included in the Act by inserting Chapter XIID with effect from June 1, 1997. Fringe Benefit Tax was included in the Act by inserting Chapter XIIH with effect from April 1, 2006. Wealth Tax is administered through the Wealth Tax Act, 1957.

1.2 Tax administrators, chartered accountants and tax payers have raised concerns about the complex structure of the Income Tax Act. In particular, the numerous amendments have rendered the Act incomprehensible to the average tax payer. Besides, there have been frequent policy changes due to changing economic environment, complexity in the market, increasing sophistication of commerce, development of information technology and attempts to minimize tax avoidance. The problem has been further compounded by a multitude of judgements (very often, conflicting) rendered by the courts at different levels.

1.3 Any complex tax legislation increases the cost of compliance as well as administration. Given that the cost of compliance is essentially regressive in nature, this undermines the equity of the tax system. Similarly, high cost of administration is wasteful.

1.4 Over the last twenty five years, the marginal tax rates have been steadily lowered and the rate structure rationalized to reflect the best international practices. Any further rationalization of the tax rates may not be feasible without corresponding increase in the tax base. Broadening of the base is important to enhance revenue productivity of the tax system and to improve its horizontal equity.

1.5 The strategy for broadening the base essentially comprises of three elements. The first is to minimize exemptions. For many decades, the tax base has been eroded through a steadily escalating range of exemptions. The removal of these exemptions will have three consequences: (i) it will result in a higher tax-GDP ratio; (ii) it will enhance GDP growth, since tax exemptions and deductions distort allocative efficiency; and (iii) it will improve equity (both horizontal and vertical), reduce compliance costs, lower administrative burdens, and discourage corruption. The second element of the strategy relates to the problem of ambiguity in the law which facilitates tax avoidance. Therefore, it is necessary to undertake a periodic exercise of rewriting the Tax Code in the light of new trends in interpretation by the judiciary, aggressive tax planning by taxpayers, and new opportunities for reducing compliance cost through massive induction of technology and public private partnership. The third element of the strategy relates to checking of erosion of the tax base through tax evasion.

1.6 The Direct Taxes Code (hereafter referred to as the 'Code') is designed to reflect this strategy.

1.7 The Code is not an attempt to amend the Income Tax Act, 1961; nor is it an attempt to "improve" upon the present Act. In drafting the Code, the Central Board of Direct Taxes (the Board) has, to the extent possible, started on a clean drafting slate. Some assumptions which have held the ground for many years have been discarded. Principles that have gained international acceptance have been adopted. The best practices in the world have been studied and incorporated. Tax policies that would promote growth with equity have been reflected in the new provisions. Hence, while reading the Code, it would be advisable to do so without any preconceived notions and, as far as possible, without comparing the provisions with the corresponding provisions of the Income Tax Act, 1961.

The Code seeks to consolidate and amend the law relating to all direct taxes, that is, income-tax, dividend distribution tax, fringe benefit tax and wealth-tax so as to establish an economically efficient, effective and equitable direct tax system which will facilitate voluntary compliance and help increase the tax-GDP ratio. Another objective is to reduce the scope for disputes and minimize litigation.

Briefly, the salient features of the Code are as under:-

: All the direct taxes have been brought under a single Code and compliance procedures unified. This will eventually pave the way for a single unified taxpayer reporting system.

: With the expansion of the economy, the number of taxpayers can be expected to increase significantly. The bulk of these taxpayers will be small paying moderate amounts of tax. Therefore, it is necessary to keep the cost of compliance low by facilitating voluntary compliance by them. This is sought to be achieved, inter alia, by using simple language in drafting so as to convey, with clarity, the intent, scope and amplitude of the provision of law. Each sub-section is a short sentence intended to convey only one point. All directions and mandates, to the extent possible, have been conveyed in active voice. Similarly, the provisos and explanations have been eliminated since they are incomprehensible to non-experts. The various conditions embedded in a provision have also been nested. More importantly, keeping in view the fact that a tax law is essentially a commercial law, extensive use of formulae and tables has been made.

: Wherever possible, an attempt has been made to avoid ambiguity in the provisions that invariably give rise to rival interpretations. The objective is that the tax administrator and the tax payer are ad idem on the provisions of the law and the assessment results in a finality to the tax liability of the tax payer. To further this objective, power has also been delegated to the Central Government/Board to avoid protracted litigation on procedural issues.

: The structure of the statute has been developed in a manner which is capable of accommodating the changes in the structure of a growing economy without resorting to frequent amendments. Therefore, to the extent possible, the essential and general principles have been reflected in the statute and the matters of detail are contained in the rules/Schedules.

: For most taxpayers, particularly the small and marginal category, the tax law is what is reflected in the Form. Therefore, the

structure of the tax law has been designed so that it is capable of being logically reproduced in a Form.

: In order to enable a better understanding of tax legislation, provisions relating to definitions, incentives, procedure and rates of taxes have been consolidated. Further, the various provisions have also been rearranged to make it consistent with the general scheme of the Act.

: Traditionally, the taxing statute has also been used as a regulatory tool. However, with regulatory authorities being established in various sectors of the economy, the regulatory function of the taxing statute has been withdrawn. This has significantly contributed to the simplification exercise.

: At present, the rates of taxes are stipulated in the Finance Act of the relevant year. Therefore, there is a certain degree of uncertainty and instability in the prevailing rates of taxes. Under the Code, all rates of taxes are proposed to be prescribed in the First to the Fourth Schedule to the Code itself thereby obviating the need for an annual Finance Bill. The changes in the rates, if any, will be done through appropriate amendments to the Schedule brought before Parliament in the form of an Amendment Bill.

Taxes are compulsory payments which citizens in a country are required by law to make to the government for defraying the cost of providing public goods and financing transfer payments. Therefore, they have to be financed from taxes. This immediately raises the question of the basis of allocating the costs i.e. the basis of determining the distribution of tax payments.

Since taxes are payments without a direct quid pro quo (except good governance) and are meant to cover the cost of common goods and services, it is generally accepted that individuals' or households' tax liabilities should be according to their ability to pay. Such a basis is considered fair. If this be granted, it would follow that those with equal abilities should make equal tax payments and those with higher abilities should be asked to make proportionately larger payments. This rule sounds simple enough but, in translating the principle into practice, a number of problems arise and several other considerations may also have to be kept in mind.

Two alternatives, income and consumption, are generally accepted as the best indicators of ability to pay. Traditionally, income has been taken as a test of ability to pay (or index of potential welfare), and direct taxation has been mainly based on income. Consumption can also represent the ability to pay and has been used as an indicator.

If equitable taxation should be in accordance with the capacity to pay of the taxpaying unit, and if income is to be taken as a measure of the capacity to pay, it must be so defined for tax purposes as to reflect adequately the potential economic welfare of the individual concerned i.e., the capacity he has to spend during a year without affecting his net worth as at the beginning of the year. This means that the definition must be comprehensive enough to include all accruals to spending power. The conventional definition of income does not do so. Ideally, we need a comprehensive definition of "income" for tax purposes. Such a definition of income would include, apart from gifts received,

(a) all earnings including labour, investment and business income net of cost of earning and depreciation;
(b) net accrued capital gains i.e. net increases in the value of capital assets owned;
(c) value of services or utility of non-business assets owned net of cost of maintenance and depreciation;
(d) imputed value of the services rendered by the members of the family;
(e) windfall gains; and
(f) casual receipts, e.g., lottery prizes.

The conceptual basis of the definition is clear: the definition equates income to consumption plus change in net worth. However, in practice it is not possible to measure satisfactorily all the elements included. First, imputation of proper values to items of income in kind flowing from non-business assets and services rendered by the members of the family unto themselves is almost impossible to measure and, therefore, they have to be left out of the definition. This is not, however, considered a serious problem except for house property. Second, in regard to changes in the present value of all assets owned by an individual, problems arise when they are not normally marketed. Two examples may be mentioned: (i) the change in the current value of pension rights; and (ii) the change in the value of the assets of closely owned businesses. Third, even when market values are known, taxing an increase in capital value on accrual, instead of on realization basis, will create hardship. Fourth, under a comprehensive income tax, strictly speaking, the pro-rata share of each shareholder in the undistributed profits of companies should be allocated to him and included in his taxable income. This cannot be done for reasons which are well recognised. Fifth, even in the absence of inflation, it is difficult to accurately measure economic depreciation. Since depreciation allowance has to be granted on the basis of rough estimation, the measurement of business income is at best an estimate and the true magnitude cannot be known.

If the pro-rata share of undistributed profits of companies cannot be taxed directly in the hands of the shareholders, the introduction of a personal income tax will lead to the formation of incorporated entities and avoidance of the tax by not distributing the profit. The intention would be to take profits out in course of time in the form of capital gains. To prevent such means of avoidance, a tax has to be imposed on the profits of corporations. This leads to the phenomenon of the so-called double taxation of dividends, which apart from the extra burden placed on equity holders, creates a bias towards debt finance.

The real income flowing from non-business assets such as consumer durables may have to be ignored for administrative reasons. But it would not be proper to leave out the real income or utility flowing from owner-occupied houses, because rental income from house property has to be included in taxable income. There would be taxpayers who would be renting their houses and living in rented houses in other places for reasons of business or for some other reason. As against this, those taxpayers who live in their own houses do not have to pay rent. The two groups would be treated equally only if the imputed income from owner-occupied houses is included in taxable income. But imputation of income is not easy when a house has not been rented for a long time or at all. Also, if in course of time rents rise substantially, the imputed income might become a large part, or exceed, the other income of the owner-occupier. Hence a neat solution is not possible, and often the income from owner occupied houses is not subjected to tax. Thus the comprehensiveness of the definition of income is further eroded.

In line with the principles and the problems discussed above, the Code seeks to adopt, to the extent possible, a comprehensive definition of income. Therefore, income for

the purposes of this Code will, in general, include all accruals and receipts of revenue and capital nature unless otherwise specified. Exemptions, if any, have been made on the consideration of positive externalities, encouraging human development and reducing risk, equity, and reducing compliance and administrative burden. Further, on account of the assignment of the taxing powers under the Constitution to the States, agricultural income has been excluded from the scope of this Code. Some exceptions, which are essentially in the nature of deferrals, have also been provided in the Code with a view to mitigating the problem of liquidity.

The public goods and services provided by the Government are enjoyed, in general, by all persons (both natural and non-natural) living within that country. Therefore, it is logical for all such persons to contribute towards such public goods and services. This forms the underlying basis of the principle of residence-based taxation of income.

The principle of residence-based taxation asserts that natural persons or individuals are taxable in the country or tax jurisdiction in which they establish their residence or domicile, regardless of the source of income. In the case of non-natural persons such as companies or firms, the place of incorporation or the place where control or management is exercised is deemed to be the place of residence. In the context of income tax, the ability to pay of the residents of that country is fully measured by their global income. Therefore, the principle of residence-based taxation of income envisages the taxation of global income. Key reasons for taxing the foreign source income of residents are to achieve horizontal and vertical equity goals and to improve the tax neutrality of investment decisions (efficiency).

However, there are individuals/entities whose "residence" is in one country but their business is actually carried on in another country and their income is earned in the latter country. In such cases, the principle of residence-based taxation would be inappropriate. This would be especially so in developing countries which attract substantial foreign investments. Therefore, there is a view that the country which provides the opportunity and facilities to generate income or profits should also have the right to tax the same. This forms the underlying basis of the principle of source-based taxation of income. This principle is invariably applied to non-residents in a country and envisages the taxation of only such income which is sourced in that country.

The term 'source' is generally not defined in the tax legislation. The common law has developed a number of principles which operate in the absence of statutory provisions. Whether or not the income will be seen to be sourced in a country under the common law principles is a question of fact in the circumstances of a particular case. International practice varies as to the nature and extent of the source rules. Generally, countries use geographical boundaries, types of income or a mixture of both to determine the extent to which they will seek to tax income sourced in their jurisdiction.

Conceptually, a country may adopt either pure residence based taxation or pure source based taxation. The pure residence based taxation is supported on the consideration that it promotes economic efficiency since the decision on the location of the investment remains unaffected by the tax rate. It is neutral to capital export. Further, it is relatively

easier to pin down the income unlike in the case of source based taxation. However, the pure residence based taxation is not adopted for three reasons. First, pure residence based taxation reduces revenues in poor developing countries, who rely heavily on source based taxation, and leans in favour of the rich developed countries where investors reside. Secondly, residence based taxation is much easier to evade or avoid, by channeling international investments through tax havens. Thirdly, political and economic considerations do not allow a country to give up the right to collect tax from foreigners doing business within its territory.

Pure source based taxation is an option that has been favoured by some experts. However, the major problem with this option is that it enables foreign investors to play one country against another or others in order to obtain the lowest source based tax rate. This leads to aggressive tax competition (race to the bottom) resulting in erosion of revenue base. In addition, the problems of determining the source of income and of unraveling aggressive transfer pricing that leads to suppression of income would become much more acute in a world of pure source based taxation.

In practice, countries have tended not to stay with the pure application of either principle. They have applied a mix of residence and source based direct taxation, the former for nationals (including non-natural persons) residing in the country and the latter for income earned within the country by non-residents. The precise nature of mixes has depended on each taxing jurisdiction's perception of the relative importance of a number of factors, notably the volume of foreign investment that is attracted, the revenue implications, the domestic administrative capabilities, and the degree of cooperation that can be expected from competing jurisdictions. Under the Code, residence based taxation is applied for residents and source based taxation for non-residents. A resident in India will be liable to tax in India on his world-wide income However, a non-resident in India will be liable to tax in India only in respect of accruals and receipts in India (including deemed accruals and receipts). The total income of a person will also include the income arising to spouse, minor child and other entities in specified circumstances. However, the Second Schedule enumerates incomes that are exempt from taxation and these incomes will not form part of the total income.

Residency rules have an important role to play in tax treaties as they clarify the right to tax and assist in the avoidance of double taxation. All countries have residence tests for both natural persons (individuals) and legal persons (companies). The residency test for individuals is usually based on either physical presence in the country (legal form, such as citizenship) or facts and circumstances that prove residence in a country (economic substance, such as the country where the person has a fiscal presence) or a combination of the two. In many cases, this may be satisfied simply by being present in a country for a prescribed period of time. The tax residence of companies (that is, where companies are

established or carry on business) is usually based on either place of incorporation (legal seat), location of management (real seat) or a combination of the two.

Under the Code, the residential status of an individual in a financial year will continue to be determined on the basis of his stay in India during the financial year and the earlier years. He would be a resident in India if,-

(a) he is in India for 182 days or more during the financial year; or
(b) he is in India for 365 days or more during the four years immediately preceding the financial year and for 60 days or more in the financial year.

The residency of an individual will be determined only on the basis of the test specified in sub para (a) of para 4.9 in the case of,-

(a) an Indian citizen who leaves India during the financial year for the purpose of employment outside India with an employer;
(b) an Indian citizen who leaves India as a member of a crew of an Indian ship; and
(c) an Indian citizen or a person of Indian origin, who comes to India on a visit during the financial year.

An individual will be treated as a person of Indian origin if either he or either of his parents or any of his grand-parents was born in undivided India.

An Indian company will always be treated as resident in India. However, a foreign company can either be resident or non-resident in India. It will be treated as resident in India if, at any time in the financial year, the control and management of its affairs is situated wholly or partly in India (it need not be wholly situated in India, as at present).

A Hindu Undivided Family (HUF), partnership firm, an association of persons or any other person will be resident in India if the control and management of their affairs are wholly or partly situated within India at any time in the relevant financial year.

A person will be a non-resident in India if he is not a resident in India.

Under the Code, the concept of "resident but not ordinarily resident" for an individual and a Hindu undivided family will be replaced by providing exemption to the income of an individual sourced outside India and not derived from a business controlled or a profession set up in India. This exemption will be available to the individual in the financial year in which such individual becomes a resident and in the immediately succeeding financial year, if such individual was a non-resident for nine years immediately preceeding the financial year in which he becomes a resident.

Under the 1961 Act, the income earned in a year is taxed in the next year. The year in which income is earned is termed as 'previous year' and the following year in which it is charged to tax is termed as 'assessment year'. For example if a person earns any income during the year beginning on 1 April 2006 and ending on 31 March 2007, then 2006-2007 will be the previous year and the income shall be assessed to tax in assessment year 2007-2008. The use of the two expressions has caused confusion in both compliance and administration. In order to simplify the provisions, the separate concepts of 'previous year' and 'assessment year' will be replaced by a unified concept of 'financial year'. The existing concept of assessment year will be done away with. Under the Code, all rights and obligations of the taxpayer and the tax administration will be with reference to the 'financial year'. This change will not change the existing system of deduction of tax at source and payment of advance tax in the year of earning of income and payment of self-assessment tax in the following year before filing of tax return. This proposal will simplify the existing provisions.

The 1961 Act provides for an inclusive definition of the word "person". It includes an individual, HUF, company, firm, association of persons, body of individuals, local authority and artificial juridical person. Taxable entities like co-operative society, any other society, non-profit organisation and private discretionary trust are assessed as association of persons. Similarly, the institution of Government, though otherwise exempt from tax in respect of its own income, is required to fulfill certain obligations in terms of withholding of tax and filing of information. In the Code, Government, trust, co-operative society, any other society and any non-profit organization will be included in the definition of 'person'. The persons specified in the Third Schedule will not be liable to income tax either wholly or partly, as specified therein.

Under the 1961 Act, assessee is a person by whom any tax or any other sum of money is payable or a person in respect of whom any proceeding under the 1961 Act has been taken (including representative assessee) or any person who is deemed to be an assessee or deemed to be an assessee in default. The definition is important since an assessee has certain rights and obligations under the 1961 Act. In the Code it is proposed to include the following "other persons" within the definition of 'assessee':-

(a) any person to whom any amount of refund is payable under the Code; and
(b) any person who voluntarily files a return of tax bases irrespective of the fact that he is otherwise not under an obligation to do so.

This change will enable taxpayers to obtain refund of tax deducted at source. It will also help tax payers currently below the threshold level to report their income and maintain a track record of filing returns in anticipation of earning higher - and hence taxable - incomes in the future.

All accruals and receipts in the nature of income, other than those enumerated in the Second Schedule, will be classified into independent sources from which the income is derived. Each of these sources would be a 'special source' or an 'ordinary source'.

The special sources are sources of income specified in the Fourth Schedule. The income from these sources will be liable to tax at a scheduler rate on gross basis. No deduction is allowed for any expenditure and the gross amount is subject to tax, generally at a lower rate. This is the application of presumptive taxation.

All other sources of income will be ordinary sources.

The accruals or receipts relating to 'ordinary sources' will be further classified under five different heads:

A. Income from employment
B. Income from house property
C. Income from business
D. Capital gains
E. Income from residuary sources.

A person may have many sources under each head. The first step will be to compute the income in respect of each of these sources. This could either be income or loss (negative income). For example, if a person carries on several businesses, the income from each and every such business will have to be separately computed. The second step will be to aggregate the income from all the sources falling within a head to arrive at the figure of income assessable under that particular head. The result of such computation may be a profit or a loss under that head. The aforesaid two steps will be followed to compute the income under each head. The third step will be to aggregate the income under all the heads to arrive at the 'current income from ordinary sources'. The fourth step will be to aggregate the current income with the unabsorbed loss at the end of the immediate preceding financial year, if any, to arrive at the 'gross total income from ordinary sources'. If the result of aggregation is a loss, the 'gross total income from ordinary sources' shall be 'nil' and the loss will be treated as the 'unabsorbed current loss from ordinary sources' at the end of the financial year. The various outcomes of this aggregation are presented in the Table below:

Current income from ordinary sources	1000	1000	1000	(-)1000	(-)1000
Unabsorbed preceding year loss from ordinary sources	Nil	(-)500	(-)1500	Nil	(-)1500
Gross total income from ordinary sources, of the financial year	1000	500	Nil	Nil	Nil
Unabsorbed current loss from ordinary sources of the financial year	Nil	Nil	(-)500	(-)1000	(-)2500

The 'gross total income from ordinary sources', so arrived, will be further reduced by incentives in accordance with sub-chapter I of Chapter III. The resultant amount will be 'total income from ordinary sources'.

A person may have many special sources. The first step will be to compute the income in respect of each of these special sources in accordance with the provisions of the Fourth Schedule. The income so computed with respect to each of such special sources shall be called 'current income from the special source'. The second step will be to aggregate the 'current income from the special source' with the unabsorbed loss from that special source at the end of the immediate preceding financial year, if any. The result of such aggregation shall be the 'gross total income from the special source'. If the result of aggregation is a loss, the 'gross total income from the special source' shall be 'nil' and the loss will be treated as the 'unabsorbed current loss from the special source', at the end of the financial year. The 'gross total income from the special source' shall be computed with respect to each of the special sources. The third step will be to aggregate the gross total income from all such special sources and the result of this addition shall be the 'total income from special sources'.

The 'total income from ordinary sources' will be aggregated with the 'total income from special sources' to arrive at the 'total income' of the taxpayer.

The loss under the head 'Capital gains' shall be ring-fenced and such loss shall not be allowed to be set off against income under other heads. Similarly the loss from speculative business will also be ring-fenced.

The losses will be allowed to be indefinitely carried forward for set off against profits in the subsequent financial years.

6.1 In line with international best practices and the principles laid down by the Courts, the following rules for avoiding double taxation or double deduction will be adopted:-

(a) An income which is included in the total income of any financial year shall not be included in the total income of any succeeding financial year.

(b) An income which is included in the total income of any person shall not be included in the total income of any other person, unless otherwise provided.

(c) Any amount which has been allowed as a deduction under any provision of the Code shall not be allowed as a deduction under any other provision of the Code.

(d) any amount which has been allowed as a deduction in any preceding financial year shall not be allowed as a deduction under any provision of this Code in the financial year.

6.2 Under the Code, the following expenditure will not be allowed as a deduction in the computation of total income :-

(a) any expenditure attributable to income which does not form part of the total income under this Code and determined in accordance with the method as may be prescribed;

(b) any expenditure incurred for any purpose which is an offence or which is prohibited by law;

(c) any provision made by a person for any liability if the liability remains unascertained by the end of the financial year; and

(d) any expenditure where the source of funds for such expenditure is unexplained;

(e) any expendutire incurred by a non-resident in respect of,-

 (i) royalty;

 (ii) fees for technical services; or

 (iii) any income which is liable to tax at the special rate of income-tax specified in Part II of the First Schedule.

6.3 Under the Code, no deduction shall be allowed for any payment in respect of which the assessee has failed to deduct tax at source in accordance with the provisions of the Code or having deducted such taxes has failed to pay the same to the Government within the specified time. However, as a general rule, an assessee will be allowed deduction in the year in which the payment is made to the Government. This general rule is subject to the following exceptions:

(i) if the tax has been deducted during the last quarter of the financial year and paid before the due date of filing of tax return for that financial year, the deduction will be allowed in the financial year; and

(ii) if the payment is made more than two years after the end of the financial year in which the tax was deductible at source, no deduction shall be allowed to the assessee.

7.1 "Income from employment" will be the gross salary as reduced by the aggregate amount of permissible deductions.

7.2 Gross salary will form part of the tax base on due or receipt basis, whichever is earlier. It will include the value of perquisites and profits in lieu of salary.

7.3 The permissible deductions will be the following:-

(a) amount of professional tax paid;

(b) transport allowance to the extent prescribed;

(c) prescribed special allowance or benefit to meet expenses wholly and exclusively incurred in the performance of duties, to the extent actually incurred;

(d) compensation under voluntary retirement scheme;

(e) amount of gratuity received on retirement or death;

(f) amount received on commutation of pension; and

(g) pension received by gallantry awardees.

7.4 The deductions in respect of the amounts referred to in items (d), (e) and (f) would be available to the extent the amounts are paid to, or deposited in a Retirement Benefits Account. The amounts received from an approved superannuation fund, hitherto exempt from income tax, will henceforth also be treated in the same manner.

7.5 This account will be required to be maintained with any permitted savings intermediary in accordance with the scheme framed and prescribed by the Central Government in this behalf. The permitted savings intermediaries will be approved provident funds, approved superannuation funds, life insurer and New Pension System Trust. The accretions to the deposits will remain untaxed till such time as they are allowed to accumulate in the account.

7.6 Any withdrawal made, or amount received, under whatever circumstances, from this account will be included in the income of the assessee for the year in which the withdrawal is made or the amount is received. Accordingly, it will be subject to tax at the appropriate personal marginal rate.

7.7 Under the Code, the salary will now include, inter-alia, the following:-

(a) the value of rent free, or concessional, accommodation provided by the employer irrespective of whether the employer is a Government or any other person;

(b) the value of any leave travel concession;

(c) the amount received on encashment of unavailed earned leave on retirement or otherwise;

(d) medical reiumbursement; and

(e) the value of free or concessional medical treatment paid for, or provided by, the employer.

7.8 The value of rent-free accommodation will be determined for all employees in the same manner as is presently determined in the case of employees in the private sector. The new regime of comprehensive taxation of perquisites across employees in all sectors of the economy will improve both the horizontal and vertical equity of the tax system.

8.1 Income from a house property, which is not occupied for the purpose of any business or profession by its owner, will be taxed under the head "Income from house property".

8.2 With a view to simplifying the determination of the taxable income and eliminating any scope for litigation, the Code will have a new scheme for computation of income from house property. The salient features of the new scheme will be as follows:-

(a) Income from house property shall be the gross rent less specified deductions.

(b) Gross rent will be the higher of (i) the amount of contractual rent for the financial year; and (ii) the presumptive rent calculated at six per cent per annum of the ratable value fixed by the local authority. However, in a case where no ratable value has been fixed, six per cent shall be calculated with reference to the cost of construction or acquisition of the property. If the property is acquired during the financial year, the presumptive rent shall be calculated for the proportionate period of that financial year.

(c) The advance rent will be taxed only in the financial year to which it relates.

(d) The gross rent of one self-occupied property will be deemed to be nil, as at present. In addition, the gross rent of any one palace in the occupation of a ruler will also be deemed to be nil, as at present.

(e) The following deductions will be admissible against the gross rent:-

  (i) Amount of taxes levied by a local authority and tax on services, if actually paid.

  (ii) Twenty per cent of the gross rent towards repairs and maintenance.

  (iii) Amount of any interest payable on capital borrowed for the purposes of acquiring, constructing, repairing, renewing or re-constructing the property.

(f) In the case of a self-occupied property where the gross rent is deemed to be nil, no deduction for taxes or interest will be allowed.

(g) The income from property shall include income from the letting of any buildings along with any machinery, plant, furniture or any other facility if the letting of such building is inseparable from the letting of the machinery, plant, furniture or facility.

9.1 The computation of income from business is the most important head of income having profound implications for the Revenue. Therefore, the Code has rationalized the provisions relating to computation of income from business.

9.2 Every business will constitute a separate source and, therefore, income will be computed separately for each business. With a view to reducing the scope for litigation, a business will be treated as distinct and separate from another business if there is no interlacing or interdependence or unity embracing the two businesses.

9.3 There are two models for computation of income under this head. The first is the model where the taxable income is equal to business profits with specified adjustments. However, this model does not provide for items of receipts which form part of business profit and deductions to be made therefrom. As a result, there are frequent disputes about taxability of receipts and deductions for expenses. The second model is the income-expenses model which is now followed in countries like U.S.A., Canada, Australia and most Asian countries. The computation of income from business under the Code will be based on the income-expenses model where the taxable income under this head will be equal to gross income minus allowable deductions. To the extent possible, the items of receipts and deductions for expenses are enumerated to reduce the scope for litigation.

9.4 The new framework for computation will be as follows:-

(i) All assets will be classified into business assets and investment assets. The business assets will be further classified into business trading assets and business capital assets.

(ii) The income from transactions in all business assets will be computed under the head 'income from business'. The income from transactions in all investment assets will be computed under the head 'capital gains'.

(iii) The profits from business will be equal to gross earnings from the business minus the amount of business expenditure incurred.

(iv) Income from business will be equal to the profits from business.

(v) Ordinarily, all accruals and receipts derived from, or connected with, business will form part of the 'gross earnings' irrespective of whether they are derived from business trading assets or business capital assets. These will, inter-alia, include the following:-

   (a) Profit on sale of business capital assets. (This will no longer be treated as capital gains).

   (b) Profit on sale of an undertaking under a slump sale. (This will no longer be treated as capital gains).

(c) The reduction or remission of any liability by way of loan, deposit or advance (other than those which are received by an individual from his relative, as defined).

(d) Consideration accrued or received in respect of transfer of any business asset self generated in the course of the business.

(e) Amount accruing to, or received by, the assessee on account of the cessation, termination or forfeiture of any agreement entered into in the course of business.

(f) Amount accruing to, or received by, the assessee, whether as advance or security deposit or otherwise, from the long term leasing or transfer of the whole or part of, or any interest in, any business asset.

(g) Amount accruing to, or received by, the assessee as reimbursement of any expenditure incurred by him.

(vi) The new items which are to be excluded from 'gross earnings from business' are:-

(a) income by way of interest other than the interest accruing to permitted financial institutions. (This will be treated as income from residuary sources).

(b) income from letting of any property consisting of any building or lands appurtenant thereto, of which the assessee is the owner, other than income from letting of any property in the course of running a hotel, convention centre or cold storage. (This will be treated as income from house property).

(vii) Business expenditure is classified into three mutually exclusive expenditure categories: (i) operating expenditure; (ii) permitted financial charges and (iii) capital allowances.

(viii) Operating expenditure is defined to include all expenditure laid out or expended wholly and exclusively for the purposes of business. This category covers all expenses which do not fall under 'permitted financial charges' or 'capital allowances'. The provision also contains a positive list of items of business expenditure which shall be treated as operating expenditure and a negative list of items of business expenditure which shall not be treated as operating expenditure.

(ix) Permitted financial charges are defined as expenses on account of interest payable on borrowed capital. These include interest payable to any creditor, discount on bonds/ debenture etc. and also other incidental charges payable for obtaining any loan. The deduction in respect of interest payable to banks/ financial institutions shall continue to be allowed on 'actually paid basis'.

(x) Capital allowance relates to deduction in respect of capital cost. It includes depreciation and initial depreciation on business assets and allowance for scientific research and development.

(xi) Depreciation on business capital assets will be allowed with reference to the adjusted written down value of the block of assets. The rates of depreciation

presently prescribed in the Income-tax Rules will be specified in the Schedule to the Code. Further, the depreciation regime will also be extended to expenses hitherto amortised.

(xii) Scientific research and development allowance will be allowed with reference to expenditure on scientific research and development since such expenditure generates positive externalities. The salient features of the allowance are:

(a) 100 per cent deduction for any revenue expenditure laid out or expended on scientific research related to the business.

(b) 100 per cent deduction for any capital expenditure, other than expenditure on land.

(c) 150 per cent deduction for any expenditure (both revenue and capital) incurred on in-house research and development by a company, excluding expenditure on land.

(d) The scope of the weighted deduction of 150 per cent will be extended to all industries.

(e) The term 'scientific research' will be comprehensively defined.

(xiii) Loss on sale of business capital assets, which is treated as capital loss under the 1961 Act, will be treated as intangible asset and depreciation will be allowed at the same rates applicable to the relevant block of assets. Effectively, therefore, a taxpayer will be allowed to set off only a fraction of the loss every year. This will, accordingly, serve as a disincentive for asset stripping and loss manipulation.

(xiv) The determination of profit of certain businesses on presumptive basis will continue. These include :-

(a) Business of civil construction.

(b) Business of supplying labour for civil construction

(c) Business of plying, hiring or leasing of heavy goods vehicle.

(d) Business of plying, hiring or leasing of light goods vehicle.

(e) Business of retail trading.

(f) Business of civil construction in connection with a turnkey power project approved by the Central Government in this behalf.

(g) Business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government in this behalf.

(h) Business of providing services or facilities in connection with the prospecting for, or extraction or production of, mineral oil.

(i) Business of supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils.

(j) Business of operation of ships (including an arrangement such as slot charter, space charter or joint charter)

(k) Business of operation of aircraft (including an arrangement such as slot charter, space charter or joint charter)

(xv) Separate income determination regimes are provided for the following:-

(a) Business of insurance.

(b) Business of operating a qualifying ship.

(c) Business of mineral oil or natural gas.

(d) Business of generation, transmission or distribution of power.

(e) Business of developing a special economic zone.

(f) Business of operating and maintaining a hospital.

(g) Business of processing, preserving and packaging of fruits or vegetables.

(h) Business of developing, or operating and maintaining, or developing, operating and maintaining, any infrastructure facility.

Income from transactions in all investment assets will be computed under the head "Capital gains".

Investment asset has been defined to mean any capital asset other than business capital asset.

Capital gain is the term used for the amount by which the sale price of a capital asset, net of any expense incurred in connection with the sale of the asset, exceeds the acquisition price of the capital asset. Capital gain is a return on investment or a form of compensation for foregoing current consumption opportunities. Since capital gain increases the ability to pay of the person receiving such gain, it should form part of taxable income.

Special treatment of capital gains under an income tax regime is merited for two reasons. Firstly, taxing gains each year, as they accrue, would strain the finances of an individual who has yet to receive these gains in hand. Secondly, the capital gain realized when a capital asset is sold is usually the accumulated appreciation in the value of the asset over a number of years. The 'bunching' of such appreciation in the year in which the asset is sold pushes the seller into a higher marginal tax bracket if the value of the asset is sufficiently high. If no special treatment is accorded to capital gains, a progressive income tax would discriminate against those whose income from capital assets is in the form of capital gains as compared to those whose income is derived from interest or dividends.

The gains (losses) arising from the transfer of investment assets will be treated as capital gains (losses). These gains (losses) will be included in the total income of the financial year in which the investment asset is transferred irrespective of the year in which the consideration is actually received. However, in case of compulsory acquisition of an asset, capital gains will be taxed in the year in which the compensation is actually received.

The present distinction between short-term investment asset and long-term investment asset on the basis of the length of holding of the asset will be eliminated.

The capital gains arising from the transfer of personal effects and agricultural land beyond specified urban limits will be exempt from income-tax.

In general, the capital gains will be equal to the full consideration from the transfer of the investment asset minus the cost of acquisition, cost of improvement thereof and transfer-related incidental expenses. However, in the case of a capital asset which is transferred anytime after one year from the end of the financial year in which it is acquired, the cost of acquisition and cost of improvement will be adjusted on the basis of cost inflation index to reduce the inflationary gains.

The capital gains from all investment assets will be aggregated to arrive at the total amount of current income from capital gains. This will, then, be aggregated with unabsorbed capital loss at the end of the immediate preceding financial year (unabsorbed preceding year capital loss) to arrive at the total amount of income under the head ‘Capital gains’. If the result of the aggregation is a loss, the total amount of capital gains will be treated as 'nil' and the loss will be treated as unabsorbed current capital loss at the end of the financial year.

The Securities Transaction Tax will be abolished. Therefore, all capital gains (loss) arising from the transfer of equity shares in a company or units of an equity oriented fund will form part of the computation process described in para 10.8 above.

For the purposes of capital gains, certain transactions are not treated as transfer, in order to allow deferral of tax liability. For example, the transfer of a capital asset under a gift or will is not treated as a transfer for the purpose of capital gains.

The cost of acquisition is generally with reference to the value of the asset on the base date or, if the asset is acquired after such date, the cost at which the asset is acquired. The base date will now be shifted from 1.4.1981 to 1.4.2000. As a result, all capital gains between 1.4.1981 and 31.3.2000 will not be liable to tax.

Courts have ruled that where the cost of acquisition of a capital asset is indeterminable, the machinery provisions for computing capital gains fail. Therefore, the gain from such asset cannot be subject to income tax. A general provision has therefore been made to the effect that the cost of acquisition of an investment asset shall be deemed to be nil if it cannot be determined or ascertained for any reason, and capital gains will be computed accordingly. A similar provision has been provided in respect of cost of improvement.

The benefit of 'rollover' will be available only to the following:-

(a) From agricultural land to one or more pieces of agricultural land.

(b) From any investment asset transferred anytime after one year from the end of the financial year in which the asset is acquired by the assessee, to a residential house, if the assessee does not own any residential house, other than the new asset, on the date of transfer of the original asset.

(c) From any investment asset transferred anytime after one year from the end of the financial year in which the asset is acquired by the assessee to deposit in an account maintained under the Capital Gains Savings Scheme.

All withdrawals, under whatever circumstances, from the account maintained under the Capital Gains Savings Scheme will be included in the income under the head ‘income from residuary sources’ and accordingly subject to tax.

11.1 The income under this head will be equal to the gross residuary income minus the specified deductions.

11.2 The gross residuary income will comprise of any income which does not form part of any other head of income.

11.3 Further, the scope of gross residuary income has been broadened to include, inter alia, some forms of income without regard to the fact that they may otherwise relate to, or have any incidental nexus with, some other head of income. These include, inter alia, the following:-

(a) Interest other than interest accruing to or received by permitted financial institutions.

(b) Amount received or retained on account of settlement or breach of any contract, if not included under the head "income from business".

(c) The redemption or withdrawal of the principal amount from any investment that is eligible for deduction in computing the total income. However, withdrawals/ redemptions from provident funds and pure life insurance policies will not be included under this head.

(d) Any amount accruing to, or received by, the assessee, whether as advance or security deposit or otherwise, from the long term leasing or transfer of the whole or part of, or any interest in, any investment asset.

11.4 Any amount exceeding Rs.20,000 taken or accepted or repaid as loan or deposit otherwise than by account payee cheque or draft shall be deemed to be income, and included under this head and taxed accordingly.

11.5 Any sum received under Life Insurance Policy, including any bonus, shall be exempt from income tax, provided it is a pure life insurance policy. In order to achieve this objective, the Code provides that deduction will be allowed in respect of any sum received under a Life Insurance Policy, including any bonus, only if the premium payable for any of the years during the term of the policy does not exceed 5 percent of the capital sum assured. Consequently, in all other cases, the sum received under the policy, including any bonus, will be included under this head and taxed accordingly.

12.1 Tax incentives take the form of exemptions or deductions. Tax incentives are usually classified into business tax expenditure or social tax expenditure.

12.2 Ordinarily, tax incentives are inefficient, distorting, inequitous, impose greater compliance burden on the tax payer and on the administration, result in loss of revenue, create special interest groups, add to the complexity of the tax laws, and encourage tax avoidance and rent seeking behaviour. The Parliamentary Standing Committee on Finance has recommended a comprehensive review of the tax incentives so that they are limited and confined to exceptional cases. Accordingly, all exemptions under the Income Tax Act, 1961 have been reviewed. Based on a comprehensive review, it has been decided that all business tax expenditures, other than for activities which create externalities, will be withdrawn. The social tax expenditures will, however, continue to be allowed with such modifications as are necessary to improve their efficacy.

12.3 Tax exemptions either exempt persons (liable to tax) or exempt income (from a specified source). Under the Code, tax exemptions have been rationalized in the following manner:-

(a) The source specific exemptions have been separately provided under section 9 read with the Sixth Schedule;
(b) The entity related exemptions have been separately provided under section 10 read with the Seventh Schedule;
(c) Exemptions which relate to specific heads of income have been provided for as deductions under the relevant heads of income;
(d) Non-profit organisations like scientific research associations, news agencies, professional association, welfare fund, education and medical institutions, religious trusts, trade unions, etc. will be allowed concessional tax treatment.

12..4 Tax incentives for savings have been rationalized so as to encourage net savings. Accordingly, in line with the best international practice in this regard, the Code proposes to introduce the ‘Exempt-Exempt-Taxation’ (EET) method of taxation of savings. Under this method, the contributions are exempt from tax (this represents the first 'E' under the EET method), the accumulation/accretions are exempt (free from any tax incidence) till such time as they remain invested (this represents the second ‘E’ under the EET method) and all

withdrawals at any time are subject to tax at the applicable personal marginal rate of tax (this represents the 'T' under the EET method).

12.5 Based on the aforesaid EET principle, the Code provides for deduction in respect of contributions (both by the employee and the employer) to any account maintained with any permitted savings intermediary, during the financial year. This account will be required to be maintained with any permitted savings intermediary in accordance with the scheme framed and prescribed by the Central Government in this behalf. The permitted savings intermediaries will be approved provident funds, approved superannuation funds, life insurer and New Pension System Trust. The accretions to the deposits will remain untaxed till such time as they are allowed to accumulate in the account.

12.6 Any withdrawal made, or amount received, under whatever circumstances, from this account will be included in the income of the assessee under the head 'income from residuary sources', in the year in which the withdrawal is made or the amount is received. Accordingly, it will be subject to tax at the appropriate personal marginal rate.

12.7 Further, the Code also provides that the withdrawal of any amount of accumulated balance as on the 31st day of March, 2011 in the account of the individual in the Government Provident Fund (GPF), Public Provident Fund (PPF), the recognised provident funds (RPFs) and the Employees Provident Fund (EPF) under the Employees Provident Fund and Miscellaneous Act will not be subject to tax. In other words, only new contributions on or after the commencement of this Code will be subject to the EET method of taxation.

12.8 The permitted savings intermediaries would be required to be approved by the Pension Fund Regulatory and Development Authority (PFRDA). These intermediaries will, in turn, invest the amounts deposited with them in government securities, term deposits of banks, unit-linked insurance plans, annuity plans, bonds and securities of public sector companies, banks and financial institutions, bonds of other companies enjoying prescribed investment grade rating, equity linked schemes of mutual funds, debt oriented mutual funds, equity and debt instruments. The choice of instruments will, in some schemes, be with the investor and in some others with the trustees of the schemes. The pattern of investment by the latter will be as prescribed.

12.9 Further, the rollover of any amount received, or withdrawn, from one account with the permitted savings intermediary to any other account with the same or any other permitted savings intermediary will not be treated as withdrawal. Hence, such rollover will not be subject to tax.

12.10 The Government will also design a system of central record keeping by an independent agency which will serve as a depository of all information relating to investment and withdrawal from the various accounts maintained by the assessee with the permitted savings intermediaries.

12.11 An individual or HUF will also be allowed deduction for amount paid towards tuition fees for children.

12.12 The aggregate amount of deduction for payment into the account maintained with any permitted savings intermediary and for the amounts referred to in para 12.11 above, shall not exceed rupees three hundred thousand.

12.13 The Code contains provisions that are intended to promote human development. Accordingly, deductions will be allowed:

(a) to an individual or HUF in respect of medical insurance premium for self, spouse, dependent children, or member of HUF upto a maximum of Rs.15,000 (Rs.20,000in the case of a senior citizen) and an additional sum in respect of medical insurance premium for parents upto a maximum of Rs.15,000 (Rs.20,000 if the parent is a senior citizen).

(b) to an individual or HUF for medical treatment or maintenance of disabled dependent of an amount of Rs.50,000 (Rs.75,000 in case of severe disability).

(c) to an individual or HUF for expenditure on medical treatment for prescribed diseases in case of self, spouse, dependent parents/children or a member of HUF up to a maximum of Rs.40,000 (Rs.60,000 in the case of a senior citizen).

12.14 Deduction of an amount of Rs.50,000 (Rs.75,000 in the case of a person with severe disability) will be allowed to an individual who is handicapped.

12.15 Deduction will be allowed to an individual for interest actually paid on a loan taken for higher education for self or spouse or children. The scope of the term 'higher education' has been enlarged. Higher education will mean full time studies in a graduate or postgraduate course.

12.16 The deduction will be allowed only if the loan is taken from a banking company or any other financial institution notified by the Central Government.

12.17 Deduction will be allowed to a company for both capital and revenue expenditure incurred by a company for promoting family planning as well as for preventing HIV/AIDS amongst its employees.

12.18 Deduction will be allowed to an individual, who is self-employed, for rent actually paid for his residence, in excess of ten per cent of his gross total income from ordinary sources. However, there will be a ceiling of rupees two thousand per month on the amount allowed as deduction.

12.19 The case for providing tax concessions for donations to non-profit organizations (charitable organizations) is based on two considerations. The first argument is that such donations usually create positive externalities. Secondly, such donations increase the flow of public goods and mitigate the burden on Governments. Therefore, the Code provides incentives for donations to non-profit organizations as follows:

(a) Deduction to all donors at the rate of 125 per cent of donations made to the following institutions:-
   (i) scientific research association or National Laboratory; and
   (ii) university, college or other institution for research in social science, scientific research or statistical research;

(b) Deduction to all donors at the rate of 100 per cent of donations made to the following institutions:-
   (i) Prime Minister's National Relief Fund;
   (ii) Chief Minister's Relief Fund;
   (iii) The Army Central Welfare Fund, The Indian Naval Benevolent Fund and The Air Force Central Welfare Fund; and
   (iv) such other funds as are enumerated in Part B of The Sixteenth Schedule.

(c) Deduction to all donors at the rate of 50 per cent of donations made to any other non-profit organization.

12.20 The case for tax holiday for certain businesses is based on the consideration that these businesses entail extremely high risk, lumpy investment, and a long payback period.

12.21 However, profit-linked incentives are inherently inefficient. Essentially, a profit-linked incentive is regressive in nature. Consequently, there is an inbuilt incentive for laundering and shifting of profits to the exempted activity. Since profit is the basis for exemption, there is no incentive for investment and upgradation during the period of tax holiday. Such profit-linked incentives also lead to significant loss of revenue and encourage rent-seeking behaviour. Hence, the Code substitutes profit-linked incentives by a new scheme. Under the new scheme, a person would be allowed to recover all capital and

revenue expenditure (except expenditure on land, goodwill and financial instrument) and he would be liable to income tax on profits made thereafter. The period consumed in recovering all capital and revenue expenditure will be the period of tax holiday. The new scheme will apply to the following:-

(a) Business of exploration and production of mineral oil or natural gas.
(b) Business of developing a special economic zone.
(c) Business of generation, transmission or distribution of power.
(d) Business of developing, or operating and maintaining, any infrastructure facility;
(e) Business of operating and maintaining a hospital in any area, other than the excluded area;
(f) Business of processing, preservation and packaging of fruits and vegetables.
(g) Business of laying and operating a cross country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of the network;
(h) Business of setting up and operating a cold chain facility; and
(i) Business of setting up and operating a warehousing facility for storage of agricultural produce.

12.22 The provisions of the Income Tax Act, 1961 that allow profit-linked incentives and other tax incentives contrary to the new scheme contained in the Code will be grandfathered.

12.23 The case for area based exemption is based on the consideration of balanced regional development. However, such area based exemptions create economic distortion, i.e., allocate/ divert resources to areas where there is no comparative advantage. Such exemptions also lead to tax evasion and avoidance. Besides, there is a huge cost of administration. Hence, the Code does not allow area-based exemptions. Area-based exemptions that are available under the Income Tax Act, 1961 will be grandfathered.

12.24 Deduction will be allowed to a resident individual, being an author, in respect of royalty received for the assignment or grant of any of his interest in the copyright of any book of literary, artistic or scientific nature and in respect of any textbook certified by the prescribed authority for an amount upto a maximum of Rs.300,000.

12.25 Deduction will be allowed to a resident individual, being a patent holder for income received by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970. The deduction will be upto a maximum of Rs.300,000.

12.26 Cooperative societies are formed for the promotion of thrift and self-help among agriculturists, artisans, crafts persons etc. The case for tax exemption to cooperative societies is based on the principle of mutuality i.e., no one can make a profit out of himself. In the context of cooperative societies, the surplus (profits) is essentially the return of what members have contributed to the society. Therefore, the surplus accruing to it cannot be regarded as income, profits or gains and subject to income tax.

12.27 Deduction will be allowed to cooperative societies which are essentially formed for self-help amongst agriculturists, artisans, craftsmen etc. The salient features of such deduction are as follows:-

(a) The profits derived from the business of providing banking or credit facilities to its members by the Primary Agriculture Credit Societies and Primary Co-operative Agriculture and Rural Development Banks will be entitled to 100 per cent deduction.

(b) The profits derived from agriculture or agriculture related activities by a Primary Co-operative Society will be entitled to 100 per cent deduction. For this purpose, "Agriculture-related activities" are defined to mean the following activities:-

  (i) purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to the members of the society;

  (ii) the collective disposal of,-

    (a) agricultural produce grown by the members; or

    (b) dairy or poultry produce of the members;

  (iii) fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to the members of the society;

(c) In the case of any other primary cooperative society engaged in activities other than those specified in (a) and (b) above, the profits derived from such activities will be entitled to 100 per cent deduction up to a maximum amount of Rs.100,000.

13.1 Companies or corporations are the most widely used and most efficient forms of doing business. They earn huge incomes. Hence, a tax on the profit of companies is considered reasonable and just. A tax on the income of companies can also be justified as a withholding tax that, in a comprehensive and timely manner, taxes the income which would otherwise flow to the shareholders.

13.2 The Code provides for taxing incomes of companies. The Code also provides for taxing dividends distributed by resident companies.

13.3 In theory, all profits should be distributed as dividends to the shareholders but, in the real world, only a part of the post-tax profit is distributed to the shareholders as dividend. A tax on dividend can either take the form of a tax in the hands of the shareholder at his personal marginal rate or take the form of a tax at a flat rate upon distribution of dividend by the company. The first method of taxation has been found to be administratively cumbersome and prone to leakage. The second method is administratively simple and with no possibility of leakage. Therefore, under the Code, dividends will be taxed under the second method in respect of dividend distributed by a resident company.

13.4 A resident company will be liable to dividend distribution tax at the rate of fifteen per cent of the amount declared by way of dividends.

13.5 Once a dividend has suffered dividend distribution tax, it will be exempt in the hands of the recipient.

13.6 A company would ordinarily be liable to tax in respect of its total income. However, owing to tax incentives and tax evasion, the liability on total income, in many cases, has been found to be extremely low or even zero. Therefore, internationally, a variety of economic bases and methods are used to calculate presumptive income so as to overcome the problems of tax incentives and tax evasion. For example, certain presumptions are based exclusively on the taxpayers' net wealth or on the value of the assets used in his business. Other presumptions are based on the gross receipts of the enterprise; some others are based on visible signs of wealth. Standard assessment methods use several key factors and indices of profitability, which vary according to the activity, to determine the taxpayer's income.

13.7 Several countries have adopted minimum taxes based on a fixed percentage of the assets of a business. The economic rationale for the assets tax is that investors can expect ex-ante to earn a specified average rate of return on their assets. Therefore, it provides an incentive for efficiency. Accordingly, the Code provides for Minimum Alternate Tax calculated with reference to the "value of the gross assets". The shift in the MAT base from book profits to gross assets will encourage optimal utilization of the assets and thereby increase efficiency

13.8 "Value of gross assets" will be the aggregate of the value of gross block of fixed assets of the company, the value of capital works in progress of the company, the book value of all other assets of the company, as on the last day of the relevant financial year, as reduced by the accumulated depreciation on the value of the gross block of the fixed assets and the debit balance of the profit and loss account if included in the book value of other assets.

13.9 The rate of MAT will be 0.25 per cent of the value of gross assets in the case of banking companies and 2 per cent of the value of gross assets in the case of all other companies.

13.10 Under the Code, MAT will be a final tax. Hence, it will not be allowed to be carried forward for claiming tax credit in subsequent years.

14.1 Under the Code, partnership firms, Association of Persons and Body of Individuals will be collectively referred to as "unincorporated body" and their members as "participants".

14.2 The salient features of the scheme of taxation of unincorporated bodies are as under:-

(a) An unincorporated body will be taxed as a separate entity.

(b) Any salary, bonus, commission or remuneration (by whatever name called), paid/payable to a working participant will be allowed as a deduction.

(c) Any interest paid to any participant will be allowed as a deduction.

(d) The total income of the unincorporated body after allowing deduction for payments referred to in (b) and (c) above will be subject to tax at the maximum marginal rate applicable to individuals. There will be no threshold exemption limit. However, the share of the participant in the profits of the unincorporated body will be exempt in his hands.

(e) The amount of salary, bonus, commission, remuneration and interest paid to a participant will be taxable in his hands.

(f) The unincorporated body will be entitled to carry forward and set off losses.

(g) In the case of change in the constitution of an unincorporated body on account of death/retirement of a participant, the body will not be entitled to carry forward so much of the loss as is attributable to the deceased/retiring participant.

14.3 Under the Code, financial intermediaries like the mutual fund, venture capital fund, pension funds, superannuation funds, provident funds and life insurance companies will be treated as pass-thru entities. As a result, they would receive to the extent possible, income without any incidence of tax. They would also not be liable to pay any tax on income received by them for, or on behalf of, their investors. The investors will be liable to tax on any income which accrues to them from investment with any of the pass-thru entities. Further, this benefit will be available to all pass-thru entities irrespective of the sector in which they invest.

14.4 Based on the principle of pass-thru, the Code provides for rationalisation of the tax treatment of life insurance. Under the new scheme, contributions by the insured will be liable to EET method of taxation of savings. As a result, life insurance companies will not be required to pay any tax on the actuarial surplus in the policyholders’ account.

Charitable purposes deserve to enjoy tax exemption. The questions that arise are: What is a charitable purpose? Who is entitled to the exemption? And what is the extent of the exemption?

The Code replaces the phrase "charitable purpose" by the phrase "permitted welfare activities". Permitted welfare activities has been defined to mean any activity involving relief of the poor, advancement of education, provision of medical relief, preservation of environment, preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility. Advancement of any other object of general public utility will not include any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a fee or for any other consideration, irrespective of the nature of use, application or retention of the income from such activity.

Trusts and institutions established for charitable purposes have generally enjoyed tax exemptions. However, the following shortcomings have been observed in the exemption regime:-

(a) The exemption regime is complex, overlapping and dissimilar since it varies across institutions based on their activities.

(b) The provisions fail to meet the test of efficiency in as much as they provide different conditions for institutions carrying on similar activities.

(c) The provisions also do not meet the test of equity in as much as the compliance cost for an institution varies depending upon the provision of law under which the exemption is granted.

(d) The concept of income of such an institution has been the subject matter of litigation. Should gross receipts of the institution or the net income of the institution be reckoned as the income? This question has been the subject matter of extensive debate.

(e) A vexed issue is whether the institution should be allowed to accumulate income not applied or utilized for charitable purposes and how the accumulation should be treated.

(f) There is unending dispute whether a business is incidental to attainment of the objectives of the institution or not, since the income from incidental business is exempt from tax.

With a view to removing the aforesaid shortcomings, the Code proposes a new tax regime for all trusts and institutions carrying on charitable activities. The salient features of the new regime are as under:-

(a) The regime will uniformly apply to all non-profit organizations irrespective of the nature of their activities.

(b) An organization shall be treated as a non-profit organization if,-

(i) it is established for the benefit of the general public;

(ii) it is established for carrying on permitted welfare activities;

(iii) it is not established for the benefit of any particular caste;

(iv) it is not established for the benefit of any of its members;

(v) it actually carries on the permitted welfare activities during the financial year and the beneficiaries of the activities are the general public;

(vi) it does not intend to apply its surplus or other income or use its assets or incur expenditure, directly or indirectly, for the benefit of any interested person;

(vii) any expenditure by the organisation does not enure, directly or indirectly, for the benefit of any interested person;

(viii) the funds or assets of the organisation are not used or applied, or deemed to have been used or applied, directly or indirectly, for the benefit of any interested person;

(ix) the surplus, if any, accruing from its permitted activities does not enure, directly or indirectly, for the benefit of any interested person;

(x) the funds or the assets of the non-profit organisation are not invested or held in any associate concern or in any prescribed form or mode;

(xi) it maintains such books of account and in such manner, as may be prescribed;

(xii) it obtains a report of audit in the prescribed form from an accountant before the due date of filing of the return in respect of-

(A) the accounts of the business, if any, carried on by it; and

(B) the accounts relating to the permitted welfare activities;and

(xiii) it is registered with the Income-tax Department under the Code.

(c) The "permitted welfare activities" have been defined as discussed in para 15.2

(d) The tax liability of a non-profit organisation shall be of the aggregate of the following:-

(i) the amount of surplus generated from the permitted welfare activities;and

(ii) the amount of capital gains arising on transfer of an investment asset, being a financial asset;

(e) The amount of surplus generated from the permitted welfare activities shall be the "gross receipts" as reduced by the "outgoings".

(f) The "gross receipts" shall be the aggregate of the following:-

(i) The amount of voluntary contributions received during the financial year;

(ii) Any rent received in respect of a property consisting of any buildings or lands appurtenant thereto;

(iii) The amount of any income derived from a business which is incidental to any of the permitted welfare activities;

- (iv) Full value of the consideration received from the transfer of any investment asset, not being a financial asset;
- (v) Full value of the consideration received from the transfer of any business capital asset of a business incidental to its permitted welfare activities;
- (vi) The amount of any income received from any investment of its funds or assets; and
- (vii) All other incomings, realizations, proceeds, donations or subscriptions received from any source.

(g) The amount of outgoings shall be the aggregate of-

- (i) voluntary contributions received during the financial year by the non-profit organisation made with a specific direction that they shall form part of the corpus of the non-profit organisation;
- (ii) the amount actually paid during the financial year for any expenditure, excluding capital expenditure, incurred wholly and exclusively for earning or obtaining any "gross receipts";
- (iii) the amount actually paid during the financial year for any expenditure, excluding capital expenditure, on the permitted welfare activities;
- (iv) the amount of capital expenditure actually paid during the financial year in relation to-
  - (a) any business capital asset of a business incidental to any of the permitted welfare activities; or
  - (b) any investment asset, not being a financial asset.
- (v) any amount actually paid during the financial year to any other non-profit organisation engaged in a similar permitted welfare activity;
- (vi) any amount applied outside India during the financial year if the amount is applied for an activity which tends to promote international welfare in which India is interested and the non-profit organisation is notified by the Central Government in this behalf.

(h) The surplus generated from permitted welfare activities will be determined on the basis of cash system of accounting. Capital gains arising on the transfer of an investment asset, being a financial asset, will be computed in accordance with the provisions under the head "Capital gains".

(i) A non-profit organisation will be prohibited from investing any of its funds or holding any of its asset in any associate concern or in any prescribed form or mode.

(j) It will be mandatory for every non-profit organisation to register with the Income-tax Department by making an application to the Chief Commissioner or Commissioner concerned. The Chief Commissioner or Commissioner will be required to pass an order within three months from the end of the month in which the application is received. If the order is not passed within three months or registration is refused, the applicant shall have the right to appeal before the Income Tax Appellate Tribunal.

(k) The registration, once granted, shall be valid from the financial year in which the application is made till it is withdrawn.

(l) The donations made to a non-profit organisation will be eligible for deduction in the hands of the donor at the appropriate rates.

A non-profit organisation shall be liable to income-tax at the rate of thirty per cent in respect of its net-worth if-

(a) it converts into any form of organization which does not qualify as a non-profit organization;

(b) it ceases to be a non-profit organization in the relevant financial year and any two financial years out of four financial years immediately preceding the relevant financial year; or

(c) it fails to transfer, upon its dissolution, all its assets to any other non-profit organisation.

The income of any trust or institution recognised/registered under the religious endowment Acts of the Central Government or the State Governments shall be fully exempt from income-tax. However, donations to such trusts or institutions will not enjoy any deduction in the hands of the donor.

The new regime shall not apply to any person who-

(a) holds any business under trust, notwithstanding a specific direction that the business shall form part of the corpus of such person or a specific direction that the income from the business shall be applied only for permitted welfare activities;

(b) carries on the permitted welfare activity involving the relief of the poor, advancement of education, provision of medical relief, preservation of environment or preservation of monuments or place or objects of artistic or historic interest ____ also carries on a business which is not incidental to the aforesaid permitted welfare activity; and

(c) ceases to be a non-profit organisation at any time during the financial year.

Tax rates are determined by the size of the tax base; if the tax base is higher, the tax rates can be lower. For the purposes of this Discussion Paper, the tax rates provided are such rates which are expected to yield the existing level of revenues with the revised comprehensive tax base proposed in this Code.

The are provided in the to provide stability to the income tax regime.

The new tax rate for can be substantially liberalised to levels indicated below:-

Rates of income-tax

(*1*)	where the total income does not exceed Rs.	***Nil***
(*2*)	where the total income exceeds Rs.1,60,000 but does not exceed Rs.	10 per cent of the amount by which the total income exceeds Rs.1,60,000;
(*3*)	where the total income exceeds Rs.10,00,000 but does not exceed Rs.	Rs.84,000 *plus* 20 per cent of the amount by which the total income exceeds Rs. 10,00,000;
(*4*)	where the total income exceeds Rs.	Rs.3,84,000 *plus* 30 per cent of the amount by which the total income exceeds Rs.25,00,000;

Rates of income-tax

(*1*)	where the total income does not exceed Rs.	***Nil***
(*2*)	where the total income exceeds Rs.1,90,000 but does not exceed Rs.	10 per cent of the amount by which the total income exceeds Rs.1,90,000;
(*3*)	where the total income exceeds Rs.10,00,000 but does not exceed Rs.	Rs.81,000 *plus* 20 per cent of the amount by which the total income exceeds Rs.10,00,000;
(*4*)	where the total income exceeds Rs.	Rs.3,81,000 *plus* 30 per cent of the amount by which the total income exceeds Rs.25,00,000;

Rates of income-tax

(*1*)	where the total income does not exceed Rs.	*Nil*;
(*2*)	where the total income exceeds Rs.2,40,000 but does not exceed Rs.	10 per cent of the amount by which the total income exceeds Rs.2,40,000;
(*3*)	where the total income exceeds Rs.10,00,000 but does not exceed Rs.	Rs.76,000 *plus* of the amount by which the total income exceeds Rs.10,00,000;
(*4*)	where the total income exceeds Rs.	Rs.3,76,000 *plus* of the amount by which the total income exceeds Rs.25,00,000;

Similarly, the tax rate for can be substantially reduced to a uniform rate of However, foreign companies would be required to supplement their corporate tax liability by a branch profits tax of on branch profits (that is, total income, as reduced by the corporate tax). The rates of tax in all other cases can continue at the existing levels.

However, the Government may consider calibrating the rates of taxes in the light of the responses and comments received on the scope of the tax base discussed in this Paper.

17.1 Two major types of taxes are levied on wealth: one applied to a person's wealth (net wealth taxes) and the other applied on the transfer of wealth (transfer taxes). Net wealth taxes are typically assessed on the net value of the taxpayer's taxable assets (i.e., value of assets minus any related liability).

17.2 The case for levy of wealth tax is based on several arguments. Firstly, the holders of substantial economic resources have the capacity to pay higher taxes than those with similar incomes but with less wealth. Secondly, it adds to the overall progressivity of an income tax without having to increase marginal rates. Thirdly, a wealth tax base separate from an income tax base helps to partially capture the income tax avoided or evaded. Finally, wealth carries with it a degree of security, independence, influence and social power that is not adequately measured by the flow of income and, hence, wealth constitutes an independent tax base which can be legitimately taxed through an annual tax on net wealth.

17.3 The Code proposes to tax net wealth in the following manner:-

- (a) Wealth-tax will be payable by an individual, HUF and private discretionary trusts.
- (b) Wealth tax will be levied on net wealth on the valuation date i.e. the last day of the financial year.
- (c) Net wealth will be defined as assets chargeable to wealth-tax as reduced by the debt owed in respect of such assets.
- (d) Assets chargeable to wealth-tax will mean all assets, including financial assets and deemed assets, as reduced by exempted assets.
- (e) The exempted assets will be restricted to the following:-
  - (i) Assets used as stock-in-trade.
  - (ii) Any one house or part of a house or a plot of land belonging to an individual or a Hindu undivided family which is acquired or constructed before 1st day of April, 2000;
  - (iii) The interest of the person in the coparcenary property of any Hindu undivided family of which he is a member;
  - (iv) The value of any one building used for the residence by a former ruler of a princely state.
  - (v) Jewellery in possession of a former ruler of a princely state, not being his personal property, which has been recognised as a heirloom by the Central Government before 1st April, 1957 or by the Board after that date.
  - (vi) Any property held by the person under trust, or other legal obligation, for carrying out any permitted welfare activity in India;
- (f) The valuation of financial assets will be at cost or market price, whichever is lower.

(g) The net wealth of an individual or HUF in excess of Rupees fifty crore will be chargeable to wealth-tax at the rate of 0.25 per cent.

(h) The threshold limit of Rupees fifty crore will not apply to a private discretionary trust.

18.1 The object of any tax law - and indeed, therefore, of the Code - is to ensure compliance with the law. The Code seeks to promote voluntary compliance. The Code also contains provisions to enforce compliance in cases where there is an attempt to avoid or evade taxes.

18.2 It is our experience that voluntary compliance is promoted by stability in tax laws, moderate tax rates, and fair and non-discriminatory application of the laws. The quality of the service provided by the tax administration, especially in matters relating to receipt and acknowledgement of tax returns, quick assessment, prompt refunds, and fair and expeditious disposal of petitions and appeals, is also a factor that promotes respect for the law and hence greater voluntary compliance. Other factors such as social values, public morality and people's perception about the fairness of the system also matter in shaping attitudes towards tax laws. The effectiveness of tax administration depends on the perceived ability of the tax authorities to detect non-compliance and penalize such non-compliance effectively, efficiently and equitably.

18.3 A tax administration may be broken down into the following components:

(i) Organizational hierarchy and design.
(ii) A taxpayer information system.
(iii) Procedural law for compliance and strategy to counter non-compliance.
(iv) A system of sanctions (penalties and prosecution) for non-complying taxpayers.
(v) Taxpayers' grievances redressal system (appeals, administrative remedies, ombudsmen).
(vi) System to identify and correct or prevent errors by the tax administration (review).

18.4 The Code deals with the design of the various components of the tax administration enumerated above.

18.5 The tax administration will be vested in a central body known as the Central Board of Direct Taxes. The Board will consist of a Chairperson and six Members who will be appointed by the Central Government in accordance with the rules made in this behalf.

18.6 The general superintendence, direction and management of the affairs of the Board shall vest in the Board which shall exercise all powers and do all acts and things which the

Board may be authorised to do under the Code. The Board shall be responsible for collecting revenues in a fair and transparent manner and for this purpose it shall-

(a) formulate strategies from time to time for,-

(i) effectively and efficiently detecting and penalizing non-compliance;

(ii) providing quality taxpayers' service to promote voluntary compliance;

(iii) educating taxpayers;

(iv) promoting tax literacy;

(v) redressal of taxpayers' grievances; and

(vi) performing such other functions as may be assigned to the Income Tax Department by the Central Government from time to time;

(b) supervise and regulate the functions of the Income-tax Department; and

(c) perform such other functions as may be prescribed.

18.7 Whether the Board should have powers to issue directions/instructions/orders/circulars to the income-tax authorities for the proper administration of the Act and whether such directions/ instructions/orders/circulars are binding upon the income-tax authorities are vexed questions that have been agitated before the courts of law. The present position in law is that such directions/instructions/orders/circulars are binding upon the income tax authorities but not upon the taxpayers. Normally, each case arising under the Code should be dealt with under the provisions of the Code having regard to the facts and circumstances of that case and the applicable legal provisions. It is only in a situation where there are a number of cases that involve the same issue or where a provision of law, because of its ambiguity or any other reason, may give rise to a number of cases, it would be desirable to lay down a general principle that would guide the income tax authorities. Hence, it is felt that the power to issue directions/instructions/orders/circulars should be carefully circumscribed and should be invoked only in rare cases. Accordingly, the provision of law has been suitably drafted. Needless to say, once a direction/instruction/order/circular is issued, it would bind the income tax authorities.

18.8 There are a number of income-tax authorities under the Code. Collectively, these authorities along with the ministerial staff assisting them will be referred to as the Income-tax Department.

18.9 The hierarchy of income tax authorities under the Code will be as under :-

(i) Chief Commissioner or Director General of Income Tax

(ii) Commissioner or Director of Income Tax

(iii) Additional Commissioner or Additional Director of Income Tax

(iv) Joint Commissioner or Joint Director of Income Tax

(v) Deputy Commissioner or Deputy Director of Income Tax

(vi) Assistant Commissioner or Assistant Director of Income Tax

(vii) Transfer Pricing Officer

(viii) Income Tax Officer or Tax Recovery Officer

(ix) Inspector of Income Tax

18.10 The Code envisages the creation of a modern taxpayer information system so as to provide deterrence against non-compliance. The principle underlying this system will be to collect information, in general, in an organized and non-intrusive manner. However, in exceptional circumstances, the Income-tax department will have the legal power to obtain information from persons who are not likely to furnish the same in the normal course. Consistent with this, the power to issue summons, conduct surveys, conduct searches and effect seizures, and to collect information through the annual information returns will continue in the new Code with some rationalization.

18.11 The collation of the large volume of information will be based on the Permanent Account Number. The information collected will be stored in electronic form and a hierarchy of users will be allowed to access the information, on a need-to-know basis, through a national network. The existing taxpayer information network (TIN) will continue to be the foundation of the taxpayer information system.

19.1 The procedural law in respect of all taxes dealt with under the Code is proposed to be consolidated and the new provisions will apply to all taxes (referred to as tax bases) unless specifically excluded.

19.2 The salient features of the provisions relating to filing of return of tax bases are as follows:-

(a) It will be obligatory for the following persons to file their return of tax base in respect of their income:-
   - (i) An individual if his gross total income from ordinary sources exceeds the threshold limit;
   - (ii) A company;
   - (iii) A firm;
   - (iv) A non-profit organization;
   - (v) A political party;
   - (vi) Any person who derives any income from special sources and is liable to pay income-tax thereon;
   - (vii) Any person who intends to carry forward the loss or any part thereof in accordance with the provisions of the Code; and
   - (viii) Any other person if his gross total income from ordinary sources exceeds the threshold limit.

(b) Similarly, returns of tax bases in respect of dividend distributed and net wealth will also be required to be filed if there is a liability to pay tax in respect of these tax bases.

(c) The due date for filing the return of tax bases under the Code will be 30th June of the year following the financial year for all non-business non-corporate taxpayers and 31st August of the year following the financial year for all other taxpayers.

(d) The time limit for filing a revised return or a voluntary belated return will be limited to twenty-one months from the end of the relevant financial year.

19.3 Taxpayers who do not voluntarily file their returns will be categorized into two categories, namely, stop filer and non-filer. A non-filer is defined as a person who has not filed the return for the relevant financial year and also for two financial years immediately

preceding the relevant financial year. A stop filer is a person who has not filed a return for the relevant financial year but has

(a) filed a return for the financial year immediately preceding the relevant financial year; or

(b) not filed a return in response to a notice calling for the return for the financial year immediately preceding the relevant financial year; or

(c) been assessed for the financial year immediately preceding the relevant financial year.

19.4 The Code provides that a notice may be issued to the non-filers and stop filers calling for their return of tax bases. However, such notice shall not be issued after twenty-one months from the end of the relevant financial year.

19.5 A two-step procedure will be followed for assessment of return filed with the tax administration. In the first stage, the return received will be processed to determine the tax payable or refund due to the taxpayer on the basis of the returned income subject to arithmetical corrections and adjustment of internal inconsistencies. In this stage, the returned income will be accepted by the Assessing Officer but the tax payable (including interest) on the returned income will be recomputed and claim of tax payment will be verified. In the second stage, the Assessing Officer will select a certain number of cases for the purpose of scrutiny. This selection will be based on parameters/criteria laid down by the Board from time to time. While the Department has initiated the process of computer assisted selection for scrutiny (CASS), the Assessing Officer will continue to enjoy discretion to select a limited number of cases on the basis of the parameters. Upon selection of the case, the Assessing Officer will undertake verification of the returned income.

19.6 The exercise of processing of returns (excluding cases selected for scrutiny) will be done along the following lines:-

(a) The Income-tax Department, or any other authority authorised by the Board, shall issue an electronic acknowledgement for receipt of the return. The electronic acknowledgement shall bear a unique return acknowledgement number.

(b) The Department shall process the return after making adjustment, if any, to the tax base in the return and determine the sum (tax and interest, if any) payable by or refundable to the taxpayer.

(c) The adjustment to the tax base shall relate to -

    (i) any arithmetical error in the return; and

    (ii) any incorrect claim, if such incorrect claim is apparent from the existence of other information on the return.

(d) The incorrect claim apparent from the existence of other information on the return shall mean to be a claim on the basis of an entry on the return -

  (i) of an item which is inconsistent with another entry of the same item or another item on such return; or

  (ii) in respect of which information required to be supplied to substantiate such entry has not been furnished; or

  (iii) in respect of a deduction which exceeds a statutory limit imposed, if such limit is expressed as a specified monetary amount, or as a percentage, ratio, or fraction.

(e) The Department shall, in all cases, re-compute the tax payable on the tax base determined after adjustment, if any, verify the claim for tax payment and determine the sum payable or refundable.

(f) The Department shall, in all cases, send an intimation in the prescribed form to the taxpayer specifying the tax bases so computed, the tax liability thereon, the amount of credit for prepaid taxes, if any, and the sum payable by the assessee or refundable to him. If no intimation is sent by the Department, the return shall be deemed to have been accepted in toto.

(g) The Department shall process the return within one year from the end of the month in which the return is furnished. However, if the return is processed beyond the time limit of one year, the taxpayer will not be liable to pay to the Central Government any sum payable on account of any adjustment to the tax base in the return. Therefore, in such cases the Department will not be entitled to issue any notice of demand in respect of such sum. This will not foreclose any claim for refund by the assessee or prejudice any demand, including interest thereon, arising on the basis of the tax base declared in the return.

19.7 The decision to select a case for scrutiny will be based on various parameters/ criteria laid down by the Board from time to time. Under the Code, the selection of cases for scrutiny will be made at a centralized level in accordance with the risk management strategy framed by the Board. This will eliminate all discretionary powers of selection presently vested in the Assessing Officer. Further, in order to prevent an assessee from circumventing the selection process, notwithstanding anything contained in any other Act for the time being in force, no information relating to the risk management strategy framed by the Board shall be revealed to any assessee or any member of the public or any organization. Upon selection of a case, a taxpayer will be communicated in writing about such selection. The communication shall be served within four months from the end of the financial year in which the return was filed.

19.8 When a return is selected for scrutiny, the Assessing Officer will issue a notice requiring the assessee to produce evidence in support of the return. After examining the evidence, if any, produced by the assessee and any other material in the possession of the Assessing Officer, the Assessing Officer will complete the assessment within twenty one months from the end of the financial year in which the return was filed.

19.9 The Code includes provisions regarding assessment proceedings, best judgement assessment, ordering special audits and reference to the Valuation Officer. The valuation made by the Valuation Officer will be binding upon the Assessing Officer.

19.10 Commissioners, Additional Commissioners and Joint Commissioners are the supervisory officers in the Department. A supervisory officer will be empowered to issue directions at the request of the assessing officer or on his own motion. The scope of such supervisory powers has been streamlined in the following manner:

(a) The Additional/Joint Commissioner may issue directions in a case at the request of the Assessing Officer and such directions shall be binding upon the Assessing Officer.
(b) The Additional/Joint Commissioner may, for the purposes of issuing a direction to the Assessing Officer, seek the directions of the Commissioner. The directions given by the Commissioner shall be binding upon the Assessing Officer.
(c) Where an Additional/Joint Commissioner himself is the Assessing officer, the Commissioner may, at the request of the Assessing Officer, issue directions and such directions shall be binding on the Additional/Joint Commissioner.

19.11 The Code provides for a mechanism for assessment or reassessment of income which has escaped assessment. The salient features of the scheme of assessment of escaped tax base, inter alia, will be as under:-

(a) A case may be reopened if the Assessing Officer has reason to believe that any tax base has escaped assessment and for reasons to be recorded by him.
(b) The tax base shall be deemed to have escaped assessment if there exists any of the following reasons:-
    (i) the computation or assessment has not been made in accordance with any decision, prejudicial to the assessee, rendered by Appellate Tribunal or National Tax Tribunal or High Court or Supreme Court in the case of the assessee or any other person under this Code or under the Income-tax Act, 1961; or by a court under any other law;

(ii) the computation or assessment has not been made in accordance with any order, direction, instruction or circular issued by the Board or in accordance with any directions issued by a supervising officer before the making of the assessment;

(iii) any objection has been raised, or observation made, by the Comptroller and Auditor General of India to the effect that the assessment has not been made in accordance with the provisions of the Code or the Income-tax Act, 1961.

(c) A case shall not be reopened after seven years from the end of the relevant financial year. However, no such time limit shall be applicable if -

(i) the reassessment is required to be made in consequence of or to give effect to any finding or direction contained in an order passed-

(A) in the case of the assessee for any other financial year by any authority in any proceeding under the Code by way of appeal, reference or revision or by a court in any proceeding under the Code or under any other law; or

(B) in the case of any other assessee for any financial year, by a court in any proceeding under the Code or under any other law; and

(ii) the period of seven years for issue of such notice had not expired at the time the order, which was the subject-matter of appeal, reference or revision was made.

(d) The notice for reopening the case shall not be issued by the Assessing Officer unless the Chief Commissioner or Commissioner is satisfied that it is a fit case for the issue of such notice and grants his approval for issue of such notice.

(e) A time of at least thirty days shall be given to the assessee for filing the return in response to the notice issued by the Assessing Officer.

(f) The notice to be issued by the Assessing Officer shall be accompanied by a notice in writing containing the reasons for reopening the case.

(g) In the case of a person (including a stop-filer or non-filer) where a search has been made or a seizure has been effected or any material has been obtained from any other authority,-

(i) it shall be mandatory to issue notice for reopening the assessments of the preceding seven financial years including the relevant financial year in which the search was conducted or the seizure was effected or the material was obtained;

(ii) the notice shall be issued after obtaining the prior approval of the Chief Commissioner or Commissioner; and

(iii) the assessment proceedings in respect of any of the seven years pending on the date of the search or the seizure or the requisition or on the date of obtaining the material requisitioned from any other authority shall abate and merge with the new proceedings.

(h) The reassessment shall include any other part of the tax base liable to tax which has escaped assessment and which has come to the notice of the Assessing Officer in the course of reassessment proceedings.

(i) The order of assessment or reassessment of escaped tax base shall not be made after the expiry of twenty-one months from the end of the financial year in which the notice of escapement was served.

19.12 Under the Code, specified international transactions are required to be reported to the Transfer Pricing Officer (TPO).

19.13 The underlying objective of creating the institution of TPO is to ensure that the arm's length price of an international transaction should be determined only by an officer with requisite expertise on the subject. Accordingly, the Code proposes the following procedure for determining the arm's length price in relation to an international transaction:-

(a) International transactions, as specified in the Code, shall be reported to the TPO by the due date of filing the return of tax bases.

(b) The TPO shall, on the basis of a risk management strategy framed by the Board in this behalf, select appropriate transactions for determination of the arm's length price and serve upon the assessee the communication of such selection, within two months from the end of the financial year in which the report was filed or the information about the transaction was received.

(c) Upon selection of the international transaction, the TPO shall inform the Assessing Officer about such selection within seven days from the date on which the communication was sent to the assessee.

(d) Upon selection of the transaction, the TPO shall serve on the assessee a notice requiring him to produce evidence, if any, on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or such other material as the TPO may require.

(e) The TPO shall serve his report, determining the arm's length price, on the Assessing Officer and the assessee within forty-two months from the end of the financial year in which the international transaction was made. Such report shall be binding upon the Assessing Officer.

(f) Thereafter, the Assessing Officer shall compute the total income on the basis of the arm's length price determined by the TPO. The assessment in such cases shall be completed within three months from the end of the month in which the report of the TPO was received by the assessing officer or thirty three months from the end of the relevant financial year, whichever is later.

(g) No separate appeal will lie against the report of the TPO. However, a taxpayer will be entitled to agitate the computation of the total income, so determined by the Assessing Officer, on the basis of the arm's length price determined by the TPO.

19.14 Further, with a view to provide certainty to taxpayers in respect of their tax liability arising from any future international transaction, the Code empowers the Board to formulate a scheme to enable it to enter into, with the approval of the Central Government, advance pricing agreements with taxpayers in relation to such transactions.

19.15 Under the Code, taxes will be collected on 'pay-as-you-earn' basis. Therefore, the Code envisages the collection of taxes through the following mechanism :-

(a) Deduction of tax at source (TDS) on payments made during the financial year, which, in general, have an income component;
(b) Collection of tax at source (TCS) on payments received during the financial year;
(c) Payment of advance tax during the financial year on the estimated income; and
(d) Self assessment tax.

19.16 There is no change in the provisions dealing with each of the above methods of collection and recovery of tax.

19.17 The rates of tax deduction at source on payments made to residents are indicated in the Third Schedule and on payments made to non-residents are indicated in the Fourth Schedule.

19.18 The provisions relating to recovery of tax have been streamlined. The Assessing Officer will have the power to recover the taxes that are due. At the end of one year from the end of the financial year in which the notice of demand was issued, the Assessing Officer will cease to have jurisdiction to recover arrears. Thereafter, the power will be exercised by the Tax Recovery Officer. The Code lays out the sequence of the steps that may be taken to recover arrears. At the final stage, arrears will be recovered by way of attachment and sale of movable and immovable property in accordance with the provisions of the Fifth Schedule to the Code.

19.19 The tax administration receives a large volume of information relating to an assessee furnished by him and by third party sources. These information, essentially, relate to his financial and commercial transactions. It is part of his right to privacy. However, the Right to Information Act enables a person to obtain commercially sensitive and private information relating to any other person which may have the effect of causing financial, commercial or personal injury to such other person. The disclosure of such information to third parties/ competitors also inhibits full compliance with tax laws.

19.20 Internationally, countries prohibit the disclosure of information furnished to, or obtained by, the tax administration, regardless of the law relating to the right to information. However, the information is allowed to be shared with other enforcement agencies to the extent it is necessary in public interest.

19.21 Steps will, therefore, be taken to amend the Right to Information Act prohibiting disclosure of information relating to any assessee to any third party except in the circumstances provided under the Code.

20.1 The Income Tax Act, 1961 contains provisions relating to imposition of penalties for various defaults. However, these provisions do not adequately support a strong deterrence programme in a moderate tax regime. Hence, provisions have been included in the Code that will ensure certainty of punishment upon non-compliance with the tax laws. The salient features of the proposed Scheme are as follows:

(a) Every person who wilfully under-reports his tax base shall be liable to a penalty not less than, and upto twice, the amount of tax payable in respect of the amount of tax base so under-reported.

(b) A person shall be deemed to have wilfully under-reported his tax base if,-
   (i) no return of tax base has been filed by the due date;
   (ii) the tax base disclosed in the return filed is less than the assessed tax base; or
   (iii) the tax base reassessed is greater than the tax base assessed immediately before the reassessment.

(c) The amount of tax base under-reported shall be the aggregate of the addition, or disallowance, made by the Assessing Officer, Commissioner or Commissioner (Appeals).

(d) However, the aggregate amount of addition, or disallowance, referred to above shall not include the following:-
   (i) amount relating to addition, or disallowance, in respect of which the assessee offers an explanation and the Assessing Officer is satisfied that:
      (A) the explanation is bonafide;
      (B) he has disclosed all the facts material to the addition or disallowance; and
      (C) he has disclosed all the facts relating to the explanation;
   (ii) amount relating to addition, or disallowance, determined on the basis of an estimate by the Assessing Officer, if the accounts are correct and complete to the satisfaction of the Assessing Officer but the method employed is such that, in the opinion of the Assessing Officer, the income cannot properly be deduced therefrom;
   (iii) the amount relating to addition, or disallowance, pertaining to any issue, determined on the basis of an estimate by the Assessing Officer, if the assessee-
      (A) has, on his own, estimated a lower amount of addition or disallowance on the same issue;
      (B) has included such amount in the computation of his tax base; and
      (C) has disclosed all the facts material to the addition or disallowance;

(iv) the amount of undisclosed tax base found as a result of search, which is subjected to a penalty at the rate of 10 per cent.

(v) the amount of tax base in respect of which the liability to tax has been discharged by way of pre-paid taxes; and

(vi) the amount relating to prima facie adjustment carried out while processing the return of tax base.

(e) The amount of tax payable in respect of the amount of tax base so under-reported shall be calculated at the maximum marginal rate in order to arrive at the quantum of penalty.

(f) In the case of search, the undisclosed tax base shall be subjected to a penalty at the rate of ten per cent if-

(i) the undisclosed tax base relates to-

(A) the financial year which has ended before the date of search but the due date of filing of return of such financial year has not expired before the date of the search and the return of tax base for such financial year has not been furnished before the date of search; or

(B) the financial year in which the search is conducted; and

(ii) the assessee does not -

(A) admit the undisclosed tax base in the course of search; or

(B) substantiate the manner in which the undisclosed tax base is derived; or

(C) pay tax and interest on such undisclosed tax base;

(g) The penalty for under-reporting of tax base shall be imposed by an order in writing by the Assessing Officer, Commissioner or Commissioner (Appeal), as the case may be, in respect of an assessment order passed by the Assessing Officer, order in revision passed by the Commissioner or order in appeal passed by the Commissioner (Appeal).

(h) Penalties for other defaults have also been rationalized.

(i) No income tax authority shall have the power to waive the penalty imposed.

(j) In a case where the amount of penalty is one lakh rupees or more, an order of penalty shall be made by an Income-tax Officer after obtaining the approval of the Joint Commissioner or Additional Commissioner. In a case where the amount of penalty is five lakh rupees or more and it is levied by an Assistant/Deputy Commissioner, the order of penalty shall be made by the Assessing Officer after obtaining the approval of the Joint Commissioner or Additional Commissioner.

(k) An order of penalty shall be passed within one year from the end of the financial year in which the notice for imposition of penalty is issued.

(l) If the tax base determined by the Assessing Officer is revised or modified by the Commissioner, Commissioner (Appeal), Appellate Tribunal, National Tax Tribunal or Supreme Court, the Assessing Officer shall, according to the revised tax base, review the order which imposed the penalty or revive the order which did not impose any penalty. Such review or revival shall be done and a

fresh order passed within a period of six months from the end of the month in which the order revising or modifying the tax base was received.

20.2 With a view to providing deterrence against non-compliance, the Code provides for prosecution of offences of a serious nature. The salient features of the scheme for prosecution of offences are as under:-

(a) Every offence under the Code shall be punishable with both imprisonment and fine.
(b) There will be no mandatory minimum term of imprisonment.
(c) The maximum term of imprisonment for certain offences will be two years or less and such offences will be prosecuted adopting the procedure of summons trial. In the case of offences where the maximum term of imprisonment is more than two years, the offence will be prosecuted adopting the procedure of warrant trial.
(d) The minimum and maximum amount of fine for various offences have been stipulated in the Code.
(e) The prosecution of an offence under the Code will be in addition to, and not in derogation of, the provisions of any other law providing for prosecution of offences under that law.
(f) It has been clarified that levy of penalty and prosecution are independent of each other and it shall be no defense to a prosecution that an order of assessment or an order of penalty has not been made, or has been barred by limitation, or has been set aside by a higher authority or a court, or for any other reason.
(g) One or more inspectors of income tax will be notified by the Board and authorised to file complaints before a court. Such Inspector of Income Tax may file the complaint regardless of the fact that he was not the Assessing Officer in respect of the proceedings or transactions that gave rise to the offence. The Inspector of Income Tax shall file the complaint on a reference made to him by the Income Tax Authority concerned and after such Authority has obtained the previous sanction of the Commissioner or Director or Commissioner (Appeals). The Inspector of Income Tax filing the complaint shall not be called upon to appear as a witness in the proceedings solely on the ground that the complaint was filed by him.
(h) All complaints under the Code shall be filed in a court which is not inferior to that of presidency magistrate or a magistrate of the first class.

Provision has been made for compounding of an offence by the Chief Commissioner or Director General at the prescribed rates. The compounding of an offence will be permissible at any time before conviction by the trial court.

21.1 A tax payer should have an easily and accessible mechanism to appeal against orders that are adverse to him. No tax payer should be burdened with a liability which is not due under the Code. The Code will provide for a hierarchy of authorities who will exercise appellate or revisional jurisdiction as prescribed.

21.2 There will be no change in the appellate structure. Against the order of an assessing officer, an appeal will lie to the Commissioner (Appeals). Against the latter order, an appeal will lie to the Income Tax Appellate Tribunal (ITAT), which will be highest fact finding body. An appeal will lie to the High Court against an order of the ITAT if a question of law arises from the decision of the ITAT. Once the National Tax Tribunal is established, it will exercise the powers of the High Court.

21.3 An assessee aggrieved by an order of the Assessing Officer or the Commissioner (Appeals) or the ITAT under the Code may file an appeal to the higher authority within thirty days of the date of the receipt of the order.

21.4 The right to appeal by the Income Tax Department against an order of the Commissioner (Appeals) or the ITAT is retained.

21.5 The power of the High Court under Article 226 of the Constitution and of the Supreme Court under Article 32 of the Constitution is not affected. The power of the Supreme Court to entertain a Special Leave Petition under Article 136 of the Constitution is also not affected.

21.6 The Income Tax Act, 1961 provides for rectification of mistakes apparent from the record in any order made by an Income Tax Authority. The Code will contain a scheme for rectification of mistakes. The salient features of the scheme are:-

- (a) The Assessing Officer, Commissioner (Appeals) or the ITAT may rectify any mistake apparent from the record.
- (b) The following circumstances may also give rise to a mistake which may be rectified by the income tax authority concerned:
  - (i) a decision of the Supreme Court or the jurisdictional High Court rendered subsequent to the passing of the original order or intimation;
  - (ii) a retrospective amendment to the law made subsequent to the passing of the original order or intimation;

(iii) any finding or direction contained in an order passed in the case of the assessee for any other financial year by -

(A) any authority in any proceeding under the Code by way of appeal, reference or revision; or

(B) a court in any proceeding under any other law which has a bearing on the liability under the Code; or

(iv) any finding or direction contained in an order passed in the case of any other assessee for any financial year by an income tax authority under the Code or by a court in any proceeding under any other law in so far as it has a bearing on the liability under the Code.

(c) The power to rectify can be exercised by an income-tax authority, either suo-moto or an application made by the assessee. This power shall not be exercised by the income-tax authority suo-moto after the expiry of two years from the end of the financial year in which the order sought to be rectified was made. In a case where the assessee seeks rectification of an order, he shall make an application before the expiry of two years from the end of the financial year in which the order sought to be rectified was made. Such application shall be disposed of by the income-tax authority within six months from the end of the month in which the application was received by the authority. If no rectification order is passed within the period of six months, the application shall be deemed to have been rejected and the assessee will be entitled to file an appeal against such deemed rejection.

21.7 There may be cases where the assessment order may be erroneous and prejudicial to the interest of the revenue because an issue of fact or an issue of law had not been raised before or considered by the Assessing Officer. In such cases, the Commissioner will be empowered to revise the order of the Assessing Officer, determine the issue of fact or law, and issue consequential directions to the Assessing Officer to modify the assessment order or pass a fresh order in accordance with such determination.

21.8 The Commissioner may revise an order of the Assessing Officer within six months from the date of the order.

21.9 The salient features of the scheme of revision under the Code are as follows:-

(a) When the Commissioner revises the assessment order and issues consequential directions to the Assessing Officer, the modified order or the fresh order passed by the Assessing Officer shall be the assessment order in that case.

(b) An assessee may file an appeal to the Commissioner (Appeals) against the modified order or the fresh order passed by the Assessing Officer.

(c) No appeal shall lie to the ITAT against an order of the Commissioner directing revision of an assessment order. An assessee aggrieved by such an order of the Commissioner may take all the grounds in his appeal to the Commissioner (Appeals) against the modified order or fresh order passed by the Assessing Officer including the ground that the Commissioner exceeded or erred in the exercise of his jurisdiction in revising the order of the Assessing Officer.

22.1 Reorganisation of a business should, ordinarily, be tax neutral. Hence, the Code contains provisions dealing with reorganisation based on this principle. However, the provisions are subject to such conditions as are necessary to prevent abuse.

22.2 Under the Code, 'business reorganisation' has been defined to mean reorganisation of business of two or more residents, involving an amalgamation or a demerger. It also includes a merger under a scheme sanctioned and brought into force by the Central Government under the Banking Regulation Act, 1949.

22.3 The term 'amalgamation' has been defined so as to provide for amalgamation of companies, co-operative societies, unincorporated bodies and proprietary concerns. The term 'demerger' has also been defined in the Code. Further, the 'amalgamating' entity and, in the case of a demerger, the 'demerged' entity are referred to as 'predecessor' in a business reorganisation. Similarly, the 'amalgamated' entity and the 'resulting' entity are referred to as 'successor' in a business reorganisation.

22.4 Amalgamation of companies will mean a merger of one or more companies with another company (amalgamated company) or merger of two or more companies to form one company (amalgamated company) subject to the following conditions:-

(a) All the assets and liabilities of the amalgamating company or companies immediately before the amalgamation shall become the property of the amalgamated company.
(b) Shareholders holding seventy five per cent or more (in value) of the shares in the amalgamating company (other than shares already held by the amalgamated company or by its nominee) shall become shareholders of the amalgamated company by virtue of the amalgamation.
(c) The scheme of amalgamation shall be in accordance with the provisions of the Companies Act.

22.5 The amalgamating and amalgamated companies shall be entitled to the following benefits in the case of business reorganisation through amalgamation:-

(a) The transfer of investment assets in amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the amalgamating company, if the amalgamated company is an Indian company.

(b) The transfer of investment assets (including shares held in an Indian company) by a foreign company to another foreign company in a scheme of amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the amalgamating company provided the scheme of amalgamation satisfies the conditions applicable to amalgamations contained in the Code.

(c) The exchange of shares in an amalgamating company for shares in the amalgamated company will not be considered as a transfer for the purposes of capital gains in the hands of the shareholders of the amalgamating company, if the amalgamated company is an Indian company.

(d) The accumulated losses of an amalgamating company shall be deemed to be the loss of the amalgamated company in the year in which the amalgamation is effected subject to fulfillment of specified conditions.

22.6 The aforesaid benefits shall be available to all companies irrespective of the nature of their business.

22.7 Amalgamation of co-operative societies shall mean a merger of one or more co-operative societies with another co-operative society (amalgamated co-operative society) or merger of two or more co-operative societies to form one co-operative society (amalgamated co-operative society) subject to the following conditions:-

(a) All the assets and liabilities of the amalgamating co-operative society immediately before the amalgamation shall become the property of the amalgamated co-operative society.

(b) Shareholders holding seventy five per cent or more (in value) of the shares in the amalgamating co-operative society (other than shares already held by the amalgamated co-operative society or by its nominee) shall become shareholders of the amalgamated co-operative society by virtue of the amalgamation.

(c) The members holding seventy-five per cent or more voting rights in the amalgamating co-operative shall become members of the amalgamated co-operative.

22.8 The amalgamating and amalgamated co-operative societies shall be entitled to the following benefits in the case of business reorganisation through amalgamation:-

(a) The transfer of investment assets in amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the amalgamating co-operative society.

(b) The exchange of shares in an amalgamating co-operative society for shares in the amalgamated co-operative society will not be considered as a transfer for the purposes of capital gains in the hands of the shareholders of the amalgamating co-operative society.

(d) The accumulated losses of an amalgamating co-operative society shall be deemed to be the loss of the amalgamated co-operative society in the year in which the amalgamation is effected subject to fulfillment of specified conditions.

22.9 The aforesaid benefits shall be available to all co-operative societies irrespective of the nature of their business.

22.10 Under the Code, a sole proprietary concern may be amalgamated with a company subject to the following conditions:-

(a) All the assets and liabilities of the sole proprietary concern immediately before the amalgamation shall become the assets and liabilities of the company.
(b) The shareholding of the sole proprietor in the company shall be not less than 50 per cent of the total value of the shares in the company.
(c) The sole proprietor shall not receive any consideration or benefit, directly or indirectly, in any form or manner other than by way of allotment of shares in the company.

22.11 On amalgamation of a sole proprietary concern with a company, the following benefits shall be available:

(a) The transfer of investment assets in an amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the proprietor, if the company is an Indian company.
(b) The accumulated losses of the sole proprietary business shall be deemed to be the loss of the company in the year in which the amalgamation is effected, subject to fulfillment of specified conditions.

22.12 Under the Code, an unincorporated body may be amalgamated with a company subject to the following conditions:

(a) All the assets and liabilities of the unincorporated body immediately before the conversion shall become the assets and liabilities of the company.
(b) The aggregate of the shareholding of the participants of the unincorporated body in the company shall be not less than 50 per cent of the total value of the shares in the company.
(c) The shareholding of the participants of the unincorporated body in the company shall, as regards each other, be in the same proportion in which their capital accounts stood, as regards each other, in the books of the firm on the date of succession/amalgamation.

(d) The participants of the unincorporated body shall not receive any consideration or benefit, directly or indirectly, in any form or manner other than by way of allotment of shares in the company.

22.13 On amalgamation of an unincorporated body with a company, the following benefits shall be available:

(a) The transfer of investment assets in the amalgamation will not be considered as a transfer for the purposes of capital gains in the hands of the unincorporated body, if the company is an Indian company.
(b) The accumulated loss of the unincorporated body shall be deemed to be the loss of the company in the year in which the amalgamation is effected, subject to the fulfillment of specified conditions.

22.14 Demerger in relation to a company shall mean the transfer by a company (demerged company) of its undertaking to another company (resulting company) subject to the following conditions:-

(a) The entities involved should be companies.
(b) The transfer shall be the transfer of an "undertaking". Undertaking shall include any part of an undertaking, or a unit or a division of an undertaking, or a business activity taken as a whole, but shall not include the transfer of individual assets or liabilities or any combination thereof not constituting a distinct business activity.
(c) The transfer of the undertaking is on a going concern basis.
(d) All assets and liabilities of the undertaking shall be transferred to the resulting company.
(e) The assets and liabilities of an undertaking transferred to the resulting company shall be valued at the book value as per the provisions of this Code on the date of demerger and such value shall be deemed to be the value of the assets and liabilities entered in the books of accounts of the resulting company.
(f) The resulting company shall issue shares to the shareholders of the demerged company on a proportionate basis as a consideration for the demerger.
(g) Shareholders holding not less than three-fourths (in value) of the shares in the demerged company (other than shares already held by the resulting company or by its nominee) shall become shareholders of the resulting company by virtue of the demerger.
(h) The scheme of demerger shall be in accordance with the provisions of the Companies Act.
(i) The transfer is in accordance with such other conditions as may be notified by the Central Government having regard to the necessity to ensure that the transfer is for genuine business purposes.

22.15 The companies shall be entitled to the following benefits in the case of business reorganisation through demerger of an undertaking:-

(a) The transfer of investment assets in a demerger will not be considered as a transfer for the purposes of capital gains in the hands of the demerged company, if the resulting company is an Indian company.

(b) The transfer of investment assets (including shares held in an Indian company) by a foreign company to another foreign company in a scheme of demerger will not be considered as a transfer for the purposes of capital gains in the hands of the demerged company provided the scheme of demerger satisfies the conditions applicable to demergers contained in the Code.

(c) The exchange of shares in a demerged company for shares in the resulting company will not be considered as a transfer for the purposes of capital gains in the hands of the shareholders of the demerged company if the demerged company is an Indian company.

(d) The accumulated loss of the undertaking of the demerged company shall be deemed to be the loss of the resulting company in the year in which the demerger is effected subject to the fulfillment of specified conditions.

22.16 Under the Code, the accumulated losses of the predecessor in a business reorganisation shall be deemed to be the loss of the successor if the successor satisfies the test of continuity of business. This test shall be satisfied upon fulfillment of the following conditions:-

(a) The successor holds at least three-fourths of the book value of the fixed assets of the predecessor acquired through business reorganisation continuously for a minimum period of five financial years immediately succeeding the financial year in which the business reorganisation takes place;

(b) The successor continues the business of the predecessor for a minimum period of five financial years immediately succeeding the financial year in which the business reorganisation takes place; and

(c) Such other conditions as may be prescribed to ensure the revival of the business of the predecessor or to ensure that the business reorganisation is for genuine business purposes.

22.17 In a case where the predecessor is a sole proprietary concern or an unincorporated body, the loss of the predecessor will be deemed to be the loss of the successor if the following conditions are fulfilled :-

(a) the successor satisfies the test of continuity of business referred to in para 22.16 above; and

(b) the share holding of the sole proprietor or the participant, as the case may be, remains fifty per cent or more of the total value of the shares of the successor company at all times during the period of five years immediately succeeding the financial year in which the business reorganisation takes place.

22.18 The benefit of set off of the unabsorbed losses of the predecessor, allowed to the successor, shall be withdrawn by making appropriate rectification, if any of the conditions referred to in paras 22.16 and 22.17 is violated.

23.1 Ordinarily, countries follow both the principle of residence-based taxation and the principle of source-based taxation. However, if two countries tax the same income, one based on the principle of residence and the other based on the principle of source, it could lead to double taxation of the same income. Hence, countries have agreed on certain principles to avoid double taxation.

23.2 The United Nations (UN) and the Organisation for Economic Cooperation and Development (OECD) have developed a series of model treaties to avoid double taxation. India has also evolved its own model and, based on this model, entered into Double Taxation Avoidance Agreements with about 75 countries. However, it must be noted that each agreement contains some variations and exceptions that are usually the result of negotiations between India and the other country. The double taxation agreements are of two kinds: (i) comprehensive DTAAs which cover all kinds of income; and (ii) limited DTAAs which cover only income from shipping and/or air transport.

23.3 A Double Taxation Avoidance Agreement provides for certainty on how and when will income of a particular kind be taxed and by which authority. The right to tax of each country is defined. If one country has the right to tax a certain income, provision is made for the other country to give tax credit or exemption to that income in order to avoid double taxation.

23.4 The right to tax may be allocated to either country by adopting one of the following methods:

- i. Full or partial rights to tax given to the country of residence, and the country of source waiving its right to tax to that extent.
- ii Full rights to tax given to one country based on source or residence and the other country obliged to exempt that income.
- iii. Full rights to tax by both countries, but with the tax in the source country limited to no more than a specified level and the country of residence giving credit for the tax paid in the source country. Thus, there is a sharing of tax revenues between the two countries.
- iv. Full rights to tax by both countries without limitation and the country of residence giving credit for tax paid in the source country.

23.4 Under the Code, power has been given to the Central Government to enter into an agreement with the Government of any country in order to provide relief on double taxation and also for the purpose of exchanging information for prevention of evasion or avoidance of income tax. Further, the Code also provides that neither a double taxation avoidance

treaty nor the Code shall have a preferential status by reason of its being a treaty or law. Therefore, in the case of a conflict between the provisions of a treaty and the provisions of the Code, the one that is later in point of time shall prevail.

24.1 Tax avoidance, like tax evasion, seriously undermines the achievements of the public finance objective of collecting revenues in an efficient, equitable and effective manner. Sectors that provide a greater opportunity for tax avoidance tend to cause distortions in the allocation of resources. Since the better-off sections are more endowed to resort to such practices, tax avoidance also leads to cross-subsidization of the rich. Therefore, there is a strong general presumption in the literature on tax policy that all tax avoidance, like tax evasion, is economically undesirable and inequitable. On considerations of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity.

24.2 In the past, the response to tax avoidance has been the introduction of legislative amendments to deal with specific instances of tax avoidance. Since the liberalization of the Indian economy, increasingly sophisticated forms of tax avoidance are being adopted by the taxpayers and their advisers. The problem has been further compounded by tax avoidance arrangements spanning across several tax jurisdictions. This has led to severe erosion of the tax base. Further, appellate authorities and courts have been placing a heavy onus on the Revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them.

24.3 In view of the above, it is necessary and desirable to introduce a general anti-avoidance rule which will serve as a deterrent against such practices. This is also consistent with the international trend.

24.4 Under the Code, the General Anti-avoidance Rule (GAAR) will be invoked if the following three conditions are satisfied:-

a) The taxpayer should have entered into an arrangement.
b) The main purpose of the arrangement should be to obtain a tax benefit and the arrangement-
   (i) has been entered into, or carried out, in a manner not normally employed for bona fide business purposes;
   (ii) has created rights and obligations which would not normally be created between persons dealing at arm's length;

(iii) results, directly or indirectly, in the misuse or abuse of the provisions of this Code; or

(iv) lacks commercial substance, in whole or in part.

24.5 An 'arrangement' will mean any transaction, conduit, event, trust, grant, operation, scheme, covenant, disposition, agreement or understanding, including all steps therein or parts thereof, whether enforceable or not. Therefore, if the motive behind individual steps is obtaining a tax benefit, but the overall scheme is not so, the individual steps will nevertheless be treated as an arrangement and the GAAR may be invoked.

24.6 An arrangement will also include any interposition of an entity or transaction where the substance of such entity or transaction differs from the form given to it.

24.7 The lack of commercial substance, in the context of an arrangement, shall be determined, but not limited to, by the following indicators:

(i) The arrangement results in a significant tax benefit for a party but does not have a significant effect upon either the business risks or the net cash flows of that party other than the effect attributable to the tax benefit.

(ii) The substance or effect of the arrangement as a whole differs from the legal form of its individual steps .

(iii) The arrangement includes or involves:

(a) round trip financing;

(b) an 'accommodating party', as defined ;

(c) elements that have the effect of offsetting or cancelling each other;

(d) a transaction which is conducted through one or more persons and disguises the nature, location, source, ownership or control of funds; or

(e) an expectation of pre-tax profit which is insignificant in comparison to the amount of the expected tax benefit.

24.8 The concepts of 'round trip financing' and 'accommodating party' will be defined in the Code.

24.9 If the conditions specified in paragraph 24.7 above are satisfied, the Commissioner will be empowered to declare the arrangement as an impermissible avoidance arrangement and determine the tax consequences of the assessee as if the arrangement had not been entered into. For this purpose, he may -

(i) Disregard, combine, or re-characterize any steps in, or parts of, the impermissible avoidance arrangement;

(ii) Disregard any accommodating party or treat any accommodating party and any other party as one and the same person;

(iii) Deem persons who are connected persons in relation to each other to be one and the same person for purposes of determining the tax treatment of any amount;

(iv) Re-allocate any gross income, receipt or accrual of a capital nature, expenditure or rebate amongst the parties;

(v) Re-characterise any gross income, receipt or accrual of a capital nature or expenditure;

(vi) Re-characterise any multi-party financing transaction, whether in the nature of debt or equity, as a transaction directly among two or more such parties;

(vii) Re-characterise any debt financing transaction as an equity financing transaction or any equity financing transaction as a debt financing transaction;

(viii) Treat the impermissible avoidance arrangement as if it had not been entered into or carried out or in such other manner as in the circumstances the Commissioner may deem appropriate for the prevention or diminution of the relevant tax benefit; or

(ix) Disregard the provisions of any agreement entered into by India with any other country under section 265.

24.10 An arrangement declared as an impermissible avoidance arrangement shall be presumed to have been entered into or carried out for the main purpose of obtaining a tax benefit unless the party obtaining the tax benefit proves that obtaining a tax benefit was not the main purpose of the avoidance arrangement.

24.11 Under the Vienna Convention, international agreements are to be interpreted in 'good faith'. In case any international agreement/treaty leads to unintended consequences like tax evasion or flow of benefits to unintended person, it is open to the signatory to take corrective steps to prevent abuse of the treaty. Such corrective steps are consistent with the obligations under the Vienna Convention. Further, the OECD Commentary on Article 1 of the Model Tax Convention also clarifies that a general anti-abuse provision in the domestic law in the nature of "substance over form rule" or "economic substance rule" is not in conflict with the treaty. The general anti-abuse rule will override the provisions of the tax treaty. The Code provides accordingly.

24.12 The power to invoke GAAR is bestowed only upon the Commissioner of Income-tax. For this purposes the Code empowers him to call for such information as may be

necessary. He is also required to follow the principles of natural justice before declaring an arrangement as an impermissible avoidance arrangement. He will determine the tax consequences of such impermissible avoidance arrangement and issue necessary directions to the Assessing Officer for making appropriate adjustments. The directions issued by him will be binding on the Assessing Officer.

24.13 These general anti-avoidance rules will be further supported by anti-avoidance rules to deal with the following circumstances:-

(i) Payment to associated persons in respect of expenditure;
(ii) International transactions not at arm's length;
(iii) Transactions resulting in transfer of income to non-residents; and
(iv) Avoidance of tax in certain transactions in securities.