# Draft Direct Tax Code Bill - 2009

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# OBJECT / SCOPE

*To deliberate upon provisions proposed in new Code vis a vis Non Profit Organization & TDS & Penalties*

***<u>Concept of Assessment Year done away with : Replaced with Financial year</u> (as stated in Discussion Paper of New Code said change will not impact the existing system of TDS; Advance Tax; Self Assessment Tax etc and is aimed to reduce confusion in compliance and administration)***

# New Concept of Tax base

- 275.**“tax bases”** means-

  (a) income or total income, as the case may be, in relation to income-tax;

  (b) net wealth in relation to wealth-tax;

  (c) dividend distributed in relation to dividend distribution tax; and

  (d) the income or total income, net wealth, or dividend distributed referred to in sub-clauses (a) to (c) of any other person in respect of which the assessee is assessable under this Code

# Revenue's Objective in Discussion Paper towards new Code

- *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 (Para 1.7)***

# Discrepancies in Discussion Paper on present taxation of NPO's

**15.3** 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.

# Discrepancies in Discussion Paper on present taxation of NPO's

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

(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.

# New System of NPO Taxation- Key Features

- The regime will uniformly apply to all non-profit organizations irrespective of the nature of their activities
- The Code replaces the phrase "charitable purpose" by the phrase "permitted welfare activities". Permitted welfare activities has been defined on lines of earlier section 2(15) in section 96(g) (six limbs)
- **Further for Ist time General Public has been defined as: "general public" means the body of unascertained persons sufficiently defined by some common quality of public or impersonal nature**;

# New System of NPO Taxation- Key Features

- The tax liability of a non-profit organisation shall be **15 per cent.** of the aggregate of the following:-

  (i) the amount of <u>**surplus**</u> generated from the permitted welfare activities;and

  (ii) the amount of capital gains arising on transfer of an investment asset,

  being a financial asset

- The amount of surplus generated from the permitted welfare activities shall be the "gross receipts" as reduced by the "outgoings

# New System of NPO Taxation- Key Features

- The surplus generated from permitted welfare activities will be determined on the basis of cash system of accounting
- Capital gains from transfer of investment asset to be determined as per sec 44 to 53.

# Conditions precedent for treatment as NPO Section 96(d)

- (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;

# Conditions precedent for treatment as NPO Section 96(d)

(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

# Conditions precedent for treatment as NPO Section 96(d)

- It will be mandatory for every non-profit organisation to register **<u>u/s 93 of code</u>** with the Income-tax Department by making an application to the Chief Commissioner or Commissioner concerned. **<u>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</u>**. *<u>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</u>*.

# Gross receipts versus outgoings

| Gross receipts Section 89 | Outgoings Section 90 |
|---|---|
| a) Voluntary contributions<br>b) Rentals<br>c) Any incoming/donation etc from any source<br>d) Full value of consideration of business capital asset and investment asset<br>e) Business income if incidental to P.W.A **provided same not involves General Public utility activity**<br>**f) Investment of funds income therefrom** | a) Specific directions - Voluntary contributions<br>b) Non capital nature expense wholly & exclusively for I) obtaining gross receipts or II) carrying P.W.A<br>c) Capital expense for business purpose of which gross receipt is includible in section 89<br>d) Capital expense for investment asset – non financial<br>e) Amount paid to other NPO engaged in similar P.W.A (not loan/advance)<br>f) Amount applied outside India if:<br>I) Promotes International Welfare of India & II) payer NPO is notified by Central Govt |

# Prohibited investments Section 91

- Investment in Equity/Capital of Associated Concern
- Investment in Bond/Debenture issued by an associated concern
- Deposit with Associated Concern
- Other prescribed modes

# Deemed use of funds for benefit of interested person

- Provisions similar to section 13 of 1961 Act
- Interested person:section 96 (f) "**interested person**" in relation to a non-profit organization means,-

  (i) the founder of the organization or the author of the trust;

  (ii) any person whose total contribution to the organization up to the end of the relevant financial year exceeds fifty thousand rupees;

  (iii) a member of the Hindu undivided family if the author or founder or person is the family;

  (iv) any manager, by whatever name called, of the organization or trustee of the trust;

  (v) any relative of the author, founder, member, trustee or manager

# Consequences of conversion of NPO TAX @ 30% ON NET WORTH

- Section 94: 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 nonprofit organization**; OR

  (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.

# Consequences of conversion of NPO

- Net Worth for section 94(2):

  (b) net worth means the aggregate value of the total assets of the non-profit organisation as reduced by the value of liabilities of the organisation;

  (c) the value of the total assets and liabilities shall be computed in accordance with the rules of valuation prescribed in this behalf

# Chapter IV for NPO's taxation : NOT APPLICABLE WHEN(SEC 95)

- 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 **and** 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

# Law relating to TDS- Chapter XI-A

# TDS New Provision IN Section 195

- Applicable to Any **PERSON;**
- **On Specified Payment:**
  - **For Resident Deductee: Sch III**
  - **For Non Resident Deductee: Sch IV**
- **Rate: Specified in aforesaid schdules relevant entries**
- **In case where no PAN: TDS @ 20% or specified rate, whichever is higher**

# TDS New Provision IN Section 195

- Earlier there were different provisions in Act going from section 192 to section 195 – Now different entries in Schedules
- Deductee (in every case) and Deductor (for non resident payee) both can approach AO u/s 197 – for Low <u>which order seems prima facie appealable u/s 183</u>

# TDS New Provision IN Section 195

- <u>No TDS u/s 200 when (inclusive):</u>
  - Interest on Time deposits if aggregate amount in a financial year =< 10,000
  - Specified debenture interest if same =< 2500
  - Other interest if same =< 5000
  - Interest payable by a firm to a partner of the firm
  - Payment of Goods Carriage by Road Transport if payee gives PAN
  - Payment by Individual/HUF if their accounts are not liable to audit during immediately preceding financial year
  - Commission/Brokerage aggregate amount of payments do not exceed INR 5,000
  - Rent aggregate amount of payments do not exceed INR 120,000 (irrespective of payee)
  - Immovable property compensation amount do not exceed 100,000

# IIIrd & IV Schedule to Code- Glimpse

- <u>Service contract "including" job work contract: TDS Rate 1%</u>
- <u>Residuary Source: "any other income: 10%" – VERY-VERY WIDE it seems TDS is on every payment of income</u>
- <u>For Non resident Deductee- TDS u/sch IV:</u>
  - <u>Interest income,Royalty, FTS Rate 20%</u>
  - <u>Capital Gains: 30%</u>
  - <u>"On Whole of other income" – 35% - Compass Uncontrolled</u>

Seems that NR having business income not taxable under the Code due to lack of business connetcion etc – also to face 35% TDS

Apparently Further no recourse possible to DTAA at TDS stage from Section 195 and Section 200 and Sch IV

# Law relating to Penalties – Chapter XII

# Section 224 Penalties

- Willful under reporting of tax base must for penalty imposition u/s 224(1)
- Section 224(2): Deemed Willful Under reporting if
  - Assessee failed to furnish required return by due date u/s 148(1) or
  - Tax base assessed > Tax base returned
  - Tax Base reassessed > Tax base assessed before

  - Tax Base Under reported shall
    - In case where no return otherwise required: assessed tax base
    - In case return furnished: assessed tax base – returned tax base etc

  - Penalty can be in range of 100% to 200% of tax payable in respect of under reported tax base

# Section 224 Penalties

- Following additions/disallowances shall not be liable to penalty (section 224(9))
  - Where assessee offers an explanation: which is bonafide; disclosed all material facts qua addition concerned and all facts disclosed qua explanation
  - Which are estimated by AO provided accounts are correct and complete and only method is such income is not deducible
  - For which liability to tax stands discharged by prepaid taxes
  - Prima facie adjustments in Return processing 224(11)

Rate of Tax payable shall be maximum marginal rate in case of Individual/HUF etc section 224(10)

Penalty to be respectively levied by AO/CIT-A/CIT qua tax base determined in a) assessment/reassessment b) appeal c) Revision- section 224(12)

# Section 226 All other penalties

| Default | Penalty |
|---|---|
| Non Accounts and Audit & TPO report | From 50,000 to 200,000 |
| TDS default | From 25% of TDS to TDS Amt |
| Return u/s 148 | 5,000 |
| Residuary Penalty for Other listed defaults | From 5,000 to 100,000 |

# Section 227 Procedure (refer earlier section 274)

| Particular/Provision | Authority For Penalty |
|---|---|
| For section 224(12) | Corresponding authorities (AO/CIT-A/CIT) |
| Section 226 defaults | before whom default committed |
| Section 225 Penalty for Undisclosed Tax base in search cases | Assessing Officer |

Thank You

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