

DIRECT TAX CODE, 2010 – SALIENT FEATURES *(Effective from 1st April 2012)*

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The DIRECT TAX CODE, 2010 “DTC” has been introduced as a bill in parliament on 30th August 2010 and is envisaged to **come into force from 1st April 2012**, to replace the existing Direct Tax Regime in India governed by the Income Tax Act, 1961 “The Act or ITA”.

The Act has been modified to inculcate global tax practices in India in light of unprecedented growth and surging foreign investment into the country. The Finance Minister and his team have attempted to strike a delicate balance between reducing the burden of Tax on the burgeoning Indian Middle Class while ensuring an increase in total Tax Collections by expanding the Tax Net in the Country. This will ensure greater disposable income to churn the second fastest growing economy in the World and increase Revenue Collection at the Centre to reduce the Fiscal Deficit in the Country.

The DTC proposes certain significant changes from an International Tax perspective that may impact Foreign Companies doing or proposing to do Business in India.

In light of these proposed changes in context of International Tax, tabled below are the Salient Features of the DTC Bill as recommended by the Finance Minister, Mr. Pranab Mukherjee and is yet to be approved as an Act in Parliament.

SNo.	Particulars	DTC 2010	Impact	Comments
1	Test of Residency for Foreign Company	<ul style="list-style-type: none"> ✓ A Company shall be Resident in India in any Financial Year, if: <ul style="list-style-type: none"> ▪ It is an Indian Company (Incorporated in India) ▪ Place of Effective Management ('POEM') is located in India, <u>at any time during the Financial Year</u> ✓ POEM of a Company is: <ul style="list-style-type: none"> ▪ The place where the BOD or ED make their decision ▪ Where BOD approves Commercial & Strategic decisions made by ED or officers, the place where ED or other officers performs their functions 	<ul style="list-style-type: none"> ✓ If a foreign company is regarded as Resident by virtue of its POEM being in India <u>at any time during the financial year</u>, it would be taxed on its worldwide income 	<ul style="list-style-type: none"> ✓ Expression <u>'at any time'</u> very wide ✓ Meaning of the expressions <u>'routinely' / 'commercial and strategic decisions'</u> not provided ✓ May create difficulties in implementation as there could be difference of opinion in regard to where is POEM
2	Levy of Branch Profit Tax (BPT) on Foreign Companies	<ul style="list-style-type: none"> ✓ Foreign Company would be subject to BPT in addition to the income tax payable on its Branch Profits in a financial year. ✓ Branch Profits shall be <u>income attributable directly or indirectly, to the Permanent Establishment</u> or an immovable property situated in India. ✓ <u>Tax @ 15%</u> on {Total Income less Corporate Income Tax on attributable income} 	<ul style="list-style-type: none"> ✓ BPT would be applicable even if there is no remittance of Profits to Head Office abroad. ✓ BPT is <u>NOT</u> subject to treaty protection 	<ul style="list-style-type: none"> ✓ Corporate Tax Structure for foreign companies has been <u>reduced from 40% to 30%</u> ✓ Effective tax rate for a Foreign Company post charge of BPT would be 40.50%.

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3	Permanent Establishment (PE)	<ul style="list-style-type: none"> ✓ <u>PE includes</u> <ul style="list-style-type: none"> ▪ Fixed Place PE ▪ Service PE (no time threshold) ▪ Construction/Installation / Assembly / Supervisory PE (no time threshold) ▪ Substantial equipment PE (no time threshold) ▪ Agency PE (excludes independent agents) 	<ul style="list-style-type: none"> ✓ Treaty definition of PE not relevant for BPT ✓ PE definition in Treaties to over-ride 'Business Connection' test ✓ Provision of Services in India resulting in Service PE, hence taxable as Business Income 	<ul style="list-style-type: none"> ✓ <u>Non-specification of time thresholds</u> ✓ No exclusions for preparatory and auxiliary activities ✓ No definition for Independent Agent ✓ This definition of PE is largely relevant for <u>determining the applicability of BPT</u>
4	Controlled Foreign Companies (CFC)	<ul style="list-style-type: none"> ✓ CFC means a Foreign Company whose shares are not traded on a RSE, and <ul style="list-style-type: none"> ▪ is resident of a territory with lower tax rates ▪ is controlled by an Indian Resident <u>Person(s)</u> ▪ is not engaged in active trade or business ▪ <u>has specified income exceeding INR 2.5mn</u> ✓ <u>Wealth Tax to be levied on resident assessee for such CFC</u> ✓ Total Income of Resident Indian to include income attributable to such CFC. 	<ul style="list-style-type: none"> ✓ Introduced to tax the <u>passive income</u> of Indian Resident ✓ Gains on sale of CFC's shares to be taxed without offsetting prior years' taxes paid due to application of CFC ✓ may impact outbound investments 	<ul style="list-style-type: none"> ✓ Applicability of CFC regime to <ul style="list-style-type: none"> ▪ Downstream investment subsidiaries of overseas operating Companies ▪ Non-corporate overseas entities ✓ passive income such as dividend not declared etc. resulting in deferral of taxes, will now be taxed under DTC

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				<ul style="list-style-type: none"> ✓ Credit / deduction in India for Foreign Taxes paid by CFC is not clarified ✓ Set-off between profits and losses of different CFCs is not clarified
5	Double Taxation Avoidance Agreement (DTAA)	<ul style="list-style-type: none"> ✓ ITA enables a taxpayer to <u>choose between a tax treaty and the ITA whichever is more beneficial to it.</u> ✓ However under DTC <u>this rule shall not prevail when</u> <ul style="list-style-type: none"> ▪ GAAR provisions are invoked ▪ CFC provisions are invoked ▪ BPT is levied 		<ul style="list-style-type: none"> ✓ Can impact the foreign business dealings adversely
6	General Anti Avoidance Rules(GAAR)	<ul style="list-style-type: none"> ✓ GAAR will be invoked if there is an Impermissible Avoidance Arrangement “IAA” with a Resident Assessee. ✓ An IAA is an agreement entered into by a Tax Payer with the main objective of obtaining tax benefits. ✓ GAAR are broad set of provisions that has the effect of invalidating such arrangement 	<ul style="list-style-type: none"> ✓ Tax Authority granted power to adjust the assessment of of the taxpayer ✓ GAAR to override Tax Treaties ✓ CBDT Guidelines on GAAR awaited for clarity 	<ul style="list-style-type: none"> ✓ This can lead to harassment and hardship for taxpayers

SNo.	Particulars	DTC 2010	Impact	Comments
7	Definition of Royalty and Fees for technical services (FTS)	<ul style="list-style-type: none"> ✓ The definition of Royalty and FTS has been expanded. ✓ Royalty and FTS to be taxed @ 20% on gross income as against 10% in the existing ITA 	✓ This can adversely affect import of technology in the country	✓ Clarifications required on what happens if such payments are connected to a PE in India, as Royalty & FTS is taxable on Gross Basis and PE on net basis.
8	Transfer Pricing Provisions	<ul style="list-style-type: none"> ✓ An international transaction means a transaction between two or more Associated Enterprises (AEs), either or both of which are NR ✓ ITA provides for specific circumstances when two enterprises would be deemed to be AEs. ✓ The definition of AEs under DTC has been expanded to include <ul style="list-style-type: none"> ▪ Provision of services by one enterprise to another, either directly or indirectly, where the conditions are influenced by such other enterprise ▪ Enterprises located in a specified location, as may be prescribed ✓ Further Advanced Pricing Arrangement provisions are introduced in DTC which broadly means an 'Arrangement' between CBDT and Resident Person(s) that 	✓ DTC also empowers the CBDT to formulate a scheme for APAs in respect of an international transaction.	

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		determines in advance, for a controlled transaction, an appropriate set of criteria for determining the Arms Length Price for such transactions		
9	Capital Gains on Equity Shares and Units of Equity Oriented Funds– Specified Deduction Exemption	<ul style="list-style-type: none"> ✓ A specified deduction is allowed on transfer of listed equity shares or unit of equity oriented funds subject to STT paid ✓ If held for more than 12 months, 100% deduction ✓ If held for less than 12 months, 50% deduction 	<ul style="list-style-type: none"> ✓ LTCG on listed shares and units, will <u>now not be exempt, however a 100% deduction means no tax payable</u> ✓ STCG on <u>listed shares and units will now be charged @ 30% after 50% deduction which effectively mean @ 15% as was earlier.</u> 	<ul style="list-style-type: none"> ✓ <u>Rate of deduction may be changed in coming years which means that these listed shares or unit subject to STT will be charged to tax</u>
10	Transfer of Assets by Non-Residents	<ul style="list-style-type: none"> ✓ Income from transfer outside India of shares or interest in foreign company shall be taxable in India if at any time in the preceding 12 months, <u>fair value of assets in India owned directly or indirectly represent 50% or more of fair value of all assets owned by the foreign company.</u> ✓ Tax on income computed under DTC 2010 to be pro-rated based on proportion of FMV of India Assets/ FMV of Total Assets 	<ul style="list-style-type: none"> ✓ This was much awaited amendment which started with <u>Bombay HC’s decision on Vodafone Case.</u> It is now expected to ensure clarity in Indian Taxation through indirect 	<ul style="list-style-type: none"> ✓ Overseas transfer of assets / shares (with underlying economic interest in India) whether taxable ✓ Meaning of the expressions ‘interest’ in a foreign company / ‘owned directly and indirectly’ by the

SNo.	Particulars	DTC 2010	Impact	Comments
		of foreign company	transfer relating to Indian Business	Company ✓ Guidelines awaited on FMV methodology, which are critical in determining applicability of this provision
11	Income deemed to accrue or arise in India	<ul style="list-style-type: none"> ✓ Section 9 of the Act currently provides provisions relating to income deemed to accrue or arise in India ✓ DTC 2010, while retaining those provisions has expanded the scope to include the following incomes:- <ul style="list-style-type: none"> ▪ Any insurance premium, including reinsurance premium, in respect of an insurance covering any risk in India ▪ Transportation charges payable by a Resident or non-resident, if the same is in respect of carriage to or from, a place in India ▪ Income accruing to non-resident engaged in business of running a news agency or of publishing newspapers, magazines, through or from activities confined to collection of news and views in India for transmission out of India 	✓ Transportation charges payable by a resident for carriage by aircraft or ship from a place outside India to another place outside India is excluded	

SNo.	Particulars	DTC 2010	Impact	Comments
		<ul style="list-style-type: none"> ▪ Interest paid by non-resident for any debt incurred and used for earning any income from any source in India 		
12	Business Deductions and Exemptions	<ul style="list-style-type: none"> ✓ DTC 2010, has done away with Chapter VI A of the ITA which provided for business deduction and exemptions ✓ <u>Schedule Twelfth and Thirteen</u>, will now govern Computation of Profits of Specified Business and related deductions. 		

13. Schedule XII - SEZs / SEZ Units

Particulars	Incentives to SEZ Units		Incentives to SEZ Developers	
	ITA, 1961	DTC, 2010	ITA, 1961	DTC, 2010
Profit – Linked Incentives	Yes, irrespective of date of commencement of operation	Yes, Commencement of operation before 31.03.2014	Yes, irrespective of date of notification	Yes, notified up to 31.03.2012
Investment – Linked Investments	Not Applicable	Yes, Commencement of operation on or after 01.04.2014	Not Applicable	Yes, notified on or after 01.04.2012
MAT Payable	NO	Yes, irrespective of date of commencement of operation	NO	Yes, irrespective of date of notification
DDT Payable	YES	Yes, irrespective of date of commencement of operation	NO	Yes, irrespective of date of notification

14. Schedule XIII – Specified Business

DTC 2010, has proposed to bring a paradigm shift in granting tax incentives to undertakings engaged in **SPECIFIED BUSINESS**. The new scheme has proposed to substitute the profit-linked incentives prevalent under the existing provisions of Chapter VIA OF the Act with the expenditure / investment based deductions. Given below is the summary of Schedule –XIII of the Code.

Specified Business	Computation of Profits	Gross Income	Business Expenditure
<ul style="list-style-type: none"> ✓ Power ✓ Infrastructure ✓ Hospital ✓ Cold Chain ✓ Processing, Preservation & Packaging of Fruits ✓ Cross country natural gas or crude or petroleum ✓ Warehousing Facility for storage agricultural products ✓ Hotel of two star or above category 	<ul style="list-style-type: none"> ✓ <u>Gross Income less Business Expenditure</u> 	<ul style="list-style-type: none"> ✓ Accruals or receipts derived from specified business ✓ Accruals or receipts derived from disposal, discarding or destruction of any business capital asset on which deduction has been allowed ✓ Others as specified 	<ul style="list-style-type: none"> ✓ Operating Expenditure ✓ Finance Charges ✓ <u>Capital Expenditure excluding expenditure incurred on the acquisition of any land including long term lease, goodwill or financial instrument</u> ✓ Any Expenditure referred above incurred before the commencement of the Business

15. Corporate Tax Structure

Category	Income Tax Act, 1961	Direct Tax Code, 2010
Income Tax - Indian Company	30%	30%
Income Tax – Foreign Company	40%	<ul style="list-style-type: none"> ▪ 30% ▪ Additional Branch Profit Tax @ 15%
Wealth Tax	1% on net wealth exceeding INR 3 Mn	1% on net wealth exceeding INR 10 Mn
MAT	18%	20%
DDT	15%	15%
Income distributed by mutual fund to unit holders of equity oriented Funds	N.A.	5% of the Income distributed
Income distributed by LIC to policy holders of equity oriented life insurance schemes	N.A.	5% of the Income distributed
Non-Resident		
▪ Interest	20%	20%
▪ Royalty	10%	20%
▪ Fees for technical services	10%	20%
Any Assessee whether Resident or Non-Resident (income from any lottery, crossword puzzle, race including horse race, card game or any other game or gambling or betting)	30%	30%

Annexure-I: List of abbreviation used in the document

S.no.	Abbreviation	Full Form
1	DTC	Direct Tax Code
2	ITA	Income Tax Act, 1961
3	POEM	Place of Effective Management
4	BOD	Board of Directors
5	ED	Executive Directors
6	FMV	Fair Market Value
7	BPT	Branch Profit Tax
8	STCG	Short Term Capital Gains
9	LTCG	Long Term Capital Gains
10	STT	Securities Transaction Tax
11	FIIs	Foreign Institutional Investors
12	CBDT	Central Board of Direct Taxes
13	HC	High Court
14	SEZ	Special Economic Zones
15	MAT	Minimum Alternate Tax
16	DDT	Dividend Distribution Tax

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