

## Impact Of Direct Tax Code On Balancing Reaping Tax Rewards

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### **Abstract**

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On implementation of the code all perks would be considered part of the gross salary for the purpose of taxation. The impact of that on tax liability of an individual will be known only when the rules are prescribed by the income-tax department at a later date. But there would be equity in the tax system both vertically and horizontally across all sectors. The tax treatment of the perks enjoyed by the government employee and the private sector employee will be the same. Till now government sector was in advantage!

We have studied following points for consideration of impact of direct tax code on balancing reaping tax rewards.

- 1 INTRODUCTION
- 2 REAPING NEEDS FOR FLEXIBILITY
- 3 TEMPORALLY NEUTRAL TAX SYSTEM
- 4 CONCLUSION

Moving to a complete consumption tax system for the individual tax code would entail little more than allowing universal, unlimited IRAs for everyone and doing away with penalties for early withdrawals. Individuals could continue with the IRAs and others they currently have or roll them over into the new plans.

### **1. INTRODUCTION**

There is a move away from the directive taxes which belong in the past when we were a closed and planned economy. Tax laws are not meant to push money into government coffers but only to motivate right investing behaviour.

There is no reason why the government should accept the onerous burden of assured returns as it presently does on PPF, etc. This of course is distinct from the need for affirmative action to improve the lot of the significant portion of our population which is below poverty levels.

The more significant reversal has been on the Minimum Alternate Tax (MAT) which in its earlier form was to say the least retrograde. It would have been a significant disincentive for setting up heavy industry which is not only capital intensive but also suffers long gestation periods.

It would have been unfeasible to invest in a gas refinery or a computer chip plant or for that matter even infrastructure projects. Thankfully the damage has been avoided and the MAT will now be computed with reference to book profits.

## **2 REAPING NEEDS FOR FLEXIBILITY**

The money in PPF should be kept there itself, if possible, as the interest earned would be exempted from tax. When ever emergent requirement occurs then only it should be taken out after paying tax. In that event tax incidence would be much lower. Of course, the rollover from one exempt fund to another fund will not be subject to tax. This means from PF or PPF you can transfer it to NSC and NPS without attracting tax.

### ***1 EXISTING PATCHWORK***

The key objective underlying the proposed enactment of the DTC is to mitigate the uncertainty and complexity created by the existing patchwork of direct tax legislations and annual finance acts,” explains Abhishek Saxena, a partner at Phoenix Legal.

### ***2 BROADENING TAX BASE***

At the same time, the DTC has not lost sight of the need for flexibility and ensures that amendments – of tax rates, for instance – can be accommodated within the schedules to the DTC. While the DTC has proposed to lower corporate tax rates simultaneously it incorporates new provisions which will result in broadening the tax base

### ***3 MERGERS AND ACQUISITIONS***

One aim of the new tax code is to provide a system which takes into account the increase in cross-border mergers and acquisitions undertaken by Indian companies over the last few years. In addition, while lowering corporate tax rates, the DTC aims to remove the administrative burden on foreign companies and investors for whom the country is now a leading target for investment.

### ***4 MAINTAINING INTEREST***

The professional community is divided over the logic and scope of some of the Code’s provisions and some experts are anxious about the impact such legislation will have on business and investment activity. The need to maintain a balance between reaping tax

rewards under the new legislation and maintaining the interest of businesses and investors is of utmost importance. There is some anxiety as to whether the DTC achieves this balance, especially given the Government of India's reputation for enforcing tax legislation.

### ***5 ENFORCEMENT OF TAX***

Since there is a direct correlation between taxation and economic growth, tax policies need to be directed so they achieve objectives such as increasing growth, savings and investments, consumption, and so on," says Vipul Jhaveri, a partner at Deloitte. "Although the goals of the DTC are laudable, some of the provisions raise concerns stemming largely from an unsatisfactory experience with the manner of enforcement of tax provisions at the field level.

### **3 TEMPORALLY NEUTRAL TAX SYSTEM :**

The code has proposed to continue with other deductions such as medical insurance premium, medical treatment or maintenance of disabled dependent, treatment for specified diseases for self and dependents, for the handicapped, interest on loan taken for higher education, rent paid for residence, donations to certain non-profit organisations and specified institutions and tuition fees for children.

#### ***1 CONSUMPTION DIFFERENCE***

Market interest rates effectively pay people to defer consumption into the future (i.e., to save). Because the tax wedge reduces those payments, people inevitably will choose less future consumption (saving) and more current consumption. This harms the economy because less saving results in less investment, less innovation, slower growth, and lower future living standards than would be enjoyed without a tax on saving.

#### ***2 TAX ON CAPITAL INCOME***

Some of this loss is a deadweight loss to society, that is, a loss to some that is a benefit to no one. Eliminating taxes on capital income would eliminate the tax wedge on saving, and total saving would be much closer to the optimal amount. The tax system would be "temporally" neutral in the sense that it would not affect the choice between current consumption and future consumption (saving).

#### ***3 BENEFITS OF CONSUMPTION***

Despite its allure of eliminating the bias against saving, a true consumption tax runs into fervent opposition from some, mostly liberal, economists. As noted, their principal objection is that the greatest direct benefits of a consumption tax would go to high-income individuals. Since they are in higher tax brackets, high-income households get a greater dollar benefit from deducting savings (traditional IRA) or having after-tax contributions accumulate tax-free income (Roth IRA).

#### **4 ADDITIONAL SAVING AND INVESTMENT**

The one objection to a consumption tax based on pure economics is that it would require a higher tax rate in order to raise the same revenue as an income tax that includes capital income. For this reason, a consumption tax would be less neutral between work and leisure than the current income tax. This would cause people to work less, and would increase the deadweight loss from the tax wedge on labor income. Advocates of a consumption tax maintain that the gains from additional saving and investment would greatly outweigh the losses from less work effort, though it is impossible to know with certainty whether that is correct.

#### **4 CONCLUSION :**

The other significant rethink has been on the proposal to determine notional rent on a presumptive basis at the rate of 6 percent, which is nowhere even near the rental returns in many urban areas especially Mumbai.

It has also done away with the proposal to tax house property not let out. Anyway capital gains through appreciation of property are taxed and tax as proposed would have been repressive and highly discouraging for investment into house property, an important source of legitimate financing for housing development.

The difference comes in the treatment of existing savings and wealth. The Bush tax cut conferred an enormous windfall on owners of existing wealth because it reduced taxes they had anticipated paying on assets they had already purchased. In other words, the cut changed the rules in their favor after the game had begun.

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