BUDGET 2002

Part A – Tax Rates, Personal Income & Deductions

1. Tax rates

The basic tax rates have remained unchanged except for two areas where the tax rates have been altered.

1.1 Surcharge

The surcharge of 2% levied due to Gujarat earthquake has been removed. In its place, a surcharge of 5% for national security is being levied. There is a net increase in surcharge of 3%. For those in 30% tax bracket, the increase in tax rate works out to 0.9%.

The new maximum marginal rates are:

For Individuals — 31.5%.

For Companies & Firms — 36.75%.

1.2 Foreign companies

Foreign companies were levied a tax @ 48%. The budget has reduced the tax to 40%. However, so far the foreign companies were not levied any surcharge. Now they will also be levied a surcharge. Thus, their tax cost becomes 42% instead of 48%.

Foreign companies will now be taxed @ 42% instead of 48%.

The difference between tax rates for foreign companies and Indian companies has certain **reasons**. The Government's stand is that India has a **classical system** of taxation whereby the company and the shareholders are treated separately. Thus, the company pays tax on its profits, and the shareholders pay tax on dividend. In case of foreign companies, the tax can be collected only once — on net profits of the foreign company. When the foreign company declares dividend to its shareholders, India cannot levy tax on the dividends as it is outside India's jurisdiction. Therefore, the foreign companies are levied a higher rate of tax. It was argued by foreign companies that the difference in the rate of tax for foreign companies (48%) and domestic companies (35%) was still quite large. Therefore, to reduce the difference, the rate has been brought down to 40%. Now the argument that there should be lower (or no) difference between tax rates of domestic and foreign companies may not hold good. In fact the situation is actually opposite. The Indian companies and the shareholders together have to pay more tax. Kindly see para 6, where we have given an illustration of impact on taxation of foreign companies. For professionals, a brief history on Double taxation is also given in paragraph 5.7.

2. Rebate for PPF, LIC, etc. — Section 88

Rebate due to PPF, LIC has been reduced for different categories of income.

2.1 A tax rebate of 20% is allowed for investments in LIC, PPF, etc. The budget proposes to reduce the rebate for certain categories.

A person who has income before deductions under chapter VI-A (80L deduction for bank interest, 80G deduction for donation, etc.) of up to Rs. 1,50,000 will continue to get rebate of 20%.

If his income is between Rs. 1,50,001 and Rs. 5,00,000, the rebate will be equal to 15%.

Those having income above Rs. 5,00,000/- will not get any rebate.

For the last few years, the Government is making a series of provisions reducing incentives for investment in Government securities. It is clear that the Government wants to reduce its internal debt.

2.2 The maximum limit up to which investment can be made in PPF, LIC, etc. has been increased from Rs. 60,000 to Rs. 70,000. For subscription to eligible shares and units of mutual fund, an additional investment of Rs. 30,000 is permitted against the earlier limit of Rs. 20,000. Thus the maximum tax reduction which can be claimed for those having income between Rs. 1,50,001 and Rs. 5,00,000 is Rs. 15,000.

3. House Property Income — Section 24

Interest for housing loan will be available as a deduction up to Rs. 1,50,000. The property should be constructed or acquired within 3 years of taking the loan.

In case of self-occupied properties, a deduction for **interest on loans** was allowed up to Rs. 30,000. This deduction was increased to Rs. 1,50,000. However, for this increase, a restriction was provided. The new house property should be acquired before 1st April, 2003. The budget has done away with the time limit of acquiring the property. Instead, now it provides that the property should be acquired or constructed within three years from the end of the year in which the loan was taken. Thus, if loan is taken in March, 2002, the property should be acquired before 31st March, 2005. Now the deduction of Rs. 1,50,000 has become open ended and applicable for all properties acquired henceforth.

Still, however, the above situation does not rectify a serious problem. In cities like Mumbai where the costs are far

higher than other smaller towns and cities, a modest property of 600 sq. ft. costs between Rs. 10,00,000 and Rs. 25,00,000. With the existing limit of Rs. 1,50,000, a maximum loan of about Rs. 12,50,000 can be taken to get full deduction of interest. A better way perhaps could be, that for one house property per family, full deduction of interest should be allowed. For more than one properties, the regular deduction of Rs. 30,000 should be allowed.

4. Tax to be deducted at source by individuals and HUFs — Section 194-A, etc.

Individuals and HUFs who require a tax audit will have to deduct tax at source from various payments.

Before making payment of income, tax has to be deducted at source under various provisions. For most of the provisions, individual persons and HUFs were not required to deduct tax at source. Now the budget proposes that those individuals and HUFs who are required to get their books of account audited under the tax audit rules, will be required to deduct tax at source from various payments. (Tax audit is required by a businessman having a turnover exceeding Rs. 40,00,000 and by professionals having gross receipts exceeding Rs. 10,00,000.)

Thus, now payments of following kinds can be made by individuals and HUFs only after deducting proper tax at source.

(i) interest on loans; (S. 194-A)

(ii) payments to sub-contractors; (S. 194-C)

(iii) commission and brokerage; (S. 194-H)

(iv) rent for immovable property; (S. 194-I) and

(v) fees for professional or technical services (S. 194-J).

Such individuals and HUFs will now have to go through the entire procedure of TDS. They will have to deduct proper tax at source, pay the same to the Government within the prescribed time, issue proper TDS certificates to the payees, and file annual TDS returns.

As far as salary payments are concerned, individuals and HUFs were always liable to deduct tax at source where applicable.