Finnomics

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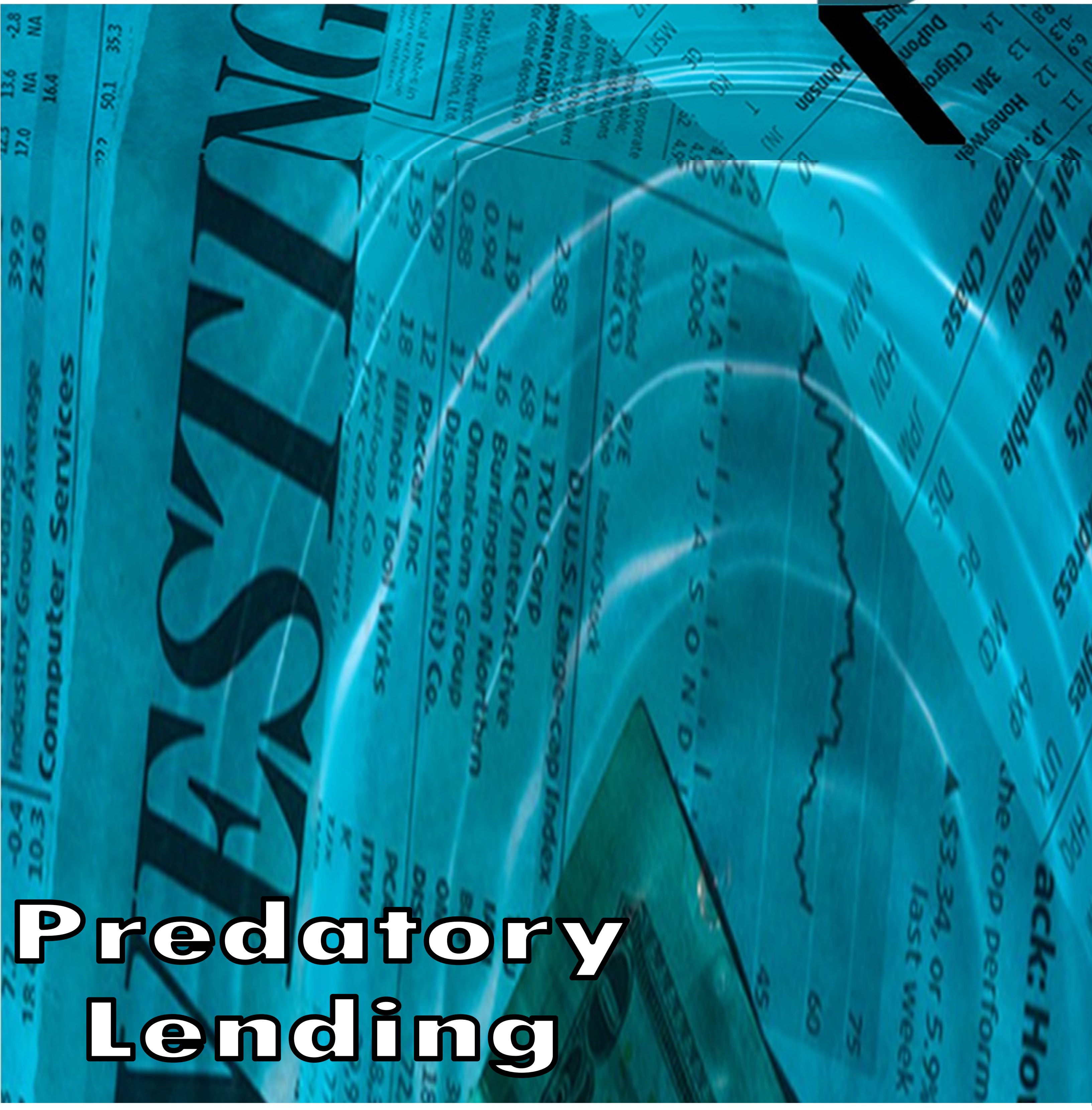
Finance Forum



Predatory Lending

“The investor of today does not profit from yesterday's growth”- Warren Buffett

Content

Market Watch

Sheriq Sumar –MMS (2010-2012)

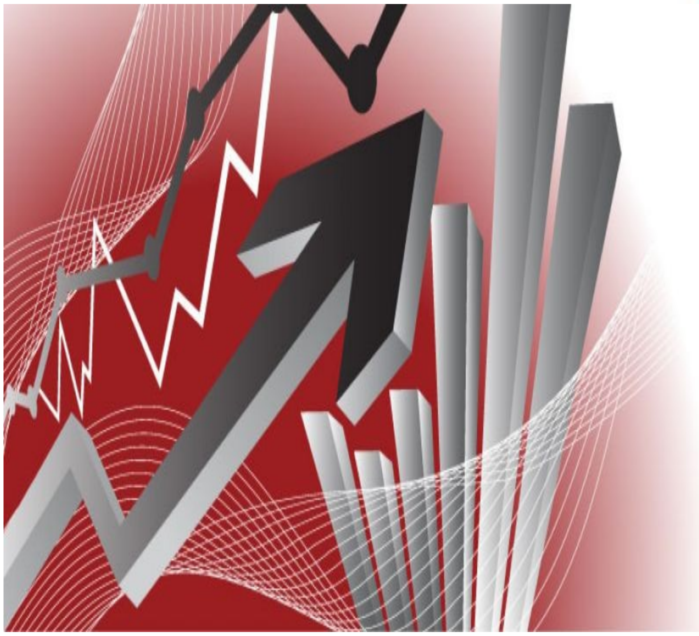
The BSE Sensex in the month of October had witnessed a rollercoaster ride; however the growth hasn't as much as expected. The Sensex rose by just 0.13% from a level of 19,980 to just 20,007. The Sensex had flirting around 21000 in many trading sessions but it had also reached a low of 19770 in the 3rd week of October.

The NSE Nifty has shown a similar pattern in this month with a marginal increase in the indices. The NIFTY opened on 1st October at a level of 6005 and with an increase of just 12 points ended the month's session at 6017. It reached a high of 6235 on 13th October and a low of 5984 on 19th October. The volatility in these indexes has been quiet high in the last few weeks.

One of the major reasons for such a flat performance can be attributed to the recent mega IPO of Coal India Pvt. Ltd. Being subscribed 15.7 times, this issue had sucked a lot of liquidity from the markets. Retailers had shown an expected enthusiasm for this IPO by subscribing to it 2.5 times. This IPO plans to raise Rs 15,500 crores and would be listed on exchanges from 4thNovember. The issue price has been finalised at Rs 245 per share which was the upper band of the price range.

The November month is expected to be similar like October with flat trends mainly due to the festive season around, and can even be expected to touch a low of 19000; however for the next 3-5 months the market is expected to reach an all time with the Sensex reaching a level of 25000 and Nifty at around 6700.

The exchange rate has seen quite a good progress in recent months. In the September end the exchange rate was hovering around Rs 45/$ to Rs 44.5/$, but after reaching a low of Rs 44/$ it has finally settled at Rs44.3/ $ on 29th October. The main reason for such an appreciation is the FII inflows this year, which has been highest in last few years at around Rs 1 lakh crore. Exports have been highly impacted by this appreciation while imports are enjoying their share of pie.



FIIs in the month of October made a net investment of Rs 14,388 crores. Gold prices as on 30th October was Rs 19,545/ 10 Gms while silver prices touched an historic high of Rs 38,000/kg. Many companies have now started coming out with their 2nd quarterly reports of which some have come out with surprises while some satisfied the markets.

The Yield on a 10 year G-Sec has also seen considerable increase this month. The average yield for the month of September on a 10 year G-Sec was 7.86% which currently stands at 8.11% as on 29th October. The October month has been the worst since July where bond prices have fell more than expected. The price of an Rs 100 face amount closed at Rs 97.88 on 29th October. The MIBOR rates as on 29th October settled at 7.66%.

The Dow Jones Industrial Average closed at 11118.5 much better than January levels of 10600. The NASDAQ closed at a level of 2508 levels on 28th October. There had been wide fluctuations in the Nikkie since January, from a high of 11300 to a low of 8800 the index closed at 9366 as on 28th October. The Hangseng Index settled at 23115.6 as on 30th October after sliding upwards throughout October.

Ketan Shah -PGDM IB (2010-2012)

In the last one and half decade telecom has been the fastest growing sector. The mobile revolution has taken country by storm. Since the implementation of NEW TELECOM POLICY, 1995, telecom sector has been growing tremendously. With the growth rate of 54 % in 2009 and 48 % in 2008 upside is clearly visible in the sector.

At present there are more than 500 million subscribers in this country. As per one of he study of U.N there are more number of mobile phones than toilets in India. There are 6 major telecom operators in India namely- Airtel, Idea, Reliance, Tata, Vodafone (earlier, Hutch), BSNL. With the auctioning of 3G spectrum on 19TH May, 2010 the gate was opened for all the prospective players to enter Indian telecom industry. Players like Videocon, Uninor etc. are some of the new entrant in the industry.

Though this sector has been the money making machine since last several year's things are different now. This is a capital intensive sector where good amount of money is to be ito 7 years to break even.

An analysis of the following factors should be done before investing.

Costs of operation:

The infrastructure at the cell site consists of active infrastructure (radio equipment, antennas and trans-receiver used for telecom signal processing) and passive infrastructure (tower, shelter, diesel electric generator). In India, active infrastructure constitutes 40 % and passive infrastructure constitutes 60 % of the total cost. As lot of infrastructure is required cost are major drains on finances of the business. Telecom companies don't have control over 70 % of the expense like- power, fuel and rental that they have to pay for tower.

Regulator:

The government of India owns the spectrum which is of huge importance for Telecom Company. At present if an operator gets Unified Access Service License (UASL) it comes bundled with spectrum. Now if this spectrum nvested in network infrastructure, distribution channels and license fees.

As per one estimate it takes some 6 is demerged from UASL its cost will be market determined which will make it costlier. Telecom companies also require ISD/NLD license for International calling. License for Internet Service Provider (ISP) is also required for providing internet service. Hence, license fee form a major component in the cost of providing a services for a new service provider.

The auctioning of 3G spectrum was expected to commence some 2 and half years ago. But it happened lately and hence this also led to opportunity lost for companies to earn revenue.

Some Numbers

Subscriber Base, Revenue Market Share, Minutes of Usage and ARPU.

- Subscriber Base- Easiest way of gauging performance of telecom companies is subscriber base. But an investor should not rely on this factor alone. This is because companies are in race to increase their subscriber base and not revenue. This is due to the age old policy of DoT (Department of Telecom) to link with spectrum subscribers base and this has compelled companies to focus more on increasing subscribers numbers rather than bottom line.

PICK UP THE CALL.......

- Revenue market share- This is also important as it denotes the profitability, quality and quantity of subscribers. In long term if the quality is good a lot of things come into play like infrastructure and technical strength. An ideal company will have both a good subscribers base and revenue market share.
- MoU-A company might report higher number of minutes of usage but it does not necessarily means it is making profit. As minutes of usage does not account for tariffs charged. And with the introduction of 1paise/minute MoU has drastically increased.
- Average Revenue per User- This is the most important indicator of company's revenue. ARPU number gives an indication about the company's earning on every minute of conversation. ARPU of GSM for companies has drastically fallen from Rs.450 to Rs.205. This shows that companies have tough time ahead.

One must also look at the Tenancy ratio. Tenancy ratio refers to the number of tenants (service provider) on a tower. Maximum of 3 tenants can be there on a tower.

Reliance communication has recently demerged their tower business into Reliance Infratel in order to create value into the tower business (though the deal was later called off). Quippo Telecom recently bought Tata Teleservices Maharashtra's (TTML) tower business for 1,318 cores thereby valuing each tower for Rs. 52 lakhs, the largest in this industry. Demerging tower business will help companies to unlock value in tower business.

The delay in auctioning of 3G could be a gain as the Europe experience has shown that initial 3G bid led to massive overbid. Huge airwaves fees (for metros in India) have left companies run losses for years after network roll out. Another favorable factor is that penetration level has also increased and 3G will be the next source of revenue for the companies as revenue from voice calls will remain stagnant.

Empirical evidence suggests that consolidation will happen across the telecom sector but when is not known. Who will survive post consolidation is also not known. An investor can buy a basket of telecom stocks. Some will win and some loose. The winners will cover the losses of losers. Hence an investor will have to keep patience in order to make money.

Words of Wisdom

"Derivatives are financial weapons of mass destruction." - Warren Buffet

"If you owe the bank $100 that's your problem. If you owe the bank $100 million, that's the bank's problem." - John Paul Getty

"October. This is one of the peculiarly dangerous months to speculate in stocks in. The others are July, January, September, April, November, May, March, June, December, August and February." – Mark Twain

"Every day I get up and look through the Forbes list of the richest people in America. If I'm not there, I go to work" - Robert Orben

"Money won't buy happiness, but it will pay the salaries of a large research staff to study the problem." — Bill Vaughn

"The only thing money gives you is the freedom of not worrying about money." – Johnny Carson

All you need to know about Predatory Lending

Priyanka Singhal -PGDM IB (2009-2011)

PREDATORY LENDING

In the year 2008, the biggest of companies like Lehmann Brothers, Goldman Sachs, AIG axed their own feet by indulging in what is termed as predatory lending. This term came in light only after the world witnessed the sub-prime crisis and since then governments have made attempts to bring this practice under control.
Predatory lending refers to the practice of unscrupulous lenders, to enter into "unsafe" or "unsound" secured loans for inappropriate purposes.

PREDATORY LENDING PRACTICES

Equity Stripping: occurs when predatory lenders charge excessive fees which are routinely financed into the loan. At the loan level, equity stripping occurs when borrowers are provided loans that (1) finance credit insurance, (2) require exorbitant up-front fees, or (3) include prepayment penalties on subprime loans. These costs result in substantially higher payments while the loan is outstanding and are deducted directly from the equity of the home when a borrower refinances or sells his or her house. Fees totaling more than 5% of the loan amount was commonly charged on predatory loans.

Steering & Targeting: Predatory lenders may steer borrowers into subprime mortgages, even when the borrowers could qualify for a mainstream loan. Vulnerable borrowers may be subjected to aggressive sales tactics and sometimes outright fraud. Fannie Mae has estimated that up to half of borrowers with subprime mortgages could have qualified for loans with better terms. This led to risk disparities as borrowers were charged more than risk could justify for the loan. Brokers originate over half of all mortgage loans, both prime and subprime. . A recent Freddie Mac study used sophisticated statistical modeling to show that subprime loans charge an extra 1% in all subprime lending (and presumably much more for predatory lenders) could not be explained by credit risk.

Kickbacks to Brokers: When brokers deliver a loan with an inflated interest rate (i.e., higher than the rate acceptable to the lender), the lender often pays a "yield spread premium" – a kickback for making the loan more costly to the borrower.

Mandatory Arbitration: Some loan contracts require "mandatory arbitration," meaning that the borrowers are not allowed to seek legal remedies in a court if they find that their home is threatened by loans with illegal or abusive terms. This makes it much less likely that borrowers will receive fair and appropriate remedies in cases of predatory practices.

Loan Flipping: A lender "flips" a borrower by refinancing a loan to generate fee income without providing any net tangible benefit to the borrower. Flipping can quickly drain borrower equity and increase monthly payments, sometimes on homes that had previously been owned free of debt.

Unnecessary Products: Sometimes borrowers may pay more than necessary because lenders sell and finance unnecessary insurance or other products along with the loan.

Prepayment Penalties: Borrowers with higher-interest subprime loans have a strong incentive to refinance as soon as their credit improves. However, up to 80% of all subprime mortgages carried and carry a prepayment penalty, a fee for paying off a loan early as against in the prime market where only about 2% of home loans carry prepayment penalties of any length.

The ultimate and tragic consequence of making loans without regard to a borrower's ability to repay is home-owners struggling to make payments under the combined weight of excessive fees and high interest rates often pay the ultimate price the loss of their home and all the equity they had accumulated in it. In addition, the equity held by neighboring homeowners is reduced as home values fall in areas of concentrated foreclosure. Finally, there are significant social costs to the pending wholesale loss of neighborhoods of homeowners.

WHAT SPIKED PREDATORY LENDING IN US?

Predatory Lending was central to the fallout of some iconic companies of US. Its therefore important to understand as to what spiked off this practice.

As investment banks provide subprime lenders with necessary funding, they wield a great deal of power in determining what sorts of loans are offered to subprime borrowers During the subprime boom, the investment banks oversaw a loosening of underwriting standards and pressured lenders to originate excessive amounts of subprime mortgages so that the investment banks could create lucrative subprime-related bonds. Investment banks set underwriting criteria in the subprime mortgage market by telling lenders what types of loans they want to buy, how much they want, and what prices they want to pay. The result was a significant spike in predatory and abusive lending.

Moreover investment banks paid more for mortgages with predatory characteristics because the loans could be packaged into more lucrative securities. Higher nterest rates on the loans themselves eventually translated into more bond-related revenues for the investment banks. In addition to paying more for these types loans, the investment banks also pressured subprime mortgage origina-tors to loosen their lending standards and make more of them.

The financial intermediaries who expanded the supply of these loans were apparently not troubled by this issue because of the strong incentives, massive revenues and bonuses generated by investment banks in the secondary market through structured financial products such as CDOs. One Fannie Mae study estimated that 50% of subprime borrowers could have qualified for prime loans. I But the predatory lenders steered subprime borrowers toward expensive, subprime loans in the interest of garnering more fees for their work.

This leads in current legs because the current legal framework surrounding lending is deficient in holding Wall Street accountable for predatory lending. Once a mortgage lender sells a mortgage to an investment bank, the homeowner's legal options virtually disappear. The most important legal hurdle in a securitization is the "true sale" of the mortgage note from the mortgage lender to the securitizer – the liability associated with the origination of the mortgage does not transfer in this sale. A legal doctrine known as holder in due course offers investment banks and investors this protection. Though investment banks may have purchased pools of mortgages full of predatory and abusive loans, they were by and large, immune from any legal challenges by the homeowner. Investment banks exploited this legal framework to reap profits from predatory and abusive loans.

LEHMAN BROTHERS

Of the many, we discuss a case of Lehman brothers predatory practices of 2003, where it funded First Alliance, a subprime lender based in California. First Alliance targeted elderly people and other vulnerable borrowers for extremely costly loans. Despite clear signs that the company preyed upon its customers, Lehman Brothers went on to lend the company $500 million through a ware-house line of credit and sold $700 million worth of First Alliance loans. After a 4-year fight, the investment bank was held responsible for just 10% of the damages done to the plaintiffs, and had to pay $5 million, a paltry sum when compared with the subprime-related revenues the investment bank continued to rake in. After this investment banks were further encouraged to purchase predatory loans without fear of substantial liability when Lehman Brothers was held minimally liable for funding.

GOLDMAN SACHS

In 2006 and 2007, Goldman Sachs Group peddled more than $40 billion in securities backed by at least 200,000 risky home mortgages, but never told the buyers it was secretly betting that a sharp drop in U.S. housing prices would send the value of those securities plummeting. It passed most of its potential losses to others before a flood of mortgage defaults staggered the U.S. and global economies. Only later did investors discover that what Goldman had promoted as triple-A rated investments were closer to junk. Pension funds, insurance companies, labor unions and foreign financial institutions that bought those dicey mortgage securities continue to face large losses.

Goldman Sachs bought and converted into high-yield bonds tens of thousands of mortgages from subprime lenders. The loans they had dispersed couldn't be justified against the incomes of the applicants. The following are few of the loans that met the criteria of investment banks like Goldman Sachs during the subprime boom:

Hybrid adjustable rate mortgages (ARMs): These loans carry low, fixed teaser rates (7-8%) that jump to much higher adjustable rates (14%+ pegged to an index) after two or three years. Often, subprime ARM borrowers' ability to re-pay was judged based on the low, initial rate. Underwriters accepted higher rates of re-financing and foreclosure by saddling these borrowers with prepayment penalties and judging ability to pay based on the value of the underlying asset a widely recognized predatory tactic. ARMs went from 73% of subprime loans in 2001 to 91% by 2006, and are causing many of the subprime foreclosures today.

Low- and no-documentation: A lack of documentation of income or residence means that the credit of the borrower cannot be verified and the loan is therefore riskier and carries higher interest rates. Lending without regard for the borrower's ability to pay is widely considered a predatory tactic. These went from 28% of subprime loans in 2001 to 50% by 2006.

Interest-only: Payments from these loans only cover interest on the mortgage, not principal, and leave the borrower in the vulnerable position of having to re-finance or sell their house down the road. These went from 0% of subprime loans in 2001 to 38% in 2005, before dipping down to 23% in 2006.

It offshore tax havens to shuffle its mortgage-backed securities to institutions worldwide, including European and Asian banks, often in secret deals run through the Cayman Islands, a British territory in the Caribbean that companies use to bypass U.S. disclosure requirements. In at least one of these offshore deals. Goldman exaggerated the quality of more than $75 million of risky securities, describing the underlying mortgages as "prime" or "midprime," although in the U.S. they were marketed with lower grades. Goldman's securities came in two varieties: those tied to subprime mortgages and those backed by a slightly higher grade of loans known as Alt-A's. Over time, both types of mortgages required homeowners to pay rapidly rising interest rates. Defaults on subprime loans were responsible for last year's housing meltdown. Interest rates on Alt-A loans, which began to rocket upward this year, caused a new round of defaults.

Investments banks like Goldman Sachs lent to funds to purchase securities against collateral which were much more complex securities not actively traded in the markets. Since the borrowers usually left the pricing of the collateral with their lending bank, they faced trouble when investment banks told their client borrowers that their securities has dropped in taking the legal value and that they must therefore post more collateral.

The clauses of the contract leaving the pricing to the lender made the clients handicapped in taking the legal recourse. Also because these banks funded them, the clients were forced to agree. In a case during 2007 the proprietary trading desks at Morgan Stanley and Deutsche Bank entered into a dispute about the value of a $16bn subprime CDO deal. Morgan Stanley valued the position at 95 per cent of its face value; Deutsche at 70. In the event, since Deutsche had lent money to the Morgan Stanley team as part of the deal, it was able to force through the lower price – creating a $9bn loss for the American investment bank.

It has been continuously alleged that Goldman used its knowledge of the market for these complicated securities to sell them to clients at high prices only to later drop its assessment of their value and ask for more collateral, all without offering adequate explanation.

FINANCIAL REGULATION

The administration of Barack Obama has repeatedly tried to present the financial reform bill as a move to get tough on Wall Street. It focused on making the pricing of securities as safe and transparent as possible by moving business on to central clearing houses and exchanges. Second, it tries to stop banks acting like hedge funds and trading against their own clients or exploiting conflicts of interest.

On price transparency, it remains unclear what proportion of the derivatives world will move into clearing houses or exchanges. The bill refers to "standardized" products but the products at the heart of the dispute about marks were not standardized and thus may not be covered. The financial regulation leave a lot of ambiguities in the loosely worded documents. Thus all we can say is that the most important lending issue today is no longer the denial of credit, but rather the terms of credit.

Just For Fun (Fin Terminologies)

Auditor: Person that arrives after battle to finish off the wounded.

Bank: A place that will lend you money only when you don't need it.

Broker: The person that you trust with thousands of your hard earned dollars. Hello!

Broker: What my broker has made me.

Budget: Written proof that you can't afford the things you want.

Bull Market: A random market movement causing an investor to mistake himself for a financial genius.

Cash Flow: The movement your money makes as it disappears down the toilet.

CFO: Chief fraud officer.

Day Trader: A more socially acceptable gambling addict.

Discounted Stock: A stock that is less expensive than last month and more expensive than it will be next month.

EBIT: Earnings before irregularities and tampering.

Market Correction: The day after you buy stocks.

Momentum Investing: the fine art of buying high and selling low.

Standard and Poor (S&P): Your life in a nutshell.

Profit: A man that prays to God.

Value Investing: The art of buying low and selling lower.

The Dawn of Direct Tax Code

Pujal H Doshi -PGDM B (2010-2012)

27th August, 2010 finally saw the end of speculation revolving around the much awaited Direct Tax Code Bill (DTC Bill) and if the parliament gives a nod then the DTC will replace the decades old Income Tax Law of 1961 from 1st April, 2012. With the main objective to simplify the tax regime in India the bill caters to eliminate distortion in the tax structure, introduce moderate levels of taxation, expand the tax base (by bringing down the number of exemptions), improve tax compliance, simplify the language and lower the tax litigation.

The highlights of DTC

Tax Slab	Tax Rate
Below Rs. 2 lakh	Nil
Rs. 2 lakh – Rs. 5 lakh	10%
Rs. 5 lakh – Rs. 10 lakh	20%
Above Rs. 10 lakh	30%

Income up to Rs. 2.5 lakh is exempted for senior citizens and the corporate tax has been kept at 30%.

Flashback

The original draft of DTC along with the discussion paper which was released in August, 2009 was received with uncertainties and objections. Many issues where brought forward the end result of which is the revised DTC. While the revised DTC has retained some aspects of the original DTC others have been altered in order to accommodate the interest of all the stake holders. A few of the aspects which were altered are as follows

Minimum Alternate Tax (MAT)

Original Proposition: A company is generally required to pay tax on its total income, but many companies had either an insignificant tax liability or a tax liability of zero owning to tax incentives. To address this problem DTC proposed Minimum Alternate Tax (MAT) on the "value of gross assets". The "value of gross assets" is computed by summation of the all the fixed assets of the company, capital work in progress and the book value of all the other assets, from this the aggregate depreciation on the value of gross block of assets and the debit balance of the profit and loss account is subtracted. The rate of MAT on the value of gross assets was fixed at 0.25% in case of banking companies and 2% in case of others.

Issues Related to the Original Proposition: The original proposition led to many objections as going by this parameter would mean the following:

1. The loss making companies, companies operating in cyclical downturn and companies going on liquidation (until such a time till the company is dissolved) would have to pay tax.
2. MAT didn't account for the gestation period in new business due to which the investment cost in new business would become really high.
3. There might be companies across various industries with same percentage of gross asset however it does not imply that they have the same income. Hence paying the same amount of tax isn't a practically alternative.
4. "Capital work in progress" doesn't contribute on revenue generation.
5. MAT doesn't account for multiple tier subsidiaries' this would tantamount to cascading effect of assets based on MAT.
6. Application of MAT on companies operating in sectors where "investment linked benefits" are extended contradicts the essence of the whole policy.

New Propositions: To overcome the practical difficulties it was proposed to compute MAT with reference to book profit. However MAT would be raised to 20% from the current 18% on the book profit.

Tax Treatment of Savings

Original Proposition: Savings include money invested by individuals in approved provident funds, approved superannuation funds, life insurer and New Pension System Trust. Initially "Exempt- Exempt-Taxation" (EET) scheme was proposed. Under this method, the contributions towards certain savings are deductible from income (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 marginal rate of tax (this represents the 'T' under the EET method)[2]. This implies that all kinds of Government Provident Fund (GPF), Public Provident Fund (PPF), Recognized Provident Funds (RPFs) and the Employees Provident Fund (EPF) would remain untaxed till such time the amount is accumulated in the account and would be subject to tax under the head "income from residuary services" at applicable personal marginal rate of tax if withdrawn.

Issues Related to the Original Proposition: When the DTC opened the forum for discussions many representation were made in respect to this proposition. It was rightly pointed out that the India doesn't have a strong social security system and people may require a lump sum withdrawal to meet some family or social obligation post retirement. Most countries that follow the EET approach have social security system in place and the EET savings of the individuals in those countries are way above their social service payments. Since that is not the scenario in our country EET method of taxation on savings would serve to be a burden to the individuals.

New Propositions: It was later decided to continue with ,EEE ("Exempt- Exempt-Exempt") on accord of absence of universal social security system which becomes crucial if EET is implemented and the fact that switching over to EET would involve lot of administrative, logistical and technological difficulties. Therefore, as of now, it is proposed to provide the EEE method of taxation for Government Provident Fund (GPF), Public Provident Fund (PPF) and Recognised Provident Funds (RPFs) and the pension scheme would be administered by Pension Fund Regulatory and Development Authority. Also the approved pure life insurance products and annuity schemes will also be subject to EEE method of tax treatment.

Taxation of Income from Employment- Retirement Benefits and Perquisites

Original Proposition: The scope of this is limited to the computation of taxable income under the head "Income from employment". Income from employment is nothing but the gross salary less the amount of permissible deductions. As per the DTC act the term salary is defined to include the value of perquisites, profits in lieu of salary, amount received on voluntary retirement or termination, leave salary, gratuity and any annuity, pension or any commutation thereof. Contributions made by the employer to an approved superannuation fund, provident fund, life insurer and New Pension System Trust is considered as salary.[4] The permissible deductions from the gross salary are compensation received under voluntary retirement scheme, gratuity received on retirement or death and amount received on commutation of pension to the extent such amounts are deposited in a Retirement Benefits Account during the course of employment. A deferral scheme of tax was proposed with reference to the retirement schemes. Under this scheme the amount received towards any retirement benefit would not be charged in the year of receipt of such an amount as long as it remains invested in the account. However, if the amount is withdrawn such a withdrawal is subject to tax liability. The only exception to these was leave encashment; the money received towards this end would be taxable on receipt basis.

Issues Related to the Original Proposition: Taxation of withdrawals from the retirement benefit account was considered to be harsh by many stakeholders as in India people have many family and social obligation to render to which may prompt them to withdraw lump sum amount.

New Proposition: Employers contribution to government approved scheme will not be considered as salary. Retirement Benefits like gratuity, commuted pension, voluntary retirement compensation and leave encashment would be exempted upto a certain limit.

Taxation of Income from House Property

Original Proposition:
Any house of an owner which is to say, self –occupied house i.e. a house occupied by its owner, house lent on rent and vacant house is dealt under this head. The original propositions were

Self occupied house – Nil
House lent on rent – 6% p.a. on (i) the actual rent received or (ii) the notional rent computed on the value fixed by the local authorities or the presumptive cost of construction or acquisition, whichever is higher.
Vacant property - flat rate of 6% on the value as decided by he local government or the presumptive cost of construction or acquisition.

It was also proposed to abolish any deductions on account of interest payable on capital borrowed for purposes of constructing, re-constructing, acquiring, repairing, or renewing the property in case of self occupied houses as the gross rent is deemed to be nil.

Issues Related to the Original Proposition: The computation of notional rent at 6% on presumptive cost of construction or acquisition for either house lent on rent or vacant houses was considered to be inequitable as increase in the cost of such properties is function of inflation and the owners have a little to do with it. Also request was made to allow deductions upto Rs. 1.5 lakh on capital borrowed for acquisition or constructions in case of self occupied house property, in line with the existing provisions of the Income Tax Act of 1961.

New Proposition: Much to the relief of individuals the taxation on vacant house was withdrawn and the clause of computation of notional rent at 6% on presumptive cost of construction or acquisition was removed. And deductions upto Rs. 1.5 lakh on account of interest on housing loan (self-occupied house) is proposed to be continued.

Taxation of Capital Gains

Original Proposition: Both the long term and short term capital gains would be taxed at the same rate thus eliminating the prevailing distinction between long term and short term investment. In case of NRI a flat rate of 30% would be charged on the capital gains and in case of the residents the capital gains were subject to applicable marginal rate. The DTC also proposed to do away with the Securities Transaction Tax. The base date was proposed to be shifted from 1.4.1981 to 1.4.2000. Also the DTC proposed a new scheme called the capital gain scheme, all the capital gains deposited under this scheme would not be subjected to tax until such time the money is withdrawn.

Issues Related to the Original Proposition:
The tax liability was bound to increase if the distinction between the long term and short term investment was removed and this might have caused fluctuations in the stock market as under the old regime 15% tax was levied on the short term capital gains on account of listed equity being transferred where as long term capital gains were exempted.

Foreign Institutional Investment (FII's) which are crucial for the growth of the stock market of the country would have taken a toll if the capital gains were charged at 30% in case of NRI. This would have been detrimental.

New Proposition: The revised paper proposes that capital gains will be treated as an income from ordinary sources and will be taxed at the slab rates applicable both for residents and non-residents. Securities transaction Tax which was initially proposed to be abolished will not be abolished completely. The base date will now be shifted from 1.4.1981 to 1.4.2000. Accounting to this shift in the base date the unrealized capital gains during the period of 1.4.1981 to 1.4.2000 would not be subjected to tax liability.

Other Proposals

Medical benefits/ reimbursements would not be charged up till a limit and valuation on account of rent free accommodation will not be charged on the basis of the market value.

Impact

If the DTC is approved it will hit the revenues generated by the government thereby increasing the Fiscal Deficit. The government will lose over Rs. 53,000 crore of tax revenue, Rs. 14,343 crore just by raising the exemption limit and widening of slab and another Rs. 38,829 crore by proposing to reduce the corporate tax which currently stands at 33.2 % to 30%. "

Totally we would lose, because of the provisions of rates of taxes proposed in the DTC Bill, around Rs 53,172 crore (in tax revenues). Therefore, the collection level will stand at Rs 5.27 lakh crore (in 2012-13)," Revenue Secretary, Sunil Mitra[5] to the reporters of Economic times. However a few of the corporate who earlier could weasel away with tax liabilities on account of tax benefit and exemption will now have to bear the brunt of higher tax liability as the MAT rates have been raised to 20%. Also the government is positive that the new tax regime will facilitate the increase in tax base which is currently Rs. 3.25 crore and also foster economic growth and equity on improved tax-GDP ratio.

IIndividuals are clearly going to be benefited especially salaried individuals but only upto a certain extent. Individuals earning over Rs. 10 lakh will save Rs. 41, 040 while those falling in the bracket of Rs. 5 lakh – Rs. 10 lakh will save upto Rs. 21,540 and the people earning between Rs. 3lakh – 5 lakh will have an additional disposable income of Rs. 7,660. Seniors citizen would also see a reduction in their tax burden by Rs. 4,420 and Rs.18,300 tax if they are earning over Rs. 5 lakh and Rs. 10 lakh respectively.

DTC is more user friendly with high clarity levels when compared to the Income Tax Act of 1961. The whole process of Tax computation is simplified up to great extent and the proposals are very much in favor of individuals. Although there are a few sectors who are still concerned about the implications which DTC might have the overall acceptance level seems quite good. All in all let's see whether the DTC is able to bring about ground breaking changes in the tax regime or not.

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