Tax Alert

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India Tax Update

In this issue, we have provided a summary of key tax updates in India.

India Union Budget 2017-18

On 1 February 2017, the Hon'ble Finance Minister of India, Arun Jaitley, presented the Union Budget 2017-18. Unlike previous years, the Finance Minister presented the budget one month in advance to enable Ministries to operationalise all activities from commencement of the new financial year starting 1 April.

The agenda set for financial year (FY) 2017-18 is to 'transform, energise and clean India'. To boost foreign direct investment (FDI) in India, the Foreign Investment Promotion Board (FIPB) is proposed to be abolished. Further liberalisation of the FDI policy is also under consideration.

Against the dismal global conditions, the Indian economy's expansion has been noteworthy. Despite an expected decline in the growth rate owning to the slowdown in manufacturing, decline in budgetary capital expenditure and demonetisation, India is expected to continue as the fastest growing large economy. The implementation of Goods and Services Tax (GST) is expected to improve tax compliance and governance, and might provide an impetus to the investments and growth in the country.

Overall, the budget strives hard to keep India on a growth track and is well intended to encourage greater compliance and strict enforcement. One hopes that the provisions are administered in an even-handed manner in a business friendly spirit of mutual trust.

In the aftermath of demonetisation, and the gathering gloom around globalisation, this is critical to ensure that India's current sweet growth spot is sustainable.

The key budget proposals have been highlighted below.

Direct taxes

- No change in corporate tax rate, except for domestic companies with the turnover not exceeding INR 500 million in FY 2015-16, for whom the rate is reduced to 25 percent (to be increased by applicable surcharge and cess).

- Long term capital gains on transfer of equity shares in a listed company, acquired on or after 1 October 2004, to be exempt from tax only if the securities transaction tax (STT) has been paid on acquisition of such equity shares or such acquisition has been notified by the Central Government. One will need to wait for the notification and assess impact on certain classes of acquisition such as IPO, FPO, bonus, rights issue, acquisition by foreign entity, etc.

- The conversion of preference shares into equity shares shall not to be regarded as 'transfer' and not subject to capital gains tax, from 1 April 2017. Further, cost of acquisition and period of holding of preference shares will be considered for determining cost of acquisition and period of holding of equity shares.

- The Finance Act, 2016 had amended Section 112 to clarify that the concessional tax rate of 10 per cent shall also be applicable to capital gains earned by a non-resident on sale of shares of a private company. The aforesaid amendment shall be applicable retrospectively from 1 April 2012 (i.e., Assessment year 2013-14 onwards).

- Eligible start-up companies are entitled to claim 100 per cent tax holiday for any 3 consecutive years out of 7 years (instead of 5 years provided earlier) from its incorporation.

- No changes proposed in the General Anti-Avoidance Rules (GAAR). Hence, the provisions relating to GAAR would come into force with effect from 1 April 2017. Recently, the Central Board of Direct Taxes (CBDT) issued a circular in the form of answers to specific questions on the implementation of the provisions of GAAR. This will be discussed briefly below.

- No changes proposed to the provisions relating to the place of effective management (POEM) of a foreign company. Hence, the provisions relating to POEM would continue to be applicable from 1 April 2016. Recently, the CBDT also issued a circular laying down guiding principles for determination of the POEM of a foreign company.

- The indirect transfer provisions shall not apply to any investment held by a non-resident, directly or indirectly, in a Category I or Category II Foreign Portfolio Investor (FPI), with effect from 1 April 2012. The Budget speech mentioned that indirect transfer provisions shall not apply in case of redemption of shares or interest of a company outside India as a result of redemption or sale of investments in India which is chargeable to tax in India, which will need to be notified separately.

- The lower withholding tax of 5 per cent on interest paid on external commercial borrowings (ECB) to non-residents extended to rupee denominated bonds with effect from 1 April 2016 and borrowings period extended till before 1 July 2020.

- The sunset date of withholding tax rate of 5 per cent on interest payable to FIIs and QFIs on their investments made in government securities or rupee denominated corporate bonds extended to 1 July 2020.

- In line with the recommendations of OECD BEPS Action Plan 4, thin capitalisation provisions have been introduced. From FY 2017-18, total interest deduction for Indian companies and permanent establishment of foreign companies shall be capped to 30 percent of EBITDA. Any interest paid (exceeding INR 10 million) to associated enterprises (AEs) representing amounts exceeding such 30 per cent cap will be disallowed. Debt issued or guaranteed (including implicit guarantee) by non-resident AE is covered. Any unallowed interest eligible to be carried forward for 8 years will be deducted in a similar manner. These provisions shall not be applicable to the taxpayer engaged in the banking or insurance industries.

- Applicability of domestic transfer pricing provisions restricted to cases where one of the entities involved enjoys specified profit linked deduction (i.e. tax holiday). Transactions referred in Section 40A(2)(b) which disallows certain expenses paid to related parties are excluded from applicability of domestic transfer pricing provisions.

  Non-furnishing of return of income within the prescribed time will attract the following penalties.

  – Penalty of INR 5,000 if the return is furnished on or before 31 December of the assessment year;

  – Penalty of INR 10,000 in any other cases;

  – However, if the total income of the person does not exceed INR 500,000, then the penalty will be restricted to INR 1,000.

Indirect taxes

- Affirmations by the Finance Minister to rollout GST within the stipulated timeline of 1 July 2017.

- No change in standard rate of service tax, excise and customs duty.

- Cashless economy attempted to be promoted through concessional customs and excise duty rates for certain technology products.

For more information, read the report prepared by KPMG in India.

General Anti-Avoidance Rules (GAAR) – clarifications

On 27 January 2017, the CBDT issued a circular to address the questions on the implementation of the provisions of GAAR.

Some of these clarifications include – whether GAAR and Specific Anti-Avoidance Rules (SAAR) co-exist; interplay between Limitation of Benefit (LOB) and GAAR; GAAR not to be applied if the jurisdiction of FPI is finalised based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit; grandfathering of convertible instruments issued before 1 April 2017 and converted post-31 March 2017.

However, there are still certain aspects which are not addressed in the circular.

The clarifications attempt to address the interplay between the LOB article and the domestic anti-avoidance provisions by stating that if the case is sufficiently addressed by the LOB article in the tax treaty, there shall not be an occasion to invoke GAAR. In some of the recent tax treaties, India has incorporated LOB article as well as Principal Purpose Test (PPT). The circular does not deal with the PPT conditions.

Pursuant to the implementation of the OECD BEPS Action Plan, India may enter into Multilateral Instruments (MLI) with some of the countries. Based on the provisions agreed in the MLI, the Indian government may need to issue another clarification vis-à-vis applicability of GAAR.

For more information, read the report prepared by KPMG in India.

How we can help

As a committed tax advisor to our clients, we welcome any opportunity to discuss the relevance of the above case to your business.

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