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BUDGET 2016

Understanding the Business Impact

Base Erosion and Profit Shifting [BEPS] India Budget update



February 2016

Equalisation levy on digital transactions (BEPS Action 1)

The growth of the digital economy has posed challenges to the application of existing tax rules, e.g., characterisation of income, establishing nexus between transaction, activity and jurisdiction, etc.

'Equalisation levy' of 6% is proposed to be imposed on consideration being made for 'specified services', viz., online advertisement, provision of digital advertising space, or any other facility for the purposes of online advertisement. The Government is empowered to specify any other service on which such levy shall apply.

Every person, being a resident carrying on business or profession in India or a non-resident having permanent establishment in India, shall deposit the levy on the considerations payable to non-resident not having permanent establishment in India. Such levy does not apply where the aggregate amount payable to non-resident does not exceeds ₹100,000 in a year. The corresponding income would be exempt from income-tax in the hands of such non-resident.

In the draft BEPS report of September 2014, one of the options under consideration was the levy of withholding tax on digital transactions. In the final report of October 2015, withholding tax on digital transactions was not included in the proposed solutions, though the OECD stated that the respective countries may introduce any of the options as additional safeguards against BEPS measures, provided they respect existing treaty obligations.

Concessional tax regime for income from patents (BEPS Action 5)

The OECD under BEPS Action 5 dealing with countering harmful tax practices has recommended the nexus approach which outlines that income arising from exploitation of intellectual property should be attributed and taxed in the jurisdiction where substantial research and development activities are undertaken rather than the jurisdiction of legal ownership only.

A concessional taxation regime is proposed to be introduced in respect of income from patents. This regime is applicable from financial year 2016-17 and would cover existing and new patents. The royalty income from patents developed and registered in India would be taxable at 10 % (plus surcharge and education cess) on the gross amount of royalty. No expenditure or allowance would be allowable in such cases. The benefits of this regime is available to a person resident in India, who is the true and first inventor of the invention and whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970.

General anti-avoidance rule [GAAR] (BEPS Action 6)

No changes are proposed to the GAAR and the same would be applicable from financial year 2017-18 onwards. Interestingly, the implementation of GAAR was deferred in 2015, to be aligned with the BEPS actions.

Three tier transfer pricing documentation approach under BEPS project adopted by India (BEPS Action 13)

Under Action 13 of BEPS Action Plans, the OECD adopted a three-tiered approach to Transfer Pricing ("TP") documentation which inter-alia, includes a local file, a master file and a country-by-country ("CbC") report.

Adopting the above approach, the Finance Bill 2016 has introduced the CbC reporting and master file requirement. The CbC reporting requirement is introduced with effect from Assessment Year 2017-18 (financial year 2016-17), requiring Indian headquartered Multi-national Enterprises ("MNEs") and certain other Indian entities of global MNEs to file the CbC report with the Indian Authority (to be prescribed). As per the Memorandum to the Finance Bill, India will adhere to the OECD prescribed group revenue threshold of Euro 750 million (₹5395 crores at current exchange rates) for the applicability of the CbC requirement, though the specific threshold in Indian currency would be prescribed later (based on exchange rate as on 31 March 2016).

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The CbC report is required to be filed on or before the due date for filing the return of income in India (typically on 30 November following the end of the Indian financial year in March). The Memorandum to the Finance Bill has also introduced the requirement to maintain master file data, though the detailed provisions are to be prescribed later. Stringent penalty provisions have also been prescribed for non-furnishing and/or furnishing inaccurate particulars.

Given the above changes to the TP documentation requirement, it is envisaged that the provisions are likely to impact several large Indian and global MNEs operating in India. Therefore, it is vital for the MNEs to evaluate their preparedness for collation and maintenance of data required in the CbC report. Further, it would also be pertinent for the MNEs to upfront analyse the data requested in the CbC report to comprehend any probable litigation and how the revenue/stakeholders may interpret the information submitted in the CbC report.

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