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BUDGET 2015
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India Budget 2015

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International Tax Update

The Indian Budget was announced on 28 February 2015. In his speech, the Finance Minister advocated an enabling tax policy and has taken board measures in the tax proposals to curb parallel economy, to focus on job creation through revival of growth and investment and promotion of domestic manufacturing and 'Make in India' program, and to ensure minimum government and maximum governance to improve the ease of doing business. The key international tax proposals of the Budget are discussed below.

General anti-avoidance rule deferred

The general anti-avoidance rule [GAAR], which was slated to be implemented from 1 April 2015, is now deferred by two years to 1 April 2017. An important policy announcement made by the Finance Minister was that the GAAR provisions would apply prospectively to any transactions that are entered into on or after 1 April 2017.

Two reasons have been cited for the deferment of GAAR. Firstly, concerns have been expressed regarding certain aspects of GAAR. Secondly, India is an active participant in the Base Erosion and Profit Shifting [BEPS] project of the OECD and the reports on various BEPS action plans and recommendations regarding the measures to counter it are awaited – it is therefore proposed to implement GAAR as part of a comprehensive regime to deal with BEPS and aggressive tax avoidance.

Companies with existing or proposed investments in India may consider reviewing their position, including holding company structures and cash repatriation mechanisms, in light of the BEPS action plans and the proposed GAAR.

Rationalisation of indirect share transfers

Close on the heels of the landmark Supreme Court judgment in the Vodafone case in favour of the taxpayer, the Indian tax law was amended in 2012 retrospectively from 1961 to provide for the taxation of indirect transfers of shares. The law clarifies that any share or interest in a foreign company will be deemed to be situated in India if its value substantially derives, directly or indirectly, from assets located in India.

Subsequently, the Shome Committee was constituted for evaluating the issue of taxability of indirect share transfers. Some of the key recommendations of the Committee that are now proposed to be accepted are discussed below.

The term 'substantial' is proposed to be explained to mean cases where the value of Indian assets: (i) exceed INR 100 million; and (ii) represent at least 50% of the value of all assets owned by the foreign company. The gains from indirect share transfers are proposed to be taxable in India on proportionate basis i.e. to the extent the gains are reasonably attributable to assets located in India.

Certain exemptions are also proposed, subject to qualifying conditions. A non-resident taxpayer who holds a minority stake will be exempted from the taxability of gains arising from indirect share transfers – a minority stake would broadly mean less than 5% of voting power or capital, coupled with no right of management or control. Moreover, an indirect transfer pursuant to an overseas merger or demerger will be exempt, subject to conditions.

Lastly, reporting obligation related to indirect share transfers is proposed to be cast on the Indian company, with penalties for non-compliance.

Withholding tax on royalties and technical service fees reduced

The base withholding tax rate of 25% on royalties and fees for technical services paid to a foreign company is proposed to be reduced to 10% with effect from 1 April 2016. This will be especially beneficial for taxpayers based in countries like the US and UK, which provide for a 15% withholding tax on royalties and fees for technical services – by applying the provisions of the Indian tax law, the base rate of withholding tax will reduce to 10%. In such a situation, a tax residency certificate may not be required; however overseas companies need to take into consideration the fact that they need to obtain tax registration in India (i.e. obtain a Permanent Account Number) to avail the 10% rate.

No permanent establishment exposure pursuant to offshore fund managers operating out of India

There has been considerable debate on the taxability of offshore funds if their fund managers are based in India. To facilitate the location of fund managers of offshore funds in India, specific exceptions are proposed in the law to provide that, subject to conditions: (i) the fund management activities will not create a 'business connection' of the offshore funds (the concept of 'business connection' is akin to 'permanent establishment' under tax treaties); and (ii) the offshore fund will not be treated as tax resident in India merely because fund management activities are carried on in India.

Other key corporate tax amendments

- The base rate of corporate tax is to be reduced from 30% to 25% over the next four years, accompanied by rationalisation of tax exemptions; this phased change will start from 1 April 2016. For the financial year 2015-16, the maximum corporate tax rate is 34.61% and the effective rate for dividend distribution tax is 20.36%; the maximum tax rate for foreign companies continues to be 43.26%.
- It is proposed that Minimum Alternate Tax provisions will not apply to capital gains earned by Foreign Institutional Investors, other than specified short-term capital gains.
- Interest paid by an Indian branch of an overseas bank to its head office or other branches is proposed to be liable to tax in India.
- Cases where no tax is withheld from overseas payments to be reported to the tax authorities; non-compliance attracts penalty. Tax 'pass through' status is proposed to be allowed to Alternative Investment Funds of Category I and Category II; such status is not available for business income. Tax 'pass through' status also proposed to be accorded to rental income of Real Estate Investment Trusts from assets owned directly by the trust.

Goods and Services Tax

Commitment to introduce a nation-wide Goods and Services Tax [GST] by 1 April 2016 has been re-affirmed. GST has been considered as a revolutionary shift towards more rational system of indirect tax and is expected to play a transformative role for the Indian economy and creating a common market place for ease of doing business in India.

Changes in effective rate of indirect taxes and duties

- The effective rate of custom duty applicable on import of goods into India has been enhanced to 29.44% from 1 March 2015.
- The standard ad valorem rate of excise duty on manufacture of goods has been increased from 12% to 12.5% from 1 March 2015.
- Service tax on supply of services is proposed to be enhanced from 12.36% to 14% with effect from a date to be notified. In addition, a cess of 2% of the value of taxable services is proposed to be made applicable from a notified date.

Facilitation and simplification measures in indirect taxes

As a part of facilitation measures for ease of doing businesses, the process of obtaining new registrations for central excise and service tax has been simplified; it has been prescribed that the registrations would be granted within two working days from the date of application. Besides, registered taxpayers would be allowed to issue digitally signed invoices and maintain electronic records for paperless compliance and reporting. The time limit for claiming credit on input services has been increased from six months to one year as a measure of business facilitation. The penal provisions under customs, excise and service tax laws have been rationalised to encourage compliance and early dispute resolution.



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