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Global Tax Update

India

Deloitte Tohmatsu Tax Co.

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India Budget 2017 – Highlights

The Indian Finance Minister presented the union budget 2017 (the Budget 2017/ the Budget) for the fiscal year 2017-18 on 1 February 2017. We have summarized a few key tax proposals of the Budget 2017 announced as of 1 February 2017 in this newsletter. The amendments suggested later in March 2017 which were later on approved by the Parliament and assented by President of India have also been incorporated.

(1) Corporate tax rates

No change in basic tax rate for companies which is 30%[1] for domestic companies and 40%[1] for foreign companies (branches / project offices of foreign companies). It may be noted that a subsidiary or joint venture company incorporated in India by a foreign company is regarded as a domestic company.

However, In the Budget 2017, the finance minister has proposed to reduce the corporate tax rate to 25%[1] for domestic companies having turnover not exceeding INR 500 million in financial year 2015-16.

Also, the corporate tax rate of 25% for newly setup domestic companies (after 1 March 2016) engaged solely in manufacture or production of any article or thing, would continue to apply subject to conditions being satisfied.

Effective tax rates for DDT[2] of 20.36%[3] and MAT[4] of 21.34%[3] for domestic companies and 20.01%[3] for foreign companies have not changed.

(2) BEPS Action 4 - Thin Capitalization Rules introduced

In line with the recommendations of OECD's BEPS Action Plan 4, it is proposed to restrict the deduction of excess interest claimed by an entity on debt.

These rules apply to Interest or similar consideration, which is in excess of INR 10 million, incurred by an Indian company or a permanent establishment of a foreign company in India in respect of any debt issued by a non-resident associated enterprise or where associated enterprise

- Provides an implicit or explicit guarantee to the lender; or
- Deposits a corresponding and matching amount of funds with the lender.

The term 'debt' has been defined to mean any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of taxable income.

It is proposed to restrict the deduction to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA).

The restriction would not apply to Indian company or permanent establishment of a foreign company which is engaged in the business of banking or insurance. As per the provisions, interest expense that is disallowed is eligible to be carried forward up to 8 years immediately succeeding the year for which the disallowance is first made.

(3) Introduction of secondary adjustment in the Transfer Pricing regulations

To align the transfer pricing provisions with the OECD guidelines and international best practices, concept of secondary adjustment is proposed to be introduced. Thereby, the new law removes the imbalance between the actual profit allocation (consistent with the arm's length principle) vis-à-vis

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1 excluding applicable surcharge and cess

2 Dividend Distribution tax

3 Including surcharge and cess

4 Minimum Alternate Tax

the cash account of the taxpayer. Taxpayer shall be required to carry out a secondary adjustment in case a primary adjustment to transfer price has been made:

- By the taxpayer in its return of income (suo moto adjustment)
- By the Assessing Officer and subsequently accepted by the taxpayer
- Pursuant to an agreement reached in an Advance Pricing Agreement
- In conformity to the margins/ rates prescribed by the Safe Harbour Rules
- Pursuant to a Mutual Agreement Procedure resolution

The excess money available with the associated enterprise consequent to the primary adjustment, if not repatriated to India within the prescribed time, shall be deemed to be an advance made by the taxpayer, requiring imputation of interest income.

These provisions, however, would not apply in case

- The amount of primary adjustment does not exceed INR 10 million; and
- The primary adjustment is for transactions of financial year 2015-16 or before.

(4) Specified domestic transfer pricing transactions

The domestic related party transactions were hitherto subject to reporting requirements under the Indian transfer pricing regulations. This had increased the burden of compliance for the taxpayers in India. It has been proposed to relax the compliance burden. Definition of specified domestic transaction has been relaxed to exclude expenditure in respect of which payment has been made or to be made to certain specified persons. This change will be effective from 1 April 2017.

However, transfer pricing regulations in respect of transactions between related parties enjoying specified profit linked deductions, will continue to apply.

(5) Life of Minimum Alternate Tax (MAT) Credits and Alternate Minimum Tax (AMT) extended

Currently, the tax credit for MAT and AMT can be carried forward and set off for a period of 10 years. It is proposed extend the period to 15 years.

It is further proposed to provide that the amount of tax credit in respect of MAT/ AMT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit allowed against MAT/ AMT and foreign tax credit allowable against the tax computed under regular provisions of the domestic tax law.

(6) Income from transfer of carbon credits

Currently, there are no specific provisions in relation to taxability of income received or receivable on transfer of carbon credits.

It is proposed to provide that any income from transfer of carbon credit, will be taxable at a concessional rate of 10%[5]. No expenditure or allowance in respect of such income shall be allowed under the domestic tax law.

(7) Clarity on applicability of indirect transfer provisions

The indirect transfer provisions are proposed to be amended to clarify that they shall not apply to any asset or capital asset being investment held by non-resident, directly or indirectly, in a Foreign Institutional Investor registered as Category-I or Category II under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 made under the Securities and Exchange Board of India Act, 1992.

The proposed amendment is clarificatory in nature and is applicable retrospectively with effect from financial year 2011-12. The amendment has been bifurcated as under:

- For Financial Years (FY) 2011-12 to FY 2013-14: exemption from capital gains tax arising due to indirect transfer of Indian assets would be available to any Foreign Institutional Investors as the Central Government has, by notification in the official gazette, specified in this behalf; and
- For FY 2014-15 and onwards: exemption from capital gains tax arising due to indirect transfer of Indian assets would be available for Category-I and Category-II FPIs under the SEBI Regulations.

(8) Concessional tax rate on interest in certain cases

1) External Commerciall Borrowings

Currently, beneficial withholding tax rate of 5% is available on interest payable by an Indian company or a business trust to a non-resident in respect of the following borrowings in foreign currency from sources outside India:

- On or after 1 July 2012 but before 1 July 2017 under a loan agreement; or

5 plus applicable surcharge and cess

- By way of issue of any long-term bond including long-term infrastructure bond on or after 1 October 2014 but before 1 July 2017.

It is proposed to extend the concessional rate for aforesaid borrowings made before 1 July 2020.

2) Rupee Denominated Bonds

Concessional withholding tax rate of 5% will be also applicable to rupee denominated bonds issued outside India (commonly known as Masala Bonds) before 1 July 2020.

This amendment is proposed with retrospective effect from year 2015-16.

3) Certain Bonds and Debentures

Beneficial withholding tax rate of 5% on interest payable to FIIs[6] and QFIs[7] in respect of investments in rupee denominated bonds of an Indian company or Government securities is also proposed to be extended to interest payable before 1 July 2020.

(9) Extension of capital gains exemption to Rupee Denominated Bonds

Currently, gains arising on account of appreciation of rupee against foreign currency at the time of redemption of Rupee Denominated Bond of an Indian company is to be excluded from full value of consideration only in those instances where the bonds were initially subscribed by the non-resident.

It is now proposed to extend the benefit even to those non-residents who are not the initial subscribers and have acquired such bonds subsequently.

Further, with a view to facilitate transfer of Rupee Denominated Bonds issued by an Indian company outside India from a non-resident to another non-resident, it is also proposed that such transfer will not be regarded as a taxable transfer.

(10) Conversion of preference shares to equity shares

Currently, conversion of bond or debenture into shares is not regarded as taxable transfer. However, no similar tax exemption was available in case of conversion of preference shares into equity shares. It is now proposed that such conversion will also not be regarded as transfer.

In determining the period of holding of such equity shares, the period of holding of the preference shares shall be included. The cost of acquisition of the converted equity shares shall be deemed to be the cost of acquisition of preference share.

(11) Retrospective amendment to extend the concessional rate for long term capital gains

Under the current provisions, a concessional capital gains tax rate is available to a non-resident on long term capital gains arising on sale of unlisted securities. The concessional rate was applicable from 1 April 2012.

However, based on certain non-tax rulings, uncertainty had arisen on the availability of such concessional tax rate on gains arising on sale of shares of private limited companies. Appropriate amendments were proposed in Budget 2016 to clarify that such benefits were available for income arising on sale of shares of private limited company.

However, there was another issue on whether the clarifications were retroactively applicable. It is proposed now in Budget 2017 that the concessional rate of tax would also be applicable in respect of private limited companies during the intervening period. The proposed amendment will be retroactively effective from 1 April 2012.

(12) No exemption for Long term capital gain of listed equity shares

Currently, income arising from transfer of a long term capital asset, being equity shares of a company or a unit of an equity oriented fund is exempt from tax if the transaction of sale is undertaken on or after 01 October 2004 and is chargeable to securities transaction tax.

It is proposed that the aforesaid exemption will be available to equity shares acquired on or after 01 October 2004 only if on such acquisition securities transaction tax was chargeable.

Certain exceptions in this regard such as acquisition of shares in IPO[8], FPO[9], bonus, right issue, etc., for which condition of chargeability of securities transaction tax on acquisition is not applicable, would be notified.

(13) Consideration for transfer of shares other than quoted shares

Currently, income chargeable under the head "Capital gains" is computed by taking into account the amount of full value of consideration received or accrued on transfer of a capital asset. To ensure that the full value of consideration is not understated,

6 Foreign Institutional Investors

7 Qualified Foreign Investor

8 Initial Public Offer

9 Follow-on Public Offer

there are certain provisions for deeming full value of consideration such as stamp duty value as full value of consideration for transfer of immovable property.

It is proposed to insert a new section to provide that where consideration for transfer of share of a company (other than quoted share) is less than the fair market value of such share determined in accordance with the prescribed manner, the fair market value shall be deemed to be the full value of consideration under the head “Capital gains”.

(14) Authority of Advanced Rulings (AAR)

With a view to promote ease of doing business, it is proposed to merge the AAR for income-tax, central excise, customs duty and service tax.

(15) Restriction on cash transactions

Receipt of an amount in excess of INR 0.2 million otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account is not permitted in the following cases:

- received from one person in a single day;
- received in respect of a single transaction; or
- received in respect of transactions relating to one event or occasion from a person

The above restriction will not apply to the amount received from Government or any banking company, post office savings bank or a co-operative bank, transactions referred to in section 269SS[10] or transactions as may be notified.

If the person receives any sum in contravention of the above provision, then penalty of 100% of the amount received will be levied. Penalty will not be imposed if there were good and sufficient reasons for contravention.

(16) Procedural issues

1) Time limit for filing revised return

Currently, a return of income can be revised before the expiry of two years from the end of the relevant financial year or before the completion of tax audit, whichever is earlier.

It is proposed that the time limit for furnishing the revised return will be available only up to the end of the next financial year from the end of relevant financial year or before the completion of assessment, whichever is earlier.

2) Tax audit timelines

The existing time lines of 33 months from the end of the relevant financial year has been reduced to 30 months for financial year 2017-18 and 24 months for FY 2018-19. This would enable faster completion of tax audits in India.

10 Taking or accepting certain loans, deposits and specified sum

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