Global Tax Update

India

Deloitte Tohmatsu Tax Co.

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1. Key changes to tax proposals proposed in Finance Bill, 2016

The Indian Parliament passed the Finance Bill, 2016 (“the Bill”) after making certain amendments to the tax proposals provided in the Bill (as presented by the Finance Minister on February 29, 2016 and detailed in our March 2016 edition of Global tax Update - “India Budget 2016 - Highlights”). The amended bill has also been assented to by the President of India and has become law.

As per amendments in the Bill[1]:

- The minimum holding period for unlisted shares has been reduced from 36 months to 24 months for classification as “long term capital assets” and computation of capital gains.
- To avail the benefit of concessional tax rate of 25% provided to certain domestic companies engaged in the business of manufacturing or production of any article or thing and set-up and registered on or after March 1, 2016, an appropriate declaration will have to be furnished to opt for the concession before the due date of furnishing the return of income. Further, any such option is required to be exercised in the year of set-up and any option so exercised once cannot be withdrawn thereafter in same or in any subsequent year. This concessional rate will also be available if the newly set-up company is engaged in research as well.
- The Bill proposed to provide 100 percent tax holiday benefit to an 'eligible Start-up' engaged in an eligible business, for any 3 consecutive assessment years out of a 5 year block beginning from the year of incorporation. The amended Bill extends the definition of 'eligible start-up' to include Limited Liability Partnerships, if it is registered between April 1, 2016 and March 31, 2019.
- In respect of the concessional tax regime of 10% for royalty income from patent developed and registered in India, it has been now clarified that the regime is optional for eligible taxpayer who has to opt for the regime by furnishing a declaration in prescribed form before the due date of furnishing return of income. The amended Bill further introduces a restriction and provides that if any eligible taxpayer opts for concessional tax regime in any tax year but opts out of the regime in any of five tax years succeeding such tax year, it shall not be eligible to opt in to the regime for a period of five consecutive tax years succeeding the year of opting out. The amended Bill further provides that in order to qualify for the regime, at least 75% of the expenditure should be incurred by the taxpayer in India.

1 We have discussed only key amendments. For all amendments, please refer Finance Bill, 2016

2. CBDT[2] directs[3] tax officers to treat income from transfer of unlisted securities as 'Capital Gains'

Characterization of income arising from sale of securities and shares has always been a matter of litigation i.e. whether to characterize the same under the head 'Capital Gains' or "Business Income'. Over the years, the courts have laid down different parameters to distinguish the securities and shares held as investments from those held as stock-in-trade. The CBDT had also through instructions[4] summarized the said principles.

In order to bring in uniformity in the tax treatment by the taxpayers and with a view to avoid disputes/ litigation, CBDT has directed the tax officers to treat income from sale of unlisted shares as 'Capital Gains', as against 'Business Income', irrespective of period of holding, except in circumstances listed below where the tax officer would examine the issue and take appropriate view:

- the genuineness of the transaction in unlisted shares itself is questionable; or
- the transfer of unlisted shares is related to an issue pertaining to lifting of the corporate veil; or
- the transfer of unlisted securities is made along with the control and management of the underlying business and the assessing officer would take appropriate view in such situations.

3. Government of India and Mauritius release Protocol amending the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius

The Government of India and Mauritius, on May 10, 2016, amended the tax treaty between the two countries.

Key changes to the tax treaty include changes to the capital gains article. The key changes have been summarized below:

- Gains from the alienation of shares, acquired on or after April 1, 2017, in a company which is resident of a Contracting State may now be taxed in that State. Previously, these were taxable only in the Contracting State where the alienator was resident. However, protection to investments in shares acquired before April 1, 2017 has been provided.
- A transitional provision has been introduced in respect of such capital gains arising during the period from April 1, 2017 to March 31, 2019, wherein the tax rate will be limited to 50% of the domestic tax rate of the State of residence of the company whose shares are being alienated, subject to the fulfillment of the conditions in the 'Limitation of Benefits' (LOB) Article (Article 27A). Full tax rate will be applicable after this period.

Key aspects relevant for Companies in Japan are as under:

- This amendment would have ramifications, for investments into India from Singapore, as the benefits of residence-based taxation of capital gains, on sale of shares under the India Singapore Protocol/ tax treaty, are available only till such benefits are available in the India-Mauritius tax treaty. Therefore, the withdrawal of benefits under India-Mauritius treaty amounts to withdrawal of benefits under the India-Singapore treaty as well. However, to avoid any confusion, India may well move forward to renegotiate treaty with Singapore in line with the India-Mauritius tax treaty.

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2 Central Board of Driect Taxes ("CBDT")

3 Order dated 2 May 2016

4 Instruction No. 1827, dated August 31, 1989 and Circular No. 4 of 2007 dated June 15, 2007

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Contacts

Deloitte Tohmatsu Tax Co.
India Practice

Hiroyuki Hayashi, Partner	hiroyuki.hayashi@tohmatsu.co.jp
Pawankumar Kulkarni, Manager	pawankumar.kulkarni@tohmatsu.co.jp

Issued by

Deloitte Tohmatsu Tax Co.
Tokyo Office

Shin-Tokyo Building 5F, 3-3-1 Marunouchi, Chiyoda-ku, Tokyo 100-8305, Japan
Tel : +81 3 6213 3800
email : tax.cs@tohmatsu.co.jp
Corporate Info. : www.deloitte.com/jp/en/tax
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