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India Catching Up On International Tax Reform

Shilpa Goel (Tax Lawyer) · Friday, March 11th, 2016

India's 2016 Budget is proof that the Government is not only aware of major tax developments taking place globally, but is also sincere in bringing the country's municipal tax system into line with global changes. The Budget, which was read out by the Finance Minister in Parliament on February 29, seeks to implement at least three of the Action Items recommended under the OECD's base erosion and profit shifting (BEPS) project: BEPS Action 1 (on taxation of digital economy); BEPS Action 5 (agreement on modified nexus approach for intellectual property regime); and BEPS Action 13 (on transfer pricing documentation and country-by-country reporting). These, along with several other proposals in the area of international tax law, are summarized below.

A new country-by-country (CbC) reporting requirement for multinational corporations from 2017

The Budget proposes to introduce from April 2017 a new CbC reporting requirement for multinational corporations with a view to implementing the OECD's recommendations under BEPS Action 13. The report would have to be prepared by Indian parents of a MNE group, Indian constituent entities of a MNE group, and in some specified situations, by Indian entities that are a part of a MNE group. The report would comprise information about the MNE group's global allocation of income and taxes paid, while also indicating the location of the MNE group's major economic activity. The Finance Minister noted in his speech that India will mirror the OECD's reporting template and will prescribe an Indian equivalent of the OECD's threshold amount of EUR750m. The reporting requirement would be supported by penal consequences, in form of fines.

A new "patent box" regime from 2017

The Finance Minister has proposed a new "patent box" regime to encourage indigenous research and development (R&D) activities in the country. Under the proposals, royalty income would be taxable at the rate of ten percent on the gross amount of the royalty, if it has its source from worldwide exploitation of patents developed and registered in India. The proposed regime adheres to the OECD's "nexus approach" recommended in its Report on BEPS Action 5. The new regime would take effect from April 2017.

A new "equalization levy" to tax the digital world

In a bid to implement the OECD's recommendations under BEPS Action 1, the Budget proposes a new six percent “equalization levy” on digital business-to-business transactions exceeding the aggregate value of INR100,000 (USD1,491) in a year. The tax would be withheld by residents making payments (for example, towards advertisement expenses) to foreign e-commerce companies, who do not have a permanent establishment in India. The Ministry will over the course of the year set out the procedure to be adopted for the collection and recovery of the levy (including defining the duties and powers of statutory authorities to administer and enforce the levy).

Deferral of place of effective management (POEM) test by one year

I had previously argued in this blog that the Ministry’s draft guidance on POEM test is low on clarity and needs to be kept at bay pending further clarifications. In a welcome move, the Finance Minister has deferred by one year (until April 2017) the application of the newly introduced POEM test to determine residence of foreign companies. The Ministry will use this period to carry out necessary corresponding amendments in the Income Tax Act as well as clarify the various compliance requirements (such as advance tax payments, TDS provisions, and set-off provisions) to which companies would be newly subject to.

Other proposals

In a big relief to foreign institutional investors and foreign portfolio investors, the Minister has laid to rest doubts surrounding the application of a minimum alternate tax (MAT) to foreign companies. The Budget proposes to amend section 115JB of the IT Act to clarify that MAT shall not be applicable, with retrospective effect from April 2001, to foreign companies that do not have permanent establishments in India.

The Ministry has clarified that capital gains arising from transfer of a long-term asset (being shares of a private limited company) shall be chargeable to tax at the rate of ten percent (there was a confusion as to whether shares of a private company can be said to be “securities”). Besides, the Budget proposes to reduce, from three to two years, the period for getting the benefit of long-term capital gains tax regime in case of unlisted companies.

Also included in the Budget is a new, one-time Dispute Resolution Scheme 2016, under which existing tax disputes (including those arising from retrospective amendments to the IT Act and involving companies such as Vodafone and Cairn Energy) can be settled by simply paying the principal tax amount without actually paying any interest or penalty.

Finally, the Budget contains a barrage of tax incentives to facilitate the setting-up of international financial centers (IFCs) in India and to bring the tax regime governing them at par with other emerging IFCs around the world. These include exemption from a dividend distribution tax; a nine percent MAT; exemption from capital gains tax in respect of long-term capital assets; and exemption from a commodity transaction tax on sale of commodity derivatives in foreign currency.

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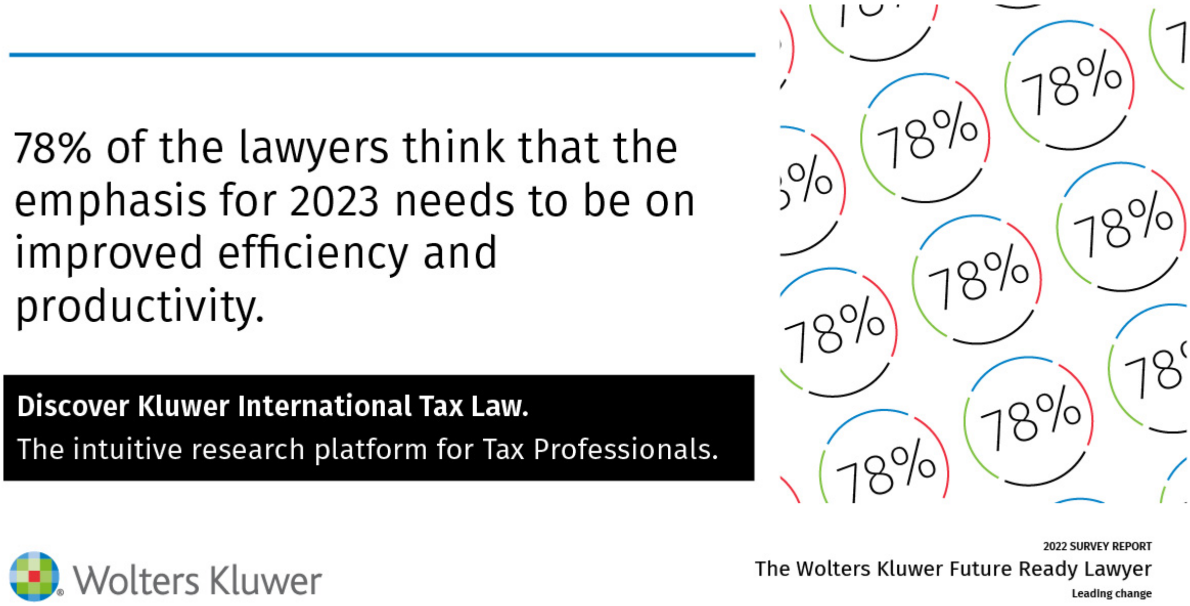

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