Current tax environment in India

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Manish Shah and *Vipool Shah* outline the key pointers that indicate that the tax environment in India has become quite dynamic and that much is being done to create a taxpayer friendly environment for compliant taxpayers

Since being elected in 2014, the intention of the Modi Government has been to promote India as an attractive business destination. To support this vision, the government has introduced a slew of new/revised legislative, technical and administrative tax reforms with a view to overhauling the existing tax law and procedures to make India an investor and business friendly jurisdiction.

The government is also creating awareness amongst the masses about being tax compliant in India and is also cracking down on instances of tax evasion and black money hoarding in India. To illustrate, the government is educating Indian school children on the importance of paying correct taxes in India!

In this article, we discuss below some of the key reforms from local as well as cross border tax perspective:

A. LOCAL TAX PERSPECTIVE

1. Tax incentive for employment generation

With a view to giving a boost to the ‘Make-in-India’ movement of the government and also generate employment across all sectors of the industry, an additional deduction from taxable profits for salaries paid to ‘new employees’ employed during the year is introduced in Finance Act, 2016. Earlier, this deduction was only restricted to Indian taxpayers engaged in ‘manufacturing’ business.

2. Central Board of Direct Taxes (CBDT) issues revised instructions for staying of disputed tax demands at stage of first–level appeal

Earlier, there was no specific guidance on the amount of disputed tax demand to be kept in abeyance by the tax officer on an application made by the taxpayer. Accordingly, based on the total discretion of the tax officer, at times the amount recovered was as high as 50% – 75% of the disputed tax demand – something akin to the UK’s accelerated payment notices.

However, the CBDT has now issued an instruction to tax officers revising the earlier instructions and asking the tax officers to generally insist on payment of only 15% of the disputed tax demand (unless need is felt otherwise). Further, tax officers have been instructed to decide on applications within 2 weeks.

3. General Anti-Avoidance Rules (GAAR)

The introduction of GAAR in India’s tax law with effect from 1 April 2017 is expected to impact decades of jurisprudence and also impact existing investment and operating structures in India. The GAAR looks to deny tax benefits in cases where entire transactions/arrangements were undertaken not for commercial reasons but for the main purpose of obtaining tax benefit in India. However, the CBDT has proactively stated that GAAR provisions shall not apply to any income arising from transfer of investments made before 1 April 2017. However, tax benefits arising from “arrangements” prior to 1 April 2017 may still be covered under the GAAR if the total tax benefit arising to all involved parties in a financial year is more than INR 30 (approximately £330,000)

4. Patent Box Regime

In order to encourage indigenous research and development activities and to make India a global R&D hub, the government has decided to put in place a concessional taxation regime for income from patents. Accordingly, an Indian resident earning royalty from a patent developed and registered in India can, subject to conditions, choose to pay tax @ 10% (plus the applicable surcharge and cess) on the gross amount of royalty. However, no expenditure or allowance from such royalty income shall be allowed. This income is also exempted from the levy of book profits tax. However, the concessional tax benefit will be available only if at least 75% of the expenditure for patent development is incurred in India.

5. Goods and Services Tax (GST)

In line with the primary goals of 'Make in India' and 'Ease of Doing Business', the government is pushing hard for the implementation of common indirect tax structure across whole of India - GST. The GST which proposes to subsume almost 15 major indirect taxes (except customs duty in India) will go a long way in decluttering the multi-layered structure of Indian indirect taxes.

The GST Bill has already been passed by the lower house (Lok Sabha) in India and is up for a review in the upper house (Rajya Sabha) in the ongoing parliamentary session. Although the talks of GST implementation in India have been in the fray for a year and a half now, the current government has deliberated well to gain a fair consensus among most of its opposition to ensure that that GST sails through in this parliamentary session. Although, at present most of the political parties have provided their in-principle support to GST, there are a few clauses in the GST Bill (relating to the GST rate), which still needs to be ironed out before the final GST bill is presented in the Upper house in August 2016 for a vote.

Given that GST enjoys a support from almost all the quarters of Indian population, be it the rich or the poor, the minority stand against GST Bill is losing steam by the day. At an administrative front, the government has already released the Draft GST Law in India for public consultation and is extremely optimistic that the April 2017 timeline set for GST implementation is achievable.

B. CROSS BORDER TAX PERSPECTIVE

1. India-Mauritius Tax Treaty Amended - Advantage India

India and Mauritius have signed a protocol on 10 May 2016 amending the over thirty year old tax treaty. In India's view, the protocol will help in curbing the menace of treaty abuse, round tripping of funds and double non-taxation of income. The major amendments to the tax treaty are the provision of source based taxation of:

- capital gains arising on sale of shares of an Indian Company
- Interest income of Mauritian banks
- service income from India

The main advantage to India from this protocol is that gains arising from sale of shares of an Indian company which are acquired on or after 1 April 2017 will now be subject to tax in India. This will bring in a lot of certainty and end to endless litigation.

2. Equalisation levy

An equalisation levy @ 6% is to be charged/deducted by an Indian resident engaged in business, on the amount paid for receipt of any 'specified service' from a non-resident. The term 'specified service' means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the central government in this regard.

This is India's version of a 'Google tax' based on the Action Plan 1 of Base Erosion and Profit Shifting (BEPS) project of the OECD. However, specific income-tax exemption has been provided to the income of the non-resident which has been subjected to the 'Equalisation Levy'.

3. Non-applicability of higher withholding tax rate provided under section 206AA of the ITA

With effect from 1 June 2016 to provide that the provisions of higher withholding tax of 20% in case of non-furnishing of Permanent Account Number (PAN – akin to tax registration number), will not apply on payments to a non-resident in certain cases subject to furnishing of alternate documentation by such non-resident. While this is a great procedural relief for such non-resident to not suffer high withholding tax in India, the same does not per se exonerate the foreign company from its liability to obtain PAN and file tax return in India.

4. CBDT notifies Foreign Tax Credit (FTC) Rules

The CBDT has notified Foreign Tax Credit (FTC) Rules which lay down broad principles and conditions for Indian taxpayers to uniformly claim deduction or credit for taxes paid in foreign jurisdictions. The introduction of such rules was much awaited as a lot of Indian companies with foreign income faced difficulties while trying to avail FTC and ended up paying taxes in both countries on the same income.

5. CBDT notifies ‘indirect transfer’ valuation rules

The Income tax law was amended by the Finance Act 2012 to tax gains arising from a transfer of a share of interest in a foreign entity that derives, directly or indirectly, its value substantially from assets located in India. However, there was ambiguity on how the computation of gains was to be made and reported in such cases. Recently, the CBDT has notified ‘indirect transfer’ valuation rules for determination of Fair Market Value (FMV) and has also prescribed reporting requirement for Indian concerns.

From the above provisions and discussions, it can be seen that the tax environment in India has become quite dynamic and the government is attempting to create a taxpayer friendly environment in India for tax compliant taxpayers after the negative press created by the previous government’s retrospective legislation following the Supreme Court decisions in *Vodafone* and other similar cases.