India and foreign multinationals: the taxman cometh!

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Foreign professionals looking to do business in India might need to reach over for the headache pills (again), after a change to the law means many of them will now be liable to pay income tax.

And the lawyers are already in the firing line.

Following an amendment to the country's Finance Act 2010, foreign firms providing technical services from outside India will now be liable to pay income tax, as opposed to before, where only those rendering services from within the country were accountable.

Linklaters - the UK law firm - was one of the first foreign companies to be implicated by the new law and the Mumbai Income Appellate Tax Tribunal ruled against it on Friday. The court said that Linklaters' taxable income for the year 1995-96 related to India was in fact £3.32m and not the £691,190 as had been originally declared. There are already plenty who don't like seeing foreign law firms in India, this high profile case has only added fuel to the fire.

While lawyers seem to be in the docks now, others are sure to follow. The change to the law affects any technical professional working for a foreign company in India. Accountants, architects, engineers and designers, just to name a few, will have to pay the 30 per cent rate if they spend more than a certain number of days in India over the fiscal year. This differs country by country depending on the tax avoidance agreements - for UK or US-based companies, employees would be liable to pay tax after 90 days.

Many have been quick to question how the amendment might affect the appeal of India as a business destination - and whether cross-border M&A might dry up. But, Girish Vanvari, Executive Director M&A Tax at KPMG like many others was unconvinced by this argument, saying that "this will not stop foreign companies from doing business in India. Yes, it's an inconvenience to keep records, but this isn't a big deal at all". Not a huge surprise from a tax director at an accountancy firm, but still.

The ironic thing is that if companies cannot reorganise their activities so that tax liabilities are not applicable, as Ashvin Parekh, Partner and Global Leader, Financial Services at Ernst and Young said most companies would do, the only other option would be to increase the charges for their Indian customer to make up the difference.

"By and large they would just create a structure so that the firm falls outside of the tax framework, but another option may be to transfer the additional cost onto the client. Either way, it is very unlikely that companies would shy away from India completely," said Parekh. He added that as companies weigh up the additional costs, there might be a slight decline in M&A activity but overall they would not be deterred.

This view was echoed by Rajesh Simhan, Associate at Mumbai-based law firm Nishith Desai who said: "I would not expect too much of an impact on M&A activities in India due to this. At the same time, if the target is rendering services to Indian residents, I would expect an additional level of due diligence to take place in respect of the M&A due to potential tax liability issues that may arise and which would need to be factored in."

Ultimately big multinationals who want to conduct long-term business in India have the financial means to cope with the added expenditure. But to save as many pennies as possible, these companies are not going to shy away from hiking their charges for their Indian clients. While the Indian government might have won the first battle, foreign corporations will surely win the war. And they've got the lawyers on their side.

Tags: law firms, M&A, red tape, tax

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