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India’s Finance Bill: What Tax Practitioners Need To Know

By Siri Bulusu

As India’s 2017 union budget was announced, tax practitioners sought clarity on several pending issues caused by a recent string of confusing clarifications regarding anti-avoidance measures and tax treatment of foreign investments.

The Narendra Modi administration made strong indications that it would bring business into India by reducing corporate taxation, increasing the country’s ease-of-doing-business score, and implementing a landmark goods and services tax regime.

Amid unfulfilled promises of the current administration, Finance Bill 2017 seeks to provide a balance between reducing the tax burden on small and medium enterprises and expanding sources of government revenue.

Below are tax-related highlights from Finance Bill 2017, following the Feb. 1 union budget, which are set for parliamentary discussion. Once the amendments and proposals are reviewed, they must be approved by both houses of parliament before the end of the budget session on Apr. 12, 2017.

Direct Tax

- For companies earning annual revenue below 500 million rupees ($7.4 million), the business income tax rate would be reduced from 30 percent to 25 percent. The change is only effective for companies and does not apply to limited liability partnerships.
- The budget would make no change to companies earning above 500 million rupees ($7.4 million).

- Manufacturing companies would continue to pay a 28.84 percent tax rate, which includes the tax rate, 12 percent surcharge and education cess.
- There is no change to the tax rates for foreign companies, limited liability partnerships nor is there any change made to the minimum alternate tax or dividend distribution tax. Limited liability partnerships are currently free from paying tax on dividends distributed to associated enterprises, and tax practitioners anticipate the government will introduce such a tax to curb the number of companies applying to become LLPs.
- The amount of income a company may declare under section 10AA of the Income Tax Act, must be a balanced profit. Prior to the change, a company could deduct all business losses. The 10AA provision refers to profit arising from business coming out of special economic zones.
- Certain start-ups may enjoy a tax holiday on profit losses for seven years, an increase from five years —taking three out of seven years instead of three out of five. If 51 percent of a start-up company changes hands to a new shareholder, the start-up may carry over the loss benefit. A lingering concern for start-up companies is whether investment income will be taxed as business income.
- The government has relaxed the concessional carbon rate to 10 percent on gross income accrued from transfer of carbon credits.
- Indian Accounting Standards would apply to a certain class of companies starting fiscal year 2016 and is intended to rationalize the minimum alternative tax provision.
- Capital gains accrued from the sale of Indian assets through foreign indirect transfer would not be taxed, as long as the income is earned overseas.
- Changes to the 'place of effective management' provision were not addressed in the Finance Bill 2017.

Transfer Pricing

- Effective April 1, 2017, the definition of "specified domestic transaction" contracts to exclude expenditure made to specific individuals. Transfer pricing regulations would continue to apply on transactions between related enterprises with profit-linked deductions. The "specified domestic transaction" provisions would then apply only if one of the entities involved in a related-party transaction enjoys specific or specified profit link deductions
- The government has introduced a "secondary adjustment" amendment that would enable Indian tax authorities to readjust the price of a transaction between a parent company and an associated enterprise. The amendment is theoretical in nature and will apply to assessment year 2018-2019. For any secondary adjustment done, it would be compulsory for the parent company to repatriate the difference between the arms-length price and the transaction price back to India. In the event that the amount is not repatriated, it will be purported that the associated enterprise in India has given an advance in that amount to the parent company and interest on that advance will need to be computed.
- The limitation of interest deduction change aligns Indian tax law with Action 4 of the OECD's base erosion and profit shifting project. The government introduced a proposal to restrict interest deduction payable by a parent company to its associated enterprise to 30 percent. The interest deduction would apply to earnings before accounting for EBITDA.
- According to the bill, the term debt would refer to "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 income chargeable under the head 'Profits and gains of business or profession.'" The disallowed interest would be carried forward for eight assessment years. The specific exemption extends to banks, insurance companies and in cases where interest expense of less than 10 million rupees ($150,000).

Advance Pricing Agreements

The following are effective from enactment of Finance Bill 2017:

- Both direct and indirect tax issues would be covered by the Advance Ruling Authority.
- APA ruling proceedings may be disposed in up to six months, an increase from 90 days.

Indirect Tax

- On Goods and Services Tax, special efforts will be made to reach out to trade and industry groups to help get businesses familiar with the GST network. No specifics were outlined regarding the release of the final GST draft law. The next meeting of the GST Council will be Feb. 18, 2017.
- Service Tax: effective from enactment of Finance Bill 2017, the value of land would be excluded from valuation of works contract services, with retrospective effect from July 1, 2010. In cases where value of land is included in value of services, a tax would be payable on 25 percent of the total value from July 1, 2010, to Feb. 28, 2013, and on 30 percent of the total value from Mar. 1, 2013, onward.
- The bill proposes to repeal the Research and Development Cess from April 1, 2017, which will removing the 5 percent payable cess on import of foreign-collaboration technology into India.
- Customs Duty: basic customs duty rate is unchanged at 10 percent while basic excise duty is unchanged at 12.5 percent.
- The following are effective from enactment of Finance Bill 2017:
- The definition of importer and exporter will be amended in Finance Bill 2017 to include beneficial owner.
- Refund of duty paid in excess is now outside the bound of “unjust enrichment,” where excess payment is evident from bill of entry.
- Payment of duty is due before the end of the day following date on which goods arrive at customs border.

Rate Change Highlights

- Customs duty payable on populated “printed circuit boards” for use in manufacture of mobile phones increased to 2 percent after Feb. 2, 2017.
- Customs duty payable upon import of liquefied natural gas reduced from 5 percent to 2.5 percent after Feb. 2, 2017.
- The government has introduced an excise duty exemption on place-of-service devices and goods used in manufacture of place-of-service goods.

Parliament is currently in discussion to approve amendments to Finance Bill 2017 until the end of its Budget Session on April 12.

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For More Information

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The Finance Bill 2017 can be found here: http://indiabudget.nic.in/ub2017-18/fb/bill.pdf