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# What Practitioners Expect From India's Union Budget

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By [Siri Bulusu](#)

There are high expectations for India's Feb. 1 Union Budget for the 2017-18 fiscal year after a year of landmark economic activity, from demonetization to the introduction of a pan-India goods and services tax.

While demonetization has been a short-term damper on India's GDP, the influx of cash into the formal banking sector is expected to have long-term gains for the economy. It has also been a major driver in the move to digital transactions, what many consider a positive step for India as it gains standing as a global economic leader.

Goods and Services Tax

A July 1 date for implementation has been set, with the fundamental issue of administrative control resolved earlier this month. States are set to assess companies earning below a threshold of 15 million rupees (\$220,000) and the central government will assess companies earning above that threshold. But some tax professionals still feel the landmark tax reform has a long way to go.

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"They haven't said much beyond the turnover threshold," Girish Vanvari, Mumbai-based tax partner at KPMG India, told Bloomberg BNA Jan 27. "There are no rules regarding execution of administrative control."

Another pending issue is the allocation of goods and services into the four tax brackets put forth by the Goods and Service Council.

“The tax rates will be 5, 12, 18 and 28,” Vanvari said. “But what goes into those rates hasn’t been decided, so basically it means nothing.”

Vanvari expects the Union Budget to be a time when the government assures industry members that the new tax regime will take effect this year, either in July or at the latest in September.

#### Foreign Portfolio Investments

Tax professionals have made representations to the Indian government in an attempt to revise the law to relieve in-bound investments from the threat of multiple layers of taxation.

The Indian government redacted a circular issued by the Central Board of Direct Taxation to clarify taxation of India-focused foreign funds after industry members said the clarification resulted in the law becoming “too far reaching.”

The circular referenced a 2012 amendment to the Income Tax Act of 1961—known as the “Vodafone tax” due to its application to offshore transaction of Indian assets.

While the tax is directed at complex offshore transactions that result in tax evasion, it resulted in taxation of almost all foreign portfolio investments.

“Foreign portfolio investments and foreign indirect investments were never intended to be covered by these provisions,” Nishith Desai, founder of Mumbai-based legal firm Nishith Desai Associates, told Bloomberg BNA in a Jan. 26 e-mail.

“It would result in excessive double, triple or multiple taxation if applied in such a harsh manner.”

Desai called India’s indirect transfer provision “an example of an ill-thought-out and reactionary measure” and said it should be dropped completely as other anti-avoidance measures are being undertaken by the government.

“This has become one of the biggest deterrent to FDI,” said Desai, and added that exceptions should be carved out for foreign portfolio investments and foreign indirect investments immediately.

#### Equalization Levy

The current scope of the equalization levy is limited to online advertising, but there is speculation the Indian government will expand its application to include other online transactions including

streaming, database access and cloud services.

The government introduced an Equalization Levy in the Finance Act of 2016 which taxed cross-border digital transactions, namely online advertisements. Unlike the cross-border internet services tax, the Equalization Levy is aimed at taxing cross-border transactions like those made over Amazon or Google.

“The levy would result in increased cost of doing business, increase in compliance burden of the tax payers and increase in litigation owing to the ambiguity surrounding the levy,” Didar Singh, Secretary General of the Federation of the Indian Chambers of Commerce and Industry, told Bloomberg BNA in a Jan. 27 e-mail.

Practitioners say the effect of the levy could be a cumulative 38 percent taxation in addition to the unknown goods and services tax rate—a rate that would “kill the charm” of doing business in India.

Singh added that there are questions of constitutional validity over the levy including definition of the term “online.”

Further, practitioners say expansion of the tax would disrupt the digital ecosystem in India and Singh added that it would be of serious concern to various businesses.

#### Transfer Pricing

India’s transfer pricing ecosystem is widely regarded as high risk in the global investment community. Multinationals fear that tax officers will take aggressive stands that result in litigation that lasts years.

“The main concern for multinationals doing business in India has been aggressive tax assessments and high pitched audits,” Shefali Goradia, Partner at BMR & Associates LLP told Bloomberg BNA Jan. 27. “Toward this end, the government has taken a few steps to be upfront about their tax bill in India.”

The current administration is focused on improving India’s “ease of doing business” score and has opened the door on several transfer pricing methods which bring certainty to a company’s overall tax liability in India.

It introduced Advance Pricing Agreements (APAs) in 2012 to help mitigate uncertainty around tax liability and have since signed over 100 APA agreements.

In the upcoming budget, the government is expected to introduce and clarify other transfer pricing incentives.

Tax practitioners expect the government to lower the mark-up in the “safe harbor” range to ensure a wider range of companies avoid tax litigation.

There is also expectation that the government will provide procedural clarity on country-by-country reporting, including timeline and deadline for initial year of reporting and prescribed format and filing norms.

Goradia said country-by-country reporting, while consistent with the OECD’s base erosion and profit shifting initiative, has multinational companies concerned about misuse of sensitive information.

“If tax officers have access to this information, they may use it to challenge the inter-company transactions,” Goradia said, adding that cost of compliance will also go up substantially.

#### Black Money

India’s economy was in shock after Prime Minister Narendra Modi’s surprise move to scrap 86 percent of India’s cash economy by demonetizing all 500 and 1000 rupee notes (\$7.34 and \$14.68).

Aimed at eliminating counterfeit notes and chocking the parallel economy, the government anticipated a third of the 15.4 trillion rupees (\$73,416,050,000) deemed useless to go unclaimed.

By the end of December, however, nearly 97 percent of that amount was returned and critics of demonetization said the move was “all pain and no gain.”

Fallout from demonetization is ongoing—the move precipitated an income tax amendment that allows the government to levy a heavy 90 percent tax and penalty on unexplained cash. The government has made various attempts to address black money— from the foreign assets declaration scheme, to a more recently enacted income disclosure scheme.

Under the current income disclosure scheme, large amounts of explained cash deposited by March 31 will be taxed at 30 percent, with a 33 percent surcharge and pay a 10 percent penalty. Large amounts of deposited cash that are not sufficiently explained will be taxed at 60 percent, plus a 25 percent surcharge and an education cess at 3 percent of the total tax and cess. A penalty of 10 percent of the total tax and cess will also be charged.

“These are tools to equip the government so they may crack the whip on black money, but not much revenue has come in since they were introduced,” Goradia said.

Goradia said there isn’t much more the government can introduce in terms of tax consequences

for income tax evaders.

“This is not something the government can consider a success, as they haven’t unearthed much black money” Goradia said, adding that the various attempts may be viewed as a symbolic success.

#### Place of Effective Management

The Indian government recently issued the final rules for a “place of effective management” provision (POEM) that tax authorities will use to determine whether a foreign company will fall under India’s tax jurisdiction, likely cementing the provisions application in the coming assessment year.

The provision was originally introduced in the 2015 Union Budget, but implementation was deferred from fiscal year 2015-2016 to 2016-2017 due to widespread criticism of the draft rules. Tax practitioners worried the subjective nature of the provision would lead to double taxation issues and increased litigation.

The recently issued guiding principles indicate the government will move forward with application of the provision, but not all concerns have been addressed.

“POEM will result in a lot of unending disputes and spoil the ease of doing business in India,” Desai said.

Without “checks and balances” POEM will bring a level of uncertainty to companies looking to conduct business in India, he added.

A more objective provision like “controlled foreign corporation” (CFC) would do a great deal in abating those concerns.

CFC is a better and less litigious option used in countries like the U.S., Desai said, adding that the government should only adopt CFC and drop implementation of POEM.

With POEM’s final rules announced a week before the Union Budget, experts have not reached consensus on whether the government will scrap the provision or not.

#### Dispute Resolution

There are an estimated 70,000 cases waiting to be resolved under the current dispute resolution scheme, and experts anticipate the government will extend the current scheme or introduce another.

According to Singh, of the Indian Chambers of Commerce and Industry, the government should evaluate key issues on tax litigation to relieve the need for an expedited resolution scheme.

He said that field officials take different approaches when applying tax provisions during assessments, which leads to uncertainty on the part of tax payers and tax officials on how to apply tax law, causing provisions to be applied in unintended situations. This means several tax provisions have little or economic or policy justification, leading to unnecessarily requiring lower tax tribunals to take up multiple cases regarding the same tax provision.

The Indian government extended a Direct Tax Resolution Scheme to January 31, 2017 to give companies a way to resolve pending tax litigation before the unveiling of this year's Union Budget.

However, few companies took the government's deal as it did not offer an attractive enough incentive for companies to concede tax demands made by the government.

"We can no longer legislate in broad, generic strokes and leave it to the courts and field officials to do the rest," Singh said.

#### GAAR

India's General Anti-Avoidance Rule (GAAR) will take effect April 1, 2017. While the final rules have not yet been released, the government did release a statement giving tax treaties with 'limitation of benefits' clauses precedence over the anti-avoidance measure.

Recent amendments to India's tax treaties—with Singapore, Mauritius and Cyprus—include 'limitation of benefits' clauses that require a business to spend a certain amount in operational expenses, or a certain number of employees before receiving any tax benefit.

The question of whether treaty-specific substance tests would override the GAAR was of major concern to industry members, but the recent statement has only brought more uncertainty.

"The industry reaction is negative because it says GAAR is required despite the special anti-avoidance measures in India's tax treaties," Vanvari said.

"Basically it says if the tax authorities don't find the limitation of benefits clause to be sufficient, GAAR will be triggered."

Vanvari called the recent clarification "dangerous" and said "the government should have a statement assuring that if limitation of benefits is satisfied then GAAR cannot be triggered. Period."

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