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LEGAL AND TAX COUNSELING WORLDWIDE

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India Budget Analysis 2016-17

For International Business Community

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Nishith Desai Associates is ranked the 'Most Innovative Asia Pacific Law Firm in 2016' by the *Financial Times - RSG Consulting Group* in its prestigious **FT Innovative Lawyers Asia-Pacific 2016** Awards. With a highest-ever total score in these awards, the firm also won Asia Pacific's best 'Innovation in Finance Law', and topped the rankings for the 'Business of Law'. While this recognition marks NDA's ingress as an innovator among the globe's best law firms, NDA has previously won the award for 'Most Innovative Indian Law Firm' for two consecutive years in 2014 and 2015, in these elite *Financial Times* Innovation rankings.

Our firm has received much acclaim for its achievements and prowess, through the years. Some include:

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India Business Law Journal (IBLJ) has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015

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We believe strongly in constant knowledge expansion and have developed dynamic Knowledge Management ('KM') and Continuing Education ('CE') programs, conducted both in-house and for select invitees. KM and CE programs cover key events, global and national trends as they unfold and examine case studies, debate and analyze emerging legal, regulatory and tax issues, serving as an effective forum for cross pollination of ideas. Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has been developed into a global case study and published by John Wiley & Sons, USA in a feature titled 'Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage' in the September 2009 issue of Global Business and Organizational Excellence (GBOE).

Please see the last page of this paper for the most recent research papers by our experts.

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India Budget 2016: Worth an Oscar or Two, but not a Clean Sweep!

The Indian Finance Minister Mr. Arun Jaitley announced India's 2016 budget proposals ("**Budget**") before the Parliament earlier today. The Finance Minister has focused on remedying a number of critical points of concern to foreign investors and he certainly deserves a few Oscars for addressing some painful issues. The Government has continued the path of systemic reforms by bringing about a number of changes to the tax and regulatory framework. These reforms include relaxing foreign investment limits in certain key sectors. A number of other low hanging fruits such as removing dividend distribution tax for REITs and InvITs (Real Estate Trusts and Infrastructure Investment Trusts respectively) and reducing the long term capital gains tax on unlisted securities of private companies from 20% to 10% have been addressed as part of the Budget. Importantly, the Government has stuck to the fiscal deficit target of 3.5% of India's gross domestic product for FY 2016-17.

In the last year, India has been an outlier of growth in the global economy with economic growth accelerating to 7.6% in FY 2015-16. This has been amidst a global economic slowdown and increased turbulence in the global financial markets. The Government has come out with new initiatives such as the Start-Up Policy and the Make in India initiative with a view to providing a renewed thrust to different sectors of the economy. The Budget 2016 is an extension of various such initiatives and the Government appears to have taken into consideration several inputs from the industry and stakeholders in introducing its reforms.

On the regulatory side, significant relaxations have also been announced in respect of the Foreign Direct Investment Policy ("**FDI Policy**"), including allowing foreign investment in insurance and pension sectors under the automatic route upto 49% as well as allowing for 100% foreign investment under the automatic route in case of asset reconstruction companies and entities engaged in marketing of food products produced and manufactured in India. Similarly, the investment limit for individual foreign investors in stock exchanges has been increased from 5% to 15%, which is important in the context of the proposed listing of the Bombay Stock Exchange and the National Stock Exchange. However, similar relaxation for foreign investment in power exchanges and commodity exchanges has not been announced. The Budget further proposes to expand the basket of eligible FDI instruments to include hybrid instruments. This may allow for innovative structures to be effectuated.

The Government has also recognized that the bond markets in India need greater depth. For this purpose, they have announced that large borrowers will be encouraged to meet their financing needs through the market mechanism. In similar vein, Foreign Portfolio Investors ("**FPI**") will also be allowed to invest in unlisted debt securities issued by corporates and pass through securities issued by securitization SPVs. While these moves will assist in deepening the bond market, one will have to wait to see the guidelines issued by the Reserve Bank of India in this regard.

On the tax side, last year the Government had proposed a gradual reduction in corporate tax rates from 30% to 25% over a period of four years. The Government appears to have taken the first step in this direction by providing that new manufacturing entities that are set up, will be entitled to a lower rate of 25% plus surcharge and cess on meeting certain conditions. Furthermore, the corporate tax rate is proposed to be lowered to 29% for a domestic company whose turnover in the FY 2014-15 does not exceed INR 5 crores (USD 800K). However, for large companies, while the Government has proposed phasing out incentives such as limiting accelerated depreciation, other investment linked incentives etc., it has desisted from reducing corporate tax rates this year. Another surprising change has been the introduction of a new dividend tax to be levied in the hands of an identified class of shareholders, i.e. those who receive dividend of more than INR 1 million in any financial year. This is a new tax apart from the existing dividend distribution tax which is levied in the hands of the company paying dividend.

On the positive side, the Government has reduced the long term capital gains tax rate levied on the sale of shares of unlisted private companies to 10% from 20% for foreign investors. It has further reduced the holding period for an investment to qualify as long term capital asset to 2 years from the earlier qualifying period of 3 years. The reduction in rates for foreign investors will provide significant relief and re-emphasize the commitment of the Government to making India an attractive investment destination for foreign investors.

The fund industry was a major beneficiary of the Budget proposals last year and continues to benefit in this year's proposals. The Government last year had permitted foreign investment into Alternative Investment Funds ("**AIFs**") under the automatic route. However, significant ambiguity was prevalent on distributions made to foreign investors by Category I and Category II AIFs where the withholding tax provisions provided for a 10% withholding rate. The Budget has now proposed that benefits under tax treaties will be extended to non-residents with respect to distributions from an AIF to such non-residents. This move will enable Indian GPs to structure fund raising through unified structures as against co-investment structures without any tax leakages. In similar vein, the Government has also eased the safe harbor norms for fund managers in India, and mere control or management of any business from India will not constitute a business connection. However, the expectation of easing a number of other safe harbor norms for fund managers has not been met.

REITS and InvITs have also been on the radar of the Budget this year. One issue that the industry is facing is that the upstreaming of amounts through dividends to REITs/InvITs is subject to dividend distribution tax ("**DDT**"). The Budget proposes the removal of such DDT. With these changes in addition to those proposed last year, it is hoped that REITS / InvITs will finally take off in India.

The Government has also followed up on its announcement for Start Ups last month by providing various tax incentives. The Government has also introduced incentives for R&D by allowing worldwide royalties derived from patents developed and registered in India to be taxed at a lower rate of 10%. This follows the international practice usually accorded in many countries to provide patent box regimes / incentives for R&D.

An interesting measure introduced in the Budget is the proposed tax incentives applicable to units that are set up in an International Financial Services Center ("**IFSC**"). The first IFSC has been set up at the GIFT city with the intent of capturing a share of the international offshore financial services market.

While there have been a number of positive measures that have been announced, the Budget still leaves an overhang over some important issues such as the retrospective tax on indirect transfers, place of effective management ("**POEM**") and General Anti Avoidance Rules, which leave it short of an Oscar clean sweep.

The Government has decided to postpone the introduction of the POEM Rules to FY 2016-17 with detailed provisions being introduced on the treatment of when a foreign company becomes a resident of India in the first year. The change introduced last year with respect to the POEM Rules was an ill thought out decision and it would have been much better if the Government had decided to revert to the old provisions which provided for the "control and management" test for a foreign company to be treated as resident in India. Similarly, the General Anti Avoidance Rules continue to be effective only from FY 2017-18 and it is hoped that the rules for their application will provide for enough checks and balances to ensure tax payer protection.

The Budget has tried to tackle the ghost of the retrospective nature of the indirect transfer provisions by providing for a dispute resolution scheme for resolving such disputes. The Scheme provides that if tax payers withdraw a litigation / arbitration arising out of such issues, the Government will waive the interest and penalties on such tax payable. It is unfortunate that the Government has not taken the bold step to bury the ghost by removing the retrospective nature of the provisions. Even today, there are neither rules that are in place to determine fair market value for application of the indirect transfer tax provisions nor are there provisions to determine the manner of apportionment of gains attributable income purportedly derived from India. These retrospectively applicable indirect transfer tax provisions and the absence of legislative certainty in this regard will continue to haunt the Government in the medium term.

The Budget also proposes an equalization levy, which will affect the online advertisement income earned by foreign companies. A fall out of the discussions during OECD BEPS Action Plan (though not finally accepted), the Budget provides for a 6% equalization levy in respect of payment of advertisement revenues to foreign companies. In the normal course of things, this would not have been a taxable transaction and this provision can have significant ramifications for companies seeking to do business in India. Another fall out of the OECD BEPS Action Plan seems to be the country by country reporting standards which have now been introduced for companies that meet certain thresholds.

The Government has used the Budget to make incremental progress and introduce changes in the sphere of tax legislation, without making any big bang reforms. It has instead focussed on the resolution of some of the smaller complexities in Indian tax legislation which have been pain points for foreign investors. Apart from substantive changes to the law, there have also been a number of procedural changes introduced with the intention of facilitating early resolution of disputes and reducing litigation backlog. The changes proposed by the Government, however, do not amount to bold action that could have sent out the strong message of welcoming foreign investors with open arms to India.

We have provided below a more comprehensive analysis and further insights on the 2014 Budget proposals. Hope you enjoy reading it. Join us for an interactive Webinar on Wednesday, March 2, 2016 (India time) for insights on India's 2016 Budget. Do also visit Nishith.tv for videos and insightful discussions on the impact of the Budget on key industries.

1. Corporate Tax Proposals – Irritants Remain

I. Corporate Tax Rates

For financial year 2016-17, the corporate tax rate in general continues to be 30%. However, in case of small companies, with turnover in the financial year 2014-15 not exceeding INR 50 million (approx. USD 750,000), the Budget has proposed lowering the corporate tax rate to 29%. Further, the Budget has proposed that companies which are set up on or after March 1, 2016 and engage solely in the business of manufacture or production, will be given the option to be taxed either at the rate of 30% or at the rate of 25% in which case they will be able to claim any profit or incentive linked benefits under the Income Tax Act (**"ITA"**).

The Budget has also introduced sunset clauses with respect to several deductions/exemptions, including deductions on export income available to units incorporated in a Special Economic Zone (**"SEZ"**), and weighted deductions available for expenditure on scientific research, among others. The Government has sought to ensure that such phasing out of tax benefits does not affect the legitimate expectation of existing investors who have commenced operations with an eye to avail such benefits for the full period for which they were intended to apply.

II. Dividend Distribution Tax

The Budget has proposed amending the ITA to provide that dividends declared by a domestic company and received by a resident individual, limited liability partnership (**"LLP"**) or partnership firm, in excess of INR 1 million (approx. USD 15,000), shall be chargeable to tax at the rate of 10% (on a gross basis) in the hands of the recipient. The amendment is proposed to take effect from Financial Year 2016 - 17 and will have the undesirable effect of subjecting profits earned by the distributing company to economic triple taxation – first, when the corporate profits are taxed at the applicable corporate tax rate; second, when the DDT is levied on distributed profits in the hands of the company; and third, when the dividend receipts in excess of INR 1 million are taxed in the hands of the shareholder.

Further, the ability for a foreign investor to claim foreign tax credit on DDT paid in India may remain a challenge in certain cases. Even Indian residents may not be able to offset losses against dividends received, to lower their overall tax burden. Previously, the Indian Economic Survey 2013-14 has recommended the phasing out of DDT and considered it to be undesirable in public finance policy. In light of the above, it would have been far better if the provisions levying DDT had been replaced entirely with a tax on dividends in the hands of the shareholders.

III. Securities Transaction Tax ("STT")

The Government has also increased the STT applicable on the sale of an option in securities, where the option is not exercised to 0.05% of the option premium, from the earlier rate of 0.017%. This increase will have an adverse impact on volumes in the futures and options markets.

IV. Withholding Taxes

The Government has addressed a long standing demand of non-residents i.e., rationalization of section 206AA of the ITA, which provides that where any person fails to provide his Permanent Account Number (“**PAN**”) to the person responsible for deducting tax at source, the latter shall be required to deduct tax at the rate of 20%, or the maximum applicable rate chargeable under the ITA, whichever is higher. This had resulted in great hardship for non-resident service providers, etc. who often suffer delays in receiving payments from India due to the time consuming process of applying for a PAN card. The Government is now proposing that non-residents may alternatively fulfil such other conditions that may be prescribed, which is likely to involve submission of alternative documents such as providing a tax identification number issued by their country of residence. This will ensure that the needless incremental burden borne by non-residents who are doing business with India is avoided.

V. External Commercial Borrowings (“ECB”)

The Reserve Bank of India (“**RBI**”) has recently revised the External Commercial Borrowings (“**ECB**”) framework to allow for rupee denominated borrowings. In this regard, the Government has clarified that capital gains arising to a non-resident investor in rupee-denominated bonds, due to the appreciation of the rupee between the date of issue and the date of redemption against the foreign currency in which the investment is made, shall be exempt from tax on capital gains. An appropriate amendment is proposed to be made effective from Financial Year 2016 - 17.

However the Government has been silent with regard to specifying the withholding tax rate applicable on interest payouts on these bonds at 5%. This is in spite of a notification issued by the CBDT in October 2015 stating that the required amendments would be brought about.

VI. Beneficial rates for capital gains on unlisted securities: Big boost for M&A and PE players

In 2012, the Finance Act modified the rate of capital gains tax for non-residents on transfer of unlisted securities from 20% with indexation benefit to 10% for non-residents without indexation benefit. However, this benefit was only applicable effectively for unlisted shares of a public company, and not a private company.

The Finance Bill has proposed to extend the reduced tax rate of 10% to transfer of shares of ‘a company not being a company in which the public is substantially interested’, thereby extending it to shares of private companies. This comes as a welcome relief to PE investors and also as a long awaited reprieve. In fact, the 2012 explanatory notes had indicated that the reduction of tax rates from 20% to 10% in respect of sale of unlisted securities was to ensure uniformity between PE investors and FPIs in terms of capital gains tax rates, since institutional investors were entitled to a 10% beneficial tax rate on capital gains.

VII. Holding period for unlisted securities decreased: A welcome proposal goes unaddressed

Capital gains are classified as long term or short term, based on the period for which the assets were held by the transferor. Long term capital gains are subject to reduced tax rates. For all securities, including unlisted securities of public / private companies, to qualify as long term prior to 2014, a holding period of twelve (12) months was applicable. However, the Finance Act, 2014 increased the holding period for unlisted securities to qualify as long term assets to three (3) years. Considering the incremental taxes on short term capital gains, the Finance Minister has proposed to reduce the holding period to a more reasonable two (2) years.

This announcement, though well received, was short lived. It finds no mention in the fine print – the Memorandum or Finance Bill. Nonetheless, it is expected that this anomaly will be resolved when the Finance Bill is passed into law.

The move, if implemented should positively impact foreign investors, since a related amendment for entitlement to a beneficial tax rate of 10% on sale of unlisted securities of private companies has also been proposed.

VIII. Buyback tax net widened

Currently, the ITA provides for an additional tax of 20% payable by the company on distributed income arising from share buybacks. Buyback has been defined to mean the purchase of a company of its own shares in accordance with section 77A of the Companies Act, 1956.

The Finance Bill has proposed that the definition of ‘buyback’ be widened to include a buyback of shares in accordance with company laws currently in force. It seems that the intention of the legislature is to cover buybacks under the new Companies Act, 2013 or any legislation that may be applicable. However, a wide definition of ‘buyback’ could have an inadvertent effect on transactions such as share capital reductions, which may also be covered under deemed dividends and lead to unintended double taxation. However, the biggest issue with respect to a step-up cost basis due to secondary purchase has not been addressed.

The concept of ‘distributed income’ on which the buyback tax was applicable has also undergone a change. Earlier, it was computed by subtracting the issue price from the consideration. The Budget has proposed that for computing ‘distributed income’, the amounts received by the company as consideration shall be determined in a manner to be prescribed. This amendment has been proposed to tackle cases where the consideration/ issue price was paid in tranches or non-monetary in nature. The fine print of the computation rules will be something to watch out for, and clarity will only be achieved once the prescribed computation mechanism is released.

IX. Tax free conversion to LLPs gets onerous

Recently, the Government proposed relaxations in the FDI policy to allow eligible foreign investments in LLPs in sectors qualifying prescribed criteria under the automatic route (i.e., without approval).

However, the Budget has proposed to introduce an additional requirement for treating conversion of company to an LLP as a tax free transfer for the purposes of capital gains. The onerous condition is that the value of the total assets in the books of accounts of the company in any of the three previous years preceding the financial year in which the conversion takes place, does not exceed INR 50 million (approx USD 750,000).

The existing conditions (such as those relating to turnover), were in any case an impediment for LLP conversions. Where more and more companies are looking to function as LLPs due to the ease of operations, tax efficiencies as well as relaxation in foreign investment, this move comes across as a regressive and arduous one.

2. Foreign Investment Norms Liberalized

The Budget 2016 has proposed to make certain positive changes to the existing foreign investment regime in India.

I. Relaxation of investment caps

The investment limits in certain sectors have been proposed to be relaxed by the Finance Minister in his Budget speech:

A. Insurance

Foreign investment in insurance entities, which include insurance companies and all insurance intermediaries registered under any regulation issued by the Insurance Regulatory and Development Authority of India, has been permitted up to 49% under the automatic route. Currently, foreign investment up to 26% of the share capital of the investee company is permitted under the automatic route and investment between 26% and 49% is permitted under the approval route. This change should be a welcome move for both industry players and investors evaluating this space, especially considering that there has been large interest in this space already since opening of the sector to 49% (under the approval route) last year.

B. ARCs

Foreign investment is currently permitted in Asset Reconstruction Companies (“**ARC**”) to the extent of 49% under the automatic route, and up to 100% under the approval route. The Budget has proposed to permit foreign investment up to 100% under the automatic route. Further, the existing regime permitted FPIs to acquire up to 74% of the Security Receipts (“**SR**”) until now. However, the Budget has permitted FPIs to acquire up to 100% of the SRs issued by ARCs.

ARCs have been an attractive structuring option for foreign investors due to their access to rights available under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“**SARFAESI Act**”). However, the 49% ceiling restricted foreign investments in ARCs. Several offshore special situation funds even chose to invest in SRs issued by an ARC sponsored securitization trust, and there were instances where the ARCs tried to arm-twist the SR holders at the time of enforcement. With the ability to hold 100% of the ARCs as well as 100% of the SRs, foreign investment targeted towards distressed assets may accentuate. However, the fine print of the amendments need to be examined to ascertain how the current requirement of ownership of certain portion of the SRs by the sponsor will be aligned with the proposed construct which allows the foreign investor to hold 100% of the SRs.

C. Stock exchanges

Thus far, residents and non-residents were permitted to individually hold only up to 5% shareholding in stock exchanges, while depositories, banking companies, insurance companies, other stock exchanges, and public financial institutions were permitted to hold up to 15% shareholding in the stock exchanges. The Budget proposal has increased this limit from 5% to 15% to bring it in line with the cap for domestic institutions.

It appears incongruous that non-residents cannot hold more than 5% shareholding in the commodity exchanges and power exchanges. Consequently, non-resident investors (who held more than 5% shareholding prior to the change) will now be required to part divest such holdings, while they can hold up to 15% in the stock exchanges. It is likely that the proposed amendment may only apply to similar institutions from abroad to invest up to the 15% limit.

D. NBFCs

Foreign investment in non-banking financial companies ("**NBFCs**") were hitherto permitted in only 18 identified activities. The Budget Speech mentions that the list of permitted activities shall be extended to such activities which are regulated by financial regulators.

Currently, for instance, foreign investment into an investment company requires approval from RBI, as well as the Foreign Investment Promotion Board ("**FIPB**"). With the proposed changes, foreign investment into an core investment company may not require approval.

E. Pension funds

Foreign investment in pension sector is permitted under the current foreign investment regime to the extent of 26% under the automatic route, and up to 49% under the approval route. The Finance Minister has now proposed a relaxation to permit foreign investment in pension sector, up to 49% under the automatic route. This change should be useful not only to investors but also from a policy perspective given the Government's intention to move towards a pensioned society.

II. Expansion of instruments

Currently, only equity shares, compulsorily convertible preference shares and compulsorily convertible debentures and warrants are permitted under the FDI route as eligible instruments. The Budget Speech has proposed to expand the scope of permitted eligible instruments. While such additional instruments have not been detailed, it seems that optionally convertible instruments (preference shares and/ or debentures) or redeemable instruments (preference shares and/ or debentures) may be permitted under the FDI route. This is likely to be a major shot in the arm for FDI investments into India, since it provides further flexibility in terms of structuring of investments in a manner which is optimized for the investor and the investee from a regulatory perspective.

3. Corporate Bonds – Increasing the Market Depth

Currently, FPIs can only invest in 'listed' or 'to be listed' securities which includes both equity and debt securities, and unlisted debt securities issued by companies in the infrastructure space. The Finance Minister has now proposed to permit FPIs to invest in 'unlisted debt securities' as well. If implemented, this would remove administrative compliances and costs in the form of listing of these securities on a recognized stock exchange. This will also shield potential issuers of such debt securities from the implications of the recently introduced Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, which impose greater restrictions than the erstwhile Securities and Exchange Board of India (Issue and Listing of Debt Securities) Regulations, 2008 and the erstwhile listing agreement with the stock exchange. FPIs have also been permitted to invest in pass through securities issued by securitization companies as well. These changes appear to be extremely promising and hopefully, the guidelines/ regulations to be implemented in this regard will sustain this conviction.

4. Other Regulatory Reforms

I. Effective implementation of Bilateral Investment Treaties (BITs)

India is a signatory to around 83 BITs with different countries. The Finance Minister in his Budget Speech has proposed a mechanism of Centre-State Investment Agreements, whereby states which opt to execute such agreements will ensure fulfilment of the obligations of the respective states under the BITs, thereby making them more favorable to foreign investment. This is a welcome step by the Government as it aims to create a holistic environment for development where the State Governments will be held equally responsible and accountable as the Central Government for the protection of investment made by a foreign investor. However, the practical implementation remains to be seen especially in light of the fact that certain states may not execute these agreements.

II. Code for resolution of financial firms

The Finance Minister, in the Budget Speech, has proposed to include a comprehensive 'Code for Resolution of Financial Firms' which shall provide for a resolution mechanism specifically designed to deal with bankruptcy situations in banks, insurance companies and financial sector entities. This, along with the pending bill on the Insolvency and Bankruptcy Code, 2015 would provide the much needed stability in the financial sector and a robust mechanism to deal with bankruptcy situations.

III. Credit enhanced infrastructure bonds

To further encourage investment into the infrastructure sector, the Finance Minister, in his Budget Speech, has proposed that the Life Insurance Corporation will set up a fund to provide credit enhancement of bonds issued by infrastructure companies.

IV. Bank recapitalization

The Finance Bill has proposed that INR 250 Billion (approx. USD 4 billion) will be earmarked towards the recapitalization of public sector banks. Though this is a welcome step, the amount earmarked by the Government seems to be lesser than expected. Experts believe that public sector banks will need as much as 10 times of the earmarked amount to comply with Basel III norms.

5. Hits and Misses for the Funds Industry

I. Distribution of proceeds by AIF: Relief for non-residents, limited gains for residents

The Finance Act 2015 had established a special taxation regime in respect of category-I and category-II AIFs that ensured tax pass through status for these AIFs. Under the aforementioned regime, income of the AIF (except business income) was exempt in the hands of the AIF and taxable in the hands of the investor. However, a major operational hurdle was placed on this provision due to the withholding requirements under Section 194 LBB of the ITA. Under Section 194 LBB, any income credited or paid by the investment fund was subject to a withholding tax of 10% which was required to be deducted by the AIF. This blanket requirement was considered to be at odds with the tax pass-through policy as it did not account for exempt investors and exempt streams of income.

Consequently, there was a demand to rationalize the tax withholding requirements to ensure that no such deduction would be required at the time of making distributions to exempt investors, and exempt streams of income that are exempt from tax and the recognition of beneficial provisions of the various double tax avoidance arrangements (**"DTAA(s)"**) that India has entered into. This call for rationalization was also in line with the Alternative Investment Policy Advisory Committee's (**"AIPAC"**) report.[1]

The Finance Bill proposes to rationalize the deduction requirements by making the following changes with respect to the amount that is required to be withheld by an investment fund:-

- Distributions to non-residents (not being a company) or a foreign company: Tax will be required to be deducted as per the "rates in force". The term "rates in force" has been defined under Section 2(37A) of the ITA and the Budget has proposed to make an amendment to the provision to include deductions under 194LBB. This would make the withholding rate subject to the rates that are applicable under the ITA or those in accordance with the applicable DTAA, whichever is more favorable. The proposed change will ensure that there is nil or lower withholding of tax required when distributions are being made to investors who are residents of countries such as Singapore or Mauritius which have a beneficial DTAA with India. This is a welcome change that will favor unified fund structures[2]and encourage participation by Non-Resident Indians (**"NRIs"**)/foreign nationals into AIFs.
- Distributions to residents: Tax will be required to be deducted at the rate of 10%. This is a continuation of the existing provisions as far as distributions to residents are considered. Consequently, the provision still does not differentiate between taxable streams of income and steams of income not subject to tax. For example, an investment fund would still be required to deduct tax at 10% when distributing income earned from dividends received. This creates an anomaly as such dividend income is not subject to tax in the hands of the investor. Further, the provision does not account for distributions to exempt domestic investors. However, Section 197 of the ITA has been amended to allow AIFs to obtain nil/ reduced tax withholding certificates with respect to exempt investors and exempt streams of income.

1. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/narayan-murthy-committees-first-report-on-aif-policy-a-mixture-of-immediate-fixes-and-long-term.html?no_cache=1&cHash=cdb91e38e1c-c0c0ee713618e05e2fb03

2. A unified structure refers to a structure where commitments from both domestic and offshore investors are pooled into a domestic pooling vehicle.

II. No pass-through for category-III AIFS

There has been a consistent demand by the industry to extend pass through benefits to category III AIFs. However, the Finance Bill does not contain any provisions relating to category-III AIFs. Since such AIFs are usually formed as trusts, their taxation shall continue to be governed by the provisions and precedents that are applicable to private trusts. Further, the Finance Bill does not provide any certainty with respect to the characterization of income of category III AIFs. At present, such AIFs face the risk of their income being characterized as business income due to the frequency of trades and the complexity of the investment strategy of the AIF. This uncertainty places category III AIFs at a significant disadvantage against offshore funds with similar strategies. This is due to the fact that such offshore funds invest as FPIs and under the provisions of the ITA, the assets held by them are deemed to be "capital assets". Consequently, the outcome of their investment is treated as a capital gain or a capital loss. Since the investment conditions for investments by FPIs and AIFs have recently been harmonized, the lack of harmonization with respect to tax pass-through policy leaves a gap in terms of equal treatment for the two.

III. Permanent establishment exemption for fund managers in India - some relaxations, but continues to be onerous

By introducing Section 9A in the ITA through Finance Act 2015, the Government had attempted to establish a special tax regime to incentivize fund management activity in India. The provision laid down certain conditions upon fulfillment of which, the fund management activity would not constitute business connection in India and the fund would not a resident in India merely because the fund manager was based in India.

The fund management industry has not taken favorably to the provision as the conditions laid down have been considered to be too onerous. The Finance Bill attempts to address these concerns by making the following changes to Section 9A:-

- The requirement for a fund to be "resident" of a country or a specified territory with which a DTAA or Tax Information Exchange Agreement has been entered into has been amended to require a fund to be "established, incorporated or registered". This has been done as there are various funds whose corporate structures are is such that they do not qualify as tax residents. This issue is faced by various US based pension funds and Luxembourg based SICAVs which are open ended collective investment schemes.
- The condition that the fund shall not carry on or control and manage any "business in India" or *"from India"* has been amended. The condition is now restricted to the requirement that the fund shall not carry on or control or manage any *"business in India"*. The rationale for this change is that the conditions of the provision should only relate to the activities of the fund in India. Therefore, there should be no condition relating to business carried on *"from India"* by the fund.

The above mentioned relaxations represent a commendable attempt to create an effective tax regime for fund managers to offshore funds. However, a few additional changes to the conditions would have been helpful in incentivizing fund management activity in India. These include (a) the requirement to not invest more than 20% of its corpus in any entity; (b) the requirement that the remuneration paid for fund management activity to be at least at arm's length; and (c) the requirement to have a minimum of twenty-five members.

IV. Revamped regime for securitization trusts: Pass-through status provided

In response to the persistent demand for reforms in the tax regime applicable to securitization trusts, the Budget has proposed a host of changes that overhaul the securitization trusts taxation regime, as inserted by the Finance Act, 2013. One of the major criticisms of the current regime is that trusts set-up by asset reconstruction or securitization companies established for the purposes of the SARFAESI Act are not covered under the definition of a "securitization trust". The Finance Bill has sought to address this concern by including such trusts within the proposed regime which will come into effect from June 1, 2016.

It is an accepted global practice to provide a tax pass through status to pooling vehicles to ensure tax neutral platforms. It is the investors or contributors to the pool who are taxed as per their respective tax status.

A tax pass through status was also provided to category I and category II AIFs last year by the Finance Act, 2015.The Budget seeks to provide a similar tax pass through status to the securitization trusts, therefore any income accruing or arising to, or received by, a person, being an investor of a securitization trust, out of investments made in the securitization trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitization trust been made directly by such investor. Further, the income of an investor of a securitization trust will also be deemed to be of the same nature and shall be in the same proportion as in the hands of the securitization trust.

If the income of a securitization trust in a given year, is not paid or credited to investors, it shall be deemed to have been credited to the account of the investors on the last day of such year in the same proportion in which the investors would have been entitled to receive the income had it been paid in such year.

This new tax pass through system also inserts a new Section 194LBC which puts an obligation on the securitization trust to withhold certain amounts from the income payable to the investors, either at the time of crediting the amount to the account of the investor or at the time of making actual payment to the investor.

The proposed withholding requirements for resident investors are as follows:

- 25% if the investor is an individual or a Hindu Undivided Family ("**HUF**"); and
- 30% if the investor is any other person.

In a welcome step, it has been clarified that non-resident investors of a securitization trust will be eligible to claim treaty benefits.

It is pertinent to note that since a deemed credit of income to the accounts of investors is contemplated under the proposed regime, the requirement to deduct tax has been extended to even those scenarios where income is not actually paid or credited but only deemed to be credited.

While a proposed amendment to Section 197 makes it possible for investors of a securitization trust to obtain a lower or nil deduction tax certificate, this process will add to the administrative burden faced by the investors.

6. Incentives For Start-Ups

In the backdrop of the Government's 'Start-Up India, Stand-Up India' initiative, there were high expectations on the incentives that would be provided in the Budget. The Budget has broadly stuck to the Government's Action Plan announced on January 16, 2016 ("**Action Plan**") and not got beyond it. [3]

Some of the highlights of the Budget for startups are as follows:

Eligibility criteria for claiming exemptions:

- Company incorporation on or after April 1, 2016, but before April 1, 2019; and
- Annual turnover not exceeding INR 250 million (approx. USD 4 million) in any preceding financial year, beginning on or after April 1, 2016 and ending on March 31, 2021; and
- Certification by the Inter-Ministerial Board of Certification as a business which involves innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property.

The Budget has used the term "eligible start-up", and has defined it to mean a 'company' engaged in eligible business. However, the Action Plan as well as the definition notified by the Department of Industrial Policy ("**DIPP**") include an LLP and a registered partnership firm. In the event that the Budget intends to restrict the exemptions only to companies, this would contradict the definition notified by the DIPP and only allow restricted flexibility for entrepreneurs to structure their business. Further, the fact that only entities that are incorporated after April 1, 2016 would be eligible to claim benefits would deprive a large section of startups from availing these benefits.

As a first announcement in the Action Plan, eligible startups have been exempted from paying income tax for a period of 3 years. This has been provided for by allowing them a 100% tax holiday. Such benefit however, can be claimed by the startup for any 3 consecutive assessment years out of 5 years beginning from the year in which the eligible start-up is incorporated. However, 'eligible startups' have not been exempt from Minimum Alternative Tax ("**MAT**") and therefore, would continue to remain liable to pay 18.5% tax in the years that they claim the exemption.

3. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/flurry-of-reforms-for-startups-in-india.html?no_cache=1&cHash=2facca0eb52f525dc5ee1c299130924f

7. REITS: Huffs, and Puffs to Reach the Finish Line… Or Does It?

Real Estate Investment Trusts ("**REITs**") and Infrastructure Investment Trusts ("**InvITs**") were introduced by the SEBI (Real Estate Investment Trust) Regulations, 2014 and the SEBI (Infrastructure Investment Trust) Regulations, 2014 respectively. The Finance Act 2014 and Finance Act 2015 brought in substantial tax reforms to make REITs and InvITs more attractive to investors. However, one of the major issues still outstanding is that any distribution by the special purpose vehicle ("**SPV**") to the REIT / InvIT in the form of dividend attracted DDT. In sectors (real estate and infrastructure) where holding assets through SPVs is the norm, coupled with the legal requirement that REITs and InvITs are required to distribute 90% of their operating income, this is a major hurdle for REITs and InvITs to take off.

However, the Budget now seeks to exempt 'specified domestic companies' from payment of DDT for any dividend payments to REITs and InvITs, whose units are required to be listed on any recognized stock exchange. 'Specified domestic companies' have been defined to mean domestic companies in which the business trust holds the entire nominal value of the equity share capital (cases where some portion of the equity share capital are required to be mandatorily held by any other person in accordance with laws, or direction of the Government have been exempted from this). Such exemption from DDT shall be available to these specified domestic companies only when dividends are paid out of accumulated profits and current profits post the date when the business trust acquires such shares in the 'specified domestic company'.

While for the other exemptions under the ITA in relation to a 'business trust', a 'special purpose vehicle' is defined as an Indian company in which the business trust holds a controlling stake, i.e. at least 50% of the nominal voting capital, the exemption under the Budget for DDT has been provided only to companies in which the business trust holds the entire equity share capital. This may restrict the exemption granted to only those SPVs where the entire free shareholding is held by the business trust.

8. A New Patent Box Regime – An Interesting Innovation

With a view to encourage research and development activities in India, the Budget has proposed a regime under which worldwide income received by way of royalty in respect of a patent developed and registered in India should be subject to tax on a gross basis at a concessional rate of 10%. However, no expenditure or allowance in respect of such royalty income shall be allowed under the ITA.

While this may be a step in the right direction and may be particularly useful for incentivizing innovations in the pharmaceutical and technology industries in India, the requirement for the patents to be 'developed' and 'registered' in India may place certain limitations on the success of this regime.

For the purposes of the concessional rate of tax, "developed" has been defined to mean "the expenditure incurred by the assessee for any invention in respect of which patent is granted under the Patents Act, 1970". However, since the Indian patent regime in conservative in nature (for instance, the limitations for protecting inventions in the software industry) many Indian residents who are the inventors, may prefer to file for patents in offshore jurisdictions rather than under the Patents Act, 1970 even in respect of inventions for which expenditure has been incurred in India. The requirement that patent must be 'registered' in India in order for the royalty to be eligible to a concessional tax rate shall effectively deny the benefits of the new budget proposals for such inventors. It is also unclear on whether a patent which has been applied for, but for which registration has not been granted will qualify under this regime.

It would have been ideal if such benefits had also been extended to inventions where the patents applications with Indian resident inventors, while not having sought registration in India due to the restrictions under the Patents Act, 1970, had obtained registration in a foreign jurisdictions pursuant to a Foreign Filing License from the Indian Patent Office.

9. Equalization Levy: India's Own Version of Google Tax?

The Budget includes a separate Chapter titled 'Equalization Levy', which proposes to impose a 6% tax on the consideration (in excess of INR 100,000 (approx. USD 1500) for any "specified service" received or receivable by non-resident persons from Indian residents or non-residents having a Permanent Establishment ("**PE**") in India. *"Specified service"* currently means *"online advertisement, any provision for digital advertising space or any other facility or service for the purposes of online advertisement and includes any other service as may be notified by the Central Government in this behalf"*. This proposal shall become effective pursuant to a notification by the Central Government.

The Equalization Levy is an attempt to tax online advertising revenues earned by non-residents from India which were previously not considered taxable in India (Please click here for our hotline on earlier judicial precedent) on the basis of physical-presence based permanent establishment tests. Once implemented, the Equalization Levy could impact several global online content providers, social networking sites, search engines, etc. including the likes of Google, Yahoo and Facebook.

The Chapter on the Equalization Levy exists as a separate code in itself (and not as part of the ITA) and outlines separate provisions governing charge of tax, collection and recovery, interest and penalties, appeal, etc. Failure to deduct Equalization Levy may result in a disallowance of expenditure claimed by the person making payment to the non-resident.

The Equalization Levy is based on one of the several proposals which were considered for the effective taxation of the digital economy but eventually not adopted as part of the final report under the OECD BEPS Action Plan. Unsurprisingly, it falls into the same traps that the OECD BEPS Action Plan had highlighted as being impediments to its effectiveness as a solution to counter BEPS in the digital economy.

Firstly, Equalization Levy is likely to be in addition to the corporate income tax payable by the non-resident in its residence jurisdiction. Availability of credit on the Equalization Levy may become a challenge and this may result in undesirable double taxation of the "specified income". Even the BEPS Action Plan had recommended the application of the Equalization Levy only in *"situations in which the income would otherwise be untaxed or subject only a very low rate of tax"*, a suggestion which appears to have gone unheeded in its adoption in India.

Should the country of residence of the recipient have a DTAA with India, the taxation of the "specified income" should be in accordance with the distributive rule specified under the DTAA. Although Equalization Levy is not amended into the ITA, many DTAAs that India has entered into, including those with Singapore and US apply to *"any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes"*. Therefore, in the absence of a PE in India, a Singapore resident should be subject to tax on its business profits only in Singapore.

In summary, the implementation of the Equalization Levy in its current form in India will end up being needlessly burdensome on legitimate online transactions, without adequately addressing the larger policy goals.

10. Country-By-Country Reporting

India is following several jurisdictions around the world in the implementation of the Country-by-Country Reporting (“**CBC Reporting**”) and the submission of a master file providing an overview of the groups’ global business and global transfer pricing policy. These enhanced reporting requirements shall come into effect from April 1, 2017 (applicable to financial year 2016-17 and later). Under CBC Reporting, Multinational Enterprises (“**MNEs**”) having a consolidated revenue above a threshold (annual consolidated group revenue equal to or exceeding EUR 750 million or INR 5395 crores) are required to file annual CBC reports based on the MNE’s consolidated financial statements and reflecting the following, among other things, for each tax jurisdiction in which they do business:

i. The amount of revenues, profits before tax, income tax paid and accrued;

ii. Total employment, capital, accumulated earnings and tangible assets in each tax jurisdiction;

iii. Identification of the entity doing business in a particular tax jurisdiction and a description of its business activities

Typically, MNEs earning annual revenues above EUR 750 million and having an Indian parent are required to furnish the CBC Report reflecting all entities within the MNE group to the Indian tax authorities. Further, Indian resident subsidiaries in an MNE group having a non-resident parent are required to disclose the country of residence of the parent to the Indian income tax authorities. Under certain circumstances which limit the ability of the Indian income tax authorities to access the CBC Report from the non-resident parent under exchange arrangements with the parent’s country of residence, the Indian subsidiary may also be required to furnish the CBC Report reflecting all entities within the MNE group.

The implementation of these proposals may significantly increase the compliance burden on the MNEs subject to the reporting requirements. Further, a graded penalty structure, prescribed for violations in respect of CBC Reporting set the penalties at a minimum of INR 5000 per day (approx. USD 80). Therefore, it shall become very important in the coming few months for the finance teams of major MNEs operating in India to prepare for the implementation of the aforementioned provisions.

11. MAT on Foreign Investors: Closing an Avoidable Chapter

Section 115JB mandates that the tax payer company pay a MAT of 18.5% of its book profit if the tax otherwise payable on total income is lesser after taking into account other allowable deductions. The AAR controversially held in Castleton Investment Ltd[4], that the provisions of Section 115JB will apply to foreign companies, including Foreign Institutional Investors (“**FIIs**”) as well. To rectify this issue, the Government passed an amendment vide the Finance Act 2015 to clarify that Section 115JB did not in fact apply to FIIs with prospective effect from financial year 2016-17. In this scenario, a Committee was established by the Government headed by Justice A.P. Shah to examine the issue and recommend suitable amendments to Section 115JB, particularly in light of the fact that FIIs do not normally have a place of business in India.

IIn view of the recommendations of the committee and to provide certainty in taxation of foreign companies, it is proposed to amend Section 115JB to provide that with effect from financial year 2001-02, the MAT provisions shall not be applicable to a foreign company if -

i. The foreign company is a resident of a country with which India has signed a Double Taxation Avoidance Agreement and does not have a permanent establishment in India; or

ii. The foreign company is a resident of a country with which India has not signed a Double Taxation Avoidance Agreement and is not required to seek registration under the company law in force in India.

This amendment will be made effective retrospectively from April, 2001, which was when MAT was introduced. This is a welcome amendment that clarifies the position of taxability of foreign companies (including FII/FPI) that do not have a presence in India and hence do not require registration under the company law in force in India. It will also lay to final rest the issue relating to the levy of MAT on foreign companies and is in line with the various statements made by the Government and will allay investor concerns.[5]

4. [2012] 348 ITR 537 (AAR)

5. For a more detailed background, See: http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/no-mat-on-fiis-fpis-Government-accepts-direct-tax-committees-recommendations.html?no_cache=1&cHash=f9b-061f3315534065b363bfb676f317d

12. Retrospective Tax on Indirect Transfers: No Respite for the Wary

The saga surrounding the retrospective application of tax on indirect share transfers which began in 2012 with the Indian revenue authorities pursuing Vodafone for failure to withhold tax[6], unfortunately still continues.

In 2014, the Finance Minister had recognized the uncertainty and loss of investor confidence caused by the introduction of retrospective provisions. He had stated, that while pending litigation would need to come to its logical end, all fresh cases relating to indirect transfer issue would be scrutinized by a high level committee set up by the CBDT. Greater clarity regarding the applicability of indirect transfer rules was also provided in the 2015 Finance Act.[7]

The 2016 Budget makes a weak attempt at resolving pending litigation arising out of retrospective taxation as part of the Direct Tax Dispute Resolution Scheme (“**DTDRS**”). If a taxpayer makes a declaration under the DTDRS on or after June 1, 2016, he will be required to pay only the amount of tax as determined (no interest and penalties to be payable).

The taxpayer will be required to furnish proof of withdrawal from all pending litigation, including proceedings filed before the any appellate authorities or the Courts or by way of way of any arbitration under a Bilateral Investment Protection Agreements (“**BIT**”) at the time of filing such a declaration.

The designated authority, upon receiving the declaration, will determine the amount payable within 60 days by way of a certificate, and the taxpayer shall pay such amount within 30 days of receipt of certificate. Such payment will be non-refundable in all circumstances, and the determination by the designated authority shall be considered conclusive and may not be reopened in any other proceedings.

The DTDRS seems to be more an attempt by the Government to realize dues expeditiously, rather than providing a practical resolution to the taxpayers. This intent is clearly reflected in the one-sided provisions which fail to establish a viable settlement mechanism for the taxpayer. Although under the DTDRS, taxpayers may only be required to pay the determined tax, the fact remains that the very application of retrospective amendments is questionable and far from global standards. In such a case, it may be unlikely that a taxpayer would be willing to waive his rights under Bilateral Investment Treaties or DTAAs in order to file a declaration under the DTDRS. Unfortunately, the Government has not taken the bold path of removing the retrospective nature of the levy.

Even today, the provisions relating to indirect transfer do not have the guidelines required for determining when a transaction can be subject to tax and the manner of apportionment. Under such circumstances, it is unreasonable to expect a taxpayer to be clairvoyant and determine what taxes are actually payable, especially for a transaction which occurred when such provisions were not even in place.

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6. *Vodafone International Holdings* (2012) 341 ITR 1

7. For a more detailed analysis of the amendments, please refer to our hotline on Budget 2015.

13. Tax Residency and Place of Effective Management – Deferral is not the Answer

Since the inception of the ITA in 1961 and up until the FY 2014-15, a foreign company was considered a resident in India only if the control and management of its affairs was wholly situated in India. In fact, this was also the test in the erstwhile Income Tax Act, 1922. Last year, however, the Finance Act 2015 replaced the (almost) 100 year old test for corporate residence with a new test which provides that, from FY 2015-16, a foreign company will be deemed to be an Indian resident if its POEM is situated in India. POEM is defined as a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.

With this change, a stable and objective test for determining residence of a foreign company in India was replaced by a subjective test. Understandably, several questions arose with respect to the interpretation and applicability of the new residence criteria. In order to remove the ambiguity surrounding POEM, the Government released draft guidelines on December 23, 2015 (almost 9 months after the effective date - April 1, 2015) providing factors which would be considered in determining the POEM of a company. However, the guidelines failed to achieve their objective and have not been finalized yet.[8]

In order to address the concerns raised, the Finance Minister has announced the deferral of POEM to financial year starting April 1, 2016. The Finance Bill also introduces a transition mechanism for a foreign company which is considered, for the first time, as a resident in India under the POEM test. For such companies, the provisions of the ITA relating to computation of income, treatment of unabsorbed depreciation, setoff or carry forward of losses, special provisions relating to avoidance of tax and collection and recovery of taxes shall apply with exceptions, modifications and adaptations as notified by the Central Government.

While the deferral of the POEM test may be seen as a temporary relief for tax payers, it will also give the Government time to finalize the guidelines pursuant to further consultation with stakeholders. However, the fact still remains that POEM is a subjective test with the potential to create unnecessary grey areas in a space that always operated in black or white. It is also questionable whether this brief postponement is sufficient to prepare the tax authorities for the challenge of enforcing POEM.

It has been this Government's goal to create a stable and consistence tax environment so as to give taxpayers confidence in the tax regime. The only way to achieve such a goal would be a reinstatement of the original test of corporate residence.

8. http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/poem-new-criteria-for-corporate-tax-residence-in-india.html?no_cache=1&cHash=441d8fd361ff3271a3788c9d241e2037

14. International Financial Services Centers: Need More to be Globally Competitive

An IFSC is a designated area for providing financial services to non-residents and residents, to the extent permissible under the current regulations, in currency other than Indian Rupees. The purpose for setting up an IFSC is to bring financial services transactions, which are currently carried on outside India by overseas financial institutions and overseas branches/subsidiaries of Indian financial institutions, to a designated center on Indian soil, while being subject to the same financial ecosystem as their present offshore locations.

India today does not have operating IFSCs. While the Government notified Gujarat International Finance Tec-city as an IFSC in 2011, push for rules and regulations was seen only in the year 2015 after the Finance Minister announced in the last budget that the regulations for operating within an IFSC would be issued. Since then, various regulators have announced regulations that would govern IFSCs in India. In this Budget, the Finance Minister has put forth the tax regime for units operating within an IFSC.

CCurrently, under the ITA, an IFSC is eligible to 100% tax exemption on income earned by the unit of the IFSC for the first 5 consecutive years and 50% for the next 5 consecutive years thereafter. The Budget provides for certain additional incentives to units situated in an IFSC including:

- Currently, tax on long term capital gains on sale of equity shares on a stock exchange is exempt provided STT is paid. The Budget provides for exemption from tax on capital gains arising from transactions undertaken in foreign currency on a recognized stock exchange located in an IFSC, even where STT is not paid in respect of such transactions.
- The current provisions of the ITA provide for applicability of a MAT on the book profits of companies at the rate of 18.5%. The Budget proposes to reduce the rate to 9% on companies being units located in an IFSC, deriving income solely in convertible foreign exchange.
- Currently a DDT of 15% on a gross basis is applicable to companies on any amount declared, distributed or paid by a company by way of dividends. The Budget proposes to amend this provision to provide that no DDT shall be payable either by the company or the shareholder on dividends declared, distributed or paid out of current income by a unit located in an IFSC which is deriving income solely in convertible foreign exchange.
- The existing provisions relating to STT and Commodities Transaction Tax (“**CTT**”) provide for levy of tax on transactions in taxable securities and commodities, respectively. The Budget provides to amend this position such that no STT or CTT shall be payable where the transaction has been entered into by a person on a recognized stock exchange located in an IFSC so long as the consideration is paid or payable in foreign currency.

The objective behind the above incentives is to provide a competitive tax regime to IFSCs. However, financial centers around the world provide many more tax incentives than those provided by the Budget. For example, Singapore provides for a concessionary tax rate of 10% for fund management and investment advisory activities, subject to certain conditions. Further, there are also special tax incentives for banks and insurance companies. While this may be a good start, a much harder push will be needed to bring IFSCs in India at par with financial centers around the world.

15. Compliance Window to Declare Undisclosed Income

The Finance Bill proposes to introduce a one-time compliance window for income tax on the lines of the compliance window introduced last year under the black money law.

This compliance window is for a limited duration of time from June 1, 2016 to September 30, 2016 for persons to declare income: (a) for which they have either not filed income tax returns or not made disclosure in their income tax returns; or (b) which has escaped assessment of tax by virtue of non-filing of income tax returns or non-disclosure of full and true material facts. This window is open for income earned up to financial year 2015-16 (“**Undisclosed Income**”).

The persons making a declaration under this window are required to pay tax at 30% of the Undisclosed Income declared, along with 25% Cess and 25% penalty on the quantum of tax payable, effectively amounting to a total levy of 45% on the quantum of Undisclosed Income.

However, the Finance Bill also excludes certain persons from availing this compliance window. For instance, where the Government has already received information under a tax treaty or has conducted a search and issued a notice subsequent to such search (with the notice period not having expired). Further, the compliance window is not applicable in relation to income and assets chargeable to tax under the black money law, prosecution under certain laws such as the prevention of corruption law, etc. It also remains to be seen how the Revenue deals with a declarant under the compliance scheme whose declaration is not accepted, to what extent is such declarant protected from prosecution under the Finance Bill or other legislations once the Revenue have the necessary information with them.

16. Rationalization Measures Relating to Tax Litigations

The Financial Bill introduces significant changes to the ITA aimed at increasing systemic efficiency and reducing the case backlog before the tax administration to enable the administration to realize its dues.

I. Dispute Resolution Scheme

A Direct Tax Dispute Resolution Scheme (**"DTRS"**) has been introduced applicable to **Tax Arrears** (i.e. tax, interest or penalty payable under the ITA or the Wealth Tax Act in respect of which an appeal is pending before the Commissioner of Income Tax (Appeals) or the Commissioner of Wealth Tax (Appeals))

IIf the assessee files a declaration with regards any Tax Arrears, in accordance with the DTRS on or after June 1, 2016, he will be required to pay:

i. In case of a pending appeal with regards tax and interest:

   - If the disputed tax amount does not exceed INR 1 million (approx. USD 15,000): The disputed tax amount + interest payable up to the date of assessment/reassessment
   - If the disputed tax amount exceeds INR 1 million (approx. USD 15,000): The disputed tax amount + interest payable up to the date of assessment/reassessment + 25% of the minimum penalty leviable

ii. In case of penalties: 25% of the minimum penalty leviable + tax and interest payable on total income finally determined

Upon the filing of such a declaration in relation to the disputed Tax Arrears, any pending appeals will be deemed to be withdrawn.

II. Other Rationalization measures

Various other measures have been proposed in the Budget with a view to reducing litigation and making procedures more efficient. Timelines have been made considerably tighter and unnecessary levels of appeal have been eliminated to streamline the process. Relief measures have been introduced in favor of litigants such as a provision permitting the assessing officer to receive security in the form of a bank guarantee and revoke any provisional attachments of property made by him that causes undue duress. Another significant measure introduced is the mandate on the assessing officer (the lowest authority in the income tax litigation hierarchy) to grant stay of demand once the taxpayer pays 15% of the disputed tax demand. These measures will prevent tax payers from being subject to undue harassment in respect of any ongoing litigations before the Income tax authorities.

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Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines"*. These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

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Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

Please feel free to contact us at
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