Tax Hotline

February 01, 2018

INDIA BUDGET ANALYSIS 2018-19

FOR INTERNATIONAL BUSINESS COMMUNITY

Earlier today, the Indian Finance Minister ("**FM**") announced the Budget for financial year ("**FY**") 2018-19 ("**Budget**"). This Budget is expected to be the last of this Government prior to elections which are expected to happen over the next twelve months, and the focus was around ensuring that the rural economy was adequately benefitted.

Although the last twelve months have seen a significant increase in investments from Foreign Portfolio Investors ("**FPI**") and Foreign Direct Investment ("**FDI**"), the Budget largely focuses on the domestic audience. Reforms are proposed in the health and rural sector with emphasis on generating higher income for farmers. On the tax and regulatory front, the Budget proposals have been minimal, especially for the global investor community. The biggest blow has been for the Indian capital markets with introduction of a long term capital gains ("**LTCG**") tax at the rate of 10% on listed equities, which were earlier exempt.

The Budget proposes a 10% tax on transfer of listed equity shares, units of an equity oriented mutual fund and units of a business trust, where such gains exceed INR 100,000 (approx. USD 1500), with effect from April 1, 2018. The Budget also proposes to introduce limited grandfathering in respect of protecting gains realized on a mark to market basis up to January 31, 2018; an increase in share value post this date would be brought within the tax net. This is in line with the Government's intent not to introduce taxes with retrospective effect and to protect any exodus from the Indian markets.

The most significant impact will be on foreign portfolio investments. The first blow to FPIs were the amendments to the Double Tax Avoidance Agreements ("**Tax Treaties**") with Mauritius and Singapore, last year, which gave India the right to tax capital gains from sale of shares. The introduction of a tax on LTCG is the second blow which will result in higher tax costs for FPIs as the treaty benefits earlier available should also no longer be available. This will be a deterrent for foreign investors and could potentially result in a movement of trading activity away from India to other offshore jurisdictions such as Singapore which offer better tax rates and sophisticated financial products.

On a more positive note, the Budget proposes to reduce corporate tax rates to 25% for Indian companies whose turnover is less than INR 2.5 billion (approx. USD 40 million). This is in line with the earlier proposals of the FM and should enhance competitiveness and encourage global investors to 'Make in India'. The exemption is broad enough to cover 99% of all tax-paying companies. It is important that in an era of tax competition where countries have been lowering corporate tax rates, India does not get left behind. While the move to reduce corporate tax rates is welcome, it would have been ideal if the corporate tax rates for large companies were also reduced to make them more competitive in the global marketplace.

Over the last couple of years, the Government has enacted several provisions in line with the Base Erosion and Profit Shifting Action Plan ("**BEPS Action Plan**") by the Organization for Economic Cooperation and Development ("**OECD**"). This year, the Budget proposes to expand the scope of the 'business connection' test (the equivalent of permanent establishment) through two sets of changes. Firstly, the scope of 'dependent agent' has been widened to include persons who habitually play the principal role leading to conclusion of contracts by non-residents. This is in line with the expansion of the concept of Permanent Establishment ("**PE**") under the Multilateral Instrument ("**MLI**"). Secondly, to tax new business models in the digital space, the Budget proposes to include a 'significant economic presence test' ("**SEP Test**"). Under the SEP Test, download of data or software, or solicitation of business activities through digital means in India could lead to non-residents coming within the tax net. Interestingly enough, the OECD in the BEPS Action Plan has not yet endorsed such an approach on the basis of economic presence. The result of these changes would effectively mean that companies would be extremely reluctant to undertake transactions with Indian entities other than through treaty countries, given the expanded scope of the provisions. The possibility of substantial

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litigation going forward also cannot be ruled out.

The justification of the Government to expand the scope of the provisions has been that going forward, these tests would be included in tax treaties resulting in the domestic law becoming favourable to the taxpayer. However, it is relevant to note that even the MLI provisions today do not provide for the SEP Test that India has introduced. In an era of technology and digital access, this move of the Government runs contrary to their stance of increasing digitization in India.

One area where the Government seems to have proactive has been in the context of bankruptcy and insolvency laws, which have always been a pain point for investors and creditors. While 2017 witnessed a large number of cases being referred to bankruptcy courts (NCLT), concerns have been raised on the fact that tax law has not yet caught up with the changes. The Budget proposes to promote the restructuring plans by introducing tax incentives such as the ability to carry forward losses despite change in ownership and Minimum Alternate Tax ("**MAT**") relief to the extent of unabsorbed depreciation and carried forward loss where a company has been admitted into the bankruptcy process. These proposals should further increase interest amongst investors in distressed assets.

In its continuous endeavour to build a robust financial services centre in the country, the Government has proposed incentives for financial services operating through International Financial Services Centers ("**IFSCs**"). Importantly, in addition to the tax reforms, the FM in his speech has proposed to establish a unified authority to regulate this space.

Another interesting takeaway from the FM's speech was the policy for hybrid instruments that will be put in place, especially for the start-up community and venture capitalists. A robust framework for investments through hybrid instruments will be vital in developing a sophisticated market to attract foreign investment.

The Start Up Action Plan introduced by the Government has garnered an overwhelming response from the start-up community. A key cause of concern for the start-up community has been the inefficient tax incentives associated with the Action Plan. Over the years, the Government has rationalized these measures. In this Budget, the FM has proposed to bring the definition of start-up in line with that provided by the Department of Industrial Policy and Promotion ("**DIPP**"). Additionally, considering that the tax incentives were not fully being utilized, the FM has proposed to extend the tax exemption for another 2 years i.e. till March 31, 2021.

Other budget proposals include introduction of a new scheme for assessments. The proposed scheme eliminates interactions between the tax officer and the taxpayer through an e-assessment model which will result in greater transparency and efficiency. The effort seems to in line with the dual aim of 'ease of doing business' and promoting the digital economy.

All in all, the Budget seems rather lacklustre for global investor community as their long standing demands such as clarity over indirect transfer tax, General Anti-Avoidance Rules ("**GAAR**") and reforms for start-up investments have remained unfulfilled.

We have provided below a more comprehensive analysis and further insights on the 2018 Budget proposals. Hope you enjoy reading it. Join us for an interactive Webinar on Tuesday, February 6, 2018 (India time) for insights on India's 2018 Budget.

- Nishith M. Desai

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1. RATIONALIZATION OF CORPORATE TAX RATES

The Finance Bill, 2018 ("**Finance Bill**") provides that the income of companies whose turnover in FY 2016-17 does not exceed INR 2.5 billion (approx. USD 40 million) is to be taxed at the rate of 25% from FY 2017-18. Earlier, only companies with a turnover less than INR 500 million (approx. USD 7.8 million) in FY 2015-16 could avail of the 25% rate. This reduction marks the latest step in the Government's drive to gradually reduce the corporate income tax rate to 25% across the board. The reduction in the corporate tax rate is also in line with a similar trend across the globe. It is hoped that the reduction will provide a fillip to the small and medium enterprises.

Further, the Finance Bill has replaced the Education Cess (2%) and Secondary and Higher Education Cess (1%), with a 'Health and Education Cess' at the rate of 4%. It will be applicable on the sum of income tax and surcharge payable by a taxpayer.

2. TAXATION OF STARTUPS – STILL IN A STATE OF FLUX

The Finance Bill extends the benefit of section 80-IAC to start-ups incorporated on or after April 1, 2019 but before April 1, 2021. Under section 80-IAC, a startup engaged in an eligible business can elect to exempt its income from income tax for any three successive years within a block of seven years commencing from the date of its incorporation. The Finance Bill has also replaced the existing definition of 'eligible business' ("*a business which involves innovation, development, deployment or commercialization of new products, processes or services driven by technology or intellectual property*") with the following: "*a business carried out by an eligible start up engaged in innovation, development or improvement of products or processes or services or a scalable business mode with a high potential of employment generation or wealth creation"*. The new definition is now closer to the definition of a start-up as notified by the DIPP[1] and should allow start-ups which are neither engaged in the development of a new product or process, nor in a business not driven by intellectual property or technology, but nevertheless engaged in a business with high wealth creation and employment generation potential, to claim the benefit of section 80-IAC. However, the start-up will still need to hold a certificate of eligible business from the Inter-Ministerial Board of Certification and have a turnover not exceeding INR 250 million (approx. USD 4 million). While the expansion of the benefit is to be commended, it is also unclear what would constitute high potential of employment generation or wealth creation.

The Government has also done nothing to alleviate the concerns of angel and venture capital investors, whose portfolio startups often receive notices from the tax authorities seeking to characterize growth capital received as income taxable in the hands of the start-up under section 56 (income from other sources) and section 68 (income from undisclosed sources). Start-ups continue to remain subject to the MAT, which makes it difficult for them to avail the benefit of losses carried forward in a meaningful manner.

3. SCOPE OF DIVIDENDS WIDENED

(a) Introduction of anti-avoidance measure

The Government has introduced certain anti-avoidance provisions to capture transactions whereby companies were avoiding the payment of Dividend Distribution Tax ("**DDT**") by way of undertaking schemes of amalgamation along with a reduction of capital to make distributions to shareholders. This could then be viewed as distribution of capital as compared to a distribution of accumulated profits. In order to plug this loophole, the Government has introduced provisions to deem that in case of an amalgamation, the accumulated profits of the amalgamated company shall stand increased by the accumulated profits of the amalgamating company as on the date of amalgamation.

(b) Increase in scope of DDT

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. Further, certain deeming provisions have been included in the ITA to curb tax evasion by closely held companies which distribute accumulated profits in the form of loans or advances to their shareholders instead of dividends in a bid to avoid paying DDT. These loans or advances are deemed to be in the nature of dividends and are brought to tax in the hands of the shareholders at the applicable tax rate and no DDT is payable at the corporate level.[2]

The issue of taxation of such "deemed dividends" has been the subject of substantial litigation. To bring clarity and increase the ease of tax collection, the Budget proposes to bring deemed dividends in the nature of loans or advances to shareholders under the scope of the DDT from April 1, 2018. Such deemed dividends are proposed to be subjected to a higher rate of tax at 30% (without grossing up) as opposed to regular dividends. The challenge as pointed out earlier is that the scope of deemed dividend has itself been a subject matter of substantial litigation. The impact of this provision will be to shift all such litigation to the hands of the company that is providing the loans and advances as compared to the recipient.

Another increase in the scope of DDT has come in the form of the proposal in the Budget to levy a DDT at 10% on any income distributed by equity oriented mutual funds to its unit holders/ investors. This proposal will impact investors in the dividend plans of equity oriented funds and has been made with a view of bringing them on the same level as investors who favour the growth plans of equity oriented funds, the redemption of units of which is also proposed to be subject to a 10% tax as discussed in the next section.

Interestingly, the Indian Economic Survey 2013-14 had 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. Further, the FM himself, in his Budget speech in 2016, had commented that the DDT "*is perceived to distort the fairness and progressive nature of taxes*" as the rationale behind introducing a new tax on dividends in the hands of an identified class of shareholders, i.e., those who receive dividend of more than INR 1 million (approx. USD 15000) in any financial year.[3] However, instead of removing the DDT, the Government seems to be increasing its scope while continuing to levy further taxes on dividends.

Since DDT is a company level tax and not a shareholder level tax, non-resident shareholders of Indian companies often face challenges in availing a tax credit in their respective countries of residence against the tax paid by the Indian company in the form of DDT. In view of the same, this increase in scope of DDT to include deemed dividends may be of some concern to non-resident shareholders.

4. REMOVAL OF LONG TERM CAPITAL GAINS EXEMPTION – SETBACK FOR MARKET PARTICIPANTS

Over the last 3 years, the Indian Government has been re-negotiating Tax Treaties with countries such as Singapore and Mauritius to ensure that the right to tax capital gains comes to country of source, i.e., India and not to country of residence, i.e., Singapore or Mauritius. The Government had also simultaneously reduced the LTCG on unlisted securities to 10% to ensure that foreign investors were not saddled with a high tax liability. An exemption was, however, provided in respect of transactions undertaken on the stock exchange for LTCG and the transactions are only subject to a nominal Securities Transaction Tax ("**STT**"). This was to encourage portfolio investors to access the Indian securities market. With significant movement of stock prices, the Government has realised that it has brought a significant opportunity to bring a wider set of investors into the tax net.

The Finance Bill has proposed a removal of the existing exemption on LTCG arising out of sale of listed equity shares of an Indian company on a stock exchange. The Finance Bill has introduced a new provision (section 112A) to levy a 10% tax on LTCG arising from the transfer listed equity shares, units of an equity oriented mutual fund, or units of a business trust where such gains exceed INR 100,000 (approx. USD 1500). This tax shall be applicable on LTCG arising on or after April 1, 2018.

As a pre-condition for claiming the beneficial tax rate of 10%, the proposal makes it mandatory for STT to have been paid at the time of sale of units, while in respect of LTCG on listed shares, it makes it mandatory for STT to have been paid at the time of acquisition and sale of the share.

Some of the key points in the proposal are as follows –

- ***Indexation and foreign exchange benefit not available***: In order to avail the 10% rate, the proposal denies the benefits under section 48 of the ITA which allow for adjustment of cost of acquisition against inflation in the economy on LTCG, and adjustment of all capital gains against foreign exchange fluctuations to non-residents.
- ***Grandfathering of gains before February 1, 2018***: The Finance Bill provides for a limited grandfathering of gains in respect of listed shares or units acquired by a person before February 1, 2018 and sold after March 31, 2018. In cases where the shares / units were acquired before February 1, 2018, the cost basis in calculating the capital gains will be considered to be the higher of:
    - The actual cost of acquisition; and
    - Fair Market Value ("**FMV**") of the asset or the full value consideration derived upon its transfer, whichever is lower.

  FMV refers to the highest price of the listed share / unit quoted on the exchange on January 31, 2018 or its net asset value as on January 31, 2018, in case of an unlisted unit.

  For example, if a listed share is acquired in December 2016 for INR 100, its highest trading price on January 31, 2018 is INR 120, and it is subsequently sold in April 2018 for INR 140, the cost of acquisition for the purpose of this transaction will be INR 120 and a 10% tax shall be levied on LTCG of INR 20. Accordingly, the difference between the actual cost of acquisition and the trading value on January 31, 2018, are proposed to be grandfathered.

  Since sale of listed shares or units before April 1, 2018 shall be eligible to the existing exemption, it leaves room for arbitrage as investors may decide to either hold on to their existing investments and claim the benefit of step up in cost basis, or sell off those investments before April 1, 2018 to claim the exemption and purchase them back again.

  OOne aspect for FPIs is that while the provision relating to FPIs does not specifically provide for grandfathering, a reading of the FM's speech indicates that the benefit should be extended to all taxpayers, including all FPIs.

- ***STT conundrum**:* Finance Act, 2017 had restricted exemptions on listed shares to only those transactions where STT had been paid also at the time of acquisition of the share. This was introduced as an anti-abuse measure to crack down on black money. Pursuant to several stakeholder representations, the Government last year came out with a notification[4] providing for transactions which would be eligible to the exemption, even though STT had not been paid at the time of acquisition of the shares, such as in case of preferential issue of shares, off-market acquisition of listed shares etc.[5]

  In order to maintain consistency, it is important that the Government notifies the same carve outs for acquisition of listed shares in order for granting the benefit of a 10% tax rate on sale of those shares. In the absence of such carve outs, the transactions listed in the notification would lose the beneficial tax rate of 10% under the proposed section 112A and will be taxable at the prevailing rate of 20%.

- ***Impact on FPIs***: The removal of exemption on LTCG on listed shares would have a significant impact on FPIs investing from Mauritius, Singapore and Cyprus which have been recently deprived of capital gains tax exemptions in light of amendments to these treaties giving India a source based right to tax capital gains. These FPIs have largely been relying on the domestic law LTCG exemption. However, FPIs from countries like France, Netherlands and Belgium may continue to avail treaty benefits on capital gains so long as the shares sold constitute less than 10% of the capital stock of the Indian company.

5. EXPANSION OF BUSINESS CONNECTION (PE TEST): ALIGNMENT WITH MLI

India has been a significant driver of the discussions with the OECD in relation to the BEPS initiative. It had originally proposed and implemented the Equalization Levy ("**EL**") in 2016, only on cross-border online advertising services, followed by the worldwide adoption of the MLI in 2017 based on the BEPS discussions. While significant discussions have taken place with respect to BEPS Action Plan 1 on Taxation of the Digital Economy and a final report slated to be released later this year, the MLI adopted in 2017 has brought into effect amendments to the existing Tax Treaty network with respect to the expansion of the definition of PE. These expansions targeted certain specific situations in relation to commissionaire arrangements and splitting up of contracts to take advantage of the preparatory or auxiliary activities exemption to avoid the creation of the PE in India.

In the above context, it was anticipated that the Indian Government would continue to make changes increasing its ability to tax as a source state with particular focus on the digital economy. The Budget proposes to introduce two changes to the ITA in this regard. The first is to expand the definition of "business connection" to harmonise it with the changes to the Tax Treaties due to the MLI and include situations where a person plays a principal role in the conclusion of contracts in India. Earlier, only if the person in India habitually concluded contracts was the business connection test attracted and did not expressly cover situations where the agent in India played a significant role in negotiating or procuring the contract.

After the introduction of this change, if the non-resident is significantly assisted by the agent in India in either negotiating and concluding contracts in the name of the non-resident or if the contract entered into relates to services provided by the non-resident, or relates to the transfer of property (including intellectual property), or permits the use of property, then that would result in the creation of a business connection, thereby forming the requisite nexus under the ITA to tax such transactions. This would result in situations such as having a sub-advisor entity in India in private equity transactions negotiating contracts in India for sale of securities held by a non-resident or a support services entity engaged in marketing of goods or services of the non-resident also coming within the Indian tax net. Without this expansion, it may not have been possible to tax such transactions despite changes in the Tax Treaty network as the more beneficial provisions under the ITA would have been applied in accordance with Section 90 of the ITA.

With respect to the digital economy, the Government has introduced the new concept of significant economic presence (SEP). Since traditionally under Tax Treaties, sufficient physical presence was required for a transaction to be taxable in India and the domestic requirements to form a sufficient taxable nexus or business connection mirrored the provisions under the Tax Treaties, many cross border transactions in the digital economy went untaxed. The changes in the ITA expand the definition of business connection such that a non-resident would be deemed to have a SEP in India if it carries out any of the following:

1. transaction in respect of any goods in India above a specified value, including digital goods; or
2. transaction in respect of any services in India above a specified value, including digital services; or
3. transaction in respect of any property in India above a specified value, including download of data or software; or
4. systematic and continuous solicitation of business from India from prescribed number of users through digital means; or
5. systematic and continuous engagement with prescribed number of users through digital means.

Note: the specified value would be on an aggregate basis and based on the value of a single transaction.

While it appears that the intention was to target digital services and provision of digital goods primarily, it would seem that the language is broad enough to cover other activities as well. For instance, if a non-resident service provider provides services to an Indian customer above a specified value (in aggregate), then even if it is a non-digital service it could still form a business connection. However, the Government has fairly conceded that unless Tax Treaties are modified to allow the imposition of tax pursuant to the formation of a business connection, the beneficial provisions under the Tax Treaty shall prevail and such transactions shall remain non-taxable.

Further, it is significant that despite many European countries considering the implementation of a variant of the EL, India has chosen not to expand either the scope of EL or the rate of EL in the Budget. It is also to be commended that the Government has stated that the thresholds for the specified value and number of users would be in consultation with the stakeholders which marks a different approach when compared with the manner in which the EL was introduced without adequate stakeholder consultation. The non-expansion of the scope of EL and the expansion of the domestic definition of business connection show that the Government is putting faith in the international discussions being undertaken on the taxation of the digital economy by not taking drastic unilateral actions inconsistent with international practice.

6. MEASURES TO FACILITATE INSOLVENCY RESOLUTION

(a) Benefit of carry forward and set off of losses

With a view to facilitate an effective insolvency resolution, the Budget has exempted private companies undergoing insolvency resolution under the IBC from the applicability of section 79 of the ITA, in respect of carry forward and set off of accumulated losses in the books of the company.

Section 79 of the ITA restricts the ability of a closely held company to carry forward its losses for set off against income earned in future, where there is a substantial change in its shareholding. Essentially, shareholders of the company at the end of the FY in which the loss was incurred must own at least 51% of the shares in that company in the year that the carried forward loss is claimed as a deduction; otherwise, the company loses the ability to carry forward the loss.

As a measure of promoting effective restructuring and rehabilitation of such companies, with effect from April 1, 2018, the Budget proposes to exclude the applicability of section 79 of the ITA in the case of companies where a change in shareholding takes place pursuant to a resolution plan being approved under the IBC, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner, or Commissioner, of Income Tax.

This is a welcome change and will go a long way in ensuring that companies undergoing insolvency are able to turn around their fortunes and chart a path to future profitability without the burden of additional tax hurdles to be overcome.

(b) Relief from MAT liability

Section 115JB of the ITA provides for the levy of MAT at 18.5% on the book profits of a company where the tax payable by the company on its total income is less than 18.5% of its book profit. The existing provisions of Section 115JB provide for the book profit of the company to be computed net of the amount of loss brought forward, *or* the unabsorbed depreciation, whichever is less as per the books of account of the company. The Explanation to Section 115JB further stated that the deduction would not be available where either the amount of loss brought forward, or the unabsorbed depreciation was nil.

On January 6, 2018, the CBDT issued a press release[6] regarding the computation of book profit under Section 115JB in the case of companies undergoing insolvency resolution. With a view to minimize the genuine hardship faced by such companies, the CBDT clarified that with effect from Assessment Year ("**AY**") 2017-18, for the purposes of levy of MAT on companies against whom an application for corporate insolvency resolution had been admitted under Sections 7, 9, or 10 of the IBC by the National Company Law Tribunal ("**NCLT**"), the total loss brought forward *including* unabsorbed depreciation would be allowed as a reduction from its book profit. However, no corresponding amendments were made in the ITA in order to operationalize this relaxation, thereby resulting in ambiguity in the formal availability of the revised deduction.

The Budget now proposes to operationalize this relaxation by inserting clause (iig) in Explanation 1 to Section 115JB, which allows the aggregate amount of unabsorbed depreciation and loss brought forward to be reduced from the company's book profit in computing its MAT liability, in situations where an application for insolvency resolution under the Sections 7, 9, or 10 of the IBC has been admitted against it by the NCLT. By inserting a specific provision in this regard, the Budget also clarifies that the relaxation should be available irrespective of whether the amount of brought forward losses, or unabsorbed depreciation is nil.

It should be also noted that the proposed relaxation only applies to companies undergoing insolvency resolution, and not to companies opting for voluntary liquidation under the IBC. The relaxation also does not apply to companies undergoing insolvency resolution through alternative methods of resolution such as the Strategic Debt Restructuring scheme or the Scheme for Sustainable Structuring of Stressed Assets. It remains unclear why the benefit of relaxation has not been extended such other resolution methods.

7. INCENTIVES FOR INTERNATIONAL FINANCIAL SERVICE CENTERS (IFSC)

In keeping with the Government's intention to give an impetus to IFSCs (which includes GIFT City), the Budget has provided certain incentives this time around as well. The Budget Speech recognised the need for a coherent and integrated regulatory framework for IFSCs to be able to compete with offshore financial centres. In the Budget Speech, the FM has declared that the Government will establish a unified authority for regulating all financial services in IFSCs. This is a welcome move. At present, different regulators such as SEBI, RBI, and IRDA have evolved specific regulations for IFSCs. However, many measures stopped short of reaching the intended effect due to lack of jurisdiction on the part of different regulators to be able to meet business expectations on a holistic basis. A unified regulator for IFSCs should provide for more effective and efficient decision making, improve ease of doing business and enhance the competitiveness of IFSCs vis-à-vis other offshore financial centres. It is also in keeping with international practices e.g. Dubai Financial Services Authority for Dubai International Financial Centre.

Apart from the big ticket announcement on a unified regulator, the Budget has also proposed an amendment to section 47 of the ITA to exempt from taxation, gains arising to a non-resident from the transfer of foreign currency bonds, GDRs, rupee denominated bonds of Indian companies and derivatives (which includes futures and options) where the consideration for the transaction is paid or payable in foreign currency.

The Finance Bill has proposed to impose tax at a concessional rate of 10% on LTCG arising from transfer of listed assets being equity shares, units of equity oriented funds or units of business trusts as long as (among other conditions) STT has been paid. However, the Finance Bill has created a carve-out from the requirement to pay STT for such transactions undertaken on a recognised stock exchange in IFSC where the consideration is received or receivable in foreign currency.

The above measures should be welcomed since they enhance the competitiveness of IFSCs and are essential to achieve the Government's objectives of putting them on par with leading international financial centres.

8. COUNTRY BY COUNTRY REPORTING – MOVING TOWARDS GLOBAL HARMONISATION

BEPS Action Plan 13 recognised the need to develop robust rules for country-by-country reporting ("**CbCR**") by Multinational Enterprises ("**MNE**") to enhance transparency for tax administrations. As part of aligning Indian tax laws with the BEPS Action Plans, Finance Act, 2016 introduced section 286 in the ITA to provide for CbCR by Indian entities belonging to international groups.

In an attempt to further standardize the format for the Indian leg of CbCR and to bring it in line with BEPS Action Plans, the Finance Bill proposes the following amendments to section 286 –

- ***Timelines for furnishing the report***: The timeline for furnishing a country-by-country report ("**CbC Report**") is proposed to be extended to 12 months from end of the relevant accounting period from the earlier timeline of 4-6 months from the end of the relevant accounting period.
- ***Reporting requirement on Indian constituent entity not being parent/alternate reporting entity***: As per the existing laws, the requirement to undertake CbCR is on Indian constituents of an international group only if they are the parent/ designated alternate reporting entity of the international group. However, the Finance Bill has proposed that even Indian constituents of an international group not being the parent/alternate reporting entity shall file a CbC Report if its non-resident parent has no obligation to file a CbC Report in its country of residence.
- ***Definitions***: The definition of 'Agreement' has been amended to include agreement for exchange of CbC Report as may be notified by the Central Government, in addition to tax treaties. Further, the definition of 'Reporting Accounting Year' has been amended to mean accounting year in respect of which financial and operational results are required to be reflected in the CbC Report to be furnished under the relevant provisions of the ITA.

The abovementioned amendments, which are retrospectively effective from AY 2017-18 onwards, are a welcome move as they intend to achieve global uniformity in terms of CbCR. From a compliance standpoint, the extension of timelines is likely to bring about much needed relief for reporting Indian constituent entities. Further, the introduction of mandatory reporting requirements on Indian constituent entities not being parent/alternate reporting entity in cases where the non-resident parent entity has no obligation to do CbCR in its home jurisdiction would be viewed as a welcome step by the global community, as it tries to fill in gaps in such reporting due to inadequate laws in other jurisdictions. Having said that, the reporting obligations (in terms of volume and procedures) continue to remain burdensome and proactive steps by the Government to simplify the reporting would be much appreciated by the MNEs with substantial presence in India.

9. TAX RELIEF FOR PARENT - SUBSIDIARY TRANSFERS

With a view to provide relief to entities transferring property to their holding companies or wholly owned subsidiaries, the Finance Bill proposes to amend section 56 of the ITA so as to exclude such transfers from its ambit.

Section 56 of the ITA brings to tax, receipt of property without consideration or for inadequate consideration as 'income from other sources'. Several transactions are however exempted from the application of these provisions, including certain transfers which are not subject to capital gains taxation as provided under section 47 of the ITA.

While transfers of capital assets between parent companies and its wholly owned subsidiaries, in cases where the recipients of the assets are Indian companies, are treated as exempt transfers under section 47 for the purpose of capital gains tax, these transfers are not excluded from the ambit of section 56. Thus, these transactions could nevertheless be caught under the residuary head of income tax under section 56, in cases where the consideration paid was below the FMV of the property. In order to facilitate such parent-subsidiary transfers, the Finance Bill proposes to exclude these transactions from the ambit of section 56, thereby making them exempt under both heads of income.

This amendment would provide much needed relief to entities which, due to the nature of their relationship, transact by transferring property at less than FMV. Further, internal restructurings involving a sale of shares within the group, will now be exempted from tax under the head income from other sources. This has effectively brought the position of such transfers at par with the exemptions provided for amalgamations and demergers under section 56.

- International Tax Team

You can direct your queries or comments to the authors

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1 Notification GSR 180(E) dated February 17, 2016

2 Please refer to Section 2(22)(e) of the ITA.

3 Please refer to Paragraph 147 of the Union Budget 2016-17 Speech by Finance Minister, Arun Jaitley.

4 Notification No. 43 of 2017 dated June 5, 2017.

5 Please find our detailed analysis of the notification at http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/cbdt-notifies-transactions-which-can-avail-exemption-from-capital-gains-much-awaited-relief.html?no_cache=1&cHash=d44366b1864b868997fb5424a36acd7d

6 http://www.incometaxindia.gov.in/news/press-release-relaxation-provisions-relating-levy-mat-8-1-2018.pdf

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