

Pre budget presentation -
Direct Taxes
7 December 2017

Corporate and International tax

Reduction in Corporate Tax rates

Budget 2015



The Finance Minister had announced reduction in corporate tax rate from 30% to 25% over the next 4 years

Budget 2016



- Lowered the base corporate tax rate to 29% for domestic companies having turnover upto INR 5 crores in Financial Year ("FY") 2014-15
- Concessional tax rate of 25% introduced for new manufacturing companies not availing prescribed deductions
- Rolled out detailed roadmap for phase out of tax exemptions /incentives (for instance, withdrawal of certain chapter VI-A deductions, weighted deduction under section 35 and providing cap on depreciation at 40%)

Budget 2017



Lowered the base corporate tax rate to 25% for domestic companies having turnover upto INR 50 crores in FY 2015-16

Impacting ease of doing business



Fluctuating tax rates on a year-to-year basis are leading to uncertainty and impacting ease of doing business for corporates while drawing up their business plans /customer contracts

Recommendations

- Tax rate may be reduced for all domestic companies in line with Budget 2015 announcement
- Tax rates for foreign companies may also be correspondingly reduced
- Reduced tax rates should also be made applicable to firms including Limited Liability Partnerships

Minimum Alternate Tax ("MAT")

Background and Issue

- MAT based on book profits currently covers certain incomes which are subject to a specific tax regime (lower rate of tax) under the Income-tax Act, 1961 ("Act") for instance –
 - Short Term Capital Gains on sale of Securities Transaction Tax ("STT") paid listed equity shares are taxed at 15% under section 111A, whereas Long Term Capital Gains on sale of such shares is exempt under section 10(38) of the Act
 - Foreign dividend received from Associated Enterprises ("AEs") are taxed at 15% under section 115BBD of the Act
- The rate of tax prescribed for such incomes is lower than the effective rate of MAT. Thus, levy of MAT on such incomes renders the specific tax rate provided under the Act ineffective
- Royalty received in respect of patents developed and registered in India is taxed at 10% under section 115BBF of the Act and has been excluded from provisions of MAT

Recommendation

- It is recommended that similar to royalty income from patents under section 115BBF, capital gains on STT paid listed equity shares and dividend income under section 115BBD may also be excluded from the provisions of MAT

Carry forward and set off of losses in case of change in beneficial shareholding – section 79 of the Act

Background and Issue

- As per provisions of section 79 of the Act, brought forward losses of a closely held company are not allowed to be carried forward and set off if there is a change in beneficial shareholding of the company of more than 49%
- The intent behind introduction of section 79 was to address 'sale of losses' to third parties
- Such provisions should not apply to internal group reorganizations where the majority ownership remains with the same ultimate parent entity

Recommendation

- Section 79 may be amended to specifically exclude internal group reorganizations where majority ownership remains with the same ultimate parent entity

Limitation on interest deduction – section 94B of the Act

Background and Issue

- Section 94B of the Act lays down a cap on interest deductible by an Indian company on debt raised from its non-resident AE. Banking and Insurance companies have been excluded from the ambit of this section
- Limiting the deduction on interest will impact capital intensive businesses with long gestation periods, such as companies engaged in infrastructure and energy sectors which are generally highly leveraged due to commercial imperatives
- In case where debt is raised from a third party lender (including resident lenders), but an implicit /explicit guarantee is provided by an AE, the debt is deemed to be raised from such AE. Such guarantee from the parent /group company is generally a pre-requisite for third party loan arrangements, such as project finance lending by banks

Recommendations

- Exclusion from section 94B may be extended to Non Banking Financial Companies (NBFCs) and companies engaged in infrastructure and energy sector
- The scope of section 94B may be narrowed to exclude debt raised through an implicit /explicit guarantee from the AE

Secondment of employees

Background and Issue

- India is the world leader in hosting Global In-house Centres (“GICs”) set up by Multinational Enterprises (“MNEs”), which provide employment to India’s skilled manpower besides earning foreign exchange for the country
- While setting up and operating these GICs, the MNEs depute employees on secondment to the GICs as a part of the business model to set up and supervise certain operations. Taxes on salary of such employees are withheld and deposited in India
- However, issues regarding their ‘legal employer’ create a Permanent Establishment (PE) risk for the parent company. Also, in cases where a portion of the salary is deposited by the parent company in the employees’ foreign bank account (for administrative convenience, e.g. social security payments), reimbursement of salary by the Indian company may be held to be Fee for Technical Services (“FTS”)

Recommendation

- In order to make India’s GIC regime more business friendly, it is suggested that suitable ring-fencing or safe harbor be provided for such secondment arrangements

Foreign companies earning passive income – Compliance requirements

Background and Issue

- Section 115A(5) of the Act exempts foreign companies earning income only in the nature of dividend and interest [as specified in section 115A(1)(a)] from filing a return of income provided appropriate tax has been withheld
- However, similar exemption from filing a return of income is not available for foreign companies earning income only in the nature of royalty and FTS [as specified under section 115A(1)(b)] even if appropriate tax withholding has been undertaken

Recommendation

- It is recommended that a similar exemption from filing of return of income should be extended to foreign companies earning income only in the nature of royalty and FTS [taxable under section 115A(1)(b) of the Act] provided taxes have been duly withheld on such receipts

Penalty provisions – section 270A of the Act

Background and Issue

- As per section 270A, taxpayers who have under-reported their income may be directed to pay penalty (in addition to tax payable, if any) equivalent to 50% of 'tax payable on under-reported income'. In case, under-reporting is in consequence of misreporting, penalty of 200% may be levied
- While determining amount of 'tax payable on under-reported' income in case of non-furnishing of return of income, a reduction of taxes already deposited by way of advance tax, Tax Deducted at Source ("TDS"), Tax Collected at Source ("TCS"), etc. is not allowed. In the erstwhile penalty provisions, Explanation 4 to section 271(1)(c) explicitly provided for such reduction
- This may lead to situations where a penalty may be computed despite entire taxes having been already deposited by the taxpayer. For instance, in cases where foreign companies have not furnished a return of income, penalty may be computed under section 270A although entire taxes are already deposited by way of TDS

Recommendation

- It is recommended that section 270A be amended to provide for reduction of taxes already deposited by way of advance tax, TDS, TCS, etc. while computing 'tax payable on under-reported' in cases where a return of income has not been furnished

Carry forward and set off of losses and unabsorbed depreciation in amalgamation - section 72A of the Act

Background and Issue

- Under the existing provisions of section 72A of the Act, the benefit of carry forward of losses and unabsorbed depreciation is allowed in cases of amalgamation of a company owning an industrial undertaking, with another company
- The current provisions do not cover companies engaged in the service sector (i.e. not owning an industrial undertaking). Thus, the benefit of carry forward of losses and unabsorbed depreciation of the amalgamating company is not available to such companies

Recommendation

- It is recommended that the benefit under section 72A to carry forward accumulated losses and unabsorbed depreciation of amalgamating company should be extended to all companies (including companies engaged in the service sector)

Patent box regime - section 115BBF of the Act

Background and Issue

- Section 115BBF provides for concessional tax rate for royalty income in respect of patents developed and registered in India
- However, there is some ambiguity with respect to applicability of section 115BBF in cases where the patent developed and registered in India is also registered overseas for the purpose of exploitation

Recommendation

- It may be clarified that royalty received from overseas for a patent developed and registered both in India and abroad qualifies for the concessional rate of tax under section 115BBF

Thank you

