# INDIA ANNOUNCES AMBITIOUS BUDGET FOR 2015–16

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The Indian Finance Minister presented the *Budget for 2015-16* and the *Finance Bill, 2015* in Parliament on February 28, 2015. These measures include, among other policy announcements, proposed amendments to the tax law.

In the run up to the budget, a revival of the Indian economy together with a plunge in crude oil prices have resulted in a conducive environment for a budget to promote economic growth. Real G.D.P. growth for fiscal year 2015-16 is expected to be about 8.5%. Consumer Price Inflation ("C.P.I.") is currently at 5.1%, while Wholesale Price Inflation ("W.P.I.") is negative. The Current Account Deficit ("C.A.D.") is expected to fall below 1.3% of G.D.P. The Finance Minister has set a target fiscal deficit of 3.9% for fiscal year 2015-16, 3.5% for fiscal year 2016-17, and 3% for fiscal year 2017-18.

Set against this background, the *Budget for 2015-16* is a realistic budget and bold on policy reforms. This budget is a growth-oriented budget with regard to every section of society and attempts to strike a balance between growth, inclusiveness, and fiscal discipline.

This article analyses some of the key proposals of the *Finance Bill, 2015*.

## POLICY ANNOUNCEMENTS

- To facilitate ease of doing business in India, and with a view to integrate services of all Central Indian Government departments and ministries, 14 regulatory permissions have been integrated on a single e-biz portal.
- It is also proposed to appoint an Expert Committee to examine the possibility of replacing the current need for multiple prior permissions with a pre-existing regulatory mechanism and to prepare draft legislation to that effect.
- Suggestions regarding the Indian Financial Code ("I.F.C.") are currently being reviewed, and the Finance Minister is hopeful that the I.F.C. will soon be introduced in Parliament for consideration.
- It is proposed to introduce tax-free infrastructure bonds for projects in rail, road, and irrigation sectors.
- It is proposed to revitalize the Public Private Partnership mode of infrastructure development with sovereign risk.
- It is proposed to set up five new Ultra Mega Power Projects, of 4,000 megawatts each, in the "plug and play mode" and to consider similar plug and play projects in other infrastructure areas such as roads, ports, rail lines, airports, etc.

- In line with the Indian Government's commitment to repatriate funds legitimately belonging to the country, it is proposed to enact a comprehensive law on black money, which will specifically deal with offshore holdings.

## DIRECT TAX PROPOSALS

### General Anti-Avoidance Rule ("G.A.A.R.")

- Provisions in respect of G.A.A.R. were previously introduced in Indian tax law, effective April 1, 2013. Due to various uncertainties within the provisions and the possibility for abuse by tax authorities, the provisions have faced considerable criticism. A committee was therefore appointed by the Indian Government to review these provisions. Based on the recommendations of this committee in 2013, the implementation of G.A.A.R. was deferred until April 1, 2015.
- In the current budget, it is proposed that G.A.A.R. will be deferred for an additional two years, *i.e.*, G.A.A.R. will come into force prospectively beginning April 1, 2017. Investments made up to March 31, 2017 are proposed to be protected from the applicability of G.A.A.R.
- Further, in view of the fact that India is an active participant in the O.E.C.D.'s Base Erosion and Profit Shifting ("B.E.P.S.") project and the report on various measures to counter B.E.P.S. is forthcoming, it would be appropriate to implement G.A.A.R. as part of a far-reaching regime, in line with global practices, that addresses B.E.P.S. and tax avoidance.
- This proposal is a step in the right direction with regard to boosting investment in Indian. It will also provide additional time for the Income Tax department to train tax officers and announce a clear set of rules for enforcing G.A.A.R. provisions.

### Direct Taxes Code ("D.T.C.")

- The D.T.C. was introduced in Parliament in 2010, to replace existing tax law. The D.T.C. contained some onerous provisions and therefore, after various representations, went through revision.
- It is now proposed to forego enactment of the D.T.C., as most of its provisions have already been included in the current law and jurisprudence under Indian tax law is well evolved.
- This proposal is a welcome step toward fostering investment into India.

### Corporate Tax Rate

- The Wealth Tax Act has been abolished as of April 1, 2015. To offset the loss in revenue, the surcharge tax rate is increased by 2% for all taxpayers (other than foreign companies) whose income exceeds ₹10 million. However, the tax rate for foreign companies will remain unchanged.
- It is also proposed to reduce the corporate tax rate from the present 30% to 25% over the next four years, beginning from fiscal year 2016-17, with the objective of bringing the rate, more or less, on par with that of other major

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Asian economies. Consequentially, it is also proposed to remove various tax exemptions and incentives available to corporate taxpayers in a phased manner. This is intended to reduce tax litigation and disputes.

**<u>Provisions Relating to the Source Rule</u>**

- Under the current tax law, a foreign company is considered to be a tax resident in India if control and management of its affairs is wholly situated in India during the year.
- Under the existing law, it is, therefore, possible for foreign companies to avoid becoming resident in India through minor actions, such as holding a single board meeting outside of India.
- It is now proposed to amend this provision and to introduce the concept of Place of Effective Management ("P.O.E.M."). It is proposed that a company will be considered a tax resident of India if at any time during the relevant year its P.O.E.M. is in India. This amendment is expected to target shell or conduit companies, which are incorporated outside of India but are effectively controlled from within the country.
- Furthermore, lack of clarity in the proposed definition of the P.O.E.M. is likely to give rise to significant litigation.
- This provision could act as a disincentive for foreign companies wishing to invest into India and could be a stumbling block to the Prime Minister's flagship "Make in India" campaign. *E.g.*, a foreign company considering investment in India and holding a meeting of Board of Directors in India (prior to investing), runs the risk of having its global income subject to tax in India.

**<u>Indirect Transfers</u>**

- As a consequence of the controversy surrounding the Vodafone judgment, a retrospective amendment was made to Indian tax law in the year 2012. As per this amendment, any share or interest in an entity registered outside of India is deemed to be situated in India if the share or interest substantially derives its value, either directly or indirectly, from assets located in India, thereby making such transfers taxable in India.
- This provision contained several ambiguities and generated considerable furore among the investor community. Consequently, a committee was set up by the Indian Government to review this provision.
- It is proposed to make various amendments to the tax law after considering the recommendations of this committee. Some of the key amendments are as follows:
    - "Assets" include both tangible and intangible assets located in India;
    - "Substantial value" of Indian assets has been defined as an amount exceeding ₹100 million (U.S. $1.584 Million as of March 13, 2015) and representing at least 50% of the value of the total assets owned by the company or entity on the specified date; and
    - Taxation of gains arising on indirect transfer will be on a *pro-rata* basis.

- It is interesting to note that the provision to tax indirect transfers was introduced to the tax law retrospectively, beginning April 1, 1961. However, the proposed amendment clarifying the taxation of "indirect transfers" will come into effect prospectively, beginning April 1, 2015.

## Taxability of Interest Paid by the Permanent Establishment of a Bank to a Non-Resident Outside India

- In the past, taxability of interest paid by a Permanent Establishment ("P.E.") of a bank to a head office or any other branch outside of India was the subject matter of litigation.
- Interest expense incurred by a P.E. of a banking company was not subject to withholding tax provisions in India, as per several judicial decisions; however, the interest paid was allowed as a deduction in computing the profits of the P.E. in India. Such interest was not chargeable to tax in the hands of the recipient outside India, effectively constituting a "double dip" situation.
- To remedy this situation, it is proposed that in the case of a non-resident engaged in the business of banking, any interest payable by the Indian P.E. of such non-resident to the head office or any other branch outside of India would be chargeable to tax in the hands of the recipient, because the P.E. would be deemed to be a person independent of the non-resident.
- Such interest would also be subject to withholding tax at the rates in force, and any failure to withhold would result in disallowance of the expenditure for the P.E. in India and would attract interest and penalty.

*"The proposed amendment clarifying the taxation of 'indirect transfers' will come into effect prospectively, beginning April 1, 2015."*

## Incentives to Fund Managers of Offshore Funds

- In order to encourage fund management activities in India, a specific tax regime has been proposed.
- The regime provides that, subject to specified conditions, in the case of an eligible investment, fund management activity carried out through an eligible fund manager on Indian soil acting on behalf of such a fund, will not constitute a business connection in India.
- In view of the above, the eligible investment fund will not be considered to be a tax resident of India merely on the basis of the location of such fund manager in India.

## Taxation of Alternative Investment Funds ("A.I.F.'s")

- A special tax regime is proposed to be introduced to rationalize the taxation of Category I and Category II A.I.F.'s ("Investment Fund"/"Fund"). This amendment will help garner funds from local High Net worth Individuals ("H.N.I.'s") into these Funds.
- Under this regime, all investment income earned by the Fund would be taxable in the hands of its unit holders or investors of the Fund, while the business income of such Fund will be taxed in the hands of the Fund.
- Due to these amendments, a Fund will be a "translucent structure" *viz.* partly transparent and pass-through with regard to certain income and partly opaque with regard to non-pass-through business income.

**Taxation Regime for Real Estate Investment Trusts ("R.E.I.T.'s") and Infrastructure Investment Trusts ("Inv.I.T.'s")**

- A special taxation regime was introduced in the previous budget in respect of two new investment vehicles, R.E.I.T.'s and Inv.I.T.'s ("business trusts").
- It is now proposed to tax the capital gains arising to a sponsor on the transfer of units in the business trust, acquired in exchange for shares in the Special Purpose Vehicle ("S.P.V."), in the same manner in which the transfer of units is taxed in the hands of other unit holders. Earlier, the tax treatment of such capital gains was akin to that of unlisted shares.
- This proposal is expected to remove the disadvantage faced by the sponsor on account of capital gains tax arising at the time of transfer of such (listed) units of the business trust, as against a situation where the sponsor had opted to exit through an Initial Public Offer ("I.P.O.").
- It is also proposed to extend the tax pass-through status to rental income received by a R.E.I.T. from assets owned directly by it. However, rental income received from assets held by the R.E.I.T. through an S.P.V. will continue to be taxed at the maximum marginal rate.

**Rate of Tax on Royalties and Fees for Technical Services**

- It is proposed to reduce the rate of tax on royalties and fees for technical services payable to nonresidents from the existing 25% to 10%, provided that such royalties or fees are not effectively connected with the P.E., if any, of a nonresident in India.

## INDIRECT TAX PROPOSALS

**Goods and Services Tax ("G.S.T.")**

- It is proposed that a modern indirect tax regime is put in place by way of a unified G.S.T., which is to be rolled out by April 1, 2016.

**Service Tax**

- It is proposed to increase the rate of Service Tax to 14% after subsuming the Education cess and Secondary and higher education cess, which will come into effect on a date that is yet to be notified.

## IN SUMMARY

Overall, the budget statement is indicative that the Indian Government is making a sincere attempt to establish a non-adversarial, stable, certain, and simplified tax regime, conducive to encouraging investment, including foreign investment. However, the *Budget for 2015-16* is only the first step in a long and arduous journey towards achieving sustainable growth. Budget proposals alone are not sufficient to address the various economic problems and need to be followed up with strong execution.