INDIAN M.A.T. EXEMPTION

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Following months of debate, the Indian Finance Ministry clarified late this September that the Minimum Alternate Tax ("M.A.T.") will not apply to foreign companies that do not have a permanent establishment and/or place of business in India.

FOREIGN DIRECT INVESTMENT

Foreign investment was limited in India until economic reforms took place in 1991. This stimulated foreign direct investment in the country, as newer policies provided automatic approval for projects with foreign equity participations that could be as great as 51% for investments in certain locations. Foreign direct investment is undertaken in line with government policies. Foreign companies now have several choices of entity to carry out operations in India. The choice of entity determines whether the company will be allowed to have a direct presence in the country and the tax rules it will be applicable. Investment incentives are designed to channel investments towards specific industries, such as infrastructure and exports.

CORPORATE TAXATION

Shibani Bakshi is a Tax Manager with JMP Advisors Pvt. Ltd. She has 12 years of experience in international and domestic tax.

Shibani has assisted various corporates on advisory, compliance and litigation assignments in relation to international tax and domestic taxation. Shibani has represented clients before various income tax authorities for assessments and for obtaining withholding tax orders for companies, as well as first level appellate authorities for appeals. She has assisted partners and tax counsels in representation before the second level appellate authorities.

The right to impose tax in India is divided between the central government and the state governments. The central government taxes income while the state governments impose sales taxes and stamp duties, historically known as non-income taxes. The Income-tax Act, 1961 mandates that a resident of India is liable to pay tax on worldwide income, while a nonresident is liable to tax only on (i) income actually received or deemed to be received in India or (ii) any income accruing or arising, or deemed to accrue or arise, in India.[1]

A domestic company is taxed at a rate of 30% and a foreign company at 40%, plus an education cess[2] in each case. In addition, where the taxable income exceeds certain amounts, a surcharge is levied on the amount of income tax at a rate of 7% or 12% in the case of a domestic company and 2% or 5% in the case of a foreign company.

A company is considered to be a resident of India if it is incorporated in India or its place of effective management is in India. A foreign company is generally not considered to be a resident in India. Nonresident entities are liable to tax on income received in India, accruing or arising in India, or deemed to accrue or arise in India;

[1] Income-tax Act, 1961, Section 5.

[2] The term "cess" generally means a small surcharge to fund education.

this includes income from business assets, capital gains, interest, royalties, and technical service fees.[3]

The tax imposed on a nonresident is collected through withholding at the source at the time of payment of royalties, fees for technical services, or any other amount chargeable to tax in India. Foreign taxpayers claiming tax treaty benefits are required to provide tax residency certificates attesting to their foreign residency. Globally, India has tax treaties and trade agreements in place with many countries. These agreements attempt to prevent double taxation, allow for more beneficial treatment of nonresidents in certain cases, ensure protection of investors, and encourage trade through the regulation of duties and tariffs.

M.A.T.

M.A.T. was enacted in India in the 1980's with the intention of targeting companies that showed book profits and declared dividends but paid little or no tax. In that regard, its purpose is similar to the Alternative Minimum Tax in the U.S. M.A.T. applies when the income tax payable by a company on its taxable profits in India is less than the minimum tax payable on the book profits, computed as specified. Currently, M.A.T. is payable at 18.5% plus a surcharge and educational cess, mentioned above. Typically, the tax was intended to be levied on Indian companies that were suppressing profits. Therefore, foreign investors claimed to be exempt from this tax in the absence of a permanent establishment in India and believed that M.A.T. only applied to those Indian companies that were required to prepare books of account, as specified in the law.

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This approach came into question earlier this year when an amendment to the tax law was adopted, which exempted Foreign Institutional Investors ("F.I.I.'s") from the imposition of M.A.T. on income generated from trading in securities on the stock exchange. This amendment was made with effect from April 1, 2015. In typical regulatory fashion the tax authorities in India announced that if an exemption was mandated by a change in law, F.I.I.'s were taxable prior to the effective date of the law change. The Revenue sent tax demand notices to hundreds of F.I.I.'s and Foreign Portfolio Investors ("F.P.I.'s") contending that they were liable to pay M.A.T. for prior years.

In this scenario, it is pertinent to note that the issue M.A.T.'s application to F.I.I.'s, F.P.I.'s, and foreign companies has been addressed in various cases, with inconsistent results. Some judicial authorities ruled in favor of the taxpayer and others in favor of the Revenue. However, a ruling in 2012 held that M.A.T. was payable by foreign companies.

This led to an uproar among foreign investors and several representations were made to the Revenue. To take cognizance of this issue, a three-member committee was formed under a retired Chief Justice to decide the issue.

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[3] Income-tax Act, 1961, Section 9(1).

The committee issued a report recommending that M.A.T. should not be made applicable to F.I.I.'s and F.P.I.'s that did not have a taxable presence in India. Based on the recommendations of this committee, a clarification was issued by the Finance Ministry that an appropriate amendment would be carried out in the law to provide that M.A.T. provisions will not be applicable to F.I.I.'s and F.P.I.'s not having a place of business and/or permanent establishment in India for the period prior to April 1, 2015.

"A permanent establishment may be triggered in India if the activities performed by the foreign company result in a taxable presence."

Subsequently, the Finance Ministry issued a press release to clarify that, as of April 1, 2001, M.A.T. provisions will not apply to a foreign company that does not have a permanent establishment in India, in accordance with an applicable treaty, or a place of business in India, if no treaty is applicable.

A permanent establishment may be triggered in India if the activities performed by the foreign company result in a taxable presence. A permanent establishment may exist in any of several circumstances:

- The foreign company has a fixed place of business through which its business is wholly or partly carried out.
- The employees of the foreign company or its dependent agents render services in India exceeding a certain time period.
- The officers or agents in India negotiate and conclude contracts, generating revenue, or performing core business activities similar to those of the overseas head office.

A permanent establishment shows that the foreign company is doing business and generating revenue from Indian sources. A foreign company wishing to avoid being subject to the M.A.T. will be required to limit its operations that take place within India so as to avoid establishing a permanent establishment or fixed place of business. It is understood that Indian revenue authorities are contacting foreign corporationss to inquire whether a place of business exists in India that might be considered a permanent establishment.

CONCLUSION

This exemption is an affirmation of India's positive attitude towards foreign investment. Despite the opportunity to levy a tax on foreign companies, the Indian government has decided to grant a conditional reprieve in the interest of encouraging foreign direct investment. There is some discussion on whether or not the press release would be a sufficient basis to exempt foreign companies from M.A.T. until such time that a legislative amendment is made.