INDIA BUDGET 2018-19

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Tags
Budget
Business Connection
Capital Gains
India
Investment Activity
Tax Policy

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INTRODUCTION

All eyes were set on the Indian Finance Minister on February 1, 2018, as he unveiled the Union Budget for 2018-19 ("Budget 2018-19"). In addition to its several important direct tax proposals, Budget 2018-19 is notable as the last full budget before the 2019 Parliamentary elections and the first budget following the implementation of the landmark Goods and Services Tax ("G.S.T.") regime. Along with proposed amendments to the tax law, Budget 2018-19 also included key economic data from the annual economic survey and policy proposals.

DIRECT TAX

The direct tax proposals discussed below are effective from financial year ("F.Y.") 2018-19 (*i.e.*, April 1, 2018, to March 31, 2019). These provisions will be introduced in the Income-Tax Act, 1961 (the "Act") and, consequently, afforded legal authority.

Tax Rates

The basic tax rate for foreign companies remains unchanged at 40%. However, for domestic companies, the corporate tax rate will be reduced to 25%, if the turnover or gross receipts of such companies in F.Y. 2016-17 does not exceed I.N.R. 2.5 billion (approximately $40 million).

In all other cases, the income tax rate remains unchanged at 30%. The education cess on income tax and the secondary and higher education cess on income tax (which amount to 3% in the aggregate) will be discontinued. A new "Health and Education" cess will be levied at 4% of income tax including surcharge, wherever applicable.

In view of these proposed amendments, the maximum tax rates for certain taxpayers for F.Y. 2018-19 are as follows:

Taxpayer	Maximum Marginal Rate (Including Surcharge and Cess)
Individual	35.88%
Partnership Firm/Limited Liability Partnership ("L.L.P.")	34.94%

[1] Tax rate is 29.12% (including surcharge and cess) if the turnover or gross receipts of the domestic company in the F.Y. 2016-17 does not exceed I.N.R. 2.5 billion.

Taxpayer	Maximum Marginal Rate (Including Surcharge and Cess)
Domestic Company	34.94% or 29.12%[1]
Foreign Company	43.68%

Accordingly, the maximum marginal tax rate for foreign companies will increase from 43.26% to 43.68%.

Under the Budget 2018-19 provisions, the Minimum Alternate Tax ("M.A.T.") will not apply to foreign companies engaged in the business of, *inter alia*, shipping, aviation, mining, or civil construction and whose income is computed on presumptive basis.[2]

This proposal will be retroactively effective from April 1, 2000.

"The Budget 2018-19 reintroduced a 10% tax (repealed in 2004) on certain long-term capital gains."

Business Connection

With a view to align the definition of "Business Connection" – the domestic equivalent of a permanent establishment under the tax treaties – with the O.E.C.D.'s B.E.P.S. recommendations, its scope will be widened to include (i) persons who habitually conclude contracts, or play the principal role in concluding contracts, for a nonresident and (ii) nonresidents having significant economic presence.

A significant economic presence would mean transactions in respect of any goods, services, or property carried out by a nonresident in India, including providing downloading of data or software in India if the aggregate payments from such transactions exceed a specific threshold which will be subsequently prescribed. Further, it would also include systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India through digital means, as may be subsequently prescribed.

Significant economic presence may be triggered whether or not (i) the nonresident has a place of business in India, (ii) the nonresident renders services in India, or (iii) the agreement for such transactions or activities is executed in India. Further, income would be taxed in India only to the extent of income attributable to the above transactions or activities in India.

This proposal is enacted despite the fact that work under B.E.P.S. Action 1 is still under way and is meant to be in the nature of an enabler to facilitate negotiation for further amendments in India's tax treaties.

Long-Term Capital Gains on the Sale of Stock and Units

The Budget 2018-19 reintroduced a 10% tax (repealed in 2004) on certain long-term capital gains ("L.T.C.G.'s"). The tax will be imposed on L.T.C.G.'s exceeding I.N.R. 100,000 (approximately $1,500) arising from the transfer of (i) equity shares in a listed company, (ii) units of an equity-oriented mutual fund, or (iii) units of a business trust. The 10% tax is a concessional rate available if Securities Transaction Tax ("S.T.T.") has been paid on the acquisition and transfer of equity shares in a

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[2] Under the presumptive taxation scheme, a taxpayer is allowed to declare income at a prescribed rate defined under the Act and, in turn, is exempt from maintaining books of account and also from getting the accounts audited.

company or on the transfer of units of an equity-oriented mutual fund or a business trust. Otherwise, L.T.C.G.'s will be taxed at 20%.

The requirement to pay S.T.T. does not apply when a transfer is undertaken on a recognized stock exchange located in any International Financial Services Center ("I.F.S.C.")[3] nor where consideration is received in a foreign currency.

In the case of a capital asset acquired before February 1, 2018, the cost of acquisition will be deemed to be the higher of the following:

- The actual cost of the acquisition
- The lower of the fair market value ("F.M.V.") and the full value of consideration received or accruing as a result of the transfer

The F.M.V. of a listed capital asset is the highest price quoted on the stock exchange on January 31, 2018. In the case of unlisted capital assets, the F.M.V. is the net asset value on January 31, 2018.

The benefit of indexation, in the case of residents, and foreign currency variation, in the case of nonresidents, will not be considered in computing L.T.C.G.'s. This provision will also be applicable to Foreign Institutional Investors ("F.I.I.").[4] However, relief will be available where there is a favorable tax treaty. The benefit of indexation will be allowed in the following cases:

- Equity shares not listed on a stock exchange on January 31, 2018, but listed at the time of transfer
- Equity shares listed on a stock exchange at the time of transfer but acquired as consideration for shares that were unlisted on January 31, 2018, where such transaction does not amount to a transfer

The above amendments will be effective from April 1, 2018.

Income Computation and Disclosure Standards

In 2015, the government established ten tax accounting standards – known as the Income Computation and Disclosure Standards ("I.C.D.S.") – for computing taxable income under the categories "Profits and Gains of Business or Profession" or "Income from Other Sources." However, certain I.C.D.S. provisions were rejected by the Delhi High Court in a recent ruling.

To provide requisite legislative support for these measures, the Act will be amended in the following ways:

- A deduction will be allowed for marked-to-market loss or other expected loss as computed under the I.C.D.S.

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[3] An I.F.S.C. is a financial center that provides financial services to nonresidents and residents, to the extent permissible under the domestic regulations, in a currency other than the domestic currency (Indian rupee in this case) of the location where the I.F.S.C. is located.

[4] An F.I.I. is an investor or an investment fund registered in a country other than the one in which it is investing. In India, all F.I.I. must register with the Securities and Exchange Board of India before investing in the country.

- A gain or loss arising from a change in foreign exchange rates will be treated as income or loss
- Profit and gain arising from a construction contract or a contract for providing services will be determined on the basis of percentage of completion method

In addition, the following accounting principles will be adopted for determining taxable income under the category "Profits and Gains of Business or Profession:"

- Inventory will be valued at actual cost or net realizable value, whichever is lower.
- The purchase and sale of goods or services and of inventory will be adjusted to include the amount of any tax, duty, cess, or fees actually paid or incurred by the taxpayer to bring the goods or services to their location on the date of valuation.
- Inventories that are securities but are not listed on a recognized stock exchange or are listed but not regularly quoted on a recognized stock exchange will be valued at actual cost.
- Inventories that are securities other than above will be valued at cost or net realizable value, whichever is lower.

Any claim for price escalation in a contract or export incentive will be deemed to be the income of the financial year in which reasonable certainty of its realization is achieved.

Furthermore, assistance in the form of a subsidy will be deemed to be the income of the financial year in which it is received, unless it is taxed in a prior year.

The above amendments will be effective from April 1, 2016.

Corporate Insolvency Resolution Process

The aggregate of unabsorbed depreciation and book loss carryforward will be deductible when computing the book profit of a company whose application for Corporate Insolvency Resolution Process ("C.I.R.P.") has been accepted by the adjudicating authority.[5] Previously, the lower of the unabsorbed deprecation or book loss was allowed as a deduction; hence, in cases where either of these amounts was zero, no deduction could be claimed.

In order to ease the restructuring and rehabilitation of companies seeking insolvency resolution, a company that takes over the business of a rehabilitating company (*i.e.*, a company undergoing insolvency proceedings under the I.B.C.) will be allowed to carry forward and set off loss of the rehabilitated company pursuant to a resolution plan under C.I.R.P. This benefit is available despite a change in shareholding exceeding 49% during the year and applies to companies whose resolution plan has been approved under the I.B.C.

Both the above amendments will be effective from April 1, 2017.

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[5] The Insolvency and Bankruptcy Code ("I.B.C."), which offers C.I.R.P, was enacted in 2016 to replace existing insolvency laws with a consolidated and comprehensive piece of legislation aimed at facilitating the simple and timely winding up of insolvent businesses to maximize the value of debtor's assets.

I.F.S.C.'s

In order to develop India as a global financial center and, more specifically, to encourage investment in designated I.F.S.C.'s, transfers of the following assets on a recognized stock exchange in an I.F.S.C. by a nonresident will be exempt from both short and long-term capital gains tax:

- Global Depository Receipts
- Rupee-denominated bonds of an Indian company
- Derivatives

This benefit is available provided that the transfer takes place on a recognized stock exchange located in an I.F.S.C. and the consideration is paid in foreign currency. However, as with L.T.C.G.'s from stock and units, discussed above, L.T.C.G.'s on equity shares, units of an equity oriented mutual fund, and units of business trusts transacted on a recognized stock exchange located in I.F.S.C. will be taxed at 10%, if the gains exceed I.N.R. 100,000.

In addition, the 9% reduced M.A.T. rate applicable to corporate entities with units in an I.F.S.C. will be extended to noncorporate entities located in an I.F.S.C.

Start-Ups

Under existing law, a start-up established between April 1, 2016, and April 1, 2019, can deduct 100% of profits earned from an "eligible business" for any three of the first seven financial years. This provision will be extended for an additional two years and will sunset on March 31, 2021. The deduction is available provided that the turnover in any of the seven financial years does not exceed I.N.R. 250 million (approximately $4 million).

The term eligible business has been expanded to include any innovation, development, or improvement of products, processes, services, or a scalable business model with a high potential of employment generation or wealth creation.

Country-by-Country Reporting

The due date to file the Country-by-Country ("C.b.C.") Report, in cases of a parent entity or Alternative Reporting Entity resident in India, will be subsequently prescribed in the Income-tax Rules. The proposed amendment follows provisions under B.E.P.S. Action 13 and will be effective from April 1, 2016.

Permanent Account Number

Taxpayers (other than individuals) and their officers (*e.g.*, managing directors of a company, partners of a partnership or L.L.P, and trustees of a trust) will be required to obtain a Permanent Account Number if they enter into specified financial transactions amounting to I.N.R. 250,000 (approximately $3,800) or more during a financial year.[6] This amendment will be applicable only to taxpayers who are residents of India (*i.e.*, nonresidents will be excluded from the scope of this provision).

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[6] A Permanent Account Number is a unique ten-character alphanumeric number issued by the Indian Income-tax Department that serves as the taxpayer's proof of identification.

CONCLUSION

Budget 2018-19 has introduced many international tax provisions intended to bring India's domestic tax law in line with global standards established by the O.E.C.D.'s B.E.P.S. Project. However, the budget has also wreaked a certain amount of havoc on long-standing domestic tax law. The reintroduction of a tax on capital gains from the sale of stock, for example, caused the national stock exchange to plummet by several points due to the bearish outlook and public outcry. At the same time, the prime minister focused on the less privileged sectors of the society and proposed reforms to benefit rural communities; improve agriculture, healthcare, infrastructure, and education; and generate employment. With this budget, the government has gone one step further in improving the standard of living for the poor and bringing the country on par with international tax norms.

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