Invigorating India's Tax Regime

Union Budget Updates

9 July 2021, Friday

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A vibrant country with a vibrant tax regime, India is sometimes described as an aggressive jurisdiction when it comes to tax. Yet, tax authorities and tax professionals around the world have continued to look towards India's bold and pioneering tax decisions in formulating their own tax regime and tax strategies.

As India focuses on economic recovery from the COVID-19 pandemic, few substantial tax changes were introduced in this year's Union Budget. Notwithstanding, several key tax updates remain pertinent to tax professionals advising businesses with a presence in the Indian market. Accredited Tax Advisor (Income Tax) Rohan Solapurkar, Tax Partner, Deloitte Singapore, shared his insights on the implications of these updates at a recent webinar organised by the Singapore Chartered Tax Professionals.

UNION BUDGET 2021–22 UPDATES

Corporate Tax

CORPORATE TAX RATES

No corporate tax rate changes were announced in Budget 2021, offering welcome stability for businesses. Effective corporate income tax rates in India vary across company types and income thresholds and are computed based on three components: the basic rate, surcharge, and education cess.

For an Indian company, the effective corporate income tax rate can go up to 34.94%, or 25.17% if it chooses not to avail tax incentives or exemptions. Eligible manufacturing companies newly set up from 1 October 2019 are taxed at a concessionary rate of 17.16%.

Foreign companies with a taxable presence in India through a branch office, project office or permanent establishment (PE) may have an effective corporate income tax rate of up to 43.68%.

EMPLOYEES' CONTRIBUTION TO WELFARE FUNDS

Similar to Singapore's Central Provident Fund (CPF), there are welfare funds in India, although they are not mandated by the central government. Typically, the employee's contribution is made via a payroll deduction that should be deposited in the welfare fund within seven days of the date of deduction, while the employer's matching contribution should be deposited in the welfare fund before the due date of filing their corporate tax return.

However, some companies have, based on certain tax positions adopted, withheld their employee's salary for the employee's contribution and only deposit both the employee's and employer's contribution to the welfare fund before the due date of filing their corporate tax return. To mitigate such tax positions being adopted and to prevent any loss for employees, the Income Tax Act has been amended to provide that companies can only claim a tax deduction on the employee's contribution to the welfare fund if such contribution is credited to the relevant welfare fund by the prescribed due date from FY 2020–21.

International Tax

EQUALISATION LEVY

As one of the forerunners in taxing the digital economy, India introduced an equalisation levy in 2016. The 6% levy targeted revenue earned by non-residents from online advertising and related services. As equalisation levy is not an income tax, tax treaty benefits are not applicable.

In 2020, the equalisation levy was expanded to include consideration received by a non-resident e-commerce operator from an e-commerce supply or services to specified payers, and an equalisation levy of 2% is applicable on such consideration. It is noted that the new equalisation levy would affect not only the mega e-commerce companies, but also any non-residents who own, operate, or manage a digital facility or platform for online sale of goods and/or online provision of services. The definition of a "specified payer" would also go beyond Indian residents; a non-resident in specified circumstances, or even a person who simply buys goods or services using an Internet Protocol (IP) address located in India, would too be a "specified payer" for the purpose of the new equalisation levy.

E-commerce supply or services were clarified to include digital activities such as the acceptance of offer for sale, placement and/or acceptance of the purchase order, payment of consideration, and supply of goods or services. The levy applies on gross consideration received for such e-commerce supplies or services, irrespective of whether the goods are owned, or services are provided or facilitated, by the e-commerce operator.

Considerations which are taxable as royalties or fees for technical services (FTS) in India (under the Income Tax Act read with the relevant tax treaty) are, however, excluded from the scope of the new equalisation levy.

"In view of the ongoing BEPS 2.0 international tax reform, the new equalisation levy may be short-lived as the agreement to BEPS 2.0 requires countries to withdraw all unilateral digital taxes," Mr Solapurkar noted. "Having said that, the tax reform is still under discussion and will have to go past significant hurdles before coming to fruition."

SIGNIFICANT ECONOMIC PRESENCE

India's new nexus rule – "significant economic presence" (SEP) – has been given legislative effect from April 2021. Previously, any income accruing in or arising from a business connection in India was taxable in India; this generally required the carrying on of operations by the non-residents in India through physical presence. Under the new nexus rule, a SEP in India of a non-resident would constitute a business connection in India. As such, income generated by a non-resident from the SEP would be taxable in India, and physical presence will no longer be required.

On the impact of the new nexus rule on Singapore companies, Mr Solapurkar commented, "SEP should not have a big impact on Singapore companies as requirement of a permanent establishment within the treaty definition would override the provision of Indian domestic tax law. However, the new nexus rule would likely be significant for non-residents located in a jurisdiction that does not have a tax treaty with India, in which case, the new nexus rule would apply in full effect."

TRANSFER PRICING: KEY AREAS OF DISPUTE

Transfer pricing (TP) in India has seen significant evolution through the years. Generally, India's TP guidelines have continued to align with the Organisation for Economic Cooperation and Development's (OECD). Despite this, businesses investing into India should be mindful of the following key areas of dispute that have transpired across the country's TP landscape in recent years:

(i) *Recharacterisation of entities based on functional analysis*

A multinational enterprise (MNE) group may set up an Indian entity to provide support functions for the group. Due to its supporting role, the MNE group would likely characterise the Indian entity as a limited risk distributor for TP purposes. However, the Indian tax authority may challenge the MNE group's position and argue that the Indian entity provide significant services in India and accordingly, should be recharacterised as a full-fledged distributor.

(ii) *Imposition of higher markup*

India generally frowns upon the use of simple cost-plus markup approaches, in search of higher residual profits for India (especially in high-value sectors such as information technology or investment advisory). Even if a cost-plus markup approach is accepted, it is not uncommon for the Indian tax authority to require a higher-than-expected markup (compared to other tax jurisdictions for similar activities).

(iii) *Invocation of additional returns for location specific savings*

Location savings are the net cost savings that may be derived by an MNE group that relocates some of its activities to another country, where labour or other costs are lower than in the location where the activities were initially performed. The Indian tax authority is generally of the view that India should enjoy a share of the MNE's location savings. Accordingly, India may make TP adjustments and invoke additional returns on the MNE group.

(iv) Selection of tested party

Based on the OECD's guidance, the tested party is generally "the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will most often be the one that has the less complex functional analysis".

Although the Indian tax authority does accept foreign comparables, generally, it would prefer the Indian entity to be the tested party for transactions between a non-resident and an Indian entity, on the basis that the Indian entity may have the less complex functional analysis. Consequently, MNE groups may have to prepare TP documentations with their Indian entities as the tested parties and rely on Indian comparables.

(v) *Creation of marketing intangible through advertisement, marketing and promotional (AMP) expenses*

When an Indian entity (that is not the owner of the trademark or brand name) incurs AMP expenses to drive sales and profits in India, such AMP activities would in turn benefit the non-resident related party which is the legal owner of the trademark or brand name. On the basis that the Indian entity is creating marketing intangibles for the non-resident related party, the Indian entity is expected to be compensated over and above what it would have normally received.

MOVING TOWARDS E-GOVERNANCE

To become more taxpayer-friendly and transparent, technology and digitalisation has been at the forefront of the Indian tax authority's initiatives. The "faceless assessment scheme" was introduced to impart greater efficiency, transparency, and accountability in the assessment proceedings by, inter alia, eliminating interface between taxpayer and the assessing officer. Where a personal hearing is requested by the taxpayer, it is done via video conferencing.

The scheme has proved a timely development amid the COVID-19 pandemic, minimising physical interactions while allowing quicker resolution of issues. The implementation of the scheme, however, is not without its challenges. Several writ petitions have already been filed by aggrieved taxpayers based on violation of principles of natural justice (in which some taxpayers were not given the opportunity to be heard completely before the tax authority passed the assessment order), and rulings have been issued by jurisdictional High Courts. It remains to be seen how the finer details will be worked out to safeguard the very purposes that the faceless assessment scheme was established for.

CONCLUSION

India's efforts to be more taxpayer-friendly and transparent are welcomed by investors, though the progress of this transition across India remains to be seen.

In the meantime, foreign MNEs must continue to stay vigilant on the ongoing developments surrounding India's tax policies, and the ever-growing list of case laws.

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