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TAX PROFESSIONALS

Technical Group Discussion

Grasp the Multi-faceted Aspects of India Taxation

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Accredited Tax Advisor (Income Tax) Rohan provided a snapshot of India prior discussion on various forms of tax treatments in India.

India has been in the limelight for many of its recent tax judicial decisions. Whilst some of the decisions are path-breaking (and other countries are emulating the principles laid down), most of the decisions are also controversial. While vast opportunities abound, investors enter the market with caution.

Since it opened its economy in 1991, India has progressed to be the tenth largest economy in the world. Indeed, with a population of 1.3 billion across 28 states, India is a trillion dollar economy with a largely self-sufficient agricultural sector, a diversified industrial base and a stable financial and services sector.

At the crux of it all is India's central bank, the Reserve Bank of India (RBI), which controls all its monetary policies with a prudent approach to ensure debt is managed. Foreign investors keen on developing India's growth are welcomed and market entry modes include setting up a branch, joint venture, wholly-owned subsidiary, representative office or project office.

Gaining a Foothold in India

Foreign direct investments (FDI) are made through two routes – automatic approval and government approval. FDIs are allowed under the automatic route in most sectors, except certain restricted sectors such as agriculture, gambling, etc. Foreign investment in certain sectors, such as retail trading, telecommunications etc are permitted but only up to certain specified percentages and after receiving prior approvals.

Foreign investors using the automatic route may incorporate a company and capitalise it by submitting documentation to the Reserve Bank of India (RBI) through a banker. Investments requiring government approval must however be submitted to the Foreign Investment Promotion Board (FIPB), following which the Secretariat for Industrial Assistance (SIA) issues industrial licenses and provides assistance The incorporation process is relatively straight forward, but can be time-consuming.

The easiest way of entry is to set up a representative office with an approval from the Reserve Bank of India. Like in Singapore, the representative office cannot accumulate income and can only incur costs. This mode is popular for businesses who want to test the market or merely need a presence for a more efficient coordination work at the ground level.

Companies may also choose to set up a branch office for a more permanent presence. An approval from the Reserve Bank of India and registration with the Registrar of Companies are required. Branch offices cannot be involved in manufacturing activities and retail trading and this form of market entry is commonly used by companies who want to distribute their products in the India market. It is considered non-resident entity and tax rates are higher. Profits can be repatriated to its parent company without incurring withholding tax. From a risk perspective, as the branch office is considered an extension of the parent company, the parent company will thus be affected if there is any liability. This can be avoided if businesses set up a subsidiary instead.

Companies can also choose to set up a wholly-owned subsidiary. Joint ventures may be set up with an Indian or foreign partner. A subsidiary company provides the maximum flexibility to conduct business in India and it can be funded through a mix of equity, debt (both foreign and local) and internal accruals.

For Limited Liability Partnerships (LLP), capital contribution by partner in a LLP should only be in the form of cash. LLPs are not permitted to leverage on External Commercial Borrowings. Profits are taxed only in the hands of the LLP and the LLP would be taxed as a partnership firm ie at the tax rates applicable to individuals. .

Shedding light on tax issues to note in order to gain a foothold in this vast market was **Accredited Tax Advisor (*Income Tax*) Rohan Solapurkar, Partner, Deloitte Singapore** in a technical discussion organised by the Singapore Institute of Accredited Tax Professionals (SIATP).

The Tax Scene

In India, the financial year is from April 1 to March 31 of the next year. Companies which have a different financial year will have to keep a separate set of accounts according to the April to March financial calendar. Similar to Singapore, the corporate tax filing date is also stipulated as November 30.

Overall, India has a multi-layered tax system. While it is not difficult to understand, implementation may be confusing for foreign investors. Taxes are levied at the national and state levels. At the national level are the corporate tax, capital gains tax, dividend distribution tax, customs duty and excise duties. Corporate tax, for example, can thus be consolidated into one tax return even if businesses have a presence across various states in India (so long as they operate as branches across India). Some of the indirect taxes such as the valueadded tax and service tax are levied by the state and may vary across the different states, though there are plans to implement a goods and services tax at the national level.

Corporate Tax Rate

The corporate tax rate differs between domestic and foreign companies (for example, between a Permanent Establishment or a branch which is not incorporated in India). A surcharge is added for incomes that cross the set threshold. There is also an additional 3% surcharge. The effective tax rate is 33.99% for domestic companies and 43.26% for foreign companies. Companies are also required to pay income tax in advance for each tax year in four instalments, on or before the 15th day in the months of June, September, December and March.

While an Indian resident company is taxed on its worldwide income, non-resident companies should note that capital gains from the transfer of capital assets situated in India and interest, royalties and technical service fees are all subject to tax in India. For example, if a Hong Kong company makes a payment outside of India, to a Singapore company, for a service rendered in India, the payment will be subjected to withholding tax.

Minimum Alternate Tax

For companies where the net profit as shown in the profit and loss statement is more than 18.5% of its tax profit, a Minimum Alternate Tax (MAT), which ranges from 19.4361% to 20.9605%, applies. Tax paid under the MAT provisions may be carried forward to be set off against income tax payable in the next 10 years, subject to certain conditions.

Dividend Distribution Tax (DDT)

Companies are required to pay DDT of an effective rate of 17% on amounts declared, distributed or paid as dividends. This is not considered as a withholding tax. When an Indian company distributes dividends to a Singapore company, it is not taxable in Singapore. An interesting point to note is that under the India-Singapore treaty, the DDT may not be eligible as an underlying tax credit as it is not a tax on profit.

General Deductions and Concessions

In general, all expenditure incurred for the purpose of business is generally deductible. However, there are certain expenditures that are allowable for deduction only on the basis of actual payment, such as employees' bonuses.

India's corporate tax system is fairly similar to Singapore. The challenge is in determining what constitutes the purpose of business and when a deduction is allowable. In the area of research and development, special concessions apply, similar to Singapore. However, only a higher deduction applies for the tax concession for R&D. There is no tax credit or refund policy in this area.

Tax Holidays

India has also set up special economic zones where companies enjoy tax holidays for a period of about 15 years. However, this benefit may have been diluted as a result of the Minimum Alternate Tax.

Losses

Losses can be either business losses are losses arising from depreciation. Business losses can be carried forward for 48 years while the latter can be carried forward indefinitely. Companies must satisfy a 51% continuity of ownership test to qualify for the business loss to be carried forward.

To utilise the losses, companies must file the tax return by the due date.. In addition, it should also be noted that there is no group tax relief. If a Singapore company has three Indian subsidiaries with one suffering losses, a group consolidation does not apply.

Withholding Tax

Withholding tax applies for any payments made by a resident to a non-resident. To claim treaty rates, a Permanent Account Number (PAN) is needed for foreign companies, otherwise the domestic withholding rate, which may be higher, applies. However, foreign companies may prefer not to apply for the PAN as they fear tax scrutiny by the Indian tax authority, although, this may not be the case in reality.

Tax Treaty Relief

India has an extensive tax treaty network. It allows credit for taxes paid overseas and grants relief from double taxation by the credit method or a combination of credit and exemption methods. Resident companies need to show that taxes have been paid in a foreign country. A non-resident seeking relief under the tax treaty will have to furnish a valid Tax Residency Certificate (TRC) obtained from tax authorities of its country of residence.

Capital Gains Tax

The capital gains tax varies based on when the sale is made from time of purchase. Rates are also different depending on whether the capital asset is a long-term capital asset or a short-term capital asset and whether the shares are from a company listed on the India Stock Exchange or not.

Transfer Pricing (TP)

Transfer pricing occurs when there are transactions between two or more associated enterprises, where there is a direct or indirect participation in management, control or capital. Either or both of the associated enterprises may be non-residents. The Transfer Pricing (TP) rules in India are based on the Organisation for Economic Co-operation and Development (OECD) approach and various prescribed transaction methods are stipulated. More and more so, countries are stipulating that profits should reflect where the activity took place. This is similar to OECD's position as stated in the Action Plan on Base Erosion and Profit Shifting published in the middle of 2013.

India implemented the Advance Pricing Agreement (APA) in August 2012. Through this, companies engage with India's tax authorities and agree on the arms length price for India. This process may take eight to 12 months and the APA would be valid for the next five years. Unfortunately, such a provision is not reflected in the Singapore-India tax treaty. As such, bilateral agreements where both authorities agree on the pricing are not possible. Companies may still engage in unilateral APAs with the country's authorities.

Individual Tax

Residents of India are tax on worldwide income and not just income earned in India. As such, an individual is still liable for taxes if he receives his remuneration outside of India but is physically in India. In addition, all benefits, such as accommodation, car, club membership, medical benefits amongst others, are also subject to taxes in India. Furthermore, an expatriate who may be earning rental income in his home country whilst he is residing in India for work purposes, will be subjected tax on the rental income received back in his home country, if the expatriate satisfies conditions of becoming a ordinary resident in India for tax purposes.

General Anti-Avoidance Rule
India will be putting in place a wide-reaching General Anti-Avoidance Rule in 2015. It stipulates that any transaction that is done primarily for the purpose of obtaining a tax benefit will be an impermissible arrangement. The guidelines are not specific and the obligation lies on the taxpayer to prove the arrangement is not done for the key purpose of obtaining tax benefit.

Current Issues Faced In India

Some of the key issues that currently face investors in India are management fees, withholding tax and accounting systems. India's tax authorities are questioning the rationale for the charges of management fee by the corporate headquarters on their India-related entities and are also examining the value/benefit received by the Indian company on account of such management charges. Withholding taxes are another area which could lead to significant litigation in India. Additionally, companies also need to make sure that its accounting systems are aligned and capable of generating information required by India's tax authorities in order to mitigate litigation in India.

The Vodafone case reflects the complexity of India's taxation system. The Supreme Court had held that India did not have the right to tax indirect transfers. This was reversed when an amendment was made in Budget 2012 and the amendment made retrospective from 1961.

All said, India continues to attract FDIs and it is a good opportunity for small and medium-sized enterprises to build global presence too. No doubt tax litigation will continue in India and the number of APAs will increase. There are plans for an introduction of an easy-to-understand version of the Income Tax Act and a national GST regime is in the pipeline. Changes are in sight and many continue to cast a positive outlook on India.

A big thank you to Rohan for sharing his valuable tax knowledge!

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About SIATP's Technical Discussions

SIATP's technical discussions have continually been very well received by accredited tax professionals. Unlike the run-of-mill Continuing Professional Educational courses which typically cover tax fundamentals, SIATP's interactive technical discussions are designed to cover tax issues that do not have clear-cut solutions or situations that may have different interpretations. Over time, these discussions contribute in boosting the overall tax standards in Singapore.

About Mr Rohan Solapurkar

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With more than 20 years of experience in international tax, Rohan has a deep understanding and knowledge of the Indian tax and regulatory framework and has been advising multinationals on various aspects such as entry strategies, cash repatriation strategies and tax minimisation strategies. His advisory work encompasses companies in diverse sectors such as IT, hospitality, infrastructure and media. During his career with several Indian companies, he has assisted them in their outbound strategies, minimisation of the effective tax rate and etc.

Rohan is a Chartered Accountant from India and holds a Bachelor of Commerce from the Bombay University. He has worked in another Big Four firm in Hong Kong and London prior to Singapore and is an Accredited Tax Advisor with the Singapore Institute of Accredited Tax Professionals.

This technical event commentary is written by SIATP's Assistant Manager, Michelle Yap.