

Reforms in Income Tax

31ST REGIONAL CONFERENCE

WESTERN INDIA REGIONAL COUNCIL

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA



CA T. P. Ostwal

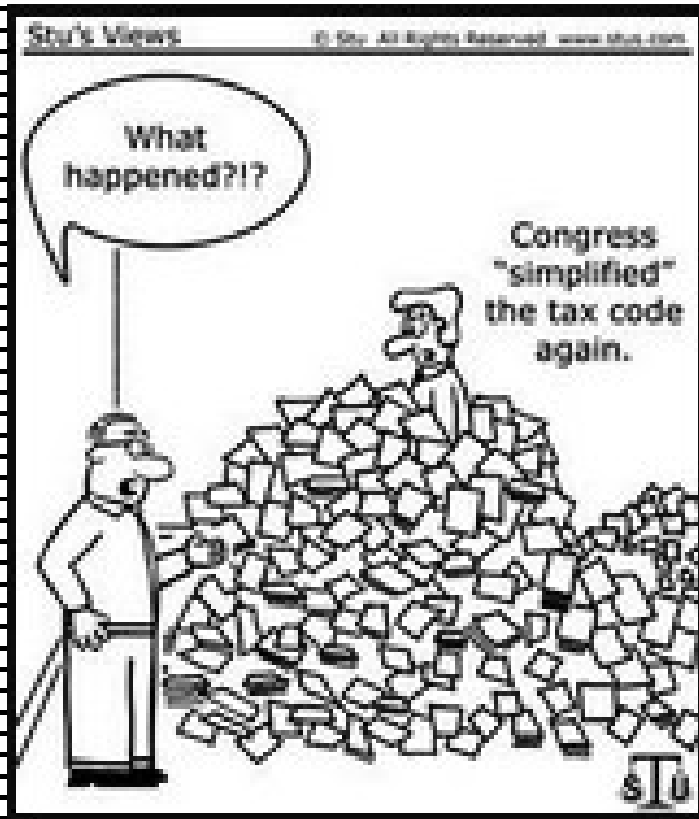
Saturday, 10th December, 2016.

TOPICS COVERED

2

- Income Computation & Disclosure Standards**
- GAAR**
- Place of Effective Management**
- Taxing “Indirect Transfer”**
- Reduction of Headline Tax Rate**
- Change of “Financial Year”**
- OECD’s BEPS Action Plans**
- Multilateral Instrument – Tax Treaties**
- Crackdown on Black Money**

Income Computation & Disclosure Standards



Overview ICDS

4

- Section 145(1) stipulates that method of accounting for computation of income under PGBP and IFoS can be either cash or mercantile system.
- Section 145(2) states that Central Government may notify accounting standards to be followed by any class of assesses or in respect of any class of income. Accordingly, two tax accounting standards were notified in 1996:
 1. Disclosure of accounting policies
 2. Disclosure of prior period and extraordinary items and changes in accounting policies
- 👉 The Finance Act, 2014 amended section 145(2) of the Act to substitute “accounting standards” with “income computation and disclosure standards” and subsequently the CBDT notified 10 ICDSs on 31st March 2015 to become effective from 1st April 2015 (AY 2016-17)
- 👉 An Expert Committee was constituted to received comments and queries from taxpayers in order to revise the ICDS.
- 👉 Expert Committee received numerous representations and queries and subsequently revised the ICDS and the CBDT notified that ICDS applicability of was deferred to AY 2017-18 (i.e. from 1st April 2016)

Overview of ICDS

5

ICDS	Coverage	Corresponding Accounting Standard
ICDS I	Accounting Policies	AS – 1; IND-AS 1 & 8
ICDS II	Valuation of Inventories	AS – 2; IND-AS 2
ICDS III	Construction Contracts	AS – 7; IND-AS 115
ICDS IV	Revenue Recognition	AS – 9; IND-AS 115
ICDS V	Tangible Fixed Assets	AS – 10; IND-AS 16
ICDS VI	Effects of Changes in Foreign Exchange Rates	AS – 11; IND-AS 21
ICDS VII	Government Grants	AS – 12; IND-AS 20
ICDS VIII	Securities	AS – 13; IND-AS 109
ICDS IX	Borrowing Costs	AS – 16; IND-AS 23
ICDS X	Provisions, Contingent Liabilities and Contingent Assets	AS – 29; IND-AS 37

ICDS - Are they needed?

6

- ICDS apply to every tax payer with PGBP income using Mercantile method of accounting – irrespective of income level. Only exemption is to individuals & HUFs that do not need to have books audited u/s 44AB.

Could this have a potential negative impact on smaller businesses and start ups?

- The introduction of a separate set of accounting principles for tax purposes is expected to increase consistency in tax assessments and reduce interpretational ambiguity which is a major cause for litigation in India.

ICDS - Are they needed?

7

- India has recently adopted IndAS, which are based on the International Financial Reporting Standards (IFRS), so as to move business accounting practices closer to international standards/ norms.
- Having ICDS and IndAS poses a challenge to business which now have to juggle the reporting and disclosure requirements of two different standards.
- For example, under ICDS, even contingent assets must be recognized when realization becomes reasonably certain, however under IndAS, the same can only be recognized once actually realized.

Could IndAS have been adopted for tax purposes instead of ICDS?

GENERAL ANTI-AVOIDANCE RULES

- ▶ Introduced first in the Draft Direct Taxes Code 2009
- ▶ Income Tax Act, 1961 amended in 2012 to incorporate GAAR effective April 1, 2014
- ▶ However, a number of representations were made and subsequently an Expert Committee on GAAR constituted to undertake stakeholder consultations and give a report
- ▶ Expert Committee submitted its Final Report in September, 2012
- ▶ Government considers the Report and announces decision to bring modification
- ▶ GAAR was deferred to be effective from AY 2018-19
- ▶ These new provisions apply notwithstanding anything contained in any other provisions of the Act.
- ▶ GAAR empowers the Tax Department to declare an “arrangement” entered into by an assessee to be an “Impermissible Avoidance Agreement” (IAA) and the consequence thereof could be denial of tax benefit either under the provisions of the Act or under the DTAA.
- ▶ Not only an arrangement, but also any step in or a part of any arrangement may also be declared as IAA.

Indian GAAR – A Snapshot

“Main Purpose” is to Obtain a “Tax Benefit”

AND

Not at
“Arm’s Length”

OR

“Misuse/Abuse” of
Tax Provisions

OR

Lacks “Commercial
Substance”

OR

Not for Bona Fide
Purposes

Impermissible Avoidance Arrangement

Consequences

**Disregard/Re-
characterize the
Arrangement**

**Disregard
Corporate
Structure**

**Deny Treaty
Benefit**

**Reassign Place
of Residence/
Situs of Assets
or Transaction**

**Reallocate
Income,
Expenses,
Relief, etc.**

**Recharacterize
Equity-Debt,
Income-Expense,
Relief, etc.**

Applies to both Indian Residents and Non-Residents

Rules For Application Of GAAR

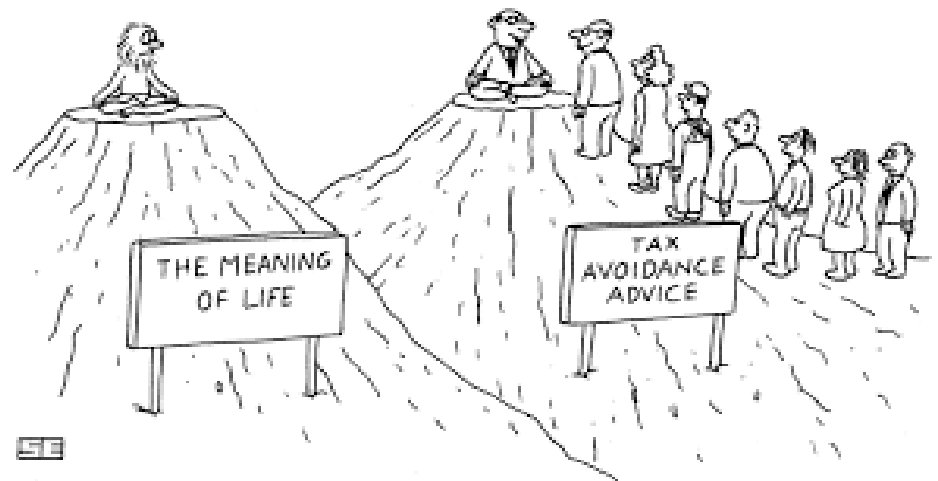
11

- ▶ GAAR would be applicable to arrangements which give rise to tax benefits on or after April 1, 2016 irrespective of the date on which an arrangement has been entered into.
- ▶ However, there is a grandfathering provision in respect of income arising from transfer of investments made before August 30, 2010, being the date on which the DTC (the first policy document which intended to introduce GAAR) was tabled in the Parliament.
- ▶ GAAR would **not be applicable** in the following situations:
 - ▶ **Threshold not exceeded** – Where aggregate tax benefits arising to all the parties under an arrangement do not exceed INR 30 million for the tax year.
 - ▶ **Specified Foreign Institutional Investors (“FII’s”)** – Where FIIs’ do not seek tax treaty benefits and make investments as per SEBI / other regulations.
 - ▶ **Non-resident investors of FIIs’** – Where direct or indirect investments have been made by non-resident investors in offshore derivative instruments issued by FIIs.
- ▶ Consequence of Impermissible Avoidance Arrangement
Where a part of an arrangement is declared to be an impermissible avoidance arrangement, the consequences in relation to tax shall be determined with reference to such part only.

GAAR Treaty override!!

12

- ▶ Beneficent treaty provision would be over-ridden by GAAR if transaction is deemed inappropriate
- ▶ However, it would be subject to threshold limits
- ▶ Tax benefit enjoyed by connected persons would also be considered
- ▶ Transaction involving TFJ entity with no substantial commercial purpose: commercial substance test
- ▶ Conditions of LOB / TRC not relieved
- ▶ Abuse of corporate structure may still injure treaty eligibility



Place of Effective Management



Place of Effective Management

14

- In India, PoEM was introduced through Finance Act 2015 & the definition of a company resident in India was changed.
- *A company is said to be resident in India in any previous year, if, (i) it is an Indian company; or (ii) its place of effective management, at any time in that year, is in India.*
Explanation- For the purposes of this clause "Place of Effective Management" means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made.
- PoEM is a key factor in determining the residential status of a company in many countries.
- PoEM was to be effective to determine residential status from FY 2016-17 but was deferred to FY 2017-18 since no clarification or guidelines on PoEM were provided.

Place of Effective Management

This amendment has a great significance in the context of operations of Multi National Enterprises (MNEs) in India. It impacts both, MNEs having subsidiaries in India; and Indian promoted companies which have overseas subsidiaries.

The draft guidelines, which were finally released in December 2015, still require clarification on various points. The final guidelines also have not yet been released.

Is PoEM useful to India, a net capital-importer? Provisions like PoEM and CFC rules are enacted as anti-avoidance measures in countries which are capital exporting and the governments are concerned about non-taxation of overseas profits?

Will PoEM reduce or put off Indians from investing overseas?

With the simultaneous implementation of GAAR, is PoEM even required?

Reforms – current & future

**Taxation of Indirect Transfer
Reduction of Headline Tax Rate &
Change in “Financial Year”**

Taxation of Indirect Transfer

17

CBDT issued the final rules (Rule 11UC) for determination of the fair market value (FMV) of assets (tangible & intangible) and the income attributable to assets located in India for the purpose of taxation of indirect transfer of assets under section 9(1)(i) of the Income-tax Act, 1961 (the Act).

The final rules also deal with related reporting requirements and document maintenance obligations in relation to the same.

This clarifies the position of Capital Gains taxation in India when shares of a foreign company with an Indian subsidiary(ies) are transferred – if more than 50% value is derived from Indian assets, it will amount to “Indirect Transfer”

Reduction in Headline Tax Rate

18

- The Modi government has promised a phased reduction in headline rate of tax – the reduction of rates to 25% by 2018 is imminent
- Possible option to new taxpayers/ companies to opt for 25% tax rate and forego claims to weighted/ special deductions & other exemptions
- India has amongst the highest rates of corporate tax @ 30%; coupled with surcharge, cess & DDT, almost 50% of profits are taxed.
- Reduction in tax rate will boost domestic investment & FDI

Change of “Financial Year”

19

- A panel headed by former chief economic advisor Shankar Acharya has been set up to examine the desirability and feasibility of having a 'new financial year'
- The present financial year in India was adopted by in 1867 principally to align the Indian financial year with that of the British government.
- A change in the fiscal year would bring India in line with most other countries

which follow the calendar year as the fiscal year

Fiscal Year	Number of Countries
January to December	156
April to March	33
July to June	20
October to September	12
Other	6

Source: <https://www.cia.gov/library/publications/the-world-factbook/fields/2080.html>

Base Erosion Profit & Shifting Action Plans

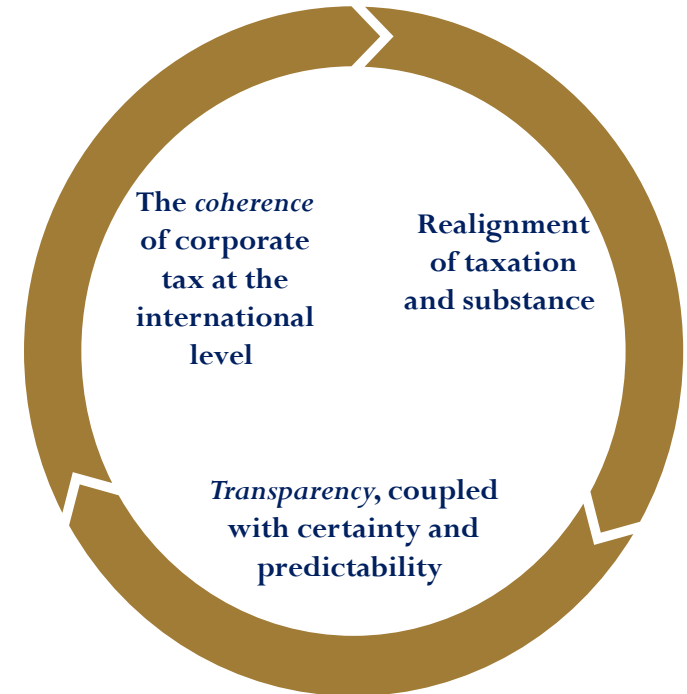


OECD BEPS – In a nutshell

On 19 July 2013 OECD released an *Action Plan on Base Erosion and Profit Shifting (BEPS)* which was presented to the meeting of G20 Finance Ministers in Moscow

Purpose of BEPS - “to prevent double non-taxation, as well as cases of no or low taxation associated with practices that artificially segregate taxable income from activities that generate it.”

“No or low taxation is not per se a cause for concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.”



15 Actions organized around *three main pillars*

Base Erosion & Profit Shifting Action Plans

International & Corporate Taxation

Action 1: Address the tax challenges of the digital economy

Action 2: Neutralize effects of hybrid mismatch arrangements

Action 3: Strengthen CFC Rules

Action 4: Limit base erosion via interest deductions & other Financial Payments

Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance

Action 6: Prevent treaty Abuse

Action 7: Prevent the artificial avoidance of PE Status

Action 11: Establish methodologies to collect and analyze data on BEPS and the actions to address it

Action 12: Require taxpayers to disclose aggressive tax planning arrangements

Action 14: Make dispute resolution mechanisms more effective

Action 15: Develop a multilateral instrument

Transfer Pricing

Action Plan 8, 9 & 10:

Assure that transfer pricing outcomes are in line with Value Creation

Action 8: Intangibles

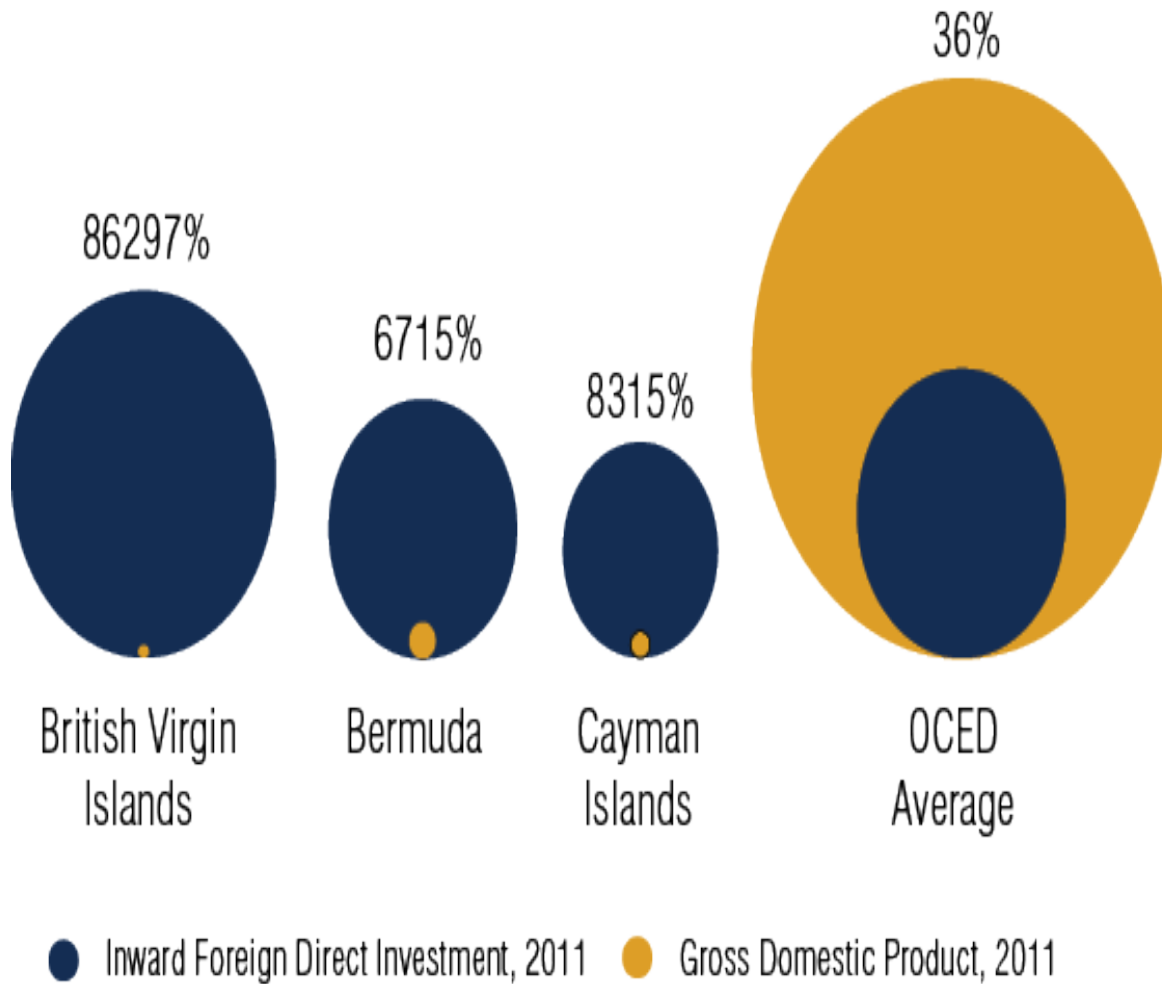
Action 9: Risks & Capital

Action 10: Other High-Risk Transactions

Consolidated OECD Report on the above 3 Action Plans “*Aligning Transfer Pricing Outcomes with Value Creation*”

Action 13: Re-examine transfer pricing documentation

Need for BEPS



“The empirical evidence suggests that income-shifting by multinational corporations is a significant concern that should be addressed through tax reform.”

The potential for misalignment of profits and value creation may arise from misalignment of form and substance, and in particular exclusive reliance on

- 1) mere contractual ownership;
- 2) mere contractual assumption of risk; and
- 3) provision of capital

Need for BEPS

Indian tax regime is already based on **“Source” based** taxation principle recommended under BEPS as against the **“Residence” based** principle.

As per the BEPS Project, income should be taxed by the country which is the source of such income, instead of merely where he income earner resides.

Profits, which are artificially shifted to low tax jurisdictions, escape taxes in the **“Source Country”**, which are generally poorer or developing economies – the aim is to prevent this by introducing measures contained in the BEPS Action Plans.

BEPS – WHOM DO THEY REALLY BENEFIT??

25

Money held offshore by U.S. companies in 2015 (in billion U.S. dollars)



Actions taken by India

26

BEPS Action Plan	Reforms/ Measures in India
Action 1 – Digital Economy	<p>India has enacted the Equalization Levy whereby a 6% “cess” will be levied on certain E-Commerce transactions</p> <p>This is similar to measures by Australia & the UK and is popularly called the “Google Tax”</p>
Action Plan 6 – Prevent Treaty Abuse	<p>India treaties are increasingly including an “LOB” clause, either through renegotiation or while signing a new Treaty</p> <p>GAAR, which will become effective from FY 2017-18, will enable the tax department to override the Treaty provisions</p> <p>India may also include BEPS suggested measures of denying Treaty benefits to inbound investments in India through mere holding/ shell companies</p>

Actions taken by India

27

BEPS Action Plan	Reforms/ Measures in India
Action 8 – Intangibles	<p>India is one of the only countries whose law contained an exhaustive definition of “Intangibles” long before BEPS brought focus on this issue</p> <p>Taxation in this respect is already</p>
Action 13 – Country-by-Country Report	<p>India already had provisions relating to “local file” and “master file” documentation requirement under Action 13.</p> <p>Section 286 was inserted in the Income Tax Act, 1961 to provide for a specific CbCR regime in line with the standardized approach towards TP documentation requirements of Action Plan 13.</p> <p>Companies with consolidated revenue of more than Euro 750 million are required to comply with CbCR.</p>

Multilateral Treaty

28

- On 24/11/2016 more than 100 countries, including India, concluded negotiations on a multilateral instrument – “*Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*”.
- The convention will swiftly implement a series of tax treaty measures to update international tax rules and reduce the opportunity for tax avoidance by multinational enterprises.
- The new instrument will transpose results from the OECD/G20 BEPS Project into more than **2000 tax treaties** worldwide.
- The signatories have agreed to implement minimum standards to counter treaty abuse and improve dispute resolution mechanisms. The convention provides flexibility to accommodate specific tax treaty policies & allow governments to strengthen their tax treaties with other tax treaty measures developed in the OECD/G20 BEPS Project.
- A formal signing ceremony will be held in June 2017 in Paris.

Tackling Black Money post the closure of the Income Disclosure Scheme



Demonetisation of High Denomination Currency Notes

30

- In a surprise move, the Modi Government, in a crackdown on black money and fake currency in circulation, demonetised high denomination currency notes of Rs. 500 and Rs. 1000 notes w.e.f 09.11.2016
- New Rs. 2000 and Rs. 500 denomination notes introduced to replace defunct notes.
- Scheme met with mixed reactions – intent has been praised by most, implementation universally criticized



Demonetisation of High Denomination Currency Notes

31

- Following the demonetization, the **Taxation Law (Second Amendment) Bill, 2016** (introduced in Lok Sabha on 28/11/2016 & passed on 29/11/2016).

Following are major amendments proposed:

- 1) Pradhan Mantri Garib Kalyan Yojana, 2016 (PMGKY) launched – “2nd IDS”
- 2) Undisclosed income will taxed at higher rates – effective rate 50%
- 3) 25% of the unaccounted cash deposited would be locked in an account for use by Govt. under PMGKY. Lock in period of 4 years with no interest.



Measures to target Gold & other undisclosed assets

32

- The Taxation Law (Second Amendment) Bill, 2016 proposes to increase the tax levied on unaccounted for gold, bullion, jewellery and investments – rate of tax increased to 60% with additional surcharge of 15% (25% of tax).
- A further penalty of 10% would be levied if such income (assets) are not disclosed in the return income and are subsequently discovered during assessment proceedings
- Therefore, total tax on undisclosed assets would be between 75% (if disclosed suo moto) to 85% (if discovered)
- Further, harsher penal provisions proposed for undeclared wealth discovered during search & seizure operations by the taxman or during assessment proceedings –
 - If the undisclosed wealth discovered is admitted & substantiated – 30% penalty
 - If undisclosed wealth is not admitted or not substantiated – 60% penalty

Restrictions on Cash dealings

33

- Tax collection at source (TCS) obligation of 1% was placed on sellers/ service providers accepting payments in cash of Rs. 2 lakhs or more.
- The existing TCS of 1% on cash purchase of over Rs 5 lakh of jewellery and over Rs 2 lakh of bullion continued.
- The Special Investigation Team (SIT) on black money has recommended a ban on cash transactions above Rs 3 lakh and restricting cash holding with individuals to not more than Rs 15 lakh to curb illegal wealth in the economy.
- Further restrictions on cash dealings could be brought in along with a general thrust to encourage use of digital/ e-payment methods



Crackdown on Benami Property

34

- The Benami Transactions (Prohibition) Amendment Act, 2016 has been effected from 1st November 2016.
- As per the Act, Properties held benami, i.e. “without name”, are liable for confiscation by the government without payment of compensation.
- An offender also faces a potential 7 year jail term.
- The government has started crackdown on anonymous properties by beginning surveys of land adjoining major highways and calling for ownership details.



**THE NEXT TARGET
AFTER DEMONETISATION**

Crackdown on Benami Property

35

In the view of Amendment, a benami transaction has been defined as:

(A) a transaction or an arrangement —

(a) where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and

(b) the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration

(B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name; or

(C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies knowledge of, such ownership;

(D) a transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious;



THANK YOU