

Direct Taxes Code

Certain Provisions for International Taxation

S. P. Singh
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Agenda

- Residence Rules & Scope of Taxation
- Deemed Income
- Rates of Taxation
- Branch Profits Tax
- General Anti Avoidance Rule
- Issues

Residence in India and scope of total income

- Definition of resident
 - Only two categories proposed viz. 'Residents' and 'Non-residents'
 - Concept of "resident but not ordinarily resident" to be deleted
- Resident to be taxed on global income
- Non-resident to be basically taxed on India-sourced income
- Special regime: Residents are proposed to be taxed only on India-sourced income for initial 2 years, if they qualify as a non resident in the preceding 9 financial years. Additional condition of 729 days to ascertain residency is proposed to be abolished

Scope of total income

Residential Status of a Company

- Part control and management in India – Resident of India
- To be tested at any time during the year
- Taxation of global income
- Control and Management – how defined ?
- Likely impact for
 - Branch / Office in India
 - Foreign subsidiary of Indian company
 - CEO / MD of foreign company visiting India

Scope of total income

Income deemed to accrue in India to include:

- Indirect transfer of a capital asset situated in India
- The activity of an agent of independent status – not clarified
- Collection of news / views for transmission outside India – not clarified
- Source Rules emphasised - Services rendered outside India
- Transportation charges in respect of carriage of passengers, livestock, mail or goods shipped to or from place in India

Carriage of goods from a place outside India to a place in India taxable
– Currently taxable only if amount received in India

Time charter payments - whether transportation charges?

Tax rates – non residents

Nature of income	Tax Rate (proposed)	Tax Rate (Current)
Income tax on a bodies	25%	40%
Minimum Alternate Tax	0.25%/2%*	15%**
Branch profits tax	15%	-----
Royalties/Technical services	20%	10%
Interest, dividends (on which distribution tax not paid), other investment income except capital gains	20% 30%	10%/20% 20%/30%/40%
Capital gains	30%	0%/10%/20%/30%/40%

*on gross assets as specified

** on 'book profits'

Special provisions for computation

Interest

- Interest on Investment - taxed on gross basis @20% as special source income
- Other interest – taxed on net basis @ 25% / @ 30% as ordinary source income

Royalty

Taxed on gross basis @20% as special source income irrespective of PE in India
Broadband/data connectivity charges included within the definition of Royalty

Fee for Technical Services

To include development and transfer of design, drawing, plan or software

Others

- Beneficial treatment omitted
 - Income of Offshore Funds from units purchased in foreign currency
 - Income from bonds/GDRs purchased in foreign currency
 - Special tax regime for FIIs
- Head Office expenditures deduction– Restricted to 0.5% of total sales/turnover/gross receipts - currently 5% of adjusted total income

Tax rates – non residents

Branch profits tax ('BPT')

Every foreign company liable to BPT @ 15% on its branch profits

Branch profits = total income minus income tax thereon

– Effective tax rate - 36.25%

Credit for pre-paid taxes will be allowed against BPT

Additional levy on foreign companies ~ effective tax liability lower

Special anti-avoidance provisions

General anti-avoidance rules(GAAR) to be introduced

- The Commissioner empowered to declare an arrangement as an impermissible avoidance arrangement (IAA) if –
 - the whole, a step or a part of the arrangement has been entered with the objective of obtaining tax benefit or
 - lacks commercial substance in whole or part or
 - creates rights and obligations not normally created in arm's length transactions, or
 - results in direct or indirect misuse or abuse of the provisions of the code
- Clear rules required
- The arm's length principle appears to being introduced to all types of transactions
- By allowing a re-characterization of debt and equity, the intention appears to bring in a thin capitalization rule. A safe harbor or guidance as to what would be a threshold debt-equity ratio has not been prescribed.
- Tax aligned supply chain type of planning and the use of hybrid instruments would be carefully considered prior to implementation

International taxation – Issues

Minimum Alternate Tax

- It is not clear whether MAT provisions can apply to foreign companies which do not have a branch or office in India
- Assessee covered by presumptive taxation will also be subject to MAT?
- It is not clear which assets should be considered for MAT in case of foreign company
- MAT is levied on gross assets and not on income ~ this may create issue for availing credit in the home country

Branch Profit Tax ('BPT')

- As the provisions stands today, all foreign companies are subject to BPT irrespective of the fact whether they have permanent establishment or office in India. This may not be in accordance with international understanding regarding branch profits tax
- It appears that BPT will also apply to special source income viz. royalty, fees for technical services, interest on investment and capital gains. Such a position will be detrimental for attracting new technology and investment into India

International taxation – Issues

- BPT is not defined as “income tax” for the purpose of the Code ~ As a result it would be difficult for foreign company to claim credit for BPT in home country under the Treaty

Capital gains

- Investment assets other than shares and units of equity oriented funds would be taxed on gross receipts without any deduction for cost in terms of Rule 2(b)
- FIIs liable to tax @ 30% on capital gains on sale of securities ~ 25% in case the investments are treated as business assets. Such a tax rate will be substantially high and will affect foreign investments into India.
- Section 5(1)(d) provides that income from indirect transfer of assets situated in India will deemed to accrue in India. This would have far reaching implications. The provisions should clarify the circumstances in which this provision will apply.

International taxation – Issues

Residential status of foreign companies

- In most Treaties, under the tie breaker rule, foreign company is considered as resident of a country where the place of effective management is situated. The residency rule proposed for foreign company may be brought on same lines
- Determination of "control and management" would be contentious issue and hence need for more clarity on the same

Interest

- Interest on investment considered as special source. The term investment is not defined. This will lead to litigation on interpretation.
- No deduction available for interest earned on investments even if earned through a PE ~ this will have a significant impact specially for foreign banks operating in India
- Deemed rule covers interest paid by a non–resident having source of income in India. This would affect the foreign investors making investment using borrowed funds. Need for clarity on this rule.

International taxation – Issues

Royalties

- Whether payment for time charter of ship would be liable to tax as "royalties" or as "transportation charges"
- Whether payment for use of ships / aircraft for oil exploration business would be liable to tax as "royalties" ~ covered within definition of royalties as well as item 7 of Table in Fourteenth Schedule

THANKS