ASHOK PRANSHU & CO.

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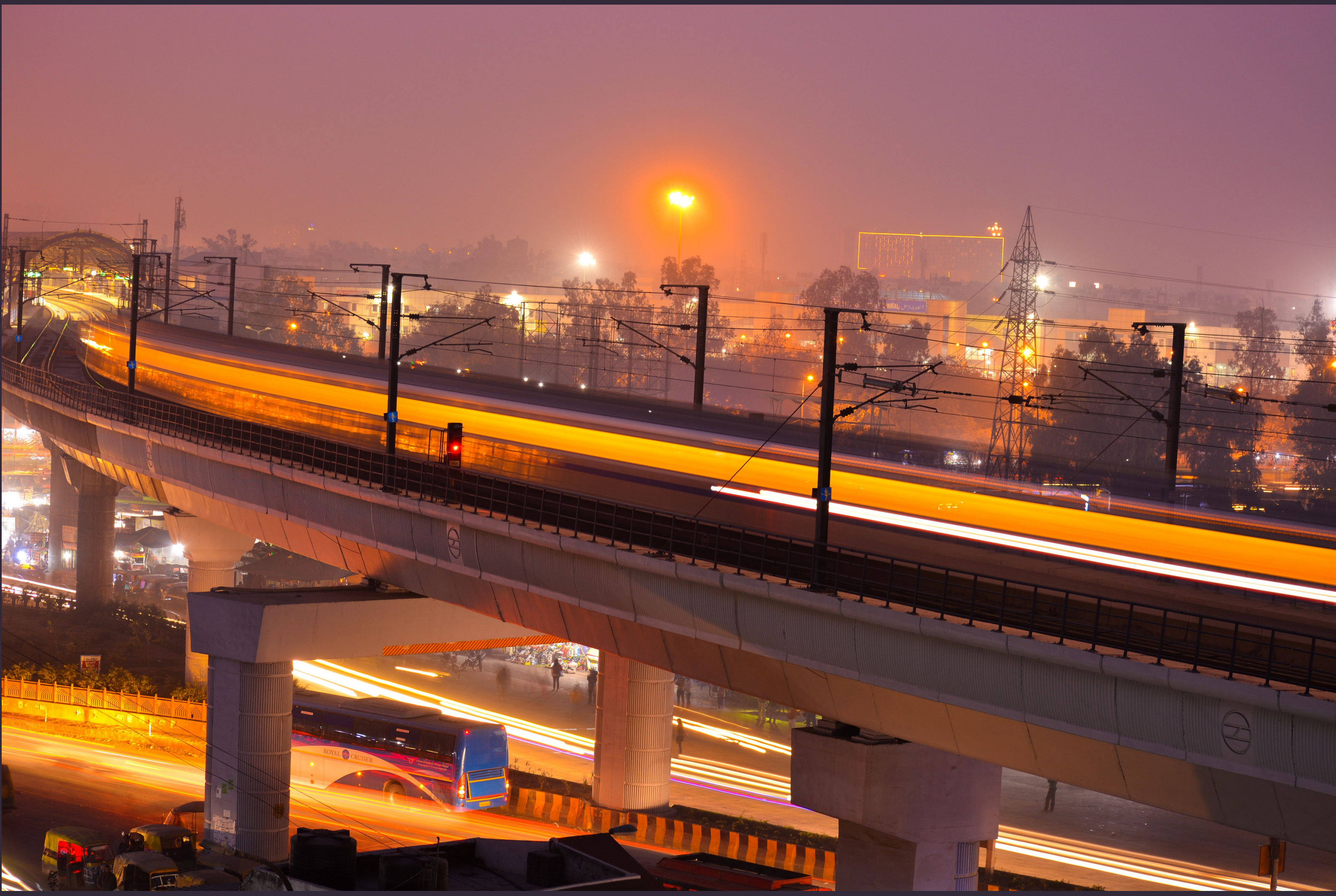


INDIA

INCOME TAX HAND BOOK 2018

INDIA'S TAX STRUCTURE

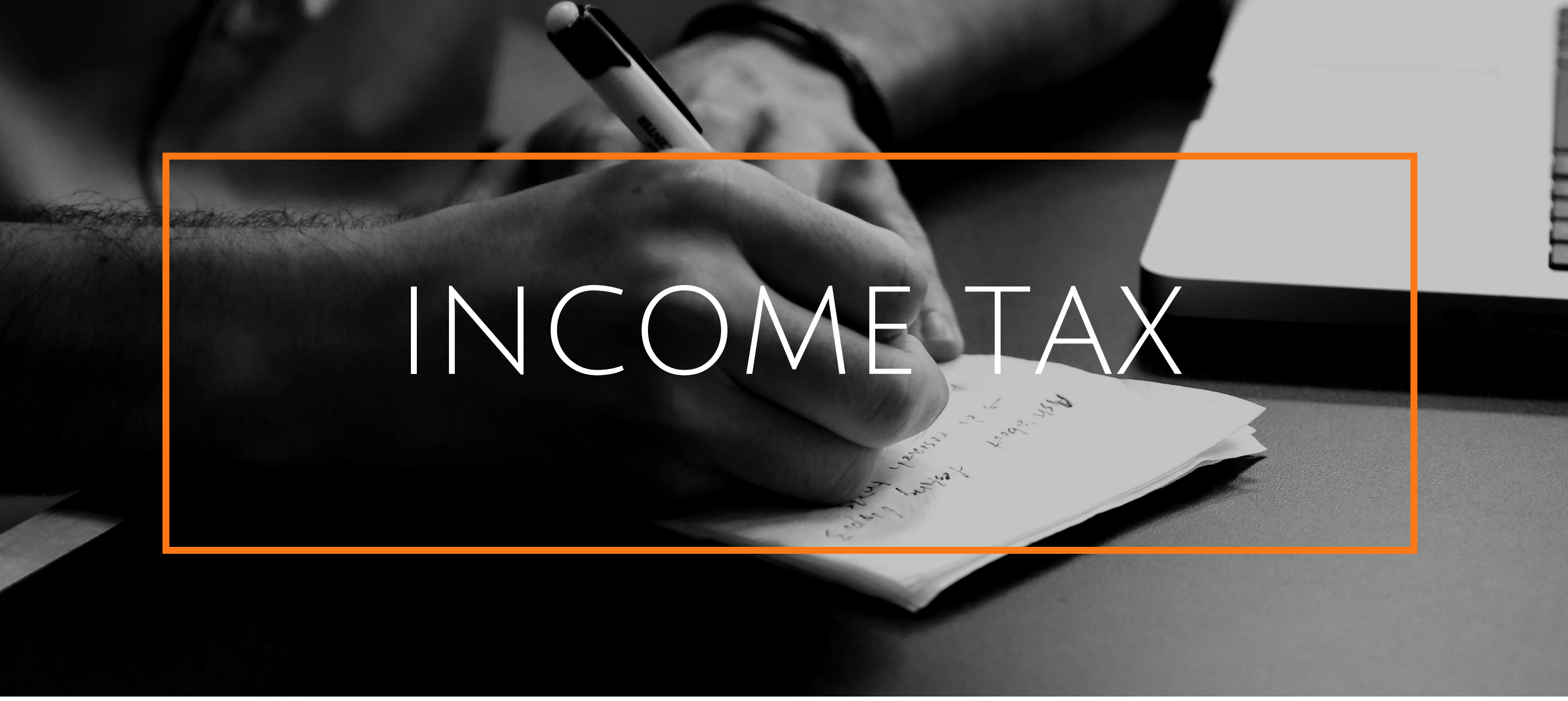
In an emerging economy as large as India, where, enterprises, individuals, around the world are investing and willing to invest, tax laws have witnessed some tremendous reforms in recent past. The tax rates have been rationalized and tax laws have been simplified resulting in better compliance, ease of tax payments and better enforcement. However, it is also a highly legalistic country with a wide range of statues and regulations, which can entangle those trying to invest or initiate business operations in India.

India has a well-developed tax structure, which is primarily demarcated into direct tax and indirect tax which are levied by central and state governments. However, there are some taxes such as stamp duty, property tax, profession tax which are levied by state governments or local bodies.

Direct tax is tax on the income earned, accrued or received in India, which is governed by the Income Tax Act, 1961 (IT Act). India also have a vast network of tax treaties with several countries for the purposes of avoidance of double taxation on the income of the persons or the enterprises investing in India or doing business with or in India. Recently, to curb the menace of tax evasion by parking the income in overseas jurisdictions, India has introduced a new law The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, to bring to tax the untaxed money parked by Indian residents in overseas countries.

Indirect tax is chargeable on the consumption of the goods and services in India. Before July 1, 2017, India had a complex indirect tax regime with multiple taxes levied at multiple stages of transactions, such as excise duty, service tax, value added tax, purchase tax, central sales tax, octroy etc. However, from July 1, 2017, all the multiple taxes have been abolished and a unified Goods and Services Tax (GST) has been introduced. GST is considered to be a great step towards transformation of the current indirect tax regime, removing the cascading effect of multiple taxes and bringing in ease of administration.

This compendium is intended to provide an overview of tax regulations in India, which should be considered while doing business in India or with India.



INCOME TAX

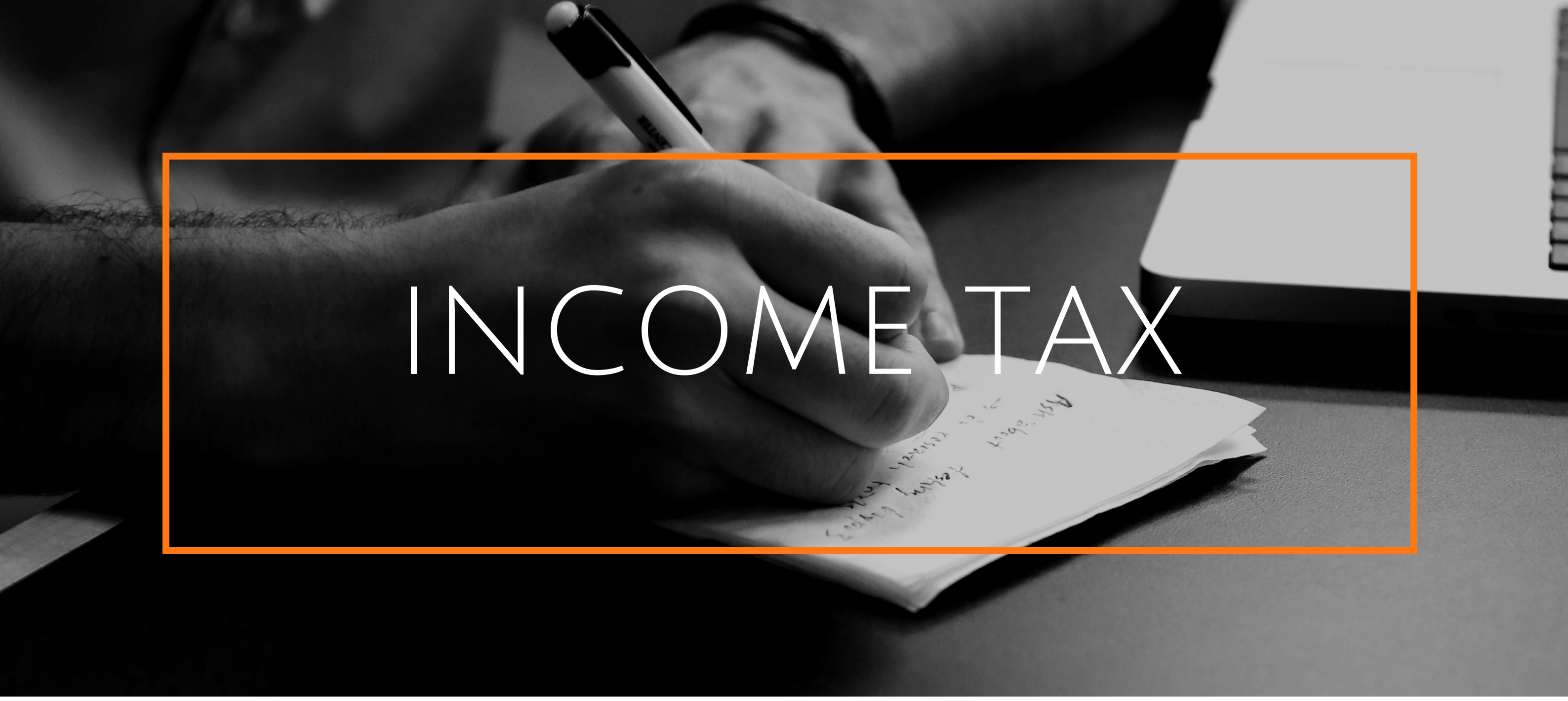
According to IT Act, every person, who is an 'assessee' and whose total income exceeds the maximum exemption limit, shall be chargeable to the income tax at the rate or rates prescribed in the Finance Act.

According to IT Act, income of an assessee is taxable under five different heads:

- Income from Salary
- Income from House Property
- Profits and Gains from Business and Profession
- Capital Gains
- Income from other sources

The term 'assessee' means a person by whom any tax or any other sum of money is payable under the IT Act, and includes-

- every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;
- every person who is deemed to be an assessee under any provision of this Act;
- every person who is deemed to be an assessee in default under any provision of this Act



INCOME TAX

A person includes:

- Individual
- Hindu Undivided Family (HUF)
- Company
- Firm
- Association of Persons (AOP)
- Body of Individuals (BOI)
- Local Authority
- Every artificial judicial person not falling within any of the preceding categories

Income Tax is an annual tax imposed separately for each assessment year which commences from April 1 and ends on the succeeding March 31.

INDIVIDUAL TAXATION

The total income of an individual is determined on the basis of his residential status in India. For tax purposes, an individual may be categorized as ordinarily resident, resident but not ordinarily resident and non-resident.

Residence of an Individual

An individual is deemed to be resident in India in any previous year if he satisfies any of the following conditions:

(a) if he is in India for a period of 182 days or more during the previous year; or

(b) if he is in India for a period of 60 days or more during the previous year and 365 days or more during 4 years immediately preceding the previous year.

Individuals fulfilling none of the above conditions shall be treated as Non-Residents.

A resident individual will be treated as resident and ordinarily resident in India during the year if he satisfies following conditions:

a) he is resident in India for at least 2 years out of 10 years immediately preceding the relevant year.

(b) his stay in India is for 730 days or more during 7 years immediately preceding the relevant year.

A resident individual who does not satisfy any of the aforesaid conditions or satisfies only one of the aforesaid conditions will be treated as Resident but not ordinarily resident.

Taxing Indian and Foreign Income

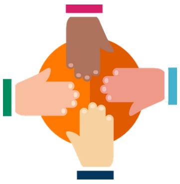
Resident Indians are taxed on their world-wide income. However, there are instances where residents are not liable to tax on their overseas income in India because of the taxing rights of the same with the other country. The same is because of the double taxation avoidance agreements between India and several countries.

Non-Residents are only taxed on the income that is received in India or arises or is deemed to arise in India. However, the same is also subject to the provisions of the DTAA. Non-residents are not taxable on their overseas income. A person not ordinarily resident is taxed like a non-resident but is also liable to be taxed on foreign income accruing abroad if it is from a business controlled in or profession set up in India.

Status	Indian Income	Foreign Income
Resident and Ordinarily Resident	Taxable	Taxable
Resident and Not Ordinarily Resident	Taxable	Not Taxable
Non-Resident	Taxable	Not Taxable

Income of the individuals, being resident or non-resident is taxable at the slab rates as under:

Annual Income (Rs.)	Tax Rate
Upto 2,50,000	NIL
2,50,001-5,00,000	5%
5,00,001-10,00,000	20%
Above 10,00,0000	30%



Company

A company has been defined as a juristic person having an independent and separate legal identity from its shareholders. Income of the company is computed and assessed separately in the hands of the company. However, the income of the company, which is distributed to its shareholders as dividend, is assessed in their individual hands. Such distribution of income is not treated as expenditure in the hands of the company; the income so distributed is an appropriation to the profits of the company.

Residence of a Company

A company is considered to be a resident in India for tax purposes during the relevant previous year if:

(a) it is an Indian company; or

(b) its place of effective management in that year, is in India

'Place of effective management' (**POEM**) as a test for residency of a company has been recently introduced. POEM is defined to mean "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". The intent behind introduction of concept of POEM is to align the provisions of the IT Act with the DTAAs entered into by India with other countries and to ensure conformity with international standards.

The concept of POEM is one of substance rather than its form. If the facts and circumstances reflect that the key management and commercial decisions in substance are taken in India by any person in India, POEM of such company shall be considered to be in India.

Corporate Tax

The taxability of a company's income depends upon its residential status. Indian companies are taxable in India on their world-wide income. Foreign companies are taxable on income that arises out of their Indian operations, or, in certain cases, income that is deemed to arise in India. Royalty, interest, gains from sale of capital assets located in India (including gains from sales of shares in an Indian company), dividends from Indian companies and fees for technical services are treated as Income arising in India. However, their taxability may depend upon the provisions of the DTAA of India with other country.

At present the domestic companies having turnover or gross receipts less than Rs. 5 Crore are taxed at 29% and domestic companies having turnover or gross receipts more than Rs. 5 Crore are taxed at 30%. Foreign companies or those companies which are considered to be resident of India because of their POEM in India are taxed at 40%. The aforesaid rates are exclusive of applicable surcharge and education cess.

Dividend Distribution Tax

In terms of the provisions of the IT Act, any amount declared, distributed or paid by a domestic company by way of dividend shall be chargeable to dividend tax. Only a domestic company is liable to tax. Tax on distributed profit is in addition to income chargeable in respect of total income.

It is applicable whether the dividend is interim or otherwise. Also, it is applicable whether such dividend is paid out of current profits or accumulated profits.

Rate of dividend distribution tax is 20.538% (Net).

Cross Border Transactions

Developments around the world have resulted into much anticipated globalised businesses and professional set-ups, resultantly investments in cross border businesses which has also been possible because of the bilateral tax treaties between the countries for avoidance of double taxation of the income earned by a person resident of one country from another country.
India has double tax avoidance agreements (DTAA) and tax information exchange agreements (TIEA) with several countries and is in the process of re-negotiating the old agreements and entering into double tax avoidance agreement with other countries. Existence of DTAAs does mitigate the risk of double taxation of income earned in one country by the enterprise/ person of another country and enable free flow of investment.

However, the same has also thrown the challenge for India to levy and collect the fair share of taxes because of the aggressive tax planning and multi layered structures devolved by the enterprises in view of the favourable position of the tax treaties. The issue of tax residency, taxation of income from investment in cross border businesses and cross border fiscally transparent entities have become contentious for the taxpayer, where the tax department of more than one country is chasing them.

In last one decade, India has witnessed substantial inflow of investments from Mauritius, Singapore and Cyprus due to the favourable tax position pertaining to taxability of capital gains on sale of shares of an Indian company. According to the provisions of such treaties any capital gain arising on sale of shares of an Indian company by a resident of other country were taxable in that other country.

Recently, India has re-negotiated its tax treaty with these countries and now India has the right to tax such capital gains.

India Mauritius Tax Treaty

The protocol amending the India Mauritius tax treaty has shifted the residency based taxation on capital gains to the source based taxation, now providing taxing rights to India on capital gains earned on alienation of shares of an Indian Company held by a Mauritius person.

With an intention to avoid any knee-jerk reaction from the investors and to provide a stable tax regime, the amendment is introduced on a prospective basis with a grandfathering clause, which protects investments made prior to April 1, 2017. In other words, investments made prior to April 1, 2017 will not be subject to capital gains tax in India and shall be eligible to take the existing treaty benefits and be taxable in the state of residence, being Mauritius, even if the divestments occur after April 1, 2017.

The protocol furthermore provides for a two-year transition period wherein a reduced rate of tax would be levied on capital gains earned on the transfer of shares of an Indian company, subject to fulfilment of certain conditions. The capital gains arising on investments in shares of an Indian company made on or after April 1, 2017 but alienated during the period April 1 2017 to March 31, 2019, shall be taxed at the rate of 50% of the domestic tax rate of India.

However, the phase-in of such lower rate of tax is subject to the fulfilment of the conditions in the Limitation of Benefits (LOB) clause. The newly introduced LOB article dispenses that a resident of Mauritius, including a shell/conduit company, shall not be entitled to the benefit of 50% reduced rate of tax, if such resident fails the main purpose test or bona-fide business test. Consequently, only Mauritius residents who have a substantial and not merely legal presence in that jurisdiction will be able to avail this benefit.

A Mauritius company shall therefore be deemed not to be a shell/ conduit company if (a) it is listed on a recognised stock exchange; or (b) its expenditure on operations in Mauritius is equal to or more than Mauritian Rupee 1.5 million or Indian Rupees 2.7 million in the immediately preceding period of 12 months from the date the gains arise. Tax on capital gains earned by a Mauritius resident after the transition period, i.e. April 1 2019, through sale of shares of an Indian company would be liable to pay tax in the source country being India, at the full rate.

ANTI AVOIDANCE REGULATIONS

Transfer Pricing

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and tax in India in the case of such multinational enterprises.
In India, comprehensive transfer pricing regulations were introduced in the income-tax legislation in the year 2001, which provides that any income arising from an international transaction between associated enterprises shall be computed having regard to the arm's length price.

Transfer Pricing Regulations are applicable to the all enterprises that enter into an 'International Transaction' with an 'Associated Enterprise'. Therefore, generally it applies to all cross border transactions entered into between associated enterprises. It even applies to transactions involving a mere book entry having no apparent financial impact. The aim is to arrive at the comparable price as available to any unrelated party in open market conditions and is known as the Arm's Length Price.

Transfer pricing has contributed to the spurt in litigations. In the midst of the growing litigations and adjustments exceeding Rs. 40,000 crores made by the tax authorities in recent years, there has been significant legislative as well judicial activism in this regard. The sudden spurt in litigation has become a cause of concern when one looks at pendency levels of matters with appellate forums.

Thin Capitalisation Rules

Introduction of thin capitalization rules can be said to be one of the most significant changes introduced recently. This 'anti-abuse' provision has been introduced to curb abusive tax structures adopted by Multi National Enterprises to obtain seamless benefit from debt and quasi-debt instruments, which have been unchecked so far. This move would have a significant impact on investments into India through the debt route – both in respect of Compulsorily Convertible Debentures (CCDs) and Non-Convertible Debentures which are widely used methods for funding into India.

The "Thin Capitalization Rules" provide that where an Indian company or Permanent Establishment (PE) of a foreign company makes interest payments (or similar consideration) to its associated enterprise, such interest shall not be deductible at the hands of the Indian company/ PE to the extent of the "Excess Interest". Excess Interest means an interest amount that exceeds 30% of the Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") of the Indian company / PE. In the event the interest payment payable/ paid is less than Excess Interest, the deduction will only be available to the extent of the interest payment payable/ paid.

General Anti Avoidance Regulations (GAAR)

The debatable principle of tax righteousness is not new, this contentious concept has always been a topic of some persuasive deliberations in the past, when it comes to the principles of tax management, tax planning or an art of paying less taxes. The momentum of aggressive tax planning, has been growing for the last few years, High Net Worth Individual(s), Corporates and Multi-National Enterprises have actively engaged themselves in building complicated tax structures to achieve less tax payouts. Though these structures are regarded by courts as legally correct but the tax department has always raised their contentions on the same.

To counter such aggressive tax planning, India has introduced GAAR and recently enforced the same. GAAR as a codified law enshrined under IT Act, hinges in primacy upon the doctrine of "substance over form", where the real intention of the parties, the effect of transactions and purpose of arrangement is taken into account for determining tax consequences, irrespective of legal structure that has been superimposed to camouflage the real intent and purpose.

It inter alia empowers the tax authorities to deny tax benefit, if the transactions or arrangements do not have any commercial substance or consideration other than achieving the tax benefit.

GAAR as an anti-avoidance measure, irrespective of anything laid down under the Act, provides power to the tax officials to treat any transaction or any arrangement as an 'impermissible avoidance arrangement', where the main purpose of entering in such transaction or arrangement is to obtain tax benefit.

DISPUTE RESOLUTION

India has an elaborate structure of tax administration, including, in particular, administrative practices for dealing with disputes. The statute provides for a four-tier appellate hierarchy for resolving conflicts between the revenue department and taxpayers, of which the higher two in the hierarchy are only law finding forums. This all-embracing administration has become all the more significant in the light of the ever-increasing growth of the inbound and outbound investments, size and quantum of international transactions, frequent disputes emerging from interpretation uncertainties, etc.

All tax disputes arise at the stage of the Tax officer who examines the return of income filed by the assessee, and then frames the assessment by applying the provisions of the IT Act either allowing or disallowing expenditures incurred and making certain additions. The assessee has a right to appeal the aforesaid assessment to the Commissioner of Income Tax (Appeals) and further to the Income Tax Appellate Tribunal and then the High Courts and finally the Supreme Court. According to the Scheme of the Act the Tribunal happens to be the last fact-finding authority. In cases of violation of principles of natural justice or fundamental rights of the taxpayers, they can directly file Tax writs before the respective jurisdictional High Court and claim the required relief. Matters directly filed before the High Court are generally not entertained for existence of adequate alternate remedy.

The mechanism of appeal under the scheme of the IT Act provides safeguard against erroneous, unjust or invalid orders. The appeal proceedings ordinarily include all proceedings whereby an appellate authority is called upon to review, revise, affirm, reverse or modify the decisions of a lower/ subordinate authority. The taxpayer has been given a right of appeal where he feels aggrieved by the order of the tax officer. However, it is pertinent to note that under the scheme of the IT Act, the taxpayer has no inherent right of appeal unless the IT Act specifically provides that a particular order is appealable. Accordingly, in order to avail the privilege to appeal, every person seeking to fight an appeal must ensure that he fulfils every condition, procedure and restriction provided under the law in order that his appeal is considered by the appropriate authority.

ALTERNATE DISPUTE RESOLUTION

DISPUTE RESOLUTION PANEL

The DRP consists of collegium of three Commissioner of Income Tax (Appeals) or Directorate of Income Tax. The DRP has the mandate to guide the Tax officer in deciding cases where the addition involves Transfer Pricing or cases of foreign companies.
In such a situation, the tax officer passes a draft order & within a month, the payer has to either approach the DRP or inform the tax officer that the draft order is acceptable as final. In case of the former, the tax payer disputes the draft assessment order before the DRP and the DRP has to decide within nine months whether the tax officer's draft order is fine or whether it needs to be amended. The tax officer passes a final order based on the directions of DRP. Tax payer can appeal before the ITAT against the direction of the DRP.

SETTLEMENT COMMISSION (ITSC)

The ITSC is a quasi-Judicial body which was set up in 1976. The prime objective of setting up the ITSC was to provide a mechanism for one time settlement of taxes to evaders or un-intending defaulters and thereby, avoiding endless litigations. There are certain pre-requisites to pursue an application for settlement commission being disclosure of additional income on which tax is payable exceeds 5 million INR, pre-payment of such taxes etc. The settlement applications filed by taxpayer goes through preliminary & final acceptance by ITSC. Subsequently, opportunity is provided to Income Tax department for enquiry or investigation of the case & taxpayer is also entitled to provide its submission against the objections of the Income Tax Department raised during the course of enquiry or the investigation. After hearing both the parties, the ITSC decides issue & determines the final income. The order of the ITSC is final and binding on the taxpayer as well as the Income Tax Department. However, the mechanism of writ petition can be filed by either party before the High Court, if the order is contrary to the legal principles.

AUTHORITY FOR ADVANCE RULING (AAR)

The primary objective for setting up of the AAR was to provide non-resident & residents entering into transactions with non-residents, to seek ruling so as to ascertain the income tax liability in advance.

It is imperative to note that AAR rulings are binding on the taxpayer/applicant and revenue for the transactions, in relation to which the ruling had been requested. The ruling can however be challenged before the courts at the instance of either the revenue or the applicant, as part of the constitutional remedy.

The ruling is required to be issued within a time span of six months from the date of application. Further, the AAR can also decide whether an arrangement entered into or proposed to be entered into by resident or non-resident meets the list of impermissible avoidance arrangement lender the general anti avoidance rules.

ADVANCE PRICING AGREEMENT (APA)

APA is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in the future. The APAs offer better assurance on transfer pricing methods and are conducive to providing certainty and unanimity of approach.

Under the provisions of the IT Act, the Central Board of Direct Taxes is empowered to enter into an APA with any person undertaking an international transaction. Such APAs shall include determination of the Arm's Length Price ('ALP') or specify the manner in which ALP shall be determined, in relation to the international transaction. The APAs are valid for such previous years as specified in the APA which in no case shall exceed five consecutives previous years. The APA shall be binding only on the person and the Commissioner (including income-tax authorities subordinate to him) in respect of the transaction in relation to which the APA has been entered into. The person entering into such APA is necessarily required to furnish a modified return within a period of three months from the end of the month in which the said APA was entered in respect of the return of income already filed for a previous year to which the APA applies.

MUTUAL AGREEMENT PROCEDURE (MAP)

MAP is a dispute resolution mechanism provided for resolving controversies arising out of application of the DTAA and is a special procedure, which is outside the scope and purview of the domestic income tax regulations.

In general, Article 25 of the model tax treaty convention provides for the said framework and the OECD convention is the one primarily used as the basis for all MAP proceedings.

The MAP applies to cases where the action leads to double taxation, which is not in accordance with the convention. Some of the common causes referred to under MAP are as follows:

- Issues relating to Permanent Establishment (PE)
- Questions relating to attribution of profits to a PE
- Cases relating to taxpayer's residence situation where the convention has not been properly applied

In addition to the above, MAP also enables the Competent Authorities to discuss matters relating to transfer pricing adjustments.

The procedures relating to MAP proceedings are prescribed under the Income Tax Rules, 1962. In order to be admissible, the MAP application is required to first be presented to the Competent Authority of the tax payer's state within three years of the first notification of an action i.e. assessment notice/ order etc. The resolution under MAP is required to be communicated to the Chief Commissioner/ Director General of Income Tax in writing and the AO is required to affect the same within 90 days of receipt of such a resolution, if the taxpayer gives his acceptance to the resolution and withdraws all appeals pending on the issue which was the subject matter of adjudication under the MAP.

UNDISCLOSED FOREIGN INCOME AND ASSETS

To curb the menace of funds illegitimately stashed abroad by Indian tax residents, India, in the year 2015 came with a draconian law named as The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 ('Black Money Act').

It has been conceived as a separate stand-alone legislation divided into 7 Chapters and 88 Sections, independent from the IT Act.

The primary objective of the Black Money Act is to tax the undisclosed foreign income and foreign assets acquired from such undisclosed foreign income and initiate punitive actions against those indulging in this illegitimate means of causing loss to the exchequer.

Any undisclosed foreign income or assets shall be taxed at a flat rate of 30% and no exemption or deductions or facility of set off of any carried forward losses shall be permitted under the Black Money Act. Further, the law also provides for applicability of interest on tax on the undisclosed income.

The highlights of the Black Money Act are the penalty and prosecution provisions whereby a penalty of 300% is levied for non disclosures of income or asset. Furthermore, slab rates of penalty have been specified for non disclosures or non furnishing of return or information, or furnishing of inaccurate particulars etc. Similarly, prosecution provisions provide for rigorous imprisonment for a period exceeding six months but restricted to seven years. However, stringent provisions for imprisonment have been provided for wilful evasion of taxes, penalty or interest etc., wherein the period of sentence has been provided for a minimum period of three years with a maximum of ten years.

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