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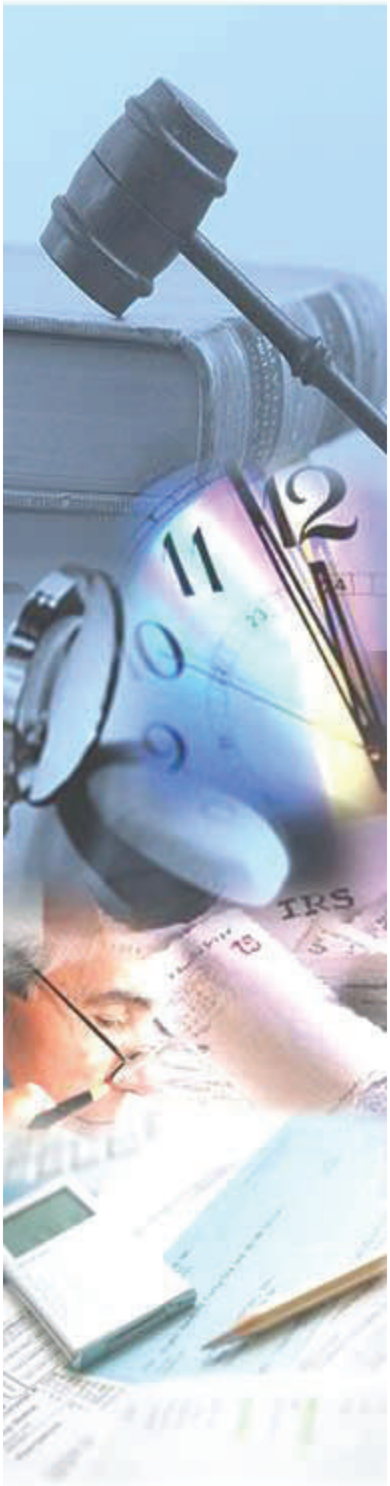
Tax Alert

SKP

Recent tax initiatives taken by the Government to rebuild investor confidence in India



Background:

The recent amendments introduced vide the Finance Act 2012 have led to a lot of uncertainties in the minds of taxpayers i.e. both Indian as well as foreign. This has mainly resulted due to retrospective amendment to the Indian Income Tax Act (ITA) to tax sale of shares outside India if such transaction derives value from Indian assets and the introduction of General Anti-Avoidance Rules ('GAAR') which would be effective from 1st April 2013. These changes as well as the approach of tax authorities on transfer pricing and other areas were causing a lot of discomfort to foreign investors and Indian MNCs. There was significant media attention – both national and international - on these issues. With all round criticism of the tax changes and concern of vitiating the investments climate in India, the Government of India (GOI) has been reaching out to address the concerns of investment community. These announcements seek to rebuild the somewhat lost confidence of investors in India. In the following paragraphs, we have summarized the measures adopted by the GOI:

Recent Measures:

1. **Formation of an Expert Committee on GAAR ('Shome Committee')** *[vide press release dated 13th July 2012 Source: http://pib.nic.in]*

As you may recollect from our earlier alert of 4th July 2012, CBDT had set up a committee for formulation of guidelines for implementation of GAAR. The draft guidelines were published for public comments on 28th June 2012. However, although the draft guidelines contained welcome clarifications on many aspects, these guidelines generated a mixed response from various stakeholders. Further, the guidelines lacked clarity on certain aspects.

Now with a view to bring further clarity and to incorporate high degree of technical expertise to the formulation of GAAR guidelines, the Prime Minister has constituted a four member Expert Committee under the chairmanship of Dr. Parthasarathi Shome, a distinguished economist.

As per the above press release, the role of the said committee is to:

- Receive comments from stakeholders and general public on the first draft GAAR guidelines by ***end of July 2012***,
- Vet and rework the guidelines based on this feedback and publish the second draft of the GAAR guidelines by ***31st August 2012*** for further comments and consultations,
- Submit the final guidelines to the Government by ***30th September, 2012.***

With this, the final guidelines are expected to address the ambiguities and fears created by the draft guidelines.

2. Taxation of Portfolio Investments referred to GAAR Committee *[vide press release dated 30th July 2012 Source: http://pib.nic.in]*

Apart from the GAAR provisions, the other major amendment which received flak from various investor groups is reaffirmation of the legislative intent to tax offshore share sale transactions on the basis of *"source rule"*. As per this amendment, where shares of a company incorporated outside India (which derive, directly or indirectly, their value substantially from assets located in India) are transferred, then the gains from such a transfer shall be taxable in India. This shall be irrespective of the residential status of the parties entering into the transaction.

Concerns were raised by portfolio investors and Foreign Institutional Investors on the effect of this amendment on transactions carried out by them. Thus, in order to rebuild confidence of such investors and to harmonize the GAAR guidelines with the intention of such investors, the Prime Minister has decided to refer the implications of this amendment to the above mentioned Shome committee.

3. Committee to Review Taxation of Development Centres and the Information Technology ('IT') Sector along with Safe Harbour Provisions *[vide press release dated 30th July 2012 and order dated 03rd August 2012 Source: http://pib.nic.in]*

Many multinational companies engaged in businesses such as IT software/hardware, Pharmaceuticals, Automobiles, Science, etc. establish 'Development Centres' in India for various activities like product development, analytical work, software development, R&D, Clinical trials etc. These activities are mainly carried out in India through captive entities. The taxation environment of such Development Centres has been uncertain.

Further, in the IT sector, issues such as tax treatment of "onsite services" of domestic software firms and high pitched transfer pricing assessments have led to controversies and concerns. To allay these uncertainties, *Safe Harbour* provisions were announced vide Finance (No.2) Act 2009, but these never saw the light of the day as they have not been notified till date.

With a view to address these issues, the Prime Minister has constituted a four member Expert Committee under the chairmanship of Shri N. Rangachary, former Chairman - CBDT & Insurance Regulatory and Development Authority of India. As per the press release in this context, the role of the said committee will be to:

- Engage in consultations with stakeholders and related government departments to finalise the approach to taxation of Development Centres and suggest any necessary clarifications by ***31st August 2012,***
- Finalise Safe Harbour Rules, sector by sector in a staggered manner, by ***31st December 2012.***

Once the above issues are resolved and the rules notified, the litigation related hassles faced by the taxpayers are expected to reduce significantly.

4. **Review of tax provisions introduced by the Finance Act 2012 having retrospective effects** *[vide press release dated 6th August 2012 Source: http://pib.nic.in]*

The new Union Finance Minister, Shri P. Chidambaram on assuming the charge of Finance Ministry, has said that his prime duty shall be to re-gain the confidence of all stakeholders.

For this, he has assured that corrective measures would be taken wherever necessary to bring about clarity in tax laws, to have a stable tax regime, a non-adversarial tax administration and a fair mechanism for dispute resolution.

Further, he has also directed a review of tax provisions that have a retrospective effect in order to find fair and reasonable solutions to pending as well as likely disputes between the Tax Department and the taxpayers concerned.

SKP's Comments:

These recent measures being adopted by the GOI are welcome steps towards addressing the concerns that have been floating in the Indian Investment environment post introduction of the Finance Act 2012. With the Indian economy in need of significant impetus of foreign investment to sustain the high growth rates witnessed in the last decade, this may be the right step by the GOI, provided the actual implementation is done in the right spirit. In addition to these measures, the GOI is also strongly promoting the Qualified Foreign Investor (QFI) Scheme to attract foreigners and non FII institutional investors to India for investing in Indian stocks, mutual funds and debt.

Have a look at some of our earlier Tax Alerts:

Volume V Issue 16 - dated 10 July 2012

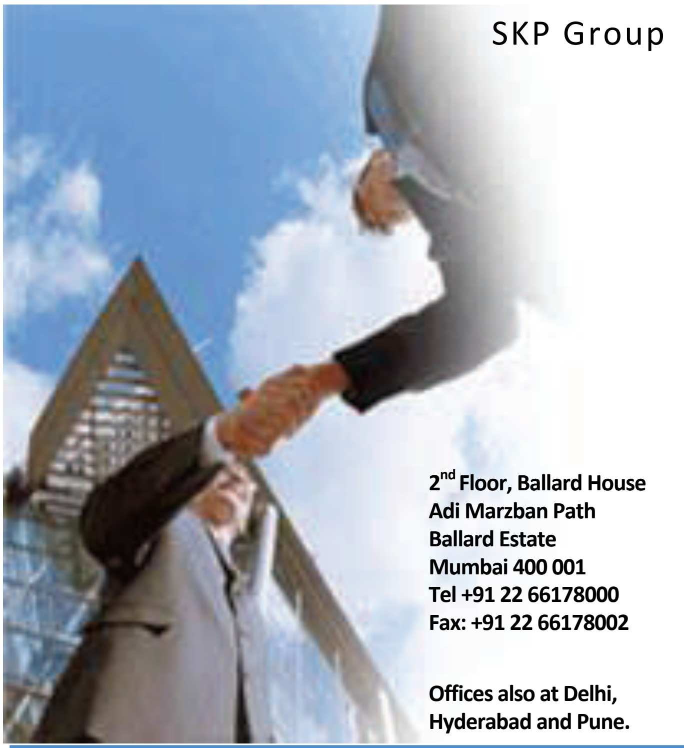
Implications of Service Tax on advocates / law firms under the new regime

Volume V Issue 15 - dated 10 July 2012

No disallowance under Section 14A with reference to investments having potential of generating taxable income

Volume V Issue 14 - dated 4 July 2012

Draft Guidelines on Implementation of General Anti Avoidance Regulations (GAAR)



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