India Tax Insights

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Building a better working world

Foreword

We are pleased to present the 22nd edition of our magazine, ***India Tax Insights.***

On 29 July 2021, the Organisation for Economic Co-operation and Development (OECD) released the third edition of its annual "Corporate Tax Statistics" publication together with an updated database. The database is intended to assist in the study of corporate tax policy and expand the quality and range of data available for the analysis of base erosion and profit shifting (BEPS) activity. The new data shows the importance of the two-pillar plan to reform international taxation rules. The report notes the importance of corporate tax as a source of government revenues and points to evidence of continuing BEPS behavior. The data showing decline in statutory corporate income tax rates in in most countries over the last two decades highlights the importance of the global minimum tax rules developed under Pillar Two.

As Government tax policymakers around the world work together on proposals for significant changes to long-standing international tax rules, data from the OECD's report show some insights that could have an impact on the finalization of the agreement in the BEPS 2.0 project that is expected in October 2021.

This edition contains insights on recent tax and fiscal policy developments. The articles cover topics ranging from tax implications for individuals due to their extended stay in India on account of COVID-19, developments in India's production-linked incentive regime in making India a global manufacturing hub, and implications from structuring of employee stock based compensation plans pre-capital raising, in addition to our regular features covering global tax news and economic trends.

In this shifting tax environment, staying abreast of changes is essential. We hope that this publication helps you monitor the issues and understand the drivers behind key tax and regulatory developments and changes happening in India and around the globe. We look forward to your feedback and suggestions.

Sudhir Kapadia

Sudhir Kapadia
National Tax Leader, EY India

In this issue

Can a carbon tax drive decarbonization and sustainability agenda?

Are carbon taxes the right option for India to limit the impact of climate change? We examine.

Rajnish Gupta

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The rise in global temperatures and the resultant climate change are now at the centre stage of public policy debates. Governments, businesses and communities are pledging to take action to reduce emissions. At the recent G20 Finance Ministers' meet on 9-10 July, 2021, all participants concurred that tackling climate change remains an urgent priority compared to other threats to growth and prosperity. The tools suggested for the effective policy mix for sustainable development included green investments in sustainable infrastructure, innovative technologies that promote decarbonisation and carbon pricing to support clean energy sources.

One of the popular policy options to reduce carbon emissions is setting a price for carbon through trading schemes or by implementing carbon taxes. Until now, India has relied on the former. For instance, electricity distribution companies are required to mandatorily source some amount of renewable energy. Similarly, government has mandated the usage of CNG for public transport. Incentives to electric vehicles and prescribing codes for greener buildings are among the regulatory measures recently used to reduce emissions.

A carbon price applied directly or implicitly to carbon emissions can be effective in reducing emissions by increasing the price of high-emissions inputs. Businesses that seek to maximize profits respond to high input prices by finding ways of limiting the use of such inputs and reducing the production of products causing pollution.

Explicit price of carbon emissions can be achieved both through carbon trading schemes and carbon taxes. In a carbon trading scheme, the government sets a cap for the level of permissible emissions. It then gives emission allowances to entities, where the total allowances equal the cap. Entities can buy and sell these allowances based on their needs and the secondary market reveals the cost of emissions. Therefore, like carbon taxes, a carbon trading scheme also provides a transparent and tangible cost of carbon emissions. However, prices for carbon trading can often be volatile as they are driven by forces of supply and demand. In contrast, carbon taxes provide greater certainty to businesses regarding the price that must be paid for emissions. Certainty in pricing helps players make better decisions about technology and usage choices.

In India, the coal cess of Rs 400 per tonne and the high level of taxation on petrol and diesel are examples of an implicit carbon tax. Currently, effective tax on petrol and diesel is in excess of 100% in contrast to the general 18% tax on most fuels subject to GST. However, India does not have an explicit carbon tax[1]. Also, clean fuels like natural gas continue to be outside the ambit of GST, impacting their competitiveness and India's ability to reduce emissions. Thus, even though some of the levies are in the nature of a carbon tax, the overall taxation structure in India does not seem to be designed to provide incentives to reduce emissions. The table below depicts that the tax treatment of fuels in India is not related to carbon emissions.

Fuel	Coverage under GST	GST Rate(%)	Emission factor (Kilograms CO2 per Million Btu) Kg CO_2/MBtu
LPG	✓	5 (Domestic) 18 (Non-domestic)	64.01
Kerosene	✓	5 (PDS) 18 (Non-PDS)	72.30
Naphtha	✓	5 - 18	72.80
Bitumen and Asphalt	✓	18	75.61
Coal	✓	5 (+GST compensation cess @ Rs. 400/ton)*	95.35
Petroleum coke	✓	18	102.10
Other Fuels	**Coverage under GST**	**Effective tax burden**	**Emission factor (Kilograms CO2 per Million Btu) Kg CO_2/MBtu**
Natural gas	×	0-25**	53.07
ATF(Aviation turbine fuel)	×	4-30**	70.90
Petrol	×	142	71.30
High Speed Diesel	×	107	73.16
Exclusion from GST makes the fuel uncompetitive			

Source: https://www.eia.gov/environment/emissions/co2_vol_mass.php,
There are different sources for Emission factors available which can be referred and varies.

* GST compensation cess can be used to develop a carbon tax in India.

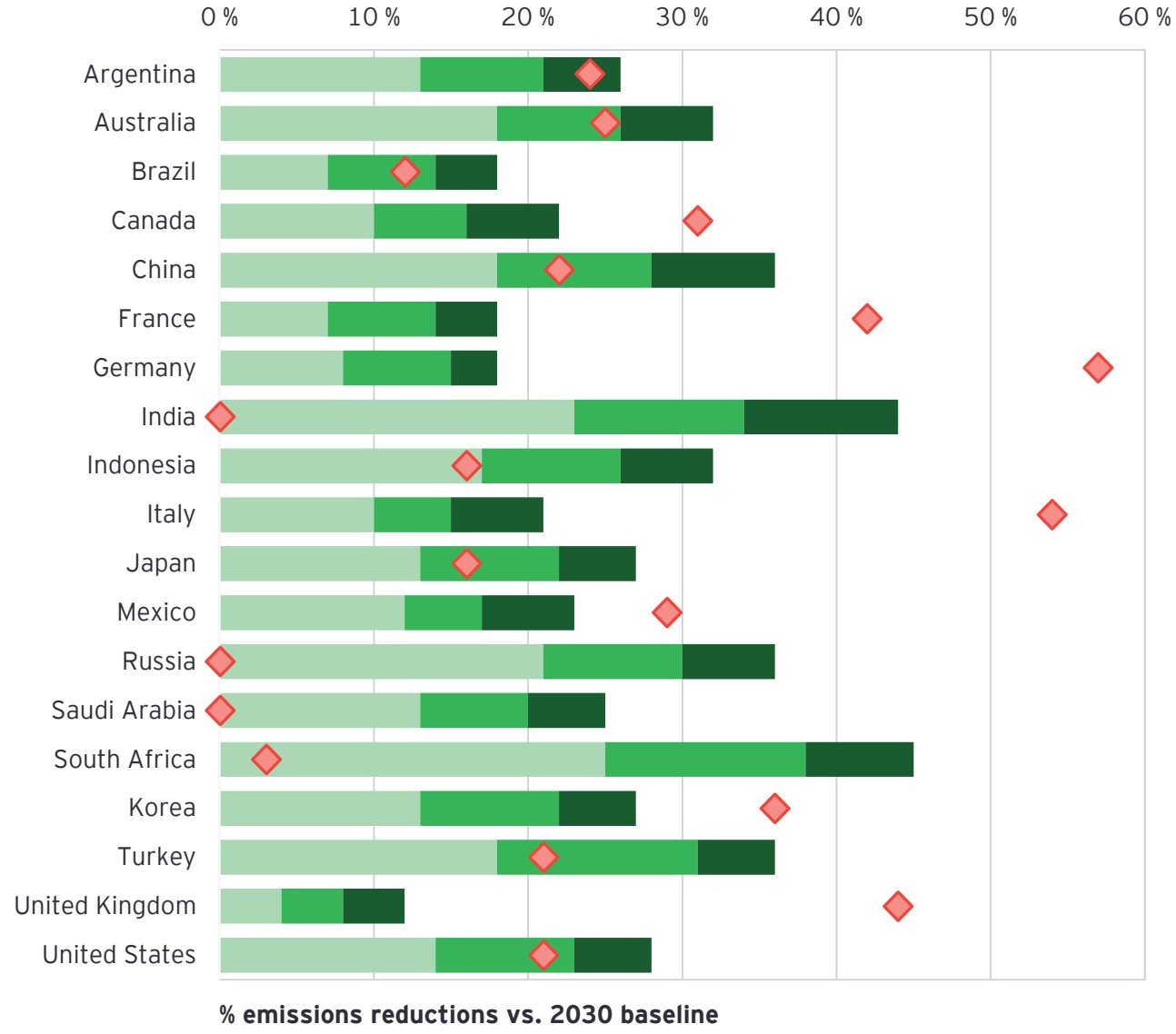
** These are standard state tax rates for these products

1 Some Indian States have imposed a green tax on old vehicles.

There are many features that make carbon taxes an attractive potential public policy instrument in India. It is possible to cover all sources of emissions through a well-designed carbon tax i.e., upto 100% of the emissions. In contrast, command and control type of regulations (e.g. green building code) apply only to a part of the emissions i.e., only the sectors for which the scheme has been designed. The implementation of command and control regulations/schemes have their own challenges.

As per the International Monetary Fund IMF, depending upon their level of ambition, energy mixes, and different starting points, reaching the emissions abatement objectives defined in NDCs requires measures equivalent to carbon price increases of US$25-75/tCO2 or more by 2030 in many G20 countries. For India, a carbon price of US$25 per tonne of CO2 in 2030 will help reduce emissions by about 25%. For achieving its commitment of reducing emissions intensity of GDP by 33-35% by 2030 over 2005 levels, a higher carbon price may be needed.

Carbon taxes could also be a significant source of revenues for governments seeking to increase the tax to GDP ratio. Assuming annual emissions of 2.0 billion metric tonnes of carbon dioxide per annum, a carbon tax of Rs 1000/tonne of CO2 (approx. US$15 per tonne) could help the government raise potentially Rs 200,000 crores of taxes annually. This could be attractive, particularly when considering the impact of COVID on public finances.



Source: IMF (Approximate values taken while recreating the graph)

The decision to impose explicit carbon taxes can have challenges too since governments need to balance economic progress and provide higher standards of living for their citizens, with ensuring lower emissions. Economic growth entails increased usage of energy. There is a trade-off between ensuring reduced emissions through carbon taxes and increased economic activity through availability of cheap and abundant energy. There is an element of the tax being regressive as it is passed on to the consumer through the supply chain. For this reason, there have been instances where carbon taxes were unpopular, as was the case in Australia[2]. At the same time, countries like Finland[3] have been successful in implementing a carbon tax. Thus, the right carbon tax design is important for achieving the balance between effective carbon pricing and growth.

It may be noted that no country can solve the problem of emissions unilaterally. The current approach has been for countries that are signatories to the Paris accord to develop their individual plans for reducing emissions. The effects of carbon emissions in any one country would be felt all over the world, and disproportionately higher in more vulnerable countries. Thus, imposition of a carbon tax by just one country could end up hurting the economy of that country, if the rest of the world does not follow suit.

EU has proposed a new Carbon Border Tax by way of an additional levy on imports of steel, aluminium, cement, electricity and fertiliser, if carbon prices equivalent to that paid by manufacturers in EU are not paid in the country of origin. This proposal indicates that application of carbon prices and taxation could start impacting trade and put pressure on countries to have their own carbon pricing mechanisms.

2 https://www.ato.gov.au/business/fuel-schemes/previous-years/fuel-tax-credits-for-business-(1-july-2012-to-30-june-2014)/?anchor=CleanEnergyCarbonCharge

3 Carbon Tax Guide : A Handbook for Policy Makers, 2017

Petroleum tax structure: Impetus needed for the sunrise sector

Higher revenues from the government's increased petrol and diesel taxes would yield good outcomes only if invested in areas with high fiscal multipliers.

Navneeraj Sharma **Chinmaya Goyal**

Senior Professionals, Tax and Economic Policy Group, EY India

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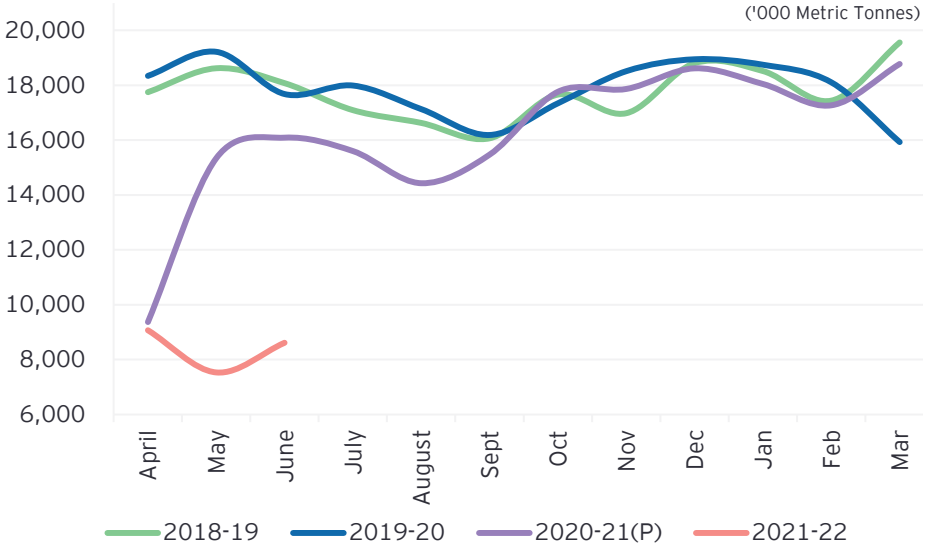
In India, taxation on petroleum products such as petrol and diesel is an important source of revenue for the central and state governments. After introducing the Goods and Services Tax (GST) in 2017, petroleum taxes became key sources or revenue, and allowed governments to quickly change tax rates and plug revenue gaps. Energy prices, therefore, can exert an outsized effect on the Gross Domestic Product (GDP) growth and consumer price inflation.

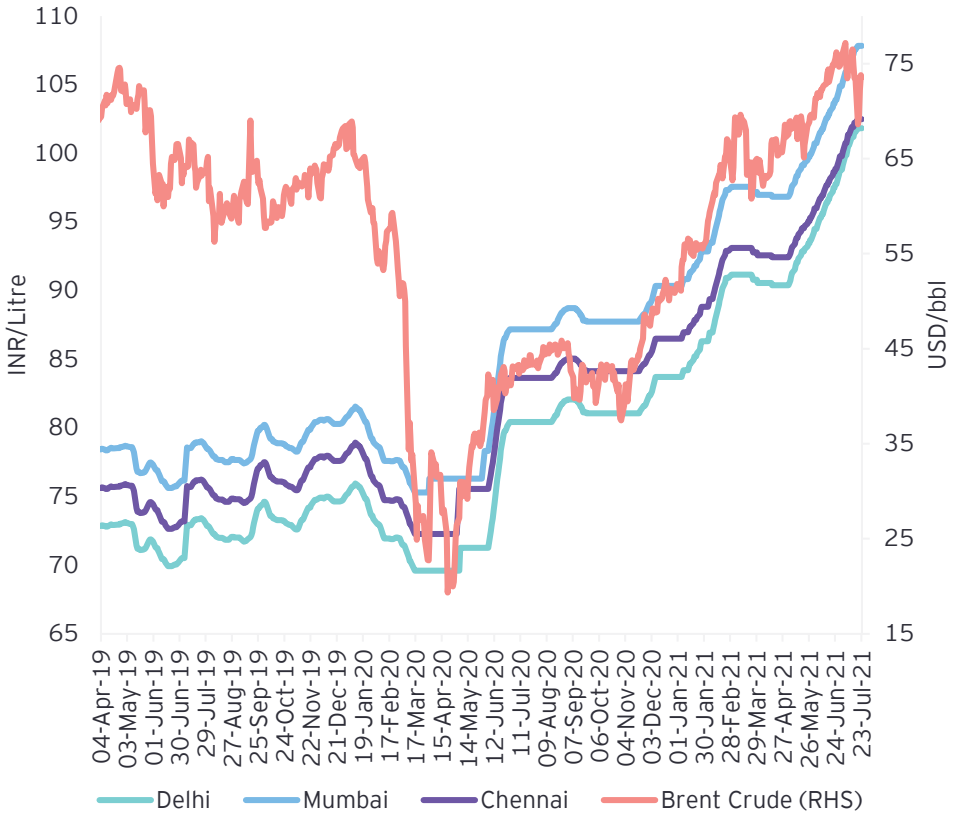
From the beginning of FY21, the COVID-19 crisis exerted a sizeable setback on the energy sector and the economy. First, the lockdowns imposed by the governments led to a sharp decrease in the consumption of petrol and diesel, as depicted in Chart 1[1] below. For example, consumption in April 2021 was lower than the consumption in April 2020. In the first quarter of FY22, the fall in petrol and diesel consumption was so sharp as to be almost 50% of the consumption levels in FY19 and FY20. The government responded by increasing tax rates to compensate for the fall in revenues because of reduced consumption.

Chart 1: Consumption of petrol and diesel



1 Source: Petroleum Planning & Analysis Cell (ppac.gov.in)

Chart 2: Domestic Oil Price Vs International



Second, due to the global nature of the pandemic, global crude oil prices crashed by almost 70% at the end of FY20 and beginning of FY21 (See Chart 2), anticipating a sharp fall in crude oil demand because of the coming lockdowns and the subsequent fall in global GDP. The major oil cartel Oil Producing Exchange Countries (OPEC) responded by cutting crude oil production to provide support to falling prices. They further extended the cuts in oil supply to recover from the previous losses despite global demand bouncing back sharply on the back of global fiscal and monetary support provided by developed economies. This has led to a rapid rise in oil prices.

Thirdly, the GDP growth rate for FY21 turned negative (-6.3%) resulting in further reduction in the demand for petroleum products. It further exacerbated the revenue impact for the government. The negative revenue impact came when the government had to increase its expenditure on COVID-19 relief to vulnerable sections and support the hard-hit sectors. The increase in fiscal deficit and debt by the government was possible only up to a certain level, given that India's credit rating has been just one level above the junk rating and any further increase in debt could have worsened the perception of rating agencies.

Given the fall in consumption levels of petroleum products and overall decrease in the revenues of the government to negative GDP growth, both the central and state governments have revised the petroleum tax structure and increased the petroleum excise duties (Chart 3) and sales taxes (Chart 4a[2] & 4b).

Chart 3: Excise Duty

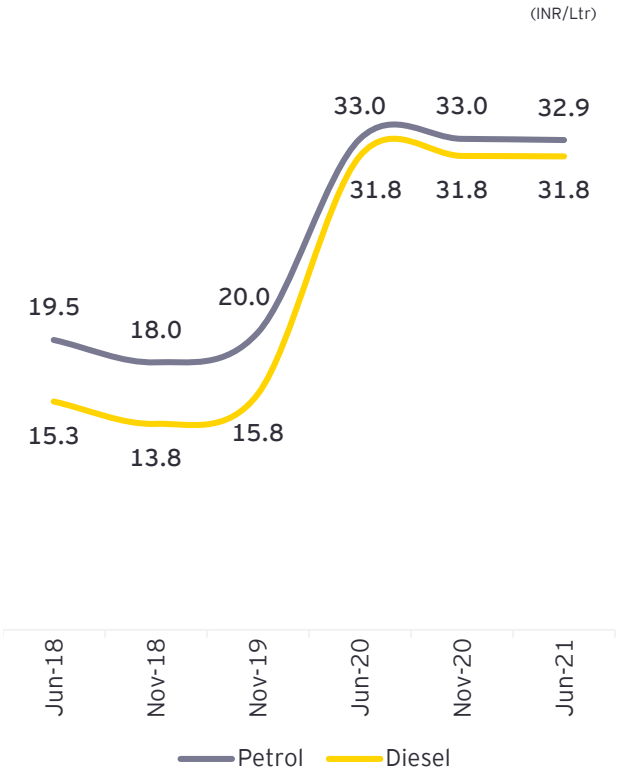


Chart 4a: Petrol Sales Taxes

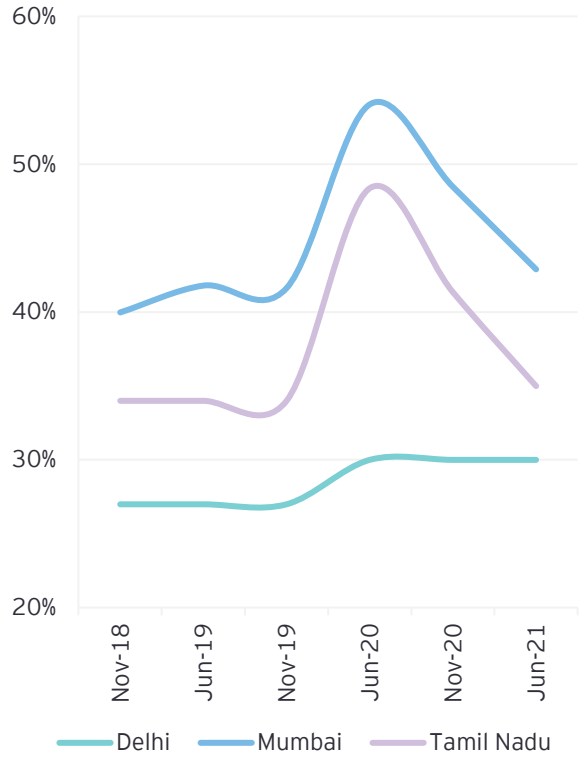
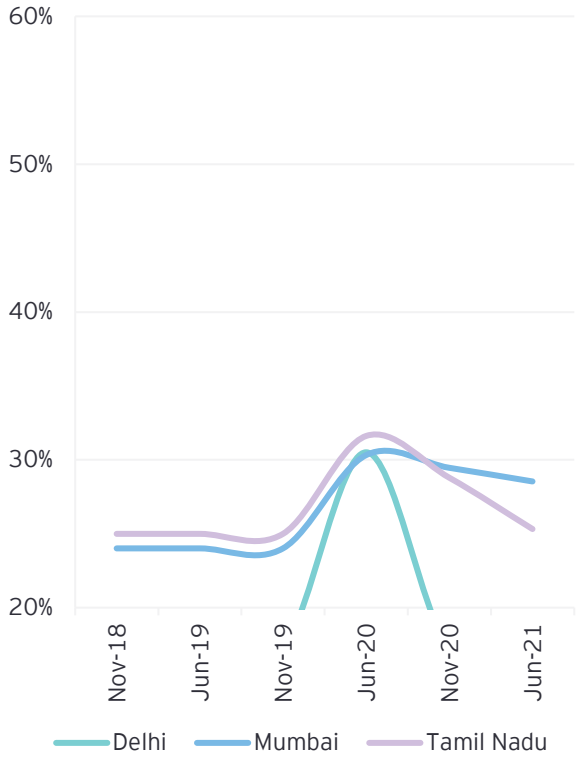


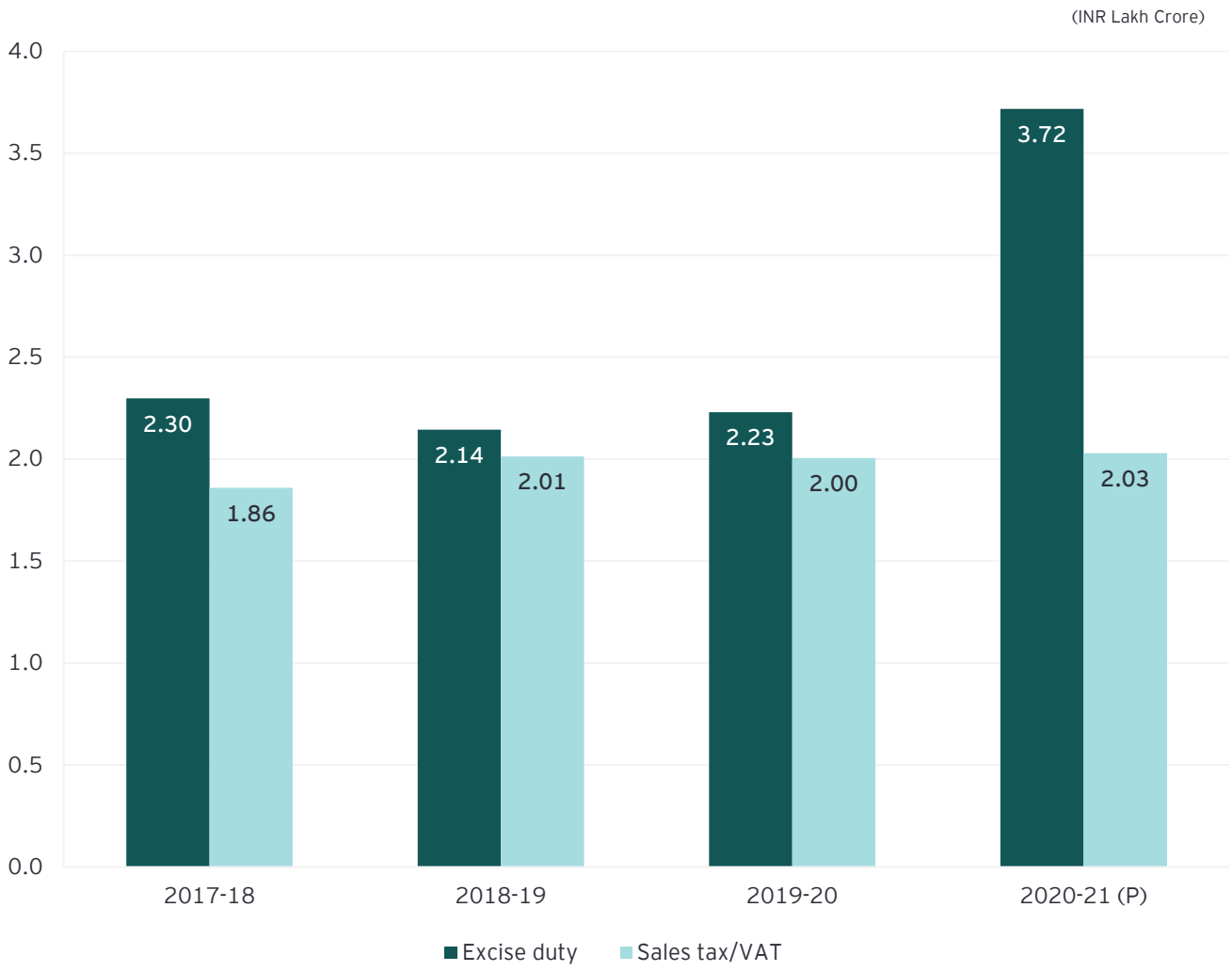
Chart 4b: Diesel Sales Taxes



2 Most states charge an ad-valorem tax rate on petrol and diesel. Many states also use a combination of ad-valorem rate and a fixed per litre tax rate. We have calculated a percentage rate on the base of price after addition of excise duty. Therefore, unlike the central taxes the base price for applying the state taxes is not fixed. In absolute terms, all three states shown above have increased their sales taxes over time. The apparent decrease in the overall sales tax rates, as seen in the charts above, is because the denominator (excise duty and oil prices) increase is higher than the numerator (sales tax).

Chart 5 below shows how, despite the reduction in the consumption of petroleum products and increase in petroleum prices, central government revenues jumped by 66.8 percent in FY21 consequent to the excise duty hikes. State governments, too, have been able to maintain their revenues from petroleum products despite the reduction in consumption.

Chart 5: Contribution to Exchequer



Macroeconomics of oil prices

As discussed earlier, oil is one of the key factors of production in an economy. At the same time given the high fiscal deficit and need for government expenditure, it is also a key source of revenue for governments. While on one side, it supported government revenues during the COVID-19 year, increase in the crude oil prices also contributed to an increase in inflation, increase in import bill, puts pressure on the exchange rate and lead to the contraction in GDP growth. As per the RBI annual report[3] published in April 21, RBI estimates suggest the following:

> "Assuming crude oil price to be 10 per cent above the baseline, domestic inflation and growth could be higher by 30 bps and weaker by around 20 bps, respectively, over the baseline... As a result, if the price of crude falls by 10 per cent relative to the baseline, inflation could ease by around 30 bps with a boost of 20 bps to growth.

Therefore, the high taxes on domestic oil prices only make sense if the government uses the money collected on capital expenditures where the fiscal multiplier is very high. If the oil tax revenues are only used to fill in the hole created by the shortfall in revenues, then the overall gains may be miniscule as the revenue gains come at the expense of shortfall in GDP and deterioration of macroeconomic situation. To the government's credit, capital expenditure has been maintained in the Union Budget. In the Union Budget 2021-22, capital expenditure as a ratio of GDP is the highest in recent years. Spending has been focused on the infrastructure sector.

Future prognosis

OPEC recently decided to increase the production of crude oil, after weighing the trade-offs of higher oil prices in terms of revenues generated vs. the negative effect on demand for petroleum products.

Although the revenue pressure on the government may stay in the near future, the recent fall in crude oil prices may provide respite to consumers and the economy.

An important factor currently at play is the long term decarbonization strategy of the government and promotion of renewable energy, natural gas and electric vehicles. In this sense, the taxes on petrol and diesel form a kind of green tax on vehicles in India. Also, sustained higher oil prices may push consumers towards buying electric or natural gas vehicles. The government may want to continue to provide that impetus to sunrise sectors of the economy.

Summary

One possible way to achieve a balance between the short-term goal of sustaining government revenues and the long-term goal of overall economic growth might be by keeping the nominal levels of the oil prices at a higher level by increasing the taxes whenever crude oil prices fall.

3 Reserve Bank of India - Monetary Policy Report

Goods and Services Tax & Production-linked incentive schemes

GST journey in India: what's next for the tax reform?

By Uday Pimprikar

How production linked incentive schemes can benefit manufacturing in India?

By Bhavesh Thakkar

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GST journey in India: *what's next for the tax reform?*

Need to simplify GST legislation and introduce robust dispute settlement mechanisms.

Uday Pimprikar

EY India Partner and National Leader - Indirect Tax

The Goods and Services Tax (GST) entered its fifth-year in July 2021. The last four years have been quite eventful, and a lot of work has gone in to create a foundation that should hopefully sustain the legislation as it continues to mature. There are a few unfinished areas that need to be tended to.

Last year–the focus was on the pandemic– bulk of the policy action was directed towards rate activity on essentials for treating the pandemic and administrative relaxations in relation to compliances to ease difficulties when the pandemic waves surged. Revenue sagged, driving action towards mitigating evasion and ensuring compliances.

Pushing through the e-invoicing agenda despite protests was visionary. E-invoicing under GST was mandated for all B2B supplies made by taxpayers having turnover above INR 50 Crores (US$7 million). For the industry, the benefits of digitalization ushered in through e-invoicing significantly outweigh the challenges faced during implementation.

Besides the above, the administration went on an overdrive to plug every conceivable avenue of Input Tax Credit (ITC) fraud. These have surely resulted in higher compliances reflected in higher revenues – this potentially allows the Government to take continue reforms.

E-invoicing under GST was mandated for all B2B supplies made by taxpayers having turnover above

INR 50 Crores

(US$7 million).

Revenue augmentation

GST revenue has not met predictions. The states were guaranteed revenue growth (related to taxes subsumed within GST) of 14% Compound Annual Growth Rate (CAGR) under the constitution till June 2022, i.e., for the first five years of GST. Any shortfall is compensated by a "compensation cess" collected for this purpose. The gap between the actual GST revenues of states and the guaranteed amount this year is estimated to be INR 2.5 lakh crores this year. The 15th Finance commission in its report dated 2021-26 (October 2020) estimated that cumulative shortfall over and above that funded by compensation cess by June 2022, would be around Rs 7 lakh crore. The states are concerned about the impact post June 2022 without the constitutional safety net.

The revenue shortfall anxiety is unfortunately triggering several negative hues. States are ruing the loss of fiscal autonomy. Both states and central governments are increasing getting to tempted to levy of individual cesses and other incremental taxes. Also, several measures have been taken to plug revenue leakages that are inadvertently increasing cascading impact of taxes. All this is eroding the benefits of the regime and diluting the efficacy of the reform.

This trend needs to be arrested. The only remedy is to bite the bullet and increase average GST rates. This can happen by partially increasing rates and rationalizing exemptions. This is essential for allowing policymakers to move ahead and embark on the critical reforms required in the legislation and compliance framework.

Source - Notification No. 05/2021 – Central Tax dated 8 March 2021

Reducing cascading impact

Revenue concerns have made the revenue extremely sensitive to any aspect related to abuse or evasion. This has manifested itself in the input credit denials interalia in relation to legitimate employee related expenses, marketing or other establishment expenses. Several exclusions are arbitrary and have been imported from the pre-GST era without adequate debate.

Petroleum taxes kept outside the GST net have increased materially over the past couple of years. Using Form C for procuring petroleum products at a concessional rate for use in manufacturing is restricted. Cascading tax impact in relation to petroleum products has multiplied several times in the last few years.

The basic structure of treating every registration as a distinct person for the GST purposes does not allow free flow of taxes across states and resultant poodles of credit blockages has increased working capital.

Further, the ever-increasing trend of policymakers being tempted to use a scorched earth policy by artificially denying or restricting input credits or export related rebates/refunds of inverted duty credits to plug avenues of evasion is exacerbating the issue.

A stringent, single-minded zero-based evaluation of the present legislative and compliance framework with the aim of reducing cascading impact needs to be consistently pursued to keep India's competitiveness.

Provide certainty for businesses

A large part of a country's attractiveness from an investment perspective (may it be domestic or international) is dependent on the ease of doing business (EODB). The EODB vector is impacted by the simplicity in tax legislations and compliance framework and the level of certainty of outcomes for legitimate bonafide businesses. The Indian GST legislation is at this stage has unique elements on account of the dual tax structure—these nuances create inadvertent complications that need to be administered sensitively. There is a real risk of an explosion of litigation otherwise and this pandemic will be extremely difficult to control on account.

There is a need to simplify legislation along with adopting measures such as issuing credible clarifications, introducing robust dispute settlement mechanisms and decriminalization of offences.This effort needs to be continuous and should be institutionalized with active participation of the industry.

Smritikona Dutta,
Tax Director, EY India has also contributed to this article

Napolean has been said to have remarked – **"yes – I know he is brilliant, but is he lucky"** apparently while appointing a general. The emperor understood the importance of luck in any eventual outcome. These are opportune times for India to find its rightful place in the global supply chain as global organisations are looking at diversification. While the luck factor cannot be discounted, it is equally critical to create an ecosystem that promotes and helps industry to invest, be competitive and grow. Time is of essence, as opportunities have a tendency to be more fickle than desired.

How production linked incentive schemes can benefit manufacturing in India?

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We analyze the progress of production-linked incentive (PLI) schemes across sectors.

Bhavesh Thakkar

EY India Tax and
Regulatory Services Partner

In November 2020, the Government of India announced the second edition of production-linked incentives (PLI) schemes across 10 key sectors. The PLI schemes were launched with the intention of scaling up domestic manufacturing facilities, accompanied by higher import substitution and employment generation. These facets were addressed in detail in our previous article.[1]

These schemes offer turnover linked incentives to approved investors, upon meeting the specified investment, capacity, and turnover criteria. Given their simple structure and the likely benefits, they have quickly become popular with businesses. There have been rapid developments on this front, with newer schemes being launched and some others nearing closure.

Through this article, we take a look at the sector wise progress of the PLI schemes.

	A	B	C	D	E
Sector and budget outlay	Closed	Open	To be announced	Announced	Evaluation stage
Mobile manufacturing and specified electronic components ***(~US$ 4.9 billion)***	✓				
Critical key starting materials/drug intermediaries and active pharmaceutical ingredients ***(~US$ 0.9 billion)****	✓				
Manufacturing of medical devices ***(~US$ 0.5 billion)****	✓				
Electronic/technology products (IT hardware) ***(~US$ 1 billion)***	✓				
Pharmaceutical drugs ***(~US$ 2 billion)***	✓				
White goods ***(~US$ 0.8 billion)***		✓			
High efficiency solar PV modules ***(~US$ 0.6 billion)***		✓			
Specialty steel ***(~US$ 0.8 billion)***		✓			
Telecom and networking products ***(~US$ 1.6 billion)***					✓
Food products ***(~US$ 1.5 billion)***					✓
Advanced chemistry cell (ACC) battery ***(~US$ 2.4 billion)***			✓		
Automobiles and auto components ***(~US$ 7.6 billion)***				✓	
Textile products: MMF segment and technical textiles ***(~US$ 1.4 billion)***				✓	

*These schemes have now been reopened for applications till 31 August 2021, for specific products

1 
Production-linked incentive scheme – A key step towards self-reliant India
By Bhavesh Thakkar

A Concluded schemes

The initial round of PLI schemes spanning mobile phones, drugs and medical devices attracted investments of over US$ 5 billion[2]. It is pertinent to note that their progress is being monitored closely. Recognizing the need for additional capacities for some drugs and medical devices, the relevant PLI schemes have been reopened for applications till 31 August 2021.

Further, the scheme aimed at the IT hardware sector also drew in investments worth US$ 35 million[3], which are likely to reduce dependence on imports in the electronics sector.

This scheme for pharmaceutical drugs and in-vitro medical diagnostic devices (concluded on 31 August 2021) covered a broad range of products, when compared with its first edition. However, the bases for evaluation of the applications were revamped and Several scheme parameters also evolved since its launch. Given the nuances involved, authorities have proactively responded to industry concerns. Despite the rapid changes to the scheme, the industry continues to remain hopeful.

B Ongoing schemes

White goods

Originally intended for the manufacture of finished goods such as air conditioners (ACs) and LED lights, this scheme was restructured and announced for component manufacturers of ACs and LED lights. The investment and incremental sales thresholds outlined here have posed a challenge to several manufacturers as they are considered higher than the industry norms. This scheme is open for applications until 15 September 2021.

Solar PV modules

Currently, the nation largely relies on imports of solar PV modules and cells. Designed to combat this issue, the scheme has drawn considerable attention from potential investors. The success of this scheme would reduce import dependence in a strategy sector like electricity, thereby, increasing its significance.

The scheme also promotes local procurement, thus triggering a cascading impact of the incentives. This will boost creation of ancillary units and augment the entire solar PV manufacturing ecosystem. The investment arising from the scheme (approximately US$ 2 billion) is expected to create an additional 10,000 MW capacity of integrated solar PV manufacturing plants. The last date for applications under this scheme is 15 September 2021.

Specialty steel

The import of specialty steel entails a large outflow of foreign exchange at present. The scheme aims to tackle this issue at its root by promoting end to end manufacture. This move will potentially bring India at par with global steel giants such as Korea and Japan. With incentives ranging from 4% to 12%, the scheme will benefit integrated steel plants as well as smaller players in the sector. The detailed guidelines for this scheme are awaited.

2 https://pib.gov.in/PressReleasePage.aspx?PRID=1710134
3 https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1732024

C Upcoming PLI schemes

Advanced chemistry cells (ACC)

Renewable energy continues to be a niche space, despite its undeniable significance. Presently, there is nominal investment in this space in India, despite the varied applications. Under the scheme, investments will be approved through a bidding mechanism for creation of cumulative 50 GWh of ACC (with additional 5 GWh for niche ACC) manufacturing facilities in India. This will support the battery requirements towards electronics, EVs, renewable energy power grids and the like.

D Schemes announced recently

Automobiles and auto components

Industry has long anticipated the launch of this scheme, which was recently approved. The scheme is aimed at promoting manufacture of electric vehicles and advanced automotive technology components of vehicles. This scheme aims at the introduction of state of the art technology in the sector. It also covers drones and drone components aiming to address the strategic, tactical and operational uses of this technology.

Textile

India has been aiming to increase its share in global textile exports. However, this has not been possible yet due to structural disabilities. This scheme aims to incentivize the manufacture of apparel made from man-made fibre and technical textiles. Interestingly, the scheme aims to promote the manufacture of apparel and not the input textiles, which are largely imported. The scheme has recently undergone some structural changes following industry feedback on investment thresholds and other parameters.

E Schemes at evaluation stage

Food processing

This scheme was met with an encouraging response from investors of all sizes. A key differentiator here was the inclusion of contract manufacturers, who play a key role in the sector. Currently, approximately 275 expressions of interest received under this scheme are being evaluated and the results are awaited. Overall, the scheme is expected to lead to expansion of food processing capacity by over US$ 4 billion and exports of approximately US$ 3.5 billion.

Telecom

This scheme intends to take the nation closer to becoming a manufacturing hub of telecom and networking equipment. This development will automatically offset the heavy reliance on imports in this niche space. While the 36 applications received are currently being evaluated, major global players have expressed an interest to expand in India based on these incentives. The approved investors are expected to bring in an investment of US$ 40 million.

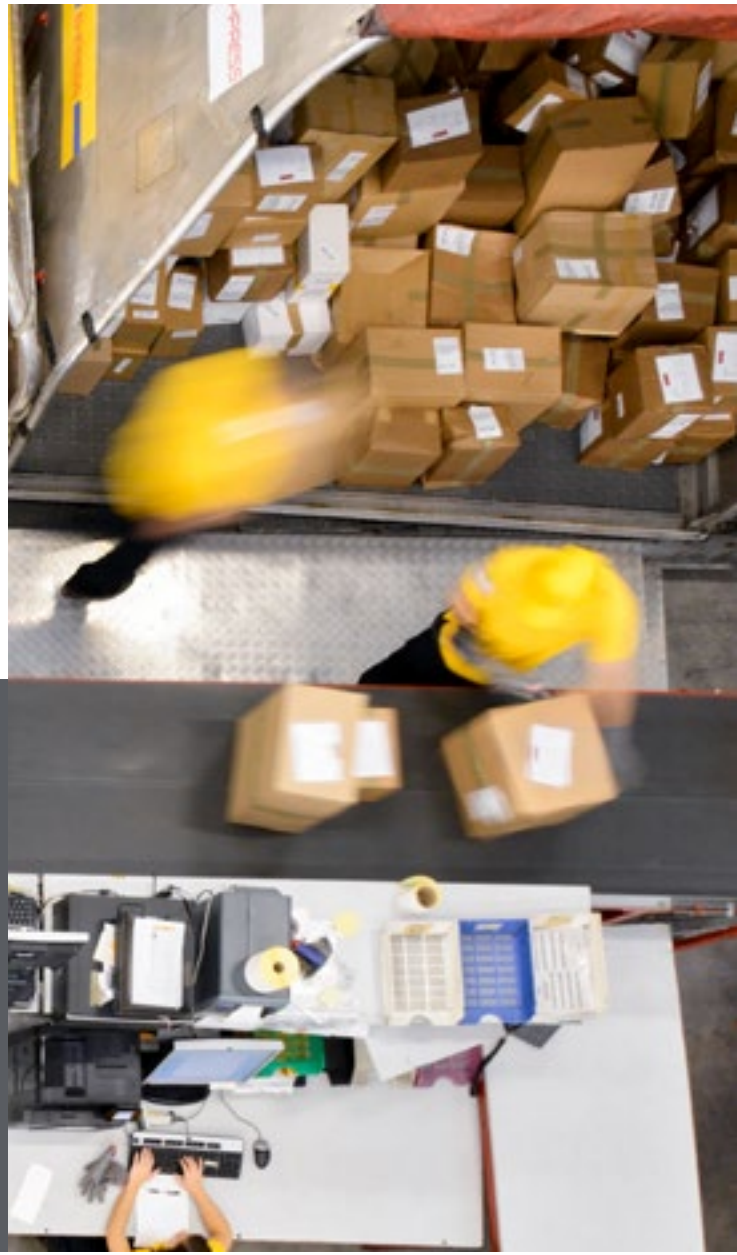
Production linked incentives seem to be the way forward for federal government grants in India. In the near future, similar incentives are likely to be extended to several other products such as electronic segment for semiconductor FAB(s), display FAB(s), wearables, hearables, IoT devices and drones.

These incentives also go hand in hand with other initiatives for the manufacturing industry such as state incentives, 'Manufacturing and Other Operations in Warehouse Regulations (MOOWR), and the 17% corporate tax rate. Viewed together, these offer composite financial support to manufacturers and should be assessed cohesively.

Prutha Pathak,
Manager, Indirect Tax, EY India has also contributed to this article

SUMMARY

Measures such as PLI schemes have generated momentum within industry and are likely to improve the Indian business ecosystem. The long-term benefits derived from these measures will lead to India's emergence as a preferred investment destination.



Personal Tax

How to effectively navigate ESOPs through the prism of IPO

By Pranav Sayta and Shalini Jain

Stranded in India due to Covid-19? Know the tax implications of working remotely from India

By Amarpal Chadha

Changing landscape of labour laws in India: what businesses should do to be future ready

By Sonu Iyer

Why framing a will is important

By Surabhi Marwah

How to effectively navigate ESOPs through the prism of IPO

The interplay between an IPO and ESOPs is an important one to understand for growing businesses.

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Employees Stock Option Plans (ESOPs) are increasingly being leveraged by new-age entrepreneurs and successful companies focused on future IPOs, as a must-have compensation tool. Typically, ESOPs do not involve payment of cash but demonstrate willingness and commitment on part of the company to share the future prosperity with its employees.

ESOPs are used by companies in different stages of growth for its multi-fold benefits such as - encouraging employee motivation and retention, serving as a competitive advantage to attract talent, driving performance of employees leading to an increase in the profitability and value of the company.

Since COVID-induced economic slowdown, ESOPs have become particularly relevant in the large and growing start-up ecosystem by companies that cannot afford to pay market competitive salaries or bonuses, as a means to attract talent as well as compensate and retain the workforce.

Interplay between IPO and ESOP

ESOPs come with the opportunity for an employee to be part of an organization's growth story. Many organizations which are on their IPO journey use ESOPs to align the interest of employees with the shareholders for sustained growth of the company. There are also companies which implement cash settled stock incentive plans (like Stock Appreciation Rights) in their earlier years but go in for ESOPs before an IPO.

Typically, employees of unlisted companies may not have much liquidity to cash out on their stock options. The expectation is that the employees who show greater commitment and continue with the company would eventually reap the benefits, potentially upon a future IPO. This trend is changing as many successful companies are providing for interim buyback allowing employees to realise the market value of their stock, without having to wait for an IPO.

A lot of unlisted companies align their exercise period with their IPO so that employees can exercise their options on IPO and reap benefit of immediate liquidity. Therefore, from employees' standpoint, an IPO is a huge milestone as their vested ESOPs may be exercisable (in case exercise is linked to the IPO) and shares are encashable at the market price, which is likely to be much more than the exercise price paid by the employee. This, in a way, helps employees from a liquidity standpoint to meet their income tax obligation as tax liability on the benefit arises at the time of allotment/transfer of shares on exercise of the stock option. This is key when it comes to ESOP taxation in India.

Some companies also link vesting itself to IPO - linking vesting to IPO pushes higher levels of performance of senior employees in leadership team in ensuring that the company makes it to an IPO. Also, some companies do not want to commit shares to employees unless there is a clear exit by way of an IPO for them.

ESOP Trust pre-IPO

Many unlisted companies use an ESOP Trust to provide exit to the employees prior to the IPO. Due to the non-marketability of shares, an ESOP trust helps in buying back shares of the company from an employee.

Administering an ESOP Trust comes with the complex requirements of funding to be made by the company, valuation of shares to be transferred and other requirements relating to transfer of shares.

ESOP Trust also entails annual compliance such as audit and tax filings.

Further, while there is no doubt on the salary perquisite taxability in the hands of the employee on transfer of shares to employee, in case of unlisted companies, the trust structure has a risk of notional capital gains taxation in the hands of the trust on transfer of shares by the trust to the employees, if the exercise price is less than a normative value fixed by income tax rules. While there may be some legal arguments to defend such notional taxation for the ESOP Trust, pending any specific relaxation in law given to ESOP Trust, taking a non-taxable position may be risky. Furthermore, any expenditure incurred by the company by way of contribution to such Trust or write-off of loans granted to the ESOP Trust may not be allowed as deduction in the hands of the company.

IPO related restrictions not applicable to ESOPs

Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 ('SEBI ICDR Regulations'), which regulates IPOs, prohibits a company from undertaking an IPO if there are any outstanding rights entitling any person with an option to receive equity shares in the issuer company. However, the condition expressly excludes outstanding ESOPs, therefore, outstanding ESOPs are not a hurdle for undertaking an IPO.

Similarly, as per SEBI ICDR Regulations, the entire pre-issue capital held by persons other than promoters shall be locked-in for a stipulated period of 6 months (12 months in certain cases) from the date of allotment in IPO. However, the said lock-in condition does not apply to shares allotted pre-IPO under an ESOP Plan, provided adequate disclosures are made by the issuer company. Therefore, ESOP shares allotted under an ESOP plan are freely tradeable post the listing of shares in the IPO. However, the equity shares allotted to the employees under an ESOP Plan will be subject to provisions of lock-in as specified in Securities and Exchange Board of India (Share Based Employee Benefits and Sweat Equity) Regulations, 2021 ('SEBI SBEBSE Regulations, 2021')

ESOP governance pre and post IPO

While the primary legislation governing ESOP is the Companies Act, 2013 both for listed and unlisted companies - unlisted companies are also subject to Rule 12 of the Companies (Share Capital and Debentures) Rules, 2014 and listed companies, to SEBI SBEBSE Regulations, 2021.

As per the SEBI SBEBSE Regulations, 2021, no company is permitted to make any fresh grant which involves allotment or transfer of shares to its employees under any schemes formulated prior to its IPO and prior to the listing of its equity shares ('pre-IPO scheme') unless such pre-IPO scheme is in conformity with the said SEBI SBEBSE Regulations, 2021. Further, the pre-IPO schemes are required to be ratified by the shareholders of the company post the IPO. Accordingly, the companies need to review their ESOP Plans and make necessary amendments to ensure that the ESOPs are in accordance with the SEBI SBEBSE Regulations, 2021. There should be a robust audit to ensure compliance with pre-IPO codes and also to effectively conduct pre-IPO tax planning.

Further, the ratification by the shareholders may be done any time prior to grant of new options or shares under such pre-IPO scheme.

The shares arising after the IPO out of ESOPs granted under any scheme prior to its IPO to the employees are required to be listed immediately upon exercise in all the recognised stock exchanges where the shares of the company are listed subject to compliance with the applicable regulations.

How does taxability of ESOP change for the employee, post IPO?

The Income-tax Act, 1961 (the IT Act) provides for taxation of ESOPs as a perquisite at the time of exercise, subject to the valuation of the perquisite as prescribed in the Income-tax Rules, 1962 (the IT Rules). As per the IT rules, the taxable value of the ESOP on exercise is the Fair Market Value (FMV) of the share on the date of allotment/transfer of shares, reduced by the exercise price paid by the employee. The IT Rules provide for separate mechanism for determining the FMV for shares listed on a recognized stock exchange in India and for shares not listed on a recognized stock exchange in India. An unlisted company has to obtain a valuation certificate from a Category 1 Merchant Banker registered with SEBI as of a date not earlier than 180 days prior to date of exercise. However, once the company is listed, it can rely on its market price (average of opening and closing) on the relevant date for the purpose of perquisite valuation.

In respect of employees of specific start-up companies (subject to conditions), there is a relaxation of timing for the payment of taxes on ESOP with effect from financial year 2020-21.

The second stage when ESOPs are taxed are when the shares allotted to the employee are sold by the employee. At the time of sale of shares issued under ESOP, the difference between sale price and FMV of the shares as on the date of exercise (i.e. FMV used for calculation of taxable perquisite at the time of exercise) is taxable as capital gain for the employee.

The capital gain is categorized as long term/short term depending on period of holding of the shares by the employees. As tabulated below, in the event of sale of shares by the employee, the holding period as well as tax rate for long term capital gain is much lesser for a listed share as compared to an unlisted share for a resident employee.

Status of shares	Holding period	Type of gain	Tax rate*
Unlisted shares	Not more than 24 months	Short term	Slab rates
Listed shares (STT paid)	Not more than 12 months	Short term	15%
Unlisted shares	More than 24 months	Long term	20% (with indexation benefit)**
Listed shares (STT paid)	More than 12 months	Long term	10% if gains exceed INR 1 lakh (without indexation benefit)

*plus applicable surcharge and cess

** 10% (without indexation) for non-resident employee

India is currently the third largest[1] start-up ecosystem in the world and is home to several unicorns and successful businesses. While the pandemic disrupted bottom-lines for some companies, it also led to unprecedented growth for others and both kinds made use of ESOPs extensively. The last year has seen numerous successful ESOP stories, where hefty ESOPs were announced by companies as a gesture of sharing their success, following successful IPOs.

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1 https://www.startupindia.gov.in/content/sih/en/international/go-to-market-guide/indian-startup-ecosystem.html

Stranded in India due to Covid-19? Know the tax implications of working remotely from India

Remote working can lead to tax liability for an NRI and PE exposure for their employer.

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The COVID-19 pandemic has created a range of challenges for organizations, especially with employees who are globally mobile. Due to the travel restrictions and border closures, many individuals were stuck in India and ended up working from India, although they were employed by a foreign company.

When employees undertake remote work while being employed abroad, they can unintentionally trigger various implications for both themselves and their employers from immigration, tax (including permanent establishment) and social security perspective. There are various Indian income-tax implications that need to be looked at for individuals who have been/are working remotely from India due to the pandemic.

Under the domestic tax laws, the residential status of an individual determines his/her taxability. A resident individual is taxable on his/her worldwide income in India, while a non-resident/not-ordinarily resident individual is taxable only on his/her India sourced income. The residential status of an individual is determined basis on his/her physical presence in India.

A resident individual is one who:

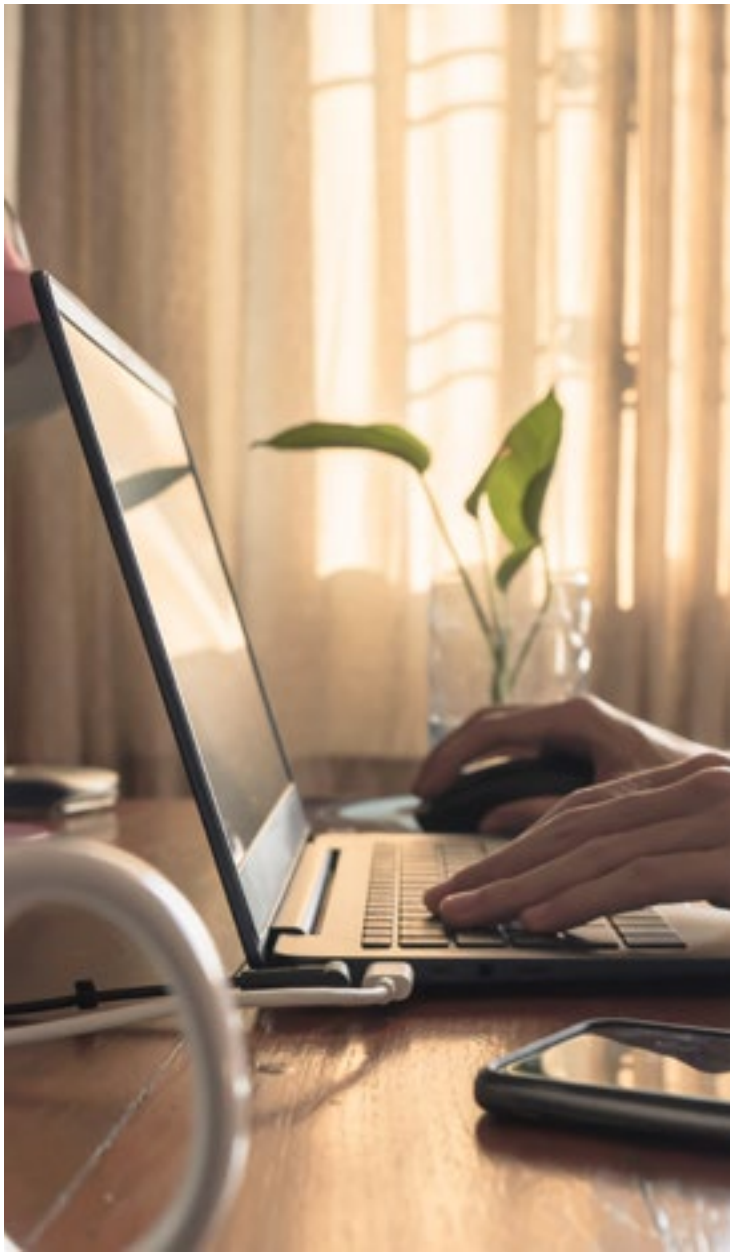
(i) stays in India for more than 182 days in a financial year or for more than 60 days in a financial year and 365 days in the immediately preceding four financial years; and

(ii) is a resident in India for at least two financial years out of the immediately preceding 10 financial years; and

(iii) has stayed in India for more than 729 days in the preceding seven financial years.

Individuals who do not satisfy both the conditions mentioned in point (i) above, will qualify as non-residents in India. Further, those who satisfy point (i) but do not satisfy the conditions mentioned in both points (ii) and (iii) will qualify as not ordinarily residents in India.

Besides the above, there are separate conditions to determine the residential status of Indian citizens or persons of Indian origin who, being outside India comes on a visit to India, based on their India sourced income.



Resident individuals will be taxable on their foreign sourced income such as rental income, interest income and capital gains, in addition to the salary income earned while working from India. This could lead to double taxation of their income in India and the foreign country. They are also required to disclose the foreign assets held by them in their India tax return. However, resident individuals could be eligible for tax relief/exemption as per the tax treaty entered into by India with the respective foreign country to avoid double taxation.

Considering the genuine hardship caused to individuals who were stuck in India due to the pandemic during the financial year 2020-21, representations were made to the Central Board of Direct Taxes (CBDT) to relax the rules for determining the residential status of such individuals who unintentionally overstayed in India.

After examining these concerns, CBDT issued a circular dated 3 March 2021 on **'Residential status of certain individuals under Income-tax Act, 1961'.** As per this Circular, CBDT determined that:

1. Short duration of stay of less than 182 days will not trigger residency in India
2. There may be a possibility of dual non-residency resulting in the individuals not being taxed in any country, if a general relaxation is given to the rule of 182 days
3. In case individuals qualify as residents of both countries, the tie-breaker rule under the tax treaty may be applied to break the residency to one of the countries
4. In accordance with the tax treaty, salary is taxable only in the country in which employment is exercised and if the necessary conditions are met, an exemption may be claimed in India
5. The individuals are eligible for tax credit in India on the taxes paid in the foreign country

Considering the guidelines issued by the organisation for Economic Co-operation and Development, (OECD) and the practices adopted by countries like the US, the UK, Australia and Germany, the CBDT decided that the domestic tax laws read with tax treaties, provide for necessary relief to avoid double taxation. Further, individuals facing double taxation after considering the tax treaty relief were to file an application in Form NR by 31 March 2021 for the CBDT to examine whether a relaxation was to be provided to that individual or a class of individuals. Thus, offering some relief to individuals who inadvertently triggered residency in India due to the pandemic.

Given the continuing nature of pandemic and the fact that the window to file an NR application was available only till 31 March 2021, one may need to wait for further guidance from the CBDT to have clarity on the residential status and the corresponding taxability with respect to financial year 2021-22.

Individuals working remotely from India should ensure the following to avoid/ minimize double taxation, and consider the tax considerations of remote work:

1. Assess their residential status accurately
2. Determine appropriate taxability in India
3. Claim exemption as per the relevant tax treaty, if the prescribed conditions are met
4. Claim appropriate tax credit in India, in case the income is taxable in the other country as well
5. In addition, employers should assess whether the employee's presence in India is creating permanent establishment exposure

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Changing landscape of labour laws in India: what businesses should do to be future ready

Labour law changes 2021 are likely to usher social equity and social security in India.

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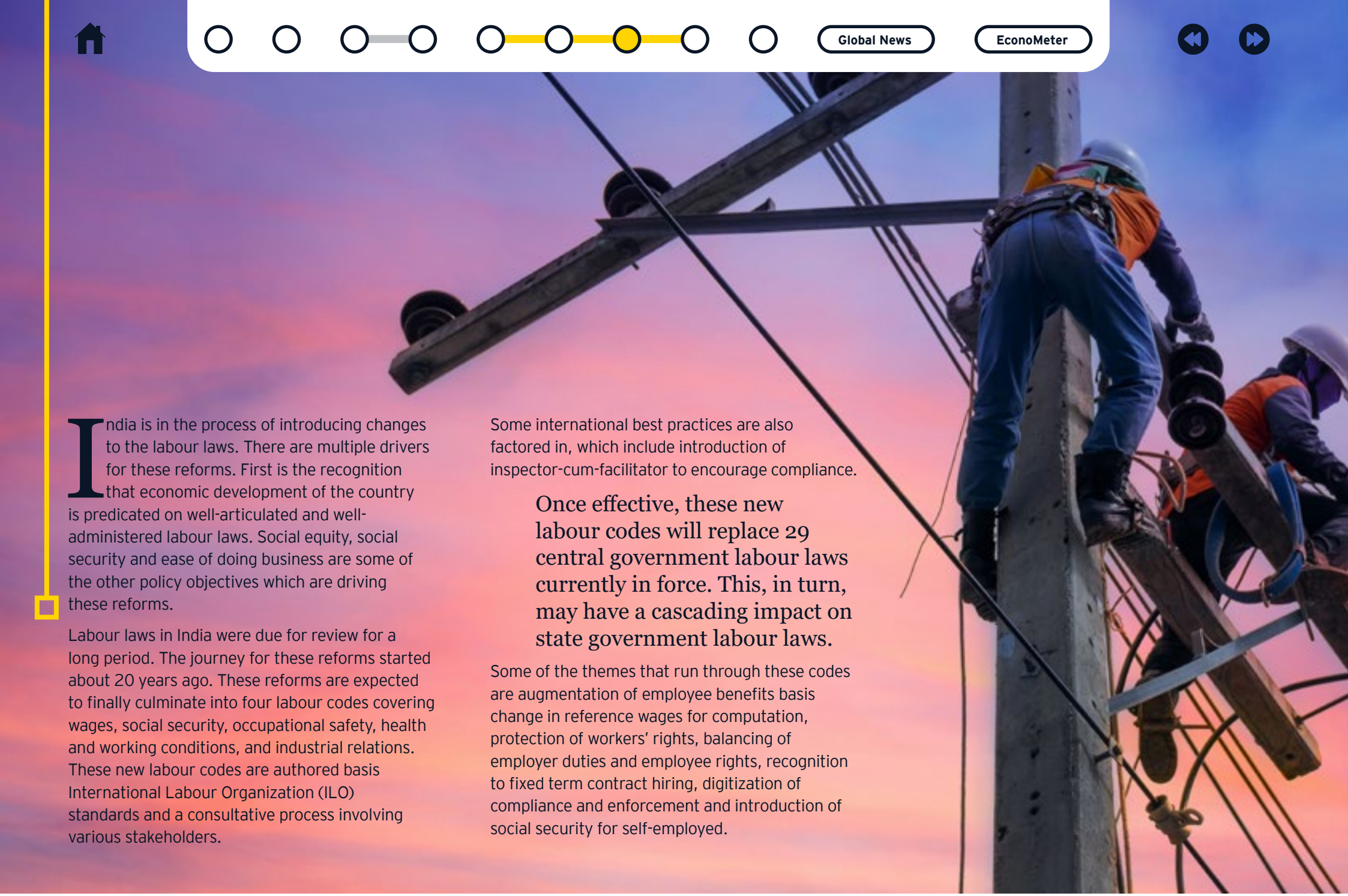

India is in the process of introducing changes to the labour laws. There are multiple drivers for these reforms. First is the recognition that economic development of the country is predicated on well-articulated and well-administered labour laws. Social equity, social security and ease of doing business are some of the other policy objectives which are driving these reforms.

Labour laws in India were due for review for a long period. The journey for these reforms started about 20 years ago. These reforms are expected to finally culminate into four labour codes covering wages, social security, occupational safety, health and working conditions, and industrial relations. These new labour codes are authored basis International Labour Organization (ILO) standards and a consultative process involving various stakeholders.

Some international best practices are also factored in, which include introduction of inspector-cum-facilitator to encourage compliance.

> Once effective, these new labour codes will replace 29 central government labour laws currently in force. This, in turn, may have a cascading impact on state government labour laws.

Some of the themes that run through these codes are augmentation of employee benefits basis change in reference wages for computation, protection of workers' rights, balancing of employer duties and employee rights, recognition to fixed term contract hiring, digitization of compliance and enforcement and introduction of social security for self-employed.

Augmentation of employee benefits

Various socio demographic studies have suggested that a significant portion of the Indian population will live longer (than in the past) and will therefore eventually need to fall back on a reliable social security system to live a reasonable quality of life when no longer economically productive. This explains the attempt being made by the government via these reforms to provide wider social security coverage to all citizens of the country and also increase the quantum of social security benefits.

The proposed new labour codes in India require all employee benefits to be calculated on new reference 'wage' as defined under the labour codes as against the current practice of calculating only on basic salary. Under the new definition of 'wages', all salary components except specific exclusions are covered. Also, there is a 50% ceiling on exclusions, meaning at least 50% of gross remuneration will now be covered under wages for all employee benefits calculations.

The new definition will mean higher quantum of benefits such as higher gratuity, overtime pay and leave encashment in the hands of employees, and is considered to be the largest benefit of the new labour codes. However, in a cost to company (CTC) structure, where benefits form part of salary, higher benefits will mean reduced monthly take home salary for employees.

However, even where benefits such as provident fund and gratuity form part of CTC of an employee, benefits such as leave encashment and overtime, which are over and above CTC, will increase cost for employers – both recurring and retrospective. There may be a significant retrospective impact on gratuity costs for employers in the labour codes, which may impact accounting provisions for the past service period. The increase in employee costs would impact hiring plans and future increments thereby impacting creation of employment opportunities.

The new definition of wages is open to interpretation on what is included and what is excluded as wages. For example, 'any bonus payable under any law for the time being in force, which does not form of the remuneration payable under the terms of employment' as excluded from the definition of wages suggests that while statutory bonus is excluded in determining wages, there is no clarity on whether annual performance bonus or similar variable incentive payments may be excluded or not. Variable payments if not excluded from the definition of wages will lead to phenomenal increase in costs and also create challenges in monthly calculations for overtime and other contributions.

> The emerging trends in Indian labour laws point toward a more equitable future.

Protection of workers' rights

Under the labour codes, all organizations will need to classify their employee population as 'employees' or 'workers'. While all individuals employed in an organization will be employees, individuals who do not have managerial or supervisory roles may potentially be workers. With this, even individuals in so-called white collared jobs working in an office may qualify as workers if they are not managers or supervisors.

While a similar definition of 'workman' exists under the current Industrial Disputes Act, it is applicable for limited purposes such as retrenchment or in cases of disputes with an employer.

If an individual is a worker, under the labour codes, he will be eligible for additional benefits from employers such as overtime for working beyond 8 hours on any day or 48 hours in any week and leave encashment for un-availed leave at the end of the year. Employers will also need to set up a grievance redressal committee where workers can file complaints on any matter.

From an employer's perspective, it may be quite challenging to identify workers given that the definition lacks clarity and has been a matter of extensive litigation in the past. Terminologies such as managerial or supervisory role have not been defined and may have very different meaning in today's digital world than that interpreted by the courts in the past. For instance, if someone is supervising work done by robots or other artificial intelligence tools, will it mean they are supervisors and therefore not workers?

Tracking of overtime specially in alternative work arrangements may be challenging for employees. Annual leave encashment will be counter-productive, as workers may not avail leave to receive a higher payout at the year end. Further, in service organizations where there is no categorization of blue-collared and white-collared jobs, companies may face a huge dilemma on how to communicate different leave encashment policies for employees and workers.

Balancing of employer duties and employee rights

Labour codes have not lost sight of challenges faced by employers because of multiple trade unions. The labour codes have given recognition to a negotiating union or negotiation council in establishments that have multiple trade unions. Such a negotiating union or negotiation council will have representatives from all trade unions in the establishment and will negotiate benefits and service conditions with the employer.

Addressing the issue faced by employers where unplanned strikes affect business continuity, the new labour codes provide that no employee will be allowed to go on strike without a mandatory 14 day notice to the employer.

> Labour codes have enhanced the threshold number of employees from 100 to 300 for an employer to seek approval from the central government for retrenchment of workers.

Fixed term contract hiring

Hiring through third parties has been a common approach to flexi hiring in India. The labour codes open doors for a different approach to flexi hiring called fixed term employees. There are no restrictions under the labour codes on the number of or period for which fixed term employees can be employed.

While hiring of contract labour through third parties is not permitted in core functions in an organization, there is no such restriction on hiring fixed term employees for core functions. However, fixed term employees should be offered the same benefits as permanent employees for similar roles. Also, fixed term employees are eligible for gratuity after one year of service.

For employers looking at agility in hiring, fixed term employees may be a good option.

Digitization of compliance and enforcement

Employers are permitted to maintain all registers and records digitally under the labour codes albeit prescriptive formats for these registers and records have been provided in the proposed rules supporting the labour codes. The Government also plans to do random web-based inspections under the online inspection scheme.

There is a specific requirement for employers to do full and final settlement of wages within two working days of employees leaving. This will require employers to automate compliance and strengthen internal processes to reduce the full and final settlement time.

Multiple aspects in human resource and payroll policy framework and processes will undergo changes to ensure compliance with labour codes.

Focus on enforcement

One of the drivers for new labour codes is to ensure effective enforcement. Attempt has been made to achieve this in many ways. By rebranding labour inspectors as 'inspectors-cum-facilitators', the government has tried to give a friendly face to the labour code inspection regime. These inspectors-cum-facilitators have been made responsible for not just inspecting but also advising employers and employees on matters relating to compliance.

Employees have been given more voice – they can directly approach courts on any matter under the Code on Wages. This may lead to labour law litigation.

For enforcement of compliance, monetary penalties have been prescribed for first non-compliance under the labour codes but imprisonment proceedings kick-in for any second non-compliance by the employer.

Social security for self employed

Work arrangements outside the traditional employer-employee relationship have been given recognition under the new labour codes. The central government has been authorized to notify specific social security schemes for gig workers and platform workers. Such social security schemes may provide life and disability cover, accident insurance, health and maternity benefits, old age protection, creche and other benefits to such individuals.

An onus has been put on aggregators who are digital intermediaries and run online marketplaces, who make use of services of these gig and platform workers, to contribute a certain percentage of their annual turnover (between 1% to 2%) towards social security schemes for such workers.

Conclusion

Implementation of labour codes is a laudable step forward. However, the impact of new labour codes is immense, like it requires huge change management for employers. Employers will need to start preparing for these codes by first analyzing the impact and then creating internal policies, processes and governance structures which are aligned with the various requirements under the labour codes. All functional groups in an organization will need to come together for successful implementation of a framework that is future-ready.

From the government's perspective, a clear roadmap on the implementation of labour codes, timely notification of central and state rules, taking away the retrospective cost impact and providing clarity on certain aspects will go a long way to ensure adoption by the industry.

> Implementation of labour codes may be seen as a journey for the next two to three years. As the law evolves, further clarity on some provisions of the labour codes may come in and industry best practices may emerge.

Why framing a will is important

Will is an important legal document to ensure effective estate planning and wealth distribution.

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A will is a legal document specifying the wishes and intentions of a person regarding distribution of their assets and wealth after their lifetime. A person who writes a will is called a Testator.

Writing a will becomes imperative to ensuring that an estate is devolved as per the wishes of the Testator. In the absence of the same, succession of their assets will take place in accordance with applicable succession laws. The benefits on estate planning are numerous, and often ensure peace. A Will is an important part of estate planning.

Succession for Hindus, Buddhists, Jains and Sikhs is governed by the Hindu Succession Act, 1956. In case of demise of the male member of a family without a will i.e. intestate, his assets/estate firstly devolves upon his immediate heirs i.e. Class-I heirs. Amongst Class-I heirs, assets will be first divided equally among the widow, mother, son and daughter.

In the event, **there are no Class-I heirs,** the assets devolve upon other heirs, in the following order of priority:

Class-II heirs

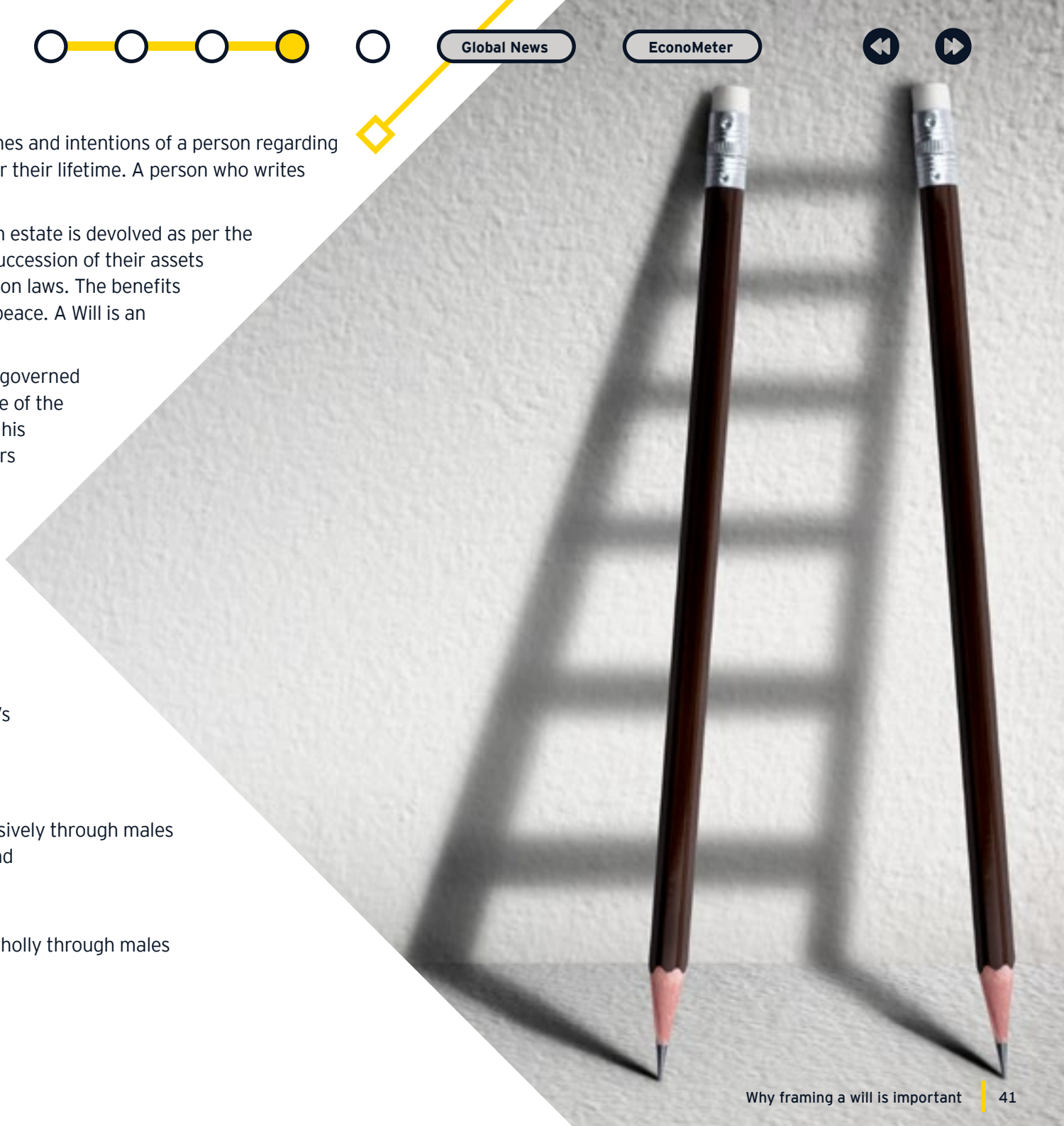
Examples are father, son's daughter's son, son's daughter's daughter and so on;

Agnates

A relative whose connection is traceable exclusively through males (for example, cousin from the father's side); and

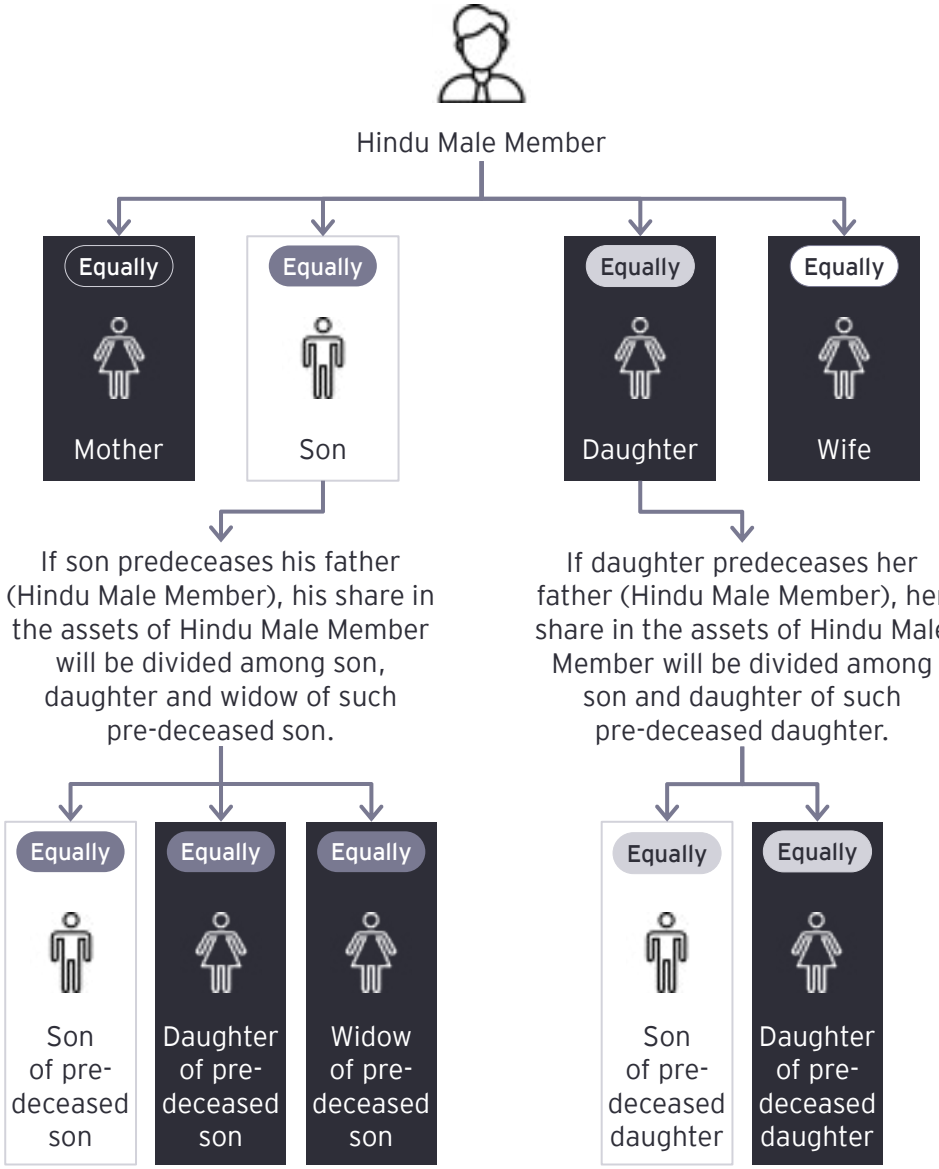
Cognates

A relative whose connection is traceable not wholly through males (for example cousin from the mother's side).

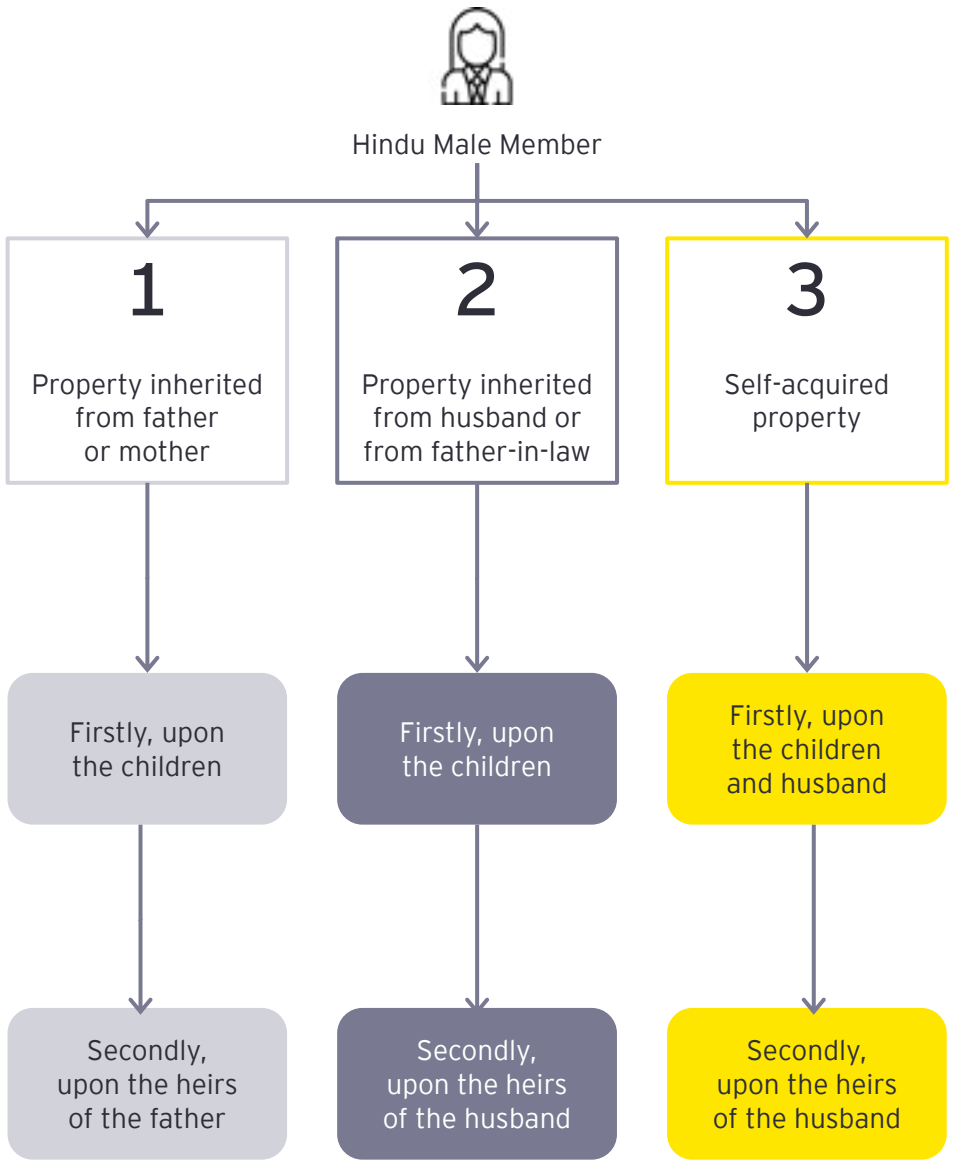


An illustrative representation of devolution among Class-I heirs is provided below:

Male Hindus



Female Hindus



Essentials of a valid will in India

A will should be drafted using clear and simple language in order to scope out any ambiguity/ interpretational issues. The testator should understand the contents of the Will clearly and properly. The Will may be drafted in a persons maiden language or translated for the respective individual while being video graphed in order to make the entire process transparent.

1 *Listing of personal wealth*

Make a list of all the assets and liabilities including immovable properties, bank deposits, share certificates, investments and mutual funds.

The testator would also be required to consider the composition of his assets and whether all the assets held by him are capable of being disposed through a will.

2 *Beneficiaries/Legatees*

Clearly identify a list of beneficiaries/ legatees under the Will. The Testator may provide for unforeseen circumstances such as if the intended legatee predeceases on the date of operation of Will, then the said asset will transfer to the second named beneficiary/legatee and so on.

Similarly, the Testator may set out certain qualifying conditions upon which the intended legatee will be entitled to receive the asset/property. For example, the intended legatee is not separated or divorced with the family member of Testator. In case of legatees being minors, the Testator may appoint guardians who shall hold the property on behalf of and for the benefit of such minor legatees.

In order to substantiate the validity of a Will, the Testator may provide reasons for exclusion of immediate relatives, who would otherwise have been legal heir under the Act, from the Will.

3 *Bequests*

While deciding the distribution of assets, a Testator may consider factors such as nature, use, value etc., of the assets. The Will should clearly set out the intention of the Testator with respect to each asset. It should clearly indicate the legatees to each property and demarcate the assets with respect to which the Will is being drafted.

A Will may also be used to set out a life interest clause that outlines who is to benefit, and any conditions associated with this benefit. For instance, a husband may provide in his Will that the residential house shall be enjoyed by his wife during her lifetime with a condition that the wife shall not have the right to deal with the property and the same shall be succeeded by his children on the demise of the wife.

4 Witnesses

The Will must be signed in the presence of at least 2 independent witnesses, being adults and witnesses should sign only when they have seen the Testator sign or affix his mark to the Will or have received a personal acknowledgment of his signature. Each of the witnesses shall sign the Will in presence of the Testator, though not necessarily at the same time. Further, in relation to Witnesses, it is recommended keeping the following in consideration:

- The Witnesses should be reliable, trustworthy and be able to vouch for the authenticity of the entire proceedings;
- Witnesses should be such persons who are likely to survive the Testator;
- The beneficiaries to the Will (Legatees) should, as far as possible, abstain from acting as Witness to the Will.

5 Medical Certificate

For a valid Will, the person making the Will should be of sound mind and legally capable of dealing with his assets. Therefore, ideally a doctor's certificate should be attached certifying that the Testator is physically and mentally fit, of sound mind, mentally competent and can take his/her own independent decisions for making his/her Will.

6 Registration

Registration of Will is not compulsory under the law. Non-registration of Will(s) does not lead to any adverse inference against the genuineness of the Will and is a personal choice of the Testator. However, once a will is registered, it is placed in the safe custody of the Registrar and cannot be tampered with, destroyed, mutilated, or stolen.
It is advisable to undertake the registration of the Will(s) for the following additional reasons:

- Provides proof that proper parties (Testator and the Witnesses) have appeared before the Registering Officer and the Registering Officer has registered the Will after ascertaining the identity of the Testator and the Witnesses.
- Provides a supplementary supporting evidence and reduces the possibility of dispute with respect to the Will's validity.

7 Alterations in the will

While a Testator can include a clause in the Will to deal with the assets acquired after making the Will, if there is a change in the status of beneficiaries or assets over a long period of time, these should be updated by the Testator and the Will can be amended to this extent to ensure that it's still reflective of Testator's future wishes. It is pertinent to note that a Will once drafted is not set in stone and may be amended/updated by the Testator as and when required. Accordingly, the last Will shall be enforceable and will supersede the previous wills.

8 Executor

Another important thing is that the Testator should wisely choose an executor, who is the legal representative of Testator post his lifetime. Executor is responsible for disposing of the assets of Testator in accordance with the wishes as specified in the Will. Generally, the Testator appoints his trusted advisor/confidante as executor of the Will who would be capable of ensuring smooth and effective transfer of bequests.

Testator may additionally entrust Executor with the following responsibilities:

- To perform such funeral and obsequial ceremonies upon demise of Testator and to spend such amounts on such funeral and obsequial ceremonies as the executor may in his/her absolute discretion deem fit;
- To do all acts, deeds and things which are reasonable, necessary and proper for the realization, protection or benefit of the estate and completing the execution formalities.

9 Safe place to keep the Will

While preparing the Will some important points which may be considered by the Testator includes who to consult, who all should have its knowledge and where it should be kept. The same needs to be considered by the Testator in detail to avoid any adverse impact on the relationships between the family members and ensure future peace and harmony.

10 Probate

Probate is a copy of Will certified by a Court granting the executor of Will for administration of the Testator's estate. Not all Wills require to be probated. As per the provisions of Indian Succession Act, 1925, probate of a Will is required in the following circumstances:

- Where the Will is made in within the local limits of the High Courts of Calcutta, Madras and Bombay;
- Where the Will is made outside these limits but relates to immovable property situated within these limits.

In the current situation of the ongoing COVID-19 pandemic, the importance of will in India has assumed even more relevance to ensure that the future of ones near and dear ones is secured. Though succession planning continues to evolve and more sophisticated arrangements are explored, a valid Will is essential in India for planning the future.

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Roopal Bajaj,
Senior Consultant, Tax
have contributed to this article

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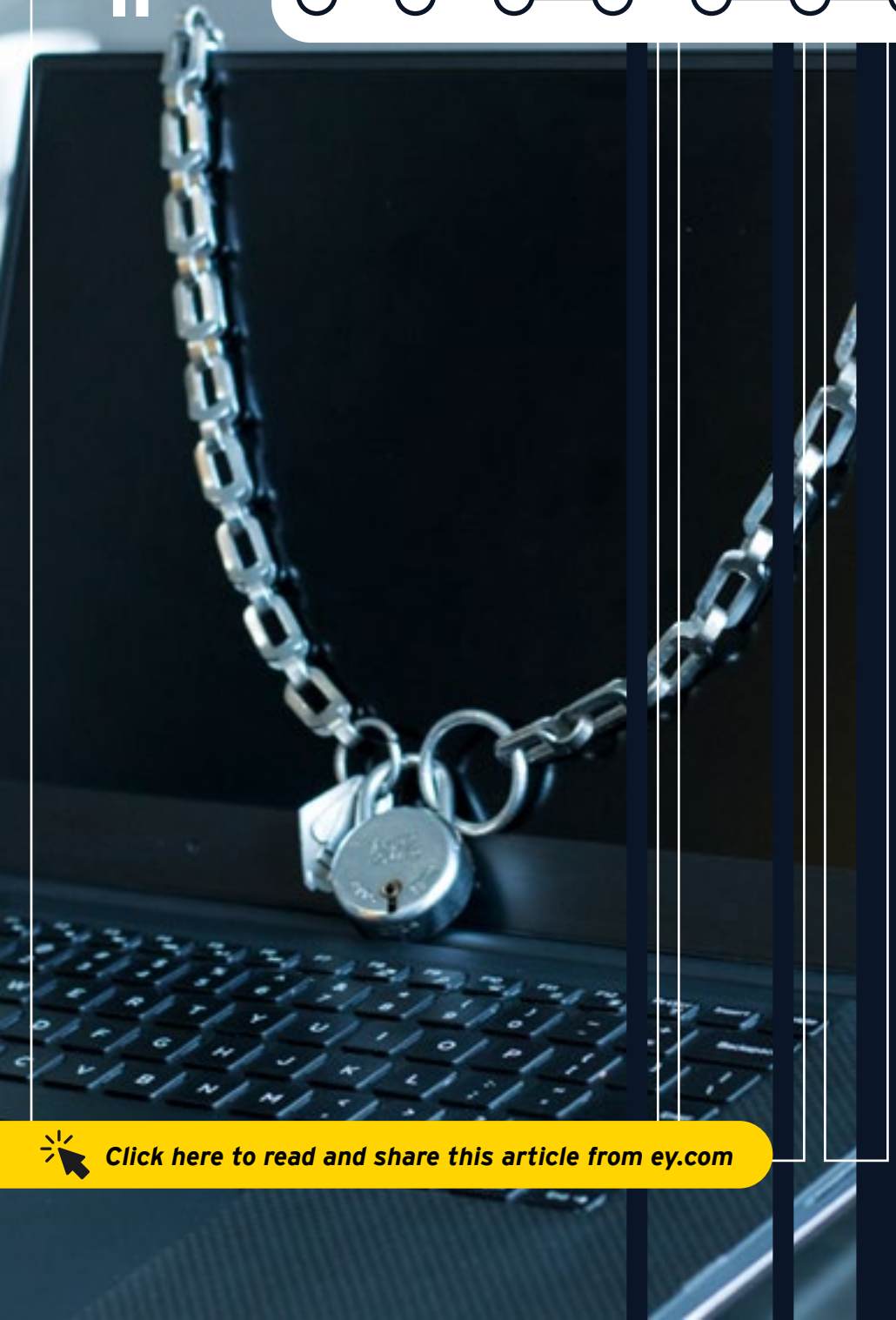

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SEBI insider trading regulations: Risk navigation - a necessity

Though the SEBI has been exploring ways to curb insider trading, it remains a challenge.

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Insider trading is a financial crime that has, in recent times, brought into sharp focus the lack of process rigor and indiscipline that is pervasive across companies and some of their senior individual stakeholders. It is not uncommon to read about Securities and Exchange Board of India (SEBI) investigations on insider trading cases and related penalties being levied on both companies and employees/directors.

Insider trading is a threat, and an important question is why.

It is an unhealthy trading practice as it places the average investor at a disadvantage. Any publicity on insider trading investigations adversely impacts a company and the involved individuals' reputations and erodes investor confidence in the securities market.

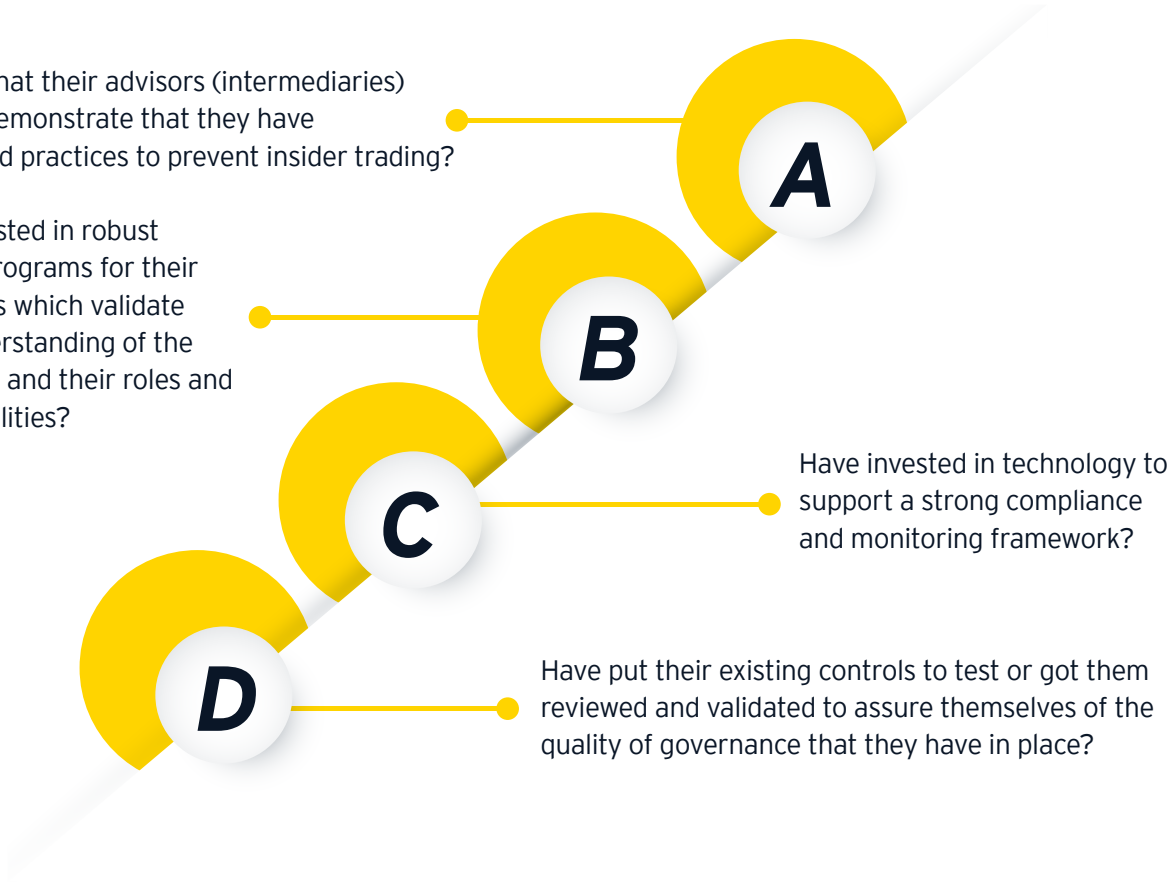
Use of technology is certainly helping SEBI improve enforcement and surveillance. SEBI's orders provide insights on the process followed, to procure information and map activities for the purpose of scrutiny. Trade details are mapped against the disclosures made by a company, Unpublished Price Sensitive Information (UPSI) available with the company, price movement around UPSI disclosures and the relationship between the individual and the company. The reviews do not stop at the immediate relationships with the company, e.g., employees or auditors but go beyond and track all possible relationships to conclude whether a person is an insider and whether his/her trade constitutes insider trading. There are cases where individuals have been treated as insiders, basis social media connections and sharing of UPSI through web applications.

The rationale for penalizing a company/individual is not only the monetary gain/avoidance of loss but also the intention to camouflage the actual trading pattern or real intentions for non-disclosure or delayed disclosure. SEBI Insider Trading Regulations does not intend to generally prohibit insiders from trading in securities of a company. It only aims to enforce disciplined trading with the underlying objective that all investors should have a fair opportunity to trade. While SEBI's investigation process is rigorous, its motive is only to punish the real 'wrong doers'. This is evident from the many cases where no penalty has been levied or where such cases have been dismissed.

We note that a majority of the cases relate inter-alia to trading while in possession of UPSI, trading during a restricted period, non-disclosures or delayed disclosures. So, were such instances of insider trading avoidable? They certainly were.

Like it has been said, "Discipline is the long and arduous process of convincing the mind to abide by one's conscience". It requires companies to move away from a 'tick in the box' approach to taking proactive steps in shaping their own compliance behavior and that of their employees, directors and other "connected persons".

How many listed companies, under the SEBI Insider Trading Regulations today:



A long and hard look at these questions and an honest response will help companies reflect on where they stand with respect to their insider trading obligations. Better insights into Indian and global best practices will help companies to reflect on their own practices.

Global News

- G20 Finance Ministers endorse key components of global tax changes and invite holdouts to back the agreement
- Danish High Court issues rulings on beneficial ownership of dividend income under tax treaty
- Spanish National High Court issues favorable decisions with respect to international holding structures after ECJ Danish cases
- Australian Taxation Office issues draft tax ruling on expanding scope of royalty withholding tax on software related payments
- German Ministry of Finance issues updated guidance on extraterritorial taxation of IP extending deadline for applicability of retroactive exemption in "clear" treaty cases

G20 Finance Ministers endorse key components of global tax changes and invite holdouts to back the agreement[1]

Background

On 12 October 2020, the Organisation for Economic Co-operation and Development (OECD) released a series of major documents in connection with the Base Erosion and Profit Shifting (BEPS) 2.0 project on addressing the tax challenges arising from the digitalization of the economy. These documents included Blueprints on Pillar One (on new nexus and profit allocation rules) and Pillar Two (on new minimum tax rules).

The cover statement accompanying the Blueprints indicated that the Inclusive Framework (IF) has agreed to keep working to swiftly address the remaining issues to bring the process to a successful conclusion by mid-2021.

Inclusive Framework Statement

On 1 July 2021, the IF issued the "Statement on a Two-pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" which reflected the agreement of 130[2] of the 139 member jurisdictions in the IF, on key components of the two pillars of the BEPS 2.0 project.

Pursuant to the above, on 5 July 2021, the OECD Secretary-General delivered a tax report to the G20 Finance Ministers and Central Bank Governors including an update on the 1 July Statement. According to the report, the current international tax system is no longer fit for the increasing challenges of globalization and digitalization and these challenges can only be effectively addressed through a multilateral solution.

The G20 communiqué

On 9-10 July 2021, at the conclusion of the G20 meeting, a joint communiqué was issued with respect to the ongoing BEPS 2.0 project. The Finance Ministers endorsed the key components of the two pillars on reallocation of profits and a global minimum tax as set out in the Statement released by IF on 1 July 2021. They also called on the IF to swiftly address the remaining issues, finalize the design elements within the agreed framework and provide an implementation plan for the two pillars by the October 2021. They also invited the IF member jurisdictions that have not yet joined the agreement to do so.

Implications

The endorsement by the G20 Finance Ministers of the key components of the two pillars of the project is an important step in advancing the work on these proposals.

However, finalization of the agreement and a detailed implementation plan by October 2021 is an ambitious timeline. There is significant work to be done by the IF to address the remaining open issues and to discuss it with the jurisdictions that have not supported the agreement. Further, the implementation process for each of the pillars around the world will create further complexity.

1 Refer EY Global alert titled "G20 Finance Ministers endorse key components of global tax changes and invite holdouts to back the agreement"

2 The nine members of the Inclusive Framework that had not joined the Statement as on 1 July 2021 were Barbados, Estonia, Hungary, Ireland, Kenya, Nigeria, Peru, Saint Vincent and the Grenadines, and Sri Lanka.

Danish High Court issues rulings on beneficial ownership of dividend income under tax treaty[3]

On 3 May 2021, the Danish High Court ruled in two cases where the Court of Justice of the European Union (CJEU) ruled regarding the applicability of Danish withholding tax with respect to the payments made from a Danish company to a company resident within the EU, which then fully or partially made payments to an ultimate parent company residing in a third country.

The NetApp case - C-117/16 Y Denmark

Facts

A Danish subsidiary company distributed dividend to its Cyprus parent company on 27 October 2005. The Cyprus parent subsequently used the dividends to pay principal and interest to its Bermuda parent company on 28 October 2005. The Bermuda parent company then used the proceeds to pay dividend to its United States (US) parent company on 3 April 2006.

In a second dividend distribution, dividend was determined by Danish Company in 2006 but was paid to Cyprus Company in year 2010 and then it was subsequently paid to the Bermuda company. Taxpayer contended that the second dividend was included in the original dividend paid by the Bermuda parent to the US ultimate parent company in 2006.

High Court Ruling

With regard to first dividend distribution, the Danish High Court held that the Cyprus parent company was not the beneficial owner of the dividend because it had no power of disposition over the dividend and the sole purpose of interposing the Cyprus company in the structure was to avoid payment of Danish withholding tax. Thus, neither the Danish-Cyprus tax treaty nor the EU Parent and Subsidiary Directive were applicable.

Further, the Court held that taxpayer had proved that the distribution had been ultimately channeled to the US ultimate parent company. On this basis the Court agreed that the taxpayer was entitled to invoke the Danish-US tax treaty whereby no Danish withholding tax was due on dividend. The fact that the dividend stayed in Bermuda for five months did not make a difference because it was a relatively short period and there was an original plan to repay the funds to the US parent company.

With regard to second distribution, Court observed that the taxpayer could not prove that dividend was included in the 2006 dividend paid to the US parent. Thus, the Danish-US tax treaty was not applicable and Danish withholding tax triggered.

Importantly, in this case, the Court accepts a look-through approach whereby Danish dividend withholding taxes may be eliminated under a tax treaty with the country of residence of the beneficial owner. However, this approach requires that the identity of each beneficial owner is disclosed, a certificate of residence is provided and that any intermediary companies are held not to be beneficial owners.

3 Refer EY Global alert titled "Danish High Court issues rulings on beneficial ownership"

The TDC case - Case C-116/16 T Denmark

Facts

There was a binding ruling from the Danish tax authorities as per which dividend from a Danish subsidiary to a Luxembourg parent company organized as a partnership limited by shares would trigger withholding tax.

In the given case, Danish subsidiary was owned (59.1%) by Luxembourg parent company. The Luxembourg parent company was owned (>99%) by another Luxembourg company (a public limited company), which was owned by private equity funds. In August 2011, dividend was paid by the Danish subsidiary to the Luxembourg parent company. The subsidiary applied withholding tax and submitted it to the tax authorities.

At the same time an appeal against the binding ruling was filed with the National Tax Tribunal where the taxpayer prevailed before the Tribunal and the tax authorities refunded the withholding tax. However, the Tribunal decision is in appeal.

Danish Subsidiary contended that the Luxembourg company was the beneficial owner of the dividend and thus, dividends withholding tax did not trigger.

High Court Ruling

Based on limited information provided by the taxpayer, the Court held that the dividend paid to the Luxembourg parent company had been repaid to the private equity funds and potentially to the ultimate investors and that the Luxembourg company had no separate functions. The taxpayer had not disclosed the identity of each of the ultimate investors and had not asserted that the private equity funds would be able to invoke Danish tax treaties if the dividends had been paid directly to the funds.

Thus, Court concluded that neither the EU Parent and Subsidiary Directive nor Danish tax treaties were applicable and thus dividend triggered withholding tax.

Spanish National High Court issues favorable decisions with respect to international holding structures after ECJ Danish cases[4]

Traditionally, the Spanish tax authorities and tax courts have taken a narrow position when interpreting the "business purpose" to qualify for the Spanish dividend withholding tax (DWHT) exemption where they challenged holding structures on the basis of the beneficial ownership clause as a separate requirement or an independent anti-abuse rule, even if not included in the wording of the Spanish tax law.

Recently, the Spanish National High Court issued three decisions favorable to the taxpayer regarding the application of DWHT exemption post-Danish cases[5].

1. First decision- Spanish National High Court[6] upheld the DWHT exemption applied by a Spanish company on a payment to a Luxembourg company. It stated that Spanish tax authorities may not set a general presumption of abuse but rather must establish the existence of elements constituting such an abusive practice[7].
2. Second decision- Spanish National High Court[8] validated a bonafide structure considering the facts of the case and held that there were valid business reasons for incorporation of the EU holding company. High Court held that for Spanish tax authorities to treat a fact pattern as abusive practice, it is necessary that they prove:
    a. an objective factor - consisting the fact that, despite the compliance with the formal requirements to apply the EU exemption, aim of EU rule to facilitate intra-EU trade is not achieved
    b. a subjective factor - consisting the intention to obtain tax advantage by means of artificial creation of a structure fulfilling the formal requirements to obtain an undue tax benefit.
3. Third decision- Spanish National High Court[9] confirms that the beneficial ownership clause is not "embedded" in the tax treaty if not expressly foreseen and therefore may not be claimed by the Spanish tax authorities to reject a reduced DWHT rate under an applicable tax treaty.

The Spanish National High Court followed the principles set forth in ECJ cases on the burden of proof and the objective and subjective factors to evidence the existence of abuse or lack thereof. This approach is more aligned with the rule of law and EU principles.

4 Refer EY Global alert titled "Spanish National High Court issues favorable decisions with respect to international holding structures after ECJ Danish cases"
5 ECJ decision dated 26 February 2019, C-116/16 and C-117/16
6 Spanish National High Court decision dated 21 May 2021, SAN 2467/2021
7 EY Global Tax Alert, Spanish National High Court overturns denial of withholding tax exemption on dividend payments to EU shareholder, dated 2 July 2021
8 Spanish National High Court decision dated 31 May 2021, SAN 3097/2021
9 Spanish National High Court decision dated 18 June 2021, SAN 2804/2021

Australian Taxation Office issues draft tax ruling on expanding scope of royalty withholding tax on software related payments[10]

On 25 June 2021, Australian Taxation Office (ATO) released Draft Taxation Ruling TR2021/D4 - Income tax: royalties - character of receipts in respect of software. The draft ruling gives extensive guidance on when royalty withholding tax (RWT) can apply and limited guidance on when it would not apply.

The ruling provides for the potential imposition of Australian RWT on software re-seller or distribution agreements for licensing, subscriptions and cloud-based software-as-a-service (Saas) arrangements. However, the principles conveyed in the ruling indicate the likely approach of ATO to broader intellectual property transactions, particularly where intermediaries are involved in data streaming and digital media distribution.

The ATO recognizes that there can be software distribution agreements that do not confer copyright related rights and therefore would not be expected to attract RWT, for example re-sale of packaged software.

In case of re-seller arrangements, draft ruling conclude that the mere existence of a sub-license arrangement between a commercial distributor and customer is sufficient to treat all or part of the master license payment or distribution fee as royalty. This leads inbound technology groups to restructure into buy/sell business models leading them to a competitive disadvantageous position as they are exposed to:

- higher levels of tax risk
- outbound transactions being potentially subject to Australia's diverted profits tax as well as the broad scope of anti-hybrid rules
- expanded scope of RWT
- normal transfer pricing rules.

The draft ruling is focused on domestic law definition of "royalties" and is silent in respect of Australia's Double Tax Agreements (DTAs). This can raise issues while claiming foreign tax credit in a licensor country if the ATO definition is not consistent with the DTA. Further, the ATO's position demonstrated by this ruling may add challenges to concluding some bilateral Advance Pricing Agreements (APAs) in the future.

The ATO indicates in the draft ruling that it intends to apply the new ruling both retrospectively and prospectively. This may be a significant tax risk issue for some taxpayers where the ruling is an expansion of the scope of the previously understood royalty definition. The draft ruling could also call into question the ability to claim a foreign tax credit in a licensor country if the ATO definition is not acceptable/consistent with the DTA. However, it will not apply to settlements of past disputes.

10 Refer EY Global alert titled "Australian Taxation Office issues draft tax ruling on expanding scope of royalty withholding tax on software related payments"

German Ministry of Finance issues updated guidance on extraterritorial taxation of IP extending deadline for applicability of retroactive exemption in "clear" treaty cases[11]

On 14 July 2021, the German Ministry of Finance published an update to the guidance addressing non-resident (NR) taxation of royalty income and capital gains relating to intellectually property rights (IP) as they have nexus with Germany, i.e., IP that is registered in a German public register (German-nexus IP).

Under German domestic law, where a non-German resident person licenses or sells German nexus IP, Germany can claim a taxing right under domestic law. Generally, tax on royalty income is administered by way of withholding tax (WHT) of 15.825% to be withheld, declared and transferred by the licensee. Capital gain is taxed through a NR tax return to be filed by the seller.

Guidance on royalty payments already made or to be made by 30 June 2022

A licensee will not be required to withhold, declare and transfer WHT on royalty payments made to a foreign licensor, if following conditions are fulfilled cumulatively:

- the licensee is NR in Germany at the moment of payment. For a body corporate, neither its corporate seat nor its effective place of management in Germany.
- the licensor, is resident in a jurisdiction with which Germany had an applicable treaty in place at the moment of payment and it is:
  - entitled to treaty benefits
  - beneficial owner of the income for purposes of the treaty
  - able to meet the requirements of the German anti-treaty shopping rules
- licensor files an application for an exemption from withholding taxes with the Federal Central Tax Office (FCTO) by 30 June 2022. Licensee may also apply for the exemption if the licensor authorizes the licensee
- all agreements relating to the remuneration covered by the application have to be disclosed to the FCTO along with German translation of essential sections of the agreements

A licensee can only abstain from withholding tax if all of these requirements are cumulatively met for a specific licensor.

If the recipient of the royalty payments is a tax transparent partnership for German tax purposes, the guidance grants relief if the requirements are met at the level of the partners.

WHT exception does not apply for royalty payments received by a licensor after 30 June 2022. In that case, general provisions of the domestic law should apply.

Capital gain transactions

The updated guidance does not provide any changes with respect to capital gain transactions or income determination as included in the original guidance[12].

11 Refer EY alert titled "German Ministry of Finance issues updated guidance on extraterritorial taxation of IP extending deadline for applicability of retroactive exemption in "clear" treaty cases"

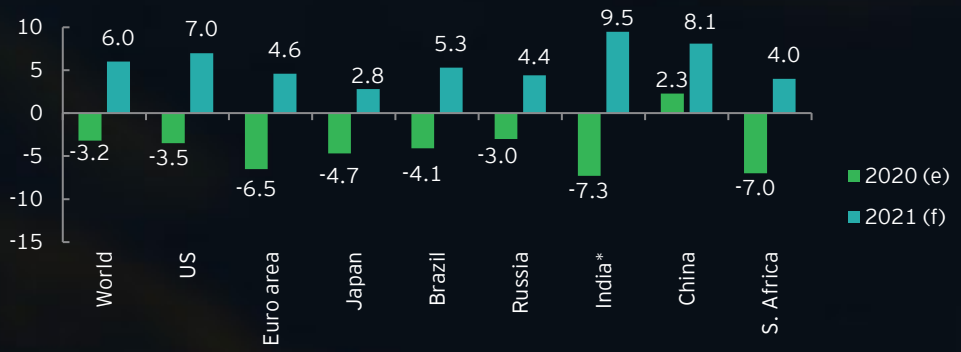
12 Refer EY Global Tax Alert titled "German Ministry of Finance Finalizes guidance on German extraterritorial taxation of intellectual property" dated 11 February 2021


EconoMeter
macro-fiscal trends

1 IMF projected global growth at 6% in 2021 with India's growth forecasted at 9.5% for FY22.

- The IMF projected global GDP to show a growth of 6.0% in 2021 following a contraction of (-)3.2% in 2020. The forecast for 2021 is unchanged from the April 2021 forecast but there are offsetting revisions across advanced economies (AEs) and emerging market and developing economies (EMDEs) reflecting differences in pandemic developments and policy shifts.
- While growth forecast for the EMDEs in 2021 has been revised down by 0.4% points to 6.3%, forecast for AEs has been revised up by 0.5% points to 5.6%.
- India's growth forecast for 2021 (FY22) has been revised down by 3% points to 9.5% following the severe second COVID wave during March to May 2021 and expected slow recovery after that.

Chart 1: Real GDP growth projections (in %, annual)



(e) refers to estimate and (f) refers to forecast
Source: The OECD Economic Outlook, December 2020
**data for India pertains to fiscal year*

2 Real GDP grew by 1.6% in 4QFY21

- Real GDP grew by 1.6% in 4QFY21 as compared to 0.5% in 3QFY21. With this, the contraction in real GDP for FY21 stood at (-)7.3% as per the provisional estimates.
- An improved performance on the demand side in 4QFY21 was led by a strong recovery in the growth of gross fixed capital formation (GFCF), which grew by 10.9% as compared to 2.6% in 3QFY21.
- Government final consumption expenditure (GFCE) also showed a strong growth of 28.3% in 4QFY21, although a large part of this growth may be attributable to a sharp increase in the subsidy component of Center's expenditure.
- Private final consumption expenditure (PFCE) grew by 2.7% in 4QFY21 following a contraction for three successive quarters.
- Both exports and imports grew by 8.8% and 12.3% respectively in 4QFY21 following a contraction in six consecutive quarters.

Table 1: Real GDP growth (in %)

Aggregate demand	2Q FY20	3Q FY20	4Q FY20	1Q FY20	2Q FY21	3Q FY21	4Q FY21	FY20	FY21 (PE)
PFCE	6.5	6.4	2.0	-26.2	-11.2	-2.8	2.7	5.5	-9.1
GFCE	9.6	8.9	12.1	12.7	-23.5	-1.0	28.3	7.9	2.9
GFCF	3.9	2.4	2.5	-46.6	-8.6	2.6	10.9	5.4	-10.8
EXP	-1.3	-5.4	-8.8	-21.8	-2.0	-3.5	8.8	-3.3	-4.7
IMP	-1.7	-7.5	-2.7	-40.9	-17.9	-5.0	12.3	-0.8	-13.6
GDP	**4.6**	**3.3**	**3.0**	**-24.4**	**-7.4**	**0.5**	**1.6**	**4.0**	**-7.3**

Source: Central Statistical Organization (CSO) MoSPI, Government of India

AD: Aggregate demand; PFCE: Private final consumption expenditure; GFCE: Government final consumption expenditure; GFCF: Gross fixed capital formation; EXP: Exports; IMP: Imports; GDPMP: GDP at market prices; AE: Advance estimate

3 Real gross value added (GVA) grew by 3.7% in 4QFY21

- On the output side, real GVA grew by 3.7% in 4QFY21 as compared to 1.0% in 3QFY21.
- Only two out of eight broad GVA sectors namely, mining and quarrying and trade transport, hotels et. al., contracted by (-)5.7% and (-)2.3% respectively in 4QFY21.
- Strong recovery was seen in the growth of construction at 14.5% and manufacturing at 6.9% in 4QFY21 as compared to 6.5% and 1.7% respectively in 3QFY21.
- Growth in financial, real estate and professional services and agriculture and allied sectors slowed to 5.4% and 3.1% respectively in 4QFY21 from 6.7% and 4.5% respectively in 3QFY21.
- GVA of public administration, defense and other services grew by 2.3% in 4QFY21 following a contraction in three successive quarters.
- In FY21, overall GVA contracted by a historic low of (-)6.2% as per the PE. This is attributable to a contraction in six out of eight broad sectors in FY21. Two sectors which showed a positive growth are agriculture and allied activities and electricity, gas, water supply and other utility services.

Table 2: Sectoral real GVA growth (in %)

Aggregate output	2Q FY20	3Q FY20	4Q FY20	1Q FY20	2Q FY21	3Q FY21	4Q FY21	FY20	FY21 (PE)
Agr.	3.5	3.4	6.8	3.5	3.0	4.5	3.1	4.3	3.6
Ming.	-5.2	-3.5	-0.9	-17.2	-6.5	-4.4	-5.7	-2.5	-8.5
Mfg.	-3.0	-2.9	-4.2	-36.0	-1.5	1.7	6.9	-2.4	-7.2
Elec.	1.7	-3.1	2.6	-9.9	2.3	7.3	9.1	2.1	1.9
Cons.	1.0	-1.3	0.7	-49.5	-7.2	6.5	14.5	1.0	-8.6
Trans.	6.8	7.0	5.7	-48.1	-16.1	-7.9	-2.3	6.4	-18.2
Fin.	8.9	5.5	4.9	-5.0	-9.1	6.7	5.4	7.3	-1.5
Publ.	8.8	8.9	9.6	-10.2	-9.2	-2.2	2.3	8.3	-4.6
GVA	4.6	3.4	3.7	-22.4	-7.3	1.0	3.7	4.1	-6.2

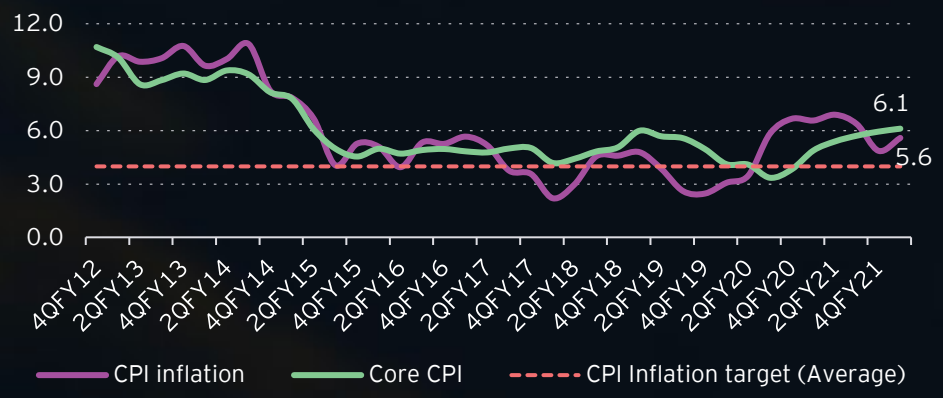
Source (Basic data): MoSPI

GVA: Gross value added; Agr: Agriculture and allied activities; Ming: Mining and quarrying; Mfg: Manufacturing; Elec: Electricity, gas, water supply and other utility services; Cons: Construction; Trans: Trade, hotels, transport, communication and services relating to broadcasting; Fin: Financial, real estate & professional services; Public Administration, defence and other services

4 The RBI retained its policy repo rate at 4.0% while maintaining an accommodative policy stance in its August 2021 monetary policy review.

- Consumer Price Index (CPI) inflation remained high at 5.6% in 1QFY22 as compared to 4.9% in 4QFY21 led by high food and fuel prices.
- Core CPI inflation[1], increased to a 27-quarter high of 6.1% in 1QFY22 reflecting cost push pressures from higher global crude and commodity prices, and high fuel taxes post-COVID.
- On a monthly basis, CPI inflation eased to 5.6% in July 2021 after staying above RBI's 6% upper tolerance limit for two successive months. Core CPI inflation was, however, sticky at 6.0% in July 2021.
- The RBI retained the repo rate at 4.0% in its monetary policy review held on 6 August 2021 considering the improving yet weak outlook for demand, and the transitory nature of inflationary pressures arising out of adverse supply shocks.

Chart 2: Inflation (y-o-y; in %)



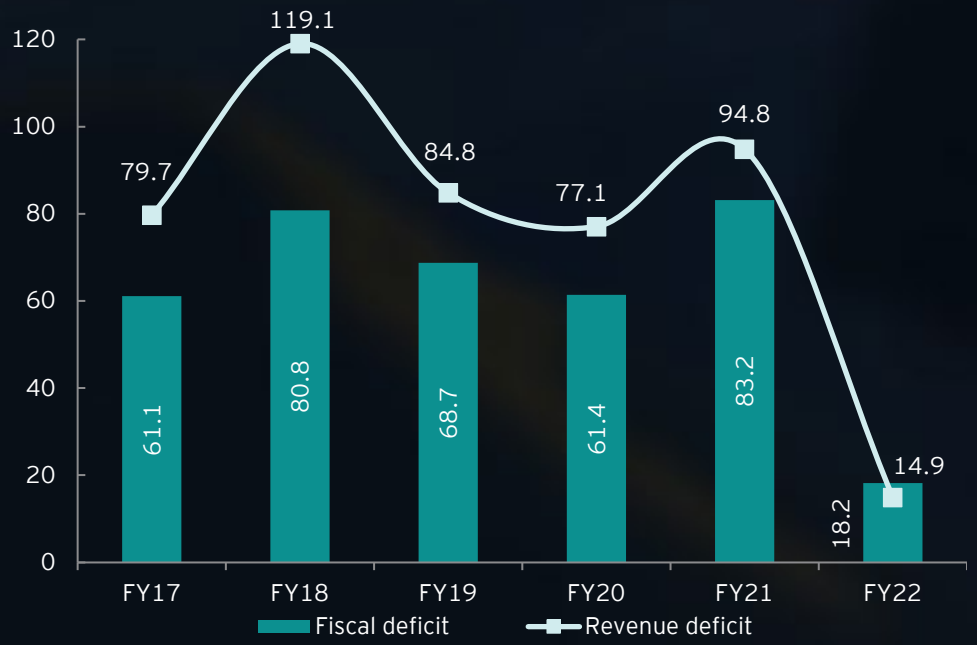
Source: MoSPI; Note: CPI stands for Consumer Price Index

1 Core CPI inflation is measured in different ways by different organizations/agencies. Here, it has been calculated by excluding food and fuel and light from the overall index.

5 Center's fiscal deficit during 1QFY22 stood at 18.2% of the budgeted target

- Center's fiscal deficit during 1QFY22 stood at 18.2% of the annual budgeted target, much lower than the corresponding numbers pertaining to 1Q of the period from FY17 to FY21.
- This is partly due to robust growth in the Center's gross and net tax revenues which implied lower dependence on borrowing in 1QFY22 and partly due to the fact that growth in revenue expenditures was negative.
- Center's revenue deficit during 1QFY22 stood at 14.9% of the annual budgeted target, its lowest level since FY11.

Chart 3: Fiscal and revenue deficit as a % of budgeted target

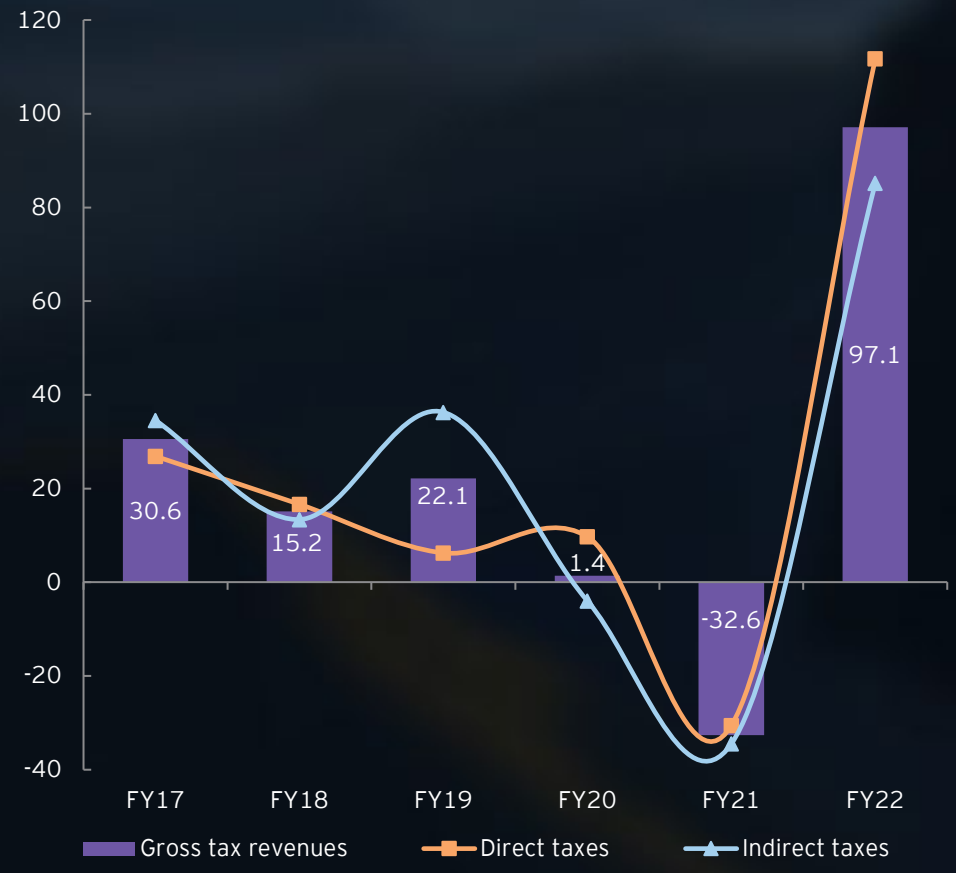


Source: Monthly Accounts, Controller General of Accounts, Government of India; Union Budget documents, various years

6 Gross central taxes witnessed a growth of 97.1% during 1QFY22 reflecting favorable base effect

- Center's gross tax revenues (GTR) showed a y-o-y growth of 97.1% during 1QFY22 owing to a strong base effect. In the corresponding period of FY21, GTR contracted by (-)32.6%.
- Both direct and indirect taxes showed high growth rates of 111.8% and 85.2% respectively during 1QFY22 as compared to contraction of (-)30.6% and (-)34.5% respectively in 1QFY21.
- In 1QFY22, the recovery was the strongest for customs, followed by CIT, PIT, UED and GST.
- In the case of the customs duties, the central government had decided to increase the customs duty rates in the beginning of FY21. Its positive impact became visible beginning 3QFY21 when the economy started to recover and import growth picked up substantially.

Chart 4: Growth in central tax revenues during April-January (in %, y-o-y)



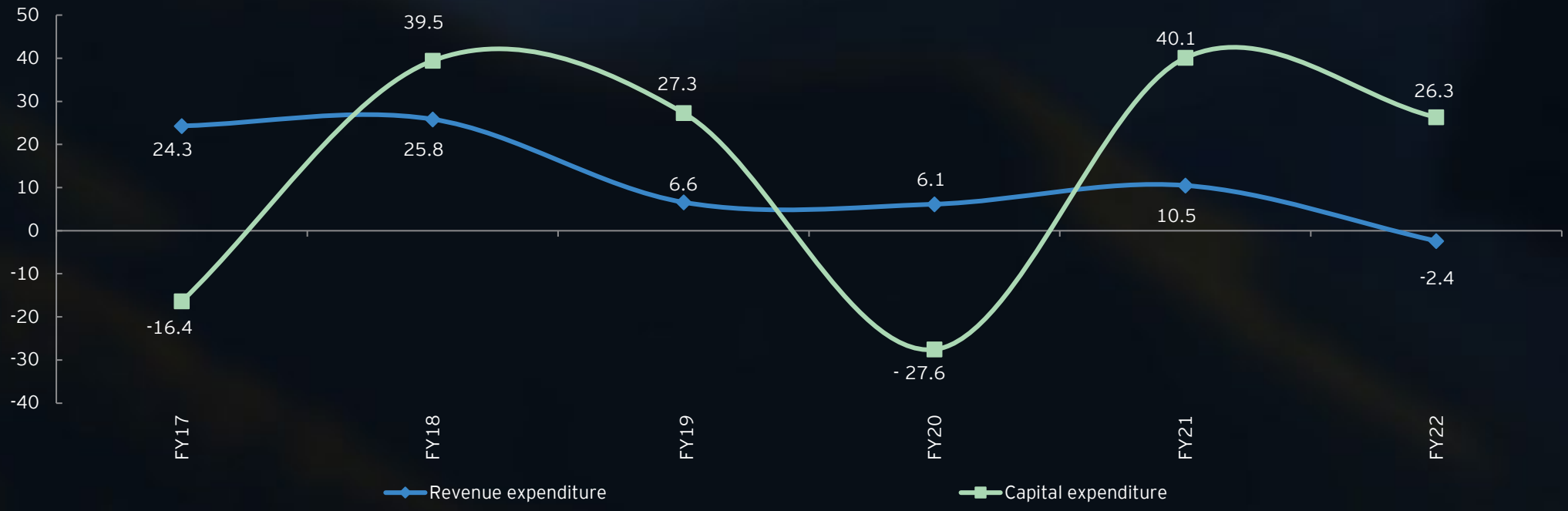
Source: Monthly Accounts, Controller General of Accounts (CGA), Government of India

Notes: (1) Direct taxes include personal income tax and corporation tax, and indirect taxes include union excise duties, service tax, customs duty, CGST, UTGST, IGST and GST compensation cess from July 2017 onwards; (2) IGST revenues are subject to final settlement; (3) other taxes (securities transaction tax, wealth tax, fringe benefit tax, banking cash transaction tax, etc.) are included in center's gross tax revenues along with direct and indirect taxes.

7 During 1QFY22, center's capital expenditure grew by 26.3% while revenue expenditure contracted by (-)2.4%.

- Center's total expenditure grew by 0.7% during 1QFY22, much below the corresponding figures for earlier years.
- There has been an emphasis on frontloading capital expenditure which grew by 26.3% during 1QFY22 while delaying revenue expenditure which showed a contraction of (-)2.4% during this period.
- Revenue expenditure during April-June FY22 stood at 24.2% of the annual BE while capital expenditure stood at 20.1% of the annual BE during this period. These are comparable to the corresponding ratios in the previous years (FY17 to FY21).

Chart 5: Growth in central expenditures during April-October (in %, y-o-y)



Source: Monthly Accounts, Controller General of Accounts, Government of India

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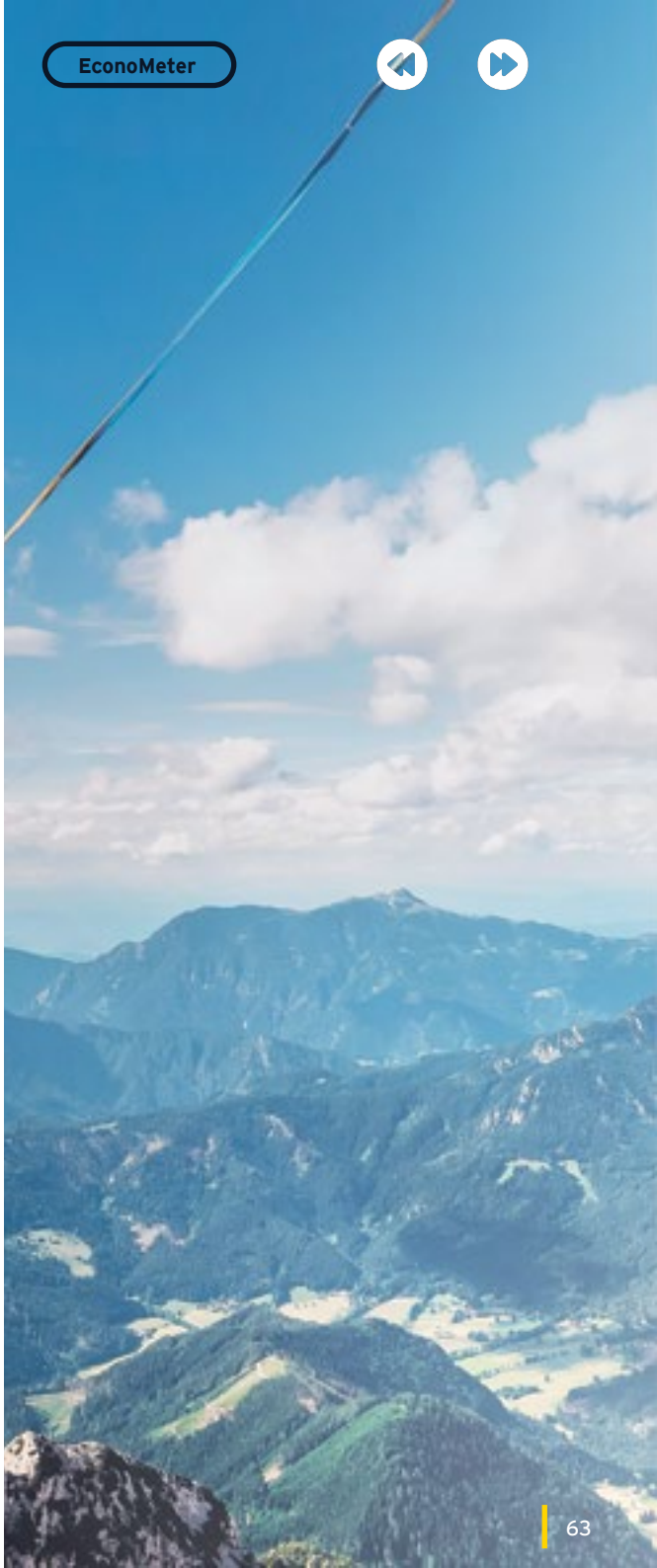

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