

India **Tax** Insights

Issue 10
February 2017

In this issue

Budget 2017: cautious approach to support growth

Analysis of the Budget fine print

CFOs' Budget

Industry speak



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Foreword

We are pleased to present the 10th edition of our magazine *India Tax Insights*. This issue focuses on the 2017 Union Budget, which was presented by the Finance Minister to the Parliament on 1 February 2017.

The Budget comes in the wake of a set of tumultuous international developments – Brexit, political changes in developed countries and two radical domestic policy actions (GST and demonetization). GST will create a common Indian market, improve tax compliance and governance, and boost investment and growth. Demonetization has had short-term costs but holds the potential for long-term benefits. Follow-up actions such as introducing further tax reforms, reducing tax rates and acting to allay anxieties about an over-zealous tax administration are required to minimize the costs and maximize the benefits. These actions would allow growth to return to trend in 2017-18, following a temporary decline in 2016-17. The Budget sets the direction for these actions and reflects the Government's commitment

to transform, energize and clean India. The Budget also contains a number of measures to broaden the tax base, which may pave the way for a corporate tax rate reduction in the near future.

The Economic Survey of 2014-15 spoke about the sweet spot for the Indian economy that could launch India onto a trajectory of sustained growth of 8%–10%. The last year's Survey assessed that "for now, but not indefinitely, that sweet spot is still beckoningly there." Dr. D. K. Srivastava analyzes the current state of the Indian economy and provides his prognosis on whether that sweet spot is enduring or evanescent.

Mr. V S Parthasarathy, Group CFO, Mahindra & Mahindra and Mr. R Shankar Raman, CFO, Larsen & Tourbo provide an industry perspective on the Budget in two insightful articles. While Mr. Parthasarathy appreciates the multi-fold objectives of fiscal prudence, driving growth and inclusiveness that the Budget seeks

to achieve, Mr. Raman, taking a pragmatic view, states that the success lies in implementation.

In a series of articles, EY India subject-matter professionals discuss key Budget proposals outlining the impact these proposals could have on business and industry. The articles cover topics such as implementation of the interest deduction limitation rules in line with the OECD-G20 BEPS Action Plan 4, introduction of secondary adjustment in the transfer pricing law to reflect allocation of profits consistent with the transfer pricing outcome, framework for harmonizing the impact of Ind-AS on the computation of Minimum Alternate Tax, use of rupee-denominated bonds for funding Indian operations, and personal tax proposals.

In addition, we have two additional features in this issue. One outlines the key tax announcements in the Budget, while the other provides an analysis of the Budget from a CFO's perspective.

We hope you find this publication timely and useful. We look forward for your feedback and suggestions.



Sudhir Kapadia

Sudhir Kapadia

Partner and National Tax Leader,
EY India

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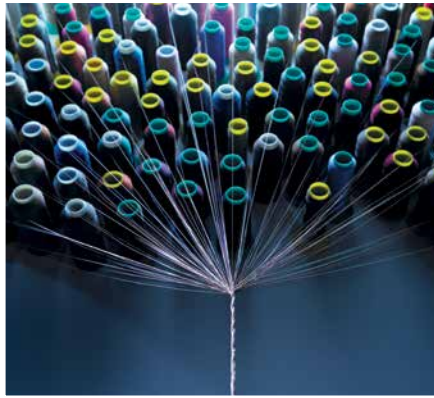
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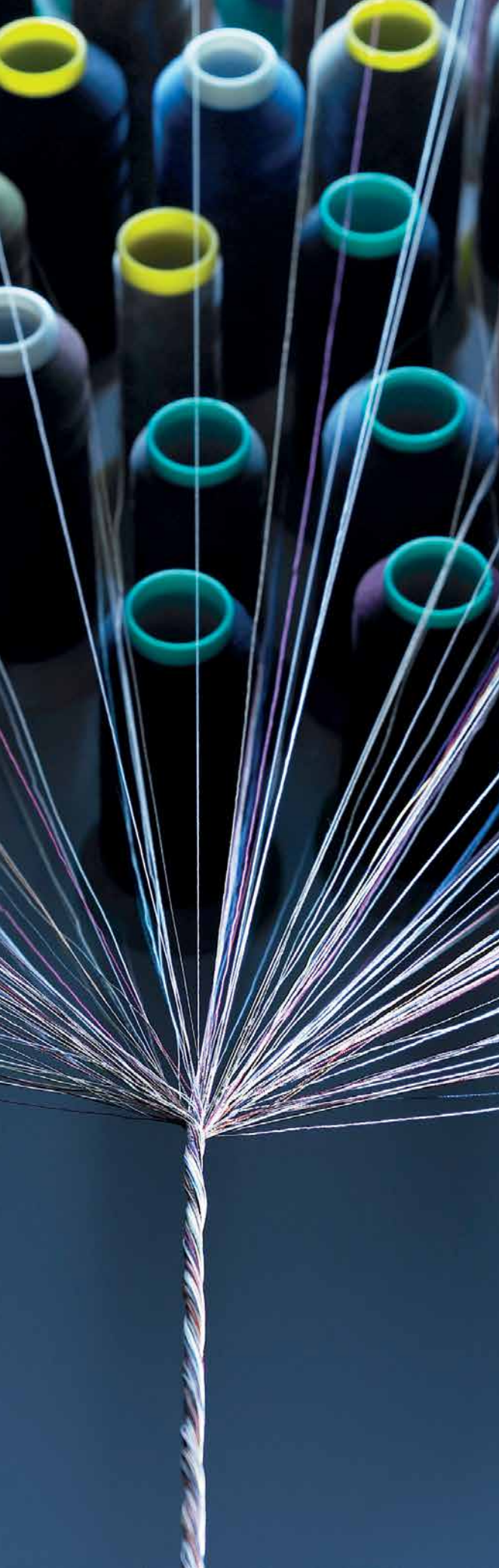


Economic Survey and Union Budget: cautious approach to supporting growth

Dr. DK Srivastava

Chief Policy Advisor, EY India





India's 8 November demonetization of high-denomination currency amounting to INR15.44 trillion, i.e., 86.1% of the currency in circulation at that time, was by all accounts a disruptive economic move. Economic Survey 2016–2017 (the Survey) estimates the extent of demonetization-linked erosion in GDP growth in FY17 to be in the range of 0.25–0.5 percentage points. This implies that the real GDP growth in FY17 would be in the range of 6.5%–6.75%, given the estimated growth rate of 7% for FY17 by the Central Statistical Organisation (CSO) without taking into account the effect of demonetization. Taken together, these imply a reduction in FY17 GDP growth in the range of 1.15–1.4 percentage points in the growth of 7.9% achieved in FY16 as per the latest CSO release (31 January 2017). This “demonetization dip” in the growth rate, as shown in Chart 1, can clearly qualify to be one of the “far-reaching structural reforms in the economy with unanticipated fiscal implications.” The Fiscal Responsibility and Budget Management (FRBM) Review Committee recommended that in the presence of such a structural reform, there would be a case for deviating from the fiscal deficit target of 3% of GDP. The Committee recommended a flexibility of up to 0.5% points. It also suggested to anchor fiscal discipline to debt rather than the fiscal deficit relative to GDP. For the medium term, it suggested that the desired target be a consolidated debt-GDP ratio of 60%, of which 40% could be central debt and 20% could be consolidated state debt. Both these provisions provided enough justification for taking up a strong fiscal stimulus in the Union Budget of FY18 for uplifting India's economic growth closer to its potential, which the Survey quantifies to be in the range of 8%–10%.

Constraints to India's growth

Apart from demonetization, which would have a short-term impact, there are longer term constraints emanating from a slowing down of investment demand and a weakening of global demand for India's exports. With the changed political situation in the US as also Brexit, the world economy is entering into an era of "de-globalization," which would adversely affect India's growth prospects. First, there is the possibility of eruption of trade tensions among major countries, impacting India's exports. Second, there could be competition among major players in lowering corporate tax rates to attract capital. Third, with the US incrementally uplifting the Fed rate, there would be steady pressure on the Indian rupee.

As Table 1 shows, gross fixed capital formation had started to contract in the last quarter of FY16. The magnitude of this contraction increased in the first and second quarters of FY17. Furthermore, CSO's latest release shows that even private final consumption expenditure slowed down considerably, with an annual growth of 5.5% in FY17 compared to 7.3% in FY16. There were other indicators of the post-demonetization slowdown in terms of a sharp fall in bank credit growth and PMI for manufacturing and services, which fell below the threshold of 50 in December 2016, indicating contraction.

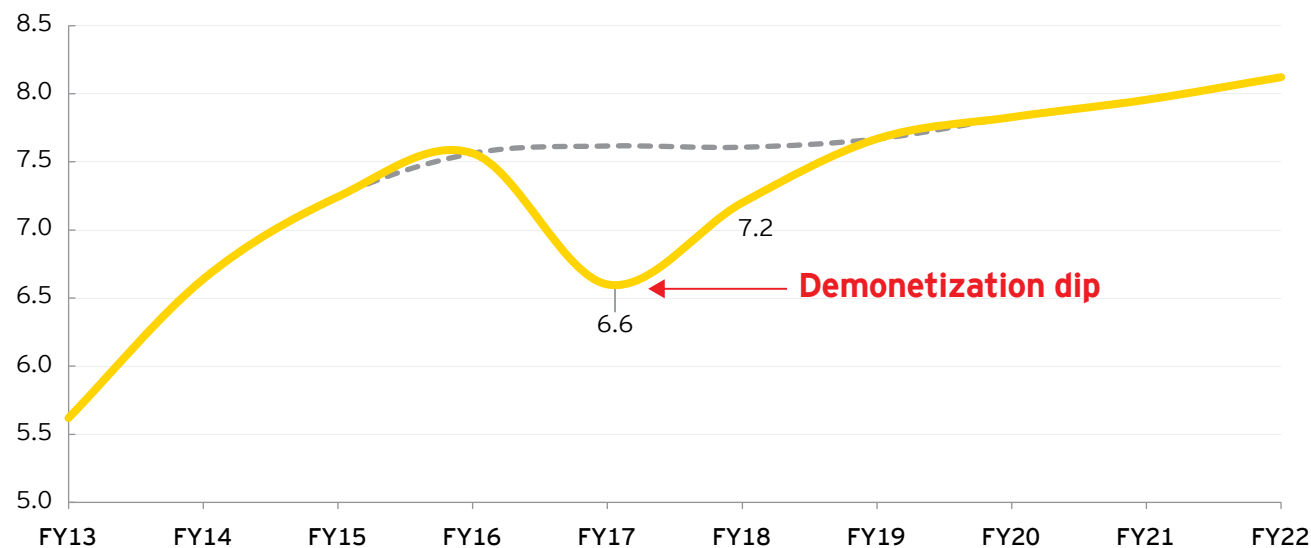
Table 1. Real GDP growth (%)

AD Component	2Q FY16	3Q FY16	4Q FY16	1Q FY17	2Q FY17	FY16	FY17
PFCE	6.3	8.2	8.3	6.7	7.6	7.3	5.5
GCE	3.3	3	2.9	18.8	15.2	2.9	26.5
GFCF	9.7	1.2	-1.9	-3.1	-5.6	6.1	0
EXP	-4.3	-8.9	-1.9	3.2	0.3	-5.4	2.2
IMP	-0.6	-6.4	-1.6	-5.8	-9	-5.9	-0.8
GDP	7.6	7.2	7.9	7.1	7.3	7.9	7
Of which							
% contribution of disc.	1.2	2.1	4.1	0.9	1.5	1.3	1.7

Source (Basic Data): MOSPI, Annual data has been taken from the CSO Release dated 31 January 2017

AD: aggregate demand, PFCE: private final consumption expenditure, GCE: government consumption expenditure, GFCF: gross fixed capital formation, EXP: exports, IMP: imports, GDP: gross domestic product, disc.: discrepancies

Chart 1. Annual GDP growth (%) up till FY22



Source (Basic Data): IMF

Note: The dotted line indicates the pre-demonetization real GDP growth path projected by the IMF

Financing fiscal stimulus in FY18

Apart from the FRBM Review Committee recommendations, the Survey also argues that India is very different from the comparators used by the rating agencies. India has a strong growth trajectory and has shown commitment to fiscal discipline. In fact, India might be able to carry much more debt than other countries. In other words, the ground has already been prepared for the Finance Minister to increase fiscal deficit from 3.2% up to at least 3.5% of GDP in FY18. Further support to demand can also be financed through various channels. First, the Government can access a one-time fiscal windfall linked to

currency extinguishment supplemented by additional tax-revenues through the Income Declaration Scheme and the Pradhan Mantri Garib Kalyan Yojana (PMGKY). Together, the extent of this gain could be as much as 0.75% of GDP. Second, many states that are asking for a relaxation of their borrowing norms due to revenue erosion as a result of the slowdown can together be allowed an additional borrowing up to 0.5% of GDP. Borrowing 0.5% points above the FY18 target of 3% of GDP would be justifiable noting that the consolidated government's debt-GDP ratio decreased to 69% in 2015 from its peak of 84% in 2003. However, the Survey recognizes that the state finances are under stress with their consolidated fiscal deficit going up from 2.5% of GDP in 2014-15 to 3.6%

of GDP in 2015-16, partly because of UDAY scheme.

Third, departmental enterprises such as Department of Post and Indian Railways and non-departmental public enterprises can be persuaded to take up their expansion plans given the prevailing low prices of investment goods. Their borrowing, largely off-budget, can add another 0.75% of GDP to the fiscal stimulus. Together, these channels could provide a stimulus amounting to 2.5% of GDP. Most of this stimulus should be directed toward augmenting infrastructure. Qualitatively, some push to construction, housing, and manufacturing, particularly the automobile sector, through sector-specific incentives should help these demonetization-afflicted sectors.

Sequencing fiscal and monetary policy interventions

As long as private investment demand remains weak, any interest rate reduction may not prove to be

effective. Investment demand would pick up only after existing inventories are exhausted. At that point, monetary stimulus would become effective. The surge in bank deposits, implying augmented financial savings, would enable the Government to borrow the extra amount without putting pressure on the interest rate. Fiscal

stimulus therefore has to come first, and it is best introduced by augmenting the Government's capital expenditure, which would increase consumption demand in the economy. But, as indicated in Table 2, capital expenditure as a percentage of GDP is slated to fall in FY18.

Table 2. Expenditure performance and prospects

#	Expenditure head	INR lakh crore			Growth (%)		As % of GDP	
		FY16 (Actuals)	FY17 (RE)	FY18 (BE)	FY17 (RE) over FY16 (Actuals)	FY18 (BE) over FY17 (RE)	FY17 (RE)	FY18 (BE)
1	Revenue Expenditure of which	15.4	17.3	18.4	12.8	5.9	11.5	10.9
	Interest payments	4.4	4.8	5.2	9.4	8.3	3.2	3.1
	Pensions	1.0	1.3	1.3	32.4	2.4	0.9	0.8
	Total Subsidies of which	2.6	2.6	2.7	-1.4	4.5	1.7	1.6
	Fertiliser Subsidy	0.7	0.7	0.7	-3.3	0.0	0.5	0.4
	Food Subsidy	1.4	1.4	1.5	-3.0	7.5	0.9	0.9
	Petroleum Subsidy	0.3	0.3	0.3	-8.2	-9.2	0.2	0.1
2	Capital Expenditure	2.5	2.8	3.1	10.6	10.7	1.9	1.8
3	Total Expenditure	17.9	20.1	21.5	12.5	6.6	13.4	12.7

Source (Basic Data): Union Budget FY18

The Survey observes that the room for monetary stimulus may be limited, as domestic prices are expected to come under pressure due to increased prices of global crude and other primary articles.

Realizing demonetization's potential gains

Facilitated by demonetization, there is an expectation of a steady increase in the tax-GDP ratio. This would be further facilitated by the Goods and Services Tax (GST) and digitization of transactions. Until a tangible increase in the tax-GDP ratio occurs, the ambitious Universal Basic Income (UBI) proposal of the Survey will have to wait, as it requires the fulfilment

of some prerequisite conditions. Two conditions that the Survey stipulates are (a) full coverage of Jan Dhan, Aadhaar and Mobile connectivity and (b) the need for Center-state negotiations, as a part of the UBI would need to be funded by states. Further, lowering the corporate tax rates to 25% while abolishing various tax exemptions and deductions would uplift the tax-GDP ratio. Budget FY18 has taken a partial step in this direction by reducing the CIT rate to 25% for companies with a turnover below INR50 crore.

In order to ensure lasting benefits from demonetization, a number of supplementary initiatives are needed. First, the stamp duty rate should be reduced to incentivize people to declare the correct value of property so that cash payments can be avoided. Similarly, financing of elections needs to be drastically reformed. Budget FY18 has taken some important steps in this context by limiting individual cash contribution to INR2,000 and issuance of electoral bonds under a Government of India scheme.

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Glimpse of Budget 2017

Corporate tax

- ▶ Corporate tax rate reduced from 30% to 25% for companies with turnover up to INR50 crore in FY2015-16.
- ▶ Minimum Alternate Tax (MAT) computation for Ind-AS companies has been clarified.
- ▶ Restrictions on cash transactions have been tightened, including penalty for cash receipts of INR3 lakhs or more.
- ▶ MAT/Alternate Minimum Tax (AMT) credit carry forward has been extended from 10 years to 15 years.
- ▶ Scope of gift taxation has been widened to include all persons receiving money or specified property without consideration or for inadequate consideration.
- ▶ For computation of capital gains on transfer of asset acquired before 1 April 1981, the base year for considering the cost of acquisition has been shifted from 1 April 1981 to 1 April 2001.
- ▶ Long-term capital gains (LTCG) on the sale of equity shares acquired on or after 1 October 2004 will be exempt only if the acquisition was done on the payment of securities transaction tax.
- ▶ Fair market value will be deemed to be sale consideration received for the computation of capital gains on the transfer of shares of a company (not quoted on a stock exchange).
- ▶ Conversion of preference shares into equity will not be a taxable transfer.
- ▶ Concessional tax rate of 10% on LTCG arising from the transfer of shares of private companies will apply retrospectively from tax year 2012-13.
- ▶ Failure to withhold taxes on payments to residents will lead to disallowance of expenditure even under the head "income from other sources."
- ▶ Higher rate of tax collection at source will be applicable in the absence of PAN.
- ▶ For delayed filing of return, fees in the range of INR1,000-INR 10,000 (instead of a penalty of INR5,000) has been introduced and the time limit for revising returns has been reduced.
- ▶ The time limit for completion of assessment (including reassessment) has been reduced.

International tax

- ▶ Interest expense deduction for an Indian entity has been restricted to 30% of its earnings before interest, tax and amortization (EBITDA) on related party borrowings, subject to a minimum threshold of INR10 million interest expense.
- ▶ Concessional withholding tax rates for interest on rupee denominated bonds (RDBs) (including masala bonds) and external commercial borrowing will be available for borrowings till 30 June 2020.
- ▶ Terms not defined under domestic laws or in a tax treaty need to be clarified by the Government.
- ▶ Foreign tax credit (FTC) will be allowed in India for disputed foreign taxes only after it is paid on the settlement of dispute in a foreign country.
- ▶ MAT/AMT credit will not be available to the extent of FTC credit claimed against MAT/AMT liability that is in excess of normal tax liability.

Transfer pricing

- ▶ Secondary adjustments in certain cases will now be applicable. A primary TP adjustment to a taxpayer's income in certain situations would trigger a secondary adjustment, i.e., an adjustment in the books of accounts to reflect the actual allocation of profits in line with the primary TP adjustment. The primary adjustment, if not repatriated to India within the time as may be prescribed, will now be deemed to be an advance made by the taxpayer to such affiliate and the interest on such advance will be computed as the income of the taxpayer in a manner that would be prescribed.
- ▶ Applicability of domestic TP will now be restricted only to related party transactions where one of the entities involved enjoys a tax holiday, whereas under the existing law payment made to related parties is also subject to this compliance requirement.

Personal tax

- ▶ Surcharge at the rate of 10% of tax payable will be levied on individuals with taxable income between INR5,000,000 and INR 10,000,000.
- ▶ House property loss that can be set off against other income for all properties (whether self-occupied or let out) has been restricted to INR2 lakhs and the balance would be carried forward for 7 years for set off against house property income only.
- ▶ The individual tax rate for the first slab, between INR 250,000 and INR 500,000, will now be reduced from 10% to 5%.
- ▶ The tax rebate available for individual tax filers will now be reduced to INR 2,500 for individuals with taxable income up to INR 350,000.

Indirect tax

- ▶ The FM did not make any major changes in indirect taxes, which largely indicates that the GST implementation is well on track.
- ▶ Extensive industry reach-out efforts for GST have been planned by the Government from April 2017.
- ▶ Several measures were taken by rationalizing Customs and Excise Duty rates to boost digitization and domestic manufacturing and also address the inverted duty structure.
- ▶ The credit reversal provisions have been aligned for the treatment of interest/discounts on loans and deposits extended by banks/NBFC.
- ▶ Levy of Research and Development Cess has been repealed w.e.f. 1 April 2017 and the corresponding service tax exemption has been withdrawn effective from the enactment of the Finance Bill.



Automobile sector

- ▶ Repeal of R&D cess is a welcome move, which would simplify the indirect tax structure as well as reduce tax costs.
- ▶ Reduction in duties on some auto components should benefit auto OEMs.



Life science

- ▶ Repealing of the Research and Development Cess Act, 1986 would mean that royalty and technical know-how payments made by pharma companies would no longer be liable to R&D cess of 5%.



Financial services

- ▶ Category I and II FPIs registered under the SEBI FPI Regulations, 2014 will be exempt from indirect transfer provisions. Further, a clarification has been proposed to be issued on the non-applicability of indirect transfer provisions on the redemption of shares/interest outside India triggered as a result of redemption/sale of investment in India, which is chargeable to Indian tax.
- ▶ The condition of minimum fund size in the year of winding up has been done away with under the fund manager regime prescribed under Section 9A of the IT Act.
- ▶ The treatment of interest on loans and deposits as exempt turnover by all banks/NBFCs, under both the available Cenvat credit schemes (i.e., proportionate reversal and 50% ad hoc reversal schemes) has been rationalized.

Glimpse of Budget 2017



Retail and consumer product

- ▶ Reforms and investments pertaining to the agricultural and food sector, dairy processing etc. are a welcome move.
- ▶ Reduction in the corporate tax rate to 25% for companies with a turnover of up to INR50 crores would also incentivize MSMEs, particularly in the small scale sector, enabling them to expand their capacity and move toward technologically advanced solutions.
- ▶ Announcement of the abolishment of the Foreign Investment Promotion Board (FIPB) in 2017-18 should make FDI vide the approval route a smoother process (through online filing and processing of applications), especially benefiting single-brand retail trading companies and multi-brand retail trading companies that are looking to invest in India.



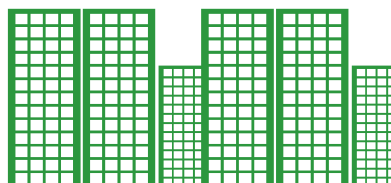
Technology and start-up

- ▶ Deduction under Section 10AA of the Income-tax Act, 1961 (Act) for SEZ units will be given from the gross total income.
- ▶ 100% deduction of profits for any 3 consecutive years out of the first 7 years (instead of 5 years) has been allowed for start-ups.
- ▶ Provisions for carry forward of losses for start-ups have been amended.



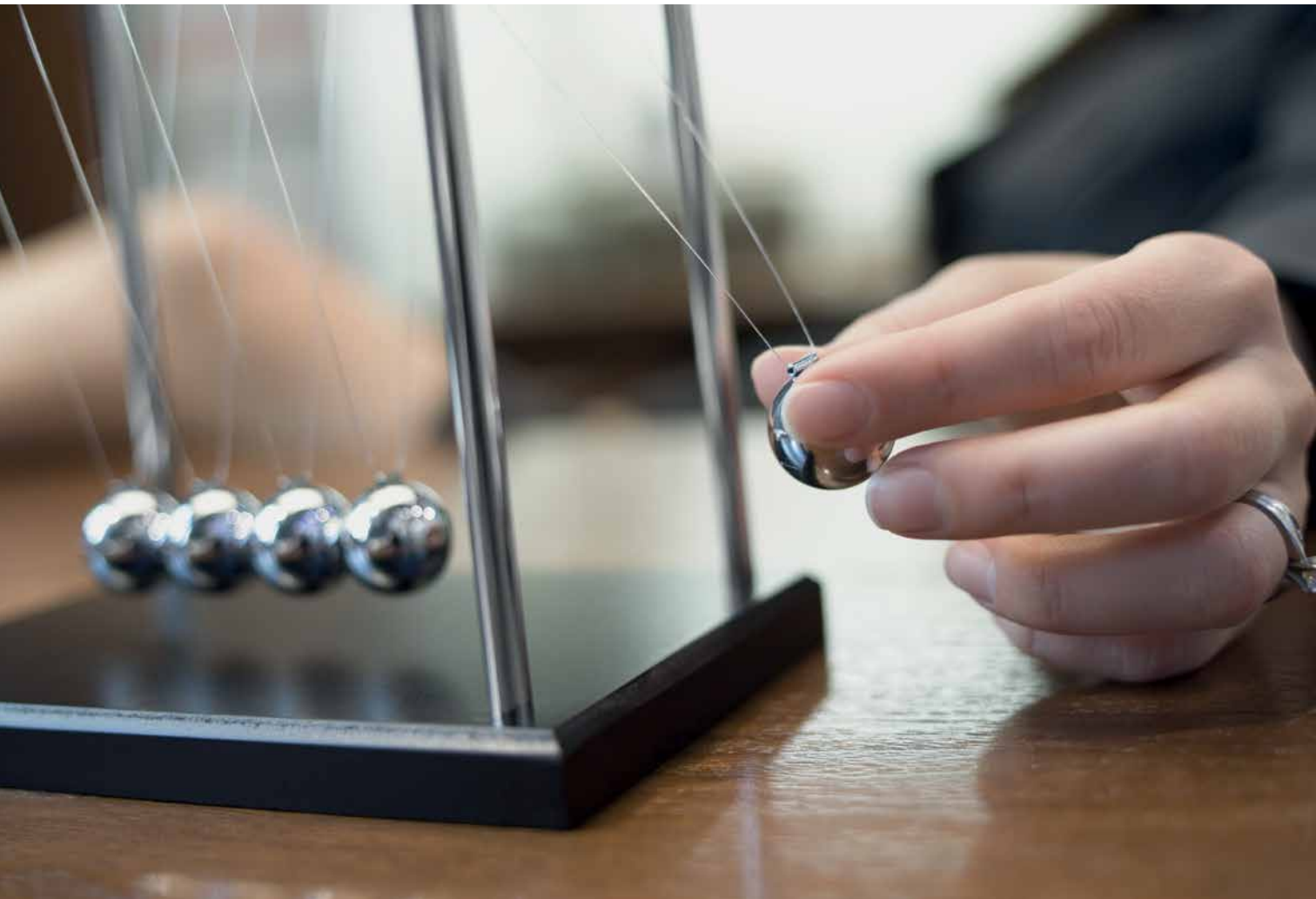
Telecom sector

- ▶ Extension of the period for claiming MAT credit to 15 years from 10 years should increase the likelihood of telecom operators being able to utilize MAT paid during tax holiday periods.
- ▶ To promote "Make in India" for components, Special Additional Duty of Customs of 2% will be levied on the populated PCBs of mobile phones.



Real estate

- ▶ Affordable housing has been granted "infrastructure" status.
- ▶ No notional tax for developers on unsold inventory for 1 year from the end of the financial year in which the completion certificate is obtained, but house property loss set off has been restricted to INR2 lakhs.
- ▶ The holding period for gain from immovable property to be considered long term has been reduced from 3 years to 2 years.
- ▶ Clarity has been provided on taxability for landowners in a JDA.
- ▶ The condition of the maximum size of residential units has been liberalized for claiming a profit-linked tax holiday for developing housing projects.



Budget continues to promote India as a preferred investment destination

Garima Pande

Tax Partner & National Leader,
Business Tax Services, EY India

“Life would be infinitely happier if we could only be born at the age of eighty and gradually approach eighteen”
Mark Twain.

Imagine if the same were the case with corporate India's lifecycle, we would have been looking at a simpler, less complex and less litigious tax market in 2017. Alas, life is not that easy, as Corporate India has many open and unresolved tax issues, and emerging complexities on account of implementation of new accounting and tax rules. Therefore, corporate India had high hopes from the Union Budget 2017 and was eagerly waiting for it for a roadmap to a simpler tax regime and clarity on controversial tax issues.

The adverse and uncertain impact on minimum alternate tax (MAT) liability on account of first-time implementation of Indian Accounting Standards (Ind AS) concerned most of the companies

to be covered under the upcoming phases of Ind AS convergence. One of the primary concerns was whether a company would be liable to pay MAT on fair valuation adjustments under Ind AS. The MAT-Ind AS Committee constituted by the Central Board of Direct Taxes (CBDT) considered the industry suggestions and comments and submitted its final report in December 2016¹. All eyes were on the Union Budget 2017 to lay down a clear framework for MAT computation considering the impact of adoption of Ind AS and, more specifically, MAT on reporting of fair value gains or losses, which may be notional or temporary.

The Finance Bill 2017 outlines a nearly similar approach for the purpose of MAT computation as suggested by the MAT-Ind AS Committee in its earlier two draft reports, and provides for (a) the start point for MAT computation as the “statement of profit and loss,” (b) timing for MAT pick-up of fair valuation adjustments reflected in Other Comprehensive Income (OCI) (i.e., generally when they are realized) and (c) 5 years MAT amortization for first-time adjustments recognized in other equity (barring certain exceptions).

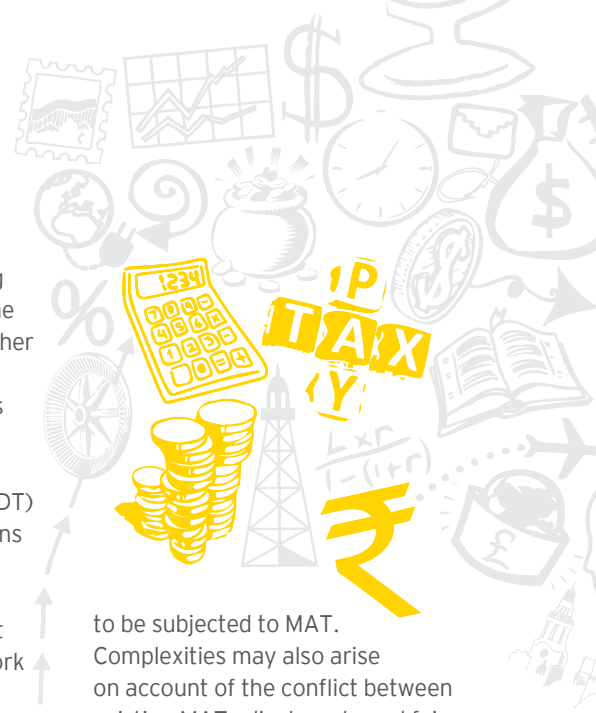
The MAT provisions proposed in the Finance Bill 2017 appear to subject OCI items to MAT levy twice since OCI items will already form part of the statement of profit and loss and will once again be adjusted as per the proposed MAT provisions. This issue may be addressed by providing the start point for MAT computation for Ind AS companies to be the statement of profit and loss before OCI items.

Further, certain fair value adjustments entering the statement of profit and loss under Ind AS (such as fair valuation of shares, financial instruments etc.) continue

to be subjected to MAT. Complexities may also arise on account of the conflict between existing MAT adjustments and fair valuation principles under Ind AS. For instance, the current MAT provisions require any provision for diminution in the value of assets to be added back in the MAT computation. Therefore, under Ind AS, fair valuation loss on assets (such as equity instruments) recognized in the profit and loss account will be disallowed, whereas fair valuation gain will get taxed resulting in a “double whammy.”

With the MAT-Ind AS Committee stating in its first report that only profits that can be distributed as dividend should be subjected to MAT, the CBDT should work together with the Ministry of Corporate Affairs (MCA) to forthwith issue clarifications on the exclusion of any fair value adjustments for computing “distributable profits” for Ind AS and make the necessary amendments prior to the enactment of the Finance Bill 2017.

While it is heartening to see clarity emerging on the computation of MAT on account of the adoption of Ind AS, companies that were mandatorily required to transition to Ind AS have already discharged three (out of four) advance tax instalments of financial year 2016-17. These companies may become liable to interest for deferment of advance tax arising on account of any incremental MAT liability because of the clarifications introduced by the Finance Bill 2017, which have a





retrospective effect. It is therefore fair for corporate India to expect a relief from this interest cost arising on account of the retrospective nature of these clarifications.

While Income Computation and Disclosure Standards (ICDS) have been made effective from financial year 2016-17, there are various aspects of Ind AS where ICDS provisions do not provide any explicit guidance (such as stock option cost amortization, service concession agreements and real estate development). Implementation of ICDS in its current form is therefore likely to create greater complexity and increase litigation, which will be contrary to the underlying intent of introducing ICDS. The Government may therefore consider scrapping ICDS in its current form and implementing an alternate tax computation mechanism, considering the complete impact of Ind AS reporting.

MAT provisions are also proposed to be amended in line with the notified rules on Foreign Tax Credit (FTC) whereby MAT credit carried forward would be restricted to the extent the FTC exceeds normal tax liability. While this amendment impacts the quantum of FTC claimed by Indian MAT paying companies from assessment year 2018-19, its applicability for assessment year 2017-18 (i.e., from the date of notification of the FTC rules) may need to be evaluated in the absence of any corresponding provision introduced in the tax laws for the year. With an increasing number of Indian companies expanding their international footprints, it is probably an appropriate time for the Indian Government to also consider introducing the concept of underlying tax credit and pooling of credits to help Indian multinationals become more competitive in the global landscape.

The Finance Bill 2017 continues to stay on course with the stated objective of promoting India as a preferred investment destination. Capital gains tax exemptions on indirect transfer of investment in case of foreign institutional investors (FIIs) registered as Category I or

HP

695
24,490
118,866
(4,459)

11,043

It is fair for corporate India to expect a relief from interest for deferment of advance tax arising on account of any incremental MAT liability because of the clarifications introduced by the Finance Bill 2017, which have a retrospective effect.


Category II foreign portfolio investor and transfer of rupee denominated bonds (RDBs) of an Indian company between non-residents outside India, are clearly reflective of this intent. Liberalization of the RDB guidelines by the Reserve Bank of India in 2016 coupled with the extension of the concessional withholding tax rate of 5% for interest earned on RDBs should further aid in maintaining steady foreign flows as well as deepening the bond market.

Promotion of a digital economy forms part of the Government's agenda to "transform, energize and clean India," and the focus to incentivize start-ups that provide an eco-system for nurturing digitization and innovation remained in-strategy for Budget 2017. Extension of the time period for claiming tax holiday to any 3 consecutive years out of 7 years (from the present 3 out of 5 years condition) and relaxation of the restriction on maintaining continuous holding of minimum 51% of voting rights to carry forward and set off business

losses (subject to conditions) have reaffirmed the Government's objective of empowering the growth of start-ups in India. However, the current draft provisions give rise to certain issues on whether the exit of any one shareholder or inter se transfer of shares between shareholders would impact the set off and carry forward of business losses in case of start-ups. These aspects should be forthwith addressed before the Finance Bill enactment to avoid any unintended conflicts.

In the wise words of Martin Luther King, "*The time is always right to do what is right*". At a time when the Indian economy continues to reel in the aftermath of the demonetization drive, the Union Budget 2017 performs a fine balancing act between the need for stimulating growth and continuing fiscal discipline without any surprises on the corporate tax front.

1 Not yet published by CBDT



Budget 2017: a bane or boon for corporate restructuring?

In the world of corporate restructuring, tax and regulatory aspects play a pivotal role in determining a feasible structure that may make or break the restructuring objectives.

Budget expectations from a corporate restructuring perspective included providing clarity on the interplay of Ind-AS with income tax. Ind-AS provides for a comprehensive guidance on accounting for all forms of business combinations, including demergers, which require fair value accounting under the purchase method. A critical condition for the tax neutrality of a demerger under the Indian tax law is the transfer of the demerged undertaking at book values. This poses a unique challenge on the tax neutrality of demergers going forward. While the Budget provides the much-needed guidance on ignoring fair valuation in case of computing book profit under MAT on deemed dividend distribution by the demerged company and fair value accounting in the resulting company (in case demerger is not a common control transaction), the question of tax neutrality under normal tax law and the MAT impact on tax neutral mergers (non-common control) still persists. Overall, it is recommended to provide suitable representations to amend the definition of a tax neutral demerger under the tax laws to align it with the

provisions of Ind-AS and clarification under MAT for tax neutral mergers.

Markets were laden with another expectation (or fear) of an increase in the holding period for long-term capital gains. While the Budget provided a relief to investors and maintained status quo, it introduced denial of exemption on long-term capital gains (w.e.f. 1 April 2017) where shares were acquired after the introduction of the Securities Transaction Tax (STT) but without the payment of STT. While the memorandum to the Finance Bill provides for the introduction of relaxation notifications in genuine scenarios where no STT is levied on acquisition – i.e., initial public offer, follow-on public offer, bonus or right issue by listed companies and acquisition by a non-resident in accordance with the FDI policy of the Government – no specific mention has been made on the acquisition of shares via employee stock option plans, gift of shares, acquisition of shares pursuant to business reorganizations, shares issued on preferential allotment and shares issued on conversion of instruments. Suitable clarifications are recommended in this regard.

If the introduction of the super-rich dividend tax (on income in excess of INR10 lakh) in last year's Budget was a blow for individuals holding significant shares, this year's Budget takes it a step further by including trust structures under the ambit. This might impact several promoter families who have restructured their business under private trust structures to achieve their succession planning objectives.

Budget 2017 has expanded the ambit of gift taxation. While specific exemption is provided under the expanded gift tax ambit to corporate restructuring *inter alia*, including tax neutral amalgamations and demergers, the receipt of specified properties (including shares of listed companies) for inadequate consideration by firms/LLPs (including capital contribution), widely held companies and foreign



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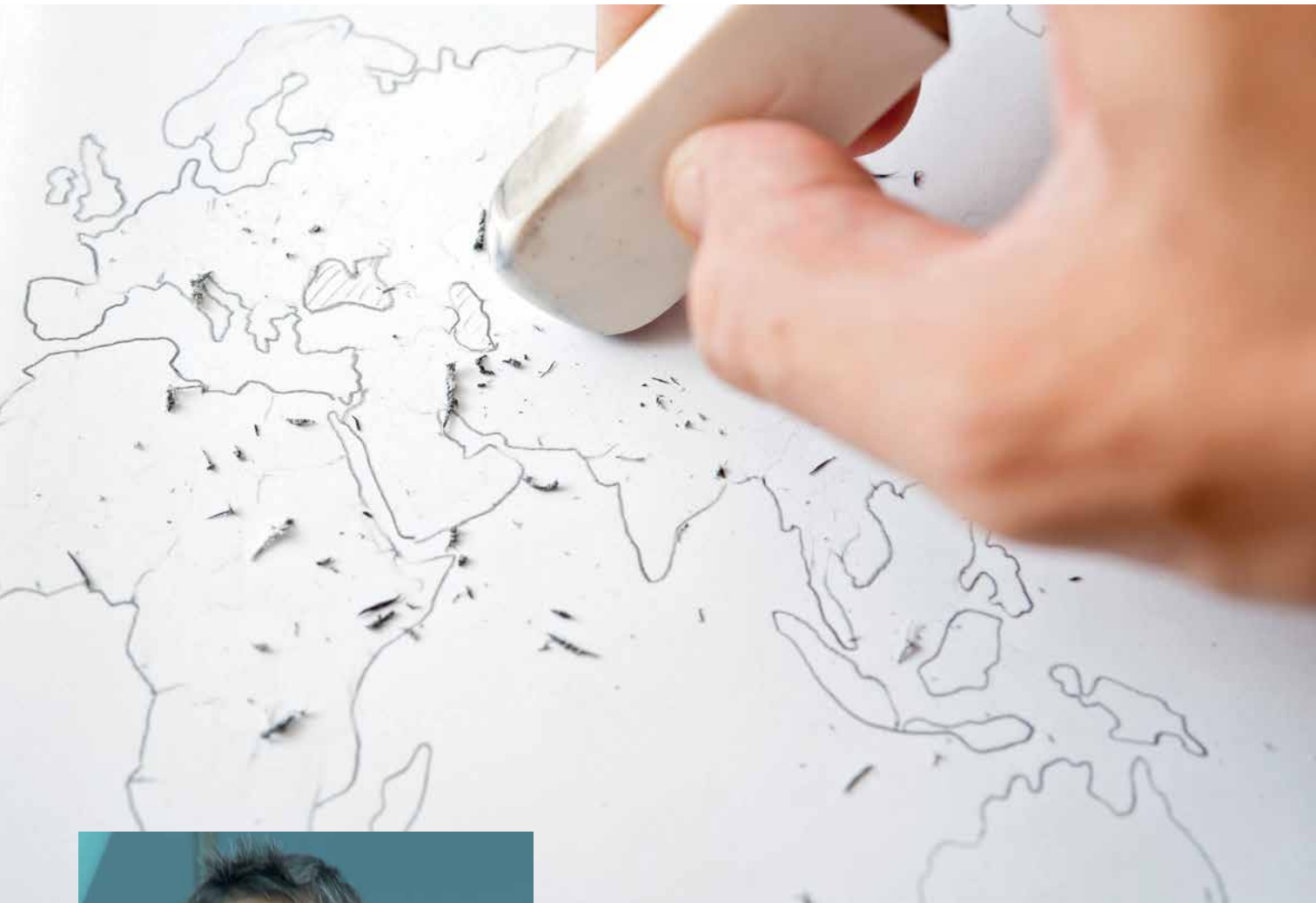
companies (subject to treaty benefit) is proposed to be part of the expanded ambit.

In addition to gift taxation, another anti-abuse measure is notional capital gain taxation at fair market value (FMV) on transfer of shares (other than quoted), where such transfer is below the FMV. The manner of determining FMV is still uncertain. This provision would impact intra-group restructuring, which often involves the transfer of shares of closely held companies as well as cases of indirect transfers where a foreign company derives substantial value from assets in India.

Notably, notional capital gain taxation and gift taxation discussed above may entail dual taxation: i) taxable as income from other sources in the hands of the recipient and ii) taxable as notional capital gains at FMV in the hands of the transferor. It may entail simultaneous taxation in respect of the same transaction. Implementation of any such transaction may need careful analysis of the new provisions.

In addition, the Budget has proposed an exemption on the conversion of preference shares into equity shares (w.e.f. 1 April 2017) and also provides for corresponding amendments for the cost of acquisition and the period of holding. However, clarification regarding the applicability of this amendment for transactions prior to 1 April 2017 is recommended.

While the Budget has introduced clarifications and anti-abuse measures, it has also left certain ambiguity in relation to the tax treatment on conversion of preference shares prior to 1 April 2017, possible double taxation on gift of unlisted shares for inadequate consideration, alignment of the definition of demerger under the tax law in line with Ind-AS etc. Introduction of several anti-abuse measures is in addition to the over-arching impact of GAAR, which re-emphasizes the paramount importance of commercial substance in corporate reorganizations. Overall, the anti-abuse measures coupled with the presence of GAAR could make innovative corporate restructuring strategies that much more challenging.



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Embracing **BEPS:**

Introduction

The Base Erosion and Profit Sharing (BEPS) initiative by OECD and G20 countries has been a game-changer in the international tax arena.

Inspired by the BEPS final reports, released in October 2015, many countries, including India, have made significant amendments to their tax laws.

Some of the anti-abuse measures undertaken by India in the past include the introduction of General Anti-Avoidance Rules (GAAR) provisions, determination of residency of foreign companies based on Place of Effective Management (POEM) under the Indian tax law (ITL) and amendment of popular tax treaties with Mauritius, Singapore and Cyprus. India has been an active participant in and contributor to the BEPS project. During FY2016–17, India implemented BEPS Action 1 on digital economy by introducing equalization levy and BEPS Action 13 by introducing country-by-country reporting.

Budget proposal on the introduction of the interest limitation rule

The Union Budget 2017 has proposed to implement BEPS Action 4 on “limiting base erosion involving interest deduction and other payments” by the insertion of Section 94B under ITL. This amendment seeks to disallow interest payment arising on debt issued by a non-resident associated enterprise (AE), to the extent of lower of (a) actual interest paid to the non-resident AE or (b) total amount of interest paid or payable in excess of 30% of earnings before interest, taxes, depreciation and amortization (EBITDA). Interest on debt issued by a non-AE lender is also covered if an AE of the borrower provides an implicit or explicit guarantee to the lender or if an AE of the borrower deposits a corresponding and matching amount of funds with the lender. The term “debt” is widely defined to cover financial lease, financial derivatives and any instrument that gives rise to interest, discount or other finance charges.

Further, this limitation applies in respect of deductible interest, which is quantified after applying various provisions of ITL under which interest may get disallowed – for example, disallowance on account of use of funds for earning exempt income, disallowance due to utilization for capital asset awaiting use and interest in excess of Arm’s Length Price. The limitation is linked to EBITDA and hence not dependent on the debt gearing ratio of the entity. Such disallowed interest can, however, be carried forward for 8 years to be set off against any unused interest capacity in subsequent years.

Prior to BEPS Action 4, the interest limitation rule was prevalent in certain countries. Diverse practices were followed internationally, with certain countries such as Finland, Norway, Germany, Greece and Spain following the EBITDA rule to disallow excess interest and certain countries such as Australia, Brazil, Canada, China and Indonesia using the debt equity ratio.¹ After the OECD recommendation under BEPS Action 4, some other countries such as the UK, Indonesia, Japan, Iceland and Norway have modified

the India way

India's proposal of the interest limitation rule, though, claimed to have been influenced by the BEPS Action 4 recommendation, has certain departures from the recommendations of the OECD in the BEPS Action 4 report

or proposed to modify their interest limitation rule in line with BEPS Action 4. These countries also do not have uniformity – some have lowered their interest limitation rate, some have introduced a group ratio rule, and some have introduced or increased the de minimis limit.

Ironically, BEPS Action 4 itself recognizes that the normative disallowance ratio is a blunt rule. India's proposal of the interest limitation rule, though, claimed to have been influenced by the BEPS Action 4 recommendation, has certain departures from the recommendations of the OECD in the BEPS Action 4 report. Some of these differences are as follows:

Particulars	Proposed Section. 94B	BEPS Action 4
Group ratio rule ²	No	Yes
Exemption to priority sector (public benefit projects)	No	Yes
Net interest expense for the purpose of computing the total interest cost (i.e., after reducing interest income)	No	Yes
Coverage of interest on debt borrowed from third parties	No	Yes
Application to capitalized interest	No	Yes

It is important to mention here that the OECD's recommendation on the interest limitation rule under BEPS Action 4 is not a mandatory or minimum standard. While it is acknowledged that denying a deduction for "excessive" interest expense is consistent with international norms and is a common anti-abuse measure, there could be a debate on whether it is the right time to introduce the provision. India is primarily an inbound economy and the tax policies should support India's growth agenda. Extending the time limit of the concessional tax rate in respect of rupee denominated bonds is a step in the right direction. In any case, there is a strong need to provide carve out in respect of priority sectors such as housing, infra and power, including the renewable energy sector, which typically has a huge thrust on borrowed capital.

Additionally, the provisions as proposed must be clarified or amended to include the following:

- ▶ A fixed ratio rule³ or a group ratio rule⁴ may be introduced in line with the OECD's suggestion. This would allow due consideration for companies that have inherently high interest cost because of the nature of their business.
- ▶ It should be clarified that the limitation applies only with respect to interest payments to non-resident AEs, as the intention is to prevent cross-border base erosion through interest payments. Ambiguity on the coverage of funding by a residents when guaranteed by non-resident AEs should be clarified.
- ▶ Regulations should exclude the reference to implicit guarantee, as either it is not possible to prove or disprove or it will be highly subjective to determine the presence/degree of implicit guarantee.

Developments in POEM and GAAR

One of the other major impact areas, particularly for India headquartered entities is POEM-based residency rules, which are applicable from 1 April 2016. As the final POEM guidelines were released only in January 2017⁵, the Government should consider deferring the POEM provisions. Further, the guidelines should contain an overarching principle that the primary object of the enactment of the POEM test is to target shell companies that are controlled from India and that the tax administration will invoke POEM in limited cases where there is prima facie evidence of tax avoidance.

Last but not the least, India's tryst with GAAR starts effective from 1 April 2017. The recent clarification⁶ by the tax department on GAAR in January 2017 contains many welcome features. However, there are many other areas where the industry looks for clarity, particularly examples that will provide due context to diverse clarifications and help taxpayers understand the ambit better. Consistent with international practice, the tax authority should be obligated to provide a counterfactual that is non-abusive but has the same commercial consequences.

Comments: India's commitment to addressing anti abuse relating to cross-border BEPS activities is profoundly evidenced by the speed in the implementation of BEPS proposals. Clarifications should be issued with the same promptness to allay doubts of misapplication or to carve out genuine business considerations.

1 IBFD

2 Under the group ratio rule, limit on interest deductions is calculated with respect to the net third-party interest/EBITDA ratio of the entire group.

3 Under the fixed ratio rule, net interest expense is benchmarked on the basis of the net interest/ EBITDA ratio.

4 The group ratio rule allows an entity to deduct net interest expense up to its group's net interest/EBITDA ratio, where this is higher than the benchmark fixed ratio.

5 Refer EY alert "India issues guidance on place of effective management," dated 3 February 2017

6 Refer EY alert "India issues clarifications for implementation of General Anti Avoidance Rules," dated 3 February 2017



Introduction of secondary adjustment:

**a step toward
global practices**



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Union Budget 2017 proposes to introduce Section 92CE in the Finance Act, 2017 to provide for secondary adjustment (i.e., an adjustment in the books of accounts to reflect the actual allocation of profits as per the primary adjustment) resulting in an increase in the total income or reduction in loss of the taxpayer on account of:

- ▶ Suo motu adjustment in the return of income
- ▶ Addition by assessing officer (AO) accepted by taxpayer
- ▶ Determination by advance pricing agreement (APA)
- ▶ Determination pursuant to Safe Harbour Rules
- ▶ Resolution under mutual agreement procedure (MAP)

The primary adjustment¹, if not repatriated to India within the time as may be prescribed, will now be deemed to be an advance made by the taxpayer to such affiliate and the interest on such advance will be computed as the income of the taxpayer in a manner that would be prescribed by way of rules in the future. This amendment will take effect from assessment year 2018-19 and subsequent years.

Exclusion from Section 92CE

It is proposed that such secondary adjustment not be carried out if the primary adjustment does not exceed INR10 million and the primary adjustment is made in

respect of an assessment year commencing on or before 1 April 2016.

The impact of Section 92CE can be understood by way of the following example:

Particulars	Amount
Value at which goods are sold by Indian company (ICo) to its US parent (FCo) (A)	INR 19 million
Arm's length price determined by TPO and accepted by ICo (B)	INR 30 million
Difference between A and B (primary adjustment) - May be treated as advance	INR 11 million

In the above example, the ICo needs to ensure that INR11 million is remitted within the prescribed time period. This will consequentially increase the income of the ICo for all purposes, including MAT.

In case the FCo fails to remit the difference of INR11 million, it will be treated as advance granted by the ICo and interest will be imputed on such advances as per the rules which are yet to be prescribed and will be charged to tax in the hands of the ICo.

Clarifications needed

Except for additions by the AO and accepted by the taxpayer, all other additions would have the consent of the taxpayer. Ambiguity arises on whether the secondary adjustment will cease in case the addition is disputed by the taxpayer in response to the addition made by the AO at higher forums. The impact of non-filing of appeal pursuant to unfavorable appellate orders needs to be evaluated.

The conditions for exclusion from Section 92CE currently appear to be cumulative. This leads to an anomalous situation where a secondary adjustment may be alleged to be applicable even in cases where the primary adjustment does not exceed INR10 million. This does not appear to be the legislative intent and calls for a suitable amendment. Further, the proposed book adjustments under Section 92CE may also lead to double taxation for taxpayers subject to minimum alternate tax (MAT).

Jurisdictions where secondary adjustments are a recognized approach

Secondary adjustment rules are a recognized approach in a number of other jurisdictions, including the US and a number of European

Union (EU) member states. Further, the OECD Model Tax Convention also does not prevent such secondary adjustments from being made where they are permitted under the domestic laws of the contracting states. However, difficulties may arise in MAP where jurisdictions are not prepared to admit secondary adjustments within the claim and negotiations.

The UK²: Her Majesty's Revenue & Customs (HMRC) has recently issued a consultation document for the potential introduction of a system of secondary adjustments in relation to non-arm's length transactions. The proposal intends to put in place a second layer of deemed taxation on transactions that are subject to primary adjustments. In essence, the cash benefit received by a group company from a non-arm's length arrangement would be deemed to be a loan from the UK counterparty and would be subject to deemed interest payments while outstanding.

Canada³: Secondary adjustments are undertaken regardless of whether the non-resident has an ownership interest in the Canadian company. Further, the rules clarify that while primary adjustments result in additional income or denial of deduction for taxpayers, the secondary adjustment reflect that, conceptually, the non-resident party to the transaction has unduly received and retained a benefit through the mispricing of the transaction, and this benefit would have been subject to withholding tax if it had been conferred as a

dividend to the recipient. Deemed dividend will not arise where the benefit is conferred on a controlled foreign affiliate, as the benefit is considered akin to capital contribution.

Apart from the above, secondary adjustment provisions also exist in various other countries such as Korea, South Africa and Spain.

India: Earlier, India did not have a specific legislation for imposing secondary adjustments; therefore, they could not be sustained at the higher appellate levels and were being struck down by the Revenue Department. With the introduction of this section, the Revenue Department now stands empowered to treat such un-repatriated amounts (on account of primary adjustments) as deemed advance and bring the interest on such advances to tax in the hands of the taxpayer. While secondary adjustments are a globally accepted principle, the timing of its introduction and implementation in India is likely to lead to an adverse situation for many companies given the current turmoil and the policy changes in the US. Many of these companies operating in India are captive service providers for US or European MNCs both in services as well as manufacturing.

Repatriation of the amount on account of TP adjustment back into India may not really benefit the IT/ITES companies, given that these amount may not be used for expansion in India.

With the introduction of secondary adjustments, the Revenue Department now stands empowered to treat such un-repatriated amounts as deemed advance and bring the interest on such advances to tax in the hands of the taxpayer

Domestic transfer pricing

The Budget also proposes to exclude expenditure in respect of payments made by the taxpayer to persons referred to in Section 40A(2)(b), from the scope of Section 92BA of the Income-tax Act. However, it will continue to apply to other transactions relating to profit-linked tax holiday units and subject to aggregate value threshold of INR200 million.

The domestic transfer pricing provisions posed an onerous compliance burden on taxpayers,

especially in case of tax neutral transactions. Removing such transactions from the ambit of documentation is a welcome move.

The UK transfer pricing legislation also covers domestic transactions but allows for certain compensating adjustments to provide relief to disadvantaged companies (i.e., if rules adjust prices to increase one entity's profit, a claim can be made to reflect the same price for the other company as well).

1 Adjustment to taxable profits basis ALP of a transaction
2 Introduction of secondary adjustments into the UK's domestic transfer pricing legislation consultation document issued by HMRC.

3 Part XIII read with Section 247(12) of the Income Tax Act (Canada).

Conclusion

Relaxation from the applicability of domestic transfer pricing is a taxpayer-friendly move. Consistent with the anti-avoidance objective of the provision, it would be desirable if a clarification is provided to keep cases of tax neutrality outside the scope of the provision

However, the provisions relating to secondary adjustments, as currently worded, are likely to give rise to additional litigation in the TP assessments of the taxpayer. It is also unclear how the interest is to be imputed on the deemed advance/loan and whether the transactions pursuant to these provisions would be deemed to be in compliance with Foreign Exchange Management Act, 1999. Taxpayers will have to wait and watch for these rules to quantify the actual impact of Section 92CE.

Budget for the honest tax payer



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Transparency

Simplification of tax

Consumer expenditure

administration

Broaden tax base

Broaden tax base

Income

Transparency

Personal disposable income

Income

Transparency

Personal disposable income

There is always an expectation from the Finance Minister each year of lowering of income tax rates for individuals and providing other tax concessions in the National Budget. This year was no different. In fact, it was more so because of the “tectonic” event of demonetization that preceded the Budget 2017. However, what the Finance Minister presented was a **Budget intended to help increase the personal disposable income of a large number of people, boost much-needed consumer expenditure, broaden the tax base, and bring in tax parity, transparency and overall simplification of tax administration.**

The following is an analysis of the expectations from the Budget, from a personal tax standpoint, the proposals and the likely rationale.

Change in tax rate and introduction of 10% surcharge

One of the biggest expectations from the Budget was that the maximum amount of income not chargeable to tax will be increased from the existing limit of INR250,000.

Budget 2017 has proposed as under:

- ▶ Lowering of the tax rate applicable to income exceeding INR250,000 up to INR500,000 from the existing 10% to 5%
- ▶ Introduction of a 10% surcharge on income exceeding INR5,000,000 up to INR10,000,000

A surcharge of 15% continues to be payable on income exceeding INR10,000,000.

The tax table proposed for Financial Year 2017-18 is as under:

Particulars	Present	Proposed
Income levels*	Rate	Rate
Up to 250,000	NIL	NIL
250,001 to 500,000	10%	5%
500,001 to 1,000,000	20%	20%
Above 1,000,000	30%	30%

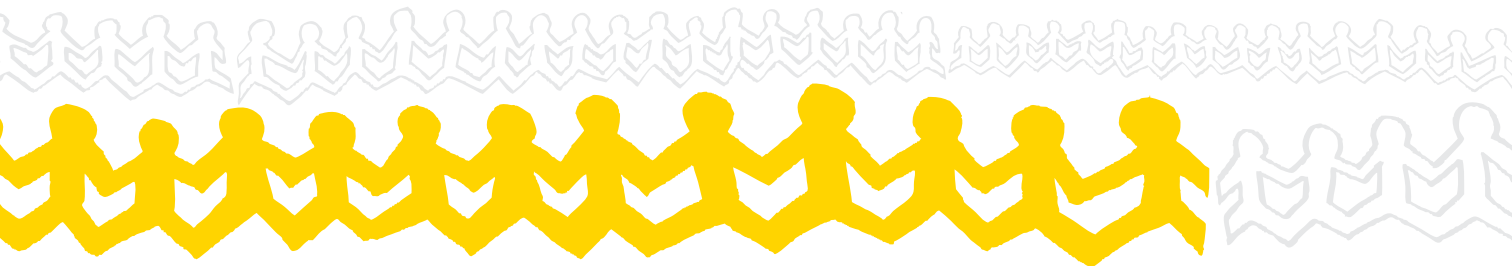
*Amounts in INR

The lowering of the tax rate to 5% will benefit all individuals, with maximum tax savings up to INR14,806. However, this benefit will be offset by the 10% surcharge introduced on income

earners between INR50,00,000 and INR10,000,000. The table below illustrates the savings or increase in tax at different income levels.

Gross taxable income** (INR)	Present tax liability (INR)	Proposed tax liability (INR)	Savings/ (Increase in tax) (INR)
500,000	5,150	2,575	2,575
2,000,000	391,400	378,525	12,875
7,000,000	1,936,400	2,115,878	(179,478)
12,000,000	4,003,610	3,988,804	14,806

**Tax has been calculated after considering the Section 80C deduction of INR150,000 from gross taxable income.



The lowering of the tax rate from 10% to 5% at a relatively low income slab of INR250,001 to INR500,000 may achieve the purpose of expanding the taxpayer base versus increasing the maximum amount of income not chargeable to tax.

With the above proposal, a taxpayer with a gross taxable income up to INR450,000 and who utilizes the deductions under Section 80C of the Income-tax Act will pay no tax.

Restriction on set off of loss from house property

Another expectation from the Budget was that the deduction available for interest on housing loan on self-occupied property will be increased from the existing limit of INR200,000 to provide relief to the middle and lower middle class considering the high cost of financing. As per the existing provision, there is no limit on the deduction available for interest on housing loan taken for the let-out property. This interest deduction allows taxpayer to compute "loss from house property," which may be set off against other heads of income in the same year.

Budget 2017 has proposed a restriction on the maximum amount of "loss from house property" that may be set off against income from any other source, in the current year, to INR200,000. The proposed restriction will apply to total "loss from house

property" (both self-occupied property and let-out property). Loss in excess of INR200,000 may be carried forward for eight years and can be set-off from "income from house property" only in subsequent years.

The proposal attempts to bring in horizontal parity between self-occupied house property owners and let-out property owners (including deemed to be let-out) to set off loss. However, this proposal may cause genuine hardship to taxpayers who are paying interest on housing loan and, in some cases, it may well lead to some part of the interest cost never being set off.

It is recommended that the Government withdraw this proposal and instead achieve its objective of bringing parity between self-occupied and let-out property owners by allowing actual interest cost deduction even in the case of self-occupied property.

Changes in long-term capital gains (LTCGs)

It was expected that the zero/discounted tax regime on LTCGs will undergo a change.

Budget 2017 has proposed to reduce the holding period of immovable property from 36 months to 24 months to be eligible for the discounted taxation regime of LTCGs. This has been done to boost investment in the housing sector. Also, this is in line

with the holding period of 24 months applied for calculation of LTCGs in case of unlisted shares.

Budget 2017 has also proposed that to claim exemption from tax on LTCG on the sale of listed equity shares acquired on or after 1 October 2004, STT should have been paid on the purchase of such shares in addition to the existing provision of STT being paid on sale. The Government will notify transactions where this additional condition of STT on purchase will not apply. This restriction has been proposed to prevent the misuse of "tax exemption" by manipulating share prices to launder unaccounted cash through off-market transactions via penny stocks.

The proposed amendment to restrict the LTCG regime of zero tax for listed equity shares where no STT is paid will cause hardship in genuine cases where listed shares are acquired by way of gift or inheritance or allotted under an employee stock option plan (ESOP) to employees.

For example, Mr. A purchased listed equity shares by payment of STT in 2015 and these shares are later inherited by or gifted to a family member. Unless the case of gift/inheritance is protected, such recipient would be in a difficult situation despite the fact that the original investor had paid STT at the time of purchase of the shares. There may also be cases where listed shares may have been acquired prior to 2004 but the gift/inheritance was after 2004.



It is suggested that the Government notification, from a personal tax standpoint, cover the below transactions:

- ▶ Acquisition of listed shares by way of gift or inheritance or on contemplation of death
- ▶ Receipt of listed shares on the partition of HUF, and distribution of listed shares to members of AOP/BOI
- ▶ Family arrangement by distribution of listed shares from a trust
- ▶ Allotment of ESOP and sweat equity shares by a listed company to its employees

Also, while computing LTCGs, the base for calculating the indexed cost of acquisition for all capital assets has been proposed to be revised from 1 April 1981 to 1 April 2001. This might impact the calculation of LTCGs in two ways: first, fair market value as on 1 April 2001 can be considered as the cost of acquisition and, second, once the base year is shifted from 1981 to 2001, the cost inflation index (CII) for 2001 will be set at 100 and the CII for subsequent years will be recalibrated with 2001 as the base year.

Encouragement to invest in the National Pension System (NPS)

As expected, the Government has proposed additional tax benefits for investment in the NPS scheme.

Currently, partial withdrawal of 25%, allowed for specific circumstances under the NPS scheme before the age of 60 years, is taxable. It has been proposed to exempt partial withdrawal from NPS. Further, for the self-employed, it has been proposed to increase the maximum amount eligible for deduction from taxable income to 20% of the gross total income instead of 10% within the overall limit of INR150,000 under Section 80C. The Government may rationalize the income tax exemption limits to be in line with the withdrawal permitted under the NPS scheme for easy administration.

A literal reading of the existing law and the proposed provisions suggests that the exemption from tax on NPS withdrawal is available only to an employee and not to a self-employed individual. It is recommended that the Government consider removing this anomaly for parity.

Moving toward a cashless economy

Currently, deduction under Section 80G is available if a donation above INR10,000 is made in any mode other than cash. It has been proposed to reduce this limit from INR10,000 to INR2,000. Another proposal has been made to restrict all transactions of INR300,000 or more otherwise than by an account payee check, an account payee bank draft or using the electronic clearing system through a bank account. These proposals may strengthen the Government's agenda of a cashless economy.

Other proposals

- ▶ Another provision to broaden the tax base is the requirement to deduct tax at source at 5% on payment of rent exceeding INR50,000 per month.
- ▶ A simple one-pager tax return form would be introduced for individuals with income up to INR500,000 (with no business income). It is expected that this will encourage tax compliance and broaden the tax base.
- ▶ A fee of INR5,000 will be levied if tax return is filed by 31 December of the next financial year and INR10,000 if filed thereafter. Such fee will be restricted to INR1,000 for small taxpayers with income up to INR500,000. It is also proposed to reduce the time limit for revision of tax returns from two years to one year. It is expected that these proposals will bring in discipline in tax return filing.

From an individual tax point, some expectations may not have been met and the restriction on the set-off of house property loss up to INR200,000 and the introduction of the 10% surcharge may be disconcerting. However, the Finance Minister has appealed to all citizens of India to bear some pain for the betterment of the nation, and the reduction in tax rate may soothe the pain.



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With the Goods and Services Tax (GST) expected to roll out in 2017, the Union Budget was expected to propose limited changes in indirect taxes. As the Finance Minister's speech unfolded, his statement that he has preferred to avoid making changes in the current excise and service tax regime underlined that message strongly.

Even the temptation to raise the service tax rate was avoided, signaling the Government's clear intent to roll out GST in 2017.

The minimal changes basically rationalized customs and excise duties, targeted at reducing duties, promoting

digitization, incentivizing domestic manufacture and removing inverted duty anomalies.

A notable decision was the repeal of the Research and Development Cess, payable on the import of technical know-how, with effect from 1 April 2017 along with the removal of the attendant service tax exemption on the enactment of the Finance Bill. This cess was not to be subsumed under GST and hence its repeal was welcome. There are several other cesses that will not be subsumed under GST and require a resolution to avoid cascading.

The focus now shifts to the critical steps for GST implementation in July 2017, the foremost being the approval and passage of GST Bills.

The GST Council meeting on 18 February 2017, is expected to approve GST laws to enable the tabling and passage of the Central Goods and Service Tax (CGST) and Integrated Goods and Service Tax (IGST) Bills in the second half of the Budget session in March. States will have to table and pass respective SGST Bills in their legislative assemblies in the March/April 2017 period. This would be followed by



Budgeted for GST

the finalization of GST Rules and their approval by March 2017.

It is not certain, though, whether the industry would get a glimpse of the final law prior to its passage in view of the tight timelines.

Segregation of goods in multiple rate structures is another important milestone that maybe achieved in April/ May 2017. While the overarching principles of what goods potentially fall in what rate basis the current effective indirect tax rate bands are fairly known, some tweaking will be required for certain goods outside these bands.

Recent media reports suggest that services, too, can be segregated into

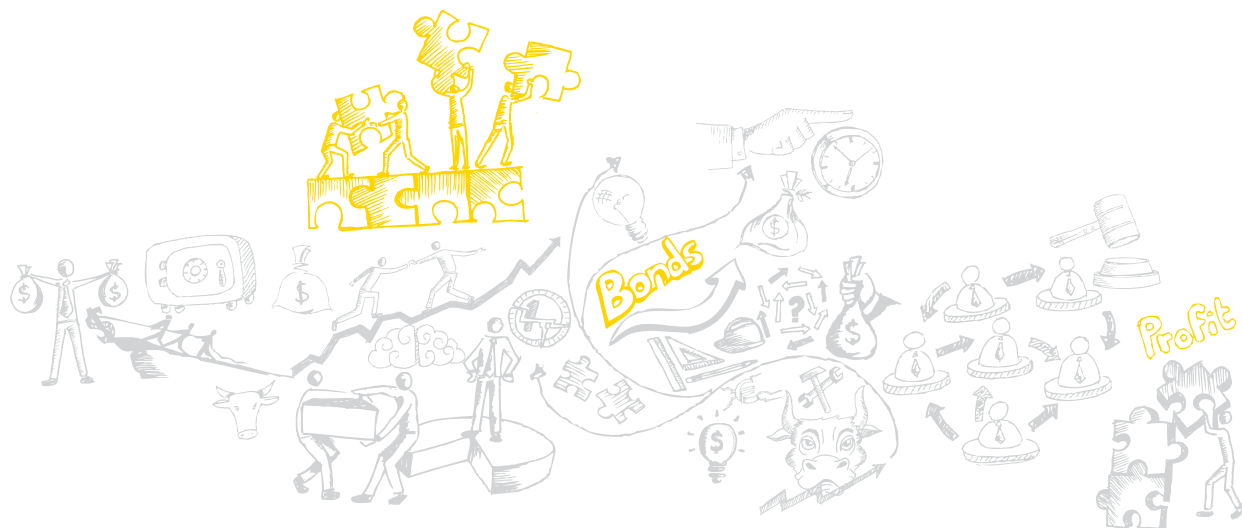
rate buckets of 12%, 18% or even 5% basis current abatements, common use etc. However, going by the current indications, clarity may emerge only by April/May 2017.

These milestones have a direct link to the readiness of the industry, to enable it to configure the ERP systems for GST transition and testing latest by May/June 2017.

Another key infrastructure that needs to be up and running before July 2017 is the GST Network (GSTN), which is fundamental for compliance. To address the compliance needs of tax payers, GSTN has shortlisted 34 GST Suvidha Providers, who, along with

Application Service Providers, will provide solutions for electronic GST reporting. They equally need to be ready for this paradigm shift.

Though the industry at large is underway with the GST transition, many were still waiting for clarity on the potential date. It is now time for them to kick-start or they will be left with no time for this massive tax reform. GST is more of a business reform with touch points across IT systems, processes, business models, compliance, pricing, margins, working capital etc. that requires senior management bandwidth with sustained intensity during the transition.



Zing in the masala

The Reserve Bank of India, in the first bi-monthly monetary policy statement for 2015-16 (April 2015), mooted the proposal to permit Indian corporates to issue rupee bonds in overseas centers with an appropriate regulatory framework. Hitherto, Indian corporates could raise Indian rupee denominated debt mainly through the issuance of debentures to foreign portfolio investors (FPIs). The policy permitting Indian corporates, and real estate and infrastructure investment trusts (and now also banks) to issue rupee denominated bonds (RDBs; also popularly known as “masala bonds”) was announced on 29 September 2015. Since then, several updates have been made to liberalize the policy based on feedback from market participants. The salient features of the framework for issuance of RDBs are as follows:

- ▶ RDBs to be issued as plain vanilla bonds overseas. The bonds can be either placed privately or listed on exchanges.
- ▶ RDBs up to INR50 billion per financial year can be issued under the automatic route and beyond the said limit under the approval route. RDBs can be issued under the aggregate limit of INR2,443.23 billion for foreign investment in corporate debt.

- ▶ RDBs should have a minimum maturity of three years.
- ▶ RDBs can only be issued in a country and can only be subscribed by a resident of a country that meets certain Financial Action Task Force (FATF) standards and other conditions.
- ▶ The all-in-cost of borrowing by issuance of RDBs should be commensurate with prevailing market conditions.
- ▶ The proceeds of the borrowing can be used for all purposes except for real estate activities (other than the development of integrated township/affordable housing projects), investing in the capital market and using the proceeds for equity investment domestically, activities prohibited as per the foreign direct investment guidelines, on-lending to other entities for any of the aforesaid purposes and purchase of land.
- ▶ The Ministry of Corporate Affairs has clarified that issuance of RDBs will not attract the Companies Act provisions dealing with prospectus and allotment of securities.

RDBs represent an attractive mode of fund raising for Indian corporates, as they do not carry any currency

risk on the interest and repayment obligations. RDBs also significantly expand Indian corporates’ lender base to a new and diversified set of foreign investors. Subject to the cost of borrowing onshore, aggressively priced RDBs could be an attractive proposition for issuers and investors. The end use restrictions that apply, while they are liberal in comparison with external commercial borrowings, may still restrict certain types of corporates from raising funds through the issuance of RDBs. From an investor’s perspective, RDBs enable foreign investors to invest in a rupee denominated debt instrument without going through the process of registering themselves as FPIs.

A number of tax incentives have been announced to make the RDBs attractive for issuers and investors. Last year, the Budget introduced a provision to disregard gains arising to RDB subscribers on account of appreciation of the rupee against a foreign currency at the time of redemption of RDBs. This year, the Budget proposes to extend the aforesaid benefit to secondary holders of RDBs. Further, with the objective of increasing the acceptability and transferability of RDBs, the Budget proposes to exempt capital gains derived from the transfer of RDBs between two non-residents.



Also, it has now been retrospectively clarified that interest paid on RDBs raised up to 30 June 2020 is liable to tax at a concessional rate of 5% (to be increased by surcharge and education cess). Notably, the concessional tax rate of 5% is available to RDBs raised up to 30 June 2020 even if the interest payments on such RDBs are made after the said date, effectively providing a concessional tax rate for the life of the instrument. In the context of FPIs, pursuant to the amendments proposed in the Budget, taxation of interest on RDBs is contained in two provisions

that have distinct sunset provisions. This may lead to a controversy on the rate of tax applicable to interest payable on RDBs on or after 1 July 2020. It would be helpful for the Government to specifically carve out from the provisions that generally apply to FPIs, the interest FPIs may earn from their investment in RDBs.

Since the introduction of the policy for the issuance of RDBs in 2015, the external commercial borrowings framework has been significantly liberalized. Further, there has also been a recent proposal to permit FPIs to

acquire/subscribe to unlisted corporate debt securities (currently only permitted in case of companies in the infrastructure sector). However, given the substantial tax benefits available to RDBs and the relaxed regulatory requirements for issuance, RDBs present a very compelling alternative for Indian corporates seeking to raise foreign debt from investors and related parties. The tax law seems to have played its part to pave the way for the success for RDBs; it is over to the market forces now!



CFOs' Budget

Budget 2017 seems to be a CFOs' and senior tax and finance professionals' Budget, as over 200 CFOs during the EY pre-Budget survey fairly anticipated the Budget that was announced on 1 February 2017.

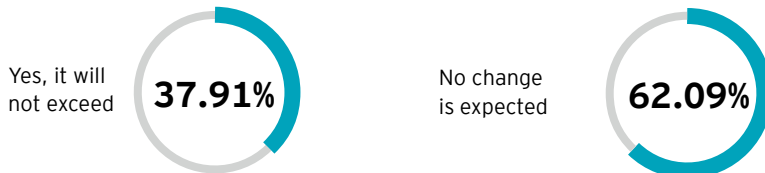
Corporate taxes

1. What would be the revised corporate tax rate given the reduction of incentives?



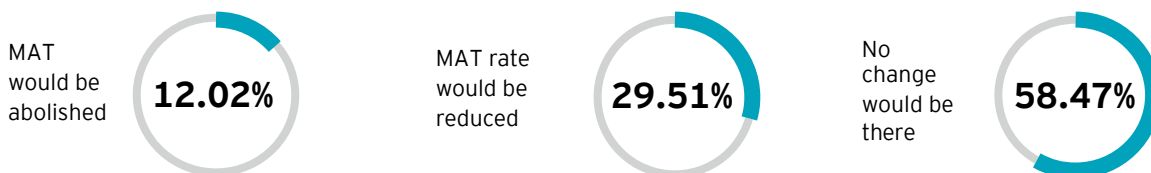
True to industry expectations, the Government has reduced the corporate tax rate but the reduction is restricted to the micro, small and medium enterprises (MSME) sector, i.e., companies with a turnover of less than INR50 crores in FY2015-16. The reduced rate of 25% is in line with the pre-Budget survey expectation.

2. Will the surcharge on income tax on domestic taxpayers be reduced?



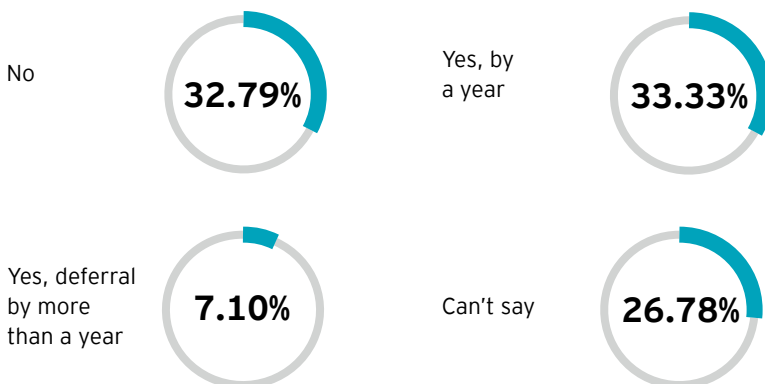
As expected, the surcharge on corporate tax rates has not been changed but a new surcharge of 10% has been introduced on individual taxpayers with taxable income between INR50 lakh and INR1 crore.

3. Would the Minimum Alternate Tax (MAT) be abolished or reduced?



In keeping with industry expectations, MAT rates have not been reduced, but relief has been provided by extending the period for utilization of MAT credit to 15 years (instead of 10 years).

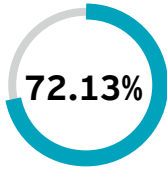
4. Would the implementation of GAAR be deferred?



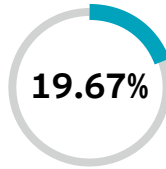
While the industry was divided over expectations of GAAR deferral, the Government has reaffirmed GAAR applicability from 1 April 2017 by not making any deferral.

5. In view of the “Make in India” campaign, do you think the Government will continue with certain income tax incentives/deduction?

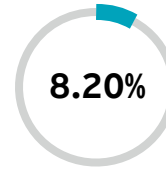
Yes, sector specific incentives/deductions would be allowed to continue



No, all tax incentives would be phased out as planned



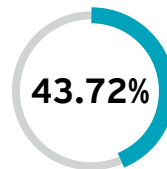
Can't say



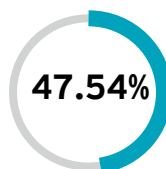
As expected, the Government has continued certain sector-specific exemptions/incentives and, in fact, has liberalized some conditions for housing development projects and start-up companies.

6. Do you think the Government may reconsider phasing out tax exemptions?

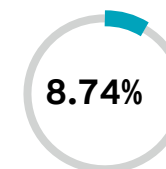
Yes, the exemptions would be reconsidered



No, exemptions would be phased out



Can't say



While the industry view was divided, the Government has not reconsidered the phase-out of any tax exemptions

Indirect taxes: the industry did not expect any big ticket announcement on indirect taxes

1. Do you expect the postponement of GST implementation to July 2017?



While the majority of CFOs expected the postponement of the GST implementation date to July 2017, the Finance Minister, during the ninth meeting of the GST Council ahead of the Budget announcement, has gone on record to suggest that 1 July 2017 would be a realistic timeline for GST roll-out. While the expected deferment of GST implementation from April 2017 to July 2017 is almost certain, the Government's reassurance on

the speed of GST implementation work (including IT preparedness) is quite positive. Also, the extensive industry reach-out efforts to initiate GST orientation for businesses starting April 2017 reaffirms the collaborative and inclusive approach of the Government to effectively implement GST. Rescheduling of GST roll-out by three months is widely seen as a time for gearing up the industry and other stakeholders to get GST-ready.

2. Do you expect the Budget 2017 to be independent of GST legislation?



The Budget did not attempt to align the current laws with the proposed GST law, which is still in the draft form, and is thus independent of GST legislation – in line with the view of the majority of CFOs. In view of the proposed GST implementation in the near future,

the Finance Minister has refrained from making too many changes in various indirect tax legislations. Keeping the changes to a bare minimum also indicates that GST implementation is well on track.

3. Do you expect the Government will bring the service tax at par with the proposed GST rate?



4. Do you expect any rate change of excise given that GST is likely to be introduced soon?



Supporting the view of those who did not expect any change in the rate of service tax, the Finance Minister kept the service tax rate of 15% (inclusive of 0.5% Swachh Bharat Cess and 0.5% Krishi Kalyan Cess) unchanged in the Budget, rather than revising the rate upward to align it with the expected standard GST rate for services.

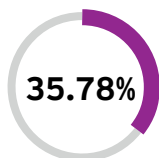
In the wake of proposed GST implementation, the Government also took a pragmatic decision of not

changing the median rate of excise duty of 12.5% in the Budget, as it would have meant the allocation of greater resource and time for the Government given that multiple product rates would have to be assessed. Also, due to the current situation of lower consumption and demand for goods in the backdrop of demonetization, any hike in the excise duty at this juncture could have had a negative impact on the economy.

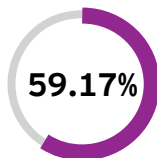
Others policy initiatives: the industry applauds the efforts made to improve tax certainty but needs faster action

1. Post demonetization, do you think the Government would reduce personal tax rates or revise the threshold limit to put more disposable income in the hands of the common man to increase consumption and demand?

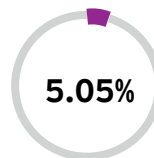
Yes, peak personal tax rate would be reduced to 25%



Yes, the threshold limit would be enhanced to INR 5 lakh



No measures needed on personal tax front

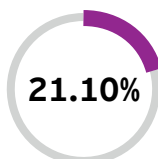


Contrary to expectations, the reduction in the personal tax rate is nominal. The effective threshold limit has been enhanced to INR3.5 lakh against expectations of INR5 lakhs. However, lower tax

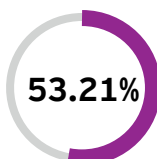
rates have been introduced on income exceeding INR250,000 up to INR500,000 from the existing 10% to 5%.

2. Would the dividends taxation policy change to the classical system, i.e., taxing the dividends in the hands of the shareholders?

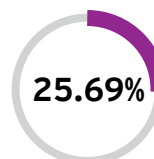
Yes, this is progressive tax



No, the current system would continue



Current system, with DDT reduced

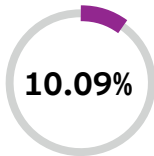


True to expectations, the dividend taxation system has not been reverted to the classical system, but more

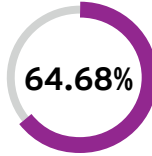
classes of resident taxpayers have been brought under the additional super rich tax of 10% on dividends above INR10 lakhs

3. Has India done enough to improve tax certainty by focusing on mechanisms to minimize and resolve tax disputes?

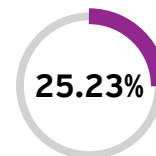
Yes, positive results can be seen



Efforts are being made, but progress is slow



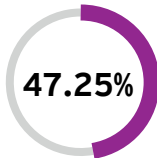
Nothing has improved at the ground level



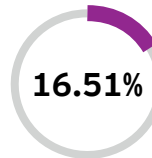
No new measures have been announced to minimize and reduce tax disputes.

4. Which of the following dispute minimization mechanisms has been the most effective?

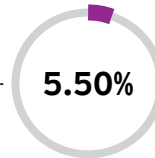
Advance Pricing Agreements (APA)



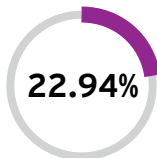
Dispute Resolution Panels (DRP)



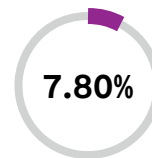
Safe Harbour



Authority for Advance Rulings (AAR)



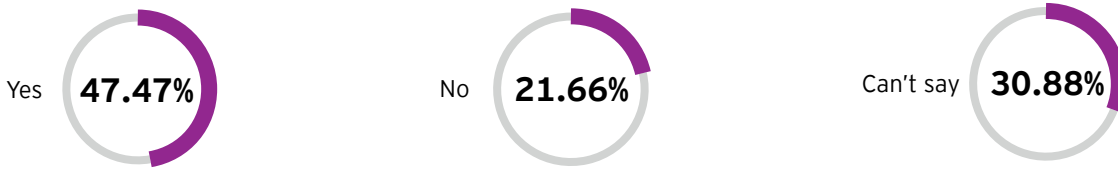
Mutual Agreement Procedure (MAP)



While no announcements have been made for increasing the benches of AAR and DRP, the Direct

Tax and Indirect Tax benches of AAR have been proposed to be combined to form a common AAR.

5. Keeping in view the revisions in the India-Mauritius treaty, do you anticipate a review of capital gains taxation policy during Budget 2017-18?

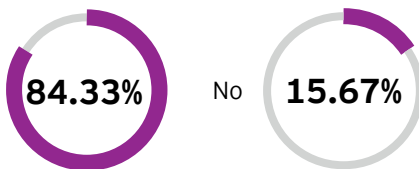


As expected, there was a review of the capital gains tax policy by way of a reduction in the holding period for immovable property from 36 months to 22 months, making it at par with unlisted shares, and advancement of the base year for indexation from

1981 to 2001. However, the proposal for the introduction of a significant anti-abuse provision for denial of long-term capital gains exemption on listed shares unless the acquisition was made by payment of securities transaction tax (except for "white list" transactions to be notified by the Government) is likely to cause significant concerns for the industry.

6. GAAR is scheduled to be implemented in India from April 2017 and an equalization levy was introduced by the Government in the last Budget. Is the Government likely to implement more such anti-avoidance measures during the Budget session?

Yes, there may be more anti-avoidance measures, particularly in line with BEPS agenda



As expected by the industry, in line with the BEPS Agenda, the Government has proposed to introduce an interest limitation rule as per Action 4 of BEPS. Other significant anti-avoidance provisions include the introduction of

secondary adjustment in transfer pricing, expansion of scope of gift taxation to all taxpayers, taxation in the hands of the seller for the transfer of unlisted shares at less than fair value and significant restrictions in cash transactions, including a penalty for cash receipts of INR3 lakhs and above.

These findings are based on an EY survey of 218 CFOs and senior finance/tax professionals conducted from December 2016 to early January 2017.



V S Parthasarathy

Group CFO, Mahindra & Mahindra

The **big** picture, the small **picture**

One does expect that an enabling atmosphere for manufacturing leadership will be created by policies and implementation

The task of ensuring longer term goals for a diverse, young and restless India, yet to be diligent about the smallest details for the short term, rendered the Budget a daunting exercise for the FM. This year's Budget strives to target multiple objectives of fiscal prudence, lesser tax burden, growth, inclusiveness, compliance, governance and entrepreneurship within limited resources and options. With the global headwinds of an adversely changing political and trade environment, the FM had his task cut.

The Budget has a clear roadmap for balancing the books of the Budget, with the fiscal deficit slated to decline in the coming years. The macro Budget numbers themselves are also practical and achievable. While gross receipts expected to grow by 6.6% in FY18 over F17, expenditure by 6.6% and the deficit capped at 3.2% in the next fiscal, the path to a balanced Budget and fiscal prudence is clear.

The Government's agenda for poverty alleviation by targeting 10 million households (Mission Antyodaya) and making 50,000 gram panchayats poverty free in a couple of years is noteworthy. Equally good is the focus on doubling farmers'

income, along with initiatives to connect farm to fork by expanding eNAM to 585 mandis. Farmers' risk mitigation will enhance with the increased allocation for crop insurance to bring 40% of the cropped area under insurance coverage.

The infrastructure fillip by allocating INR3.10 trillion in capex – covering rural areas, smart cities, inland water, national highways, railway track expansion, dedicated freight corridor and time-bound electrification of all villages – is in the right direction for growth.

Innovative ideas to fund political parties with bond issuances will make clean democracy a reality, and capping anonymous cash donation at INR2,000 is a laudable attempt.

The script for a vibrant digital India is being written with enabling policies, and the recent demonetization hastened the journey. The Budget

underlines the message that concerted work among the Government, people and businesses will take us there quickly.

In a way, the phasing out of FIPB is partly to do with the digital initiatives, and certainly lessening

of officialdom will be furthered by the digital movement.

Make in India may not be explicit but is consistent with the Government's efforts. One does expect that an enabling atmosphere for manufacturing leadership will be created by policies and implementation.

The lowering of the income tax rate at threshold levels brings more equity in taxation for the middle class. Similarly, the 5% reduction in corporate tax for the MSME sector will benefit 96% of companies. However, for listed and large private sector, there is no gain but pain in the fine print.

Consistency, sustenance, discipline, farmers, rural and poor oriented – that's the Budget focus. So, growth will be accomplished by consumption, some demand creation and some supply creation measures. The key will be how much of the spend on infrastructure and rural creates assets. This Budget's great success will hinge on execution excellence, and when all pieces of jigsaw puzzle excel in implementation, it may create magic.

Consistency, sustenance, discipline, farmers, rural and poor oriented – that's the Budget focus.

Implementation holds the key

The Finance Minister has used the positive macroeconomic profile of the country to his advantage while striking the balance between expanding the spend on focus areas and garnering the requisite resource base. India is well placed to shift gears toward growth with low consumer inflation, a comfortable current account deficit and a controlled fiscal deficit.

Infra spending is one of the key elements of India's investment story, and Budget 17-18 did well to retain the focus on the sector with a host of positive announcements.

In transportation infrastructure, higher capex is proposed in Railways to add new lines, redevelop stations and improve safety. The new metro rail policy is expected to harness the potential that metros hold in improving the country's transport infra. Road project awards and execution could see a pick-up with the availability of a higher corpus of about INR650 billion. Public-private partnership (PPP) in airport operation and maintenance could improve efficiency in the sector, with players not requiring to invest huge sums of capital upfront.

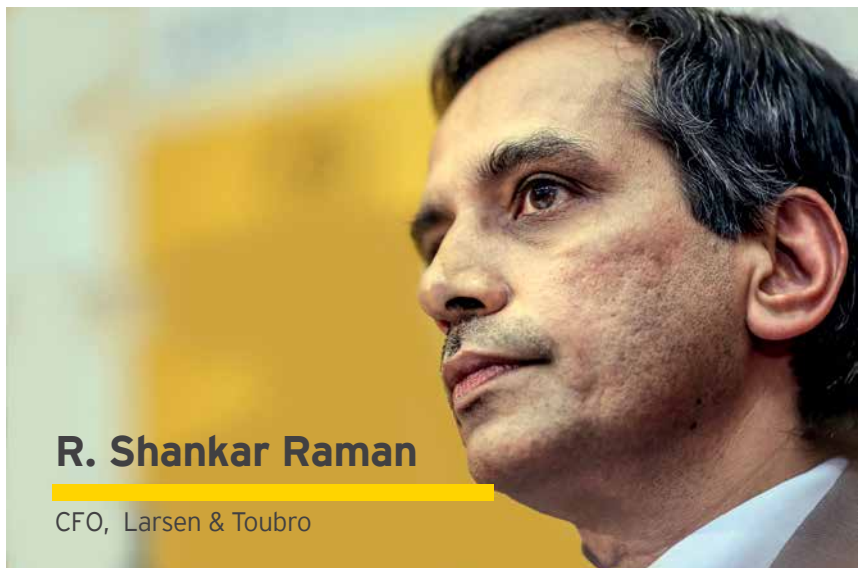
Going digital continued to be a distinct theme in the Budget. The Government has allotted INR100 billion for the Bharat Net project, which aims to create seamless yet affordable

broadband connectivity by laying optic fiber cables throughout the country. Last mile connectivity to citizens is proposed to be provided by creating Wi-Fi hotspots. The vision of Digital India could provide the push for new-age areas such as Smart Cities.

The real estate sector, which has seen a sluggish environment in the wake of demonetization, has received a much needed relief. Conferring "infrastructure status" on affordable housing will give the sector access to flexible and low-cost funding options, apart from profit-linked tax incentives.


On the energy front, the Government has continued the initiative of conserving crude oil by promoting the import of LNG through custom duty reduction. Thrust to solar power with a plan to add 20 GW and achieve 100% electrification in rural areas augurs well for the renewable and power T&D sectors. The Budget, however, has not emphasized the requirements for promoting competitive manufacturing. Perhaps it is an opportunity lost for Make in India programs, especially in areas such as defense manufacturing with static capex outlay.

Budget 17-18 pins its hope on widening the tax base to generate



R. Shankar Raman

CFO, Larsen & Toubro



Efficient follow-through implementation is crucial for achieving the targeted outcomes

significantly higher tax revenues for financing its investment plans. Accordingly, the Finance Minister has chosen to reduce reliance on Government borrowings, which improves the headroom for monetary policy easing. Banks, which are an important source of financing for the infrastructure sector, are not yet out of the woods insofar as non-performing assets (NPAs) are concerned. The Government has chosen to allocate a modest sum of INR100 billion for recapitalizing public sector banks, which may prove inadequate. Abolishing the Foreign Investment Promotion Board (FIPB), retaining the tax structure with respect to capital gains and extending the tax provisions relating to rupee-denominated bonds till 2020 etc. are important enablers for the flow of funding for the development program outlined by the Budget.

It is encouraging to note that the Government has proposed a mechanism for the resolution of disputes in infrastructure-related construction contracts, PPP and public utility contracts. Once effective, this will go a long way in inspiring investor confidence.

While Budget 17-18 is high on intent and focuses on the right areas, efficient follow-through implementation is crucial for achieving the targeted outcomes.



Praful Poladia

Senior Tax Professional, EY India

Time for remonetization with a focus on incentivizing the digital ecosystem and avoiding the regeneration of a cash economy

Inception of tapping parallel market

Any economy where there is extensive use and acceptance of cash is vulnerable to evils such as black money generation, corruption, counterfeit currency and terror financing.

In a country like India, where a sizeable population is in remote rural areas and is still under educated and the spread of digital education is slow, a completely cashless economy may be a dream today. However, a visible attempt is being made by the Government of India (GOI) to have a “less” cash economy.

The GOI, in the past couple of years, has taken a series of steps to unearth black money. These include formulating the Black Money and Imposition of Tax Act 2015 to tax unaccounted

foreign assets/income and the Income Declaration Scheme 2016 to provide a final opportunity to taxpayers to declare unaccounted domestic assets/income, making tax crimes a predicate offence¹ under the Prevention of Money Laundering Act, revamping the Benami Transactions (Prohibition) Act 1988, initiating proactive measures to collect and exchange information within India and with countries outside India and initiating proceedings against secret Swiss bank account holders.

Additionally, the GOI has also tightened the requirement mandating taxpayers to quote Permanent Account Number (PAN) in several financial transactions, including high-value transactions of purchase of jewelry, cars etc.

Aftermath of the unprecedented move of demonetization

To continue its crusade against black money and tackle the risks of counterfeit currency etc., the GOI took a significant action on 8 November 2016 of demonetizing high-denomination currency notes. This move secured the collection of a substantial quantum of notes in the banking system and has posed a two-fold challenge before the GOI. On the one hand, the GOI has a huge task of verifying the genuineness of ownership of funds in large deposits, whereas on the other hand it has concerns on how to retain money in the formal system and prevent the regeneration of a cash economy.

In the backdrop of demonetization and as a severe deterrent, the GOI substantially enhanced tax rates and penalty on unexplained bank deposits to 83.25%. It also provided an alternative scheme “Taxation and Investment Regime for Pradhan Mantri Garib Kalyan Yojana 2016” to allow defaulting taxpayers to come clean by paying tax and penalty aggregating to 49.9% and by channelizing 25% of the black money in a four-year interest-free refundable deposit, which is intended to be used for various social causes.

Further, to promote digital payments, the GOI has launched the Lucky Grahak Yojana (for consumers), under which 15,000 lucky draws are announced every day, and the DigiDhan Vyapar Yojana (for traders), wherein 7,000 weekly draws are announced; benefits are available if payments are made through either debit or credit cards,

mobile-based apps, phone banking or Aadhaar payment app. These schemes are valid for 100 days, which will be concluded by a mega draw offering sizeable cash gifts.

Certain measures are also proposed in the recently announced Union Budget 2017 to promote a digital economy and discourage cash transactions.

Tax-related Budget proposals

To incentivize digital payments, the GOI has proposed a tax relief to small traders by taxing the total turnover that is in digital form/through the banking channel at a reduced presumptive profit rate of 6%. There is also a proposal to mandate that all collections and receipts of the GOI, beyond a prescribed limit, be through digital means. These measures should give a significant push to the Digital India movement.

With a view to effectively curb cash usage, a punitive ban has been imposed on recipients who accept cash exceeding INR3 lakh for any purpose. A penalty equal to the cash receipt has been proposed. This restriction triggers in even if the receipt is from disclosed sources of income of the payer and even if the recipient is willing to offer the amount to tax.

Other restrictions on cash transactions from a payer perspective include scaling down of the threshold limit for revenue expenditure and cash donations, and disallowance of depreciation on assets acquired in cash.

Also, to provide transparency in the financing of elections, political parties have been banned from accepting cash donations exceeding INR2,000 from any one person.

The GOI's other measures include making use of e-assessments/information technology to reduce human interaction. The GOI has come out with a scheme "Operation Clean Money" for e-verification and data analytics of large deposits to target those who have unscrupulously channelized unaccounted funds. After verification of online information and the explanation submitted by the taxpayer, potential cases of tax evasion are being forwarded to the tax authority for further investigation. The measure aims to ensure that tax investigation remains well targeted and honest taxpayers are not put to deeper tax scrutiny.



Other proposals

The Budget has also proposed certain non-tax measures such as allocating funds for building a digital payment infrastructure in rural and semi-urban areas, providing relief from basic custom duty, excise duty etc. to manufacturers of point-of-sale (POS) card readers, m-POS, fingerprint readers etc. and providing incentives to merchants and individuals on the use of digital modes. There is also a proposal to mandate digital payments at places such as petrol pumps, colleges and hospitals.

Impact

The Budget proposals seeking to curb cash transactions show the GOI's sincere and well-directed efforts to reduce, if not completely eliminate, the parallel cash economy and are a welcome move. However, to have a significant impact on black money, there is scope to further strengthen the measures.

What further measures can be taken?

The agricultural sector is cash-centric. States may consider levy of moderate or nominal state agricultural tax to prevent misuse of income tax exemption by those who are not

hardcore agriculturalists. It may be noted that the prohibition on cash receipt beyond INR3 lakh will apply to cash dealings of rich agriculturists as well.

Reduction of direct interface between revenue officials and taxpayers may assist in controlling corruption. The e-governance mode of compliances could be a check on many malpractices. However, giving revenue officials the power of search without the obligation of disclosing the reasons for the search action and the levy of penalty etc. may prove to be counter-productive. What is more desirable is to rationalize the rates of tax as also the level of compliance so as to make the laws bearable.

As a further illustration, rationalized stamp duty structures may bring in greater transparency in the real estate sector, which is now likely to be regulated by the Real Estate Regulation and Development Act.

Also, taking cue from the international experience, rebate in income tax may be provided to individuals to move them toward electronic payments. Further, interest rate on bank deposits may be made more attractive coupled with higher threshold of tax relief on interest income to encourage/retain deposits with banks. Akin to the benefit offered in countries such as Argentina and Columbia, business may be offered concessions in value-added tax on the sale or purchase of goods through the digital mode. These countries offer rebate in the range of 2%-5% of VAT².

Comments

The overall success of the efforts to combat black money would lie in the ability of the tax authority to analyze potentially harmful cases from enormous the financial database and take timely action. The revenue department will also have to gear up with extensive use of automation and digitization to keep pace with the developments.

Further, measures to increase financial literacy right from the middle school level will help reduce the customer bank account dormancy rate and equip the youth with the knowledge of digital transactions.

To sum it all up, the Budget has positively geared up India for realizing the dream of a "less cash economy" and "Digital India." Still, a lot depends on how the provisions of the Budget are implemented and on the schemes that might be introduced in the years to follow.

The measures taken so far, clubbed with measures for improvement in internet network connectivity, cyber security and banking channel growth in India, will surely speed up the process toward an economy where a smartphone will be all the cash that one needs.

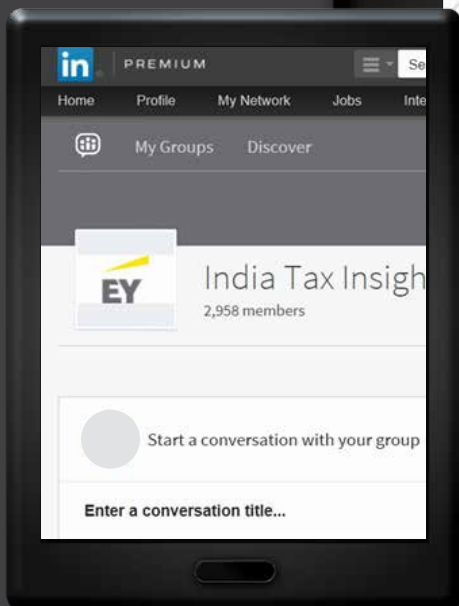
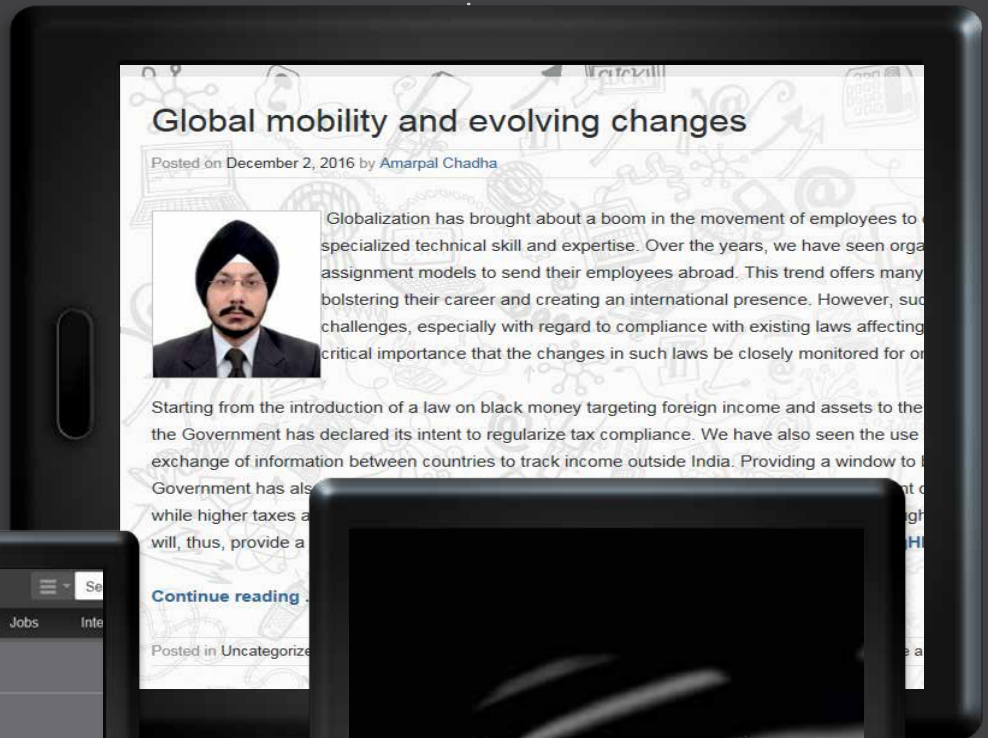
- 1 Predicate offence denotes the registration of a crime under the Indian Penal Code or the Criminal Procedure Code of India.
- 2 Report submitted by Watal Committee on digital payments to the GOI in December 2016.

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EYIN1702-014
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