India

Tax Insights

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In this issue

International tax: An evolutionary phase

Technology: The shifting of the goal post for tax functions

The politics of business tax policy: Vision 2022

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Foreword

Sudhir Kapadia

Sudhir Kapadia

Partner and National Tax Leader,
EY India

We are pleased to present the fourteenth edition of our magazine India Tax Insights, covering a wide range of recent tax and regulatory developments.

2017 was an eventful year for global tax reforms and 2018 is shaping up to deliver much the same outcome, if not more. We will see many countries continue to implement the Base Erosion and Profit Shifting (BEPS) action items of the Organization for Economic Cooperation and Development (OECD) at a fast pace in 2018, including signing of the multilateral instrument (MLI) and various tax-related exchange of information agreements. The European Union (EU) is working on several initiatives that go beyond what has been agreed upon by the OECD member countries. The US tax reform has been enacted, with many countries now in the process of reacting to it. It will also be marked as the year in which companies around the world really start to understand how all of these changes combine to impact their businesses and how they may need to adjust. At the same time, reform initiatives, far from abating, will continue, especially in the area of digital taxation, an area where intangibles play a strong role.

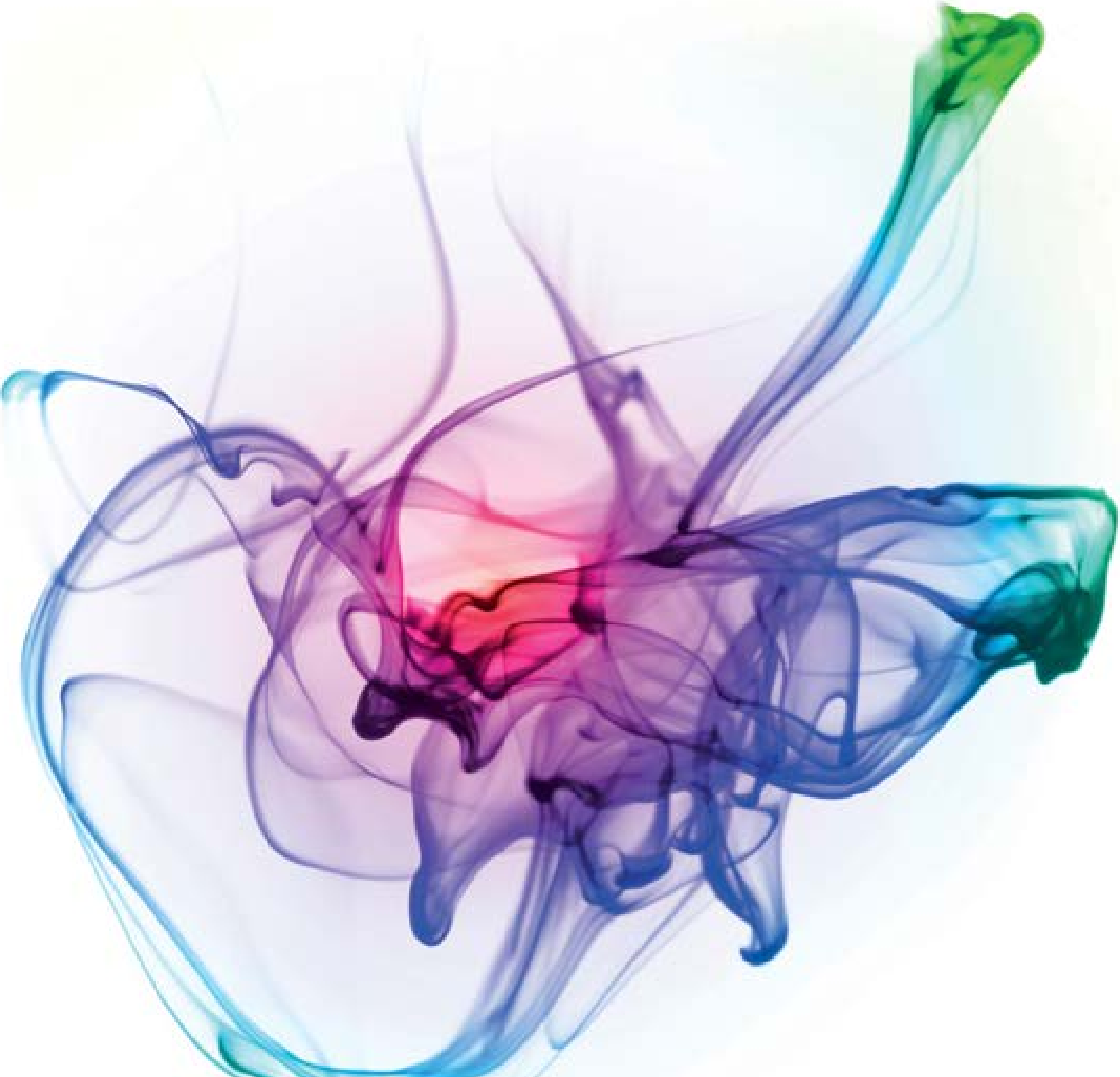
Businesses are also taking steps to adapt their tax functions to a global tax environment that demands greater transparency, real-time compliance and accountability. Businesses need to take full advantage of the tools, technology and personnel that will enable their tax functions to run more efficiently and become a strategic business partner and value creator. An underinvestment in technology would mean that many businesses would lag behind tax administrations in the use of digital technology and data analytics. An increasing number of tax authorities are building sophisticated data gathering platforms that enable matching and sharing of taxpayer data.

Against this backdrop, this edition of our magazine cover topics such as the status of BEPS implementation in India, developments in digital economy taxation, recent tax policy developments, expectations from the fifteenth finance commission, tax technology, impact of US tax reforms, and India's Vision 2022 for tax policy.

We hope you like the articles in this edition and find this publication timely and useful. We look forward to your feedback and suggestions.

In this issue

Regulars

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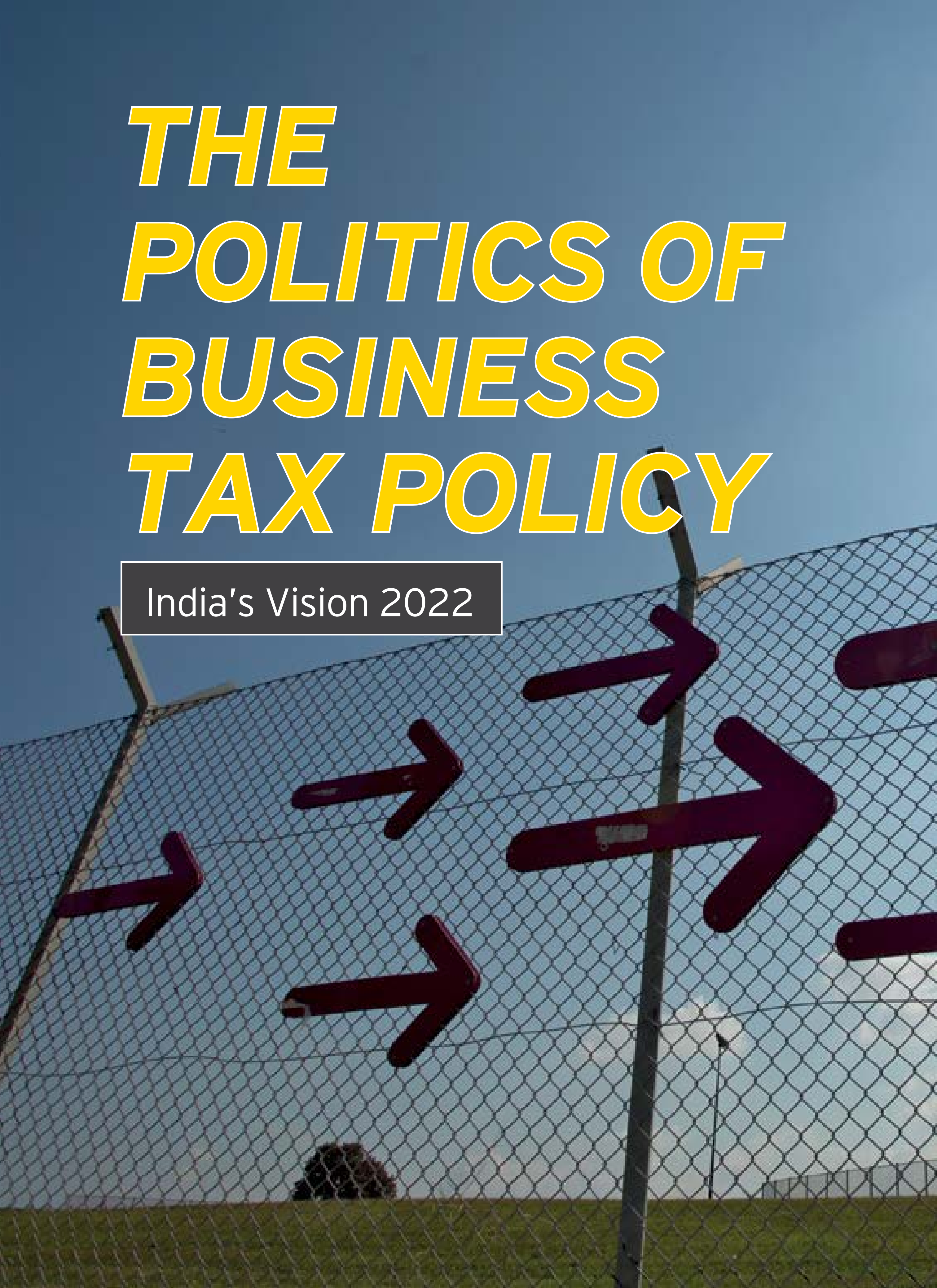
THE POLITICS OF BUSINESS TAX POLICY

India's Vision 2022



Sudhir Kapadia

National Tax Leader, EY India

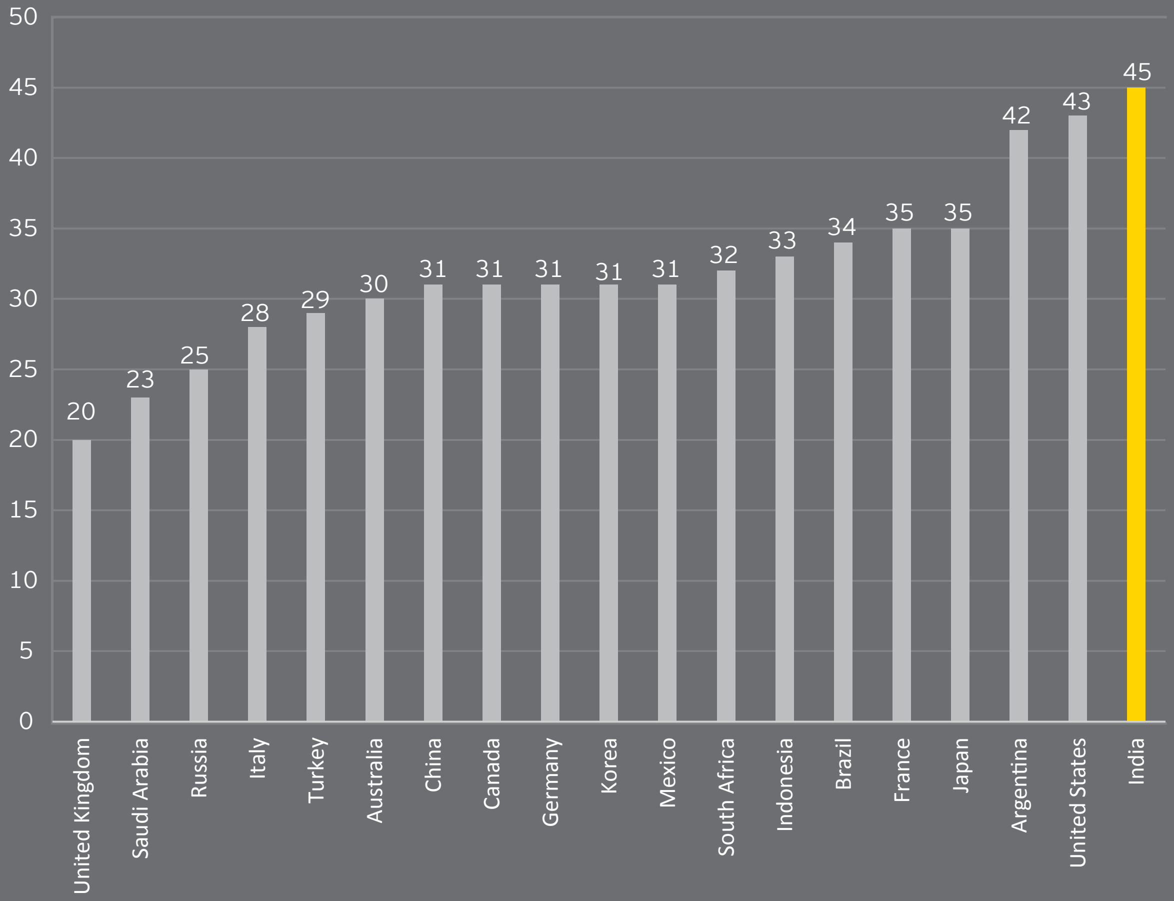
One of the hallmarks of the NDA government is a relentless focus and communication on the New India Vision 2022 and a slew of forward looking and transformative measures across infrastructure, social and physical, banking, affordable housing, power and health to name a few. From a business perspective, demonetization, Goods & Services Tax (GST) and the Insolvency & Bankruptcy Code (IBC) were specific policy interventions to transform the underlying paradigm of doing business in India. One of the key challenges plaguing the fiscal policy landscape over the years is the stubbornly low tax-to-GDP ratio implying severe revenue constraints for successive governments' attempts to redress agrarian distress, initiate and expand social security and welfare of the poor and create world class physical and social infrastructure. Undoubtedly, with stabilization of GST and greater formalization of the Indian economy, along with stringent anti-tax and fiscal evasion measures, the tax buoyancy is slated to improve over time. The government has generally been agile in improving processes in both direct and indirect tax regimes and has been fairly proactive in dealing with tax issues across many sectors in the economy. One of the consequences of these far reaching changes is the increase in complexity of the tax laws, especially the ones dealing with business taxation. In addition, to keep up with developments in the digital economy and cross border businesses, the government is in a continuous process of legislating on these matters. It is in light of these momentous changes that the impending unveiling of the proposed new Direct Tax Code (DTC) has far reaching implications for fiscal policy in India. Till very recently, one noticeable feature of the NDA Government's tenure was its '"distancing" from big business, seemingly to ward off a perception sought to be created by the governments' opponents to the effect that this government represents only the interest of corporate India. In four years, it is clear the government's focus is firmly on eliminating poverty in India and the fairly successful implementation of quite a few transformative social programs negates the perception of this government only siding with the big businesses. In fact, ironically, Indian businesses have felt somewhat forlorn and, even unwanted, in light of the political rhetoric in recent times. It has, therefore, come

as a welcome relief that no less than Prime Minister Modi himself has finally and forcefully defended "good" businesses and acknowledged the role of business and industry in creating jobs and growth of the economy. The question now is to what extent this thinking will inform business tax policy under the proposed DTC. It is interesting that the government has already taken bold steps like announcing a roadmap for corporate tax rate cuts, removal of plethora of tax exemptions, eliminating capital gains tax exemptions under tax treaties with Mauritius and Singapore and imposing a 10% long term capital gains tax on equity shares. However, the reduction in corporate tax rate extends only to "small companies" and the cumulative impact of the base rate, surcharges and the dividend distribution tax (DDT) makes India's prevailing corporate tax rates one of the highest in the world. The proposed DTC thus affords a great opportunity to rationalize various tax exemptions, simplify a complex capital gains tax system, replace DDT with tax in the hands of shareholders and above all, embrace the 25% corporate tax rate for all companies across the board. One of the main reasons for progressive moderation in corporate tax rates globally is the increasing competition in attracting business and investments thus reversing an age old phenomena of relative higher corporate tax rates which prevailed for many decades (latest, of course, is the significant decrease in the US corporate tax rate from 39% to 21%). The analysis below will illustrate these data points.

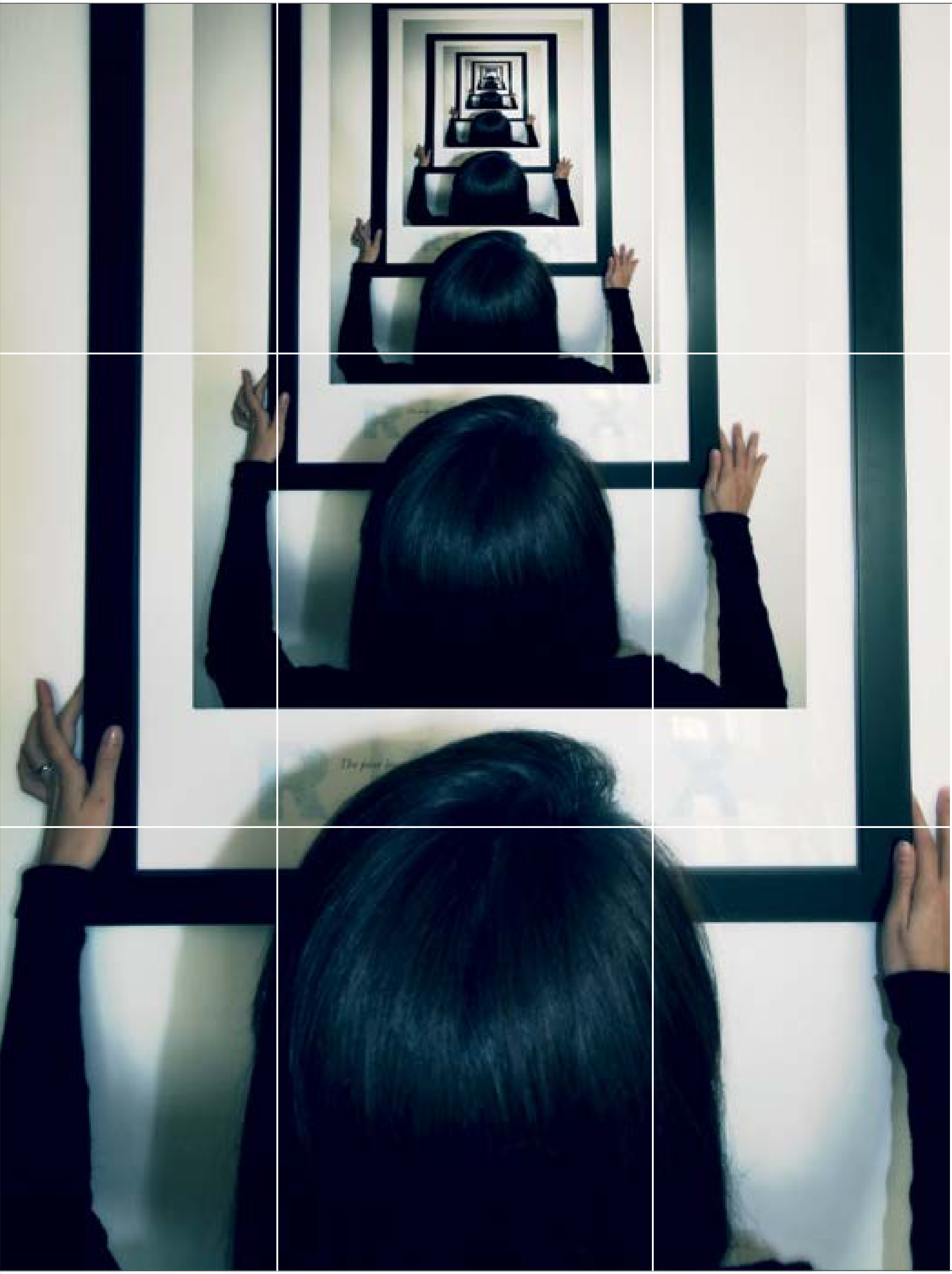
Corporate Tax Rates

India's corporate tax rate is already high

Combined statutory tax rates on international dividend payments in G20 countries, 2016 CIT + Average withholding tax rate on outbound dividends (to OECD and G20)



- *For India, the 45% rate comprises 30% CIT rate on corporate profits and 15% DDT (exclusive of surcharge and cess). In 2017, the applicable rate goes upto almost 55% with surcharge and cess*
- *India's CIT contributes 20.3% of the total tax revenue. OECD average CIT contributes just 8.2% of total tax revenue.*



Global corporate tax trend

Jurisdiction	Corporate Tax Rate (2005)**	Corporate Tax Rate (2016)**
India	36.6	34.6
G20	31.5	28.6
OECD	28.2	25.0

*** Simple average*

- *In the United Kingdom, further phased reductions in the corporate tax rate to 17% and then to 15% are planned in the next three years*
- *The US proposes to bring down the corporate tax rate down to 21% and introduce territorial system of taxation with participation exemption*
- *Singapore applies a tax rate of 17%*
- *Vietnam and Thailand have corporate tax rates at 20%*

The DTC should also consider substituting the Minimum Alternate Tax (MAT) on companies with the far simpler Alternative Minimum Tax (AMT) which may obviate the complexities caused by differences in accounting and tax treatment for many items of income and expenditure. In India, so far any talk of reduction in corporate tax rates is viewed from a unilateral prism of "revenues lost", thus assuming that there would be no "collateral gains" in the economy by way of increase in investments. The experience so far in other countries and in India too, has been to the contrary. (Note that tax rates have been progressively reduced in India too over the decades lifting "animal spirits" for investments in businesses.) Therefore, whilst continuing with much needed "anti-tax evasion" measures against recalcitrant businesses, the government would do well to consider the positive impact of tax rate cuts (along with streamlining of tax exemptions, etc.) for the economy as a whole.

A final question remains to be addressed. Given the prevailing political rhetoric in the year headed towards the next general elections in 2019, can the government afford to be seen as "endorsing" corporate tax rate cuts, howsoever salutary may be its collateral advantages? In fact, if there is one political leader in India today who has the ability to convincingly and credibly explain the economic rationale of such fiscal measures to people at large, it is Prime Minister Modi himself. He has already spoken in defense of "good" business and earlier, on the "Good and Simple Tax". He will now do well to speak on the need for considering holistic impact of a lower corporate tax rate and other simplification measures on the economic march towards the shared vision of New India 2022. Defending a good tax policy need not mean that the government of the day is oblivious to the needs of poorer sections of society. In fact, an attractive and stable tax policy is a sine quo non for economic growth which, in turn provides the much needed resources for poverty alleviation. After all, it is now an accepted truth that government alone cannot make the investment required in the economy to create jobs for the roughly 10-12 million new graduates coming out of India's universities every year. It is absolutely imperative that private investment is encouraged to meet these daunting challenges. It is high time that we free ourselves from the prevailing political rhetoric which most times implies that resources magically appear from "thin air" to fund much needed social welfare measures and create necessary jobs in the economy. One hopes that a common political consensus emerges for the need to support and incentivize business and make business (big and small) a partner in this continuing journey of economic growth much beyond 2019!

(This article first appeared in August 2018 on Moneycontrol.com)

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US tax reform

New tax law is landmark change for the US, world

The US Tax Cuts and Jobs Act (TCJA) is often touted as a landmark reform for the world's largest economy.

"Taxpayers have been looking forward to tax reform in the US for decades," says Cathy Koch, EY Americas Tax Policy Leader. "Now that it is law, it will be evaluated in large part on how businesses respond to it. Will we see more investment and more economic activity in the US? Will other countries respond in turn?"

But the new law could also spur global change. Now other countries may be under pressure to review their own tax laws and introduce new rates or policies to remain competitive in the global economy.

US tax reform lowered the country's corporate tax rate from 35% to 21%, in the process dropping the marginal effective tax rate from 34.6% to 18.9%, according to a paper from the School of Public Policy at the University of Calgary by Philip Bazel, Austin Thompson and Jack Mintz. (Mintz is also a National Strategic Policy Advisor at EY.)

That is lower than the G7 average of 26.9%, and slightly higher than the Organisation for Economic Co-operation and Development (OECD) average, at 18.2%. Countries may lower their headline tax rates and firm up incentives regimes ahead of what's anticipated to be a shift in where corporations site their functions, corporate investment and intellectual property.

There is much at stake: the TCJA will affect multinational enterprises and their foreign subsidiaries which account for almost 50% of global foreign direct investment (FDI) stock, according to a February 2018 report from the United Nations Conference on Trade and Development (UNCTAD), Tax Reforms

Kate Barton

Global Vice Chair-Tax, EY

> *Other countries may be under pressure to review their own tax laws and introduce new rates or policies.*

in the United States: Implications for International Investment.

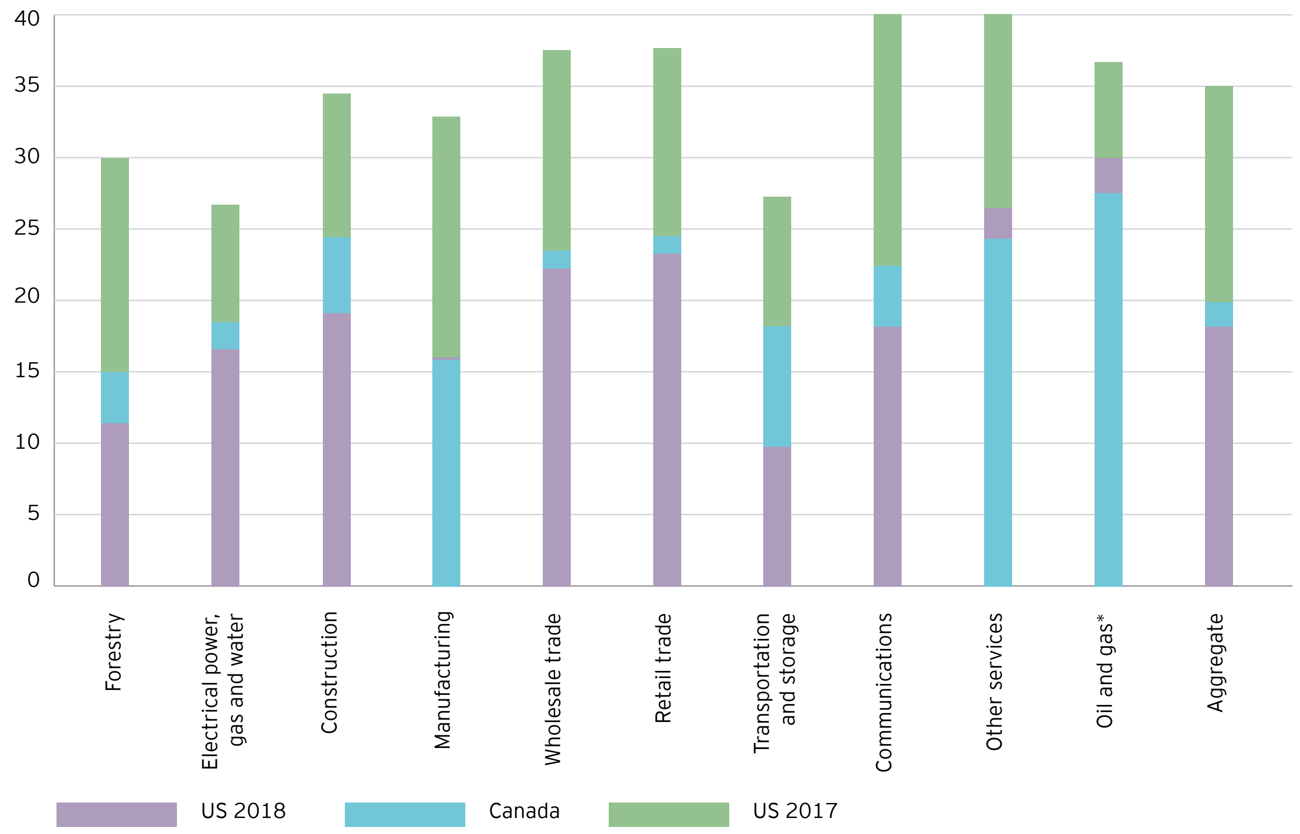
"The US reform changes the international landscape," says Chris Sanger, EY Global Head of Tax Policy. "Other countries are taking note, reviewing their systems and enhancing incentives."

Tax transformed

Digital disruption, globalization and the global financial crisis have already forced countries around the world to modernize their tax policies. One major global initiative, the Base Erosion and Profiting Shifting (BEPS) project spearheaded by the OECD, is currently being implemented by more than 110 countries around the world. The goal of this initiative is to curtail strategies that utilize gaps in tax rules to shift profits to low-or no-tax locations.

In the European Union (EU), the Competition Commission has investigated tax rulings in Member States and ordered some to collect more tax from the involved corporation. US tax reform could prompt the EU to adopt a common consolidated corporate tax base for member states, says Marlies de Ruiter, EY Global International Tax Services (ITS) Tax Policy Leader.

Marginal effective tax rates on capital for Canada and the United States
(previous and under the final US Tax Cuts and Jobs Act)



Source: P.Bazel and J. Mintz, School of Public Policy, university of Calgary.
*Oil and gas is not included in the aggregate result.

But while participating governments continue to cooperate on these global initiatives, they are more likely to separately introduce changes to their respective tax policies as a consequence of US tax reform.

The UK, France, Sweden, Belgium and other jurisdictions, for example, also have announced rate cuts for corporate income tax, with countries increasingly settling on a range between 20% and 22%, according to our data.

Incentives will also be a tool to attract investment going forward. While jurisdictions have agreed to review, change and even forego certain types of tax incentives in light of BEPS and other internationally coordinated tax reforms, this doesn't signal an end to the use of tax incentives to attract investment.

With R&D investment and jobs so highly prized by many countries, tax policy may take on an outsized role in the ongoing global competition to attract this kind of investment. "Countries have already focused on things like having the right infrastructure and workforce," says Rob Thomas, Director in our Global Tax Policy & Controversy network. "Despite the focus on aligning tax systems, how a country taxes can still be a differentiator for inward investment — albeit under the constraints of the BEPS project."

In fact, our outlook for global tax policy in 2018 found 14 of 41 countries polled are considering new offerings to attract R&D investment. In Singapore, for example, the 2018 budget released in February 2018 featured several types of incentives. Businesses investing in R&D projects in Singapore will earn a tax deduction of 250% for employee costs and consumables between 2019 and 2025, up from 150% previously. The government also doubled the deduction on the first S$100,000 of licensing costs for intellectual property (IP) registration and in-licensing to 200% for the same time period.

Taking action

Canada could be among the countries most profoundly impacted by the new US tax laws. It was for years a lower-tax option, and one that offered access to the US via the North American

Free Trade Agreement (NAFTA). For new investment in particular, that has changed, with the marginal effective tax rate on investment (METR) at 20.3% in Canada, compared with a decline in the US aggregate METR to 18.9% from 34.6%, according to EY calculations.

Now could be the time for tax reform. Canadian Finance Minister Bill Morneau has pledged to be deliberative rather than impulsive in reacting to the new US tax laws, according to a CBC report in February. Tax policy debates around the world could mushroom into full-fledged tax reforms, which may include lower corporate income tax rates.

China is another country reviewing its tax policy in the wake of the US reform. The Chinese government itself has significant exposure to tax-policy changes as it is the world's third-largest recipient of foreign investment. Under the current resident-based tax system, China taxes businesses on their worldwide income. A 1-trillion-yuan tax reform plan aims to encourage businesses to invest in China by offering lowered corporate tax rates, value-added tax reforms and tax deferrals on corporate profits reinvested in the country, according to a December 2017 report from the South China Morning Post.

Reactions to US tax reform have come at the multilateral level as well, in particular from the EU. European leaders have raised various concerns in recent months, including that the new US tax law could lead to double taxation and hurt trade, and that it may ultimately not be in line with World Trade Organization (WTO) rules. In March 2018, the EU asked the OECD's harmful tax practices forum to review the US tax reform, according to a Bloomberg report.

Next steps

- Although countries are lowering their headline corporate income tax rates, there are other taxes, incentives, exceptions and exit taxes to consider as well when comparing jurisdictions.
- Calculating marginal effective tax rates provides a more complete picture of a multinational's potential tax exposure on the next dollar invested, as long as the measure reflects state and local taxes, as well as indirect taxes like excise and payroll taxes.
- Businesses should take a global, holistic view, including reviewing R&D incentives that are available to them.
- Business should keep on top of the myriad tax policy changes as they emerge: how countries are implementing BEPS as well as how they are pursuing their own changes affecting tax rates and incentives.

BEPS Implementation at centre-stage,

is it the game changer yet?

Jayesh Sanghvi

Partner & National Leader,
International Tax, EY India

International tax rules are in an evolutionary phase, moving towards a more substance based taxation, which is sought to be achieved through greater transparency and consensus based approach by various countries globally.

BEPS Action 15 inspired the Multilateral Convention (MLI), for swift and consistent implementation of BEPS recommended treaty provisions to deal with hybrid mismatch arrangements, treaty abuse, permanent establishment (PE) avoidance and dispute resolution. The successful implementation of the MLI would really prove the success of the initiative or we may see the outcome of the BEPS project!

Implementation of MLI: What changes for India inbound businesses?

After signing on 7 June 2017, India is now a signatory to the MLI along with 77 other jurisdictions. While the MLI will enter into force on 1 July 2018 for some countries[1], for India, it will come into force three months after India ratifies the MLI under its domestic law and deposits the ratified copy of the MLI with the OECD, together with final reservations / notifications – which is yet to happen.

Signatories of the MLI have provided a list of tax treaties, which they propose to amend through MLI [Covered Tax Agreement or CTA] as well as their

1 Austria, the Isle of Man, Jersey, Poland, Slovenia, Malta

positions on adoption of MLI provision for each CTA. At this stage, the list of CTAs and positions are provisional in nature and same may change before MLI's ratification.

India notified all its 93 treaties. Based on matching positions, treaties with key investment and trade partners like Singapore, UK, Netherlands, Canada, France, Australia, Luxembourg, Russia, South Africa and Cyprus are set to undergo various changes . While some other treaties, e.g., with the US, Brazil and Thailand would remain unaffected due to these countries not having signed the MLI. Interestingly, though Mauritius, China and Germany have signed the MLI, they have not included India in the list of their CTAs. As an alternative to the MLI, such treaties may be amended to include the BEPS treaty measures by bilateral negotiations, as is specifically expressed for the India-Mauritius tax treaty[2].

Impact of the MLI positions on India inbound arrangements can be broadly understood as below:

1 For curbing the treaty abuse under Action 6, India has adopted application of Principal Purpose Test (PPT), together with Simplified Limitation of Benefits (SLoB) as cumulative conditions to test the treaty eligibility.

Usually, MNCs may choose a jurisdiction for a business arrangement, for various commercial reasons. A good treaty network providing tax benefits is an additional advantage that a jurisdiction may provide. However, there is reported misuse of tax treaties in cases where profits are artificially shifted to low or no tax jurisdictions. For example, T Co from State T is desirous of acquiring a stake in S Co incorporated in State S. There is no treaty between State T and S and, therefore, any dividend paid by S Co to T Co is subject to a withholding tax on dividends of 25% in accordance with the domestic law of State S. T Co is advised of treaty between State S and State R under which there is no withholding tax on dividends paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State. Similarly, T-R treaty provides is favorable, with no withholding position on dividend payments. To avail treaty benefit, T Co may consider two alternatives: (a) T Co will assign to R Co (an independent financial institution resident of State R), the right to receive the dividends that have been declared but have not yet been paid by S Co. (b) Establish an intermediary R Co2 in State R solely for the purpose of investing in S Co, without having any other operations. Under the existing treaties, T Co could be able to claim exemption from source taxation under both the above alternatives in absence of any anti-abuse rules.

However, if T-R treaty is modified with the MLI, the PPT rule would prevent treaty benefit under alternate (a) once it is established that one of the principal purposes for the arrangement was to obtain the

2 Source – Press Release dated 5 July 2016 by the Mauritius Ministry of Finance and Economic Development

treaty benefit. Also, under alternate (b), R Co2 is unlikely to satisfy LOB (limitation-on-benefits) conditions if it is a shell entity set up merely to hold investment in S Co. Hence, any treaty benefits may be denied in such case.

On matching positions, illustrative treaties of India with Australia, South Africa and Singapore will include only PPT as opted by these countries being the minimum standard. However, in case of Singapore, LoB condition of existing treaty will continue to apply.

2 India already follows a broad PE policy in its tax treaties. Consistent with the above, India has opted for all the PE related provisions of the MLI which will broaden the definition a PE in its CTAs, unless not opted by a treaty partner, like Singapore.

Amongst other PE provisions, the expanded scope of Agency PE provision will have a widespread impact on supply chain arrangements of MNCs. To illustrate, consider the case of a multinational group head quartered in say, Netherlands (N Co) and having regional sales and marketing entities in various south-east countries (including India). The Indian affiliate (I Co) undertakes host of functions like conducting market research, general marketing and sales promotion activities, identifying/ approaching potential customers, campaigning of N Co's products to such customers, sending catalogue, customer relationship building, etc. I Co also engages with buyers through personal visits or emails, etc. The final contracts are always by N Co outside India and goods are directly shipped by overseas entity to the customer. Hitherto, there was no exposure under the existing treaty, in absence of I Co having any authority to conclude contracts in India. However, under the MLI, I Co is likely to be seen as playing principal role in conclusion of contract between customers and N Co. This would lead to the trigger of Agency PE in India. Major impact can be seen on MNCs from Netherlands, France, Israel, etc. However, treaties with Japan, Russia, Norway, etc. would be marginally impacted since the scope of MLI Agency PE largely overlaps with the current provision containing "securing orders" clause.

Multinationals based out of countries like Australia, Netherlands, South Africa and Russia and claiming a PE exemption will need to substantiate preparatory or auxiliary nature of activities in India. Further, the unique anti-fragmentation rule will be adopted in treaties Netherlands, South Africa, France, Japan, etc. which will make claims of PE exemption stricter.

3 In addition to the above, some other changes to Indian treaties via the MLI includes Mutual Agreement Procedure (MAP) route to determine treaty residency of dual resident entities, bilateral resolution through MAP of TP cases, etc. India doesn't agree to mandatory binding arbitration and treaty eligibility of fiscally transparent entities.

Concluding thoughts

Most of the developed and developing economies have joined the BEPS initiative to keep up with the changing international landscape and updated tax rules to preserve tax bases. Significant upgradations are being made to domestic laws as well, especially in the field of digital economy. In addition, substantial reporting requirements and automatic information exchange intends to upgrade the transparency quotient between countries by several notches.

India's changes in its domestic laws as well as the rigorous choices made under the MLI, reflect the Indian tax administration's commitment to align with OECD's approaches.

With many BEPS changes already seeing the light of day and even more action expected with the MLI / treaty amendments coming into force, there is an urgent need for multinational enterprises to actively monitor the developments in various countries where it has business presence and assess the impact of these changes in their current as well future business arrangements.

Digital Economy

At the cross roads of international taxation

"We cannot solve our problems with the same thinking we used when we created them" -Albert Einstein

Digital businesses have transformed the world as we knew it- seamless operations transcending borders, connected users in a data rich environment, efficient fulfilment systems, no real need to establish a physical presence and yet, one is acutely aware of their presence. Most digital businesses are not profitable in the advent years and with multiplicity of ideas breeding competition, businesses are constantly in investment mode. Valuations are based on future prospects and potential, marking a departure from profit linked traditional models.

While the evolutions and revolutions of the past had raised tax challenges, they were still confined to a physical periphery. The tax administrators around the world are realizing that digital businesses pose very unique tax challenges which they had not encountered before and their tools are currently not adequate to stem the tax base erosion.

The Organisation for Economic Co-operation and Development (OECD), at the beginning of 21st century recognized a potential need to change tax rules on account of unique digital business models. In the year 2002, after much deliberations, giving into the ask of letting digital businesses establish themselves before taxmen demand a share, OECD recommended that changing tax rules then would be ahead of its time.

The second wave of reforms gathered momentum post the global financial meltdown. The OECD developed action plans to counter tax base erosion and the spotlight was on specific issues and businesses. The OECD also provided a platform to non-member countries such as India, to voice their opinion.

As OECD embarked on its maiden voyage of developing a tax framework for digital economy businesses, hoping to stitch a consensus, it soon realized its perils dealing with conflicting interests of various members. Equally, the world was almost out of the financial slumber and digital businesses were seen as the new messiahs for job creation and revival. The final report issued in 2015, outlined three alternative approaches[1] to tax the digital economy (DE) and suggested waiting for the outcome of some other suggestions put forth as recommendatory measures under transfer pricing and permanent establishment final report being able to deal with DE tax issues, before changing the tax rates for DE for the time being.

The report also indicated a follow-up work to be carried out and final decision be reached in 2020.

1 Potential options evaluated but not recommended to address tax challenges under DE

- New nexus based on "significant economic presence"
- A withholding tax on digital transaction
- Introducing an "Equalisation levy"

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Tax Partner, EY India

Nirav Shah
Tax Director, EY India

Developments since 2015

"There is nothing more powerful than an idea whose time has come"

- Victor Hugo

Few developing economies and certain members of EU (notably also OECD members) felt that DE businesses were mature enough to warrant an immediate taxation and the measures recommended under other BEPS Action Plans were not adequate to bring these businesses to a tax charge in the countries where they had an extensive user base with little or no physical presence. Some of the court rulings which upheld that these businesses could not be taxed under the prevalent tax framework also had a bearing on further percolating this thinking[2].

A recent French Administrative Court ruling made this very evident, where it concluded in favor of the taxpayer stating that:

"The taxpayer didn't illegally dodge French taxes by routing sales in the country (France) from its European headquarters (located outside France). The European headquarters ..... can't be taxed as if it also has a permanent base in France, as requested by the nation's administration ... as the French operations didn't have the sufficient autonomy from the (European headquarters.....)"

Actions by India

India has been vocal proponent of expanded "source" rule taxation encompassing scenarios that involve virtual presence in the country. India had vehemently supported change of tax framework during OECD BEPS agenda discussions and was not very pleased with the BEPS final report commendations. India became the first country to introduce the Equalisation Levy (EQL) at 6% on online advertisement and related transactions, with a flexibility to expand the list. EQL was introduced as a separate tax code outside the domestic tax law, a unilateral measure beyond the scope of the tax treaty network. This was followed by service tax (now GST) compliances for B2C providers of certain online services.

The current year's budget[3] has introduced the concept of Significant Economic Presence (SEP) in the domestic law. Once SEP has been established, income attributable to SEP will be taxable in India.

In line with government's stated intention of being business friendly, the specific rules defining SEP (like, revenue and user threshold) will be finalized through a consultation process of major stakeholders. An assurance has been given that domestic law amendment will not hamper the tax treaties, unless renegotiated (a very likely step considering global developments).

2 Select actions taken by certain countries is provided as an Annexure

3 Finance Bill 2018, received President's assent on 29 March 2018

Other unilateral actions

While India's actions were initially criticized, various countries have followed the suit through unilateral actions notably amongst them are Israel, Italy, France, Japan, South Korea and Saudi Arabia. There are also various enactments that are not specifically for DE, but have a great impact thereon by countries such as the US, the UK and Australia.

Recent action by OECD

Considering the global developments, OECD preponed its interim report which was otherwise due in 2019 and released it in March 2018. The Interim Report did not make any specific recommendations due to lack of global consensus on the merits of, or need for, interim measures.

The Interim Report however, included a framework for designing interim measures such as fresh levy like EQL, indirect tax like VAT, amending the PE definition, specific withholding tax, etc. The report also emphasized the need to have a permanent solution such as modified PE definition and attribution rules.

The Multilateral Instrument (MLI), which is currently in the process of being notified by member countries may have some direct effect on DE taxation, through the changes such as tightening the definition of dependent agency PE, introducing novel concepts of 'anti-fragmentation' rules though it may not be very effective in the current form.

Developments in the EU

The average ETR of digital businesses in Europe is 9.5% as against 23.2% for other businesses[4]. This may be attributable to a variety of factors, a significant one being the inability of traditional tax regime to tax DE. Falling tax revenues, stagnant economic growth and unilateral actions by few members compelled the EU to act rather than waiting on the side lines.

Earlier this year[5], The European Commission (EC) laid the proposal to levy Digital Service Tax (DST) as an interim measure at 3% on the gross revenues from certain digital services (subject to global and EU revenue thresholds). DST would be tax deductible against corporate tax base. DST alone is likely to bring tax revenues of €5 billion to the EU.

The EC, however, has also emphasized the need to have a consensus based approach to arrive at long-term solution by reworking PE definition based on new nexus rules, i.e., Significant Digital Presence (SDP) along with revised profit attribution rules that apart from traditional Functions, Assets and Risks (FAR) analysis also consider value generated by user/data.

This was always considered to be ultimate aim of DE taxation movement, though the EU broke the first barrier by identifying objective parameters instead of merely discussing on principles.

This is in line with the Common Consolidated Corporate tax base (CCCTB) approach that EU is propagating to apportion the income and taxes based on certain key business parameters.

While the DST is not envisaged to violate treaty obligation, tax treaties with non-EU members would need to be amended for the SDP to apply. The EU proposals will be submitted to EC for adoption and is likely to transpose into national law by January 2020.

Both these proposals will require unanimity among the EU member states, although there is the option to apply for a specific bloc, once approved by minimum nine members. The US Department of Treasury has spoken publically on these proposals of the EU, in that the US does not believe that the DE is sufficiently unique, requiring a separate treatment.

4 European Commission - Fact Sheet : Questions and Answers on a Fair and Efficient Tax System in the EU for the Digital Single Market (Dated, 21 March 2018)

5 The committee recommendation was issued on 21 March 2018

Next steps

Considering the tax activism in multiple jurisdictions, it is widely believed that the EU action will be path breaking and is likely to be followed widely.

The significance of a cohesive approach and an aligned conclusion simply cannot be undermined to avoid unintended consequences on the businesses and consumers, as all DE structures may not be intended to avoid tax. Also, though dominated by a few global players, the majority of DE constituent entities are still burning cash. In a need to provide level playing field to traditional businesses, business realities of DE should not be overlooked.

The global tax luminaries are having a tough time in identifying a protocol that meets the expectations of all stakeholders. In the current geo-political scenario where economic powerhouses of the world are flexing their muscles to attain trade and strategic supremacy, this identification seems like a distant dream. Uncertainty surrounding the US tax reforms and Brexit could certainly make this even more complicated. Recent discoveries and the debate on the privacy of user data may also have an impact on operating models.

Multinational companies, operating in DE especially in India, while awaiting definitive guidance on Indian SEP and impact assessment of the EU's DST, need to be on their toes. The roller coaster ride of DE taxation is at a critical juncture now and there is no option to jump off. Artificial intelligence, virtual reality and beyond earth habitation opportunities are all indicating at a faceless and human interaction-less future that debunks the rules on which current tax framework is based.

A two pronged approach is the need of the hour with roots still in the traditional wisdom: Deal wisely with present and plan for the future. Whether we like it or not, the future is happening and the taxman will have to find a place to co-habit in a non-disruptive manner. What Charles Darwin said still holds good:

"It is not the most intellectual of the species that survives; it is not the strongest that survives; but the species that survives is the one that is able to adapt to and to adjust best to the changing environment in which it finds itself"

Select actions taken by certain countries include:

Action	Countries
VAT, based on the geographical location of the consumer	South Korea, China, Japan, India
Withholding taxes	Italy (proposed)
Equalisation levy	India, EU (proposed)
Virtual PE	Israel, Saudi Arabia, Kuwait
Anti-avoidance (not specific to DE)	Australia, UK
TP related measures where TP rules are reformed to take into account the location of the consumer market	Italy

(Contribution: **Ashish Tripathi**, Senior Tax Professional, EY India)

TECHNOLOGY

The shifting of the goal post for "tax functions"

As the old adage goes, "fight fire with fire". Technology is transforming the environment around the tax function- and so the tax function should answer with appropriate technology.

The modernization of business has picked up pace within the last few years, with the advent and adoption of technologies like Robotics, Process and Automation (RPA) and the rise in the use of data analytics. This was recently illustrated when I visited the tax director of a large Indian multinational. In the past where his desk used to be strewn with legal literature, it was a welcome change to see him poring over data points regarding his company's withholding taxes that were culled out with the help of an analytical tool. Using business analytics and associated tools has afforded him a better view on his company's tax compliances and help predict trends that are likely a future tax liability of the company. Using these tools, he has been able to undertake a sharper assessment of the issues impacting the company's cash tax payout and effective tax rate (ETR). The prescriptive and predictive analytics on cash tax payout of his company helped him identify the reasons leading to cash tax blockage and improve the working capital cycle by an average of five days.

This was done by deploying Robotics Process Automation (RPA) and advanced data reconciliation tools. These technology interventions helped in:

- Seamless interaction with his customers on lower withholding tax certificates (LDCs) obtained from the tax authorities by his organization

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- Undertaking regular reconciliations between taxes withheld on payments received and the withholding tax rate prescribed in the LDCs
- Coordination with the customers on excess taxes withheld by them
- Subsequent three-way reconciliation between withholding tax reported by the customers to the income tax department, withholding tax to be deducted as per the LDC and withholding tax receivable recorded in the books of accounts of the organization

The shift in the goals of tax functions is very visible.

The requirement of various stakeholders from the tax function today is very distinct from and significantly more than in the recent past. Along with managing legal interpretations and compliances (which used to be the primary expectations from tax functions hitherto) tax functions need to cope up with:

- **Rapidly changing business landscape- requiring a very connected tax function**

Digital technologies are radically altering business and operating models. For example –

- Businesses are now 24X7
- Instead of simply selling products, solutions are being be offered
- Service delivery models are growing borderless (multiple-location deliveries)

Unless a tax function is very closely integrated with the business, the quality and speed of response may be significantly impacted.

In a recent survey conducted by EY[1] 44% of the respondents felt that adding value to business through tax insights is the biggest challenge today

1 EY India Survey, 2018: 'Reimagining the tax and finance'

In the EY survey, 63% of the respondents perceived an increase in risk of their tax profile due to targeted electronic data gathering by tax authorities

98% foresaw the need for increased collaboration with other business functions to ensure compliance with various transparency initiatives

89% of the respondents believed that the increasing importance of ensuring transparency in business has increased the workload on the tax function

38% voted lack of technology as the most significant factor impacting tax to deliver outcomes on sustained basis

62% voted that business will fund new expansion in tax

- **Technology savvy, agile tax authorities**

The Indian tax authorities are leveraging digital platforms to assess taxpayer data, including cross-referencing information at the source, running it through increasingly sophisticated analytics and sharing it among other agencies. This is rapidly changing the manner and quality of audits.

Traditional ways of operating (working in silos, relying solely on finance for veracity of data, etc.) can create tax risks for organizations.

- **Significantly increased and stricter reporting and transparency requirements**

The reportings required to be made to the authorities are becoming granular and real-time (for example, reporting for GST, CbCr, withholding taxes, etc.). The connected, digital world is enabling authorities to get closer to the source of information, providing them entry points and direct access to transactions, tax and finance data than ever before.

Tax functions are under a lot of stress due to the increased workload, risk and speed at which such reportings need to be made.

Tax technology

As the old adage goes, "fight fire with fire". Technology is transforming the environment around the tax function- and so the tax function should answer with appropriate technology.

Appropriate use of technology can significantly ease the current strain on the tax functions. The answer to issues on increase in workload, data verification and management and coordination with business lie in technology.

The tax technology landscape has rapidly evolved and matured over the last few years. A range of technology solutions are available to address the varied needs of the tax function:

- Off the shelf products- viz CbCR, TP documentation, tax engines, tax tool for provisioning
- Software as a service- viz ASPs offering comprehensive platforms for GST compliance service providers

- Use of RPA is catching on. Software robots emulate human activity and are able to execute tasks which include interaction with multiple software applications. Robots can deliver repetitive, high-volume tasks efficiently and accurately
- Newer technologies like blockchain, Intelligence Automation (IA) , cognitive computing and machine learning are on the anvil for tax- but currently not very prevalent due to cost considerations

Some areas where tax technology can be introduced are:

- Document management
- Litigation management
- Management of income and reporting
- Management and group reports
- Data collection and reconciliation
- Process controls and workflow in the tax function
- All compliances and reportings

For most tax functions the challenge today is determining and crystallizing their requirements, tax technology strategy and resources to execute the strategy rather than availability of solutions.

Business case for tax technology

With the advent of cloud computing, cost of deployment and maintenance of large applications has come down significantly, the cost of sub-optimal compliance is becoming

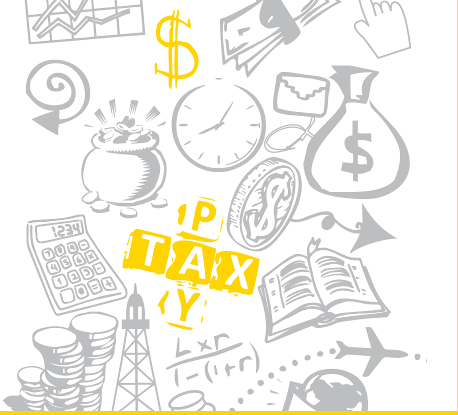
steeper- there seems to be a viable business case. However, where the investment and maintenance costs are envisaged to be significant, companies are also considering the option of outsourcing the tax function, fully or partially.

Given the dynamic requirements, evolving technologies corporates need to have a long term tax technology strategy in place.

Tax technology strategy

There is no "one size fits all" for tax technology strategy. It has to be a customized plan for each organization. Following are some of the key considerations:

- **Integrated approach:** Choice and the broader tax technology strategy needs to fit with the group's operational structure, strategy and risk profile, IT – finance integration and infrastructure and cost benefit analysis, in order to be effective
- **Integrated source of data/ datalake:** As data is the foundation of accurate and timely reporting, being able to collect and manage data is critical to timely and accurate compliance. Since tax-related data resides everywhere across the organization, from operations to marketing to finance departments, it is important to have a seamless, consolidated and integrated view of that data. This will prevent a siloed approach and facilitate the availability of 360-degree data across departments at all times
- **End-to-end automated tax process:** A streamlined automated tax process ensures efficiency in obtaining source data, integration with financial systems, automated calculation, consolidation and dynamic reporting
- **Adopt analytical applications:** Analytical applications can be very usefully deployed for planning, forecasting and exceptional review purposes



Conclusion

The need of technology for tax is not a debate any longer. The discussion today is more on the road map to digital transformation of the tax function, prioritization of areas within the tax function to be automated and the nature of technology/ tools to be adopted to successfully address the tax function's challenges.

Given the increased thrust on tax transparency by the tax administrations globally, tax authorities having access to transaction level data of tax payers and a much sharper ability to undertake a targeted audit on the tax payer, the more progressive the C-suite wants to see the "excel" school of tax graduate to "digital" school of tax and ensure that the C-suite has a much faster and sharper visibility on the organization's tax risks and opportunities for tax optimization.

With the expectations of the tax administration and C-suite continuing to evolve at a rapid pace, it is clear that maintaining the status quo is no longer justifiable for tax functions of the future. There is a compelling need to embrace new technology in the transformation of the tax function along with realignment of archaic processes and reskilling/ upskilling people to sustainably evolve the future tax operating model.

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Policy compliance

The seven commandments

Rajiv Chugh

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Compliance leaders are currently going through a challenging period, due to the **Companies Act 2013,** Section 134 (5d), which deals with Directors' responsibility statement. Directors are to devise proper systems to ensure compliance with the provisions of all applicable laws and ensure that these systems are adequate and operate effectively.

As per SEBI listing agreement clause 49, the Board is to periodically review the compliance reports of all laws applicable to a company and prepared by it as well as the steps taken by it to rectify instances of non-compliance.

Recent events in the markets have transformed the way institutions operate and the importance of complying with policy changes is being elevated. At the same time, business decisions are subject to scrutiny, as pressure to reduce expenses continues to mount. Businesses today are challenged on account of their geographical spread of operations, which gets compounded with multiple lines of business and the need to comply with multiple laws. Since the policies are changing from state to state, there is a need for constant alignment with changing regulatory policies in specific sectors.

People must **"know what they need to comply with"**.

- "Compliance owners" must be proactively informed before compliances become due
- They must be able to see the health of compliance at any given point in time across entities and locations

Organisations need to create the ability to hold people accountable for non-compliance, ensure timely responses to show cause notices and litigation, timely closure of tax assessments and document and publish their positions under different laws.

For compliance professionals, success is no longer achieved solely by interpreting regulations and providing guidance. Today, success requires balancing core responsibilities, adapting to a shifting business environment and serving as change agent, risk manager, voice of leadership and organizational visionary.

Every organization may have to incorporate the seven commandments to deal with the following challenges:

1. **Governance:** Create and maintain a strong empowered compliance function with an overview of all laws and regulations
2. **Identification:** Identify and be aware of all regulatory challenges and compliance risks
3. **Risk analysis:** Set up a methodology to perform compliance risk analysis and translate the results to an action plan
4. **Policies and procedures:** Embed the translation of laws and legislation in all relevant policies and procedures
5. **Claims and remediation:** Deal with claims, remediation and exit procedures of clients
6. **Risk culture/Awareness:** Create a sound risk culture
7. **Workflow tooling:** Implement the right compliance tooling to obtain oversight of laws and legislation and have a continuous management information dashboard

To meet such new demands, institutions might need to design effective, flexible and robust compliance programs to address unique business, regulatory, risk tolerance, technology and operational model requirements. This may involve reviewing regulatory and management structures and reporting programs, analyzing the integrity of compliance-related data and protocols for monitoring, testing and surveillance or assessing preparation for regulatory examinations.

Tighter investor and regulatory scrutiny may require institutions to review their strategies and business models to "do more with less" as well as meet investor demands for greater return on capital.

The Indian regulatory landscape is highly complex. Issues include varying levels of regulatory maturity to sovereign agendas, not to mention trying to maintain a balance between principle and prescriptive regulatory requirements on the same agenda. The concept of "one size fits all" would be hard to apply.

The good news is that this complexity is providing a healthy arena for the development of new ideas and applications of technology. Furthermore, conflicting deadlines for compliance to various policy/regulations have already left institutions struggling to keep abreast and this leaves them with limited bandwidth to actively explore regulatory innovation. Instead, compliance functions remain heavily focused on remediation rather than strategic implementation and even when they do, there are often cultural impediments to adopting technology-based solutions amongst compliance professionals.

The ongoing globalization of regulatory policy and continued fragmentation creates significant challenges. This results in higher expectations from and importance of the compliance function. It is important to have a clear vision on the kind of compliance risks your organization is exposed to and imbibe the seven commandments.

*Dissecting the concept of **"Significant Beneficial Ownership"** under the Companies Act, 2013*

Bharat Varadachari

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As a G20 member, in 2014, India had committed to adopt various principles with respect to transparency of beneficial ownership of entities within its jurisdiction and maintain updated information on the same. These principles were based on the 2003 guidelines issued by the Financial Action Task Force (FATF), an inter-governmental body set up to promote effective implementation of measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

Who is a Significant Beneficial Owner (SBO)?

Under the Companies Act, 2013 read with the SBO Rules, an SBO is defined as an individual who-

- is not a registered shareholder of the company;
- acts alone or together or through one or more persons or trusts (including persons or trusts outside India); and
- holds ultimate beneficial interest of at least 10% in the shares of a company or actually exercises or has the right to exercise significant influence or control over the company

Where no individual is identified as the SBO, the individual who holds the position of Senior Managing Official is to be treated as the SBO.

Several guidelines issued in India like the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (PMLA Rules), Securities and Exchange Board of India (SEBI) 2013 Guidelines (SEBI BO Guidelines) and the Reserve Bank of India KYC Directions, 2016 (RBI KYC Guidelines) require banks and other regulated entities to identify natural persons who are beneficial owners of their customers in different circumstances. However, the provisions of the Companies Act, 2013 (CA, 2013) were considered inadequate as there were no definitions of beneficial interest or beneficial ownership and no obligations on a company to independently identify its beneficial owners or maintain an updated register of beneficial owners in line with international practices. Hence, amendments were made to the CA, 2013 to address these requirements and relatedly, the Companies (Significant Beneficial Owners) Rules, 2018 (SBO Rules) were notified.

Compliance requirements/Consequences of defaults

The CA, 2013 and SBO Rules require SBOs to provide true and correct information and make full disclosure of all material information as part of their declarations of significant beneficial ownership (and any changes) to the company.

The company in turn needs to both report details of SBOs to the Registrar of Companies and maintain an updated register of SBOs. Where no declarations have been received, the company needs to issue a notice to any person believed to be or have been an SBO (in the preceding three years) or have knowledge of the SBO. If no response is received, the company needs to file a letter with the National Company Law Tribunal (NCLT) requiring all or any of the rights with respect to the shares to be regulated.

There are hefty penalties prescribed for failures by the SBO/company to comply with the prescribed requirements. Willful furnishing of false/incorrect information or suppression of material information by the SBO is treated as fraud and is liable for imprisonment (in addition to penalties).

If information related to a company's SBOs remains unknown even after investigations, there could be dire consequences; the NCLT could potentially order that any or all the rights attached to the shares of the company be restricted and in extreme cases even order the freezing of the company's bank account until the information is received. In Brazil, for example, failure to comply with the country's beneficial ownership requirements results in suspension of a company's tax registration number and prohibition of banking transactions.

Key questions/Issues

The SBO provisions have triggered a lot of debate due to certain omissions, use of ambiguous language and some open issues. Some of the questions/issues raised have been captured in the following paragraphs.

Legal entity coverage / Exemptions

Regulations in other countries recognize that complex investment structures set up to hide the real owners of an organization are not limited to companies incorporated in a country and hence, also require beneficial ownership of partnerships, LLPs, foreign companies, certain types of trusts, etc. in the country to be disclosed (e.g., the UK, Germany, Brazil and Singapore). The SBO provisions in India currently only cover companies incorporated in India. It is possible that this requirement may be extended to other forms of legal entities under their governing regulations in due course. However, from a company perspective, it would be useful if the applicability or exemptions in certain situations (e.g., companies wholly owned by the Government of India or other countries, foreign companies, etc.) are clarified.

Several countries around the world exclude local or foreign listed companies and their subsidiaries from the purview of similar regulations because they already have obligations to disclose information about their beneficial owners (e.g., the UK, Germany, Ireland, Hong Kong, Singapore and Germany). In India, the PMLA Rules, RBI KYC Guidelines and SEBI BO Guidelines all provide that where the client/customer is a listed company or a subsidiary of a listed company, it is not necessary to identify beneficial owners. The MCA should consider extending the exemption to such cases under the CA, 2013.

Computation of 10% ultimate beneficial interest

Due to inconsistent language between the CA, 2013 and the SBO Rules and also within the SBO Rules, the manner of computation of the 10% ultimate beneficial interest and the level at which such interest is to be computed have been left open to interpretation.

The objective of the SBO provisions is to determine the natural persons who hold "ultimate" or "effective" beneficial interest of at least 10% in the shares of the company for which the SBO is being determined. Accordingly, it should be clarified that one needs to "look through" the investment structure, irrespective of the number / legal form of the entities in the chain, to determine the 10% beneficial interest. For example, if Individual X holds 10% interest in Company Y which holds 90% interest in Company Z, the effective holding of X in Company Z is 9% interest (10% x 90%) and hence, X does not satisfy the 10% ultimate beneficial interest threshold to be considered as the SBO.

Individuals "acting together"

This term has neither been defined in the SBO Rules nor in any other section of the CA, 2013 and is open to interpretation. It should be clarified that if two or more individuals enter into an arrangement to exercise one or more of their rights in their shares jointly in a pre-determined manner, they could be said to be "acting together". In this context, the position with respect to beneficial interest in shares of a company held by "relatives" should also be clarified.

Senior Managing Official (SMO)

The Rules provide that where no natural person is identified as the SBO, the natural person who holds the position of SMO is to be treated as the SBO. Firstly, it should be made explicitly clear that an SMO should be treated as the SBO only if no natural person "meets the prescribed SBO criteria" and not just if an SBO is "not identified". Secondly, a definition of the term SMO (currently missing in the SBO Rules) needs to be incorporated to avoid interpretational issues. Finally, in line with the FATF guidelines / regulations in other countries (e.g., Ireland), it should be clarified that the SMO needs to be identified at the level of the company with respect to which the SBO needs to be identified. Else, it may also be interpreted that an SMO needs to be identified at the level of the entity which is the immediate member of the company or the legal entity up the chain of holdings that is the ultimate holding entity of the company.

Significant influence and control

While interpreting the terms "significant influence" and "control" in the context of a significant beneficial owner, a reference is to be made to the definition of these terms under the CA, 2013. These definitions include control of at least 20% of the total voting power, control of, or participation in business decisions under an agreement, right to appoint majority of the directors, right to control management or policy decisions directly or indirectly, whether by way of agreements or in any other manner. It would help if detailed principles and examples are issued to explain the meanings of "significant influence" and "control" as these concepts are open to interpretation (e.g., the UK, Hong Kong, Singapore). In addition, exceptions should be made for individuals acting in specific situations, for e.g., providing advice or direction in a professional capacity, e.g., lawyers or consultants, exercising a function required under law, e.g., liquidators or fulfilling the functions ordinarily expected from their roles, e.g., directors.

Beneficial interest in shares held jointly, by a nominee or as a security

The MCA should clarify how an SBO is to be determined where shares are held under different circumstances, e.g., jointly, by a nominee, or as a security, etc. (e.g., the UK, Singapore, Hong Kong). The crux of this determination is the identity of the individual(s) who hold the beneficial interest in the shares, i.e., who exercise any or all of the rights with respect to the shares.

In case of shares held jointly by more than one individual, typically, each of them holds the rights attached to the shares. In these circumstances, it should be clarified that each of the joint holders should be treated as SBOs, if the shares carry at least 10% beneficial interest.

Wherever shares are being held "on behalf of" another individual(s), e.g., as a nominee, the rights to the shares are typically treated as being held by the individual for whom the nominee is acting. In these circumstances, it should be clarified that such individual (and not the nominee) should be treated as the SBO wherever the shares carry at least 10% beneficial interest.

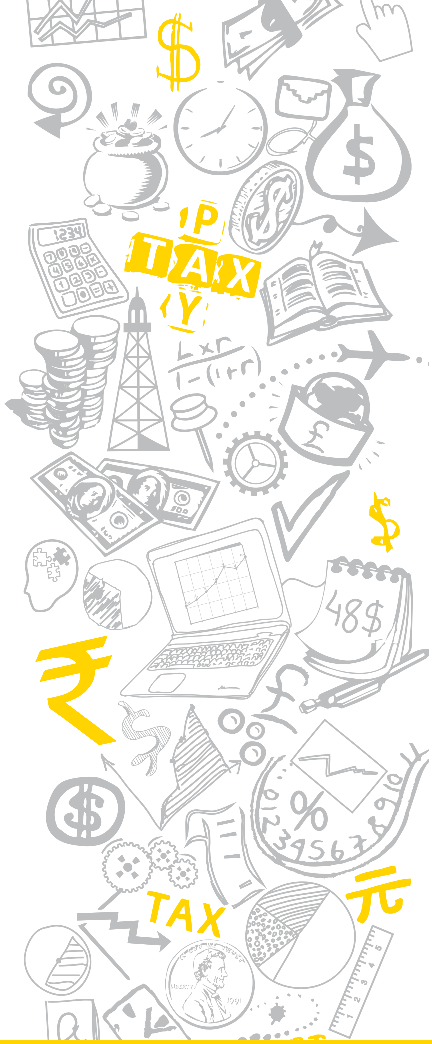
In case of shares provided as security, the nature of the rights retained by the security provider with respect to the shares should be examined. Typically, in such circumstances, the rights attached to the shares are exercisable only in accordance with the instructions of the individual who provides them as security (except where the exercise of such rights is for the purposes of preserving the value of the security or realizing the security). It should be clarified in such cases that the provider of the security should be treated as the SBO, if the shares carry at least 10% beneficial interest.

Non-voting shares and shares of a beneficiary in a discretionary trust

These are interesting practical situations that may arise in investment structures.

The term "beneficial interest" has been defined very widely to include any or all of the rights attached to a share. Hence, even if an individual, for example, does not have voting rights but has dividend rights to the extent of at least 10%, he/she should be treated as an SBO.

In case of discretionary trusts, while the beneficiaries are known, the shares of the beneficiaries in the assets/income of the trust are indeterminate and distribution of assets/income of the trust is at the discretion of the trustee. The trustee may be guided by the principles laid down in the trust deed at the time of distribution, but there is no asset/income identifiable upfront to a specific beneficiary. In such cases, individuals other than the beneficiaries will need to be identified as SBOs basis the ultimate effective control they exercise over the trust. This could be the author, trustee or even some other person based on the facts.



Source Regulations:

Brazil - Normative Instruction No. 1634 effective January 1, 2017

Singapore - Companies (Amendment) Act, 2017 effective March 31, 2017 and ACRA Guidance on Register of Controllers for Companies, Foreign Companies and LLPs dated September 7, 2018

Hong Kong - Companies (Amendment) Ordinance, 2018 effective March 1, 2018

Germany - German Anti-Money Laundering Act, 2017 effective June 26, 2017

Ireland - EU (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2016 effective November 15, 2016

UK – Part 21A of the Companies Act, 2006, Register of People with Significant Control Regulations, 2016 and Guidance on Register of People with Significant Control – June 2017

Conclusion

The omissions and ambiguities that are often witnessed in legal frameworks in India are sources of uncertainty, anxiety and risk for businesses and their investors. The new SBO provisions are a good illustration of this. Due dates for compliance with the SBO provisions have been extended due to feedback received on the open issues from a cross-section of professionals and industry and basis the need to revise the prescribed forms.

Taking a cue from other countries, the MCA might do well to issue detailed guidelines and FAQs (covering multiple fact patterns of investment, influence and control). These could be supplemented with illustrations of completed registers, recommended additional wordings/notes under different circumstances and draft notices / declarations, to both address the various issues /uncertainties and also, facilitate accuracy, efficiency and consistency in compliance with the SBO provisions.

Why review of cesses by Finance Commission is important

The 14th Finance Commission had recommended that the states' share in the net proceeds of the union tax revenues should be increased to 42% as against 32% recommended by the 13th Finance Commission- the largest ever change in the percentage of devolution.

Shalini Mathur

Director, Tax and Economic Policy
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The terms of reference of the Fifteenth Finance Commission (FFC) are significantly different from the previous Finance Commissions and have evoked considerable interest. One of the aspects that the FFC may examine is the use of cesses as revenue raising tools by the government and whether the imposition of cess, the receipts from which are retained by the central government, distorts the devolution of taxes between the center and the states.

The 14th Finance Commission had recommended that the states' share in the net proceeds of the union tax revenues should be increased to 42% as against 32% recommended by the 13th Finance Commission- the largest ever change in the percentage of devolution. At the same time, the amount of cess collection has witnessed an increase over the years. In 2018-19, the union government expects to collect more than INR3.2 lakh crore from cesses and surcharges- nearly 28% higher than the INR2.50 lakh crore it collected in 2017-18. (See Table 2)

States' effective share in divisible pool has reduced

The cesses reduce the divisible pool of central taxes and increase the discretionary grants. In fact, due to the increased use of cesses and surcharges, the effective share of the states in the center's gross tax receipts has tended to be much lower than the recommended share. For instance, over the last three fiscal years (2015-16 to 2017-18), the average effective share of the states in the gross central taxes was only 35%, marking a shortfall of 7% against the recommended 42% share by the 14th Finance Commission. The reduced share constrains the fiscal space for states, which have been demanding a larger share owing to their substantial spending obligations.

Short transfer of cesses to public account

Another aspect is that the experience of utilization of cesses, in many cases, has not been satisfactory as brought out by the government data on cess revenue and its utilization. For instance, the Research and Development Cess Act enables the creation of a fund for Technology Development and Application to

Table 1: Effective share of the states in gross central taxes

Finance Commission	Recommended share in divisible pool (%)	States' effective share in gross central taxes (%)	Shortfall in effective share relative to recommended (% points)
Tenth (alternative devolution scheme)	29.0	27.4	(-) 1.6
Eleventh	29.5	27.1	(-) 2.4
Twelfth	30.5	26.3	(-) 4.2
Thirteenth	32.0	28.2	(-) 3.8
Fourteenth	42.0	34.9*	(-) 7.1

*Source: Indian Public Finance Statistics (2015-16) and Union Budget Documents | *Averaged for the period 2015-16 to 2017-18 (RE)* be administered by Technology Development Board (TDB). The fund is maintained outside the government account and is credited with the grants released by the Government of India out of cess collected on the import of technology by the industrial concerns under the provisions of the R&D Cess Act. The R&D cess collection is administered by the Department of Science & Technology. Out of the total R&D Cess collected during the period 1996-97 to 2016-17, only 7.73% was utilized towards the objectives of levying the said cess, with 92% of the funds remaining unutilized for the purpose.[1]

Similarly, from the total collection of Secondary and Higher Education Cess (SHEC) in the Consolidated Fund of India during 2006-07 to 2016-17, no amount could be transferred to the earmarked fund in Public Account[2]. No schemes were identified on which the cess proceeds were to be spent and no designated fund was opened in the Public Account to deposit the proceeds of SHEC. Another glaring example is that of the Clean Energy Cess collections during the period 2010-11 to 2016-17, of which only about 29% was transferred to the National Clean Energy Fund, resulting in a short transfer of more than 71%[3]. There are other cases too of short transfer of cess to other earmarked funds in Public Account.

Clean Energy Cess: Utilization should match the objective

The cesses also need to be evaluated on the basis of whether the collections are being utilized for the purpose for which they were imposed. A case in point is the Clean Energy Cess. The National Clean Energy Fund (NCEF) was created out of cess on coal produced / imported for the purposes of financing and promoting clean energy initiatives, funding research in the area of clean energy or for any other purpose relating thereto. Subsequently, the scope of the fund was expanded to include clean environment initiatives also.

However, after the implementation of GST, the coal cess constitutes the GST Compensation Fund and the same would be utilized to compensate the states for five years for potential losses on account of GST implementation. After five years, any amount left would be shared on 50% basis between center and states. Thus, the GST Compensation Cess would be spent on all the states who suffer loss in revenues under GST, irrespective of the environment considerations. For instance, the coal rich states such as Jharkhand, Odisha, Chhattisgarh, Madhya Pradesh and Assam bear a considerable environment burden. However, even though a coal cess of INR400 per tonne is collected, their environmental burden remains uncompensated as the cess collections are being utilized for all states whose SGST revenues are lower than the projected revenues. This is an example of mismatch between a stated objective and the resultant outcome.

The states that are mineral-rich and also have a large forest cover play a twin environmental role in terms of bearing the pollution costs on one hand, while enriching the environment on the other cover. These aspects should be recognized by the Finance Commission and these states should be suitably compensated.

The above dimensions of levy of cess are significant. As and when the Finance Commission studies the legal framework for the cesses and surcharge levied by the central government, these issues would merit a review. With the implementation of GST from 1 July 2017, many cesses have been rolled back[4]. It would be important to ensure that the remaining cesses are properly utilized to meet the objectives for which they were introduced.

1 Report No. 44 of the CAG on Union Government Accounts 2016-17

2 Report No. 44 of the CAG on Union Government Accounts 2016-17

3 Report No. 44 of the CAG on Union Government Accounts 2016-17

4 These include education cess on excisable goods, secondary and higher education cess on excisable goods, clean energy cess, Swachh Bharat cess, infrastructure cess, krishi kalyan cess and some cesses on commodities such as cess on rubber, automobile, tea, coal, beedis, sugar and jute goods.

Table 2: Cesses and surcharges imposed by the union government *(INR crores)*

Items	FY13 Actual	FY14 Actual	FY15 Actual	FY16 Actual	FY17 Actual	FY18 RE	FY19 BE
Corporation Tax							
Surcharge	6,640	13,007	14,302	17,754	20,110	55,401	63,711
Education Cess	10,161	11,167	12,212	12,704	13,999	16,420	29,538
Taxes on Income							
Surcharge	177	739	1,343	1,565	2,299	9,348	36,895
Education Cess	5,651	6,890	7,581	8,445	10,266	9,663	19,923
Krishi Kalyan Cess	0	0	0	0	711	2,000	0
Customs							
Addl. Duty of Customs on M. Spirit	26	20	18	0	0	0	0
Addl. Duty of Custom on HSD Oil	46	29	0	2	0	8	0
SAD of Customs on M. Spirit	78	60	53	0	0	0	0
Education Cess	2,624	2,704	3,432	3,687	3,922	2,000	0
Sec. & Higher Education Cess	1,348	1,443	1,603	1,779	1,880	1,000	0
Social Welfare Surcharge	0	0	0	0	0	1,300	8,000
Cesses on Exports	36	16	39	122	177	100	112
Union Excise Duties							
Addl. Duty of Excise on M. Spirit	3,819	4,120	5,978	17,301	18,828	22,000	...
Addl. Duty of Excise on HSD Oil	15,514	15,143	19,144	52,239	53,572	59,250	0
SAD of Excise on M. Spirit	11,578	13,178	15,090	18,171	18,780	32,000	36,000
Surcharge on Pan Masala and Tobacco Products	1,059	979	1,091	1,562	3,348	1,000	0
Education Cess	4,504	4,532	4,283	47	45	12	0
Sec. & Higher Education Cess	2,258	2,225	2,145	22	21	6	0
Cess on Crude Oil	0	0	14,655	14,311	12,618	14,000	14,850
Cess on Bidi	0	0	150	146	136	33	0
Cess on Sugar	0	0	565	1,008	2,882	779	0
Cess on Automobiles	0	0	370	386	409	96	0
Others	17,528	18,506	89	393	1,524	60	0
Clean Environment Cess	3,053	3,472	5,393	12,676	26,117	12,100	0
Infrastructure Cess	0	0	0	288	3,918	905	0

Items	FY13 Actual	FY14 Actual	FY15 Actual	FY16 Actual	FY17 Actual	FY18 RE	FY19 BE
Duty of Excise on M. Spirit and HSD Oil (Road & Infrastructure Cess)	0	0	0	0	...	4,350	1,13,000
Union Excise Duties							
Coal and Coke	556	565	597	611	640	400	0
Salt	3	3	4	4	1	0	0
Rubber	127	115	105	100	102	92	0
Mica	2	23	3	3	0	0	0
Iron Ore, Manganese & Chrome Ore	14	35	15	16	8	0	0
Lime Stone and Dolomite	13	65	14	31	11	0	0
Cine Workers	2	7	2	2	1	0	0
Prevention & Control of (Air & Water) Pollution (Net)	226	262	251	243	216	146	0
R&D	686	738	654	915	1,187	450	0
Beedi Fund	160	158	156	146	0	12	0
Cess under other Accounts	4	4	6	10	3	0	0
Textiles & Textile Machinery	1	1	1	1	2	0	0
Service Tax							
Education Cess	2,939	2,936	3,170	917	75	25	0
Sec. & Higher Education Cess	1,086	1,383	1,550	421	40	13	0
Swachh Bharat Cess	0	0	0	3,926	12,475	4,100	0
Krishi Kalyan Cess	0	0	0	0	7,669	2,700	0
Goods and Services Tax (GST)							
GST Compensation Cess	0	0	0	0	0	61,331	90,000
All Cesses	**72,387**	**76,562**	**84,188**	**1,32,901**	**1,73,453**	**1,52,719**	**1,77,424**
All Surcharges	**19,531**	**27,963**	**31,879**	**39,053**	**44,537**	**99,049**	**1,44,606**
Total Cesses + Surcharges	**91,918**	**1,04,526**	**1,16,067**	**1,71,954**	**2,17,990**	**2,51,768**	**3,22,029**
Growth Rate	**3%**	**14%**	**11%**	**48%**	**27%**	**15%**	**28%**

RE: Revised Estimates BE: Budget Estimates

Global
News

Developments in digital economy

01

OECD and EU developments

Previously on 16 March 2018, the OECD had released Tax Challenges Arising from Digitalization - Interim Report 2018 (the Interim Report)[1] in connection with Action 1 of its Action Plan on Base Erosion and Profit Shifting (BEPS). The interim report sets out the BEPS Inclusive Framework's (IF) agreed direction of work on digitalization and the international tax rules through 2020. The Interim Report provides an in-depth analysis of the main features commonly found in certain highly-digitalized business models and value creation in the digitalized age.

Although an update on the OECD's work will be provided in 2019 and the BEPS IF working towards a consensus-based solution by 2020, various countries are already taking national action with respect to the tax treatment of activity in the digital economy.

Close to heels, the European Commission (the Commission) had issued two proposals (Proposals) on 21 March 2018[2] for new Directives to provide methods to tax digitalized forms of business activity. The Commission's proposals focus on a two-phased approach:

- An interim solution, referred to as the Digital Services Tax (The DST or DST proposal)
- A longer term Council Directive setting forth rules relating to the corporate taxation of a significant digital presence (SDP or the Significant Digital Presence proposal)

Both solutions will be delivered by new directives. The above solutions were recently discussed on 7- 8 September 2018[3] at the informal meeting of the Economic and Financial Affairs Council (ECOFIN or the Council), finance and economic affairs Ministers of the European Union (EU) Member States. At the meeting, the Council supported the implementation of the short-term solution of the DST as soon as possible. According to the announcement of the Austrian Minister of Finance Hartwig Löger, the prospect of reaching agreement by the end of this year is realistic.

The Ministers also agreed that there is a need to prepare further measures against no-tax and low-tax systems and to develop in the OECD, an EU position with regard to this taxing digitalized activity that is as united as possible.

1. *Refer EY Alert titled "OECD releases interim report on the tax challenges arising from digitalization"*
2. *Refer EY Global Tax Alert dated 21 March 2018 titled "European Commission issues proposals for taxation of digitalized activity"*
3. *Refer EY Alert titled "ECOFIN discusses the Commission's proposals for taxation of digitalized activity"*

02

Recent country developments

On 2 October 2018[4] the Australian Treasury released a discussion paper on a fairer and more sustainable tax system for the digital economy in Australia, as announced in the 2018 Federal Budget. The discussion paper does not provide any recommendations on taxation of digital activities. The paper includes a detailed discussion on long-term solutions and interim solutions including the European Union (as aforesaid) and global consideration of a turnover tax on digital activities.

Treasury is seeking feedback by 30 November 2018 in relation to 13 discussion questions on areas including:

- User-created value and value associated with intangibles
- Changes to existing profit attribution rules
- Changes to existing nexus rules
- Options for broader reform
- Design considerations for interim options

4. *Refer EY Alert titled "Australian Treasury releases discussion paper on taxation of digital economy"*

03

Russia's Supreme Court holds service payments to foreign contract partners constitute "passive income" subject to withholding tax in Russia[5]

A Russian company made payments to a Canadian company under a service and work contracts. The Russian company refrained from withholding tax when making the transfers, as in its view the payments in question constituted income from "active operations" in accordance with Russian tax law.

The tax authority adopted a view that payments to the Canadian company were effectively made on a non-reciprocal basis and were not connected with any actual business operations (devoid of economic substance). It constituted passive income that was taxable at source in Russia. As a result, the Russian company was charged with withholding tax and corresponding penalties. As against this, the Russian company argued that the payment was not on a non-reciprocal basis, since it was clear that the Canadian company was under obligation to provide services to Russian company. Further the taxes should be recovered from the Canadian company and not from tax agent in Russia.

On 7 September 2018, the Russian Supreme Court issued a ruling supporting the conclusions of the tax authority that payments made to foreign companies under a service contract should be classified as passive income and thereby subject to withholding tax in Russia, on the basis of the following:

- The tax authorities proved that there was no genuine business relationship between the Russian company and the Canadian company and that the Russian company had artificially created documentation relating to the performance of contracts that had no reasonable business purpose with a view to obtaining an unjustified tax benefit
- Since the payments to the Canadian company were not connected with any actual business activity carried on by that company, what effectively took place was the distribution of a part of the Russian company's assets (capital) to the foreign company on a non-reciprocal basis. The income in question must be classified as passive income, and specifically as "other income" under Article 21 of the Russia-Canada tax treaty, meaning that it is subject to withholding tax in Russia

This case is the latest in a series of disputes over the reclassification of payments by Russian entities to foreign contract partners as concealed distributions of passive income through the application of the unjustified tax benefit concept. The case demonstrates the thorough approach taken by the tax authorities with respect to the evidence-gathering process in such disputes.

5. *Refer EY Alert titled "Russia's Supreme Court holds service payments to foreign contract partners constitute passive income subject to withholding"*

Developments on virtual currency

04

Israeli Tax Authorities address issues regarding issuance of Utility Tokens, block-chain technologies and cryptocurrencies, including related tax benefits[6]

Recently, the Israeli Tax Authorities (ITA) published a Tax Circular explaining its position towards the tax implications of "digital tokens" issued for the provision of services or products under development (Utility Tokens) as part of Initial Coin Offerings (ICOs)/Token Generation Events (TGEs), including the tax aspects associated with such services or products (the Tax Circular). A previous Tax Circular presented the ITA's view that a virtual currency (such as Bitcoin, Ethereum, etc.) is an "asset" within its meaning in the Income Tax Ordinance, and therefore subject to capital gain tax rules upon disposal (unless the activity generating such income constitutes a business, which case the income is treated as a business income, with the relevant income tax and value added tax (VAT) implications).

Under the Tax Circular, the ITA generally determines the revenue recognition method for funds received as part of such an ICO and allow the deferral of such recognition, according to the relevant and applicable accounting rules, up until the occurrence of particular events, for example, the actual provision of the services or products developed.

The Tax Circular also establishes the tax treatment for Utility Tokens issued to employees, directors and service providers as part of an ICO; the VAT implications that apply, with the distinction between Israeli and foreign residents; and applies the same rules to back to back structures, in which a wholly-owned subsidiary company issues the Utility Tokens and transfers the funds received and their corresponding liabilities (to provide the services/products) to that Israeli parent company.

Most importantly, the Tax Circular allows for companies that carry out such ICOs to potentially enjoy the tax incentives available for qualifying companies, including those provided under the Base Erosion and Profit Shifting (BEPS)-compatible new Israeli Innovation Box regime, which offers a corporate income tax (CIT) rate of 12% for qualifying companies with global consolidated revenue below ILS10b (approx. US$2.5b), or of 7.5% if located in Jerusalem or in certain northern or southern parts of Israel; or a CIT rate of 6% for qualifying companies with global consolidated revenue below ILS10b(approx. US$2.5b).

The regulated tax regime, as outlined in the Tax Circular, demonstrates Israel's invigorative approach towards block chain technologies and cryptocurrencies. Together with the Israeli research and development (R&D) environment and the new Innovation Box regime, this Tax Circular positions Israel as a principal location for multinationals that are seeking for new opportunities in the virtual era.

6. *Refer EY Global alert titled "Israeli Tax Authorities address issues regarding issuance of Utility Tokens, blockchain technologies and cryptocurrencies, including related tax benefits" dated 14th September 2018*

05

Luxembourg releases circular on the tax treatment of virtual currencies[7]

On 26 July 2018, the Luxembourg Tax Authorities issued an administrative circular (the Circular) providing guidance on the characterization of virtual currencies and tax treatment of income derived from related trading or mining activities by Luxembourg taxpayers. Certain key points from the Circular are as under:

- Virtual currencies are intangible assets for income, municipal and net worth tax purposes and thereby, possibility of filing tax returns or preparing annual accounts in virtual currency is ruled out. Further, income, gains, expenses, fees, etc. shall be converted into euros basis the exchange rates published by the European Central Bank. Whether or not payments are made in virtual currency does not have an impact on the nature of the income.
- Income from mining of virtual currencies is to be treated as income from trading or mining activities and is taxable only if it falls under business income or other income basis the provisions of Luxembourg income tax law, irrespective of being realized in a real or virtual world. While it is stated that the conditions for business income are typically met in the case of mining of virtual currency or operating online exchanges or ATMs for virtual currency, on a case to case basis, it is to be analyzed whether the activity constitutes a business activity or management of private wealth. Operating costs such as electricity charges linked to the mining of a virtual currency or the conversion fees of exchange platforms are only deductible if they are related to the business
- Where the activity does not constitute business activity, income from virtual currency could be taxable as other income under the tax law
- A sale of the virtual currency for simultaneous acquisition of another currency, goods or services would be the "exchange" for tax purposes. Exchange or purchase of goods or services within six months after the purchase of virtual currency leads to "speculation profits or losses" and are not taxable if speculation profit is below 500 euros in a taxable year
- Consistent and continuous documentation to be maintained by the taxpayers on date of acquisition or creation of virtual currency and related costs and the burden of proof of the same lies upon the taxpayer. However, if identification of exchanged currency is difficult or impossible, the same is to be determined as per the average weighted price method only

7. *Refer EY Global alert titled "Luxembourg releases circular on the tax treatment of virtual currencies" dated 02nd August 2018*

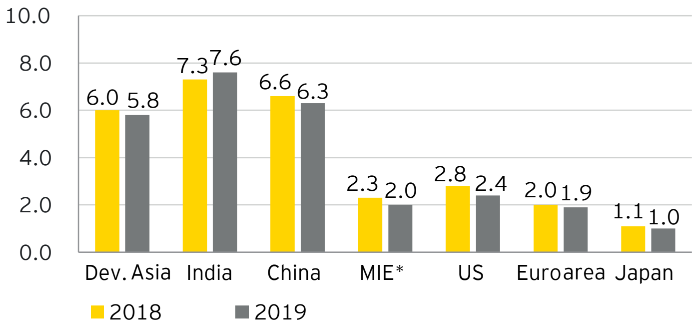
EconoMeter

macro-fiscal trends

1 ADB retained its growth forecast for Asia at 6% in 2018

- According to the ADB [Asian Development Outlook Supplement, September 2018], growth in developing Asia is projected at 6.0% for 2018. Growth forecast for 2019 has been trimmed down to 5.8%
- India's growth prospects remain strong and unchanged at 7.3% in 2018 and 7.6% in 2019 driven by robust domestic demand and growth in exports particularly manufactures
- Growth forecast in China remained unchanged at 6.6% in 2018 but is revised down to 6.3% in 2019 due to slower demand growth and implementation of US tariffs and China's countermeasures

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



Source: Asian Development Outlook Supplement, September 2018.
*Major industrial economies.

2 Real GDP growth accelerated to 8.2% in 1QFY19

- Real GDP grew at a strong pace of 8.2% in 1QFY19, the fastest rate since 1QFY17. After having fallen to a low of 5.6% in 1QFY18 from 8.1% in 1QFY17, growth gradually picked up in each subsequent quarter thereby showing a V-shaped recovery
- GDP growth in 1QFY19 was supported by growth in private final consumption expenditure (PFCE) and exports
- Growth in PFCE accelerated to 8.6% in 1QFY19 from 6.7% in 4QFY18. PFCE growth in 1QFY19 was the highest in the last six quarters
- Although contribution from net exports continued to remain negative at (-) 0.4% points in 1QFY19, it was significantly lower than (-) 1.5% points that it was in 4QFY18
- Growth in both GFCE and GFCF slowed to 7.6% and 10%, respectively in 1QFY19 as compared to 16.8% and 14.4% in 4QFY18

Table 1: Real GDP growth (%)

AD component	2Q - FY17	3Q - FY17	4Q - FY17	1Q - FY18	2Q - FY18	3Q - FY18	4Q - FY18	1Q - FY19
PFCE	7.5	9.3	3.4	6.9	6.8	5.9	6.7	8.6
GCE	8.2	12.3	23.6	17.6	3.8	6.8	16.8	7.6
GFCF	10.5	8.7	4.2	0.8	6.1	9.1	14.4	10.0
EXP	2.4	6.7	6.6	5.9	6.8	6.2	3.6	12.7
IMP	-0.4	10.1	6.6	18.5	10.0	10.5	10.9	12.5
GDP	7.6	6.8	6.1	5.6	6.3	7.0	7.7	8.2

Source: CSO, MOSPI, Government of India.

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

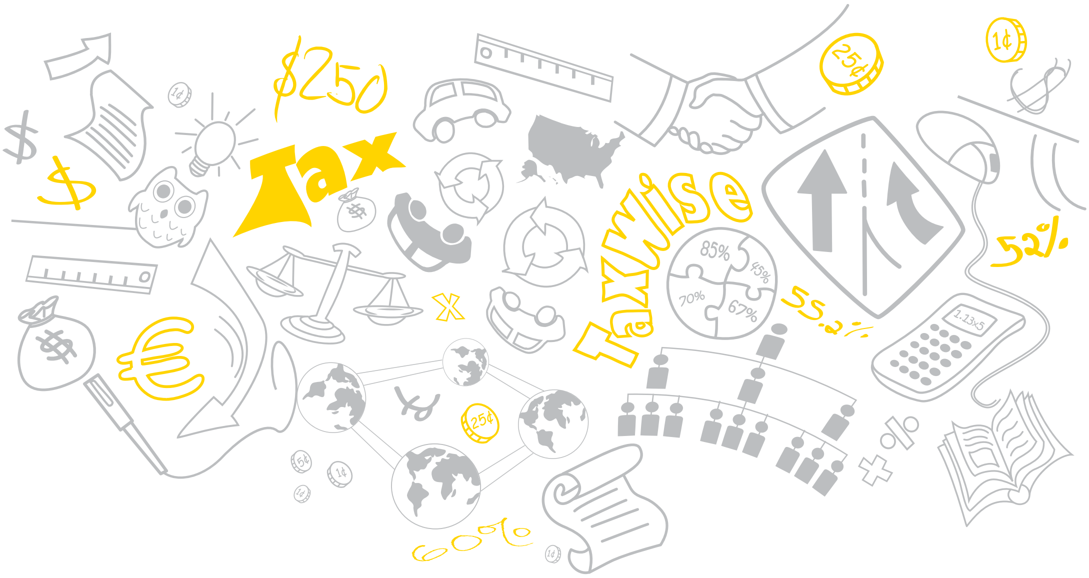
3 *Sustained growth in real GVA was driven by growth in manufacturing, financial and real estate services*

- On the output side, gross value added (GVA) growth increased to 8.0% in 1QFY19 from 7.6% in 4QFY18. Growth momentum gained further traction led by higher growth in manufacturing, financial and real estate services
- Growth in the manufacturing sector accelerated to a nine-quarter high of 13.5% in 1QFY19 while that in the financial and real estate services rose to 6.5% in 1QFY19
- Though the construction sector grew at a strong pace of 8.7% in 1QFY19, it was lower as compared to the growth of 11.5% in 4QFY18. Similarly, growth in public administration and defense was also lower at 9.9% in 1QFY19 as compared to 13.3% in 4QFY18
- Growth in agricultural and allied sectors strengthened further to 5.3% in 1QFY19 from 4.5% in 4QFY18. Higher agricultural output is expected to support rural demand in the months ahead

Table 2: Sectorial real GVA growth (%)

Sector	2Q - FY17	3Q - FY17	4Q - FY17	1Q - FY18	2Q - FY18	3Q - FY18	4Q - FY18	1Q-FY19
Agr.	5.5	7.5	7.1	3.0	2.6	3.1	4.5	5.3
Ming.	9.1	12.1	18.8	1.7	6.9	1.4	2.7	0.1
Mfg.	7.7	8.1	6.1	-1.8	7.1	8.5	9.1	13.5
Elec.	7.1	9.5	8.1	7.1	7.7	6.1	7.7	7.3
Cons.	3.8	2.8	-3.9	1.8	3.1	6.6	11.5	8.7
Trans.	7.2	7.5	5.5	8.4	8.5	8.5	6.8	6.7
Fin.	8.3	2.8	1.0	8.4	6.1	6.9	5.0	6.5
Publ.	8.0	10.6	16.4	13.5	6.1	7.7	13.3	9.9
GVA	7.2	6.9	6.0	5.6	6.1	6.6	7.6	8.0

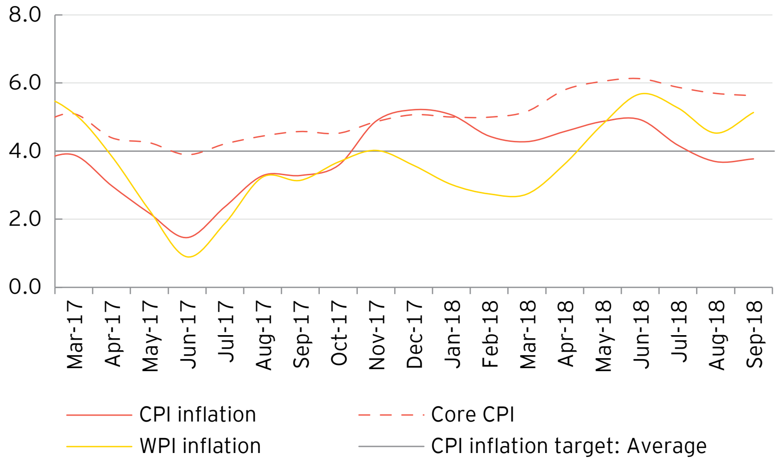
Source (Basic Data): MOSPI., GVA: Gross value added.



4 The Reserve Bank of India (RBI) retained the repo rate at 6.5% in its October 2018 Monetary Policy Review, contrary to market expectations

- Consumer Price Index (CPI) inflation rose marginally to 3.8% (y-o-y) in September 2018 from 3.7% in August 2018 driven by declining pace of contraction in vegetable price
- Core CPI inflation[1] eased further to a five-month low of 5.6% in September from 5.7% in August 2018
- The RBI expects CPI inflation to range between 3.9%-4.5% in 2HFY19 and 4.8% in 1QFY20
- As per the October Monetary Policy Review by the RBI, outlook for headline CPI inflation is likely to be influenced by benign food prices, surge in the price of Indian crude basket, depreciation of the rupee and the dissipating effect of the increased house rent allowance for central government employees

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

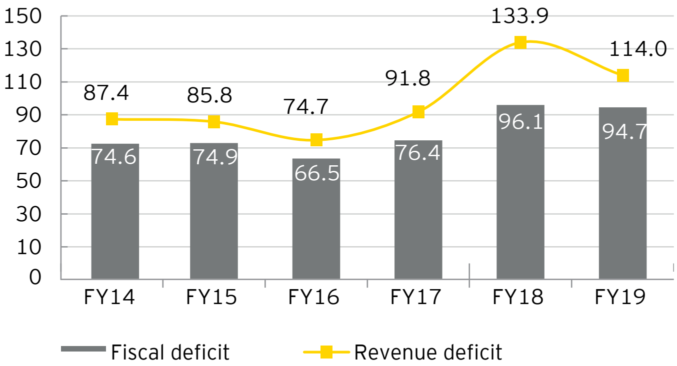


Source: MOSPI.
Note: CPI stands for Consumer Price Index

5 Center's fiscal deficit during April-August FY19 was 94.7% of its FY19 annual budgeted target

- The center's fiscal deficit during April-August FY19 stood at 94.7% of the FY19 annual budgeted target as compared to 96.1% in the corresponding period of FY18
- Although the finance minister, in a press statement on 14 September 2018, reiterated the government's adherence to the fiscal deficit target of 3.3% of GDP for FY19[2], higher than budgeted global crude prices may lead to short-term fiscal pressures
- The center's revenue deficit during April-August FY19 was at 114% of the FY19 annual budgeted target, lower than 133.9% in the corresponding period of FY18

Chart 3: Fiscal and revenue deficit during April–August FY19 as a % of annual budgeted target



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

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

2 https://www.bloombergquint.com/business/2018/09/14/finance-minister-arun-jaitley-announces-5-measures-to-control-indias-current-account-deficit#gs.dD0hRAA

6 *Growth in tax revenues slowed to 8.7% during April–August FY19*

- Gross central taxes grew by 8.7% during April-August FY19, lower than 20.0% during April-August FY18
- Growth in direct tax revenues improved to 16.1% during April-August FY19 as compared to 14.2% in the corresponding period of FY18 due to buoyant growth in income taxes and a pick-up in the growth of corporate income taxes
- Growth in indirect taxes (comprising union excise duties, service tax, customs duty, Central Goods and Service Tax (CGST), Union Territory Goods and Service Tax (UTGST), Integrated Goods and Services Tax (IGST)* and GST compensation cess) dropped to 4.6% during April-August FY19 as compared to 23.6% in the corresponding period of FY18
- Center's non-tax revenues grew by 42% during April-August FY19 as compared to a contraction of (-) 34.1% in the corresponding period of FY18

IGST revenues are subject to final settlement

Table 3: Gross tax and non-tax revenue (growth rates, %)

	Y-o-Y							
Tax/Non-tax revenue	4Q - FY17	1Q - FY18	2Q - FY18	3Q - FY18	4Q - FY18	1Q - FY19	Apr–Aug FY18	Apr- Aug FY19
Gross tax revenue	17.1	15.2	23.0	13.4	0.8	22.1	20.0	8.7
Direct taxes*	15.6	16.6	11.7	22.6	21.7	6.2	14.2	16.1
Indirect taxes**	15.1	13.4	30.3	8.1	-17.1	36.3	23.6	4.6
Non-tax revenue	32.6	-6.5	-38.2	-48.7	-13.9	39.3	-34.1	42.0

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

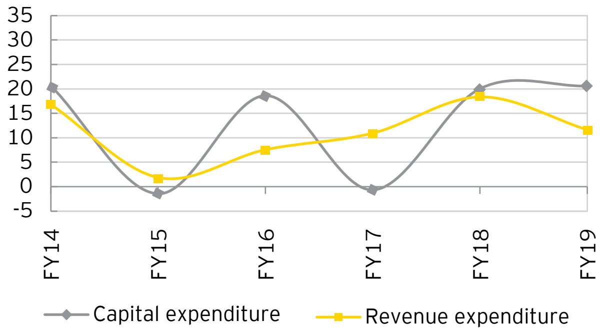
*Personal income tax and corporation tax

**Union excise duties, service tax, customs duty, and CGST, UTGST, IGST and GST compensation cess from July 2017 onward

7 *Center's total expenditure grew by 3.0% up to May 2018*

- Center's total expenditure during April-August FY19 grew by 12.7% as compared to 18.6% in the same period in FY18
- Growth in revenue expenditure was at 11.6% during April-August FY19, lower as compared to 18.4% in the corresponding period of FY18
- Center's capital expenditure grew by 20.6% during April-August FY19, marginally higher than 20.1% in the corresponding period of FY18

Chart 4: Growth in revenue expenditure during April–August FY19 (%, y-o-y)



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

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- **Faster response time to business needs**
- **More agile and scalable approach**
- **Improved tax efficiency - identifying opportunities and raising red flags**
- **Increased management time to focus on core competencies and strategic areas**

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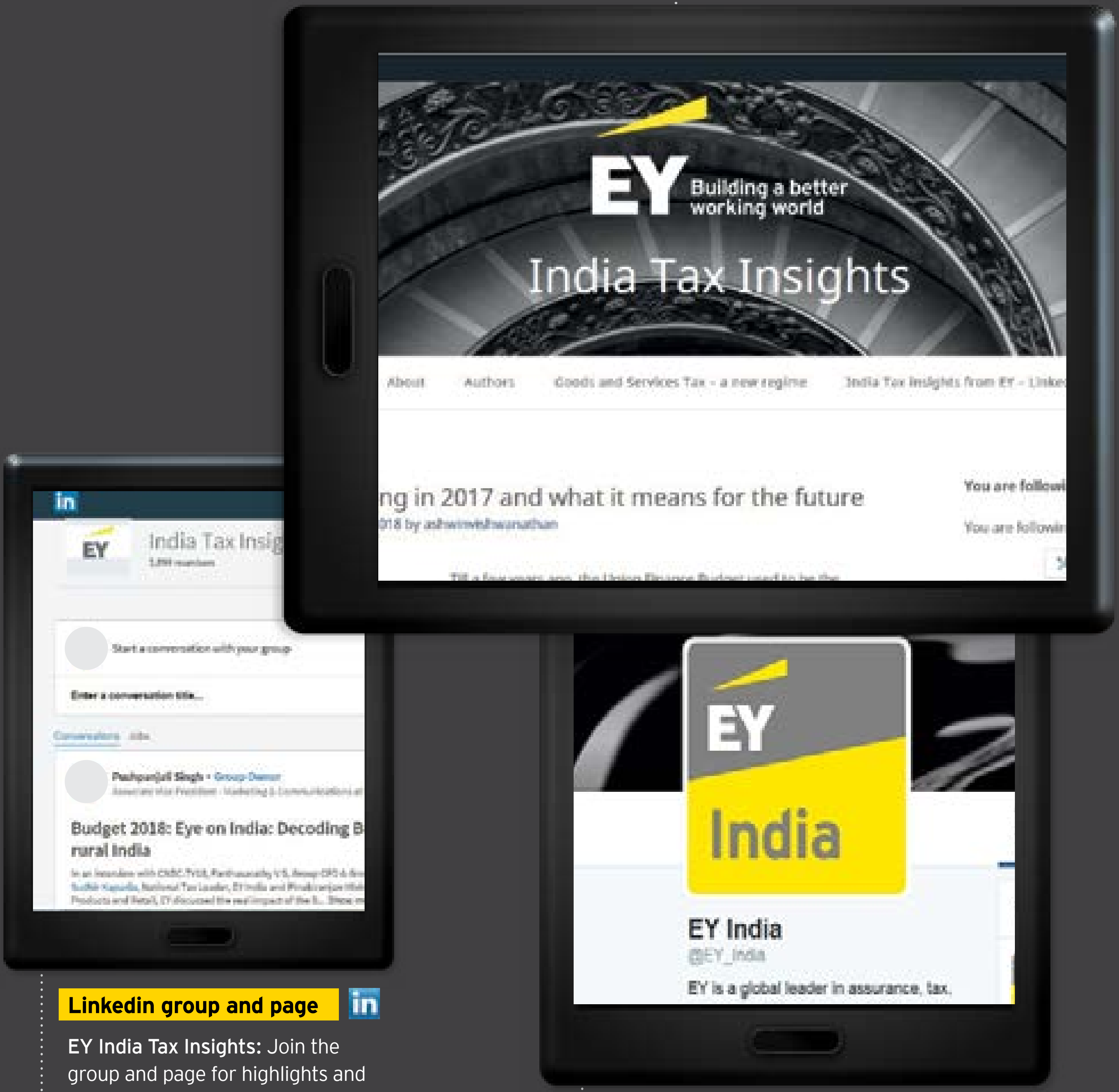

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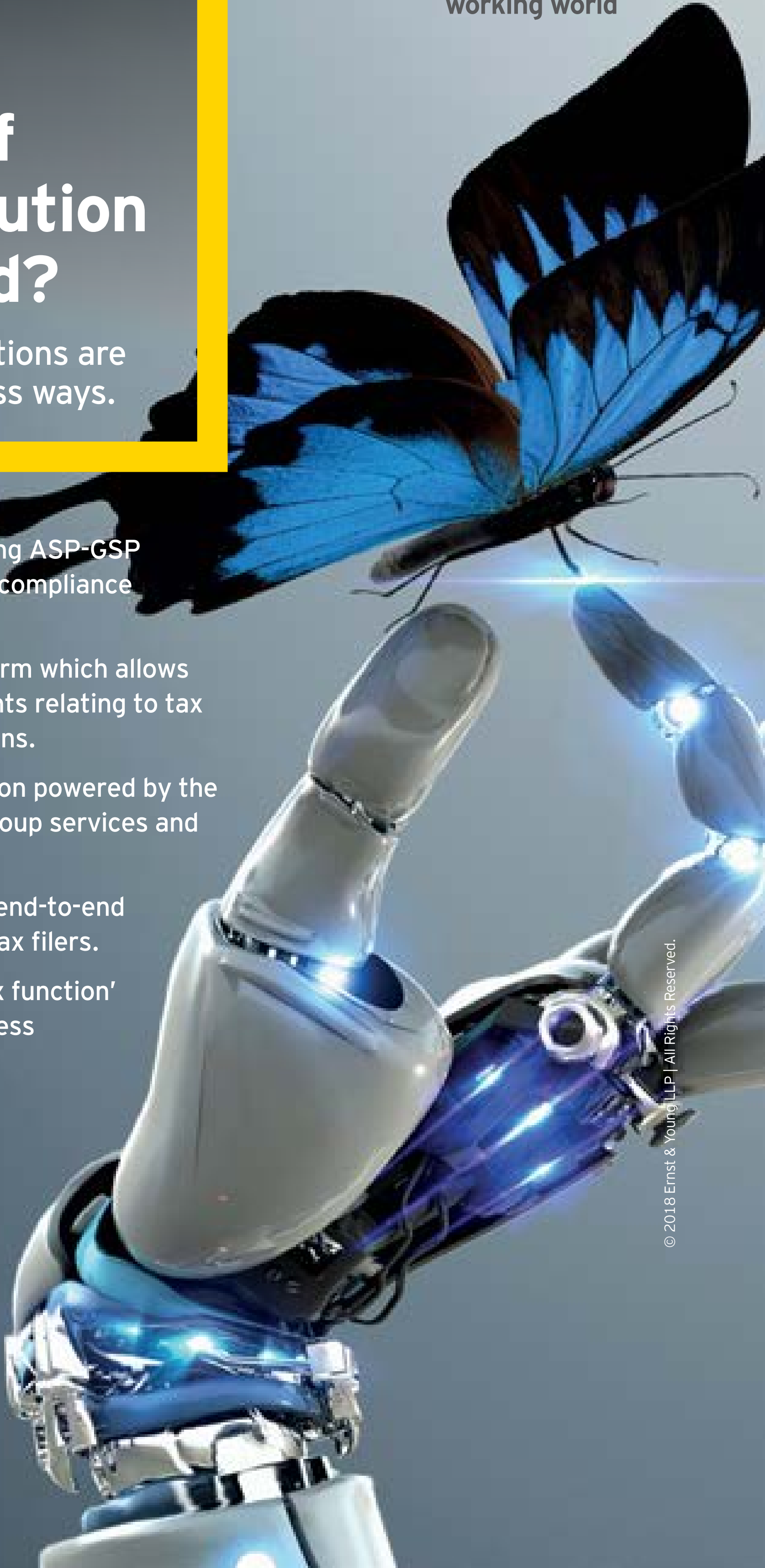

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