Changes to the Indian tax regime

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With the focus of the international tax arena on the latest trends in the Indian tax regime and following the judgment in the Vodafone case, India is at the threshold of bringing in a far-reaching change, with the Direct Taxes Code (DTC)[1] and the Goods and Services Tax[2].

Recent legislative changes

The Finance Act 2011 (the Act) has not made any significant change to the corporate tax rate[3] apart from a reduction in the surcharge from 2.5% to 2% for foreign companies, and 7.5% to 5% for Indian companies. The rate of dividend distribution tax (DDT) on dividends distributed by domestic companies to its shareholders remains constant at 15%. In order to incentivise repatriation of offshore funds to India, the Act has reduced the tax on in-bound dividends received by Indian companies from their foreign subsidiaries from 30% to 15%.

There is a marginal increase in Minimum Alternative Tax (MAT) from 18% to 18.5%. The key benefits available to Special Economic Zones (SEZ) units and developers was exemption from MAT in respect of their income; this exemption has been curtailed for both SEZ units and developers, who are now liable to pay MAT at the rate of 18.5%. Further, developers of SEZ exempted from the DDT are now required to pay DDT at the rate of 15% on the profits distributed as dividends.

MAT is now imposed on limited liability partnerships computed at 18.5% of adjusted total income and deemed to be the income tax liability where the regular income tax payable for a particular financial year is less than the corresponding MAT.

To combat ineffective exchange of information, specific 'black money and toolbox provisions' have been introduced and are applicable in cases of transactions entered into with persons located in countries and jurisdictions which do not effectively exchange information with India, known as 'notified jurisdictional area' (NJA). Besides the restriction provisions relating to disallowance of deductions, the transfer pricing regulations have also been extended and would be applicable to transactions entered into by an Indian taxpayer with a person located in the NJA, and any income earned by residents of NJA from an Indian source may be subject to a withholding tax of 30%.

Judicial trends

India has been a forerunner in tax jurisprudence, with tax litigation affecting cross-border transactions and taxation of foreign companies rapidly increasing. The Indian revenue authorities have taken aggressive positions in relation to numerous cross-border transactions.

Presently, the most talked about Indian tax case in the world is that of Vodafone, which involves the taxability of capitals gains on the sale of shares of an offshore holding company, and raises uncertainties with respect to taxation of cross-border mergers and acquisitions between two foreign entities, involving direct or indirect subsidiaries or affiliates in India. The tax authorities have embarked on assessing tax on the transaction, based on the grounds that the transferred entity had enderlying Indian shares and assets. The High Court of Bombay upheld the Indian tax department's jurisdiction to proceed against Vodafone on its $11.1bn acquisition of Hutchison's Indian telecom operations in February 2007. The High Court upheld the long-stated position in India that the form of the transaction will have to be respected in the absence of a sham or a colourable device situated in India, on the grounds that the transferred entity had underlying Indian shares and assets. Currently, the appeal filed by Vodafone is ongoing before the Supreme Court of India, and hopefully the Supreme Court's verdict will put an end to the emerging trend of the tax authorities taxing the offshore shares, where there may be an underlying Indian asset.

The most recent controversy on entitlement to benefits available under the India-Mauritius tax treaty arose with the transfer of shares of the Indian company Idea Cellular Ltd (ICL) by a Mauritius entity (M Co) to Aditya Birla Nuvo Limited (ABNL), and the transfer of shares in the Mauritius entity by the US parent company (US Co) to Tata Industries Limited, in the case of *Aditya Birla Nuvo Limited v Dy DIT* before the High Court of Bombay. The issue was whether the said ICL shares were owned by M Co or by its US Co. The High Court held that US Co was carrying on business in India and according to the agreements, M Co was not conferred any beneficial ownership since it held the shares only as a 'permitted transferee'. The High Court noted that all the rights vested with the US parent, and that the US Co was designated a representative to exercise all the rights and to perform all the obligations, with a few exceptions. In light of the above, the High Court held that the income accruing or arising in India on transfer of a capital asset situated in India, ie sale of shares of ICL to ABNL, would be income deemed to accrue or arise in India to US Co and may be assessed in the hands of the US Co (or in the hands of ABNL as an agent of the US Co under the Income Tax Act).

The landmark decision in the case of Azadi Bachao Andolan[4] was inapplicable on the grounds that the transaction was a colourable transaction, and in such cases the tax authorities are permitted to determine to the real owner of the shares.

The controversy on the issue of whether the payer is required to withhold tax at source with respect to all remittance (whether chargeable to tax or not) was resolved by the Supreme Court judgment of GE India, holding that the withholding tax obligation would only fasten if the income is actually chargeable to tax, and not in respect of every payment to a non-resident. In determining whether the income is chargeable to tax, the provisions of the tax treaty would also need to be taken into consideration.

New DTC

With the assurance of the Finance Minister, the DTC is proposed to come into effect on 1 April 2012. The DTC will replace the existing income tax and wealth tax law in India. The DTC may have an impact on cross-border transactions with India, especially in the light of the key new provisions dealing with anti-avoidance measures. The proposed general anti-avoidance rules (GAAR), are based on the economic substance doctrine which is against the long-settled Indian jurisprudence that respects the form of a transaction. Wide discretionary powers are given to the Indian revenue authorities to disregard specific legal entities or individual steps in a series of transactions to re-characterise, re-allocate income between parties and re-characterise legal instruments used in transactions. The concept of controlled foreign corporation (CFC) is also introduced, whereby the passive income earned by a foreign non-resident company, falling within the definition of a CFC in connection with an Indian resident tax payer, would be taxable in India. Under the new regime, the criteria for determining the corporate residency would change from 'control and management of the affairs of the company situated in India' to the 'place of effective management' where a foreign company is situated, and a foreign company even partly in India at any time during the year may be considered as a resident of India.

In addition to corporate tax, foreign companies will be liable for branch profits tax at the rate of 15%.

With the widening of the scope of income for a non-resident, the DTC seeks to tax offshore transaction resulting in an indirect transfer of a capital asset situated in India, wherein at any time in the 12 months preceding the transfer, the fair market value of the assets in India owned, directly or indirectly, by the company, represent less than 50% of the fair market value of all assets owned by the company. However, it will be interesting to see the final form in which the DTC arrives.

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Notes

1) The DTC is likely to come into effect by 1 April, 2012.

2) The Goods and Service Tax is likely to come into effect by 1 April, 2012.

3) The corporate tax rate for resident companies is 30% and foreign companies is 40%.

4) In Azadi Bachao it was held that a tax residency certificate granted by the Mauritius government was sufficient to prove residence in Mauritius and real ownership.

India – Leading tax law firms

• New Delhi

AZB & Partners provides the full spectrum of tax advice to domestic and international corporates, either as part of a wider corporate service or on a standalone basis. The firm's prominent reputation for M&A means that the tax team regularly provides tax structuring advice, such as its recent work for Bharti Airtel on the Zain Africa acquisition. Ajay Bahl and Percy Billimoria are recommended.

LakshmiKumaran & Sridharan fields '*one of the standout tax practices*', and

	2004	2005	2006	2007	2008	2009
Collected tax revenues	17.11	17.57	12.01	12.45	11.03	10.22
Collected indirect tax revenues	11.72	11.98	6.13	5.85	4.91	4.03
Collected corporate taxes	2.87	3.09	3.66	4.05	3.89	3.99

Figures are given as percentage of GDP

	2006	2007	2008	2009	2010	2011
Tax evasion does not damage public finances*	–	3.05	3.39	2.81	2.66	2.71
Real corporate taxes do not discourage entrepreneurial activity*	5.93	5.53	6.36	5.71	6.05	6.93
Corporate tax rate on profit (maximum, calculated on profit before tax)**	33.66	33.99	33.99	33.99	33.99	33.22
Consumption tax rate (standard rate of VAT/GST)***	4.00	4.00	12.50	12.50	12.50	–

**IMD WCY Executive Opinion Survey based on an index from 0 to 10 (0 hampers business activity; 10 does not hamper business activity) **IMD World Competitiveness Online ***Source: OECD, national sources*

handles the full array of contentious and non-contentious matters, although it is best known for its knowledge of indirect taxation. Recent work includes advising domestic and international clients on customs-related issues including customs tariff classifications. The *'very experienced'* V Lakshmi Kumaran is recommended.

Vaish Associates' four-partner direct tax team has an excellent reputation in the market and represents both domestic and international corporates. It is best known for its litigation work, and has handled a number of significant transfer-pricing cases. Managing partner Ajay Vohra heads the practice.

Amarchand & Mangaldas & Suresh A. Shroff & Co provides advisory and contentious tax support for its blue-chip roster of corporate clients. The firm provides crucial tax structuring advice on major corporate transactions, and is praised for its *'ability to provide a true one-stop-shop service'*. Team head Aseem Chawla recently advised FedEx on the tax structuring associated with its $100m acquisition of two Indian courier companies.

FoxMandal Little regularly provides tax advice on significant M&A transactions. In addition, the firm is often instructed on a standalone basis across issues as diverse as sales tax, international tax planning and income tax matters.

India: New Delhi – Leading tax law firms

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AZB & Partners	1
LakshmiKumaran & Sridharan	
Vaish Associates	
Amarchand & Mangaldas & Suresh A. Shroff & Co	2
FoxMandal Little	
Khaitan & Co.	
Kochhar & Co	
Luthra & Luthra	
Seth Dua & Associates	
DSK Legal	3
IndusLaw	
LexCounsel	
Titus & Co	
Associated Law Advisers	
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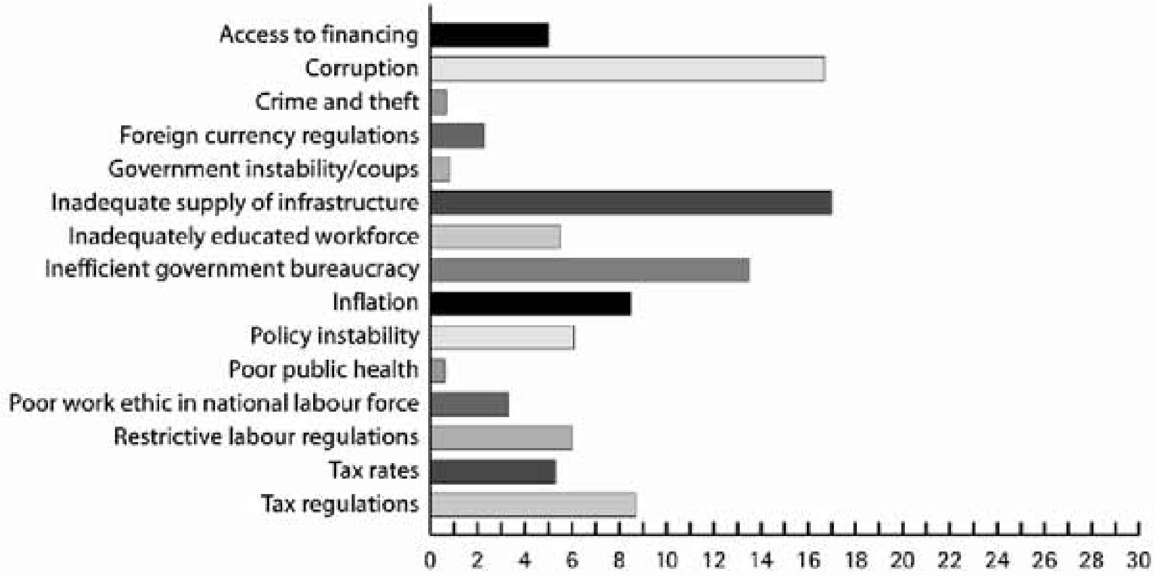
Singhania & Partners	
Sunil Kansal & Associates	
Trilegal	

Firms are listed A-Z within tiers

Manish Mishra heads **Khaitan & Co.**'s New Delhi office, which advises a number of clients on indirect taxation issues, including transactional and advisory matters and disputes. Mishra recently represented Jindal Power before the Director General of Foreign Trade and persuaded the body to allow the

The most problematic factors for doing business



client to transfer capital goods to a group company without incurring additional customs duty liability.

Sanjay Kochhar heads **Kochhar & Co**'s busy four-partner team which handles an impressive volume and range of mandates including litigation, transfer pricing, structuring and compliance advice. Kochhar recently prepared a transfer-pricing report regarding cross-border transactions between Nihon Denkei India and associated enterprises based outside the country. Shahid Khan and Vijay Ravi are other key members of the team, which also acts for clients such as Landmark Holdings and Maclellan.

As a corporate and M&A heavyweight, it is perhaps not surprising that a significant amount of **Luthra & Luthra**'s tax work lies in tax structuring as exemplified by its recent work on Abbott Laboratories' $6.2bn acquisition of Solvay Pharma India. However, the team also recently successfully handled several pending income tax litigations for Jubilant Food Works. Other clients include Arcelor Mittal, Rolls Royce Group, Kingfisher Airlines and Moser Baer. Vikas Srivastava and Sanjeev Sachdeva are recommended, respectively for their direct and indirect tax expertise.

Praised for its '*understanding of the different cultural norms of Western business practices*', **Seth Dua & Associates** is particularly accomplished at representing international clients including SAB Miller, Verizon, Fiserv and Deutsche Telekom. Lauded for its '*killer instinct*' on contentious matters, the firm is representing Foster's Group in high-profile withholding tax litigation relating to SAB Miller's recent acquisition of the company. Atul Duah as '*excellent knowledge of Indian tax law*', and has previously worked at both KPMG and Coopers & Lybrand (now PwC).

Although the bulk of the firm's tax work is handled out of Mumbai, **DSK Legal**'s New Delhi office has some exposure to transactional structuring tax work.

IndusLaw advises clients on contentious and non-contentious tax matters, and recently successfully represented Max India before the Customs, Excise and Service Tax Appellant Tribunal regarding the classification of certain classes of services. Tapas Misra heads the team.

LexCounsel advises clients on contentious and non-contentious aspects of issues relating to double taxation, customs law and VAT. The firm also provides niche expertise to charities, trusts and non-profit organisations across a range of issues including tax exemptions.

Diljeet Titus heads **Titus & Co**'s '*business-sensitive and pragmatic*' tax team, whose clients include Hirotec America, Raytheon and ARB.

• Mumbai

Nishith Desai Associates advises clients such as Chartis Insurance UK, Vodafone, Standard Chartered and Marriott International on high-end tax matters. It also recently advised two international banks on developing cross-border structured financial products, and acted for a leading US-based private equityfund in global restructuring. This is a '*top-notch*' team in which the key figures are Bijal Ajinkya and founding partner Nishith Desai.

Economic Laws Practice's '*excellent*' tax team is led by managing partner Rohan Shah. Its clients include Diageo, Zee Entertainment Enterprises, J V Gokal and Tata Communcations, as well as new clients such as the International Association of Drilling Contractors. Vikram Nankani and Rohit Jain are recommended.

ALMT Legal recently advised an Indian company on service tax and excise issues relating to the transformation of high-tension-electricity into low-tension electricity. It also acted for the Indian subsidiary of a Swiss multinational on numerous excise issues. Aliff Fazelbhoy and Statira Ranina are recommended.

DM Harish & Co advises both domestic and international companies as well as individuals on tax matters.

Khaitan & Co. advised the promoters of Andhra Pradesh Paper Mills on structuring the tax-efficient sale of their

India: Mumbai – Leading tax law firms

Nishith Desai Associates ●	1
Economic Laws Practice ●	2
ALMT Legal DM Harish & Co Khaitan & Co.	3
A.R.A. LAW Amarchand & Mangaldas & Suresh A. Shroff & Co Crawford Bayley & Co DSK Legal Gagrats JBSS & Co Kanga & Company, Advocates and Solicitors LakshmiKumaran & Sridharan Majmudar & Co	

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● indicates that firms are listed in the directory section

53.5% stake in the company to US-based buyer, International Paper Company. The team also advised Philips Carbon Black on setting up a joint venture in Vietnam. Daksha Baxi, Sanjay Sanghvi and Nihal Kothari are recommended.

A.R.A. LAW is praised for its funds-structuring practice as well as its transfer-pricing expertise.

Amarchand & Mangaldas & Suresh A. Shroff & Co advises corporate clients on a variety of tax-related matters.

Crawford Bayley & Co has a strong practice in indirect tax.

DSK Legal has substantial experience contesting tax investigations for a variety of clients.