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Demystifying Complexities

Base Erosion & Profit Shifting (BEPS) Action Plan – Measures taken by India

February 2017

BEPS Action Plan – Measures taken by India

Background

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In the wake of globalization, tax jurisdictions across the globe have an important concern to take care of, namely avoidance of tax leakages. With the intention of putting to an end the practice of taking unintended advantage of regulatory gaps and favorable tax treaties to lower effective tax rate by some taxpayers, the Organization for Economic Co-operation and Development (OECD) along with the G20 framed the Base Erosion & Profit Shifting (BEPS) Project around 3 years back.

OECD released the final report in 2015, as an initiative towards surpassing the outdated international tax standards.

The specific areas identified by the OECD have been addressed by way of a 15-point Action Plan, with each action explaining the particular concern and OECD's recommendation on how each country can identify and tackle the said concern.

Following Slides explain the 15 Action Plans as per OECD Report

Action Plans as per OECD Report

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1	Address the tax challenges of the digital economy
2	Neutralize the effects of hybrid mismatch arrangements (i.e. situations of differential tax treatment of a financial instrument/entity in 2 or more tax jurisdictions)
3	Empowerment of Controlled Foreign Company (CFC) rules
4	Limit base erosion via interest deductions and other financial payments
5	Counter harmful tax practices more effectively considering transparency and substance
6	Prevent abuse of double-taxation avoidance agreements
7	Prevent the artificial avoidance of tax presence (Permanent Establishment) rules
8-10, 13	Aligning Transfer Pricing Outcomes with Value Creation, Guidance on Transfer Pricing Documentation and Country-by-Country Reporting
11	Measuring and monitoring BEPS
12	Mandatory disclosure rules
14	Make dispute resolution mechanisms more effective
15	Develop a multilateral instrument to amend bilateral tax treaties

BEPS Action Plans

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The measures as per BEPS report could go a long way in helping countries tackle issues relating to tax evasion. Success rate, however, depends on how and to which extent each country implements the recommendations.

As its contribution towards BEPS initiative, India has tried to implement the following major BEPS Action Plans:

Amendment in Income-tax law	BEPS Action Plan	Measures adopted by India
Union Budget 2017 (Proposed amendment)	Action Plan 4	Limiting Base Erosion via interest deductions and other financial payments beginning Fiscal Year 2017-18 onwards
Finance Act 2016 (Last year)	Action Plan 13	**Transfer Pricing:** Introduction of concepts of Master File and Country by Country (CbC) Reporting beginning Fiscal Year 2016-17 onwards
Finance Act 2016 (Last year)	Action Plan 1	Equalization levy @ 6% on digital transactions with effect from 1 June 2016
June to December 2016	Action Plans 6 & 7	Amendment of India's Double Taxation Avoidance Agreements with Mauritius, Cyprus & Singapore

Limitation of Interest Deduction (BEPS Action Plan 4)

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<u>Financing of a Company through Debt / Equity :</u> A company is typically financed through debt and / or equity. The way a company is financed often has significant impact on its taxable profits. This is because usually the tax laws allow a deduction for interest payment while dividend is not tax-deductible. In other words, the higher the level of debt in a company, lower is its taxable profit. For this reason, debt is often a more tax efficient method of finance than equity.

<u>Limitation of Interest Deduction:</u> Multinational groups are often able to structure their financing arrangements to maximize this benefit. For this reason, Government often introduces limit on the amount of interest that can be deducted in computing a company's taxable profits. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, and thus aimed to protect a country's tax base.

<u>Amendment proposed by India</u>: The Indian Government has proposed to insert a new provision (Section 94B) in the Income-tax Act, to provide that **interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its earnings before interest, taxes, depreciation and amortization (EBITDA) or interest paid to associated enterprise, whichever is less.**

<u>Applicability of the new provision</u>: The provision is applicable to both, an Indian company as well as taxable presence of a foreign company in India (‘Permanent Establishment), who pays interest to a non-resident. It is permitted to carry forward disallowed interest expense upto 8 years. A threshold limit of INR 10 million in terms of interest payment has been provided to ensure that only large interest payments fall foul of the said provision. Banking & Insurance business of course, has been excluded considering the special nature of their businesses.

Country by Country (CbC) Reporting (BEPS Action Plan 13)

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The BEPS Report on Action Plan 13 recommends a 3-tier transfer pricing documentation as below.

Description	Master File	Local File	Country by Country (CbC) Reporting
Overview	• Overview of the group's global operations • Information on group's global transfer pricing policies • Value drivers & supply chain model	• Local country transfer pricing documentation • FAR (Functions, Assets & Risks) analysis of international transactions between local (regional) entity and associated enterprises	• Summary data & economic activity in each country • To be presented in tabular format giving crisp information about each group-entity
Level of Centralization	Centralized	Decentralized	Substantially Centralized
Responsibility of Preparation	Ultimate Parent Company	Local entity	Ultimate Parent Company
Whom to Submit	Tax authorities of all countries	Local tax authority	Tax authority of ultimate parent company (to be shared with regional tax authorities through official channels)
Effective from	Fiscal Year 2016-17	2001	Fiscal Year 2016-17
Monetary Threshold limit, if any	No threshold	Detailed transfer pricing study required where annual value of transactions between Indian entity & associated enterprises > INR 10 million	Multinational groups having annual revenue > EUR 750 million

Country by Country (CbC) Reporting (BEPS Action Plan 13)

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Impact on Outbound investments from India

The major impact lies on outbound investments from India, since Master File & CbC Reporting are primarily the responsibility of ultimate parent.

It is relevant for Indian multinationals to consider doing a fresh analysis of their businesses to meet the above requirements and also take corrective actions if required.

Impact on Inbound investments into India

Indian entity of a foreign multinational group is required to disclose the details of its ultimate parent company to the tax authorities, so that the latter can obtain CbC report from tax authority having jurisdiction over the ultimate parent company.

The concept of Master File & CbC Reporting should not be considered as a mere compliance requirement, but as an opportunity to revisit the global business format and create more efficiencies for multinational groups.

Equalization Levy (BEPS Action Plan 1)

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Despite tremendous increase in e-commerce business in India, till last year there was no clarity regarding the taxability of a non-resident's income from digital transactions in India.

The existing stringency of residence-based tax rules had resulted into global digital companies paying no taxes in India, despite India being one of their top customer-bases. India had recommended introduction of withholding tax on digital transactions, a position that was finally accepted in the OECD report.

From June 2016, an Equalization Levy @ 6% was introduced on income received by a non-resident from India from digital transactions, unless of course the non-resident has a tax presence in India in which case it would anyways be liable to pay tax in India. A threshold limit of INR 100,000 was provided for. In case the Indian-resident fails to withhold equalization levy or deposit it with the Government, it shall not be allowed a tax-deduction of these expenses. Equalization levy is chargeable on income received by a non-resident from online advertisement, provision of digital advertising space, & any other facility or service for the purpose of online advertisement

Amendment to Double Taxation Avoidance Agreements (BEPS Action Plan 6 & 7)

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Despite India having double taxation avoidance agreement (tax-treaty) with more than 85 countries, the dispute between whether source country or the host country has the right to tax certain kinds of income, has been perennial.

The source country has to prove existence of tax presence (permanent establishment) in its jurisdiction, to tax a multinational company on its business income. The OECD vide Action Plan 6 & 7 has issued guidance in relation to how tax-treaties can be made more effective in terms of their intended objective.

The most evident step that has been taken by India in this direction, is amendment of its double taxation avoidance agreement with Mauritius, Singapore and Cyprus, an action which had been pending for many years. India has always been aware and wanted to plug the loophole in its treaty with Mauritius which had tied its hands in taxing capital gains arising from sale of shares of an Indian company held by a Mauritius company.

Going by the existing language of the tax treaty, such capital gains were neither taxable in India nor Mauritius, resulting in double non- taxation. Taking advantage, some multinationals formed shell companies in Mauritius just to take benefit of the said loophole. No doubt, Mauritius had been the top country in terms of FDI into India. Similar amendments have been made to India’s treaties with Singapore & Cyprus. Cyprus has been removed from the list of 'Notified Jurisdictional Areas (NJAs)' of India (an NJA means a country with which India lacks effective exchange of information)

Conclusion

Like every reform, the success of BEPS initiative also depends on how each country over a long-term implements the recommendations of OECD in its tax jurisdiction.

While of course the intention is to curb tax evasion globally, certain challenges like excessive documentation & compliance, half-hearted implementation by various countries and even the possibility of genuine businesses being hit by anti-abuse provisions in the law, cannot be ruled out. A wait-&-watch situation regarding the extent to which India is able to capitalize on the BEPS scheme !

Disclaimer

About KrayMan

Who we are

KrayMan

KrayMan was founded by professionals from consulting and industry experience with a vision to set up a distinctive accounting services Firm.

Our forte lies in demystifying the complex Indian regulatory compliance environment thereby making it easy for our Clients.

We service diverse Client mix of multinationals, domestic companies, non-corporate entities and expatriates.

We advise and hand-hold foreign companies in establishing their operations in India and partner in their growth story.

Global Alliances

We are Member of two prestigious International Alliances:

Global Alliances
Cross Border Associates (CBA): Headquartered in Germany, CBA is a Global Network of Business Advisers, Legal and Tax experts specializing in cross border midmarket Mergers and Acquisitions and related services. The Network has presence in 76 countries globally.
Prime Advisory Network (PAN): Headquartered in London (UK), PAN is an International Accounting Network of Chartered Accountants and Lawyers, having presence in more than 40 countries globally.

Service offerings

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Setting up India operations

- Assessment of legal entity options for entry into India
- Setting up of presence in India and other start-up services
- Simplifying the procedures and addressing the bottlenecks
- Strategic, Governance & Management advisory services
- On-going tax & regulatory advisory & compliance services
- Virtual CFO services

Audit

- Statutory Audit, Tax Audit, Internal audit
- Review of financial statements
- Risk assessment / advisory
- Certification & Attestation
- Internal control reviews, reporting requirements, physical verification of assets
- Audit support on behalf of management / management letters

Accounting & Payroll

- Accounting & Financial Reporting
- Preparation of financial statements
- Accounting system implementation
- Forecasting and projections
- Financial analysis of reports
- Payroll processing of salary

Tax & Regulatory

- Tax planning & Advisory
- Direct tax compliances: Corporate tax, Withholding tax, Expatriate tax, Transfer Pricing
- Indirect tax compliances: Sales tax, Value added-tax, Service tax
- Litigation management support
- Company law & Exchange control advisory & compliances

Service offerings

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Virtual CFO

- Design and implementation of best practice framework for internal governance
- Setting up standard operating procedures (proper authority for transactions, internal compliance processes, adequacy of documentation, filing system & record keeping)
- Evaluation of internal controls and monitoring results
- Timely and accurate adherence with legal requirements

Corporate Secretarial

- Preparing & maintaining statutory registers as per companies law
- Conducting directors' and shareholders' meetings as per secretarial standards
- Preparation of agenda, notices, minutes and resolutions of directors' and shareholders' meetings
- Preparation & filing of Annual Return including Balance Sheet, Profit & Loss account & other documents
- Preparation and filing of forms with Registrar of Companies

Advisory

- Mergers & Acquisitions
- Due diligence
- Compliance health-check
- Valuation
- Business structuring
- Outsourcing
- Accounting advisory services
- Corporate finance

HR Advisory

- Building HR infrastructure for start ups.
- HR policy/ manual design
- Talent Acquisition and Induction policies/ programs
- Role defining and Competency framework
- Employee Engagement/ communication policies and programs
- Performance Management System

Contact Us

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