RESOURCE PAPER - 19

INDO-JAPAN CHAMBER OF COMMERCE & INDUSTRY

Tax Framework in India

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PREFACE

Dear Reader,

Quite often, heard our Japanese friends lament, the Indian tax system 'so complex and difficult to understand'. India being geographically vast and heterogenous in nature, such reforms take time. It might be recalled, when GST was introduced, a Resource Paper was brought out exclusively on the subject for our readers. To provide a guideline on this subject, after careful analysis, Mr. R. Sridhar and his colleagues have presented this Resource Paper "Tax Framework in India". We hope it would serve as a 'ready reckoner' for the Japanese businessmen. Any additional input / expert opinion required from the Japanese side will be gladly provided by IJCCI Expert Panel.

Mr. R. Sridhar is a Commerce Graduate, Company Secretary, specialised in Law and also an expert in investment structuring, corporate restructuring, tax planning, ESOP planning, drafting, negotiating agreements, drafting MoU with the State Government and other bodies, assist in Indian corporate laws, foreign exchange regulations matter etc. He is the Partner, Tax in Grant Thornton India LLP (a member firm within the Grant Thornton International Ltd. Group), one of the oldest, the largest and the most prestigious accounting and advisory firms in India to help global businesses.

Mr. Pranaav Murali is a Chartered Accountant and senior consultant and Mr. Prasanna CP is an expert in audit assignments, indirect compliance and advisory, are working with Walker Chandiok & Co. LLP (a member firm within the Grant Thornton International Ltd. Group).

Hope our readers would find the Resource Paper informative and useful.

July 01, 2018

Suguna Ramamoorthy
Secretary General

Tax Framework in India

Income Tax:

Corporate Income Tax:

Income is broadly divided into the following heads

a) Profit and Gains from business or profession

b) Capital Gains

c) Income from Other Sources

The global income of a resident company is taxable in India. However, for a non-resident, only income that is received in India, or that accrues or arises, or is deemed to accrue or arise, in India would be taxable in India.

Residential Status:

A Company is treated as a resident in any previous year if

a) It is an Indian Company; or

b) Its Place of Effective Management is in India.

Place of Effective Management ("PoEM") The Income Tax Act, 1961 ("IT Act") states that "Place of Effective Management" means a place where key management and commercial decisions that are necessary for the conduct of a business or entity as a whole, are in substance is made. PoEM acts as a tie-breaker rule for most of the tax treaties entered into by India.

The Central Board of Direct Taxes has also issued a circular on 24 January 2017, containing the principles for determination of PoEM of a Company.

Tax Rates:

The effective Corporate tax rates (including surcharge and cess) for the Financial Year ("FY") 2018-19 are as follows:

Turnover	Income lower than Rs. 1 Crore	Income Greater than Rs. 1 Crore	Income Greater than Rs. 10 Crores
Domestic Companies-Turnover Less than Rs 250 Crores	26.00%	27.82%	29.12%
Domestic Companies-Turnover Greater than Rs 250 Crores	31.20%	33.38%	34.94%
Foreign Companies	41.60%	42.43%	43.68%

Turnover for the above purpose shall be based on financial statements for the FY 2016-17. Surcharge is applicable at the rate of 7% for domestic companies and 2% for foreign companies if the total income exceeds INR 1 Crore and 12% for domestic companies and 5% for foreign companies if the total income exceeds INR 10 Crores.

Minimum Alternate Tax ("MAT")

Companies are liable to pay MAT on their adjusted book profits where the tax liability under the normal provisions (excluding surcharge and cess) of the Income-Tax Act, 1961 ('IT Act') for the year is not more than 18.5% (excluding surcharge and cess) of such book profits. If tax is payable under MAT, any amount paid over and above the normal tax liability will be accrued by the Company as MAT credit and can be carried forward for 15 years.

However, MAT credit to the extent of difference between the foreign tax credits allowed against MAT over such credit allowable against the tax under the other provisions of the Act shall not be eligible to be carried forward. MAT provisions are not applicable to foreign companies that do not have a permanent establishment ("PE") in India.

Capital Gains from the transfer of securities, interest, royalties, and fees for technical services accruing or arising to a foreign company (which has a PE in India) have been excluded from chargeability of MAT if tax payable on such income is less than 18.5% (exclusive of surcharge and cess). Further, expenditure, if any, debited to the profit and loss account corresponding to such income shall be added back to the book profit for the purpose of computation of MAT.

Type of Company	If Book Profit <INR 1 Crore	If Book Profit >INR 1 Crore	If Book Profit >INR 10 Crores
Domestic Company	19.24%	20.58%	21.54%
Foreign Company	19.24%	19.62%	20.20%

If the Company is located in the International Financial Services Centre, the applicable MAT rate is 9%.

Capital Gains

Capital Gains refers to the gains made on transfer of a capital asset. The tax treatment depends on the type of asset and the period the asset was held. They can either be short term or long term.

A gain is long-term if the underlying asset was held for at least 3 years (exception period of 1 year / 2 years are applicable for certain shares, units and bonds, based on listing status). The cost of assets resulting in long-term capital gains is indexed in accordance with the cost inflation index.

Short-term capital gains derived by domestic companies are taxed at the normal income tax rate. However, tax on short-term capital gains arising from the sale of securities on which the securities transaction tax has been paid is 15%.

The rate applicable to long-term capital gains derived by domestic companies is 20%. Long-term capital gains arising from the sale of securities on which the securities transaction tax has been paid are taxable at the rate of 10%, on the amount exceeding INR 1 Lakh (Subject to grandfathering benefit until February 01, 2018).

The tax on long-term capital gains arising from the sale of securities on which the securities transaction tax has not been paid is chargeable to tax at the rate of 20%, with indexation benefit.

Other Taxes:

Dividend Distribution Tax ("DDT") Any amount declared, distributed or paid by a company by way of a dividend is taxable at the rate of 15% and the tax has to be paid to the Government within 14 days from the date of declaration, distribution or payment, whichever is earlier. The taxable amount shall be reduced by the amounts received from its subsidiary as a dividend, if the subsidiary has paid DDT on the same. The DDT rate has to be grossed up and the effective DDT rate after grossing up is 20.55%.

However, no tax shall be chargeable on distribution of dividends by Companies being a unit of an International Financial Services Centre, deriving income solely in convertible foreign exchange.

Patent Box Regime In order to encourage more research and development activities in India, the Government has made the tax regime for royalty income of inventors at a concessional rate of 10%, from 30% on the gross income of royalty, subject to conditions specified under Section 115BBF.

Buyback of Shares Any amount of distributed income by the Company on buy-back of shares from a shareholder shall be charged to tax at the rate of 20% on the distributed income.

Securities Transaction Tax("STT") STT is applicable on the purchase and sale of equity shares, derivatives, units of equity oriented funds purchased through a recognised stock exchange. It is also applicable on the sale of unlisted equity shares under an offer for sale to the public or through an Initial Public Offer (IPO) where such shares will be subsequently listed on a recognised stock exchange.

Deductions

The expenses allowable as a deduction for the purposes of computation of taxable income are revenue expenditure which are laid out exclusively for the purpose of business of the company during the year.

A weighted deduction is allowable for expenditure on scientific research.

The following are few of the expenditures which are not allowable as deduction:

a) Capital expenditure

b) Personal expenditure

c) Expenditures which are penal in nature

d) Dividends paid by the Company

e) Corporate Social Responsibility expense

f) Expenses prohibited by law

g) Any sum paid on account of any rate or tax levied on the profits or gains of any business or profession

Depreciation Tangible and Intangible Assets are depreciated using the written down value method at the rates specified in the IT Act. Depreciation is applied on the "block of assets". Unabsorbed depreciation can be carried forward indefinitely and set off against future income, under any head. The following are the common depreciation rates for various block of assets -

Block	Rate (%)
Residential Buildings	5
Office Buildings	10
Furniture and Fittings	10
Plant and Machinery	15 / 60
Computers	40
Intangible Assets	25

Also, additional depreciation of 20% is allowed on new plant and machinery purchased during the year by companies engaged in the business of manufacture of articles or things, or in the business of generation, transmission or distribution of electricity.

The depreciation (including additional depreciation) is restricted to 50% of the applicable rates, if the asset is used for less than 180 days in the FY. The balance 50%, if any, shall be allowable in the subsequent FY.

Additional deduction in respect of employment of new employees

A deduction of 30% of the additional employee cost incurred shall be allowable as deduction, provided the employee was employed for at least 240 days during the FY. However, in the case of companies engaged in the business of manufacturing of apparel or footwear or leather products, a lower period of 150 days can be considered.

If an employee is employed for a period less than the aforesaid days, then deduction shall be allowable in the subsequent FY, subject to fulfilment of certain conditions.

Losses

Losses incurred under a head of income are set off first against an income under the same head, and then against income from other heads of Income.

Losses which are carried forward can be set off in the following manner :

Loss	Can be set-off against	Time Limit
Loss from House Property	Income from House Property	8 Years
Loss from Business or Profession	Income from Business or Profession	8 Years
Short Term Capital Loss	Short Term or Long Term Capital Gain	8 Years
Long Term Capital Loss	Long term Capital Gains	8 Years
Loss from Speculation Business	Income from Speculation Business	4 Years
Unabsorbed Depreciation	Income under any head	No time Limit

Withholding Taxes There is an obligation on the payer to withhold tax on certain specified payments. Withholding tax on payments made to Non-resident's shall be deducted based on the rates in force.

The following are a few important withholding tax rates for payments to resident's :

Type	Threshold	Rate (%)
Professional or Technical Services	30,000	10
Commission or Brokerage	15,000	5
Rent of Plant, Machinery or Equipment	1,80,000	2
Rent of Land, Building or Furniture	1,80,000	10
Payment on Contracts (Except to Individuals / HUF)	30,000 (Single Payment) 1,00,000 (Aggregate Payments)	2
Payment on Contracts (Except to Individuals / HUF)	30,000 (Single Payment) 1,00,000 (Aggregate Payments)	1
Royalty or Fees to Technical Services	30,000	10

Taxable returns and assessment - The Assessment Year starts on April 01. The tax return must be filed by November 30 for a company which has international transactions or specified domestic transactions and by September 30 for all other companies.

Advance Tax A Company is liable to pay advance tax in four instalments **:**

a) 15% of the tax payable by June 15;
b) 45% of the tax payable by September 15;
c) 75% of the tax payable by December 15;
d) 100% of the tax payable by March 15.

Any tax remaining to be paid is payable along with applicable interest on filing the income tax return.

Tax Holiday Tax incentives are available to the below mentioned extent in the case of new units located in a SEZ commencing activities on or after April 01, 2006 but before the April 01, 2021**:**

First Five Years	100% of Profits
6th Year to 10th Year	50% of Profits
11th to 15th Year	50% of Profits or amount transferred to credit of SEZ re-investment allowance reserve, whichever is lower

Exemption for Start-ups The profit earned by a company, being a start-up, shall be exempt from paying tax for three consecutive assessment years out of seven years beginning from the date of incorporation of start-up, subject to certain conditions.

Indirect Taxes in India

An indirect tax [such as sales tax, per unit tax, value added tax (VAT), or goods and services tax (GST)] is a tax collected by an intermediary (such as a retail store) from the person who bears the ultimate economic burden of the tax (such as the consumer). The intermediary later files a tax return and forwards the tax proceeds to government with the return. In this sense, the term indirect tax is contrasted with a direct tax, which is collected directly by government on income earned by persons (legal or natural) on whom it is imposed.

Prior to imposition of Goods and Services Tax (GST), there was a multitude of indirect taxes imposed on taxpayers. These included:

- **Central Excise Duty** Excise duty was a duty paid on manufactured goods, which was levied at the moment at the manufacturing. This tax was payable by the manufacturers who would then shift the tax burden to retailers and wholesalers.
- **Service Tax** Service tax was a tax levied by Central Government on services provided or agreed to be provided excluding services covered under negative list and considering the Place of Provision of Services Rules, 2012 and collected as per Point of Taxation Rules, 2011 from the person liable to pay service tax. It was an indirect tax wherein the service provider collects the tax on services from service receiver and pays the same to government of India. It was imposed on the gross or aggregate amount charged by the service provider on the recipient.
- **Sales Tax** A sales tax was a tax paid to a state government for the sales of certain goods and services. This tax was paid by the retailer, who would then shift the tax burden to customers by charging sales tax on goods and service.
- **Value Added Tax (VAT)** It was collected on the value of goods or services that were added at each stage of their manufacture or distribution and then finally passed on to the customer.

The following major taxes are now subsumed under GST:

Central taxes subsumed under GST	State taxes subsumed under GST
Central Excise duty and Additional Excise Duties	Value Added Tax (VAT)
Central Sales Tax	Entertainment Tax (other than those levied by local authority)
Service Tax	Luxury Tax
Special Additional Duty (SAD) and Countervailing Duty (CVD) Additional customs duties	Taxes on lottery, betting and gambling
Central Surcharges and Cesses	State Cesses and Surcharges (related to supply of goods and services)
Excise duty levied under Medicinal and Toiletries Preparation Act	Entry Tax

Apart from the above listed central and state taxes some of the local municipal taxes such as Octroi and Local Body taxes are also subsumed by GST.

Goods and Services Tax Goods and Service Tax (GST) is an indirect tax (or consumption tax) levied in India on the sale of goods and services. GST is levied at every step in the production process, but is creditable to all parties in the chain of production other than the final consumer.

The tax came into effect from July 01, 2017 through the implementation of One Hundred and First Amendment of the Constitution of India.

GST has three components:

- **CGST:** Collected by the Central Government on an intra-state supply;
- **SGST:** Collected by the State Government on an intra-state supply or UTGST: Collected by Union Territory on an intra-state supply;
- **IGST:** Collected by the Central Government for inter-state supply.

Transaction	Taxes	Revenue Sharing
Sale within the State	CGST + SGST	Revenue will be shared equally between the Centre and the State
Sale to another State	IGST	There will only be one type of tax (central) in case of inter-state sales. The Center will then share the IGST revenue based on the destination of goods

GST Rate Structure

Sl. No.	Particulars	GST Rates
1.	General rates on supply of goods and services	Five tax slabs - 0%, 5%, 12%, 18%, 28%
2.	Special rates on rough, precious and semi-precious stones	Special rate of 0.25%
3.	Special rate on gold and jewellery	Special rate of 3%
4.	Compensation cess on few items such as aerated drinks, luxury cars and tobacco products	It can be either Specific amount per unit or on Ad Valorem basis or Specific cum ad valorem basis.

GST is making sure the slogan “One Nation, One Tax, One Market” becomes the reality of our country.The biggest relief under GSTso far is clearly the elimination of the 'cascading effect of tax' or the 'tax on tax' quandary.

Structure of GST

- Input Tax Credit: At the time of paying tax on the final product, one can reduce the tax an entity has already paid on its purchases and pay just the balance amount. This is called Input Tax Credit which works on the principle that tax is to be paid on the value added by the entity and not on the entire produce.
- Composition Scheme under GST: A Composition Scheme is available for small businesses with a turnover below Rs.1.5 crore (75 Lakh for North Eastern states and Himachal Pradesh). As per the scheme, such small businesses don't have to go through the time-consuming formalities of GST but only pay the tax at a fixed rate based on their business turnover. For service providers are not eligible for the composition scheme.

Type of Business	CGST	SGST	Total
Manufacturers and traders (goods)	0.5%	0.5%	1%
Restaurants not serving alcohol	2.5%	2.5%	5%

- Higher threshold for registration of Rs 20 Lakhs is provided for under the GST regime compared to the earlier regime.

Goods Kept Outside the GST purview

Alcohol for human consumption: Alcoholic beverages for human consumption are kept out of the purview of GST as mandated by constitutional provisions. Sales Tax/VAT would be continued to be levied on alcoholic beverages as per the existing practice. VAT is also levied on alcohol purchases in some states, and there will be no change to such levy. Excise duty, which is presently levied by the states, is also unaffected.

Petrol and petroleum products (GST will apply at a later date) viz. Petroleum crude, High speed diesel, Motor Spirit (petrol), Natural gas,

<u>Aviation turbine fuel:</u> The full range of petroleum products, including crude oil and motor spirits including Aviation Turbine Fuel (ATF) and High Speed Diesel (HSD), are kept outside GST. Although the GST constitutional amendment provides for levying GST on these products, it allows the timeframe for their inclusion to be decided by the GST Council. Accordingly, till such time, Sales tax would continue to be levied by the States on these products with the prevailing floor rate. Similarly, Centre would also continue its levies such as CENVAT. It is not clear whether natural gas is kept outside the GST purview. A view from the government will be issued after further deliberations.

The existing taxation system under VAT and the Central Excise Act will continue for both of the commodities listed above.

Customs

The Customs Act, 1962 and The Customs Tariff Act, 1975 are the principal legislations that levy customs duty on imports.

Section 12 of the Custom Act provides that duties of customs shall be levied at such rates as may be specified under the Customs Tariff Act, 1975 or other applicable on goods imported into or exported from India.

The basis of levy of tax is specified in Section 12, charging section of the Customs Act. It identifies the person or properties in respect of which tax or duty is to be levied or charged. Under assessment, the liability for payment of duty is quantified and duty is duly collected by the government. Generally, exports are duty free (unless detrimental to the nation). On the other hand, imports are subject to several types of customs duties.

S.No.	Various customs duties at the time of imports	Customs duty rate
1.	Basic Customs Duty BCD (normally levied as a percentage of value). BCD may be exempted by notifications under section 25.	General basic rate is 10%
2.	The basic duty may have two rates - Standard and Preferential Rates under the first schedule to customs tariff act, 1975.	Preferential rate / for goods imported from any preferential area covered under the government of India agreements. Standard rate / where there is no provisions for preferential rates.
3.	Additional customs duty or counter vailing duty (CVD) or IGST. For those goods covered under GST, IGST is charged and for those goods not covered under GST, CVD is still payable.	CVD/IGST is calculated on the value of imports at effective rates notified for such goods as if it is procured from India.

S.No.	Various customs duties at the time of imports	Customs duty rate
4.	Special Additional Duty (SAD)/IGST. For those goods covered under GST, IGST is charged and for those goods not covered under GST, SAD is still payable	SAD is levied at rates notified by central government not exceeding 4%. IGST is levied at the effective rates notified for such as goods as if it is procured from India.
5.	Protective Duty levied in order to protect the domestic products and markets (Currently the duty is not in force)	Duty is levied by Central government upon recommendation made by Tariff Committee and upon CG being satisfied to provide protection to any industry.
6.	Safeguard Duty the Central Government may impose safeguard duty on specified imported goods, if it is satisfied that the goods are being imported in large quantities and they are causing serious injury to domestic industry.	The total period of levy of safeguard duty / is restricted to 10 years.
7.	Provisional Safeguard Duty / is levied when the Final Safeguard duty is pending for determination.	The provisional safeguard duty shall not remain in force for more than two hundred days from the date on which it was imposed.
8.	Anti-Dumping Duty (ADD) levied on dumped articles i.e., where any article is exported by an exporter or producer from any country or territory to India at less than its normal value.	The Central Government may, by notification in the Official Gazette, impose an anti-dumping duty not exceeding the margin of dumping in relation to such article. The Anti-dumping duty is dumping margin or injury margin whichever is lower.

Note with respect to determining the ADD

The margin of dumping is the difference between the normal value and the price charged for exports to India. Normal value means comparable price in the ordinary course of trade, in the exporting country, after making adjustments to the extent of conditions of sale, taxation, etc. Injury margin means difference between fair selling price of domestic industry and landed cost of imported product.

Other Indirect taxes in force Apart from the GST and customs there are several other indirect taxes still in force such as the stamp duty (that is levied by States on certain kinds of documents/ agreements / conveyances etc.), Social Welfare Surcharge has been recently introduced through union finance bills @ 10% on the notified list of imported goods. Entertainment tax is levied by the Local authority. Professional tax, License fee on entry of vehicles are levied under THE CANTONMENTS ACT, 2006 etc.

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