India Budget 2024

Impact on MNCs in India

July 2024

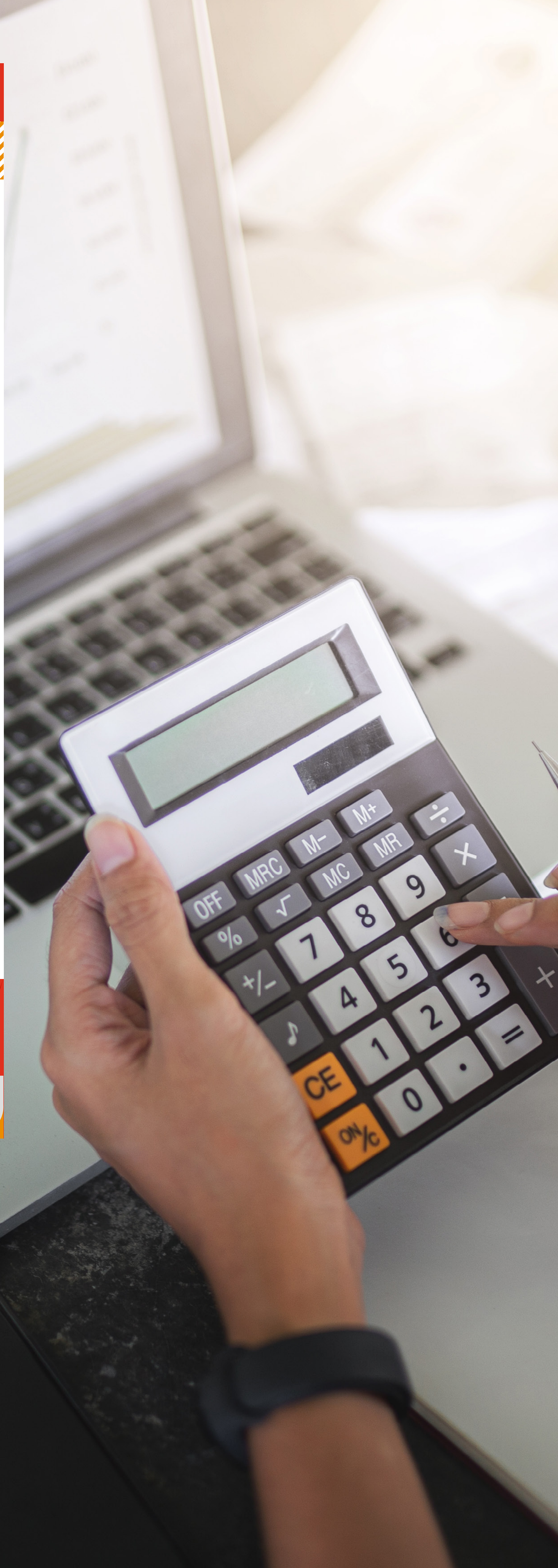
pwc

Preface

The Finance Minister presented the first budget of the new government on 23 July. At the macro level, the budget lays out a path for a Viksit Bharat or Developed India, with a focus on infrastructure, skill development, manufacturing, energy security, urban development, innovation and research and development (R&D) and next-generation reforms around labour, land and foreign direct investments, amongst others.

On the tax front, the theme continues to be stability and certainty with no adverse surprises. Moreover, there are a host of welcome simplification and rationalisation measures, which will ease compliances, reduce disputes and bring more certainty in the law. In keeping with the theme of next-generation reforms even in tax, the Finance Minister has announced a new tax code that will be unveiled in six months. The purpose is to make the new tax code concise, lucid, and easy to read and understand.

There are almost 150 proposed amendments and changes. Amongst these myriad changes, which budget proposals impact you, as a MNCs, in doing business with Indian third-party customers or dealing with your Indian subsidiaries and affiliates? We present a concise summary of these key changes for your reference.



Doing business with India

Tax rates

Headline rate for foreign companies

The income-tax rate applicable for a foreign company (other than in cases of identified streams of income such as royalty and interest) is 40% plus the applicable surcharge and cess. This rate has remained unchanged for the past several years. It is proposed to reduce this rate to 35%. This is in line with the trend of reducing tax rates over the past few years.

Customs duty rates

The proposals around changes in Customs duty rates largely focus on supporting manufacturing and local value addition in India. As a result, the duty rates are rationalised on various products when supplied to India and are meant for use in further manufacturing in India. An illustrative list of such products is provided below.

- Capital goods for use in the manufacture of solar cells and panels.
- Key raw material for the manufacture of steel and copper in India, namely ferro nickel and blister copper.
- Parts of medical equipment to promote localisation in the phased manufacturing programme.
- Minerals such as lithium and copper intended for use in renewable energy, space, defence, telecommunications, etc.

The above measures are a step further in the direction to make India a competitive destination for global brands to set up their new manufacturing facilities.

Equalisation Levy

The Indian version of the digital services tax was originally introduced in 2016 for advertising and ancillary services provided by foreign companies at the rate of 6% on a gross basis. The digital services tax was expanded in 2020 by bringing sale of goods and services or their facilitation in an online format within its ambit and taxing them at the rate of 2%. It is now proposed to remove this Equalisation Levy (EL) from 1 August 2024.

This is a simplification measure, since the expanded provision includes a lot of ambiguity. The fact that India has removed EL indicates its commitment to implementing Pillar 1 in the near future. In any event, the government is committed to give credit for this EL against Pillar 1 taxes in the future.

Safe-harbour provisions for Transfer Pricing

The primary objective of the existing transfer pricing (TP) Safe Harbour Rules (SHR) is to reduce TP disputes and provide more certainty to taxpayers. However, the SHR, in their current form, have received lukewarm response from the taxpayer community in India because of various factors, such as uncertainty in the categorisation of services, perceived high margins and low thresholds for eligibility.

Some activities covered under the current SHR are as follows:

- Software development services
- Information technology-enabled services
- Knowledge process outsourcing services
- Contract R&D services relating to software development and generic pharmaceutical drugs

In addition, the safe harbour is applicable only in case the turnover for such activities is up to INR2bn (~US$25m). The Finance Minister, during her budget speech, announced plans to further expand the scope of the SHR. However, more details on this proposal are awaited. This move could translate into a more predictable and less contentious TP environment in India.

Reduced period of limitation for reaudits under income tax

The reaudit law was substantially revamped in 2021 to provide certainty to taxpayers and reduce litigation. Besides the procedure, the general limitation period for reaudits was significantly reduced to three years, which can be extended to ten years in specified cases, if the auditor possesses documentary evidence that there is escapement of income.

To further rationalise these provisions, the time period for reaudit in the above-mentioned specified cases is reduced to five years from ten years. This should help provide further certainty to taxpayers.

Amnesty scheme for tax dispute settlement

Income tax

One key tax agenda of the government for the past several years is to reduce tax litigation. The government focused on this mainly because of the substantial amount locked in tax disputes coupled with the growing backlog of cases in India.

In this regard, the government introduced a tax settlement scheme in 2020 called the Vivad Se Vishwas (VsV) Scheme or settlement of disputes pending as on 31 January 2020. The scheme allows the settlement of ongoing disputes by taxpayers upon paying the following amounts:

- 100% of disputed tax, if the appeal is filed by a taxpayer and 50% of disputed tax, if the appeal is filed by Revenue authorities.
- 25% of disputed interest, penalty or fee, if the appeal pertains to other than the main appeal.

The interest and penalty are waived in all cases. This scheme was successful, and disputes to the extent of approximately 0.147m are settled. This scheme ended in 2021.

The first appellate process is not functional since 2021 for various reasons. Hence, the number of pending disputes has proliferated again. To address the pendency, the budget proposes another VsV Scheme. This new scheme provides for similar terms, as in the case of the earlier scheme described above, with the following additional terms:

- 110% of disputed tax, if the appeal proceedings are before 31 January 2020.
- 30% of disputed interest, penalty or fee, if the appeal pertains to other than the main appeal and occurs before 31 January 2020.

This is intended to reduce the time and resources embroiled in disputes and ease doing business in India.

GST law

Similar to the VsV Scheme under income tax, the government proposes an amnesty scheme within the GST framework. This scheme considers various interpretational issues arising during the initial years of GST implementation in India, resulting in prolonged disputes and unwarranted litigations.

The scheme is introduced for the first three FYs (i.e. 2017–18 to 2019–20) and provides a complete waiver of interest and penalty to the taxpayer on the condition that the disputed tax is paid unconditionally by the prescribed date. The scheme's modalities are yet to be announced.

This scheme was much awaited and could go a long way in settling unwanted disputes, especially for the initial period. It is expected that the industry will show a positive response to this scheme and opt for settlement in large numbers.

However, one key issue remains unanswered: Where a tax proceeding involves more than the first three FYs, whether the benefit of the amnesty scheme is available or not. A clarification from the government on this aspect will be useful.

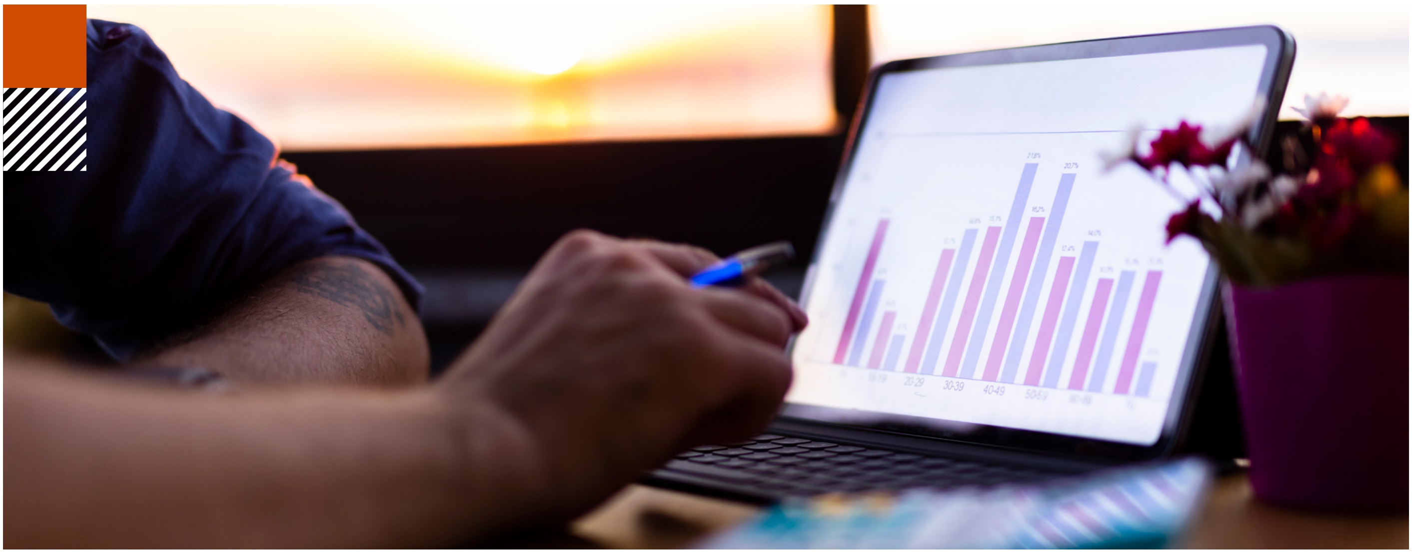
Capital gains tax

The capital gains tax regime in India is complex with multiple asset classifications and rates. This is because the regime has evolved over time with new asset categories added as businesses have evolved and new instruments and asset classes have been introduced. This creates confusion in many cases and in many situations, similar assets are taxed in different ways. To address both the complexity and confusion and provide clear and rational provisions, introduction of a new capital gains regime is proposed.
The changes are as follows:

Proposed capital gains regime							
Sl no.	**Particulars**	**Period of holding**		**Resident**		**Non-resident**	
A	**Long-term capital gains**	Old	New	Old	New	Old	New
1.	Shares (securities transaction tax [STT] not paid)	24 months	24 months	20%	12.5%	10%	12.5%
2.	Equity shares (STT paid)	12 months	12 months	10%	12.5%	10%	12.5%
3.	Listed bonds and debentures	12 months	12 months	10%	12.5%	10%	12.5%
4.	Units of real estate investment trusts and infrastructure investment trusts	36 months	12 months	10%	12.5%	10%	12.5%
B	**Short-term capital gains**						
1.	Equity shares (STT paid)	12 months	12 months	15%	20%	15%	20%
2.	Unlisted debentures	36 months	Deemed short term	20%	Applicable rates	10%	Applicable rates

- The indexation benefit, which allows transferors to adjust their purchase price for inflation, is removed
- For long-term capital gains on non-residents' sale of unlisted shares (STT not paid), foreign exchange fluctuation benefit can be availed.
- Indexed cost is available for shares not listed on 31 January 2018 and sold in an offer for sale.
- For unlisted debentures or bonds (transfer or redemption), deemed short-term capital gains are taxable at applicable rates.

This is a simplification and rationalisation measure to bring consistency in the law. However, removal of the indexation benefit in case of long-term capital assets is causing concerns with many investors, since they may have to pay tax on nominal gains without any inflation adjustment, albeit at a lower tax rate.



Buyback tax

In 2013, the Indian Government introduced special provisions relating to tax on distributed income of a domestic company from the buyback of shares. Herein, the Indian company was subject to buyback distribution tax at the rate of 20% on the distributed income on the buyback of shares. This scheme of taxation was in line with the then dividend distribution tax (DDT), under which any dividend distribution was taxed in the hands of the distributing Indian company. In 2020, DDT was removed, and the dividend is subsequently taxable in the hands of shareholders.

This year's budget includes an announcement regarding a change in the mechanism by which the buyback is taxed in India, with effect from 1 October 2024. This was in line with the similar regime in place for dividend taxation in India since 2020. Buyback proceeds are now taxable in the hands of the investor as deemed dividend (on a gross basis) rather than earlier being taxable in the hands of the Indian company as buyback tax. It is announced that the cost of acquisition of the shares bought back is to be treated as capital loss in the hands of shareholders; it is to be allowed to be set off against any capital gains.

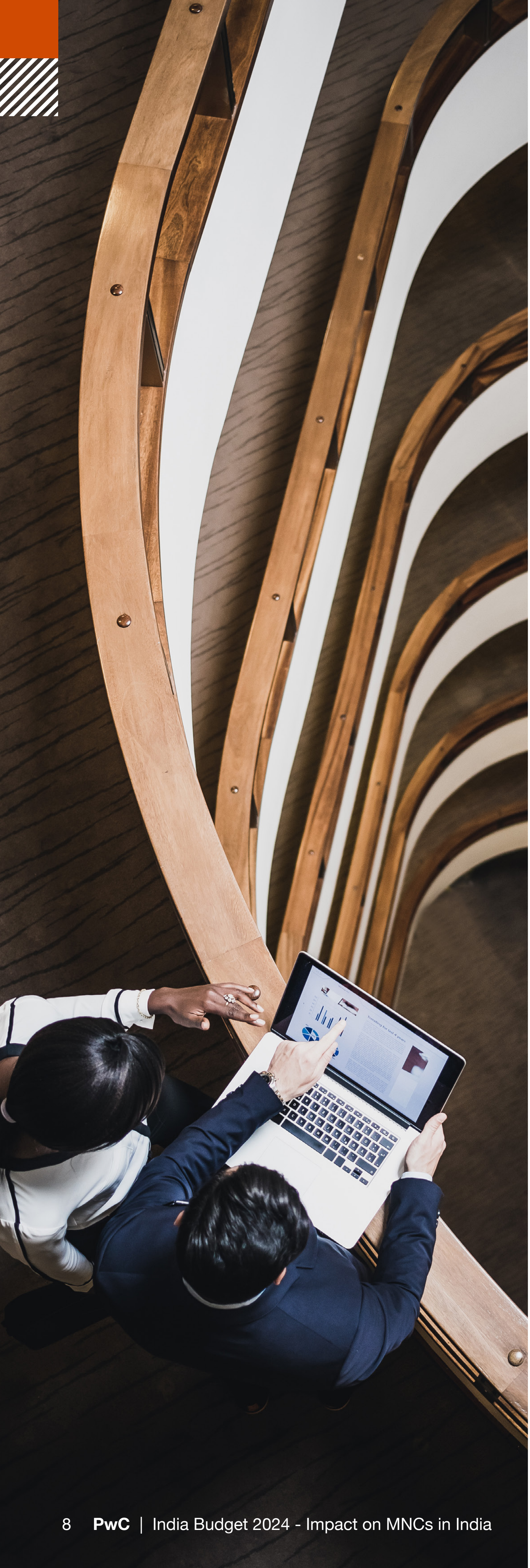
An announcement is made to treat the taxation of both forms of distribution of accumulated reserves, i.e. dividend and buyback, at par with each other. This will help the government widen and deepen its tax base in India.

Angel tax

The angel tax provisions were introduced by the Finance Act, 2012 to tax a company on the issue of shares for a consideration higher than the fair-market value (FMV), as prescribed under the Income tax rules. These provisions were introduced to prevent generation and circulation of unaccounted money through the share premium received from resident investors. This was extended to include investments from non-resident investors in 2023. However, this creates issues since, on many occasions, start-up valuations use unconventional valuation methods that traditional valuation models do not support, creating a risk of this tax in the hands of the start-ups.

While the provision was introduced to plug the loophole used by unscrupulous entities to avoid paying taxes, these provisions negatively impact the initial-investment stage in start-ups, as the FMV mechanism is applied for the valuation of shares.

It is now proposed to remove the tax for all category of investors. This will remove the ambiguity and give a fillip to the start-up ecosystem in India.



Insolvency and debt recovery

The Insolvency and Bankruptcy Code, 2016 (IBC), has proved a boon to the debt recovery and resolution of non-performing loans in the Indian banking sector. It has granted a swifter, time-bound and definitive process to recover monies from defaulters in the country. It is also an effective mechanism for strategic and financial investors to acquire distressed assets from across the world.

To further strengthen the IBC, appropriate changes are proposed to the statute and regulations issued thereunder. It is also proposed to set up an integrated technology platform to improve the outcomes under the IBC, as well as achieve consistency, transparency, timely processing and better oversight for all stakeholders.

Moreover, it is proposed to strengthen existing tribunals and increase their numbers to deal with matters related to both IBC and debt recovery.

These reforms will help entities find efficient and timely resolutions of their bad debts in the country. It will also help them find and conclude deals for the acquisition of stressed assets in India in a swifter and more efficient manner.

Foreign investment

The Finance minister has also announced that next generation reforms will also be implemented in various areas. One of them is foreign investment policy. Appropriate steps will be taken for simplification and facilitation of both foreign direct investment into the country and overseas direct investment outside the country. These will be announced in due course.

In summary

The budget proposals include some bold and progressive changes in the tax regime aimed at simplification and rationalisation of the law. It continues with the theme of providing clarity and certainty to taxpayers, which is a constant ask of the industry. It is also noteworthy that these themes have continued now for several years, and the lawmakers continue to take progressive strides to keep the law relevant with the overall context of the economy and the country. It is expected that the new tax code, which will be unveiled in six months, as announced by the Finance Minister, will also be progressive to match with the aspirations of a developed India—Viksit Bharat—by 2047.

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