Indian Tax Landscape

The year gone by and what to expect in 2019

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Dynamics of Indian Tax Scenario

The past year 2018 has been a witness to some unforeseen economic challenges at the global level. With the backdrop of the Turkish financial turmoil, Brexit crisis and the trade war between the two biggest superpowers – the USA and China, it was expected that the Indian economy was sure to feel the impact. In addition to that, on the home turf, worrying issues, such as the IL&FS liquidity crisis was already building mounting internal pressure. The situation began to appear brighter towards the later half of 2018, as the oil prices fell. This resulted into the consolidation of Rupee thereby increasing foreign inflows in India.

Since 2018 was marked by consolidation, 2019 might be marked by realistic optimism, especially with general elections just around the corner. In the meantime, the array of amendments/introductions in Budget 2018 (which included issues pertaining to SEP, LTCG Tax, etc.,) OECD report on Digital Economy, GST updates and others will play a crucial role in the decisions and policies adopted by taxpayers in FY 2019-20.

It is with this backdrop that we have tried to capture, in this publication, the key tax events of 2018 and present our thoughts on what can be expected from 2019.

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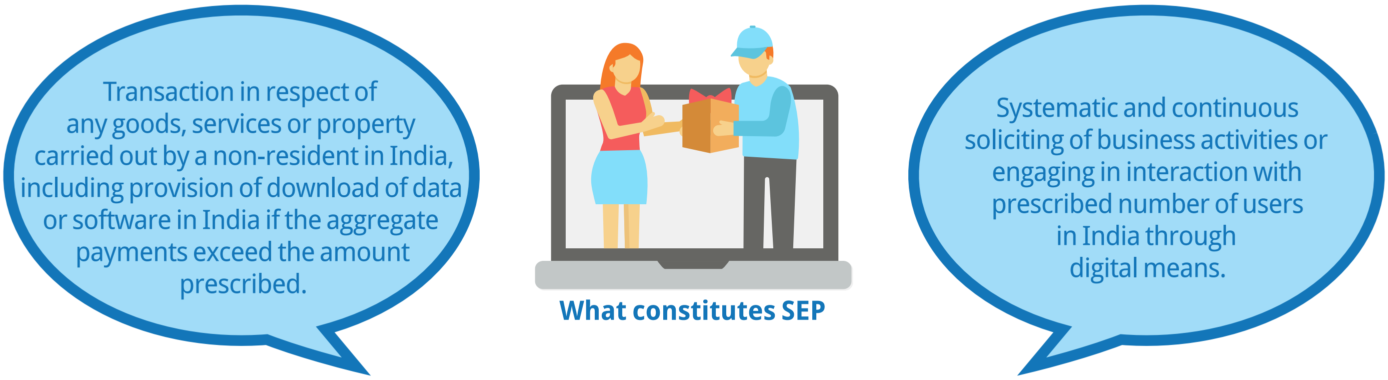
2018 — The year gone by!

DIRECT TAX

Enlarging ambit of Business Connection — India leads the way

Introduction of SEP

India has been a frontrunner in implementing the Base Erosion Profit Shifting (BEPS) Project. India in Budget 2018 has expanded the Business Connection definition by introducing concept of “Significant Economic Presence” (referred as ‘SEP’ or “Digital Permanent Establishment”) to tax digital transactions.



Open Areas

- Even though the law has been implemented from April 2018, no limits have been prescribed by the government. The government had sought suggestions from stakeholders on limits in August 2018. Also, once the limits are out, it would be clear as to whether only tech giants are impacted, or even mid-size companies would be under the tax net.
- The provisions of the current law are extensive. It appears that the same may also cover non-digital transaction for goods and services. Also, it is still unclear as to which business models the SEP tests shall apply. Would the intermediaries that merely provides online platforms to facilitate interaction between the domestic buyer’s foreign sellers be taxable in India if they meet the prescribed thresholds?
- Profit attribution: Computation of income attributable to the business connection would be a complex and highly subjective exercise. Also, the profit attribution currently is based on “functions, assets, and risks;” the responsibilities involved in shifting this established principle is enormous on India due to risks that it can be extended to transfer pricing as well.
- The phrase ‘systematic and continuous’ is both subjective and ambiguous. It could be open to tax litigations.
- Need to renegotiate tax treaties: Concept of Digital PE finds a place in the domestic tax law of India; however the tax treaty definition of PE remains the same. As such, until tax treaties are re-negotiated, Digital PE rule remains a domestic tax law concept and may not apply to non-residents who are eligible for tax treaty benefits.

India has taken the lead to carve out provisions to tax digital transactions. These provisions presently are at a nascent stage and are likely evolve over a period of time. However, businesses should evaluate their business model and see how these regulations would impact them.

Expanding the scope of Dependent Agent PE (DAPE)

India has been at the forefront in implementing the initiatives of the Organisation for Economic Cooperation and Development (OECD) and the G20 on the BEPS Action Plan. The final report on the BEPS Action Plan had recommended various amendments to domestic laws and tax treaty provisions to deal with international tax issues faced globally due to changing business environment.

In line with the same, India expanded the definition of 'business connection' under the domestic tax laws. The expanded definition of business connection under the Indian local tax laws now provides for a more stringent definition of DAPE.

Pre-Amendment	Post-Amendment
Dependent Agent acting on behalf of Foreign Enterprise and: • Habitually exercises the authority to conclude contract; • Habitually maintains stock of goods in India; • Habitually secures order in India.	• Has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts by the non-resident principal and the contracts are: - In the name of the non-resident; - For the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or - For the provision of services by the non-resident • Habitually maintains stock of goods in India; • Habitually secures order in India.

Typically, most agency arrangements in India are structured in such a manner that the that the agent in India performs the entire sales function and the foreign principal does the mere signing of the ultimate contract. Based on the earlier definition, such situations were not brought under the tax net as contracts were concluded outside India. This issue was highly litigated in India.

In order to capture such situations, the revised definition provides that a DAPE would be established even in cases where the agent plays a principal role in concluding contracts. The term 'principal role' has not been defined and it would be interesting to see how the Indian Tax Authorities, as well as taxpayers, would interpret this term. In common parlance, the principal role would mean playing an important role in concluding the transaction and not merely acting as a coordinator.

Furthermore, it also appears that the revised definition would also capture cases where contracts (including service contracts) are in the name of an Indian party, but a majority of the obligations of the contract are to be fulfilled by the foreign company.

DIRECT TAX

Permanent Establishment — Key Judicial Precedents

MasterCard Asia Pacific Pte Ltd. (2018) 94 taxmann.com 195 (AAR-New Delhi)

The Authority of Advance Rulings (AAR) held that the MasterCard Interface Processor (MIP), installed at the premises of customer's banks in India, satisfied permanency, fixed place and disposal tests as enumerated by the Apex Court in the case of Formula One decision. The AAR also held that MasterCard Network (MCN) (MIP plus related infrastructure for processing transactions) which connects the MIP and the processing centers engaged in transaction processing activities, partly located in India, was at the disposal of the taxpayer and also satisfied permanence and fixed place tests. Hence, MIP as well as MCN, constituted a fixed place PE in India.

Daikin Industries Ltd. v. ACIT (2018) 94 taxmann.com 299 (Delhi–Tribunal)

The Delhi tribunal held that based on email communication between the taxpayer and DAIPL, though DAIPL was not involved in finalizing the contracts of direct sales in India but was involved in the activities of negotiating and finalizing the contracts, etc. which is crucial to any sales transaction. Hence, the Delhi Tribunal held that DAIP, wholly owned subsidiary of the taxpayer in India, created a DAPE in India.

Production Resource Group (2018) 89 taxmann.com 219 (AAR-New Delhi)

Taxpayer provided on a turnkey basis, lighting and searchlight services during the opening and closing ceremonies of the Delhi Commonwealth Games (CWG). Employees and equipment of the taxpayer were in India for an aggregate period of 66 days for preparatory services, installation and dismantling of equipment. The AAR held that the taxpayer met each of the criterion for establishing a PE, namely place of business, the power of disposition, the permanence of location, business activity, etc. Hence, the taxpayer had a fixed place of business in India.

Indian tax authorities have apparently become more aggressive when it comes to assessing the existence of a permanent establishment in India. Even if companies apply arm's length pricing in their dealings with group entities, this does not seem to eliminate the exposure if the same is not backed by robust documentation and justification. MNC doing business with India need to judiciously assess the operations being carried out in India (either through their employees, agents or through other digital means) in light of these recent rulings.

DIRECT TAX

Introduction to Long–term Capital Gains Tax

One of the most controversial tax amendments of 2018 was the introduction of Long-term Capital Gains (LTCG) tax on the transfer of listed shares and unit of an equity-oriented fund which was earlier exempted from tax. Indian Government proposed a charge of 10% on capital gains more than INR 1,00,000 from FY 2018-2019.

However, Government kept its promise of not applying these provisions retrospectively by grandfathering the gains to January 31, 2018. Indian Government had estimated a tax collection of approximately INR 370 billion from this amendment. It is yet to be seen whether after such a big hue and cry, any rejig happens on this in Budget 2019.

DIRECT TAX

Angel Tax — A Devil in Disguise

In order to maximize return on investments, HNI's, PE funds and other investors often invest in start-ups. The said investments are usually made at a premium on the premise that the return on investment (usually beyond three-five years) would be far superior to the initial investment. As a result, in the nascent stage itself, the start-up entity may receive substantial funds to meet its commercial objectives. Typically, these investments are called as "Angel Investments."

Recently, many start-ups have received tax notices from the Indian Tax authorities seeking to tax premium received over an above fair value of the company. As per the provisions of section 56 of the Act, the Indian Tax authorities are trying to tax the difference between the price at which shares have been issued by a closely held company to a resident investor and the FMV (viz. higher of net asset value, DCF valuation arrived at by a Category I merchant banker of the shares or any other method of valuation). Unfortunately, this provision provides an exemption only for venture capital undertakings, receiving funding from venture capital company/fund and eligible investors who invest in recognized and approved start-ups.

This has created a huge uproar in the industry as there are fears that this may bring down the angel investments in start-ups considering the consequential tax liability and impact on the returns. In order to calm the nerves of the industry, the Central Board of Direct Taxes (CBDT) in December 2018 had issued a notice to the tax officer requesting them not to use any coercive measures to recover the demand. Further, the Department of Industrial Policy and Promotion (DIPP) has also assured that they will look into the issue and ensure that there is no harassment on Angel Tax Investors and start-ups.

However, recently, in January 2019, the Indian Tax authorities have once again issued notices for recovery of demands to many start-ups, and this has once again created uncertainty and fear. In order to calm the nerves, the Government of India has formed a committee to address the issue. On 16 January, DIPP has released a notification for providing relief to certain start-ups. However, this would cover only smaller start-ups and the litigation would continue for large players. It needs to be seen whether any additional relief/ clarifications are provided on this issue or not.

DIRECT TAX

General Anti-Avoidance Rules (GAAR) in an M&A Perspective — The Ghost Continues to Haunt

In the recent past, the Indian economy has witnessed a notable increase in M&A deals and cross-border investments. The government has also been making continuous efforts for simplifying tax regime, widening the tax base and have left no stone unturned in identifying and plugging tax evasion strategies. In this regard, the government has been making continuous efforts and has introduced various measures such as disclosure of foreign assets and income, income disclosure scheme, etc. but is yet to taste success.

The Introduction of GAAR in India puts the country at par with several other countries such as Australia, Canada, Singapore, and South Africa that have already enacted similar provisions in their domestic tax laws. In India, provisions on GAAR were introduced vide Finance Act, 2012. However, the Shome Committee Report urged the Government to defer the implementation of GAAR due to various factors, including (but not limited to) the representations from multiple stakeholders, interpretational issues and the practical challenges of its implementation. Accordingly, the government has deferred implementation of GAAR till 1 April 2017.

Broad Concept

Under GAAR, the tax authorities have been granted powers; nevertheless, the said provisions can be invoked only when it has been proved that an 'arrangement' has been entered with the primary objective of obtaining a tax benefit. Such an arrangement has been identified as an Impermissible Avoidance Arrangement (IAA) Further, the provisions of section 102 of the Act has held an IAA to be an arrangement between parties for a transaction that:

- Creates unusual rights and obligations;
- Results in abuse or misuse of the provisions of the Act;
- Lacks commercial substance; or
- Is not conducted in a bonafide manner.

Although certain terms have been explicitly defined under the GAAR provisions, such as 'commercial substance' and 'bonafide purpose' presently haven't been, which leaves room for debate and speculation. Further, the onus to prove that an arrangement is an IAA currently is on the tax authorities, and consequently, litigation concerning interpretational issues cannot be ruled out.

GAAR and M&A

M&A transactions are generally driven by commercial considerations and not by the motive to obtain tax benefit. However, recently in the case of Gabs Investments Pvt. Ltd., the National Company Law Tribunal (NCLT) rejected the merger with Ajanta Pharma by invoking GAAR. The NCLT held that by investing INR 480 million, the promoters would receive shares worth of INR 14,770 million without paying any tax as contended by the tax authorities. Thus, the promoters in their independent capacity and Gabs Investments Pvt. Ltd. together intended to avoid the consequential tax liability through this arrangement.

Based on the above, the tax authorities are considering the substance of a merger transaction over the legal form. Going forward, the taxpayers should ensure that there are sufficient commercial reasons for any scheme of arrangement.

In order to attract foreign investors and maintain a stable tax environment, the government may consider providing clarity on the application and implementation of the GAAR provisions by adopting the settled global practices.

DIRECT TAX

E-Assessments — A Dawn of New Era

In India, litigation with tax authorities can be a long-drawn process. Typically, a case in India can take more than a decade to conclude. Once a tax return is picked for a detailed revenue audit, it could lead to a long process of compiling details, drafting submissions, multiple visits to the tax office, etc.

In order to streamline the above process and eliminate person-to-person contact and to increase greater efficiency and transparency, the Indian Government has notified a new scheme of assessment where the assessment would be done in electronic mode. This scheme has been implemented in 2018 on a pilot basis with considerable success.
The key highlights of the scheme are as follows:

- A step towards Digital economy;
- Completion of assessment basis limited scrutiny and full scrutiny would help to bring down unnecessary documentation in case of small taxpayers;
- Helpful in reducing the time and costs involved in the process and should significantly reduce the discretionary powers of the tax authorities;
- Multiple visits to the tax office cut-down leading to greater efficiency;
- No personal hearing (unless specifically called for) would reduce corruption and favoritism to a great extent;
- Transparency and accountability in conducting assessment proceedings.

This is a welcome step by the Indian Government and in line with the best practices followed in developed countries. Also, the success of this initiative would be determined by the fairness of the process and approach adopted by the Indian tax officer. It should be ensured that taxpayers are treated fairly and should not be slapped with arbitrary orders.

The next step could be to have a more consultative approach between taxpayers and tax authorities to avoid long drawn litigation especially on settled issues and issues having divergent views.

DIRECT TAX

CBDT Retrospectively revises Appeal–filing Monetary Limits — Effort to reduce frivolous litigation

The Income Tax Department is a top litigant in India. As of March 2017, there are approximately 1,37,176 direct tax cases under consideration at the level of Income Tax Appellate Tribunal (ITAT), High Courts (HC) and Supreme Court (SC). Further, merely 0.2% of these cases constituted nearly 56% of the total demand value, and on the other hand 66% of pending cases (each less than INR 1 million) accounted for only 1.8% of the total demand value.

The rise in litigation only increases the administrative and operational costs of the tax authorities as well as the taxpayers. To address the rising litigation, the government along with the CBDT has increased the monetary limits for the filing of appeal/cross objections/references by the Income Tax Department before the ITAT, and Special Leave Petition (SLP) before the SC.

Key Takeaways from the Circular

- The monetary limit for filing appeal by tax department is enhanced as under:

Redressal Authority	Existing limits	Revised limits
Before ITAT	INR 1 million	INR 2 million
Before HC	INR 2 million	INR 5 million
Before SC	INR 2.5 million	INR 10 million

- Relating to computing tax effect, it is clarified that Cess and surcharge should form part of the tax effect. Also, the mechanism to compute tax effect in the case of company liable to pay MAT is specified (erstwhile circular was silent); The circular is applicable retrospectively, and any pending appeals below the specified tax limits shall be withdrawn/not pressed;
- The circular emphasizes that even where the tax effect exceeds the specified monetary limits, the appeal shall be preferred only based on the merits of each case;

- Withdrawal/non-filing of appeal would not tantamount that the revenue has accepted the taxpayer's claim;
- Department has the rights to file the appeal in few cases as specified in the circular even if tax effect is below the prescribed monetary limit.

The circular is in line with the government's initiative and commitment to reduce litigation and improve ease of doing business and provide relief to the taxpayers. This step of the Indian Government would go in a long run to provide tax certainty, reducing litigation and consequently boosting investors' confidence in India's growth story.

TRANSFER PRICING

Master File and Country by Country Reporting (CbCr) — Lessons from the first filing

Since its introduction in the year 2002, the Indian government has taken several measures to align Indian transfer pricing regulations with global Transfer Pricing regimes. Being committed to the OECD, BEPS Project and BEPS Action Plans, India amended its local laws, vide Finance Act 2016, and introduced the 3-tier transfer pricing documentation structure consisting of Master File, Local file and CbCR.

Challenges

By the time the final rules (October 31, 2017) were notified, the due date to file the forms was fast approaching, and in the absence of clarifications on the new terminologies/ connotations, applicability parameters, disclosure requirements of the first-year filing process was quite challenging.

The major challenge for the companies was collation of extensive data that was required to be submitted. Specifically, for Indian subsidiaries of Multinational Corporations (MNC) to obtain extensive data from their parent company/head office was a tedious task.

Considering the importance and far-reaching implications of the data, the biggest challenge was to re-validate the data to ensure that it does not create any risk in any jurisdiction in which the group operates. Additionally, some deviations existed between Indian requirements vis-à-vis that of the OECD, and certain open items in connection with disclosure requirements that were not clarified by CBDT, which led to the companies to adopt a conservative approach and ensured necessary filings were done considering the penal implications.

Way Forward

Going forward there are possibilities of increased scrutiny by the tax authorities as the detailed group level economic information will be at their disposal. At a more practical level, MNCs would be increasingly required to explain their business realities and demonstrate the economic value-creation activities to the tax authorities.

Therefore, the need of the hour for the Indian outbound companies and MNCs operating in India is to re-align their existing transfer pricing policies with value creation-based on substance if it’s not already done.

TRANSFER PRICING

Reduction in Litigation — Issues such as AMP and Marketing Intangibles continues

India, in 2001, introduced a Transfer Pricing legislation with the primary aim to prevent shifting of profits from India to other jurisdictions. In the initial years, it did not disrupt taxpayers since the legislation was new to tax officers as well. However, the transfer pricing adjustments increased and reached its peak of INR 700 billion (FY 2012-13), which led to a huge outcry from foreign investors.

Considering this upward trend in litigation, tax administration also made certain amendments to transfer pricing law such as increasing the threshold limit of specified domestic transactions from INR 50 million to INR 200 million, replacing the method of selection of cases by the tax officers based on threshold criteria to risk-based criteria, etc. Due to these measures, the litigation rate showed a bearish trend in recent years.

Prolonged litigation was always a concern for the taxpayer in India. However, recently this trend has seen a reduction in the field of transfer pricing due to the revised scrutiny selection parameters. Not only have taxpayers witnessed a decrease in litigation, but the quality of assessments carried out by the transfer pricing officers have also changed.

While these positive changes in the Indian transfer pricing litigation arena are welcome, the pending adjudication on certain important issues like the Advertising, Marketing and Promotion expenses (AMP) and Marketing intangibles continue to remain a concern for the taxpayers.

Issues faced by taxpayers in India

The AMP saga has mainly revolved around the intangible value (i.e., nature of brand promotion) anticipated to be created by an Indian entity of an MNC group.

The Tax authorities have alleged that the taxpayers who are manufacturing and distributing foreign branded products in India incur excess AMP which is in the form of brand promotion service to its AE. Following the 'bright-line test,' tax authorities have held that the expenditure on advertisement and brand promotion expenses which exceed the average of AMP expenses incurred by the comparable companies in India, is required to be reimbursed/compensated by the overseas AE.

On the other hand, taxpayers have been contesting that the incurrence of AMP expenses on a stand-alone basis cannot be said to constitute an international transaction in the absence of an arrangement/evidence for where specific services have been rendered.

Due to long pending adjudication in this matter, the tax tribunals are unable to conclude on a similar issue and merely restore the case in light of Sony Ericsson and Maruti Suzuki Delhi High Court rulings.

It would be intriguing to see if the Supreme Court concludes the fate of this issue or not in the coming year. It is high time now that the tax authorities should on a serious note consider options to conclude the matter, so it reaches some finality in this prolonged debatable AMP issue.

TRANSFER PRICING

APA continues to shine — Leads the way in Dispute Resolution

Advance Pricing Agreement (APA) program with its arrival in 2012 did not only became the game changing event in the landscape of Indian transfer pricing litigation but also was one of the remarkable initiative by the Indian Government to reduce litigation in India and provide tax certainty to foreign investors. However, the success of this program was a big concern amongst the MNC way back in 2012 due to lacklustre response and failure of few existing alternate resolution schemes of the Indian Government and confidentiality concerns.

It has been six years now and the response received by this APA program has been enormous which demonstrates the efforts taken by the Government of India to address the concerns and the ground realities of the taxpayer.

Key Achievements

The CBDT had published the second APA Annual Report for the FY 2017-18 in August 2018. Some of the key facts and statistical details are listed below:

- 985 applications were filed till 31 March 2018 of which 821 were unilateral APAs and 164 were bilateral APAs;
- Of the total applications filed, 219 APAs were concluded of which 199 were unilateral APAs and 20 were bilateral APAs. The number of concluded APAs were much higher in number compared to FY 2016-17;
- The average time taken to conclude unilateral APAs was 31.75 months and bilateral APAs was 45.78 months in India;
- Most of the concluded APAs were from the service sector; majorly belonging to the ITeS and software segment. The services sector has been the largest contributor to India's international trade constituting nearly 69% of the economic activity for the signed UAPAs and 78% for the BAPAs;
- In majority of the applications filed in India, taxpayers have considered Transactional Net Margin Method (TNMM) as the most appropriate method followed by Comparable Uncontrolled Price Method (CUP Method).

The data contained in the second APA Annual Report (2017-18) report states that India has concluded 219 APAs in five years, while China has signed off 139 APAs in 12 years (between 2005 and 2016). Through the 219 APAs signed-off so far, CBDT has managed to provide cumulative tax certainty for 1428 years (which includes 387 years covered in rollback period of concluded APAs).

The report also highlighted the fact that post the conclusion of Mutual Agreements with the Competent Authorities of Treaty partners, there was an increase in the number of BAPAs signed by the Indian taxpayers. Indian Government has shown a willingness to accept BAPAs even in the absence of Article 9(2) or its equivalent (correlative adjustment) within the tax treaty with the intent of avoiding double taxation, which is an encouraging fact.

The key facts and statistical details in the APA Annual Report provide a heads-up that APA program, is clearly backing its specific long-term vision with which the government is moving forward on its reform agenda. It is conservatively estimated that the 219 signed APAs have resulted in additional income of about USD 1382.93 million, thus, resulting into tax payment of about USD 414.88 million without getting into any litigation or dispute.

The government by concluding couple of APAs involving complex transactions, by adopting practical approach (accepting customs valuation as arm's length price) and by renewing its first unilateral APA has demonstrated that they are working hard to understand the practicalities of tax payers' business and identify mutually acceptable solutions. This itself speaks volumes of commitment shown by the government and its genuine effort to ensure success of the APA program and indicates that the APA program has evolved/matured over the period and has gained the confidence of the taxpayers.

DIRECT TAX

OECD releases Interim Report on the Digital Economy — Will this lead to new litigation?

OECD and G20 countries together introduced BEPS Action Plans principally to curb tax evasion and double non-taxation. Briefly, BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax jurisdictions.

BEPS contains 15 Action Plans, of which Action Plan 1 deals with addressing challenges posed by taxation of the digital economy. It discusses and analyses potential options to address the challenges posed by taxation of the digital economy which are as follows:

- New nexus in the form of a SEP
- Withholding tax on certain types of digital transactions; and
- Equalization levy

However, none of the above options were eventually recommended by the Action Plan 1. Notwithstanding the above, it was provided that countries could introduce all or any of the options mentioned above in their domestic tax laws or their tax treaties as interim measures, provided the countries respect existing tax treaty obligations.

Basis the Action Plan 1, the G20 Countries directed the OECD to deliver an interim report on the implications of taxation of digital economy by April 2018 and a final report to follow. India being pro-active, introduced in its domestic tax law the concept of 'equalization levy' with effect from 1 June 2016 and SEP to tax digital transaction in February 2018 while the OECD released the said Interim Report in March 2018.

Besides providing for in-depth analysis on tax challenges posed by taxing digital economy, the Interim Report also provides for certain common considerations that are required to be followed by India and other countries who have introduced these interim measures in their domestic tax laws against BEPS so as to avoid any uncertainty in deciphering taxation of digital economy across jurisdictions. Lastly, it would be interesting to see the interplay between the interim measures adopted by India and other countries vis-à-vis the final report.

GOODS AND SERVICES TAX

Major Amendments including rates rationalization

The introduction of Goods and Services Tax (GST) from 1 July 2017 has revolutionized the indirect tax system in India. It has resulted in elimination of multiple taxes, removal of double taxation, checked tax evasion and simplified compliances. In order to manage the complexities and resolve difficulties faced by the taxpayers, which was always expected in a change of this magnitude, the government actively intervened by bringing in a slew of amendments spread over 31 GST council meetings and issuance of 447 notifications, 91 circulars and 21 orders have been released by Government of India so far.

Key Decisions

The major decisions include –

- Proposing simplified compliance process
- Rationalization of GST rate for restaurant services
- Slashing rates in the 28% and 18% categories,
- Speeding up of export refunds and making refunds fully online
- Liberalization of Input Tax Credit (ITC) on motor vehicles
- Extension in the time limit to take ITC and filing of GST audit report.

Around 228 items were included in the 28% GST category at the beginning of the GST era. The number has come down to 28 post the 31st GST council meeting held on 22 December 2018. The only items now left in the 28% category include luxury goods apart from certain automobile parts and cement. This gradual transition of rate cuts is in sync with the long-term objective of the government to smoothly withdraw the 28% slab and merge most of the goods now in 18% and 12% category into a new category of 15%.

GOODS AND SERVICES TAX

Reconciliation of Input Tax Credit

The initial design of the GST law was such that a recipient would get (ITC) only if the supplier declares the corresponding supply in his returns which should match with the inward supplies declared by the recipient. However, with the suspension of inward supply register in GSTR-2, it was largely anticipated that taking of ITC would not be system driven and can be suo-motu. However, with the release of annual return form in GSTR-9, it is presumed that the government would insist for matching of ITC with the supplies declared by the suppliers in GSTR-1. The initial deadline of 25 October 2018 for availing ITC has been extended to 20 April 2019 and accordingly taxpayers may revisit their ITC numbers to avail or write off the amounts after reconciling the same with the supplies as per the form GSTR-2A.

Few checklist points for taxpayers to keep on track with ITC reconciliation are listed below:

- Ensure purchases from compliant dealers
- Maintain proper records of purchases period wise
- Ensure timely reconciliation of ITC availed with GSTR 2A report
- In the case of mismatches, propose appropriate action points including vendor follow ups
- Ensure to avail all the eligible ITC by the due date of furnishing return of GSTR 3B for the month of March 2019 i.e., 20 April 2019.

Challenges on the Annual Return and Audit Front

Being the first year of GST and the initial deadline of 31 December 2018, GST annual return (GSTR 9) and GST Audit (GSTR 9C) forms were much awaited. The first version of GST annual return and GST Audit was released in the first half of September 2018.

The GST annual return form released in September 2018 was merely an aggregation of GST monthly returns filed from July 2017 to March 2018. The GST audit form i.e., the reconciliation statement has been designed to verify if GST has been discharged on all the transactions as disclosed in the books of accounts and to pay the additional liability in case of any shortfall. The government has released a new version of the forms on 31 December 2018. The major change observed in the latest version of annual return form is that the supplies made during the year have to be declared in the Annual return instead of a mere aggregation of supplies declared in the returns filed during the year. This will enable the taxpayers to declare or correct their supplies etc., made during the FY, irrespective of whether they were declared in the GST return. However, the taxpayers are restricted to avail any unclaimed ITC in the annual return and therefore the same should be availed in GSTR 3B only.

Being the initial year of filing annual return and reconciliation statements, it is expected that there will be interpretational issues which would be welcomed, if the government issues timely clarifications to ease the confusion amongst the taxpayers.

GOODS AND SERVICES TAX

Impact of Rulings by Authority of Advance Rulings

An advance ruling under GST is a decision given by the tax authorities to an applicant on questions in anticipation of the proposed transactions. More than 300 Advance ruling have been so far pronounced by various state AARs covering various subject matters. While the ruling of an AAR is an advance ruling, it is binding only on the applicant and not on any other taxpayer. It can have persuasive value and can serve as a guide to understand the view of the authorities and the possible interpretations to a question of law. There are certain important rulings which were widely discussed given their implications. Some of these rulings are discussed below:

Columbia Asia Hospitals

It was held (and further upheld by the Appellate AAR) that the activities carried out by the employees from corporate office for accounting and other administrative functions with respect to units in other states should be treated as 'supply' and hence taxable under GST. This has created a flutter within the corporate world requiring revisiting the tax positions to be adopted in respect of common expenses at Head office and employee-related costs.

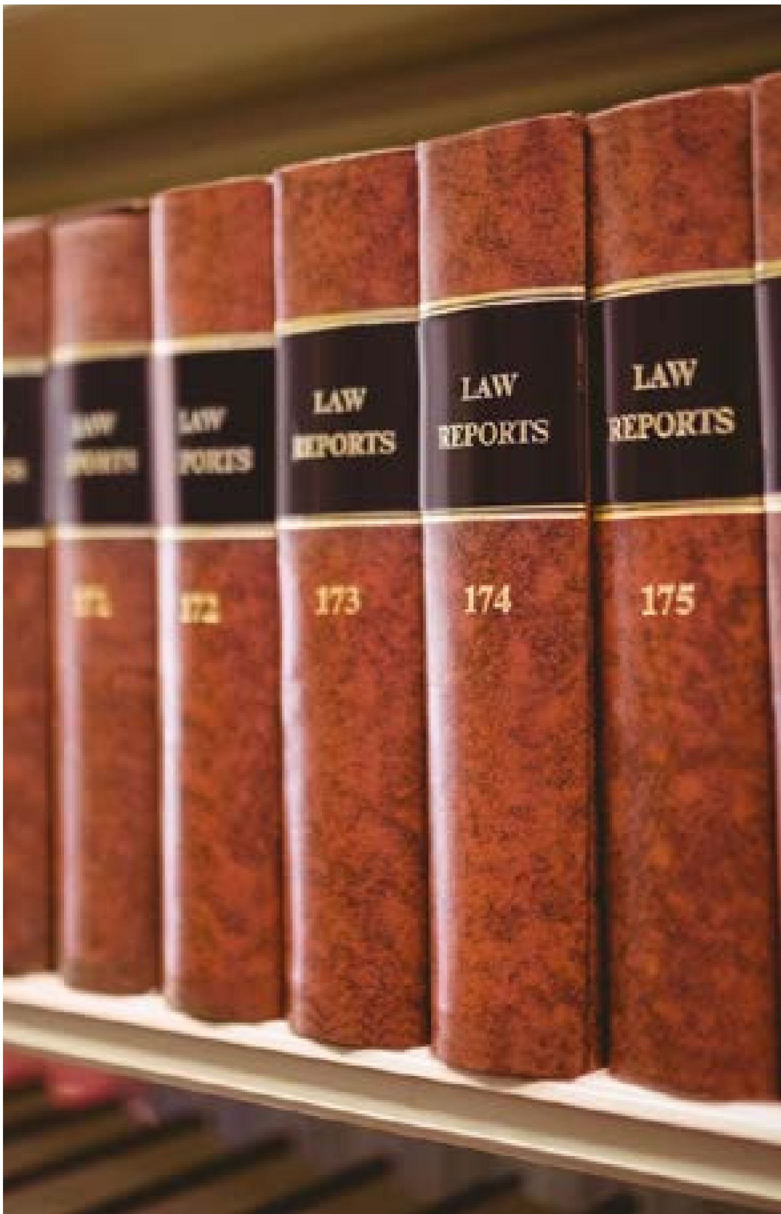
Maharashtra State Power Generation Company Limited

The applicant had entered into a contract with various contractors on a turnkey basis for construction of new power plants or renovation of old plants. The applicant received liquidated damages (as per the clause of contract) for the delay in commencement of the contract. The AAR held that the liquidated damages would be subject to GST as the same are towards the tolerance of the delay caused by the contractor which will be covered as a 'supply of services' under GST. The potential of ascribing a wide meaning to the term 'tolerance of an act' may result in tax disputes. It is important for businesses, especially finance companies, to evaluate any GST exposure on the recovery of similar charges.

Rod Retail Private Ltd

Supply of goods to the international passengers going abroad from 'duty free' shops located on international airports, i.e., place beyond the customs frontiers of India were held to be within the territory of India under the CGST Act and hence, liable to GST at the applicable rates. The given AAR has made a strict interpretation of the definition of the term 'exports' and deprived the duty-free shop from the basic benefit allocated to them under the erstwhile laws.

Furthermore, in view of the conflicting rulings given by different state AARs for the same subject matter, the GST council has resolved to set up a Centralized AAR to deal with such conflicting decisions made by two or more state AAR's.



REGULATORY CHANGES

Liberalization of External Commercial Borrowing Regulations (ECB) — Key Highlights

In light of the recent depreciation of the Indian Currency, India has liberalized the ECB regulations in order to encourage foreign currency inflows into India. The key highlights of the same are as follows:

- **Eligible Borrowers –** All entities would now be eligible to receive foreign direct investment including start-ups
- **Eligible Lenders –** Any resident of Financial Action Task Force or International Organization of Securities Commissions compliant country, Multilateral and Regional Financial Institutions where India is a member country and foreign branches/subsidiaries of the Indian banks
- **Minimum Average Maturity Period –** Relaxed from 1-10 years to 1-5 years irrespective of the category of ECB
- **Individual Borrowing Limits –** Borrowing limits have been increased from 500 million USD to 750 million USD
- **Available Routes –** ECB can be raised through automatic route. However, government approval is required if certain conditions mentioned in the revised regulations are not met.

The ECB regulations have been liberalized to a great extent and now all entities who are eligible to receive foreign direct investment can raise funds through this mode also. Furthermore, Limited Liability Partnerships, trading companies,etc. would also be able to take the benefit of these regulations as LLPs are also eligible to receive foreign direct investment. This initiative by the government would boost foreign investments in the long run and would benefit most entities and would also encourage inflows into the country.

Foreign Direct Investment regulations for e-commerce made stringent — Will it push local players?

Large e-commerce players were luring customers by offering huge discounts and incentives. Offline traders have been complaining that they were not able to match the large e-commerce players as the latter had access to foreign investments.

In light of this background, the government issued revised Foreign Direct Investment (FDI) regulations for the e-commerce sector vide Press Release dated 26 December 2018. The key highlights of these regulations are as follows:

- FDI is allowed for Marketplace e-commerce Entity only. Marketplace Entity means providing an information technology platform by an e-commerce entity on a digital and electronic network to act as a facilitator/ mediator between the buyer and the seller.
- The Marketplace Entity cannot exercise ownership or control over the inventory i.e. goods purported to be sold. Furthermore, it has been clarified that if the marketplace entity or its group companies purchase more than 25% from a vendor, then it will render its business into the inventory-based model.
- Marketplace entity is barred from engaging in discriminatory practices in respect of different vendors (i.e., cashbacks or freebies to customers cannot be based on specific vendors only).
- Marketplace entity cannot have exclusive tie-ups with suppliers or seller entities.
- These revised regulations are further subject to the conditions laid down in the FDI policy on services sector along with the applicable laws and regulations if any.

Tech giants such as Amazon and Flipkart may be impacted by this amendment and may have to revisit the business model in India.

Key Expectations in 2019

DIRECT TAX

India Budget 2019 and Direct Tax Code

Considering that general elections are around the corner, the expectation of the budget is to be a populist one. The key expectations from the Budget 2019 are:

- Increase in basic exemption limit for individuals
- Reduction in corporate tax rates to 25% for all companies
- Rationalization of three tier dividend tax
- Capital Markets - STT can be abolished post introduction of LTCG
- Equalization Levy - Addition of new services
- Direct Tax Code - Way forward and implementation road map

TRANSFER PRICING

First round of Audits for Master file

In light with BEPS project, India introduced enhanced transfer pricing documentation in the form of Master File and CbCR. Both filings were applicable for FY 2016-17, and the first round of audit is expected to be undertaken in 2019.

With the completion of the second round of transfer pricing compliance post introduction of BEPS provisions, there remains anxiety amongst industry with regard to the use of such information in the following assessment proceedings. It is expected that the submission of CbCR and Masterfile could revolutionize the approach of tax authorities followed till date in identifying transfer pricing risks and tackling disputes during the assessments.

Significant pointers on the approach of tax Authorities

The Masterfile, which gives a blueprint of the entire value chain of the group and the data contained in the CbCR that provides a snapshot of the group's financial indicators, would now depict Indian entity's exact role in the entire group and expose the entire structure before the tax authorities. This could help tax authorities in decoding the complexities embedded in the group structure aimed at achieving tax effectiveness and unplugging BEPS related issues if any.

Thus, with access to meaningful data, tax authorities would be better equipped in identifying high-risk arrangements, undertaking risk assessment and conducting further inquiries into an international group's transfer pricing arrangements in the course of a tax audit.

Hence, it is important for companies to understand the information required to be submitted before the tax authorities, to ensure consistency in terms of having a harmonized picture between CbCR, Masterfile and Local file along with the year-on-year disclosures made in the past transfer pricing documentation reports. It is also important to step back and review the existing structures, and models to evaluate the preparedness in addressing the possible queries, which tax authorities might raise after analyzing the Masterfile and CbCR. The first round of assessment will also provide guidance to the tax payers in terms of questioning their existing structures and determining whether the remuneration received is adequate or not, by taking into consideration the Indian entity's contribution in the entire value chain. Thus, the taxpayers now will need to shift their focus on the principles of substance over form.

As tax authorities across the globe will have access to the same information going forward (by way of CbCR and Masterfile), it is expected that in the coming cycle the litigation may shift from being India-centric to global-centric with more intense scrutiny of a multinational group's transfer pricing policy and its value chain.

Also, taking cue from the OECD's Handbook on Effective Tax Risk Assessment on the types of the risks that can be identified by review of the CbC Report, the taxpayers can expect detailed scrutiny and questions based on:

- The jurisdictions showing significant activity but low levels of profits (or losses);
- The jurisdictions with significant profits and low tax rate but little economic activity;
- The results in a jurisdiction not reflecting market trends;
- The multinational groups having marketing entities located in jurisdictions outside key markets;
- A multinational group having procurement entities in jurisdictions outside its key manufacturing locations;
- A high proportion of related party revenues in a particular jurisdiction.

While it is expected that there may be an increase in the number of disputes being picked up for assessment in the initial years, however, with growing transparency and exposure of tax structures, the disputes may reduce in number, but may rise in terms of complexities, in the years to come.

DIRECT TAX

Supreme Court Ruling on Software Payments

Taxability of software has been a matter of debate which has affected many corporations especially MNC. The debate is surrounding the characterization of revenue received from supply of software as 'Royalty' or 'business income.'

Legacy of Controversy

- Tax authorities have taken a position that such payments are for acquiring intellectual property rights/copyright in the software and hence are royalties within the meaning of the Act and Double Taxation Avoidance Agreement (DTAA). The taxpayers, on the other hand takes a position that the payment is for a copyrighted article and therefore the same is not taxable as 'royalty.'
- The debate over taxability of receipts from sale of software as 'royalty' took an interesting turn, after two High Courts (Karnataka HC in case of Samsung[1] and Delhi HC in case of Ericsson[2]) delivered conflicting rulings on this issue.
- Apart from the High Court rulings, there are a plethora of ITAT and AAR rulings, taking diametrically opposite views on the taxability of software receipts. The divergent views taken by various courts have created significant amount of confusion regarding shrink wrapped software is a 'copyright' or 'copyrighted article?'

The Supreme Court is to determine whether the payment for software is taxable as royalty in a batch of over 50 cases. It had admitted the SLP filed by IBM, Sonata Information Technology against Karnataka HC ruling (in case of Samsung) wherein payment for packaged software was held as royalty under the Act as well as tax treaty. As per latest news, hearing is expected to be in the month of January 2019.

1. 16 taxmann.com 141 (Pending for adjudication before Supreme Court)
2. 16 taxmann.com 371

Anticipation from Supreme Court ruling

Reference to international tax laws - OECD Model commentary and commentaries on various international taxation by renowned authors like Klaus Vogel, draws out distinction between 'copyright' and 'copyrighted article' as the main criteria to determine the taxability towards software payments.

The Supreme court is expected to take cue from the following decisions –

- In the cases of Dassault Systems[3] and Geoquest Systems[4], it was observed that only when the rights in the copyright granted enabled commercial exploitation, the payment could be regarded as 'royalty'.
- In the cases of Motorola Inc. v. DCIT[5] , the Tribunal held that the crux of the issue was whether the payment was for a 'copyright' or for a 'copyrighted article'. The tribunal analyzed and concluded that the payment for a copyrighted article cannot be treated as payment for copyright, which could be taxed. The Tribunal here relied on the ratio of decision of the Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh[6] wherein it was held that a transaction for sale of canned goods was clearly sale of goods.
- The Delhi High Court in case of DIT Vs Ericsson A.B.[7], held that a software being an integral part of the hardware equipment could not have an independent use and consequently it could not be taxed as royalty. Although the court here did not deal separately with taxability of off-the shelf software, the High Court relying on the TCS decision (supra) to arrive at this conclusion, is one of the important aspects to decide the aforesaid issue.

The Supreme Court ruling will bring to rest the controversy around taxability of packaged software payments and will provide much-awaited clarity on the vexed issue of taxation of software payments.

3. 322 ITR 125
4. 327 ITR 1
5. 95 ITD 269
6. 271 ITR 401
7. 16 taxmann.com 371

GOODS AND SERVICES TAX

New Compliance Mechanism

The most awaited development on the GST front is the new compliance mechanism, which the government is slated to introduce on an optional basis from 1 April 2019 and compulsorily from 1 July 2019. The GST Council in its 28th meeting had approved the key features and new format of the GST returns which is as below:

Return filing process

- Outward Supplies
  - Facility for continuous uploading of invoices by the supplier and viewing of such invoices by the recipient on the GST common portal.
  - These would be auto populated as 'Annexure of outward supplies' in the main return.
- Inward Supplies and ITC
  - Annexure of inward supplies: To be auto-drafted based on invoices uploaded by suppliers.
  - Credit mechanism
    - Recipient to avail ITC only on the basis of invoices uploaded by supplier.
    - ITC pertaining to invoices uploaded by supplier by tenth of the subsequent month to be available in the same month. The invoices uploaded by the supplier after the tenth of the subsequent month will be available to the recipient only in the return of the next month. For example, if an invoice of April 2018 is uploaded by the supplier on 11 May 2018, the recipient can claim ITC available in respect of such invoice in its return for the month of May 2018 and not of April 2018 resulting in working capital blockage.
  - Provisional ITC in the transition phase
    - The ITC availment mechanism would be relaxed in the transition phase of six months after the new system of return filing is implemented.
    - In the transition phase, the recipient would be able to avail provisional ITC on a self-declaration basis even in respect of those invoices that are not uploaded by the supplier by the tenth of the next month.
    - A 'missing invoice' facility would be available for this purpose. Reporting of 'missing invoices' can be delayed by the recipient for up to two tax periods to allow him time to follow up and get the missing invoices uploaded from the supplier.
- Main return

  A monthly return for all registered persons to be called as "monthly return" in form GSTR to be filed by 20th of the subsequent month. Most of the details of outward and inward supplies to be auto-populated. Certain fields would be required to be entered manually by the taxpayer such as:
  - Advances;
  - Exempt and non-GST supply;
  - ITC reversal; and
  - Amount of tax, interest or late fee.

Other key points

The new return filing procedure has certain additional key aspects such as:

- Amended return filing facility;
- Offline IT tool to be provided by the government for matching of invoices;
- Nil return filing facility through SMS;
- Small taxpayer (annualized turnover for the year 2017-18 up to INR 50 million) can opt for quarterly filing with a monthly payment of taxes - Forms SUGAM and SAHAJ.

The new simplified compliance regime is a significant overhaul of the compliances under the GST and it is imperative for businesses to undertake systemic changes, undertake business impact/ readiness analysis to ensure readiness. The vendor-customer relationships would have to be strengthened in view of their inter-dependency in determining GST liability. Systems should be put in place to ensure smooth and timely compliances. Though the new compliance mechanism is expected to ease the compliance burden and simultaneously check evasion, it would be interesting to see how it would be practically implemented for smooth and timely compliances.

GOODS AND SERVICES TAX

Impact of Special Audits and Data Analytics to Check Evasion

In 2019, it is expected that the government will put into action the provisions of section 65 and section 66 of the CGST Act, 2018 which will provide for audits and special audits to be initiated by departmental officers. Simultaneously, the government has developed data analytics which runs specific programs through the taxpayers' data to identify compliance gaps, mismatches and even evasion. While the taxpayers were being issued unofficial notices by departmental officers to explain such discrepancies, it is expected that in the new year, such mechanisms to check these discrepancies will be intensified. The e-way bill mechanism has also come a long way to check evasion prone supplies without proper invoicing with confiscation of goods and heavy penalties.

In the year 2019, the government is expecting the GST regime to stabilize which will be the right time to tighten anti-evasion measures. The annual return, reconciliations statement and the new compliance mechanism will be the additional tools in the hands of the government to achieve this objective in an effective manner.

GOODS AND SERVICES TAX

Recent Amendments in 2019

The close of 2018 has been cheerful for GST taxpayers with extension in due date for availing ITC pertaining to FY 2017-18, an extension of GST annual return and GST audit due date, waiving of late fees for delay in filing of GST returns and many rate reductions.

The new year of 2019 has brought relief for small and medium-sized enterprises with introduction of composition scheme for service providers (earlier only restaurants had this option), increase in threshold limit under composition scheme for the supplier of goods (from 1 millionto 15 million) and simplification of compliance procedure for composition dealers. With this, the government is encouraging taxpayers to opt for composition scheme and take benefit of the simplified compliance system.

Furthermore, the council has empowered the states to increase the threshold limit to register under GST from INR 2 million to INR 4 million for a supplier of goods. In a nutshell, it can be seen that the recent decisions taken in the GST council meeting are reflective of the government's intention to further simplify GST and minimize the impact of this transformative tax reform on the MSME sector.

Global Developments expectation – 2019

- Digital Economy - Final Report issuance by OECD
- Introduction of VAT in other GCC Countries
- Implementation and Adoption of MLI
- First tax filing in USA - Post Tax Reforms

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