Executive summary

On 29 February 2016, India released the Finance Bill, 2016 (FB 2016) for financial year 1 April 2016 to 31 March 2017. The FB 2016 introduces a number of proposals influenced by the Organisation for Economic Co-operation and Development’s Base Erosion and Profit Shifting (BEPS) initiative. These include implementation of Master File and Country-by-Country (CbC) reporting, introduction of a withholding tax on certain specified digital services and a “Patent Box” tax regime for royalty income. Other significant proposals include but are not limited to a one-year deferral of the applicability of place of effective management (POEM) test in determining corporate residency status, certain exemptions of income of a foreign corporation, exemption from dividend distribution tax (DDT) for companies with units in an International Financial Service Centre (IFSC), reduction in corporate tax rates and a broader application of buyback tax (BBT). Unless otherwise specified, the proposals generally apply to a taxable year beginning on or after 1 April 2016.

This Alert highlights the key international tax proposals in the FB 2016.
Detailed discussion

Implementation of Master File and CbC reporting
The FB 2016 proposes to implement the Master File and CbC reporting for international groups with consolidated revenues exceeding €750 million (US$815 million). Detailed provisions are expected to be introduced at a later date.

New withholding tax on certain digital services
The FB 2016 proposes to introduce a 6% withholding tax on consideration for specified services received or receivable by nonresidents (NRs) from an Indian resident or an NR with a permanent establishment (PE) in India.

Specified services include online advertisements, provision for digital advertising space, provision for any facility or service for online advertisements and other notified services.

No withholding tax will be assessed if the NR providing the specified service has a PE in India to which the service is effectively connected or where the aggregate amount of consideration in a taxable year does not exceed INR 0.1 million (US$1,500).

This tax will become effective as of the date specified in a notification to be issued separately.

“Patent Box” tax regime for royalty income
The FB 2016 proposes to introduce a 10% (plus surcharges) concessional tax rate on gross basis for worldwide royalty income arising from the exploitation of patents developed and registered in India by Indian residents. Income eligible for this benefit includes royalties from a transfer of all or any rights of a patent, making available of any information concerning the working or the use of a patent, or use of any patent or rendering of any services in connection with the preceding activities.

One-year deferral of POEM test to determine corporate residency
The applicability of the POEM test to determine corporate residency status has been deferred by one year until tax year 2016-17 and thereafter. Accordingly, for the tax year ending 31 March 2016, a foreign company would continue to be treated as a resident of India if during the year, the control and management of its affairs is situated wholly in India.

Income exemptions for foreign companies
- Storage and sale of crude oil stored in facilities in India
  The Indian Government will be setting up underground storage facilities for storage of crude oil to achieve its price stability.
  The FB 2016 proposes to exempt income of the foreign company arising from storage of crude oil in any facility in India and sale of crude oil from it to any person in India, subject to certain conditions. These provisions would retroactively apply for tax years beginning on or after 1 April 2015.
- Activities of display of uncut and un-assorted diamonds in “special” zones
  A Special Notified Zone (SNZ) was created to facilitate shifting of operations by foreign mining companies (FMCs) to India and to permit trading of rough diamonds in India.
  Under the FB 2016, when the activities of FMCs are confined to display of uncut and un-assorted diamonds in an SNZ, no taxable income would arise in India. This will be retroactively applicable for tax years beginning on or after 1 April 2015.

Tax incentive for a unit set up in IFSC
The current ITL provides for certain income-linked incentives in respect of a unit in an IFSC. To facilitate and incentivize the growth of the IFSC regime into a world class hub, the FB 2016 proposes the following additional tax benefits:
- For a company located in an IFSC that derives its income solely in convertible foreign exchange:
  - A 9% (plus surcharges) MAT rate would apply
  - Distributions (either in the hands of the distributing company or in the hands of the recipient) are not subject to DDT
  - Long-term capital gains from transfer of equity shares or units of an equity oriented fund or units of a business trust would be exempt from tax, provided the transaction is undertaken in a foreign currency on a recognized stock exchange located in an IFSC. This proposal would become effective as of 1 June 2016
Beneficial tax rate/exemption in certain cases of capital gains income

The FB 2016 includes a plan to extend the 10% (plus surcharges) concessional tax rate of to long-term capital gains on a transfer of private company shares. Further, the current three-year holding period requirement will be reduced to two years for private company shares, although this has not been specifically stated in the FB 2016.

Corporate tax rate reductions

To implement a corporate tax rate reduction from 30% to 25%, the FB 2016 proposes to introduce the following:

Reduction in tax rates

- A 25% (plus surcharges) rate for domestic companies set-up and registered after 1 March 2016, engaged in manufacturing business and not claiming any tax incentives
- A 29% (plus surcharges) rate for domestic companies where the total turnover in the tax year ended 31 March 2015 does not exceed INR50 million (approx. US$0.75 million).

The rate reductions will have corresponding phase-outs of exemptions and deductions.

Exemption from furnishing Permanent Account Number (PAN)

NRs without a PAN (Indian tax identification number) are currently subjected to the higher of 20% withholding tax or the applicable tax rate on receipt of taxable Indian income. The FB 2016 contains a provision which would exempt an NR from obtaining PANs, if certain conditions are met by the NR. This amendment is proposed to be made effective as of 1 June 2016.

Broader application of BBT on distributed income on a prospective basis

Under the ITL, a BBT is imposed on a company that buys back its unlisted shares on the amount of distribution reduced by the amount received by the company for issue of such shares, if the share buyback is undertaken pursuant to certain provisions of the Indian Corporate Laws. The FB 2016 would extend this assessment to buybacks under other provisions of the Indian Corporate Laws, including court approved buybacks. These provisions are proposed to be effective as of 1 June 2016.

Implications

The FB 2016 demonstrates India’s commitment to implement a number of BEPS recommendations over a period of time through legislative amendments, as well as through changes to rules and administrative procedures. International investors would need to carefully monitor developments and assess the impact on their operations. International groups would need to assess readiness and begin preparing for complying with the Master File and CbC Reporting requirements.
For additional information with respect to this Alert, please contact the following:

**Ernst & Young LLP (India), Mumbai**
- Sudhir Kapadia  
  +91 22 6192 0900  
  sudhir.kapadia@in.ey.com

**Ernst & Young LLP (India), Hyderabad**
- Jayesh Sanghvi  
  +91 40 6736 2078  
  jayesh.sanghvi@in.ey.com

**Ernst & Young LLP, Indian Tax Desk, New York**
- Riad Joseph  
  +1 212 773 4496  
  riad.joseph1@ey.com
- Amit Gouri  
  +1 212 773 7096  
  amit.gouri1@ey.com
- Sameep Uchil  
  +1 212 773 4862  
  sameep.uchil@ey.com

**Ernst & Young LLP, Indian Tax Desk, San Jose**
- Neeraj Khubchandani  
  +1 408 947 5600  
  neeraj.khubchandani@ey.com

**Ernst & Young LLP, Indian Tax Desk, Chicago**
- Romit Patel  
  +1 312 879 2526  
  romit.patel1@ey.com

**Ernst & Young LLP, Asia Pacific Business Group, New York**
- Chris Finnerty  
  +1 212 773 7479  
  chris.finnerty@ey.com
- Kaz Parsch  
  +1 212 773 7201  
  kazuyo.parsch@ey.com
- Bee-Khun Yap  
  +1 212 773 1816  
  bee-khun.yap@ey.com

**Ernst & Young Asia Pacific Business Group, Houston**
- Trang Scott  
  +1 713 751 5775  
  trang.scott@ey.com
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