



INDIAN LEGAL AND BUSINESS UPDATE

JULY 1- JULY 31, 2009

1. Highlights of Union Budget 2009

The Annual Budget of the Federal government, which contains the key tax proposals of the Government, was presented by the Finance Minister before the Parliament on 6th July 2009. Here are some key tax proposals:-

a) Direct Tax

- New Direct Tax code to be introduced shortly for public debate.
- Maximum tax rate for individual and firm reduced from 33.99 percent to 30.90 percent on account of removal of surcharge.
- No change in the corporate tax rates.
- The Fringe Benefit Tax Scheme introduced in 2005 is proposed to be abolished. It is also proposed to restore the taxation of fringe benefits including employee stock options as perquisites in the hands of the employees.
- The rate of minimum alternate tax is proposed to be increased from 10 percent – 15 percent.
- Commodities Transaction Tax is proposed to be abolished.
- Taxation scheme for LLP prescribed on the same lines as currently applicable for Partnership Firms, ie. Tax will be levied on LLP and Partners will be exempt from tax.

b) Indirect Tax

i. GST

The Finance Minister has reaffirmed the commitment of the Central Government in accelerating the introduction of the GST by April 01, 2010 and has commended the work done by the Empowered Committee of State Finance Ministers in preparing the design of the dual GST. The dual GST will comprise the Central GST and the State GST and that the Centre and State will each legislate, levy and administer the Central GST and the State GST respectively.

ii. Customs

The peak rate of Basic Customs Duty (BCD) for all non agricultural products has been maintained at 10 percent.

iii. CENVAT

The general CENVAT rate of 8percent has been retained. The duty rate on items currently attracting 4 percent has been increased to 8percent with some major exceptions. These changes reflect a step towards the convergence of the CENVAT rate to 8percent.

iv. Service Tax

The rate of service tax continues at 10percent. The Government has broadened the service tax base by introducing several new categories of services and by expanding the scope of certain existing services.

2. Annual Economic Survey of the Government of India

The Economic Survey predicts GDP growth as high as 7.75percent in 2009-10 if the global economy turns up by autumn, and a reasonable 6.25percent if the global recession drags on. Exuding confidence on the external front, the survey predicts a current account surplus of upto 2.8 percent of GDP, and estimates that the inflow of FDI into India in 2008 was USD 46.5 billion.

The document suggests that disinvestments of public sector undertakings can raise at least Rs. 25,000 crore (USD 5 Billion) per year for the government. The survey also suggests the re-introduction of tax on dividends (in place of the corporate dividend tax). If implemented, millionaires who today pay no tax on dividends will pay it henceforth at the highest rate. The document claims that high savings and investment rates, rural prosperity, and resilient service exports have kept the economy going despite horrendous global conditions. It focuses less on the need for fresh economic stimuli than on post recession strategy to reverse fiscal and monetary easing, and stresses the need to return to FRBM targets, possibly by 2010-11.

On the fiscal side, the proposed reforms include a cyclically-adjusted zero deficit target; limiting LPG consumption to 6-8 cylinders/year per family; decontrolling petrol, diesel prices and fertilizer and sugar industries freeing fertilizer prices and instead giving fertilizer subsidies directly to farmers; auctioning 3G spectrum; eliminating tax exemption and moving towards a uniform duty structure that eliminates inverted duties; lifting the ban on agricultural futures; liberalizing spot and future currency markets; auctioning rights to external commercial borrowings; phasing of FDI limits in banks and aligning voting rights with shareholding; allowing private sector entry into coal mining and nuclear power; creating a competitive electricity market by liberalizing open access; raising FDI

limits to 49 percent in insurance, and to 100 percent for companies providing every type of insurance; raising the FDI limit to 49 percent in insurance, and to 100 percent for companies providing every type of insurance; raising the FDI limit to 49 percent in insurance, and to 100 percent for companies providing every type of insurance; raising the FDI limit to 49 percent in defense industries, implementing police, judicial and administrative reforms and amending labour laws to permit up to 12 hours work per day including overtime.

3. Government allows firms to share space in IT SEZs

The Union Commerce Ministry has allowed leasing of space within infotech Special Economic Zones (SEZs) on shift basis, making it possible for two companies to operate from a common space within the zones at different times of the day.

The ministry has clarified that an IT SEZ developer can now lease the same space to two companies on shift basis. Each of these companies will operate from the same area, but will have some dedicated space to store their equipment like data servers. Detailed guidelines in this regard will be announced soon.

In another significant move, the ministry has laid down guidelines for a single window clearance mechanism for the zone.

4. Foreign data providers' income not taxable

Foreign data service providers' earnings through subscription fees from an Indian company will not be taxed in India, the Authority for Advance Rulings (AAR) has ruled. However, the AAR has held that providing access to compact information through data retrieval software could be treated as service of a 'technical nature'. Such payments are taxable. Data service providers, which have databases outside India, but subscribers in India, are likely to gain from this ruling.

The AAR has given the ruling in the case of US based financial data analytics firm Fact Set Research Systems, which provides financial and economic information to Indian customers by entering into licence agreements with them, granting them the right to use its database and software tools.

As per the AAR, providing a client with the use of search and retrieval software and access to a database does not involve the exercise of special skill or knowledge when the software and database is delivered to the client. Thus, payments by Indian companies cannot be seen as money spent on service of a 'technical nature'. Under the income tax laws in India, receipts in lieu of technical services are taxable. While ruling by the AAR are case specific, they have a persuasive impact on tax assessment in cases of other firms under similar circumstances. The Income Tax department had argued that the money received by Fact Set Research was towards consideration of the transfer of copyright held

by the company on its database.

5. Government to revive Companies Bill without any changes

The Cabinet approved re-introduction of the Companies Bill of 2008 as the Companies Bill, 2009, in the Budget session of Parliament. The Companies Bill of 2008, which intends to modernize and ushering a single framework for regulating Indian companies from incorporation of liquidation, was passed in the lower house of the Parliament last year, but lapsed with the change of the government. The Bill is being revived in its current form without any tinkering done with it.

The Bill is unlikely to be cleared in the current session of Parliament and is likely to be referred to a standing committee, which would delve into the Bill and likely recommend changes. These recommendations would be incorporated in the Bill before it is presented before Parliament for approval. The process can take at least a year.

The Companies Bill, 2009, seeks to enable the Indian corporate sector to operate in a regulatory environment of best international practices that foster entrepreneurship, investment and growth.

6. Gay sex legalized - Section 377 of Indian Penal Code held unconstitutional by Delhi High Court

In a victory for gay rights activists, the Delhi High Court legalized homosexual acts among consenting adults, holding that the 149 year old law, making it a criminal offence was violative of fundamental rights and not punishable. However, the Bench ruled that Section 377 of the Indian Penal Code which criminalizes homosexuality will continue for non consensual and non vaginal sex involving minors.

7. Companies routing funds to evade taxes to be brought into tax net

The government is mulling new laws to bring into the tax net domestic companies which deliberately route their overseas investments through tax havens to avoid paying taxes at home. The inclusion of new provisions in the existing tax laws, called Controlled Foreign Corporation (CFC) laws, was also suggested by the Kelkar Task Force on tax reforms. In view of a spurt in overseas investment by Indian companies, it has become necessary to frame CFC laws to prevent loss to the exchequer. Several developed countries like the US, the UK and Germany have similar laws. Some of the countries like China, Malaysia and Indonesia, too, have framed their own set of laws to tax companies which try to evade payment of tax by routing investments through tax havens.

India, however, is still debating on the modality of the CFC, though the Kelkar report, submitted to the government six years ago, had recommended "introduction of anti-abuse provisions in the domestic law, enacting of CFC regulations and the law relating to thin

capitalisation”. The advantage of having CFC laws is that it will not be affected by the Double Taxation Avoidance Agreement (DTAA). As per the OECD and UN model Convention (on tax laws), CFC rules are not affected by the double tax treaty. Currently, the profits of subsidiaries of Indian companies are not taxable in India, as there are no laws to bring them under the tax net. In fact, foreign subsidiaries do not declare their dividends to avoid being taxed in India. In case such tax laws come into place, a rule will have to be inserted into the original tax laws of the country. Also, a change has to be introduced in the tax return forms to mention if any company has a foreign subsidiary, and if it does, which countries.

8. Government mulls ‘creeping disinvestment’

The Union Finance Ministry is examining a proposal that seeks to dilute the government’s stake in all listed public sector undertakings to at least 90 per cent.

The proposal is an offshoot of the government thinking that there is no need for a big band approach to PSU disinvestments. In fact, the new government’s agenda for action, finalized by the Cabinet secretariat, had recommended that public sector disinvestments should take place in small doses. There are about a dozen listed public sector undertakings (PSUs) in which the government’s stake is between 90 and 99 per cent.
