Budget 2014: 5 tax rules that need immediate attention of the FM

By Daksha Baxi

The upcoming budgetary announcement is perhaps the most eagerly awaited one in recent memory. It is viewed as first big policy announcement on the economic front by the new government and an indicator of the direction the government would take towards economic growth. With only a few weeks to go, we present our predictions on changes the Finance Minister may make to the tax laws of India.

1. **Retrospective Taxation:** Post the decision of the apex court in the Vodafone case, the tax law was retrospectively "clarified". It said that transfer of shares of a foreign company which derived substantial value from Indian assets was taxable in India. The ambiguity of the clarification and retrospective application created uproar. First, the law does not specify what constitutes 'substantial value'. Second, it does not provide how this valuation should be determined. Is it the valuation of the Indian company as per Indian valuation norms or the valuation of the foreign company that must be considered? This retrospective change in application of law is unfair for past transactions. It should not only be made prospective, but there should be absolute clarity on the manner in which such transaction would be taxed in India. Even where substantial value is derived from Indian assets, only gains attributable to Indian assets should be taxed in India. Certain transactions should be exempt from this tax. For instance, transfer of shares of a listed foreign company which derives value from Indian assets should be outside the purview of the Indian tax net, since typically the listing and subsequent transfer of such foreign shares is not with the intention of avoiding Indian tax, but is aimed at tapping foreign capital markets. The retrospective amendments have had a negative impact on India's image as a jurisdiction where the rule of law is upheld, and remedial action is a must.

2. **General Anti-Avoidance Rules (GAAR):** Another area of concern is the GAAR which seeks to counter tax avoidance adopted by taxpayers. It is set to come into effect from 1 April, 2015. Under this law, the tax authorities are given wide powers to classify a transaction as a tax avoidance arrangement. However, the criteria set out for determination of what constitutes a tax avoidance arrangement are largely subjective, and this in turn has made investors nervous. The Finance Minister should set out certain objective and tangible criteria for determining the applicability of GAAR to a transaction. Further, where specific anti-avoidance provisions apply, GAAR should not be invoked so as to avoid application of multiple anti avoidance provisions.

3. **Tax on long-terms capital gains earned by NRI investors:** The Finance Act, 2012 reduced the tax rate on long-term capital gains earned from sale of unlisted securities by non-resident investors from 20% to 10%. The use of the term "security" as defined under the Securities Contracts (Regulation) Act, 1956 has created ambiguity. This restricts the applicability of lower rate to gains from transfer of shares only of unlisted public companies and not of private companies. Clarity needs to be provided.

4. **Reviving Special Economic Zones:** Growth in the manufacturing sector in India has been lacklustre and this has contributed to the fiscal deficit. Fixed term tax sops for the developers of SEZs and for units operating in SEZs are essential to provide a fillip to the sector. The present tax regime takes away the benefit of sops by imposing Minimum Alternate Tax (MAT) on the income of developers of SEZ and units operating in SEZ. This coupled with issues surrounding land acquisition has been primarily responsible for the lack of growth of SEZs. The abolition of MAT for both developers of SEZs and the SEZ would boost this sector.

5. **'Tax pass through' for all categories of AIFs:** SEBI introduced the Alternate Investment Funds (AIFs) Regulations, replacing the erstwhile Venture Capital Fund Regulations (VCF Regulations) two years ago. While a 'tax pass through' status is given to all venture capital funds registered under the VCF Regulations, in the case of AIFs the pass through status is extended only to a certain sub-category of category-I AIFs and that too with additional conditions and riders. AIFs are a critical source of inexpensive capital. The Finance Minister will do well to accord a pass through tax treatment to all Categories-I AIFs, if not all categories of AIFs.

The author is Executive Director in the Tax practice at the law firm Khaitan & Co, Mumbai.

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