

CBDT Provides Tax Clarity on M&As

An internal instruction by the foreign tax division of the Central Board of Direct Taxes (CBDT) will put an end to litigation relating to the tax to be withheld at source in India by the Indian payer in cross-border transactions, including mergers and amalgamations (M&A) deals.

If the Indian payer has failed to deduct tax at source, it will be liable for non-deduction only in respect of that portion of payment which is taxable in India in the hands of the overseas party, says a recent internal communique addressed to all Chief Commissioners and Director Generals of Income-tax.

Under India's tax laws, when any payment is made to a non-resident or a foreign company - say for purchase of goods or services, or purchase of shares in an M&A deal - tax is required to be deducted at source (TDS) by the Indian payer at the applicable rate. If this is not done, the Indian payer is treated as an 'assessee in default' and is subject to penal interest and stiff penalties.

Further, even the payment made on which tax has not been deducted is denied as a business expenditure in the hands of the Indian payer.

This internal instruction clarifies that in cases of non-compliance with TDS provisions, the Indian payer can be treated as an 'assessee in default' only in respect of that portion which is chargeable to tax in India in the hands of the overseas recipient. These instructions will provide a lot of clarity to cross-border M&A deals where the quantum of overseas remittances involved is very high. According to various research reports, outbound cross-border M&As were valued at more than \$9 billion during 2013.

"For instance, in a cross-border M&A transaction, when remittances are being made by an Indian company for purchase of shares from a non-resident, tax should be deducted at source only on the capital gain if it is chargeable to tax in India and not on the gross purchase consideration. These internal instructions will bring clarity to M&A transactions. Further, it will also considerably reduce litigation with the tax department when the Indian payer was treated as an 'assessee in default'," illustrates Punit Shah, co-head of tax at KPMG.

This internal instruction is binding on the tax authorities. To ascertain the liability in the hands of the Indian payer who is treated as an 'assessee in default', tax officials will have to consider the nature of overseas remittance, the income component in such remittance and other relevant facts.

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