To widen tax base, govt may tweak foreign taxation rules

New norms to apply to profits of foreign firms as well as those of Indian ones abroad

India is set to revamp its foreign taxation norms in the upcoming direct tax code to widen its corporate tax base and prevent other nations from taking a bigger chunk of profits their multinational companies earn in India. A government task force is studying the Income Tax Act to identify provisions that need to change and propose amendments, an official aware of the matter said. The new norms will apply to profits of foreign companies in India, as well as that of Indian companies abroad.

The task force is expected to make its recommendations by the end of May, after which a public consultation for legislative work on the new tax code will start. The move could reset the balance of taxation powers between India and developed nations with respect to cross-border investments. It could also necessitate business strategy changes by both Indian firms investing abroad and non-resident companies doing business in India without a subsidiary.

This assumes significance in the wake of US having in late 2017 enacted the Tax Cuts and Jobs Act under which taxes accumulated on un-repatriated foreign earnings of US companies were treated as 'deemed dividend'. This tax is applicable whether or not the US shareholder of the foreign firm has received the dividend.

"We are reviewing global taxation provisions in the Income Tax Act. Globally, every country wants to protect its tax base. However, developed countries and developing nations do it in different ways. Developed countries are net exporters of capital and technology while developing countries are net importers. The US, for example, wants to tax profits of its firms that are generated in other markets while India wants to tax as much of the profits here," said the official mentioned above who is also aware of the discussions in the task force, on condition of anonymity.

The move to revamp foreign taxation norms could strengthen tax provisions relating to foreign companies accessing Indian markets as well as Indian companies with global operations, but keep profits outside the country, said experts. "The idea is to make sure every business pays its fair share of tax," said Girish Vanvari, founder of advisory firm Transaction Square. Non-resident firms with operations in India other than in the form of a subsidiary are now subject to a 40% tax on their profits attributable to India. The focus is on ensuring that the profits attributable to India are in line with the actual margins they earn from Indian operations.

The second area that may be strengthened is India's 'place of effective management' rules that determine whether a foreign incorporated entity is an Indian resident firm for tax purposes, based on where its effective management is located. Pharma, IT, auto components, chemicals, and tyres are key sectors in which Indian firms have been investing abroad.

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