Uncertainty in tax laws still major concern for foreign investors

The govt recently decided not to appeal against the Bombay HC's ruling in the Vodafone case

After the government removes uncertainty over share transfers to parent companies by Indian subsidiaries of multi-national corporations (MNCs), tax analysts say that investors are eyeing similar steps by the authorities in other areas of dispute to allay their fears about uncertain tax policies in India.

These relate to retrospective amendments in indirect transfers and royalty carried out in 2012, even as the government has assured investors about extreme caution in using these laws in practice. The amendments remain in statute and have not been done away with.

Although the government has more or less settled cases similar to the Vodafone case, it is yet to sort out issues relating to mark-ups in other transfer pricing (TP) cases.

The government on Wednesday decided not to appeal against Bombay High Court's ruling that went in favour of Vodafone over a TP case, related to share transfer of Vodafone India Services Private Limited (VISPL) to its parent company.

VISPL is a wholly owned subsidiary of a non-resident company, Vodafone Tele-Services (India) Holdings Limited, Mauritius. In August, 2008, VISPL issued shares (at a premium of Rs 8,509) which resulted in VISPL receiving a total consideration of Rs.246.39 crore from Vodafone Mauritius. This was shown as "Capital Receipts" in the books of accounts. VISPL reported this transaction as an "International Transaction" and stated that this transaction does not affect its income. Transfer pricing officer did not accept the share valuation of the company, but the basic point in law was whether income arising out of share transfer could be taxed in India.

With Bombay High Court's ruling that this income cannot be taxed in India, and the government not appealing, similar cases are now settled.

However, there are still TP cases where there is disagreement between companies and tax officers relating to margins or mark-up in transaction of multinational companies with their Indian subsidiaries. This issue is yet to be settled particularly relating to BPO and KPO sectors.

The issue was more or less settled with US after New Delhi and Washington sealed an agreement to this effect.

The major concern for MNCs and other nations is the mark-up and tax dues on costs for services provided.

Instead of a fixed mark-up, the framework sets out the process for determining it.

"The mark-up will be based on activities of the company. That will make it easier for companies and tax authorities to work through cases," said a tax official.

Neeru Ahuja, tax partner with Deloitte India, said tax authorities are taking margins as high as 30-35 per cent, which BPO and KPO companies find too high.

After signing with US, the tax authorities are looking at inking similar agreements with UK, France and other European markets to settle such rows with MNCs.

Also, the government may sign bilateral advance pricing agreement with US after assessing the impact of the agreement on the mark-up issue.

Many multinational corporations adopt advance price agreements to avoid litigation while doing business in India. In 2012, 146 applications were filed, followed by 232 the next year.

India recently signed a bilateral advance price agreement (APA) with Japan's Mitsui for five years. Such bilateral agreements involve the governments on the two sides as well as the company concerned, unlike unilateral APA's where the overseas government concerned is not involved.

In the first tranche, the governments are hoping to resolve 60 cases pending with the income tax department in various stages of litigation and assessment.

There are more than 250 cases against US companies, some dating back to 2004. Many of these include royalty and permanent establishment and involve software development and infotech-enabled services.

In this respect, retrospective amendments relating to widening of ambit of royalty for software payments and payments to telecasting companies still remain in statute. The amendment, carried out in the Finance Act of 2012 is valid from 1976.

The more publicised and controversial retrospective amendment relating to indirect transfers is also there in law, even though the government has assured the investors that it would be extremely cautious to apply it in practice. The amendment which led to a dispute with Vodafone even after the Supreme Court verdict in the company's favour has scared investors away, the government has said time and again.

Vodafone and India are embroiled in arbitration relating to the case.

Ahuja said though the government has assured the investors, but the very fact that amendments are there in the Finance Act creates uncertainty in the minds of foreign investors.

In the Budget for 2014-15, Finance Minister Arun Jaitley had said,"The sovereign right of the Government to undertake retrospective legislation is unquestionable. However, this power has to

be exercised with extreme caution and judiciousness keeping in mind the impact of each such measure on the economy and the overall investment climate."

He had assured investors that the government will not ordinarily bring about any change retrospectively which creates a fresh liability.

The finance minister had also said that the government has decided that all fresh cases arising out of the retrospective amendments of 2012 in respect of indirect transfers will be scrutinized by a High Level Committee of the Central Board of Direct Taxes before any action is initiated in such cases.

"This only refers such cases to higher authorities, but does not remove uncertainty," a tax expert said on the condition of anonymity.

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