Direct Tax

UNION BUDGET 2011-2012

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No big-bang reforms, there were only a few small surprises

- Govt imposes minimum alternate tax on SEZs; big jolt to IT companies, developers
- Corporate tax surcharge cut to 5% brings little cheer as tax burden is only a tad lower
- Tax on foreign dividends lowered to encourage Indian firms to bring back cash from overseas arms
- Tax exemption on infrastructure debt funds to give a big boost to the sector

VOYAGE FROM '91

Corporate Tax: A Case for Cleanup

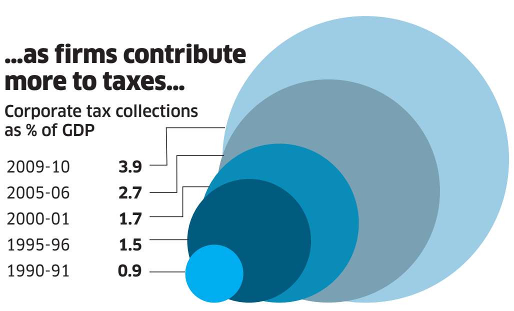
India has moved progressively towards lowering corporate income tax rates and the results have been good for companies and the government. But the tax regime is still complicated and unfair to smaller companies

Lower tax rates and better compliance have helped raise collections...

Tax rates in %, collections in ₹ cr

YEAR	TAX RATE PUBLIC CO	TAX RATE PRIVATE CO	COLLECTION
1990-91	51.75%	57.5%	₹5335Cr
2009-10	33.2%	33.2%	₹255076Cr

...as firms contribute more to taxes...



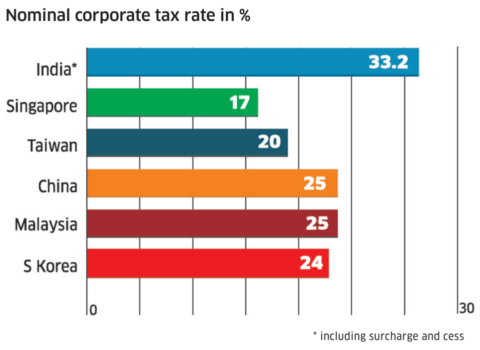
...which is in line with the trend in the developed world

$4 Trillion

This is the amount India Inc is expected to shell out in corporate taxes by 2050

The direct tax regime is still complicated which prevents the government from lowering the rates as...

Nominal corporate tax rate in %



* including surcharge and cess

...yet the effective burden of tax is less than the rate...

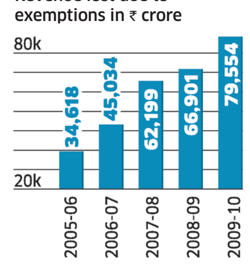
Effective tax in %

PBT* (₹ Cr)	EFFECTIVE TAX RATE
0-1	25.52
1-10	23.99
10-50	22.35
50-100	22.21
100-500	22.26
Over 500	22.05

*Profit Before Tax

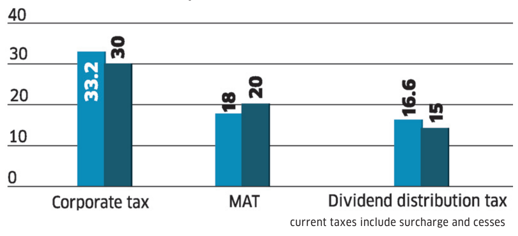
... because of the slew of exemptions enjoyed by India Inc

Revenue lost due to exemptions in ₹ crore



Towards a Simpler Regime

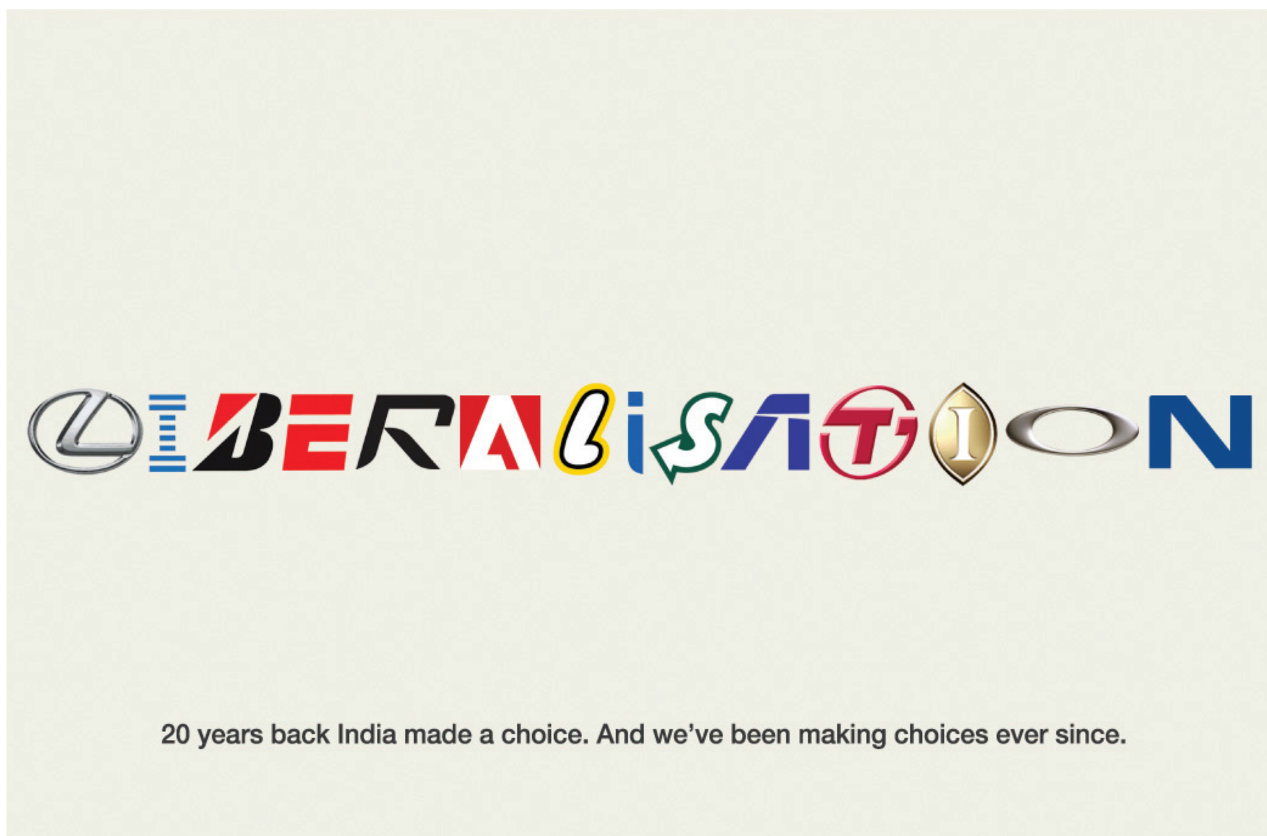
India is poised to get a new tax code that will settle rates at a lower level, simplify rules, remove exemptions and evenly distribute the tax burden



current taxes include surcharge and cesses

Tailored, not Tinkered

With a firm April 2012 deadline for implementing the Direct Taxes Code, the budget focuses on removing big ticket exemptions and creating a stable tax regime. The big new change is MAT on SEZs



MCCANN WORLDGROUP

The choice 20 years ago was between continuing one of the oft-taken path or charting a new course. India took the new road and the Indian consumer is now spoilt for choice. As a result of the reforms initiated in 1991, the world is coming swiftly to terms with India's growing power and its rapid rise in the world order

what it means for india inc

No Major Cut, But Some Relief

The cut in surcharge on corporate tax for domestic firms will bring down their overall tax rate by 0.77%. Though this is not a major reduction, it is a welcome relief. Also, the minimum alternate tax has been raised marginally to off-set the reduction in surcharge, meant to be a temporary levy. Surcharge will end once the DTC kicks in by April 2012.

Transfer Pricing Norms Tweaked

Multinational companies doing business in the country will find it tough to shift hefty profits to off-shore group firms to escape tax. The tax department will now have additional powers to clamp down on MNCs mis-pricing products or services. But disputes could come down once the government fixes a markup or acceptable deviation from the market price.

The surcharge on corporate tax was cut last year while MAT rate was hiked

Lower Tax on Foreign Dividends

With the aim of providing incentive to domestic firms to repatriate money from their overseas subsidiaries, the Budget has halved the rate of tax on dividends received by a company from its foreign subsidiary to 15%. This will encourage local companies to bring back cash from their overseas arms. Joint ventures, where an Indian company owns less than 50% equity, will not enjoy the concessions.

Tax Break for Cheaper Foreign Funds

Debt funds for financing infrastructure will get tax exemptions. The government is betting big on cheaper overseas funds, with FII investment cap in corporate bonds of infrastructure firms raised from $5 billion to $25 billion. NRIs and others investing in infrastructure funds will now enjoy a lower withholding tax of 5%, encouraging them to bring back the money they may be holding on behalf of residents.

In Black and White

THE Budget has no amnesty scheme to bring back black money stashed away in tax havens. But there are measures to "punish" countries that hide tax cheats. Indian companies that do business in such countries will be charged a higher withholding tax-like fee on services they offer. These companies will also have to face transfer pricing audits to prove they are not shifting profits outside India. They won't get any tax benefits in India on payments made to financial institutions based in such countries. They will also have to explain the source of funds.

ET COMMENT

HEMA RAMAKRISHNAN

Tax Reform Beats Tax Lobbies

PRANAB MUKHERJEE HAS presented a few commendable proposals on direct taxes to enable a stable tax regime. Among them is a masterstroke ending tax holidays for developers of Special Economic Zones (SEZs) and the companies located within such zones. In doing so, the government has fast-tracked reform and said clearly it is shunning patronage.

It has also resisted pressure from companies housed in software technology parks to extend the tax holiday on export profits beyond 2011. A higher Minimum Alternate Tax on zero-tax companies shows the government's resolve to end exemptions. Correctly, the government does not want to persist with incentives for pre-selected economic activities, estimated to cost ₹88,000 crore this fiscal.

A lower corporate surcharge also signals the government's intent to end temporary levies and cut the corporate tax burden. A bolder reform would have been to abolish the surcharge and prepare the ground for a cut in the corporate tax rate to 25% next year.

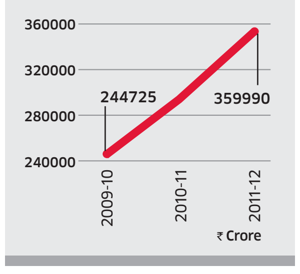
Thankfully, Mukherjee has not announced any scheme to reward tax cheats. Instead, there are proposals to curb tax evasion and prevent companies from stashing billions of dollars in tax havens. Any sanction on countries that refuse to share information on suspected tax evaders is an indirect punishment. It will make the cost of doing business in these places more expensive, diminishing their attractiveness. New transfer pricing rules for multinational companies will ensure that they do not shift profits outside the country. Overall, compliance and collections will improve.

Pranab Pulls the MAT from Under the Industry's Feet

In Focus

Soaring Collections

Corporation Tax



FINANCE MINISTER Pranab Mukherjee left industry grumbling as he ended the tax holiday for developers and companies in Special Economic Zones (SEZs), a year ahead of the roll-out of the biggest direct tax reform framework in the country.

Both companies and developers will pay a minimum alternate tax — charged on companies that enjoy exemptions and pay no tax at all — of 18.5% starting this year.

They will not be spared either of the dividend distribution tax of 15% after June 1, this year.

Industry honchos say the move will dent India's credibility as an investment destination. "The government gave a commitment of no taxes while attracting investments into special economic zones.

It has instead advanced the tax by a year. This is a big negative for foreign investors and another sign of India reneging on commitments," said Dinesh Kanabar, chairman tax and deputy CEO of KPMG.

Sudhir Kapadia, Partner E&Y reckons that the tax regime for long gestation investment decisions should be stable. Else, the entire business assessments go awry.

IT companies are complaining the most. This is because the government has ended the 10-year tax holiday for companies housed in software technology parks. Many software companies have already moved to SEZs to enjoy the tax holiday.

Shefali Goradia, Partner, BMR Advisors, says SEZs will become unattractive for India's $60 billion IT industry. Jeya Kumar, CEO of Patni Computer Systems, agrees.

"We believe that bringing SEZs under MAT will reduce productivity of companies," he said.

The direct taxes code, which will replace the 50-year-old Income Tax Act, had proposed bringing SEZ developers and companies under MAT, given that the broad thrust of the code is to end exemptions. The tax breaks for SEZs alone cost the exchequer ₹5,000 crore in 2009-10. However, tax experts say the government should have waited for the Bill to be vetted by the parliamentary committee.

"The move will adversely impact exports and defeat the goal of doubling India's exports to $450 billion by 2014," said Jatin Mehta, chairman of the Export Promotion Council for EOUs and SEZs. Exports from Sezs stood at ₹2,20,711 crore in 2009-10, accounting for a third of the country's total exports.

"The two biggest attractions for SEZs – no MAT and no DDT have been neutralised in one shot. The rush for SEZs will slow down," said Amitabh Singh, partner in charge of tax and regulatory affairs at Ernst and Young. CA Gupta, tax partner at Deloitte, too, said that it will erode the competitiveness of companies and developers of SEZs.

Team ET

Budget Reflects Good Intent, But Falls Short on Delivery

By Invite

LAKSHMI NARAYANAN
VICE-CHAIRMAN, COGNIZANT

PRESENTING A BUDGET IN the backdrop of multiple headwinds such as high inflation, rising crude prices and slowing economic momentum is a challenging exercise. In that context, reiterating the roadmap of fiscal consolidation has to be viewed as a positive headway. However, the absence of big-bang reforms, especially on the foreign direct investment front, is disappointing.

But starting from where he left off in the last Budget, the finance minister's continued policy thrust on education and technology resonates well across the knowledge industry.

In fact, the IT industry didn't have high expectations. The call for continuation of benefits for STPIs (Software Technology Parks of India) from a cross-section of the industry was muted as the case was made on behalf of the micro, small and medium enterprise (MSME) segment. To be fair, the administration of such a scheme only for a certain segment of the industry would have been very cumbersome. In some respects, I am glad no new complexities have been added.

The ambiguity around service taxes for units in SEZs and the choice of excise versus service tax on software continues. While new clarifications have been made, I don't think it has eliminated any ambiguity. So the administration of various schemes remains as muddled, but thankfully, not significantly worse.

The absence of big-ticket reforms, especially on FDI front, is disappointing

Lastly, nothing reflects the finance minister's accent on "a transition towards a more transparent and result-oriented economic management system" more than the focus on e-governance initiatives introduced on the direct and indirect tax fronts. The multiplier effect of such e-Governance initiatives, including the UID programme, cannot be underestimated in setting the tone for what he called "a newer, vibrant and more efficient economy".