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| **Special Cases- Determination of income of non-residents** | | |
|  | **Rule 10: Attribution of profits to a PE under a tax treaty** | 1. **Adoption of “separate and distinct entity” approach**   At present there exist three standard versions of Article 7 in the tax treaties viz. the two versions that existed in the OECD Model Tax Convention (MTC) pre-2010 and post-2010 and the one that continues to be a part of the UN Model Tax Convention (hereinafter referred to “UN MTC”). The Authorized OECD-approach (AOA) terminology, which was introduced in 2008, is contained in Article 7 of the OECD MTC and to its Commentary of 2010. However, many tax treaties have not yet adopted Article 7 based on the 2010 update. Further, some OECD countries as well as non-member countries have reserved their right to use the previous version of Article 7. Also, the AOA was not accepted by the UN Committee of Tax Experts in the 2011 version of the UN MTC.  The concept of “separate and distinct entity” approach which is embodied in tax treaties pre-dates the introduction of the AOA terminology and the post-2010 OECD MTC. The operative part of Article 7(2) as contained in the OECD MTC (pre and post-2010 versions) and which is contained in almost of India’s tax treaties is as follows: “*…if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment…*” These words clearly represent the arm’s length principle. Subject to a minor change, these wordings have remained the same since the 1963 OECD Draft Convention.  While it is recognized that India has reservations on the AOA and other countries (including OECD members) have not fully endorsed the AOA, one cannot infer or imply that the arm’s length principle as a standard for attributing profits has not been accepted. While reconfirming the “separate and distinct enterprise” approach which already existed prior to 2010, the AOA moves away from a more “restricted concept of independence” which prevailed pre-2010 towards the theory of full independence post-2010. Countries may have reservations against full or greater independence of Permanent Establishment (PE) because of which the same may yet not be reflected in many tax treaties. However, even under the restricted concept of independence, the arm’s length principle is still accepted.  Full independence of PE under the AOA envisions taking into account dealings between a PE and its Head Office (HO) to a greater extent than is recognized by the UN MTC. However, certain aspects of the AOA would therefore be in conflict with Article 7(3) of the UN MTC which generally disallows deductions for amounts paid (other than toward reimbursement of actual expenses) by a PE to its HO. A similar rule can be found in most of India’s tax treaties as well.  Subject to the above significant difference (and the limited “force of attraction” rule), Article 7 in the UN MTC and the 2008 OECD MTC are largely consistent. Specifically, there is general acceptance of the arm’s length principle embodied in the OECD MTC, under which the profits attributable to a PE are those which would be earned by the PE if it were a wholly independent entity dealing with its HO as if it were a “separate and distinct enterprise” operating under conditions prevailing in the regular market. Thus, for attributing profits, “separate and distinct entity” approach using the “arm’s length principle” is followed. This principle applies regardless of whether a tax treaty contains the pre-2010 version of Article 7 (that does not require the use of the AOA) or the post-2010 version of Article 7 of the OECD MTC.  The application of the arm’s length principle to the allocation of profits between the HO and its PE presupposes for most countries that the domestic legislation authorizes a determination on the basis of the arm’s length principle. As observed in paragraph 14 of the Commentary on Article 7 of the 2008 OECD MTC, since the arm’s length principle also extends to the attribution of profits which the PE, where an enterprise of a contracting state carries on its business activities in the other contracting state through a PE situated therein, it would be necessary to attribute to such PE the profits which it could be in a position to make if it were a “separate and distinct entity” engaged in the same or similar activities under the same or similar conditions and operating at arm’s length, and dealing wholly independently with the enterprise of which it is a PE.  Accordingly, all of India’s tax treaties have also been negotiated and signed based on “separate and distinct entity” concept for attributing profits to PE. This clearly embeds the “arm’s length principle” as dealt with in the TP analysis which requires undertaking a FAR analysis. Further paragraph 4 of Article 7 of the 2008 OECD MTC as well as UN MTC (as contained in the Indian tax treaties) allows for apportionment of profits where the correct amount of profits attributable to a PE is incapable of determination or the determination thereof presents exceptional difficulties. However, this does not disregard the inherent arm’s length principle, since Article 7(4) explicitly provides that the result shall be in accordance with the principles contained in Article 7, routing back to the “arm’s length principle”.  **Therefore, determining profits attributable to PE on the basis of the “arm’s length principle” is not a new concept arising out of 2010 update to OECD MTC, but a concept which is embedded in taxing principles for a long time. Also, the international consensus has been that the profits should be attributed to a PE based on the “separate and distinct enterprise” concept, and the application of the “arm’s length principle”. Given the above, it is recommended that the arm’s length principle should not be disregarded while implementing the principles. The adoption of this principle would be consistent with the Indian TP rules as well as the Indian jurisprudence on the matter, as has been discussed in the ensuing sections.**   1. **Indian TP rules and jurisprudence on PE profit attribution**   The Indian TP rules as well as the Indian jurisprudence on PE profit attribution require and recognize the use of the “arm’s length principle” between a PE and its HO. This is discussed below.  The Indian TP regulations prescribe that any income, allowance for any expense or interest arising from an “international transaction” shall be computed having regard to the arm’s length price. However, as an exception, the above provision shall not apply in a case where the determination of income, allowance for any expense or interest has the effect of reducing the income chargeable to tax or increasing the loss, as the case may be, of the taxpayer. According to Section 92B(1) of the Income-act Act, 1961 (the Act), the term “international transaction” means:   * A transaction between two or more AEs, either or both of whom are non-residents; and * The transaction is in the nature of purchase, sale or lease of tangible or intangible property (IP), or provision of services, or lending or borrowing money, or any other transaction; and * Such transaction is having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more AEs for the allocation or apportionment of any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.   **Further, the term “enterprise” is defined under Section 92F(iii) of the Act to mean a person (including a PE of such person) who is or has been or is proposed to be, engaged in in certain activities or business.** **In view of the specific inclusion of the term “PE” in the definition of the term “enterprise”, the transaction between the non-resident and its PE in India would be regarded as “international transaction” for the purpose of Section 92 of the Act.** Accordingly, the “international transaction” between non-resident and its PE should meet the arm’s length principle. Further the non-resident is required to comply with the TP documentation rules and as per which[[1]](#footnote-2) among other things, a description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the AEs involved in the “international transaction” needs to be documented along with the comparability analysis in respect of the “international transaction”.  Further, the Courts in India have repeatedly endorsed the right of the Assessing Officer (AO) to attribute profits under Rule 10, even in cases where tax treaties were applicable, thereby confirming that application of Rule 10 is permissible for attribution of profits in such cases. **However, it may not be correct to say that Indian Courts have upheld India’s right to attribute to profits based on apportionment since, there are plethora of cases which have upheld the significance of TP principles for profit attribution to PE. The application and adoption of the Indian TP regulations in the context of a PE and HO has been recognized and upheld by the Indian courts including the Supreme Court of India. Moreover, post introduction of TP provisions in India, the general tendency of the courts have been to look at the attribution based on TP principles. However, in some cases, inadequate TP analysis have led to conclusions based on formulary apportionment approaches.**  Reference can be drawn to the landmark judgment of the honorable Supreme Court in the case of Director of Income-tax (International Taxation) vs. Morgan Stanley & Co[[2]](#footnote-3) which states as follows:  *Article 7 of the U.N. Model Convention inter alia provides that only that portion of business profits is taxable in the source country which is attributable to the PE. It specifies how such business profits should be ascertained.* ***Under the said Article, a PE is treated as if it is an independent enterprise (profit centre) dehors the head office and which deals with the head office at arm's length. Therefore, its profits are determined on the basis as if it is an independent enterprise. The profits of the PE are determined on the basis of what an independent enterprise under similar circumstances might be expected to derive on its own. Article 7(2) of the U.N. Model Convention advocates the arm's length approach for attribution of profits to a PE****.[Para 31, Emphasis Supplied]*  *The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm’s length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to the PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporates on the basis of the concept of Economic Nexus is an important feature of Attributable Profits (profits attributable to the PE).*  In the case of Hyundai Rotem Company vs. Assistant DIT (International Taxation)[[3]](#footnote-4), the Delhi Income Tax Appellate Tribunal (ITAT) upheld the attribution based on TP principles and ruled that the AO cannot resort to Rule 10 unless he has rejected the TP study on “valid basis”. The relevant extract is as follows:  *16. On a plain reading of this rule suggests that it can be applied in the cases where income accruing or arising to any non-resident from any business connection is such which cannot be definitely ascertained.* ***In the present case, assessee has submitted the transfer pricing report and buttressed its contention with the material that income shown at cost+9% is at arm’s length. Learned Assessing Officer nowhere pointed out that income cannot be definitely ascertained on the basis of the material placed on record by the assessee and, therefore, he is computing the income under Rule 10.*** *Similarly, Learned CIT(Appeals) has not adjudicated this issue rather simply observed on page 31 that no prejudice is caused to the assessee by determining its income under Rule 10. To some extent, we agree to the contentions of the Learned DR that Rule 10 provides a mechanism for taxing the income of a PE under Rule 10, also because once a rule is in existence in a statute book, its existence cannot be denied.* ***One has to determine whether the conditions enumerated in the rules are available for its application or not.******In the present case, if we weigh the procedure provided under Rule 10 read with section 9 vis-à-vis under sec. 92 to 92F read with rules 10A to 10E in the light of transfer pricing study carried out by the assessee vis-à-vis its consistent stand of showing income from this one project spread over in a number of assessment years under a particular method, then the scale would tilt towards the detailed method provided under sec. 92 to 92E read with rules 10A to 10E, for computing the income of PE, like the assessee.******We do not have any dispute about the preposition that it is the Assessing Officer who has to determine the ultimate income of the assessee and recommendations of the TPO are not binding upon him. Similarly, in a given case, rule 10 can be applied. But before that Assessing Officer has to demonstrate that income of non-resident accruing or arising from any business connection in Indian cannot be definitely ascertained from the accounts or from the material available on the record.*** *For the present assessee, the department itself has accepted the method of assessee in a number of years. The Assessing Officer has not pointed out as to how income of the assessee cannot be ascertained in assessment year 2002-03 and 2003-04. Sub Article 5 of Article 7 of the DTAA between India and South Korea provides that profits attributable to PE shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.* ***No reasons are assigned by the Assessing Officer for adopting different method from same source of income, in different years. He simply jumped to apply rule 10 which is not a right course in this case.*** *In view of the above discussion, we hold that income of the assessee be computed at cost+9% as declared by it, and accepted in subsequent year from the same contract.*  In the case of Nipro Asia Pte Ltd[[4]](#footnote-5), the Delhi ITAT noted as follows:  *8. It has been noticed above that the direct sales made by the head office were not recorded in the books of the branch office. It is further not disputed that the assessee booked all the expenses incurred in marketing activity for such direct sales made by the head office without receiving any corresponding income.* ***In such circumstances, coupled with the absence of any correct transfer pricing study report, the AO was left with no alternative but to determine income on some reasonable basis, for which he invoked the provisions of Rule 10 of Income-tax Rules, 1962****.*  *12. ………………. There can be no hard and fast rule of attribution of profit to marketing activities carried out in India at a particular level. In fact, attribution of profits to PE in India is fact based, depending upon the role played by the PE in the overall generation of income. Such activities carried out by a PE in India resulting in generation of income, may vary from case to case. Attribution of income has to be in line with the extent of activities of PE in India.*  In the case of Daikin Industries Limited[[5]](#footnote-6), although the Delhi ITAT computed the profits attributable to PE on an ad-hoc basis; however, it recognized that the profit attribution to PE is a fact based exercise which needs to be examined in light of the TP analysis undertaken by the taxpayer. The relevant extracts are as follows:  *20. …………. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case’. The extant case falls within the ambit of the exception spelt out by the Hon’ble Summit Court inasmuch as transfer pricing analysis in the hands of DAIPL captured only two functions, whereas it actually carried out several others functions as well, which have been itemized above. `In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered.*  *27. It goes without saying that there can be no hard and fast rule of determining the rate of profit attributable to marketing activities carried out in India. It is a fact based exercise, depending upon the role played by the PE in the overall generation of income. Such activities carried out by a PE in India resulting in generation of income, may vary from case to case. Attribution of income has to be in line with the extent of activities of PE in India.*  In the case of B4U International Holdings Limited[[6]](#footnote-7), the honorable Bombay High Court recognized the importance of TP principles in relation to profit attribution to PEs post introduction of TP provisions in India vide Finance Act, 2001. The relevant extract is as follows:  *12. In this regard, Mr. Mistri has rightly pointed out that the requirement and in relation to computation of income from international transactions having regard to arm's length price has been put in place in Chapter-X listing special provisions relating to avoidance of tax by substituting section 92 to 92F by the Finance Act of 2001 with effect from 1st April, 2002. Therefore, such compliance has to be made with effect from assessment years 2002-03 relevant to which is the previous year commencing from 1st April, 2002. ……*  In the case of LG Electronics Inc.[[7]](#footnote-8), the honorable Allahabad High Court stressed that the TP analysis needs to be undertaken between the HO and its PE keeping in mind the principle of arm's length price. However in the absence of the same or where the TP analysis does not adequately reflect the functions performed and risks assumed, it would result in further attribution of profits to PE for those functions or risks that have not been considered. The relevant extract is as follows:  *The transfer pricing analysis is t/o be undertaken between the petitioner and its permanent establishment which has not taken place as yet. Once a transfer pricing analysis is done, the computation of income arising from international transaction has to be done keeping in mind the principle of arm's length price. Once this is done, there is no further need to attribute profits to a permanent establishment.* ***However, where the transfer pricing analysis does not take into account all the risk taking functions of the enterprise and it does not adequately reflect the function performed and the risk assumed by the petitioner, the situation would be different and, in such a situation, there would be a need to attribute profits to the permanent establishment for those functions/risk that have not been considered.***  In the case of Galileo International Inc.[[8]](#footnote-9), the Delhi ITAT held as follows:  *9. ………………………Though no guidelines are available as to how much should be income reasonably attributable to the operations carried out in India, the same has to be determined on the factual situation prevailing in each case****. However, broadly to determine such attribution one has to look into the factors like functions performed, assets used and risk undertaken. On the basis of such analysis of functions performed, assets used and risk shared in two different countries, the income can be attributed****.……………………..*  In the case of Convergys Customer Management Group Inc.[[9]](#footnote-10), the Delhi ITAT attributed profits to PE on the basis of formulary apportionment since the taxpayer did not prepareIndia specific accounts and hence the attribution of profits on the basis as disclosed in the TP study for assets and software was not accepted. However before arriving at the conclusion to use formulary approach, the Delhi ITAT did acknowledge that the attribution of profits to PE should be made in accordance with the TP principles. Relevant extract is as follows:  *C. The attribution of profits to the PE should be made by the transfer pricing principles supported by the CBDT Circular No. 5 of 2004 as well as the judgment of the Supreme Court in Morgan Stanley (292 ITR 416). As per the Supreme Court in the case of Morgan Stanley, it has been held as under:*  *"The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to the PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporates on the basis of the concept of economic nexus is an important feature of attributable profits (profits attributable to the PE). "*  Similarly, in the case of Pioneer Overseas Corporation[[10]](#footnote-11), the Delhi ITAT held as follows:  *86. As already discussed above,* ***in the light of the Article 7(1) and (2) of Indo-US Treaty, the Indian permanent establishment is to be treated as a separated profit center, and profits to be attributed to it should be worked out by following arm's length principle.*** *In this connection as to the method of determining profit attributable to PE in India, the ld. counsel for the assessee has submitted that the revenue authorities below have not made out any case for any exceptional difficulty or has not established that the present case is an unusual one but, on the other hand, after the insertion of Transfer Pricing Provisions in the Income Tax Act effective from A.Y. 2002-03, the AO has determined the arm's length price of the services rendered by Indian branch office i.e. Indian P.E. to the US Head Office, at a percentage ranging from 12.5% to 18% of the cost of the services.* ***We are in agreement with this contention advanced by the ld. counsel for the assessee, and in the light of the provisions contained in Article 7(2), we hold that the arm's length principle would be applied for attribution of profit of the US Head Office to the PE in India in respect of the services rendered by the Indian PE to the HO, and the manner of computation of profit attributable to the operations carried out in India adopted by the AO, as partially confirmed by the Ld. CIT(A), is not in order. In the present case, the Indian branch office must be treated as a distinct and independent entity and profit center, and the attribution of profit under Article 7(1) and (2) can be made only on the basis as to what an outsider would charge the Head Office for providing the result of research at arm's length. In other words, profits to be attributed to branch office in India are those that branch office in India would have made if instead of dealing with its Head Office, it had been dealing with an entirely separate enterprise under the same conditions and at prices prevailing in the ordinary market. This method corresponds to the "arm's length principle"………………………***  **As it can be seen from the above, the above rulings reflect the adherence towards TP principles for attribution of profits over other methods. Therefore, since the Rule 10 require “fractional apportionment” for attributing profits to PE, the same could be in conflict with the existing TP regulations as well as judicial decisions at various appellate levels which require determining “arm’s length price” for international transactions through FAR analysis for the transactions between HO and PE. In this regard, it is recommended that the TP principles should not be discarded while undertaking a PE profit attribution analysis rather it should prevail over “fractional apportionment”.** |
| **Offshore fund management in India** | | |
|  | **Application for approval of the Fund as per Rule 10VA(3) and applicability of Rule 10VA(8)** | **Background:**   * As per Rule 10VA(3), the application for seeking approval under section 9A shall be made 3 months before the beginning of the previous year for which the fund seeks the approval and as per Rule 10VA(8), the approval once granted, shall be applicable for the previous year and subsequent previous years unless it is withdrawn by the Board.   **Rationale and Issue:**   * The current rule implies that the approval for tax safe harbor shall be applicable only from the beginning of the next fiscal year. This leads to genuine hardship in cases where either the eligible investment Fund is newly incorporated during the year or seeks to appoint an Indian fund manager during the year.   **Recommendation:**   * It is recommended that approval under section 9A of the Act be made effective from the date of receipt of the approval under section 9A of the Act such that Indian fund managers are allowed to start managing offshore funds with immediate effect pursuant to receiving the approval. |
|  | **Allow wider participation of private equity players** | **Issue**   * One of the conditions for qualifying for a safe harbour under clause (k) of section 9A(3) of the Act, is that the eligible fund should not carry on or control any business in India. For this purpose rule 10V(4) deems an ownership/voting power of more than 26% of an Indian company sufficient for meeting with this threshold. It is recommended to increase this threshold to 51%.   **Rationale**   * The proposed amendment would allow for wider participation of private equity players who seek a higher participation in Indian companies (beyond the 10% threshold applicable to FPIs) but yet do not control the business of operations of the underlying Indian company. Allowing such funds which participate in growth companies would provide a huge incentive to the success of onshore management in the private equity space.   **Recommendation:**   * Proposed amendment to allow for wider participation of private equity players.   *“For the purposes of clause (k) of sub-section (3) of section 9A, a fund shall be said to be controlling or managing a business carried out by any entity, if the fund directly or indirectly holds such rights in, or in relation to, the entity, which results in the fund holding the share capital or a voting power or an interest exceeding ~~twenty six~~ fifty one per cent of the total share capital of, or as the case may be, total voting power or total interest in, the entity.”* |
| **Application of General Anti-Avoidance Rules** | | |
|  | **Non applicability of General Anti-Avoidance Rules (GAAR) provisions for Foreign Portfolio**  **Investors in the IFSC** | **Rationale and Issue:**   * IFSC has been set-up mainly to bring to India all financial services transactions related to India that were till now being carried out from other countries like Singapore, Hong Kong, Dubai and London. It extends to the entire Financial Services spectrum including Banking, Capital Markets, Insurance, Asset Management and other ancillary services. * While the efforts of providing tax incentives by the Government is appreciated, we would like to highlight the fact that the Act also contains certain anti-abuse provisions (GAAR) under Chapter X-A wherein the tax exemption/ incentives can be denied if an arrangement is entered into with the main purpose to obtain tax benefit. * The provisions of GAAR are drafted in wide manner and confer wide discretionary powers on the Indian Revenue Authorities. * Given the sweeping powers that Indian Revenue authorities (IRA) have to invoke GAAR, there is an exposure that the Tax Authorities may allege that units have been set-up in IFSC with the main purpose of obtaining a tax benefit (as they avail of benefits under section 10(4D) of the ITA 1961 (i.e. Schedule VI of ITB 2025). * An exposure to applicability of GAAR brings in uncertainty to the eligibility to tax incentives which are provided by Government to promote IFSC.   **Recommendation**:   * It is recommended that exemption should be granted from applicability of GAAR provisions to an entity in IFSC and its investors which claims various tax exemptions/ incentives/ deductions as provided under the provisions of the Act. * Accordingly, it is recommended that it should be clarified by way of amendment to Rule 10U(b) that where a taxpayer is availing benefits of various provisions of section 10 of the ITA 1961(i.e. Schedule VI of ITB 2025) in relation to activities or transactions of or with IFSC unit, provisions of Chapter X-A (i.e. Chapter XI of ITB 2025) shall not apply. |
| **Determination of fair market value of the property other than immovable property** | | |
|  | **Appropriate valuation rules to be prescribed for receipt of VDA as gift or inadequate consideration** | **Rationale**   * Finance Act 2022 has amended definition of “property” under clause (d) of Explanation to S.56(2)(vii) (i.e. S.92(5)(f) of ITB 2025) to include VDA. Such definition of “property” is applicable in case of S.56(2)(x) (i.e. S.92(2)(m) of ITB 2025) by virtue of Explanation to S.56(2)(x). * S.56(2)(x)(c) (i.e. S.92(2)(m) of ITB 2025) provides for taxation of income where property is transferred for NIL or inadequate consideration as compared to fair market value (FMV). The difference between FMV and consideration in excess of Rs. 50,000 is considered as income in hands of recipient. * Explanation to S.56(2)(x) r.w. clause (b) of Explanation to S.56(2)(vii) (i.e. S.92(5)(c) of ITB 2025) defines fair market value of property as per prescribed method. Rule 11UA prescribes the manner of determination of FMV of property. * The amendment provides for gift taxation of receipt of VDA in hands of recipient where the VDA is received for NIL or inadequate consideration. While VDA has been included within the definition of property u/s.56(2)(x) (i.e. S.92(5)(f) of ITB 2025), there is no valuation mechanism prescribed for determination of value of VDA under Rule 11UA. * In absence of valuation mechanism for determining FMV of VDA, it is difficult to determine income chargeable to tax under S.56(2)(x)(c) (i.e. S.92(2)(m) of ITB 2025).   **Recommendation**  Considering the nature of VDA and volatile nature of pricing of VDA, it is recommended that appropriate valuation rules should be introduced in Rule 11UA for valuation of VDA after giving due consideration to current market practices and without casting unreasonable burden on the taxpayers |
|  | **Clarification on dispensing audited balance sheet for valuation** | **Background:**   * As per the Section 56(2)(x) (i.e. S.92(2)(m) of ITB 202, if any person “receives” any property on or after 1 April 2017, without consideration or for consideration which is less than the aggregate fair market value by an amount exceeding Rs 50,000, the difference shall be taxable under the head ‘Income from Other Sources’ in the hands of the recipient.   **Rationale and Issue:**   * The Income tax rule 11U requires determination of value of share based on audited balance sheet as on the transaction date. This is very difficult to implement as audited balance sheet is generally available only on yearly / half yearly basis.   **Recommendation:**   * Suitable amendment be made to consider the latest audited balance sheet, which is not older than six months from the transaction date for the purpose of valuation as per Rule 11U |
|  | **Amending reference of “merchant banker” in Income-tax rules relating to valuation by adding “registered valuer” or “accountant” pursuant to SEBI’s decision to prohibit Merchant Bankers from valuation activities** | **Background:**   * ITA 1961 provide for valuation of shares and other assets by Category I Merchant Banker regulated under SEBI Guidelines in various circumstances like ESOP perquisites, indirect transfer u/s. 9(1)(i), gift taxation u/s. 56(2)(x), etc. For this purpose, “merchant banker” is defined to mean Category I merchant banker registered with Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) (Refer, for instance, Rule 11U(c))   **Rationale and Issue:**   * SEBI in its 208th Board Meeting held on 18 December 2024 has approved amendments to SEBI (Merchant Bankers) Regulations, 1992. As per SEBI’s Press Release No. 36/2024, following are the main features of the amendments as relevant to valuation activity by merchant bankers :-   “3.1 Merchant Bankers, other than Banks, Public Financial Institution and their subsidiaries, shall undertake only permitted activities. MBs may carry out other regulated activities as a separate business unit after obtaining registration/ confirmation from the respective regulatory authority.  3.1.1 Permitted activities which come under the purview of SEBI have been specified.  3.1.2 Activities other than permitted activities by MB shall be hived off to a separate legal entity with a separate brand name, within a period of two years. MBs which have to hive off activities and the hived off entity, shall abide by such code of conduct as may be specified by SEBI from time to time.  3.1.3 The separate entity may be allowed to carry out activities other than the permitted activities by sharing the resources with the MB on an arm’s length basis without casting any legal liability in respect of the same, on the MB.  3.2 MBs shall not undertake fresh valuation activities as part of its MB Registration. However, existing valuation assignments taken up by MBs may be completed. If an MB wishes to take up valuation activities, it shall obtain registration from the concerned regulator or authority, within a period of nine months.”   * The above referred amendments may be notified any time soon by SEBI. Upon such amendment becoming effective, Merchant Bankers will need to cease undertaking any fresh valuation assignments. Any new valuation assignment will need to be undertaken by obtaining registration from concerned regulator or authority, within a period of nine months. Such concerned regulatory authority could be Insolvency and Bankruptcy Board of India (IBBI), Institute of Chartered Accountants of India (ICAI), etc * This development has immediate and significant impact on income tax compliances concerning valuation by Category I Merchant Banker under various Income-tax rules. This is because for all new valuation assignments accepted after the effective date of amendment, the valuation will not be in the capacity as Category I Merchant Banker and therefore, there could be litigation on whether it is valid for income tax purposes.   **Recommendations**   * Since this amendment has immediate and significant impact for taxpayers in general in relation to compliances involving valuation by Category I Merchant Banker , we request for an immediate amendment to the Income-tax Rules which refer to valuation by “merchant banker” by adding an appropriate category of valuers who can carry out such valuations. A list of such rules is annexed herewith as Annexure A for your ready reference. * Reference to “merchant banker” may be amended to add registered valuer referred in section 247 of the Companies Act, 2013 (18 of 2013) or an accountant (wherever accountant is not already covered therein). The recommendation to add instead of substituting “merchant banker” with registered valuer is in view of transitional period post notification of SEBI amendment where existing valuation assignments can be executed by merchant bankers. * The reason for recommending registered valuer referred in s.247 of Cos Act 2013 is that the said section read with Companies (Registered Valuers and Valuation) Rules, 2017 provides for a comprehensive regulatory framework for recognition of registered valuers organisations, eligibility & qualifications of the valuers, registration of the valuer with IBBI, valuation standards, model code of conduct, penalty and punishment for violations, etc which regulates the professional practice of valuation. Such is also the basis for SEBI’s decision to discontinue valuation activity by merchant bankers in their capacity as merchant bankers. SEBI has also prescribed valuation by registered valuers u/s. 247 of Cos Act 2013 only under various SEBI Regulations such as SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (“ICDR, 2018), SEBI (Delisting of Equity Shares) Regulations, 2021, SEBI (Buy-back of Securities) Regulations, 2018 (Refer, para 9 of SEBI’s Consultation Paper dated 28 August 2024) * Needless to say, immediate action of CBDT by amending the relevant rules will clear any ambiguity, lead to certainty & better compliance by taxpayers and avoid any unwarranted litigation on valuation aspect.**(Refer Annexure A below)** |
|  | **Non-applicability of S.50CA and S.56(2)(x) to genuine transaction undertaken closer to listed price** | * S. 50CA (i.e. 79 of ITB 2025) and 56(2)(x) (i.e. S.92(2)(m) of ITB 2025) were introduced as anti-abuse provisions to counteract abusive cases of bogus capital building, unaccounted incomes, etc. The intent of the provisions was never to bring to tax a notional amount (towards completely non-existent deemed income) in the case of genuine bona fide transactions entered into by honest taxpayers, merely because the actual transaction price is lower than a normative FMV arrived at by applying the method prescribed by the relevant Rule 11UA. * In M&A deals, typically there is always a time gap between the signing of the deal and its eventual closure i.e. consummation of the transaction. For instance, an acquirer agreeing to acquire controlling interest in shares of a listed company having signed a definitive binding agreement would have to go through the elaborate processes under the SEBI Takeover Code before the final acquisition as agreed can be consummated. This causes a significant problem especially where listed price moves up between the date of signing and the eventual acquisition/transfer of the shares. For instance, if an agreement for acquisition of shares is signed at a price of Rs. 105 per share and on that date the listed price is say Rs. 100 and if thereafter the listed price runs up to Rs. 120 by the time of closing of the deal, the difference between Rs. 120 and Rs. 105 may be deemed to be a gift in the hands of the acquirer. This seems totally unintended since the acquirer actually signed the deal to acquire the share at Rs. 105 at the time when the listed price was only Rs. 100.   **Recommendation:**   * It should be clarified that so long as the acquisition price is more than the prescribed Rule 11UA value (listed price) on the date of signing of the deal, the provisions of section 56 ought not to apply and that the deemed gift cannot exceed the difference between the acquisition price to the extend it is less than the Rule 11UA value on the signing date. |
|  | **Section 50B and Rule 11UAE** | **Rationale:**   * S.50B(2) (i.e. S.77 of ITB 2025) and Rule 11UAE was notified on 24-05-2021 to provide for computation of consideration of slump sale/exchange at fair market value (‘FMV’). * The amended s.50B(2) provides that FMV of the undertaking as on the date of transfer, calculated in the prescribed manner, shall be deemed to be full value of consideration. This amendment is made effective retrospectively from 01-04-2020 i.e. AY 2021-22. There could be many bonafide situations where the actual transaction value is genuinely lower than Rule 11UAE value. It is for this reason that all anti-abuse provisions like section 56(2)(x), 50C, 43CA, 56(2)(viib) etc. have a ‘safety valve’ where the taxpayer is given opportunity to rebut the normative value. Absence of such ‘safety valve’ in Rule 11UAE leads to taxation of notional or artificial gain which taxpayer never earns in view of fair market value of undertaking being lower than Rule 11UAE value for bonafide reasons. It may be noted that some of the slump sale/exchange deals are struck after carrying out valuation through registered valuers and after seeking shareholder, NCLT and other regulatory approvals. Thus, the consideration for the transfer is arrived in a bonafide manner after obtaining requisite approvals of regulatory authorities. It would not be correct to substitute such value with an artificial Rule 11UAE value. * Further, the term ‘immovable property’ for the purpose of Rule 11UAE is not defined. This can lead to litigation on scope of the term and consequent application of stamp duty ready reckoner values.   **Recommendation:**   * Amend Rule 11UAE to provide an opportunity to taxpayer to rebut normative FMV [similar to section 50C(2)]. * Similar to Rule 11UAD, in case of NCLT / Court approved scheme of slump sale between unrelated parties, consideration as per the scheme should be accepted. * Valuation of undertaking arrived adopting internationally accepted method of valuation should be accepted. * A clause be added to Rule 11UAE to define the term ‘immovable property’ to mean land or building or both to provide consistency with similar definition/ provisions in section 43CA, 50C, 56(2)(x), 194-IA and 194LA. |
|  | **Rule 11UA, Rule 11UAA, Section 56(2)(x) and Section 50CA** | **Rationale:**   * Rule 11UA and Rule 11UAA provide for computation of fair market value for the purpose of s.56(2)(x) (i.e. S.92(2)(m) of ITB 2025) and s. 50CA (S.79 of ITB 2025). * In case of shares of a company, the said Rule provides for taking most assets and liabilities at book value[[11]](#footnote-12) except land and building, which is to be taken at stamp duty value. In case where such normative values are much higher than commercial fair value of the specified assets, there is no option to value shares of an entity by any other method such as DCF method, which is a method used worldwide to compute enterprise value of a business. * The method prescribed Rule 11UA/11UAA is unreasonable and unequitable. Any acquisition of running business cannot be valued taking stamp duty value of land and building and book value of other assets and liabilities. Further, in case of leased land, there being restrictions on use and subsequent transfer on rights therein, the stamp duty value may not reflect the fair market value.   **Recommendation:**   * Amend Income Tax Rules and allow valuation of shares of a company by a recognized merchant banker based of DCF method or any other internationally accepted method at the option of the taxpayer where taxpayer claims that normative values as per Rule 11UA is higher than actual commercial fair value. * Alternatively, in case the assessee contends that stamp duty value is not fair market value, then the AO should be empowered to refer the issue of valuation to a recognized government valuer for arriving fair market value. |
|  | **Notify cases to which s.56(2)(x) and s.50CA will not apply** | **Rationale**/ **Recommendation**:   * Pursuant to industry representations, the Finance (No.2) Act 2019 amended s.50CA and s.56(2)(x) to give power to CBDT to notify cases to which these provisions will not apply. * Obviously, such is the correct approach since it would be very difficult to provide for all bonafide situations to which notional capital gains in hands of seller and gift taxation in hands of buyer in the Act itself. * However, so far the CBDT has used this power sparingly in context of restructuring involving public interest like ILFS, Yes Bank, Air India, etc (Refer Rules 11UAC and 11UAD). Hence, the challenges indicated in following illustrative cases continue to be faced by the industry:-   + Sale of foreign company’s shares where it is difficult to apply Rule 11UA valuation   + Exempt transactions like foreign amalgamation or demerger which involves transfer of shares of foreign company deriving substantial value from assets located in India u/s. 47(viab)/(vicc), conversion of bonds or debentures into shares u/s. 47(x), transfer of land of sick industrial company managed by workers’ co-operative u/s. 47(xii), conversion of firm into company or company into LLP (s.47(xiii)/(xiiib)), etc.   + Fresh issue of shares in scenarios like Initial Public Offer (IPO), private placement, rights, bonus, etc.   + Investment made by holding company into its wholly owned subsidiary (domestic as well as foreign company)   + Time lag involved between fixing up share price by the parties under an agreement and actual allotment / transfer of shares due to time taken in making regulatory compliances and / or seeking shareholder or regulatory approvals   + Options or share warrants which are issued at a particular date giving option to the holder to subscribe for shares at a future date at the prefixed value which is generally at FMV on the date of issue of options/warrants.   + Conversion of an existing instrument into equity shares as per the terms specified at the time of issuance based on the valuations at that time - The CBDT on 21 January 2019, issued a Circular clarifying that the section 56(2)(viia)/ section 56(2)(x) of the Act (as the case may be), applies to “issuance” of shares by a company other than a company in which the public are substantially interested. This implies that the provisions of section 56(2)(x) of the Act are applicable pursuant to conversion of an existing instrument into equity shares.   + Transfer or issue of shares or securities in case of corporate insolvency resolution process under IBC or stressed companies, whose book value of assets is much higher than the actual realizable value.   + Where companies forming part of the same group need to enter into transactions for realignment of shareholding due to number of reasons such as synergies of business, consolidation of shareholding etc. Transfer of shares amongst ultimate holding and any step-down subsidiary or amongst fellow subsidiaries should be exempted from the applicability of section 50CA and section 56(2)(x) of the Act. For consistency, the definition of holding company and subsidiary company should be defined as per the Companies Act, 2013.   + Transfer of assets between relatives for consideration lower than FMV or on account of family settlement   + Transfer of shares of a listed company through an off-the-exchange transaction at a pre-determined value (where SEBI takeover code is applicable)   **Recommendation**:  Hence, it is recommended that CBDT should expedite the amendments to Rules 11UAC & 11UAD. Further, prior to the issue of Final Notification, it is recommended that a draft Notification should be published for stakeholders’ comments to ensure that all possible bonafide cases faced by industry get adequately represented in the Final Notification. |
| **Miscellaneous** | | |
|  | **Issues Relating to PAN-Aadhaar Linking, Higher TDS/TCS for inoperative PANs** | **Issue & Rationale:**   * The amended Rule 114AAA(3) provides for specific consequences with respect to inoperative PANs including application of higher rates of TDS and TCS. There are various issues in practically implementing the above provisions. * It is observed in some cases that PANs which were earlier flagged as ‘Operative’ in the Compliance Check Functionality were later updated to ‘Inoperative’. The reasons for such feature are not comprehensible given that PAN-Aadhar linkage is a one-time compliance and hence once the compliance is done, the Operative PAN cannot turn ‘Inoperative’ later. * The Functionality does not provide for linkage date, in absence of ‘linkage date’ deductors/collectors cannot determine from when new rate is to be applied. There is lag in linking PAN and Aadhaar and the status being updated in income tax utilities, which have also resulted in TRACES demand for already linked PANs. * Non-residents claiming benefits of a Double Tax Avoidance Agreement (DTAA) are not granted the benefit if their PANs are inoperative. In terms of section 90(2) of the Act, provision of Act or DTAA should be applied whichever is more beneficial to the assessee. Accordingly, provisions of section 139AA r.w.s. 206AA/206CC cannot override the DTAA and benefit of DTAA cannot be denied. * CBDT notification no. 37/2017 exempts certain categories of person from provisions of section 139AA i.e. PAN Aadhaar linkage. Exemption is not available if such person holds Aadhaar. Deductors are not in a position to correctly verify the Aadhaar holding status of the deductee. Exemption from PAN-Aadhaar linkage should be granted to all persons exempted from PAN-Aadhaar Linkage vide CBDT Notification No. 37/2017, irrespective of the person holding Aadhaar or not.   **Recommendation**   * CBDT to kindly address to the above points either by amending rules or by issuing a circular in form of FAQs |
|  | **Rate of exchange for the purpose of deduction of tax at source on income payable in foreign currency** | **Background and issue:**   * As per notification no. 64/2023/F.No. 370142/27/2023-TPL, dated 17 August 2023, CBDT prescribed ‘SBI TT buying rate’ to be the rate of exchange to be used for the purpose of TDS calculation on any income payable in foreign currency to a non-resident/ to or by a unit located in IFSC. As per the notification, SBI TT buying rate is to be used by the payer as on date of deduction. * Further, Rule 115 of IT rules provides for SBI TT buying rate as on the specified date to be used for conversion of foreign currency into local currency for the purpose of reporting. * All transactions are undertaken and recorded in foreign currency in an IFSC unit and every Bank has its own mechanism to compute its own TT buying rate which is fed in system for the purpose of conversion for recording and disclosure purposes. Hence, existence of two rates for conversion would not be feasible for a unit in IFSC and create multiple reconciliation requirements.   **Recommendation:**   * For promoting hassle free functioning of IFSC units and ensuring ease of doing business in India, taxpayers located at IFSC should be permitted to use TT buying rates applied by their banks for the purpose of reporting as well as computing TDS on FC transactions. Alternatively, a permitted variance range of +/- 5% with the SBI TT buying rate should be prescribed. |
|  | **Rule 26, Rule 128 requiring SBI TT Buy rate for conversion** | **Rationale:**   * In case of foreign remittance or claim of foreign tax credit, the relevant income tax rules prescribe use of SBI TT Buy Rate for the purpose of conversion * SBI TT Buy Rates are not easily available and again becomes an onerous compliance. SBI charges fees for giving this information. * As the foreign remittances from India usually take place against well-accepted foreign currencies, the exchanges rates don’t differ much within payment banks, RBI or SBI   **Recommendation:**  Rules should be suitably amended to allow use of foreign exchange rates for well-traded currencies at the transaction value itself or an average exchange rate prevailing on the date of transaction or relevant month. |
|  | **Foreign Tax Credit on aggregate basis (Rule 128)** | **Rationale**:   * An option is available to the assessee to apply either the provisions of domestic law or of the treaty law, whichever is more beneficial to him, in respect of countries with which India has concluded DTAA. The CBDT has notified FTC rules according to which the taxpayer is required to compute the FTC. * Indian MNCs have global operations with permanent establishments in many countries. The present method of computing FTC for each country by referring to the relevant treaty is onerous for both the assessees as well as the tax administration in view of the fact that each tax treaty is a code in itself and has to be contextually interpreted.   **Recommendation:**   * The domestic law should provide for a simpler method of granting FTC by aggregating all foreign sourced incomes. The taxes paid in foreign country should be allowed as credit on aggregate basis against the India tax liability. |
|  | **Carry-forward of excess Foreign Tax Credit (Rule 128)** | **Rationale**:   * The FTC is restricted to the tax liability of the assessee in India. In the following situations, the assessee is not granted full credit for the foreign taxes paid:   + The working formula prescribed in Section 91 or the relevant tax treaty is not yielding optimal results by way of granting FTC.   + Where the assessee incurs a loss on its worldwide income for any assessment year, no FTC is granted.   + Where the Indian tax payable on the worldwide income is lower than the foreign tax paid, FTC is partially available.   + The method of computing the income in the foreign countries is different from the method of computing the income under the Income Tax Act.   + The time period within which tax credit should be claimed and allowed is not defined. Owing to differences in laws and practices in tax administration in foreign jurisdictions, the tax liability for any financial year could get determined much after the conclusion of assessment for the same year in India.   **Recommendation**:  Assessees need to be allowed carry forward of the “unutilized” foreign tax credit for 5 years. It is recommended to suitably introduce the provisions to allow such relief which is due to the assessee. Accordingly, rule for FTC should provide for the carry forward of the FTC. |
|  | **Tax Residency Certificate** | **Rationale**:   * Many of the India based companies execute cross border purchase and/or sale transactions. In case of purchase transactions, for getting the benefit of lower/nil rate of withholding of tax under the provisions of applicable Double Tax Avoidance Agreement signed with the payee’s country, the Indian companies are required to provide Tax Residency Certificate/s (TRC) issued by the Income Tax Department. * Procuring TRC is a time-consuming process which is an administrative burden both for the industry as well as for the Department.   **Recommendation**:   * The entire process of issuing the TRC needs to be digitized which will enable companies to download the digitally signed Tax Residency Certificate from Department’s website which may be linked to the filing of the Tax Return by the companies. |
|  | **Relaxation in documentation requirement for providing benefit of lower withholding tax rate as per tax treaty to a Foreign Portfolio Investors (FPIs)** | **Background:**   * Proviso to s.196D(1) (i.e. S.393(2) of ITB 2025) provides that payer shall withhold tax at the rate of 20% or rate specified in DTAA (whichever is lower) where, * DTAA entered between India and other country is applicable to FII payee * Payee has furnished TRC * Prior to the amendment by Finance Act 2021, tax was required to be deducted at higher rate of 20% (plus applicable surcharge and cess) under the IT Act and FPIs were required to claim refund of the excess withholding tax in their tax return. Pursuant to the amendment, option to withhold lower rate of tax under the applicable tax treaty has been extended to dividend income. The above is certainly a welcome provision and will help FPIs in claiming lower rate of withholding tax on dividend income. However, there are several operational challenges of availing tax treaty benefit as per the current process. We have articulated the challenges and proposed some measures to overcome these issues.   **Issue:**   * As per section 90(4) of the IT Act 1961 (i.e. S.159 of ITB 2025), relief of lower tax rate under the tax treaty will be available only if the tax residency certificate (TRC) is provided. Along with TRC, the deductor also requires the recipient to provide Form 10F and a declaration confirming that the recipient is the beneficial owner of the income and it does not have a Permanent Establishment (‘PE’) in India. Out of the aforesaid 3 documents, there is no standard format of the declaration for beneficial ownership and no PE declaration * In view of this, each payer may devise its own format resulting in FPIs providing the same declarations in different formats to different payer entities. Considering the large volume of FPI investments in Indian entities, this may lead to significant operational challenges for FPI’s claiming treaty benefit, as the format of declaration acceptable to one payer may not be acceptable to another. * This may result in each of the FPIs sending out several thousand declarations to Indian companies in various formats on a repetitive basis, which may result in a huge administrative hassle to both the recipient companies as well as the FPIs. Thus, while it is reasonable for the corporates to verify the underlying facts and legal status before granting treaty benefits, it is equally important that the whole process is efficient and easy to comply from a “ease of doing business in India” perspective. * In light of the above background, we would like to make to the following recommendations to resolve the administrative hassles without compromising the compliance documentation.     **Recommendation:**   * Given the above, it is recommended that a standard format of no PE declaration (including beneficial ownership condition) should be prescribed which can be used by all payers. The standard format can be included as an Annexure to Form No 10F. Notifying such annexure by the Government would help both payer entities and FPIs to carry out administrative documentation in complying with withholding tax provision relating to dividend payout. * In addition to the above, the authorities may allow depositories to hold the copies of the documentation in form of Form 10F and annexure thereof containing no PE and beneficial ownership declaration, which may be shared with the investee companies on demand. * The above will ease out the compliance burden on the FPI, the custodian as well as the dividend / interest paying company. |
|  | **Challenges emanating from electronic filing of Form 10F for non-resident** | **Background and issue:**   * In December 2022, Central Board of Direct Taxes (CBDT) issued Notification No. 3 of 2022 dated 16.07.2022, enabling a new category for registering on the income-tax portal, i.e., ‘non-residents not having a PAN and not required to have a PAN to file Form 10F online. There are, however, certain practical challenges which the NRs are facing in e-filing Form 10F. In the absence of PAN, the portal requires tax identification number of home country to file Form 10F electronically. * **Difficulties in receiving the 'Mobile OTP’** * The process for NRs to file 'e-Form 10F' involves a two-step procedure:   + One-time registration on the income-tax portal, creating a login account with User ID and Password   + Submitting 'e-Form 10F' on the income-tax portal after completing the one-time registration (i.e., by logging into the portal and filing the form) * Both the above steps require validation using both 'Mobile OTP' and 'Email OTP.' NRs are however encountering difficulties in receiving the 'Mobile OTP' on international mobile numbers, thereby preventing successful registration on the income-tax portal and subsequent filing of e-Form 10F * Further, while a mechanism is provided for resolving queries and raising grievances at e-filing and Centralized Processing Center helpdesk (‘e-filing helpdesk’), time to resolve queries is being observed at 3-4 weeks and sometimes more.   **Concerns around providing date of birth and Tax Identification Number ('TIN') of key person**   * While registering on the income-tax portal, date of birth and Tax Identification Number ('TIN') of key person of the NR is required to be provided. Considering personal information protection laws being in force in the respective countries, NRs have concerns around providing the date of birth and TIN of the individual.   **Recommendation:**   * + - The functionality of getting mobile OTP on international number should be smoothened. Alternatively, the two-factor authentication should be changed to email only authentication, so that the OTPs are received over email.     - Mechanism provided for raising grievances at e-filing helpdesk should be scaled up to resolve queries in a shortened period of 3 working days. A dedicated toll - free number can also be set up for such NRs to call for resolving the OTP issues.     - The registration form should be amended so that the registration can be done without providing date of birth and TIN of key person. While the key person’s name, email ID and phone number can be provided as the same is appropriate, NRs are uncomfortable providing personal information such as date of birth and TIN.     - Alternatively, it is recommended to not mandate electronic filing of Form 10F for non-residents not having PAN in India, and the provision to obtain physical copy of Form 10F from such non-residents should be reinstated as it was prior to 2022. |
|  | **Notification of automatic MFN clause** | **Issue/Rationale:**  The Hon’ble SC in Nestle’s case, inter alia, held that even with reference to autonomous most favoured nation (MFN) clause already agreed as part of existing treaty where treaty and protocol are both notified, the MFN clause in terms of which beneficial provisions entered into with third country are to be applied, cannot be made applicable unless a third notification is issued.  This has wide ranging ramifications on cases where MFN benefit under various tax treaties have been claimed in the past based on automatic MFN clause on lower tax rates for royalty/FTS or restrictive scope of FTS, etc.  The industry bonafide applied the autonomous MFN clauses in treaties like France, Spain, Hungary, etc based on majority of the rulings in favour of application of such autonomous MFN clause without need for a third Notification.  There is risk of reopening of past cases u/s. 201(1) and/or 147 based on SC ruling which will unsettle all past transactions. Since most such transactions are on “net of tax” basis, the additional tax burden will fall on Indian industry. It will negatively impact the investment environment in India.  The difficulty can be addressed by Government issuing Notifications to activate the lower tax rates for royalty/FTS or restrictive scope of FTS, etc. from the past dates from which they are intended to take effect. Such notifications giving benefit from past dates have been issued by CBDT in the past. Illustratively:   * Canada (where treaty benefit was granted retrospectively for any contract signed after 12 December 1988, vide a notification issued on 24 June 1992) and * France (where treaty benefit was granted retrospectively from 1 April 1995 for interest, and from 1 April 1997 for dividends, vide a notification issued on 10 July 2000) and * Netherlands (where treaty benefit was granted retrospectively from 1 April 1997 for dividends and interest, vide a notification issued on 30 August 1999).   Responding to industry representations, the Government issued a Notification on 19 March 2024 lowering tax rates under India-Spain treaty for royalty/FTS to 10% but with prospective effect from AY 2024-25.  **Recommendation**   * At the root of the controversy is absence of notification for clarifying the benefit of automatic MFN clause which was intended by the treaty negotiators to take effect from the date of “trigger event”. Therefore, all the adverse implications for past years can be avoided if the Central Government notifies the effect of automatic MFN clause from date of trigger event from which they were intended to be applied by treaty negotiators of both countries. It will put the entire controversy to rest and avoid any adverse actions for past years * It is, therefore recommended, to collate the list of tax treaties contain automatic MFN clause and notify the same in Official Gazette from date of trigger event (from which they were intended to be applied by treaty negotiators of both countries). Following is an illustrative list:-  |  |  | | --- | --- | | **Nature of benefit for royalty/FTS** | **DTAAs impacted** | | Make available clause for FTS | France, Hungary, Sweden, Spain, Belgium | | No equipment royalty pursuant to India-Sweden DTAA | Hungary, France, Spain |  |  |  | | --- | --- | | **Interest related benefit** | **DTAAs impacted** | | Interest arising in India shall be exempt from tax if the same is paid by the Government or local authority of India virtue of India-Italy | Netherlands, France, Hungary, Sweden | | India-Ireland/Denmark - restricts source country from taxing the interest on loan extended or **guaranteed or insured** by the Government, a political sub-division, a statutory body or a local authority | France, Hungary, Sweden |  * It would provide certainty and transparency for both Indian and foreign entities involved in cross-border transactions and adopting such measures would reflect the government's commitment to fostering an equitable tax environment. |
|  | **Prescribe NBFC exempt from thin capitalization rules** | S.94B(3) (i.e. S.177 of ITB 2025) to provide that thin capitalization provisions shall not apply to:   * an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance; or * such class of non-banking financial companies (NBFC) as may be notified by the Central Government in the Official Gazette in this behalf.   However, the class of NBFCs to be excluded from these provisions are yet to be prescribed.  **Recommendation**   * It is recommended that necessary notification/ circular/ amendment in the Act should be introduced to clarify the class/ category of NBFCs that would be exempted from the application of section 94B. |
|  | **Special transitional provision for POEM resident companies (S. 115JH)** | **Rationale**/ **Recommendation**:   * **Requirement for increase in threshold of turnover for POEM evaluation:**    + The CBDT issued a Circular No. 8/2017 dated 23 February 2017, prescribing a threshold of INR 50 Cr of turnover or gross receipts in a particular financial year for application of the POEM guidelines to a foreign company. However, this threshold is too low for a foreign company.   + It is recommended that the thresholds are increased so that small and medium sized foreign companies or the ones which have marginal business from India should not fall within the garb of POEM to avoid undue burden of compliance. Furthermore, it is recommended to incorporate this in Income tax Rules itself for ease of referencing by taxpayers. * S.115JH grants power to the Government of India to notify certain exceptions and adaptations to the existing provisions of the Act in relation to company which is treated as POEM resident of India. A Final Notification No.29/2018 dated 22 June 2018 was issued, to prescribe certain exceptions, modifications or adaptations, subject to which provisions of the Act will apply to a POEM resident foreign company. It is recommended that this Notification be incorporated in the Income tax Rules for ease of referencing by taxpayers. * Furthermore, certain provisions of the said Notification require revisit and amendments as suggested below for ease of compliance and reducing litigation. * **Due date of filing of return of income (ROI) in case of a foreign company which has hitherto not been assessed as a resident of India**   + If the foreign company which has not been assessed as a resident in any earlier year is considered as POEM resident pursuant to a finding u/s. 6(3), followed by completion of assessment proceedings, any ROI, furnished by foreign company for any previous year which ended before the date of completion of proceedings may be considered to have been furnished within the due date applicable to the company u/s. 139(1) of the Act, if such returns are furnished within 180 days from the date on which notice for furnishing ROI is received by the company for that previous year. * **Compliance obligations: Tax audit report, transfer pricing report, ICDS etc.**   + Consistent with the philosophy and spirit of s.115JH, the foreign company should be relieved of all procedural compliances/obligations such as obtaining of tax audit report u/s. 44AB or TP documentation and TP audit report compliance, etc.   + If at all the obligation is imposed, the compliance obligation ought to take into account statutory obligations in the country of its incorporation about maintenance of books of account and supporting records. The company should not be expected to do those compliances which are not capable of being fulfilled having regard to norms of maintenance of books and records as per statutory requirements in the country of its incorporation.   + Without prejudice to the above, following may be considered:     - **Transfer pricing compliances**       * With wide reach of BEPS projects and inclusion of meaningful countries in BEPS agenda, the requirements may be relieved in case of a foreign company which has been subject to transfer pricing and documentation related compliances in its home country, for any past year upto the year of completion of assessment proceedings u/s.6(3) of ITA and India has an information sharing agreement with such jurisdiction.       * On an assumption that the foreign company is not eligible for dispensation as aforesaid, there should be *de minimis* threshold to exclude entities from purview of Chapter X for the previous years where the turnover of the company as per books of account in accordance with the accounting standards applicable in the country where it is assessed to tax is less than INR 250 Cr.       * For companies not covered by above, the time limit for compliance of obligation u/s. 92D in respect of maintenance of documentation and information and audit report u/s. 92E should be extended along the lines of time frame available for filing of ROI as stated above.   + **Country by Country reporting (CbCR) compliance**     - The compliance done by MNE Group under CbCR may be accepted to be due compliance in terms of s. 286 of ITA.     - If the group is not covered by CbCR for any reason for any of the years, S. 286 should be made inapplicable for all the previous year up to the end of previous year in which the company is upheld to be POEM resident for the first time.   + **Non-applicability of ICDS provisions to first time POEM resident foreign companies:** POEM companies should be relieved from applicability of ICDS for computation of income in order to reduce compliance burden.   + Consistent with philosophy of nationality non-discrimination provision in almost all comprehensive treaties which India has signed, the benefit of concession, exemption or relief which is available to an Indian company should, equally be extended to foreign company triggering POEM residency. Illustratively, this may include benefit of concessional rate of tax rate u/s. 115BBD in respect of dividend received from specified foreign company upto A.Y. 2022-23, capital gains exemption for transfer inter se between holding and subsidiary company covered by S.47(iv)/(v) etc.   + Alternatively, the CBDT may consider adopting an approach whereby foreign companies would be taxed in India at a prescribed percentage of their book profits determined as per laws of foreign jurisdiction. Such approach shall relieve the first time POEM resident foreign company from tedious compliances under ITA. * **General point on notification:**    + For providing abundant clarity, each of the guidelines may be explained by means of a suitable illustration. We believe that, but for illustration, Guidelines may be prone to varying interpretations and may become a source of litigation. * **Brought forward losses and unabsorbed depreciation**   + In case of a foreign company assessed to tax in the foreign jurisdiction, Notification provides that brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the previous year and shall be deemed as losses or unabsorbed depreciation brought forward on the 1st day and shall be allowed to be set off and carried forward as per provisions of ITA.   + Further, for this purpose foreign jurisdiction may be considered as referring to the jurisdiction in which foreign company is taxed as a resident on comprehensive basis instead of considering jurisdiction of incorporation of the company. This will avert any issues that may arise in case of companies which are assessed to tax in more than one jurisdiction.   + The losses which are appearing on the tax record should be presumed to be losses of the previous year for which assessment as a resident is made in India.   + It needs to be clarified specifically that the benefit of carry forward will be allowed notwithstanding that there may have been change in shareholding of any past year contrary to s. 79 and notwithstanding that ROI for year of residence may have been furnished beyond due date.   + Data as per assessment records or as per books of accounts of overseas jurisdiction should be accepted as valid and no independent evaluation should be done whether such ascertainment is in accordance with tax laws of overseas jurisdiction.   + It may be noted that the scheme of determination and characterization of losses as per tax/books of accounts of foreign company can be different under ITA and under foreign law. For instance, short term capital loss and long-term capital loss has different tax treatment under ITA based on holding period whereas foreign jurisdiction may not have any such distinction or may have different holding period of asset. Further, it is unclear on how the balance of loss appearing in books of accounts may be attributed to different types of loss incurred under each head of income and to unabsorbed depreciation. Thus, it is recommended that an appropriate mechanism (with suitable illustrations) for determining the nature of losses incurred in foreign jurisdiction may be notified by the CBDT to enable transition of such losses and unabsorbed depreciation. For instance, clarity may be provided with respect to bifurcation of losses into short term and long-term capital loss.   + It may be clarified that loss so quantified will be admissible irrespective of whether, as per Indian law, loss would have been admissible subject to certain conditions – say, for example, furnishing of return of income in time, change in shareholding, etc. * **Non-applicability of MAT provisions to first time POEM resident foreign companies:**    + Presently, provisions of MAT are not applicable to a foreign company if the company is a resident of other country with which India has DTAA and the company does not have PE in India as per the applicable DTAA provisions. In case where there is no DTAA, the foreign company is a resident of other country and the company is not required to seek any registration under laws relating to company.   + Generally, foreign company is not required to maintain books of accounts in India and prepare financial statements under provisions of the Companies Act, 2013. Thus, a foreign company may not have financial statements which are prepared under the Companies Act, 2013 basis which MAT provisions are applicable.   + There is no clarity whether foreign company whose residence is determined in India will get benefit of the said exclusion from MAT provisions. Thus, POEM resident foreign company should be kept outside the purview of MAT provisions. * **Compliance with withholding tax provisions by first time POEM resident foreign company:**   + Para A(ix) of the Notification No. 29/2018 prescribes that compliance by foreign company with provisions of TDS prior to it becoming resident is considered as sufficient compliance.   + A literal reading of Para A(xi) appears to provide exemption/protection only up to a period when F Co was a non-resident.   + Reference to “prior to its becoming Indian resident” may not strictly protect transitional years in which POEM residency is determined.   + Reference may be drawn to the intent of the Legislature expressed in Explanatory Memorandum to FB 2016 and as also reiterated in Explanatory Circular to FA 2016. The Legislature has admitted that there is difficulty faced by first time POEM resident company in complying with provisions of TDS and its related procedure. Further, the legislature has also noted that there shall be difficulty in compliance as POEM may be determined in assessment proceedings after closure of the relevant tax year.   + While the legislative intent is to apply the clause to first year of POEM residency, the plain language of the clause applies to period ‘prior to company becoming Indian resident and is not aligned with the object.   + In order to avoid unintended litigation or ambiguity, CBDT should simplify that the language of Para A(xi) to state that the compliance of TDS provisions by foreign company in capacity of foreign entity shall be considered as sufficient compliance for the transitional year/s. It should also be expressly clarified that provisions of S.40(a)(i)/(ia) or 40(a)(iii) will have no applicability during such transitional period and the consequences of levy of interest and penalty would also not apply during transitional year/s. * **Clarity on Para D of the Notification dated 22 June 2018**   + Para D of the Notification prescribes that any ‘transaction’ of F Co with any other person or entity shall remain unaltered even if there is change in residential status of F Co. The exact issue addressed by the said clause is unclear. It is also not clear the context in which Para D will operate and parties to which it wants to protect.   + The CBDT should amend the language of Para D in order to clarify the exact intent of introduction of Para D and appropriate illustrations can be provided for understanding the scope of the provisions. * **Applicable exchange rate for conversion of balance sheet of foreign company**   + Rule 115 provides exchange rate for conversion of income arising in foreign currency for the purposes of computation of income under ITA. Notification No.29/2018 also prescribes for conversion of value expressed in foreign currency into INR in accordance with provisions of Rule 115. It may be noted that Rule 115 primarily applies to ‘income’ computed as per provisions of ITA which accrues or arises in foreign currency.   + While F Co may prepare P&L and balance sheet as per foreign accounting standards, the F Co may be required to convert such P&L and balance sheet into INR for reporting purposes in India.   + As Rule 115 is not applicable to items of balance sheet, it is suggested that CBDT should provide for a conversion mechanism for converting transactions recorded in foreign company balance sheet into INR. * **Determining computation of income for intervening year of POEM residency**   + The language of S.115JH(1) provides that exception, modifications and adaptations (EMAs) notified under Notification No.29/2018 are applicable only for the previous year in which the F Co becomes POEM resident for the first time in India.   + Consider a situation where POEM is determined in India for a foreign company in Year 1 and 2. In Year 3, such foreign company is thereafter regarded a Non-Resident whose POEM is outside India. However, in Year 4, POEM of such POEM is once again determined to be in India.   The present language of S.115JH(1) does not cover strictly Year 4 in the illustration. There could therefore be challenge in computation of income of Year 4 in the hands of POEM resident F Co. Also, the Notification does not address such type of scenario. The CBDT should provide clarity on manner of computation of income in such scenario. |
| **Advanced Pricing Agreement Scheme** | | |
|  | **Streamlining Advance Pricing Agreement (APA) (Legislative and Administrative change)** | The APA programme of the Central Board of Direct Taxes (CBDT), introduced in 2012, has been very successful in providing certainty on TP matters to taxpayers. The taxpayers have been appreciative of the flexible and solution-oriented approach of the APA authorities while determining tax positions. From merely 135 applications filed in the first year of APA programme, more than 1,840 applications were filed till March, 2024[[12]](#footnote-13), including both unilateral and bilateral APA applications.  As on 31 March 2024, 641[[13]](#footnote-14) APAs were concluded, which is a considerable achievement. Each APA requires a complex analysis before conclusion and the CBDT must be lauded for creating a global benchmark in providing such certainty to the taxpayers.  However, with more applications filed, the inventory of APAs (more than 800 applications[[14]](#footnote-15)) that are pending conclusion is still quite large.  To sustain the momentum of concluding APAs, and process the cases speedily, the measures that may be considered by the government are suggested in the paragraphs below.   1. **Reasons for the slow-down of APA process**   Following are some of the key reasons for the slowdown in APAs:   1. In the recent years, the number of APA applications have increased significantly due to factors such as absence of options for controversy and dispute prevention is driving MNCs to APA option. 2. In addition to the above, wherever the MNCs have desired tax certainty with mitigation of double taxation risks, the taxpayers have looked at filing bilateral APA applications. In the recent years, the number of bilateral APA applications has increased significantly due to factors such as:  * Relaxation in Article 9(2) of tax treaties (which provides for co-relative relief) to invoke bilateral APAs. This has opened more doors for bilateral APAs. * Opening of bilateral APAs by the United States of America (US) in 2016 and conversions from unilateral to bilateral APAs.  1. APA renewal process has, so far, been essentially a “repetition” of the original APA process, requiring submission of documents from scratch, site-visits and filing detailed responses rather than leveraging the work done in the original APA. This is bringing down the efficiency of the programme and causing the delay as well. 2. Multiple levels of approvals within the APA programme slow down the decision-making framework. There is also a long-time gap between processing of APA file and conducting site visits. 3. Despite such increased workload, the number of APA officials in CBDT have not increased commensurately to deal with the rising inventory. Further, frequent transfers/team changes are adversely impacting the turnaround time for some closures. 4. Also, with transfers/ new deputations, difficultly is also faced in terms of lack of experience/ training for the newly inducted team members in the APA teams. 5. **Need to improve the speed of the APA programme**   The slow-down in the overall APA process has had an adverse impact on India’s ability to minimize disputes and collect taxes on time, which in turn impacts tax certainty.  Given India’s growth potential and the focused and pro-investments reforms undertaken by the government, India has witnessed steady increase in foreign investments. The government recognizes that FDI is critical for exchange rate stability, mitigating current account deficit, and reducing dependence on government debt in the economy. FDI is also necessary to bridge the crucial gap in domestic private investments, with high capex spend planned on physical and social infrastructure.  Among the several factors considered by foreign investors for investing in a jurisdiction, tax certainty holds considerable significance.  Thus, the efficiency and effectiveness of the APA programme is important for achieving triple objectives for the Government, viz. (a) providing conducive environment for the taxpayers (b) swift collection of taxes and (c) uplifting the economy with more investments into India.   1. **Suggestions for enhancing the efficacy of APA programme in India**   As discussed above, given the existing backlog of cases as well as influx of new applications, a twin-fold approach to resolve the APA cases is recommended viz. (1) immediate measures (2) structural measures.   * 1. **Immediate measures**  1. **Consider adopting “framework” approach for resolving pending APA cases with low complexity/ risk**   Many taxpayers with simple fact patterns/low complexity have opted for APA to have certainty, as this is easily accessible. This has resulted in huge influx of APA applications primarily involving low complexity cases/ fact patterns.  Given the maturity curve in the Indian APA programme, it should be possible to segregate the pending APA cases into high, medium and low complexity/ risk buckets having regard to the nature and complexity of cases. Typically, cases involving intellectual property transfer, high end research & development activities, licensing, marketing intangibles, financial transactions, profit attribution to permanent establishment may be considered as “high complexity/risk” category; whereas cases such as typical routine distribution/ contract manufacturing types of activities can be put into “medium complexity/risk”. The balance can be considered as “low complexity/risk” cases e.g., routine back-office Information Technology (IT)/ Information Technology Enabled Services (ITES) centres, business support services etc.  There could be some additional checks and balances while categorizing the cases into least complex and most complex.  A large portion of the long pending applications pertains to IT/ ITES followed by other sectors. Therefore, given the extensive experience of the Indian APA teams in dealing with such IT/ITES cases, efforts should be made to conclude such standard rather low complexity/ risk cases as part of a “framework” (agreeing on a specific rate/margin). Such an approach would clear large part of the pending cases. For the balance cases involving high and medium complexity cases, appropriate attention can be given by the respective teams. This would also reduce the workload to greater extent and bring in quality and efficiency in terms of closing some complex matters.   1. **Allocate additional and specialist resources to the APA team**   The Indian APA programme has seen some of the best people in administrative as well as operational roles. However, with the promotions and retirements, unfortunately some of these senior officers had to move out of the APA regime. Given the current backlog of cases, the Government can support the APA programme by bringing back some of these experienced officials, on special duty, to help in resolving all pending APA cases. This can be done in specific window (say for 6 months or so). Further, the services of such senior and experienced officials can be availed for resolving “high” and “medium” complexity cases so that appropriate attention is given to resolve the pending backlog on priority basis. Further, support can be requested from third party industry experts to quicken up the process.  Given the increasing number of bilateral APA cases requiring involvement of the Competent Authority, the government could consider creating an additional Joint Secretary post in the Foreign Tax & Tax Research (FT&TR) Division with an appropriate team under the office to enable swifter disposal.  With faceless assessment in place, the Indian APA team can also get some support from the Technical Unit specializing in TP matters to support resolution of existing backlog of APA cases specifically involving “low complexity/risk” or “framework” cases. This can be done in specific window (say for 6 months or so). The support from Technical Unit would also be helpful in faster revenue collections from standard APA cases.   1. **Use online media for preliminary consultations, site visits and negotiations**   It is relevant to note that the coronavirus pandemic has changed the working style across industry sectors and government organizations. Under the pandemic constraints, there has been greater dependence on the virtual working modes. The new working ways have brought tax administrations around the world closer. In fact, the US Internal Revenue Services has noted that such virtual environment has helped in more closure of APA cases due to greater collaboration[[15]](#footnote-16). CBDT too should increase adoption of virtual ways to connect with taxpayers and tax authorities for certain APA stages to enable speedy resolutions. This includes increased use of technology for site visits and for other negotiations as well.  In most of the standard cases such as IT/ITES, a site visit can be completed quickly and through online media (e.g., video conferencing, conference calls). The CBDT can consider permitting “lite versions” of the site visits - to be conducted either through conference calls, management representation at APA office or electronically through video conferencing. This would optimize costs and provide flexibility to the APA teams and taxpayers in terms of availability of personnel. Thereafter if required, the APA team can decide as to whether a full-fledged physical site visit is required or not. Further, in cases involving specific transactions (such as financial transaction), option to conclude APAs without site visit should also be included.   1. **“Accelerated APA” - special window for clearing up old cases**   Like the Vivad Se Vishwas Scheme, the Government can also introduce a limited period window i.e., “Accelerated APA” to clear all backlog of APAs wherever the site visits are concluded or where limited fact finding is needed. For this purpose, as mentioned above, depending on the complexity and risk, additional teams (with people who have extensive experience as well as use of Technical Unit) can be allotted to resolve the pending cases. This approach could very well be appreciated by the investor and taxpayer community.   1. **Fast track APA renewals**   APA renewals could be expedited in cases where facts have remained unchanged from the original APAs. In such cases, site visits could be exempted to achieve faster closure. Countries such as US and Denmark have also introduced measures for fast tracking of APA renewals cases. Given such international best practices on APA renewal, similar process is recommended in India to bring quick closure to APA renewal cases.   1. **Delegation of authority for approval of APAs**   As highlighted earlier, there is a long-time gap between processing of APA file and conducting site visits. This is primarily because there are multiple levels of approvals within the APA programme. To reduce the time lag, it is suggested that depending on the complexity level, the authority for approval can be delegated. High complexity cases may be approved by CBDT members whereas the approvals for medium risk can be delegated to the Joint Secretary – FT&TR Division and low risk cases can be approved by CCIT (APA). Such delegated approval ladder would quicken the process of resolving APA cases.  Even the TP orders are currently passed in a similar way as suggested above. Depending on the risk factors, Joint Commissioner can approve some orders for medium to low-risk cases whereas Commissioners would only look at the approval of high-risk cases. Reference can also be made to mutual agreement procedure (MAP) resolutions where officials at Commissioner rank would have the power to negotiate and agree on range of margins which are broadly well within the blanket approval given by CBDT.  All the above suggested measures require administrative changes within the Tax Department and does not require any amendment to ITA.   * 1. **Structural measures**  1. **Bring necessary changes to safe harbour rules to reduce the load on APAs (which are perceived as the only option for tax certainty)**   As announced in Budget Speech on 23 July 2024, the safe harbour rules may be rationalized (based on trends in concluded APAs) to make them more attractive for taxpayers, so that the burden on APAs can be reduced. The safe harbour rules must cover additional sectors/ transactions to ensure maximum coverage. The intention should be to reduce the risk of double taxation by ensuring that the rate isn’t beyond arm’s length range and reduce the substantial compliance costs.  **The key benefit of this suggestion is that the eligible taxpayers would also start looking at simple and easy to follow certainty routes, thereby reducing the load on APAs.**   1. **Issue detailed APA guidance to set the right expectations**   It would be useful to inform both tax authorities and taxpayers as to what would be acceptable filing positions, expected documents/ information for effective negotiation, minimum expectations of the Government from such APAs (sector-wise) and possible resolution. This would reduce the uncertainty and subjectivity (to some extent) specifically on the APA process and brings in much required consistency and uniformity across all APA Commissionerate. This would also provide a basis for much speedier APA resolutions. To enhance clarity, possibility of publishing actual APA outcomes in some complex matters on an anonymous basis, may also be considered just to show-case how both tax authorities and taxpayer worked together to resolve the matter.  **The key benefit of this suggestion is that this would set the expectations from the taxpayers for speedy APA resolutions.**   1. **Opt-ins for “roll forward” for APA renewals**   One of the key hindrances of the APA renewal programme is the time taken to conclude the renewal, even though the facts and circumstances are the same. APA renewal process essentially repeats the entire original APA process, requiring submission of documents from scratch, site-visits and filing detailed responses rather than leveraging the work done in the original APA.  It is suggested that in year 5 of the APA term, an option should be given to the taxpayers to opt in for “roll forward” the ongoing APA upon establishing the fact that there would be no change in the facts, functional profile and other circumstances of the APA. Taxpayers can provide a management representation by way of a meeting with APA teams or by way of a written confirmation. Having such an option in the year 5 greatly saves the time in rolling forward the APA benefits. In this regard, it is also useful to look at some of the country practices in relation to “roll forward” options such as Germany and China who provide for simpler forms for such extension requests.  **The key benefit of this suggestion is that this relieves a lot of burden on the APA officials; thereby enabling them to focus on key APA cases which have more revenue potential.**   1. **Endeavor to conclude APA in a timely manner**   As discussed above, there is no stipulated time for closure of APA cases under the law. This leads to delays (whether intentional or unintentional) both at the end of taxpayers and APA teams. A firm commitment on time for closure will make both taxpayers as well as APA team accountable for speedy resolution. In cases where taxpayers are non-responsive, the CBDT could direct the APA application to be closed after providing an opportunity of being heard within a reasonable time (say 6 months) and clear the pending inventory. Further, efforts should include quick timelines for issue of questionnaires, site visit map, expected timeline for negotiation and closure, thereby reflecting the strong commitment to close APAs in a time bound manner.  **The key benefit of this suggestion is that it expedites the closure; thereby leading to faster collection of revenues for the Government. It also brings in more efficiency in the overall process.**   1. **Bring transparency in the overall APA process**   One of the concerns is the lack of transparency in providing the taxpayers the basis of negotiations as well as movement of APA cases within APA teams and the CBDT. In the absence of adequate information from APA teams, taxpayers are unable to have conversations with their foreign counterparts in a meaningful manner. They are also unaware about the status of the application. With greater digitalization, we recommend that the process be made online wherein all the status of each application can be seen on the dashboard of respective taxpayers’ profile on the Income Tax e-Filing Portal with clear information on the below elements:   * Status of pending application, where it is pending including the official’s details (who is reviewing the file) as well as reason for such pendency and time left to resolve the APA case. * Basis for arriving at a particular rate/ margin * E-filing will allow expeditious handling and maintenance of voluminous documents/records.   **This will be helpful in bringing in transparency in the overall process and help in forecasting a reasonable time for closures.**   1. **Keeping the regular TP assessment in abeyance during the APA process (legislative change)**   Currently, the time limit for concluding assessments does not consider keeping TP assessment under abeyance or extending the time limit until the signing of APA for the APA covered years including roll back. Further, the Income-tax Act, 1961 does not provide for suspension in collection of tax until signing of APA. This results in administrative inconvenience for the taxpayers to simultaneously go through the rigorous assessment proceedings despite having opted for APA regime. Given the inordinate delay in APAs, the Government can consider extending the time limit for completing TP assessments for APA applicants/ APA covered international transactions by a couple of years on putting the assessment on hold for the period when the APA is pending, by amending s.153 of ITA. Such interim period could be excluded for purposes of the statutory assessment timelines. Similar practices or rules for keeping the assessments in abeyance or deferral of assessments are followed in countries such as the US, Australia, Germany and Hong Kong, as part of their bilateral APA or MAP programme. Also, if the APA does not get concluded within the prescribed time as mentioned above, possibility of having a “block assessment” for the APA covered years can also be recommended to bring in efficiency for the CBDT.  **The key benefit of this suggestion is that it would bring in “ease of doing business” for the taxpayers and encourage them to opt for APA route.**  APAs have contributed to the Government’s commitment to a non-adversarial tax regime and faster revenue collections. We believe timely conclusion of APAs will continue to help achieve the programme’s objective of:   1. providing certainty, 2. collecting fair amount of taxes on timely basis, 3. promoting non-adversarial tax regime, and 4. boosting the country’s attractiveness to foreign investors 5. improving India’s ease of doing business quotient   The suggestions above may be considered, and necessary steps may be taken to further strengthen the APA programme. |
| **Safe Harbour Rules** | | |
|  | **Making Safe harbours Attractive** | **Background**  To curb the increasing number of transfer pricing audits and prolonged disputes, the CBDT issued Safe Harbour Rules (SH Rules) in September 2013 and periodically updated thereafter. However, the rules need to be amended substantively to keep up to changing economic landscape. The SH Rules provide the circumstances in which tax authorities shall accept the transfer price declared by the taxpayer.  The honourable FM had announced in the last budget, that with a view to reduce litigation and provide certainty in international taxation, government will expand the scope of safe harbour rules and make them more attractive.  The suggestions for making safe harbours attractive are given below. Making safe harbours attractive will also help to reduce the burden on Advance Pricing Agreements (APAs).  **Issues of concern and suggestions**   1. **SH Margins:**   The margins are as high as 17-18% for IT/ITeS sector, making the option of safe harbour unattractive. Government should rationalise the high margins - e.g., the margins for IT/ITeS can be reduced to 14-15%. This would be most useful for IT and ITeS sector and the Global Capability Centers (GCCs) who are playing a significant role in the Indian economy today[[16]](#footnote-17). Similarly, the margins of 24% for contract R&D in the generic pharma industry should be reduced significantly to encourage investment in this sector.   1. **Threshold value:**   As per current Safe Harbour Rules, a taxpayer cannot avail the benefit for eligible transaction if transaction value is more than INR 200 crore. The benefit of specified domestic transactions has been very limited, covering Government electricity companies and select co-operative societies.  These revenue thresholds should be removed so that even the larger companies can avail the benefit.   1. **Sectoral scope:**   Currently, Safe Harbour Rules only cover manufacturing and export of core and non-core auto components. There are various other industries which are involved in manufacturing and exporting goods/components to associated enterprises, such as, textiles, renewable energy, pharmaceuticals, components of medical devices, etc. which are not covered as part of the safe harbour rules.  Safe harbour rule should be extended to international transactions involving contract manufacturing and export of pharmaceutical products, investment advisory services, marketing support services, and captive research and development (R&D) services other than R&D in information technology (IT) etc. It may even be extended to banks, including foreign banks.   1. **Low value-added services:**   In respect of “low value-added services”, the definition should align with that provided by Action 10 of the Base Erosion and Profit Shifting (BEPS) project of Organisation for Economic Co-operation and Development (OECD) and the prescribed rate should apply irrespective whether Indian party is receiving or rendering the services and not only where Indian party is receiving such services.  Further, the scope of low value-added services is currently restricted to transaction value of INR 10cr. This scope should be expanded, and SH should be introduced even in case of provision of low value-added services at a markup of 5% itself.   1. **Corporate guarantee:**   Current rules provide a single corporate-guarantee fee of 1% p.a., irrespective of credit rating of Associated Enterprise where amount guaranteed is within INR 100cr, and irrespective of credit rating falling within adequate to highest safety where amount guaranteed exceeds INR 100cr.  However, charging guarantee fee depends upon a lot of factors including amount guaranteed, purpose of borrowing, credit rating of borrower, impact of implicit support of Parent Group (shareholder function), etc. A general observation from the various tribunal decisions is that a corporate guarantee fee between 0.5% to 0.85% has been considered to be at arm’s length.  Over past 10 years, Government itself has entered into APA on Corporate Guarantee in more than 30 cases and thus the trend can be used to rationalise the fee basis credit ratings of borrower rather than blanket rate of 1% which is on a higher side.   1. **Interest on borrowings:**   Rationalise safe harbour rules for interest on borrowings as current margins are again on higher side.   1. **TP Documentation:**   Under the existing safe harbour rules, the taxpayer is required to undertake many TP documentation related compliances. To make it more attractive for small and medium industry players, requirement of maintaining TP documentation may be done away with in case the taxpayer applies for Safe Harbour and the same has been accepted by the tax authorities. |

**Annexure A**

**List of Income-tax rules which refer to valuation by merchant banker**

| **Rule** | **Context** | **Eligible valuer** |
| --- | --- | --- |
| ***Valuation by merchant banker or accountant*** | | |
| **Gift taxation u/s. 56(2)(x) and 50CA** | | |
| Rule 11UA | Value of unquoted shares and securities (other than equity shares) for S.56(2)(x) and 50CA | Open market value determined by ***merchant banker*** or accountant |
| **Indirect transfer u/s. 9(1)(i)** | | |
| Rule 11UB(3) | Value of unlisted shares of Indian company held by foreign entity deriving substantial value from assets situated in India | FMV determined by ***merchant banker*** or accountant |
| Rule 11UB(4) | Value of interest in partnership firm or AOP held by foreign entity deriving substantial value from assets situated in India | FMV determined by ***merchant banker*** or accountant |
| Rule 11UB(5) | Value of any other asset held by foreign entity deriving substantial value from assets situated in India | Open market value determined by ***merchant banker*** or accountant |
| Rule 11UB(6)(i) | Share of or interest in foreign entity where transfer is between non-connected persons- Market capitalisation based on the full value of consideration for transfer+ liabilities | Book value of liabilities as certified by ***merchant banker*** or accountant |
| Rule 11UB(6)(ii)(b) | Share of or interest in foreign entity where transfer is between connected persons and shares of such foreign entity are not listed on recognised stock exchange | FMV of shares/interest in foreign entity and liabilities considered in FMV is determined by ***merchant banker*** or accountant |
| **Exit tax for charity** | | |
| Rule 17CB- Exit taxation for charitable entities registered S.12AA, 10(23C), S.12AB | Value of any other share or securities (other than equity shares) by specified charitable institution u/s. 115TD | Open market value determined by ***merchant banker*** and accountant |
| ***Valuation by merchant banker*** | | |
| **ESOP perquisite taxation** | | |
| Rule 3(8) | Value of unlisted shares issued under ESOP scheme | FMV to be determined by ***merchant banker*** only |
| **“Angel tax” u/s. 56(2)(viib) applicable upto 31 March 2024** | | |
| Rule 11UA(2) | Value of unquoted equity/preference shares for determining excess premium | FMV to be determined by ***merchant banker*** only under Discounted Free Cash Flow or other methods |
| **Buyback distribution tax for buybacks till 30 September 2024** | | |
| Rule 40BB(8) | Determining amount received for shares bought back where shares are allotted as part consideration for acquisition of any asset or settlement of any liability, amount received shall be determined based on the formulary approach- (value of assets or liabilities/ number of shares) | While determining amount received- FMV of assets and liabilities to be determined by ***merchant banker*** only |

1. Rule 10D(1)(e) [↑](#footnote-ref-2)
2. TS-88-SC-2007 [↑](#footnote-ref-3)
3. TS-612-ITAT-2012(DEL) [↑](#footnote-ref-4)
4. TS-66-ITAT-2017(DEL) [↑](#footnote-ref-5)
5. TS-274-ITAT-2018(DEL) [↑](#footnote-ref-6)
6. TS-246-HC-2015(BOM) [↑](#footnote-ref-7)
7. TS-476-HC-2014(ALL) [↑](#footnote-ref-8)
8. [2009] 116 ITD 1 (Delhi)/[2008] 19 SOT 257 (Delhi)/[2008] 114 TTJ 289 (Delhi) [↑](#footnote-ref-9)
9. [2013] 34 taxmann.com 24 (Delhi - Trib.)/[2013] 26 ITR(T) 443 (Delhi - Trib.)/[2013] 58 SOT 69 (Delhi - Trib.)(URO)/[2014] 159 TTJ 42 (Delhi - Trib.) [↑](#footnote-ref-10)
10. [2010] 37 SOT 404 (DELHI) [↑](#footnote-ref-11)
11. Certain assets like jewellery, bullion, etc are to be valued at fair market value [↑](#footnote-ref-12)
12. APA Annual Report (FY 2023-24) published in November 2024 [↑](#footnote-ref-13)
13. APA Annual Report (FY 2023-24) published in November 2024 [↑](#footnote-ref-14)
14. APA Annual Report (FY 2023-24) published in November 2024 [↑](#footnote-ref-15)
15. Andrew Velarde, Virtual Environment a Boon to IRS Mutual Agreement Work, Tax Notes Today (12 February 2021). [↑](#footnote-ref-16)
16. EY expects the GCC market size to cross US$100b by the year 2030, with 4.5 million Total headcount [↑](#footnote-ref-17)