India

Indian tax heads frustrated by slow tax reform with no timeline

Tax heads at India's largest companies are disappointed about the long wait for tax reform, especially the move to a 25% corporate tax rate, as the country tries to balance its tax base and stimulate its economy.

By **Danish Mehboob**

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The Indian finance ministry appointed a government task force in 2017 to draft a direct tax code that aims to simplify tax provisions, improve tax certainty, and reduce tax disputes in India. The government task force, led by Akhilesh Ranjan, member of the Central Board of Direct Taxes and key figure in the international tax community, delivered the proposal to the ministry earlier this week with a suggestion to cut the corporate tax rate to 25% for companies without a subsidiary.

The direct tax code overhauls India's Income Tax Act and addresses an economic slowdown in the country. Advisers said that the pace of India's economic growth has forced the government to look at tax reform to increase investment in high growth industries such as semiconductors.

The proposed rules on direct tax introduce schemes to reduce tax disputes and lessen tax on income that is repatriated to a parent company in the form of dividends. A direct tax code draft suggestion to replace the Dividend Distribution Tax (DDT) - with withholding tax on dividends - is a particular highlight for multinational companies.

"The trouble with DDT is that it pushes up the tax rate of an Indian company significantly," said Subhankar Sinha, head of tax at Siemens India. "[The] effective tax rate becomes 48.31% with DDT and the foreign parent [receiving the dividend] doesn't get any foreign tax credit under the [existing] tax treaties."

While tax heads said that the suggestions are positive, including replacing DDT and cutting the corporate tax rate to 25%, they fall short of expectations. The wait for corporate tax reform could hamper corporate investment and growth as India looks at options to stimulate its economy.

A head of tax at a multinational industrial manufacturing company said that the 25% rate has been expected for the last four years, since the proposal in the 2015 Indian budget. "However, the government has not kept its promise," he added.

The Indian finance ministry has so far only cut the rate in 2019 to 25% for companies with annual sales of up to INR 4 billion ($56 million). The growing economy appears to be justifying the imposition of a 30% corporate tax rate on larger domestic companies and 40% on larger foreign firms.

"Most other countries have gradually responded to tax competition and aligned their tax rates to attract foreign capital and investment," said Jimmy Spencer, CFO at Chemtex Group in India. "The Indian tax rate is much higher than that of most OECD countries, including the US, UK and many countries in the Asia-Pacific [region]."

The draft proposal is not publically available yet, but will be released following further evaluation from the Indian finance ministry. The information on the rate cut was provided anonymously by a source at the finance ministry.

"Apparently there would be a significant revenue loss, approximately INR 1.2 trillion ($16.7 billion) if the 25% rate is extended to all companies," said Sinha. "So it's a bit difficult to speculate when the government will bite the bullet, given the fiscal situation."

Rakesh Nangia, managing partner at Nangia Advisors, said that Indian companies have been waiting for bold tax reforms.

The recommendations in the draft proposal may be adopted in India's 2020 budget proposals, but tax heads at the largest companies in India do not expect changes any time soon.

"I find it difficult to envisage any drastic changes in the near term, but there may be some tinkering in every annual budget [on] threshold revenue, where the lower tax rate may be applicable," added Spencer.

Some tax heads and advisers do not expect India's finance ministry to adopt the suggested changes in the direct tax code by the next budget announcement in 2020, but do hope that the 25% rate will be expanded.

India continues to remain a high tax jurisdiction for multinational companies and this is likely to continue to discourage investment, but adopting suggestions in the direct tax code by 2020 could boost economic growth and investment in the midst of fierce global tax competition in the short term.

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