

India's tax code overhaul plan criticised

By Mary Watkins and James Fontanella-Khan in Mumbai

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Plans for the first major **overhaul of India's tax code** in nearly 50 years would make the country a far less attractive place for companies to do business, leading industry analysts have warned.

Proposals outlined by the finance ministry this month would see corporate tax in India drop to 25 per cent from 30 per cent as part of a sweeping plan of reforms aimed at simplifying the tax system and stopping evasion.

However, lawyers and accountants say that, while there are beneficial elements to the draft legislation, it is being raced through parliament, lacks clarity on key issues, and will create major obstacles for businesses operating in India.

The finance officer of one of the largest foreign companies operating in India said it was concerned about the implications of the tax proposals – which will be discussed in the winter session of parliament with a view to being enacted in 2011 – and would be submitting its reaction soon.

Under the draft code, companies that enjoyed a tax-free holiday period during the development phase of their operations, such as energy groups, would now potentially have to pay tax on their assets no matter whether they had made a profit or not.

"Now tax will be levied on the gross value of the assets of a company. That is going to be a huge change," said Uday Ved, head of tax at KPMG in India. "In a large infrastructure project a company could incur losses in the initial period but still pay tax on 2 per cent of assets."

Potentially an even bigger issue is that the code would give unfettered powers to tax commissioners.

Nishith Desai, an international corporate and tax lawyer based in Mumbai, said the code intended to override tax treaties and also allow tax commissioners to ignore existing double tax avoidance agreements signed by India with more than 70 countries.

By opening up the possibility for foreign companies operating in India to be taxed there as well as in their home markets, this could have ramifications for India's political and economic relations.

"Tax treaties are part of international law. The [code] would give commissioners the power to disregard a treaty," said Mr Desai.

A senior official at the finance ministry said: "On tax avoidance provisions, yes, we are giving commissioners greater power to make sure that the rules are applied correctly ... we want to make sure that people aren't hiding things from us ..."

The new code would also have negative implications for special economic zones, which currently allow companies operating in them up to 15 years of tax breaks, as well as a host of other incentives designed to encourage business to a region.

India has hundreds of SEZs, but under the new code they could be deemed as a "tax exception" and forced to pay tax at the normal rate.

The finance ministry said: "All SEZs' benefits up to March 1 2011 will be granted. So if a developer starts his SEZ project today, the developer will continue to get the benefits offered under [the] existing SEZ tax regime ..."

"But anybody setting up their project after March 1 2011 will have to pay the same amount of tax as any other non-SEZ based company."

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