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Indian government proposes to defer general anti-avoidance rules

Overview

The Indian Finance Minister today presented in Parliament the government's revised Union Budget 2012 proposals (the budget), which include some significant changes from the original budget proposals released on March 16, 2012.

Key changes from the original proposals include a postponed introduction of general anti-avoidance rules ("GAAR") and a reduced long-term capital gains tax rate on the sale of unlisted securities. Notably, the revised budget does not include changes to the indirect transfer tax proposals (i.e., the proposals responding to the Vodafone decision).

The Parliament will debate the revised budget proposals over the next two weeks. They will be effective once approved by both houses of Parliament and upon obtaining Presidential assent.

This newsalert summarizes the key tax proposals in the revised budget that may affect US investors in India. For coverage of the initial budget proposals, see Asia Pacific Tax Newsalert, "India announces 2012 budget proposals," March 16, 2012.

GAAR

After receiving several responses to the GAAR proposals in the original 2012 budget, the Finance Minister proposed the following changes:

- The effective date of GAAR would be delayed to April 1, 2013. The deferral may be designed to increase acceptance of the proposal and to add some safeguards to the rules.

- The burden of proof for establishing that a transaction results in tax avoidance would be on the Revenue authorities; under the original proposal the taxpayer had the burden of proving that the main purpose of a transaction was not to obtain a tax benefit.

- Taxpayers will be permitted to obtain an advance ruling on whether a transaction is covered by GAAR.

- To add an independent party to the GAAR regime, the panel that will evaluate GAAR transactions would include an independent representative. Under the original budget proposals, the panel included only tax officials at the level of Commissioner of Income-tax.

- The Finance Minister also announced the formation of a committee chaired by the Director General of Income-tax (International Taxation) to recommend rules and guidelines for implementation of the GAAR provisions and to suggest safeguards. The Committee is expected to submit its recommendations by May 31, 2012.

Capital gains tax

Currently, the sale of unlisted Indian securities is subject to 20 percent capital gains tax. In an attempt to provide relief to private equity investors, the revised budget proposes to reduce the long-term capital gains tax rate on the sale of unlisted securities to 10 percent.

The budget would impose a 0.2 percent securities transaction tax on the seller of unlisted shares in the case of transactions pursuant to an offer for sale (i.e. initial public offering). In respect of such transactions, the investors will be exempt from long term capital gains tax.

These proposals would bring the taxation of private equity investors in line with the taxation of foreign institutional investors in this regard.

Although the revised budget proposals do not contain any provisions relating to taxation of Participatory Notes ("P-Notes"), earlier comments from Finance Ministry officials suggest that a separate clarification may be issued on this issue.

Taxation of indirect transfers

Contrary to many observers' expectations, the revised budget does not change the proposed retroactive tax on indirect transfers in India when substantial value is derived from underlying Indian assets. While the Finance Minister has stated that these proposals will not override tax treaties and that completed audits will not be reopened, the proposals have not been amended to clarify this. The government has

not yet clarified what would constitute "substantial" value for this purpose.

Taxpayers may need to wait for final budget proposals to see the exact language.

Conclusion

While the revised budget proposals provide some taxpayer relief, investors still await developments on the taxation of indirect transfers as well as other proposals such as the introduction of domestic transfer pricing rules and Advance Pricing Agreements.

Taxpayers should continue monitoring these developments as the revised budget proposals as Parliament debates and finalizes these proposals in the coming weeks.

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