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Corporate Structures ‘Face Heat’ From India's Tax Evasion Curb

By Siri Bulusu

India's latest move against tax evasion will hit corporate structures, according to practitioners.

The country's tax authority issued final rules this month on how private limited companies will value unlisted shares, clarifying a change that aims to stop tax evasion in a private share sale.

Snapshot

- Measure is one of several announced in Finance Bill 2017 on the share sales
- Sale or transfer of unlisted shares forms important part of India's economy

Corporate restructuring will “face the heat, in this case” as the government's measure targets tax planning that capitalizes on deliberately underpricing unlisted shares, Neha Malhotra, executive director of Delhi-based Nangia & Co. LLP, told Bloomberg BNA in a July 20 telephone interview.

The measure also poses issues for corporate structures in which subsidiary companies are controlled by another, according to Vispi Patel, head of Mumbai-based accountancy firm Vispi T. Patel & Associates.

In these chain-like and complex structures, minority shareholders will struggle to “determine the valuation of unquoted equity shares because they may not have access to all the relevant information” to make the calculation, he told Bloomberg BNA in a July 20 telephone interview.

Fair Market Versus Book Value

Announced July 12, the clarification from India's tax authority said that fair market value should be the basis for the valuation of unquoted shares instead of book value. The second approach can be manipulated, increasing the chances of tax evasion on capital gains.

The amendment is one of several anti-avoidance measures introduced in the Finance Bill 2017 that address taxation of sale of shares. As India continues to attract private investors, the sale or transfer of unlisted shares is set to continue forming a part of the country's growing economy.

Long-Term Capital Gains

Taking effect from April 2018, the latest measure applies to domestic and foreign companies that have an entity treated as an Indian resident for tax purposes. The capital gains rate applicable to resident companies is 20 percent for long-term capital gains after indexation benefits. For nonresidents, the rate is 10 percent for long-term capital gains without indexation benefits.

With publicly listed shares, “the picture is pretty clear because the market is determining the price of shares, but with unquoted equity shares, you can play with book value,” Malhotra said. The latest action from the Indian government will eliminate this sort of tax evasion, he added.

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