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MNC UNITS, INDIAN FIRMS GET TAX NOTICES FOR RECEIVING FDI

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MUMBAI: After slapping 'angel tax' notices on startups, the taxman's attention seems to have turned to foreign direct investment (FDI) in multinationals and Indian companies where a 'premium' was paid over and above the 'fair market value' of shares.

The income tax department has started issuing notices to several companies that have received FDI, claiming that the 'premiums' they received on such transactions are 'unexplained credits' that can be held as income, people familiar with the development told ET.

This is similar to the so-called angel tax, which is applicable on capital raised by unlisted startups against issue of shares in excess of 'fair market value', on the ground that this excess amount is akin to "income from other sources".

Industry trackers said the I-T department is questioning valuations of several FDI deals and this could result in about 30% tax on the 'premiums' paid by the investors. Investments by multinationals in their subsidiaries and by foreign investors in Indian companies through share transfer are also being questioned, tax experts said.

Deals Are Based on Commercial Factors, Say Experts
"Companies will have to pay about 30% tax on the differential investment over and above the fair market value derived by the tax department," said Rajesh H Gandhi, partner at Deloitte India. "Section 56(2) (viib) (of the Income Tax Act) specifically covers issue of shares to residents; however, if the differential is taxed in the hands of a non-resident shareholder under Section 68 it could have a bigger, perhaps unintended, impact," he said.

A case in point is an investment of around Rs 1,000 crore that an American multinational headquartered in New Jersey made in its Indian subsidiary. The tax department has issued a notice to the company, questioning the valuation. I-T sleuths believe that the transaction should have been valued at half the price and they want to levy tax on the 'premium', a person aware of the development told ET.

In some cases investments by private equity funds or other investors located outside India have also been questioned, tax experts said.

"The decision on what price must a share capital infusion transaction happens is purely based on commercial considerations and should be decided between the company and the investor," said Punit Shah, partner at Dhruva Advisors. "The tax on the genuine FDI investment, whether made by PE funds, strategic investors or parent of a multinational company, would be contrary to the law and will only lead to more litigation," he said.

The notices are being issued under Section 68 of the Income Tax Act, tax experts said.

BLACK MONEY
Under Section 68, an I-T officer can question details when he suspects round-tripping or involvement of black money in a deal as well, experts said.

People in the know suspect that the tax department has started issuing notices to companies probably because it is suspecting some wrongdoing in those transactions, including disguising fee as investment to save tax. They pointed out that otherwise income tax isn't levied on inbound foreign direct investment, and investors paying a premium aren't unusual in investment deals.

The FEMA (Foreign Exchange Management Act) norms of the Reserve Bank of India (RBI) mandate Indian companies to get a valuation of their company done from an independent chartered accountant in unlisted companies before a deal. The company cannot sell the shares at value lower than the prescribed valuation or fair market value. In all the cases where notices have been served, the deal was done over and above the valuation or fair market value.

The I-T department suspects that some of these companies may have provided some services or goods to the foreign investors, people with direct knowledge of the matter said. "The department suspects that these companies have provided some services to the foreign investors, and instead of payment, the money is routed as capital investment to save tax," one such person told ET on condition of anonymity. "The department is also suspicious about the source of these investments."

While notices to startups and multinationals have been issued under different income tax laws or sections, the end result is the same — a claim of 30% tax on the premiums paid on the investment, industry trackers said.

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