Shome Committee Report

Shome Committee Report On Deferment of GAAR

The Prime Minister constituted expert panel on General Anti Avoidance Rules (GAAR) has recommended postponement of the controversial tax provision by three years and abolition of capital gains tax on transfer of securities thereby win back the confidence of foreign investors.

Recommendations by the Committee

The Parthsarathi Shome Committee Report sought to address investor concerns on GAAR and also do away with the negative vibes of foreign investors about India. It said that the three year deferment would provide a window of opportunity to taxpayers to prepare themselves for the new regime and to the tax official to be trained for successful implementation.

As a step towards reassuring global investors, the Committee in its draft report, suggested that GAAR provisions should not be invoked to examine the genuineness of the residency of entities in Mauritius.

Mauritius is the most preferred route for foreign investments because of the liberal taxation regime in the island country. India has a double taxation avoidance treaty with Mauritius.

The Committee has recommended that GARR be applicable only if the monetary threshold of tax benefit is Rs 3 crore and more.

The draft report, which was submitted to the Finance Minister on September 1, also sought comments from the stake holders by September 15. The Shome Committee was set up by Prime Minister Manmohan Singh to address the concerns of foreign investors.

Meanwhile, the Finance Ministry has also expanded the scope of the terms of reference of the committee to include all non-resident tax payers instead of only FIIs.

The draft report of the Shome committee said: "...GAAR should be deferred for 3 years. But the year, 2016-17, should be announced now. In effect, therefore, GAAR would apply from assessment year 2017-18. Pre-announcement is a common practice internationally, in today's global environment of freely flowing capital".

In view of wide-spread concerns by foreign investors, the government had earlier postponed implementation of GAAR, which was introduced by the then Finance Minister Pranab Mukherjee in his Budget for 2012-13 to check tax evasion, by one year.

The report of the Shome Committee, which seeks substantial modification of the original proposals, was made public within days of Parliamentary Standing Committee of Finance expressing concerns over deterioration of investment climate.

In its report on Current Economic Situation and Policy Options, the Standing Committee had said that investment climate in the country has suffered serious setback and investors confidence was hit mainly because of the concerns over the impact of retrospective tax laws and GAAR.

Earlier, Central Board of Direct Taxes (CBDT) had come out with draft guidelines on GAAR which did not find favour with Prime Minister Manmohan Singh, who was looking after the Finance portfolio. He had announced setting up of Shome panel to come up with fresh report after talking to stake holders.

Addressing the Concerns Of Mauritius Investors

In order to address the concerns of Mauritius-based investors, the Shome panel has suggested that the provisions of the GAAR should not be invoked to "examine the genuineness of the residency of an entity set up in Mauritius".

The draft further said that the government should retain the provisions of the CBDT circular, which was issued in 2000, on acceptance of Tax Residence Certificate (TRC) issued by the Mauritius.

"...if Government cannot accept it (proposal to abolish capital gains tax on transfer of listed securities) on political economy grounds, a second best alternative would be to retain ... the Circular accepting Tax Residence Certificate issued by the Mauritius authorities", the report said.

India has been expressing concern over misuse of Double Taxation Avoidance Agreement (DTAA) by foreign investors who route their investments from Mauritius to avoid tax liability.

The Committee wants, "the Government should abolish the tax on, gains arising from transfer of listed securities, whether in the nature of capital gains or business income, to both residents as well as non-residents. In order to make the proposal tax neutral, the Government may consider to increase the rate of Securities Transaction Tax (STT) appropriately".

As per the recommendation, GAAR should apply "only in cases of abusive, contrived and artificial arrangements".

Besides, it said the administration of Authority for Advance Ruling (AAR) be strengthened so that rulings can be obtained by corporates within a time frame of six months.

It said the I-T Act may be amended to provide that only arrangements which have the main purpose (and not one of the main purposes) of obtaining tax benefit should be covered under GAAR.

The committee said where the treaty itself has anti-avoidance provisions, such provisions should not be substituted by GAAR provisions.

"The Committee recommends that where SAAR (Specific Anti-Avoidance Rules) is applicable to a particular aspect/element, then GAAR shall not be invoked to look into that aspect/ element," it said.

It suggested that if there is evidence of violations of anti-avoidance provisions in the treaty, the treaty should be revisited, but GAAR should not override the treaty.

Highlighting that the objective of GAAR should be deterrence rather than revenue, the Committee recommends that the Approving Panel should consist of five members including Chairman, who should be a retired judge of the High Court.

Besides, two members should be from outside Government and persons of eminence drawn from the fields of accountancy, economics or business, with knowledge of matters of income-tax, and two members should be Chief Commissioners of income tax or one Chief Commissioner and one Commissioner.

The Committee further said the assessing officer shall not invoke GAAR where the taxpayer submits a satisfactory undertaking to pay tax along with interest in case it is found that GAAR provisions are applicable in relation to the remittance during the course of assessment proceedings.

Besides, it suggested that GAAR can be invoked only with the approval of the Commissioner.

The report also recommended grandfathering of the income arising from investments made prior to the GAAR regime as being covered by the earlier regime.

The US Power Game

In a waning presidential first term nothing compares to the importance of securing another one. In Barack Obama's case, there is an added spur to his drive for re-election. The president believes the American economy will spring back to life over the next four years and cannot abide the thought of Mitt Romney reaping the credit.

Mr. Obama's impulse is more than understandable. However unearned, an economic revival that coincided with a Romney first term would easily be marketed as a "Romney boom". But even if — as many expect — Mr Obaina wins on 6 November, he should be wary of the growing belief in America's impending manufacturing renaissance.

Too much of it is based on hope. America's pallid — and again waning — economic recovery is already into its fourth year. The typical length of the business cycle is about seven years. It requires optimism at this stage to believe the patient is about to arise and go for a jog.

Here is the case for America's coming manufacturing boom. First, the US is in the early stages of an energy windfall that will transform its attractiveness as a location to do business. In addition to the unfolding energy supply shock, which will lower the cost of electricity and the feed-in stock for many kinds of production, the cost of American labour looks increasingly attractive next to wage inflation in China and other emerging market economies.

According to the Boston Consulting Group, the US could create between 2m and 5m new direct and indirect manufacturing jobs between now and 2020. That would make up for about one-third of what it has lost in the past decade.

On the top of that, the US housing market has finally bottomed out and is likely once again to become a net plus to US growth. Finally, as Roger Altman recently argued in the FT, Washington could surprise us all by skirting the cliff and striking a fiscal deal that would rekindle America's animal spirits.

Much of this is indisputable; the US is well on the way to a new era of energy abundance. Estimates of its impact range from mildly positive to something far bigger. Much of it is also probable: it would take a huge shock to push the US housing market back into free fall. Some of it is less so: it would be a surprise if Congress struck an intelligent fiscal bargain in the coming months. Should the Republican "fever break" - as some Democrats describe the anticipated Republican change of heart - it would certainly qualify as a positive shock to the economy. Both Moody's and Standard & Poor's, the two biggest credit rating agencies, cite political risk as America's chief vulnerability.

Yet it is hard to get excited about a revival based on so many ifs and buts. Even if the rosiest forecasts prove correct, they are based on sobering assumptions. First, the boom would be based on the continued decline in US unit labour costs. By 2016, according to Boston Consulting Group, the gap with China would have narrowed to just seven cents an hour. These would be neither the high-tech jobs of the future nor the golden middle class jobs of the past.

Rising US labour productivity growth will play its part. So too will declining US wages. Hourly pay for new "two-tier" hires in US auto assembly plants and elsewhere is roughly-half that of the original tier (and with a fraction of the benefits). None of this would alter the calculus for the higher-tech manufacturers, such as semiconductors and robotics. At a typical Intel plant, whether in China or America, 'labour costs' amount to just a tenth of total overheads. Tax rates, market access and the cost of land are far more important factors.

Second, the hollowing out of America's middle class -still politely described as median income stagnation rather than "decline" - is accelerating rather than slowing. According to the US Census last week the US 'median' household is 4.8 per cent poorer now than at the start of the recovery in 2009. Median incomes have now fallen to the pre-internet level of 1993. All of the gains of the Clinton years have been lost. The decline in the past three

years follows a 32 per cent drop during the recession, which itself followed a shrinkage during the 2000-2007 cycle. Far from a new dawn, of broad-based growth, America's middle class decline is getting worse.

Recent days will chiefly be remembered for Mr Romney's decision to stand by his disparaging comments about the 47 per cent of Americans who pay no federal income tax. They will also be remembered for the release of his full 2011 tax return, which showed that the former Bain Capital executive pays a lower overall rate than the poorest fifth of Americans. In an era of increasing economic insecurity, Mr Romney has made a hash of his campaign.

Were he a better politician, Mr Romney would have seized on a report earlier this month that showed a sharp fall in US competitiveness. In 2007 the US was ranked first by the World Economic Forum, which published the report. By 2011 it had fallen to fifth. This year it dropped to seventh. The chief culprits are bad governance, macroeconomic instability and declining infrastructure. Here, too, the American trend points the wrong way.

Should he still pull off a victory, Mr Romney 's tax plans would skew the fiscal system- even further towards the wealthiest. If, as Mr Romney says, Mr Obama is a "re distributionist", then he is clearly not a very effective one.

Whoever wins the 2012 election, America can certainly rely on a coming energy boom - in fact it is already well under, way. Most of the rest looks like either hype or hope.