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INDIAN BUDGET 2020 | DIRECT TAX PROPOSALS

2 February 2020

BUDGET ERGO SCORECARD	
Personal Income-tax Rates	🙄
Dividend Tax | For Non-Resident Shareholders	🙂
Dividend Tax | For Resident Shareholders	🙄
Change in Tax Residency Rules | Presence test made stringent	🙁
Change in Tax Residency Rules | Ease in becoming RNOR	🙂
Tax Return Filing Exemption for Non-Residents	🙂
Provisions relating to Start-Ups and ESOPs	🙂
Deferred sunset clauses for reduced withholding tax on interest	🙂
Safe Harbour Provisions and Advanced Pricing Agreements on Non-Resident profit attribution	🙂
Business Connection Extended Test (SEP) Deferred	🙂
Real Estate Relaxations	🙂
Payment of 20% of Tax Demand for ITAT stay	🙁
Taxpayer's charter to be codified	🙂
Dispute Resolution Scheme to be introduced	🙂

TAX RATES

The tax rates and income slabs under the Income-tax Act, 1961 (IT Act) remain the same, other than the following proposed changes.

Companies

Corporate tax rates remain unchanged.

- Domestic companies continue to be taxed at 15% / 22% / 25% / 30%, depending on factors like nature of business, commencement of operations, turnover in Financial Year (FY) 2018-19, choice of claiming certain exemptions, etc.

- Foreign companies continue to be taxed at 40%.

Incentive for new electricity generating companies

Currently, under the IT Act, a concessional rate of 15% is available to a domestic company engaged in the business of "manufacture or production of an article or thing", subject to satisfaction of various other conditions.

The Finance Bill 2020 (Bill) proposes to include the "business of generation of electricity" as "manufacture or production of an article or thing" for the purpose of availing the concessional rate of 15%.

The proposed amendment is in view of several representations from the industry and comes as a welcome fillip to generating electricity in the country.

While the Bill is silent on the effective date, as per the Memorandum to the Bill (Memorandum) this amendment is proposed to be effective for FY 2019-20 and onwards. However, it is possible that there is a typographical error in the Memorandum else the Government would have highlighted the intention to pass a retrospective amendment.

Partnerships and Limited Liability Partnerships (LLPs)

Partnerships and LLPs continue to be taxed at 30%. The desire to witness parity between tax rates of corporates and LLP remains unfulfilled.

Individuals and Hindu Undivided Family (HUF)

While the tax rates remain unchanged, the Bill proposes to provide these taxpayers an option to pay tax as per specified lower slab rates, provided they forego their claim of certain prescribed exemptions and deductions.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Co-operative societies

The Bill proposes to provide an option to resident co-operative societies to pay tax at a lower rate of 22% upon the fulfilment of the prescribed conditions, as compared to the current maximum slab rate of 30%.

This amendment is proposed to be effective for FY 2020-21 and onwards.

GETTING BACK IN THE RIGHT LANE; DDT ABOLISHED

Currently, dividends distributed by a company are subject to Dividend Distribution Tax (DDT) at an effective rate of 20.56%. Such DDT is levied on the post-tax income of the company, i.e. after the company has already suffered corporate tax on its profits. Since DDT is a tax obligation of the distributing company (i.e. it is not in the nature of tax deduction at source), such DDT is not available as a credit to the shareholder. Dividend so received from the distributing company is exempt from tax in the hands of shareholders (except certain non-corporate resident shareholders).

Under the proposed regime, which is essentially a throwback to the manner of taxing dividends prior to 1997, dividend income will be taxed in the hands of the shareholders as follows:

- Tax rates for resident shareholders – applicable rates. The company would deduct tax at source at the rate of 10%.

- Tax rates for Non-Resident (NR) shareholders – 20% (plus surcharge and cess) or at such beneficial rates as provided under the tax treaties. The company would withhold tax at source, at applicable rates. NR investors will now be eligible to claim a credit in their home jurisdiction for the tax paid on dividends.

With differential withholding rates depending on the residency status of shareholders, listed companies, which have several shareholders, may find it practically challenging to correctly discharge their withholding tax obligations.

Further, the proposed regime of taxing dividends in the hands of shareholders leads to a dichotomy in the rate of taxation for NR (who will be taxed at 20% (plus surcharge and cess)) and resident High Networth Individuals (HNIs) (who will be taxed at a peak rate of 42.74% (inclusive of surcharge and cess)). Thus, resident HNIs may evaluate other options for cash repatriation such as buyback which is still taxed at 20% (plus surcharge and cess) or look at other forms of doing business such as limited liability partnerships whose income is tax exempt in the hands of the partners.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Distribute freely; intercorporate dividends exempt

Currently, the provision setting out the DDT liability provides for exemption of DDT when dividends are received from subsidiaries and are further up streamed in the same FY in which they are received from the subsidiary.

The Bill proposes to continue to avoid cascading effect and provides for a deduction of dividends received by companies from other companies (and not just a subsidiary). Further, the period within which the dividend should be up streamed, to be entitled for the tax deduction, has been extended beyond the same financial year.

Separately, companies would be able to claim expenditure incurred toward earning dividend income. However, with respect to interest expenditure, the deduction would be capped at 20% of the dividend income earned in a given year.

NAMASTE NON-RESIDENTS

Frequent Flyer No More? Residency Redefined for NRIs

The IT Act specifies that tax residency for individuals shall be determined only on physical presence. The relevance of citizenship was limited. Further, a Non-Resident Indian (NRI) who is an Indian citizen or a Person of Indian Origin (PIO) was provided additional leeway when calculating the day count in India. Importantly, Indian residents are taxed on their worldwide income and must report their offshore assets and income in their annual tax returns. NRs, on the other hand, do not shoulder such a reporting obligation and are taxable only on their Indian-sourced income.

Currently, an individual is treated as a resident if he spends more than 182 days in a FY in India. In the alternative, an individual will be treated as a resident in India if he spends more than 60 days in a FY and had spent more than 365 days in the preceding 4 years. However, the 60-day test is not applicable to an individual, who is a citizen of India or a PIO, visiting India.

The Bill proposes to treat Indian citizens as residents of India, where they spend more than 120 days (instead of 60 days) in a FY and have spent more than 365 days in the preceding 4 years. The intent underlying this reduction in the day count is primarily to curb misuse in cases where NRIs are actually carrying out substantial economic activities from India and manage their stay to avoid being categorised as an Indian resident.

It was further observed by the Government that several individuals are 'managing' their presence in such a way that they do not pay tax in any other country. Accordingly, the Bill proposes to deem an Indian citizen to be a resident of India, where the individual is not liable to tax in any other country by reason of domicile, residence or other criteria.

Currently, to enable smooth transition for returning Indians, a special classification, called 'Resident but Not Ordinary Resident' (RNOR) is provided for individuals who are treated as residents. The RNOR are, akin to non-residents, only taxed on their Indian source income.

A dual test for determining RNOR status is prescribed, whereby an individual should qualify as a non-resident in 9 out of 10 preceding years or should have spent 729 days or less in the 7 preceding years. The Bill proposes to substitute the dual test with a single test; the individual shall be an RNOR if he has been a non-resident of India in 7 out of the 10 preceding years. Accordingly, the condition to qualify as an RNOR has been relaxed.

For ease of reference, the revised residency threshold after incorporating changes proposed by the Bill would be as follows:

- 182 days or more in the FY; or
- 365 days or more in the preceding 4 years and 60 days or more in that FY.

  However, the above 60-day threshold shall be increased in the following cases to:

  - 182 days or more in case an Indian citizen leaves India for the purposes of employment outside India in the FY; or
  - 120 days or more in case an Indian citizen or a person of Indian origin visits India in the FY.

Further, an individual shall qualify as an RNOR in a FY, where he has been a non-resident in 7 out 10 preceding years.

The deeming residency rule unexpectedly treats citizenship as a basis for taxation. Indian citizens who are residents of any foreign country, on account of their presence or domicile, but are not taxed in such country due to the exemption in their tax law, should not be deemed to be residents of India. The relaxation in conditions to qualify as an RNOR are welcome. Nonetheless, the paradigm shift in the residency rules shall certainly require NRIs with significant Indian social and economic ties to revisit their travel plans.

This amendment is proposed to be effective for FY 2020-21 and onwards.

All play and no work; non-residents to enjoy earning income from India without worrying about filing tax returns

Currently, the IT Act contains beneficial provisions whereby NR taxpayers are not required to file tax returns in India if their income comprises only certain specified types of investment income such as dividend or interest income. However, the exemption from filing tax return is subject to the requisite tax being withheld by the payor.

The Bill proposes to extend the exemption from filing of tax returns to NR taxpayers whose income consists of royalty income or Fees for Technical Services (FTS), so long as the tax has been withheld at source.

Such widening of exemption from filing tax returns in India would provide NR with administrative and procedural ease of investing in India.

Importantly, NR taxpayers are exempt from filing tax returns only if tax withheld on dividend, interest, royalty, FTS is as per the rates mentioned under the domestic tax laws. Therefore, if lower tax or nil tax is deducted due to relief under a tax treaty with India, then NR taxpayers would still need to file their tax returns.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Sun to set another day; reduced withholding to continue on interest income!

Currently, Section 194LC of the IT Act provides for a concessional rate of withholding of 5% by an Indian company or a business trust, on payment of interest to non-residents on certain forms of borrowings made in foreign currency from sources outside India. Presently this reduced rate of Tax Deducted at Source (TDS) was applicable if these borrowings were made:

- Under a loan agreement;
- By way of issue of long-term bond including long-term infrastructure bonds; and
- By way of issue of Rupee Denominated Bonds (RDB).

Such concessional rate is applicable only to borrowing made prior to 1 July 2020.

Separately, Section 194LD of the IT Act provides for lower rate of withholding of 5% on payment of interest to Foreign Institutional Investors (FII) and Qualified Foreign Investors (QFIs) on their investment in Government securities and RDB of an Indian company. The reduced rate of withholding is applicable if the interest is payable before 1 July 2020.

The Bill proposes the following:

- To extend the sunset on concessional rate of withholding of 5% for a further period of 3 years from 1 July 2020 to 1 July 2023;
- To introduce a further reduced withholding of 4% on the interest payable to a NR, by way of issue of any long-term bond or RDB between 1 April 2020 and 1 July 2023 and which is listed only on a recognised stock exchange located in any International Financial Service Centre;
- To extend the concessional rate of 5% on interest payable to FIIs and QFIs on or after 1 April 2020 but before 1 July 2023 on investments made in a municipal debt security.

These amendments are a welcome move and in line with the endeavour of the Government to attract fresh investment and thereby stimulate the economy.

While the Bill does not mention the effective date, as per the Memorandum the amendments are proposed to be effective for FY 2020-21 and onwards.

Sure to be taxed, sure what to pay tax on? NRs to know their tax costs!

Currently, the IT Act taxes NRs on income arising through or from “business connection” in India. The global income of the NR is to be attributed to the activities carried out through the business connection. Such attribution is to be carried out in accordance with the prescribed rules. Further, to provide tax certainty and reduce tax litigation on account of transfer pricing, the IT Act provides:

- Safe Harbour Rules (SHRs) that prescribe for acceptable margin for computing arm’s length price; and
- The Advance Pricing Agreements (APAs) mechanism that provides for the tax authorities and the taxpayer to negotiate and agree upon acceptable arm’s length price to be adopted for a fixed period.

The Bill proposes that SHRs and APAs shall also be available for determining the acceptable attribution of income in the case of NRs having business connection in India.

This proposal is a welcome move inasmuch as it aims to provide tax certainty and avoid tax disputes for NRs.

While the Bill is silent on the effective date, as per the Memorandum, (i) the amendment with respect to the applicability of SHRs for NR Attribution is proposed to be effective for FY 2019-20 and onwards. However it is possible that there is a typographical error in the Memorandum else the Government would have highlighted the intention to pass a retrospective amendment; and (ii) the amendment with respect to the applicability of the APA Mechanism for NR Attribution is proposed to be effective for the APAs entered into or after 1 April 2020.

Foreign banks presented a level playing field

Currently, under the IT Act, deduction of payment of interest is capped at 30% of the Indian company’s EBITDA, which has borrowed funds from its related party (Associated Enterprise), who is a NR. Such cap on deduction is also known as “thin capitalisation”. Two unrelated entities may be treated as related where the loan granted by one entity is

equivalent to half the book value of total assets of the borrower. This would even apply where funds are borrowed from banks.

Further, branches of foreign banks are treated as NRs of India. Accordingly, the cap on deduction could apply where an Indian company borrows money from Indian branch of a foreign bank, even though such deduction would not apply to amounts borrowed from Indian resident banks.

The Bill proposes to abolish the applicability of such thin capitalisation norms to interest paid by Indian companies to Indian branches of foreign banks, even where the two may be deemed to be related entities.

Such change would bring parity amongst Indian banks and Indian branches of foreign banks. Accordingly, Indian branches of foreign banks would be an equally attractive option for borrowers.

This amendment is proposed to be effective for FY 2020-21 and onwards.

DIGITAL FOOTPRINT

Off the hook for now! Threat continues; digital presence sufficient to be taxed in India

Currently, the IT Act provides that NRs having Significant Economic Presence (SEP) in India shall constitute 'business connection'.

SEP has been defined to include:

- A transaction in respect of any goods, services or property carried out by a NR in India including provision of download of data or software in India if the aggregate payment exceeds the prescribed amount; and

- Systematic and continuous soliciting of business activities or engaging in interaction with prescribed number of users in India through digital means.

Given that the Government is yet to consider and finalise the rules for determination of SEP, the Bill proposes to defer the applicability of SEP to make it applicable for FY 2021-22 and onwards.

While the applicability of SEP has been deferred, it is proposed that the provisions relating to income of NRs attributable to operations carried out in India shall include:

- Income from advertisement which targets a customer who resides in India or from a person who accesses the advertisement through an internet protocol address located in India;

- Income from sale of data collected from a person who resides in India or from a person who uses an internet protocol address located in India; and

- Income from sale of goods or services using data collected from a person who resides in India or from a person who uses an internet protocol address located in India.

The proposed amendment is quite wide, and it may be a tough task for taxpayers as well as the tax authorities to identify the income that has arisen from a person who uses an internet protocol address located in India as well as income in relation to data obtained from India. Thus, it would be necessary to prescribe the operative mechanism to apply the aforesaid provisions to avoid hardship for taxpayers. Needless to mention the impact on NRs under DTAAs read with the provisions under an MLI would need to be considered to determine their ultimate tax liability.

Interestingly, NRs receiving any sum from Indian residents or entities having a PE in India towards advertisement and similar services are subject to equalisation levy at 6%. Thus, the interplay between equalisation levy and the NR rendering services determined to have a business connection under the aforesaid proposed amendment would need to be evaluated.

This amendment is proposed to be effective for FY 2020-21 and onwards.

TDS getting more tedious for e-commerce operators!

Currently, the IT Act provides for tax to be deducted at source at specified rates in respect of certain specified payments to resident payees. All payments made to NR payees, are subject to TDS, if chargeable to tax in India. Further, the minimum rate of TDS is 20%, where the payee does not furnish its Permanent Account Number (PAN) to the payer.

The Bill proposes to insert a new section in the IT Act to levy TDS at the rate of 1% (plus applicable surcharge, cess) on the gross amount paid by the 'E-commerce operator' (i.e. a person who owns, operates or manages E-commerce facility) to the 'E-commerce participant' (i.e. a resident person selling goods or providing services through E-commerce facility).

The Bill further proposes that:

- Payment made by a purchaser directly to the E-commerce participant, shall also be subject to TDS. However, such TDS would be payable by the E-commerce operator;

- Where the E-commerce participant (i.e. seller) is an individual or HUF, the new TDS levy shall not apply if (i) the aggregate amount receivable by the E-commerce participant (i.e. seller) does not exceed INR 0.5 million, and (ii) such E-commerce participant (i.e. seller) has furnished its PAN or Aadhaar number to the E-commerce operator; and

- Where the E-commerce participant (i.e. seller) does not furnish its PAN, the minimum rate for TDS shall be 5%.

This proposal seeks to widen the scope of TDS on E-commerce transactions in a bid to widen and deepen the tax base. It may have to be considered by the E-commerce operator as to how it would discharge its liability to pay TDS to the Government, where the payment is being made by the buyer to the E-commerce participant (i.e. seller) directly.

While the Bill is silent on the effective date, as per the Memorandum this amendment is proposed to be effective from 1 April 2020.

Bye bye auditors; relaxation for small businesses

Currently, the IT Act mandates filing of a tax audit report in cases where business receipts exceed INR 10 million. The Bill proposes to increase the aforesaid threshold to INR 50 million provided receipts / payments in cash do not exceed 5% of all receipts / payments.

The Bill further proposes that such tax audit reports and other reports statutorily required to be filed under the IT Act, need to be furnished by taxpayers 1 month prior to the due date of filing of return of income.

Notably, though the Bill has proposed that taxpayers are not required to get accounts audited, taxpayers would still be required to comply with the withholding tax compliance in respect of payments made for professional services, works contracts, commission/brokerage, interest payments etc. if their gross receipts from business exceed INR 10 million.

This amendment is proposed to be effective for FY 2020-21 and onwards.

TAX IMPLICATIONS FOR FUNDS

Sweetener to Sovereign Wealth Funds

In order to promote investment by sovereign wealth funds in India, the Bill proposes tax exemption on investment income in the nature of dividend, interest or long-term capital gains.

The exemption would be applicable if the following conditions are met:

- The investment is made by:

  - a wholly owned subsidiary of the Abu Dhabi Investment Authority (ADIA), which is a resident of the United Arab Emirates (UAE) and makes investment, directly or indirectly, out of the fund owned by the Government of UAE; or

  - a sovereign wealth fund which:

    - is wholly owned and controlled, directly or indirectly, by the government of a foreign country;

    - is set up and regulated under the law of the foreign country;

    - credits its earnings either to the account of the government of the foreign country or to any other account designated by that government such that no portion of the earnings inures any benefit to any private person;

    - vests its assets in the government of the foreign country upon dissolution;

    - does not undertake any commercial activity whether within or outside India; and

    - is notified by the Central Government in the Official Gazette for this purpose.

- The investment is in a company or enterprise carrying on the business of developing, or operating and maintaining, or developing, operating or maintaining any infrastructure facility (such as a road, highway project, water supply project or a port) or such other business as may be notified by the Central Government in this behalf.

- The investment is required to be made on or before 31 March 2024.

- The investment is required to be held for at least 3 years.

The amendment would go a long way in inducting sustainable and long-term capital in India considering the tendency of sovereign funds to lean towards long-term investments and to seek long-term returns. India presently attracts investments from global sovereign wealth funds and a 100% exemption would further boost infrastructure investments in India. However, given that exemption would only be conferred to funds wholly owned and controlled by foreign government, funds where public has even a minority investment would not be attracted by the proposed exemption. Further, given that each eligible sovereign fund would have to be notified by the Indian government, such funds may need to make representation to the Indian government to get notified.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Unlisted business trust brought at par with listed

Currently, the IT Act provides tax pass through of income – being other than interest and rent – accruing to a business trust (Infrastructure Investment Trust and Real Estate Investment Trust) which is registered under the relevant regulations made under the Securities Exchange Board of India Act, 1992 and the units of which are required to be listed on a recognised stock exchange in India.

Currently, interest and rent income of a REIT / INVIT is granted pass through status and taxed directly in the hands of the investor. Further, the pass-through status is available only where the units of REIT / INVIT are listed.

Considering that Securities Exchange Board of India has done away with mandatory listing of units in case of INVIT, it is proposed to align the provisions of the IT Act to provide for pass through status even for unlisted INVIT / REIT.

This is a welcome move aimed at bringing parity in tax implications for INVIT / REIT and would act as a fillip by encouraging the investment in infrastructure sector.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Welcome and stay; permitted tax free Indian presence for foreign funds further liberalised

Under the IT Act, foreign entities are taxed in India only where they have income sourced from India or have a business connection in India. To attract fund managers into India, the current law provides for conditions where the presence of fund manager in India would be granted immunity from being treated as a business connection of the eligible foreign fund. Further, the immunity would extend to the eligible foreign fund not being a resident of India by virtue of the presence of the fund manager in India.

One of the conditions is that the aggregate participation or investment in the fund, by persons resident in India, shall not exceed 5% of the corpus of the fund. The fund managers have to themselves contribute significant amount to the corpus of the fund in the initial stages, in order to attract investment. Accordingly, such investment by eligible funds manager results in breach of the 5% threshold for Indian investments. The Government has appreciated the commercial difficulty faced, It is therefore proposed to relax the existing condition by providing that the contribution by the eligible fund manager up to INR 250 million, during first 3 years, shall not be considered for determining 5% threshold of participation or investment by Indian residents.

Another existing condition requires the eligible investment fund to maintain monthly average of the corpus of the fund to at least INR 1000 million. Such condition is required to be satisfied as at the end of 6 months from the last day of the month of establishment or incorporation or at the end of previous year, whichever is later. This results into an anomaly as certain funds due to its date of establishment and incorporation get favoured or discriminated. It is hence, proposed that the condition of maintaining monthly average corpus shall be fulfilled within 12 months from the last day of the month of establishment or incorporation of the fund.

While the Bill is silent on the effective date, as per the Memorandum this amendment is proposed to be effective for FY 2019-20 and onwards. However, it is possible that there is a typographical error in the Memorandum else the Government would have highlighted the intention to pass a retrospective amendment.

Give and take; dividend exempt for business trust but taxable for investors

Currently, the IT Act provides that dividend income received by a business trust from a Special Purpose Vehicle (SPV) is exempt from tax in the hands of business trust as well as the investors provided:

- The business trust owns whole of the share capital of the SPV (except where equity share capital is mandatorily required to be held by any other person as per the applicable law); and

- Dividend is paid out of current income of the SPV on or after the date of acquisition of the SPV by the business trust.

In line with the proposed amendment for abolishing dividend distribution tax and levy of tax in the hands of shareholders, it is proposed that dividend income received by a business trust from its SPV shall be exempt from tax in the hands of business trust without any requirement to satisfy the conditions referred to above, and such dividend income would be taxed in the hands of the investors of business trust at the applicable tax rates.

This proposed move seeks to do away with the complete exemption from tax available on dividend income received by a business trust and entails additional tax cost in the hands of the investors. Further, taxability of dividend income in case of NR unitholders would need to be analysed under applicable tax treaty, to determine their final tax liability on such dividend income.

As the dividend would be taxed in the hands of investors, the business trust would be required to deduct tax at source at 10% at the time of distribution of dividend income to its investors. Further, in the absence of corresponding amendment to the provision relating to deduction of tax at source on dividend by Indian companies, the SPV making dividend payment to business trust, would also need to deduct tax at source at 10%. This would result into a double dip situation and hence, necessary clarifications may be issued in this regard.

This amendment is proposed to be effective for FY 2020-21 and onwards.

START-UPS

Bigger start-ups extended tax shelter

Currently, an eligible start-up is allowed to claim a deduction of 100% of its profits for 3 consecutive FYs out of 7 consecutive FYs (at its option), from the year in which the eligible start-up is incorporated. However, the exemption is only available where the total turnover of the start-up does not exceed INR 250 million in any of the previous FYs.

The Bill proposes to provide this deduction to eligible start-ups for 3 consecutive FYs out of 10 (instead of the present 7) FYs. Further, it also proposes to expand the total turnover condition from INR 250 million to INR 1000 million.

This rationalisation will definitely give the much-needed stimulus to the start-up industry, especially since the gestation period of certain businesses is longer than 7 years. Further, increase in the turnover threshold will also allow larger start-ups to avail tax exemptions. However, it would have been ideal if the exemption had been linked to profits instead of turnover.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Well intended but rightly executed? ESOP tax deferral for start-up employees

Receipt of any shares, on exercise of an Employee Stock Option Plan (ESOP) or an equivalent equity incentive scheme triggers taxation in the hands of the employees at the time of allotment of shares. Accordingly, the employer has to withhold applicable taxes.

The Bill proposes to provide that for receipt of shares by an employee of an eligible start-up pursuant to an ESOP (or similar plans), the tax could be withheld within 14 days from the happening of the following events, whichever is earlier:

- After the expiry of 60 months from the end of the relevant FY in which the share is allotted;
- From the date of sale of shares, so allotted; and
- From the date the individual ceases to be an employee of the employer

basis the rates in force for the FY in which the shares were allotted or transferred.

Equity incentives have long been considered a tool for talent retention. Rationalisation in taxation for employees in this avenue is a welcome move as the payment of the tax liability is deferred to a time when employees receive real benefit. However, given that it would still be the liability of the company to deduct and pay tax, employers may start retaining part of the salary payable to employees to shelter themselves from any withholding tax obligation that may arise at the time of employee's exit, which cannot be foreseen. This may not result in any actual cashflow benefit so far as the employee is concerned.

This amendment is proposed to be effective for FY 2020-21 and onwards.

REAL ESTATE

Circle rate worries lessened

Currently, the IT Act provides for adopting the circle rate of the property (i.e. stamp duty value of the property) as deemed sales consideration for computing the profits / gains on sale of immovable property, where the actual consideration is less than such circle rate. Such deeming provisions apply to sale of property held as capital asset or as stock in trade. Separately, the buyer is taxed on the difference between the circle rate and consideration paid, where the consideration paid is lower. However, the buyer is not taxed where the property is acquired as a business asset i.e. stock in trade.

Separately, such deemed tax, for the seller and the buyer, is not applicable where the difference in the circle rate and the actual consideration is not more than 5%.

The Bill proposes to increase the scope of exemption by providing for a variance of 10% between the actual consideration and the circle rate.

This proposal is a welcome move as it seeks to remove the difficulties faced by taxpayers intending to sell or acquire immovable property(ies), especially in light of slowdown in the real estate industry, where it is not uncommon for the prescribed circle rates to be higher than actual market value of the property.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Affordable Housing window extended

Currently, Section 80-IBA of the IT Act provides for a deduction of 100% of the profits and gains derived by a taxpayer from the business of developing and building affordable housing projects; provided that, the project is approved by the competent authority by 31 March 2020.

The Bill proposes to extend this period of approval from 31 March 2020 to 31 March 2021, in order to

- Incentivise building affordable housing; and
- Boost supply of such houses.

This amendment is proposed to be effective for FY 2020-21 and onwards.

DISPUTE RESOLUTION AND SIMPLIFICATION

Pay for stay; Tribunal would require 20% upfront

Currently, the Income-tax Appellate Tribunal (ITAT) can grant a stay on tax demand, after considering the merits of the application made by the taxpayer. Such stay can be for a period of 180 days (extendable by another 185 days in certain circumstances).

The Bill proposes to provide that ITAT may grant stay of demand only where the taxpayer deposits 20% of the amount of disputed tax, interest, fee, penalty, or any other sum payable under the provisions of this Act. In the alternative, the ITAT may grant a stay where the taxpayer furnishes security, instead of cash payment, of the required amount.

Currently, the stay in appeals before Commissioner of Income Tax (Appeals) is also usually granted on payment of 20% of the disputed tax demand. However, the tax authorities have the leeway of granting stay on payment of lesser amount, or even grant a full stay, in deserving cases. However, no such discretion has been provided to the ITAT to grant stay without deposit of 20% of the tax demand even where it deems fit. Accordingly, where the taxpayers have procured a stay, prior to coming before the ITAT, on paying less than 20% they would be required to now pay 20% of the outstanding demand.

This amendment is proposed to be effective for FY 2020-21 and onwards.

Filing return made easier

Currently, the IT Act provides that in case of a company, a tax return is to be verified by the Managing Director (MD). If there is no MD or if the MD cannot verify it for any unavoidable reason, then any director of the company may do so. Similarly, in case of an LLP, the tax return is to be verified by the designated partner or in the absence of one or inability of such designated partner to verify the tax return, any partner of the LLP may do so.

The Bill proposes to remove the specificity of the individuals that could verify the tax return of a company and/or LLP and provides that the CBDT may prescribe persons who may verify the tax returns of such entities.

Further, the IT Act also provides for the persons who can appear before the tax authorities in relation to any proceedings under the IT Act on behalf of a taxpayer as its "authorised representative".

In order to eliminate the personal hardships caused to corporate debtors due to the lack of express mention of an insolvency professional in the list of persons who may act as an authorised representative, the Bill proposes to amend

the provision to enable any person, as may be prescribed by the Board, to appear as an authorised representative. It is a welcome move and one hopes that the category of persons is prescribed soon.

These amendments are proposed to be effective for FY 2020-21 and onwards.

CHARITABLE ORGANISATION: (RE)-CHECK, (RE)-APPROVE, (RE)-NEW!

Rationalising the process of Registration and Approval

Currently, trusts, institutions, funds, universities, hospitals, etc engaged in charitable activities (exempt entity) are required to go through a labyrinth of processes to get a registration and an approval under the IT Act before actually undertaking charitable or similar activities. The registration enables such exempt entity to claim their income as exempt in accordance with the provisions of the IT Act.

The Bill proposes to streamline these processes of registration and approval by providing the following:

- A fresh application may be made by an exempt entity, which will be provisionally approved or registered for a period of 3 years on the basis of the application without any detailed enquiry, even when the activities are yet to begin. The exempt entity will have to apply for approval/registration again, within 6 months from the date of expiry of the provisional registration/approval or start of activities (whichever is earlier);

- An existing registered / approved / notified exempt entity will have to apply for approval / registration / intimation of its status. Subsequently, such approval/registration/ notification shall be valid for a period not exceeding 5 years at one time; and

- Any application that is currently pending approval or registration shall be treated as an application in accordance with the new provisions.

This intent of streamlining the application and approval processes is to put checks and balances in place so as to ensure that the conditions for approval or registration or notification are adhered to. But given that the approval will have to be sought every 5 years, the process could be cumbersome.

Checking the Donation Box

Currently, the IT Act provides that an exempt entity may accept donations for utilisation towards their objects or activities in respect of which the donor gets deduction in computation of his income. The exempt entity does not have any obligation to report such donations received.

With a view to standardising the process of matching the donation amount received by the exempt entity to the amount being claimed as a deduction by the donor / taxpayer, the Bill proposes that the entities receiving donation shall furnish a statement in respect of donations received and issue a certificate to the donor. The donor can then, on the basis of the certificate, claim deduction. Any failure to properly file or furnish the statement would lead to levy of penalty. Accordingly, the process of claiming deduction for donation is being streamlined with the process applicable to TDS and claiming of credit of such TDS.

The above-mentioned amendments are proposed to be effective from 1 June 2020.

MISCELLANEOUS PROVISIONS

Opt out to opt in; reduced corporate tax rates made more effective

Generally, capital expenditure is allowed as deduction over the years by way of depreciation. However, currently, for the purposes of certain ‘specified businesses’ (infrastructure facility, hotel, hospital, etc), a taxpayer is entitled to claim a deduction of the entire capital expenditure incurred, in the year of expenditure itself (Accelerated Deduction). Further, such Accelerated Deduction is mandatory. Consequently, on account of availability of Accelerated Deduction, no further deduction is allowed under any other section in respect of such capital expenditure. Accordingly, annual depreciation is not available.

Notably, a domestic company which chooses to be covered by the recently introduced concessional corporate tax rate of 15% or 22% is not allowed the benefit of Accelerated Deduction. In such situation, given that the domestic company does not have an option to forego Accelerated Deduction, it is also not provided the deduction spread over the years by way of depreciation, which results in complete loss of such deduction.

The Bill proposes to make Accelerated Deduction optional. Accordingly, the company electing for reduced corporate tax rates could opt out of Accelerated Deduction and get benefit of annual depreciation in relation to its capital expenditure.

While the Bill is silent on the effective date, as per the Memorandum this amendment is proposed to be effective FY 2019-20 onwards, so as to effectively cover the first year of concessional corporate tax rate as well. However, it is possible that there is a typographical error in the Memorandum else the Government would have highlighted the intention to pass a retrospective amendment.

Certainty and reduction in TDS rate

Currently, any taxpayer (except certain individuals or HUFs), paying fees for professional or technical services to a resident, is required to deduct tax at the rate of 10 % at the time of making such payment.

Separately, a lower rate of 2% is specified for payments made to a resident for carrying out any work under a contract.

Due to the inherent overlap between the interpretation of 'technical services' (which attracts 10% TDS) and 'work undertaken pursuant to a contract' (which attracts 2% TDS), taxpayers were issued notices for being in default due to the short deduction of tax.

The Bill proposes to lower the rate of withholding tax, whereby a rate of 2 % shall apply in case of payments to residents for technical services rendered.

This move to align the two provisions which caused ambiguity is indeed helpful for taxpayers who are often faced with the issue of applying the right withholding tax rate.

Separately, in relation to deduction of tax on payment for contract manufacturing activities, the Bill proposes to amend the scope of 'work' to include contract manufacturing arrangement where the contract manufacturer does not purchase material from the customer but from a specified related party of such customer. Accordingly, tax would be required to be deducted at source even where a contract manufacturer purchases material from a specified related party of the customer and sells the finishes product to the customer.

While the Bill is silent on the effective date, as per the Memorandum these amendments are proposed to be effective from 1 April 2020.

- *KCO | Direct Tax Team*

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