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THE FINANCE BILL 2020 ENACTED AFTER SIGNIFICANT AMENDMENTS

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Introduction

The Finance Bill 2020 was presented in the Indian Parliament on 1 February 2020 (Finance Bill) as part of the Budget proposals (see our Ergo on direct tax related budget proposals here). On 23 March 2020, it was passed by the Indian Parliament with certain amendments – some of which are significant including widening the scope of equalisation levy (popularly referred to as Google tax). After receiving the Presidential assent earlier today, it is now in force (Finance Act).

Key amendments and effect thereof are summarised below:

- Tax residency criteria further amended:

  Income threshold prescribed

  - The Finance Bill had proposed that (i) Indian citizens / persons of Indian origins (PIOs) coming to India on visit(s) and staying in India for 120 days or more (reduced from currently applicable 182 days) in a year, and (ii) stateless persons (i.e. Indian citizens who are not liable to tax in any country) (Stateless Residency Rule), shall be deemed as Indian tax residents.

  - As per the Finance Act, these provisions will be applicable to individuals having total income (excluding 'foreign sourced income') exceeding INR 1,500,000 during the relevant year. Accordingly, unless these individuals have Indian sourced income in excess of the aforesaid monetary threshold, the 120-day residency rule and the Stateless Residency Rule will not apply to them.

  Visiting Indians and stateless persons to be 'not ordinarily residents' (RNOR)

  - Unlike an ordinarily resident individual, whose global income is taxable in India, an individual who is a RNOR is subject to tax in India only on his / her Indian sourced income and is required to make lesser disclosures (not required to file Schedule FA – which contains details of foreign assets of a person).

  - As per the Finance Act, (i) Indian citizen / PIO having Indian sourced income exceeding INR 1,500,000 and who spends 120 days or more in India, but less than 182 days, and (ii) Indian citizen, who is deemed as Indian tax

resident on account of the Stateless Residency Rule shall be considered as RNOR.

- The Finance Bill had proposed a substitution for the qualifying criteria for RNORs.

- However, as per the Finance Act:

  - ✓ the existing criteria for qualifying as an RNOR be retained viz. (a) being non-resident for 9 years out of 10 immediately preceding years, or (b) physical presence in India for 729 days or less during 7 immediately preceding years, and

  - ✓ two new criteria should be added to qualify as an RNOR viz. (a) Indian citizen / PIO having Indian sourced income exceeding INR 1,500,000 who spends 120 days or more in India, but less than 182 days, and (b) Indian citizen who is deemed as Indian tax resident on account of the Stateless Residency Rule.

- Dividend taxation rationalised:

  The Finance Bill had proposed a shift in taxation of dividends – from a company-level distribution tax (DDT) to a shareholder-level tax and corresponding amendments. The Finance Act seeks to rationalise impact of that proposal in the following manner:

  Surcharge rate capped

  - As per the Finance Bill, the maximum effective tax rate on dividend income of non-corporate taxpayers was going to be 43% approximately (after including the maximum rate of surcharge of 37% which was announced last year and cess of 4% on tax amount increased by maximum surcharge).

  - The Finance Act has provided a relaxation in this regard by capping the rate of surcharge applicable to dividend income of non-corporate taxpayers (residents and non-residents) at 15% (10% if income exceeds INR 5,000,000 but not INR 10,000,000, 15% if income exceeds INR 10,000,000). Thus, the maximum effective tax rate will now be 36% approximately.

  Clarity provided for dividends declared up to 31 March 2020 but distributed thereafter

  - Since dividends will be treated as taxable income in the hands of the shareholders, the currently available exemption provision was withdrawn by the Finance Bill for dividend income received on or after 1 April 2020.

  - To address a situation of possible double taxation in cases where dividends are declared prior to 1 April 2020 (which would be subject to DDT under the current regime), but received by the shareholder on or after 1 April 2020, the Finance Act has clarified that in cases where DDT has been paid by the company, the shareholder level exemption for dividend income will continue to apply.

  Cascading effect addressed

  - As part of the new dividend taxation regime, to ensure that there is no cascading effect of dividend tax flowing through a multitiered corporate structure, the Finance Bill had proposed that the Indian companies would be able to claim a deduction in respect of dividends received from another Indian company and distributed further to its shareholders (subject to conditions).

    - The Finance Act has enlarged the scope of the said deduction to also include dividends received by an Indian company from business trusts (REITs and INVITs), and foreign companies.

- Business trusts (REITs/ InvITs) – Dividend taxation issue addressed partially:

    - Currently, dividends distributed by a special purpose vehicle (SPV) (subject to conditions) are neither subject to DDT nor any tax in the hands of the business trust and unitholders. However, as part of the new dividend taxation regime proposed by the Finance Bill, DDT is being abolished for all companies (including SPVs owned by business trusts) but there was no exemption with respect to taxation of dividends to the unitholders.

    - The Finance Act has sought to address this partially by providing that income in the nature of dividends distributed by business trusts will be taxable in the hands of the unitholders only where the SPV has opted for the recently announced concessional corporate tax regime of 22% (as against the general rates of 25% / 30%). In such a scenario, the business trust will be required to withhold tax at the rate of 10% on distribution of dividend to resident and non-resident investors.

    - It may be noted that while the withholding tax by the business trust is capped at 10%, in absence of a corresponding amendment to a related provision specifying tax rate on dividend income for non-resident investors, the overall tax payable may be higher. Also, in absence of any express carve out from the general withholding tax provision, the SPVs will be required to withhold tax at the rate of 10% when distributing dividends to business trusts – even though the business trust is a tax pass through vehicle with respect to such dividend income. This may create unintended cash flow issues.

- Tax exemption for sovereign wealth funds widened and liberalized:

    - The Finance Bill had proposed a tax exemption for sovereign wealth funds (subject to conditions) for debt and equity investments made before 31 March 2024 in entities engaged in specified infrastructure business.

    - Now, the Finance Act has amended the income-tax law to :

        - ✓ extend this tax exemption to foreign pension funds as well (subject to conditions), in addition to the sovereign wealth funds as proposed in the Finance Bill,

        - ✓ extend this tax exemption to investment in the form of units of InvITs, category I & II alternative investment funds (AIFs) (having 100% investment in specified infrastructure entities) besides the equity and debt investments in entities engaged in specified infrastructure business as proposed in the Finance Bill,

        - ✓ provide that this tax exemption to sovereign wealth funds, foreign pension funds is available only if the investment is made on or after 1 April 2020, apart from the same being made before 31 March 2024, as proposed in the Finance Bill,

        - ✓ claw back the exemption claimed in the earlier years and tax the income in the year when conditions for exemption are breached.

    - The widening of scope of this exemption will give a level playing field to foreign pension funds intending to invest in Indian infrastructure space. Further, the proposal to permit downstream investments in InvITs, specified category I / II AIFs will also increase the chances of this exemption achieving the full potential of Indian infrastructure development.

    - Thus, sovereign wealth funds and foreign pension funds should evaluate whether they meet the eligibility criteria for this tax exemption.

- Scope of 'Equalisation Levy' (EL) widened to tax digital economy – final frontier conquered?

    - In the past, India had introduced EL (popularly referred as google tax) at the rate of 6% on payments received by non-residents (subject to conditions) for the specified services rendered in the online marketing and advertising domain industry.

    - The Finance Act has widened the scope of EL to cover a non-resident e-commerce operator and levy 2% tax of the sales consideration received from the following: -

        - ✓ Indian residents or any person who is using Indian IP address for online sale of goods or services.

        - ✓ Non-residents in specified circumstances such as sale of advertisement targeting Indian resident customer or customers accessing through Indian IP address, or sale of data collected from Indian residents or persons accessing the Indian IP address.

    - If the turnover / gross receipts of the e-commerce operator does not exceed INR 20,000,000 or if the e-commerce operator has a 'permanent establishment' in India (and the e-commerce supply is effectively connected with such 'permanent establishment'), then, EL will not apply.

    - Further, the Finance Act has also provided certain consequential compliance requirements in this regard for the non-resident e-commerce operator (such as deposit the EL on quarterly basis and file an annual return).

    - With concepts like EL, 'significant economic presence', India has been at the forefront when it comes to taxing digital transactions and with the proposed widening of scope pertaining to EL, it will be imperative for companies engaged in digital space to evaluate the implications surrounding them.

- Exporters exempted from the levy of Tax Collection at Source (TCS):

    - The Finance Bill had introduced TCS levy of 0.10% on sale of goods by a seller (whose turnover exceeded INR 100,000,000 in the immediately preceding FY) on the sale consideration in excess of INR 5,000,000. TCS is essentially a collected from the payer and the payer is given a credit of the same in its tax returns.

    - Due to the wide language proposed in the Finance Bill, even offshore importers of Indian goods who had no Indian sourced income would have been subject to levy of TCS and comply with tax return filings to avail refund of the TCS.

    - The Finance Act has given a breather to the importers and proposed that this TCS levy will not apply to goods exported out of India.

    - The Finance Act has also provided that the TCS related amendments shall be applicable from 1 October 2020.

- Rationalization of TCS in Liberalized Remittance Scheme (LRS):

  - The Finance Bill had introduced TCS levy of 5% on money received by an 'Authorised Dealer' in relation to LRS, provided the money received exceeds INR 700,000 in a year.
  - The Finance Act has provided that (i) the INR 700,000 limit applies only to single payments (i.e. not to be aggregated on an annual basis), (ii) TCS will be applicable only on the amount in excess of INR 700,000, and (iii) for foreign education loans, TCS rate shall be 0.5%.
  - The amended proposal will ensure that there will be no compliance burden (and related compliance costs) for small scale LRS related payments.
  - The Finance Act has also provided that the TCS related amendments shall be applicable from 1 October 2020.

- Others:
  - The Finance Bill had proposed a concessional TDS rate of 2% (as against the applicable rate of 10%) for 'fees for technical services' paid to Indian tax residents. The Finance Act has extended this concessional TDS of 2% to '*royalty in the nature of consideration for sale, distribution or exhibition of cinematographic films*'.
  - The Finance Bill had proposed that income distributed by mutual funds will be subject to a TDS of 10%. The Finance Act has provided a relaxation in this regard by exempting income distributions in the nature of capital gains from this TDS levy. This is a welcome amendment and it will ensure that there is no cash flow issue for Mutual Fund investors. This amendment will give some fillip to this much needed industry.

Comment:

Pursuant to the introduction of the Finance Bill, various stakeholders reached out to the Government requesting reconsideration, amendment or clarification on certain provisions. Taking cognizance of these suggestions, the Government had introduced certain amendments to the Finance Bill (one of which created an anomaly with respect to business trusts (REITs / INVITs) but the same has been corrected while enacting the Finance Bill), though some loose ends still exist.

Given the COVID-19 crisis and the imposition of a lockdown, the Finance Bill had to be passed in a short timeframe. Some amendments are welcome (such as rationalization of the tax residency criteria and dividend taxation proposals, extension of the scope of tax exemption to foreign pension funds). Having said so, with the widening of scope of Equalisation Levy provisions, it is clear that e-commerce and digital tax are on Government's top radar and companies in digital space would need to closely assess the developments and impact in this regard.

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