



India Union Budget 2020

Unveils issues on International
taxation

1. Changes in rules relating to determination of 'residence' in India

The scope of income of a person liable to tax in India depends upon his residential status in a particular financial year. Indian Income Tax Act 1961 (the Act) recognizes three statuses, namely, Resident and Ordinarily resident' (ROR), 'Resident but not ordinarily resident' (RNOR), and Non-resident (NR). If a person is ROR then his global income is taxable in India; if he is a RNOR then only his Indian income and any income from any business or profession outside India which is controlled from India is taxable in India; and for NRs only their Indian income is taxable in India.

Three changes are proposed in Section 6 of the Act by Finance Bill 2020:

- i. Under the existing provisions an individual is treated as ROR if his stay in India during the year is 182 days or more; OR if his stay in India within 4 preceding years is 365 days or more and his stay in India during the year is 60 days or more. However, as a relief for Indian citizens and Persons of Indian Origin an exception was provided that the second condition will trigger only if their stay in India is 182 days or more.

The Finance Bill proposes to reduce the period of 182 days in the exception clause relating to Indian citizens and PIOs to 120 days, on the ground that it was being misused.

- ii. Under the existing provisions an individual or HUF is treated as RNOR if he (or the Karta of HUF) was a non-resident in India in 9 out of 10 preceding years or his cumulative stay in India is less than 730 days during 7 preceding years.

The Finance Bill proposes to replace this provision and instead provide that an individual or HUF will be RNOR if he (or the Karta of the HUF) was non-resident in India in 7 out of the 10 preceding years.

- iii. The Finance Bill proposes a new category of 'deemed residents'. This is defined to mean Indian citizens who are *"not liable to tax in any other country or territory by reason of domicile or residence or any other criteria of similar nature."* The Explanatory Notes mention that this change is to include those individuals who change their residential status or shift to a tax haven to avoid payment of tax in India and who enjoy double non-taxation. In a subsequent Press Release dated 2nd February 2020 CBDT stated that the income earned outside India by 'deemed residents' shall

not be taxed in India unless it is derived from business or profession in India. The Press release however does not appear to be in consonance with the current legal position. It is possible that the provision in Finance Bill may be modified before the Bill is passed.

2. Deferring the provisions of 'Significant Economic Presence'

Income accruing to a non-resident from 'business connection in India' is taxable in India. In 2018 the definition of 'business connection in India' was expanded to include profits derived from 'Significant Economic Presence' in India. This was done to include profits of digital businesses which earned income from India without any physical presence in India. However, the relevant rules for computation etc. were not notified due to pending decisions on this issue in international forums.

Finance Bill 2020 now proposes to enlarge the definition of SEP, and to make the provision applicable from Assessment Year 2022-23 as discussions on this issue are still going on in G20-OECD BEPS project.

3. Enlarging the scope of income attributable to operations carried out in India

Under the existing provisions only that part of income arising to a non-resident from 'business connection in India' is taxable which can be attributed to its operations in India. In order to bring profits of international digital companies deriving profits from digital transactions in India in the tax net, the Finance Bill 2020 proposes to define 'income attributable to operations carried out in India', to include incomes from :-

- (i) advertisement which targets a customer who resides in India or accesses the advertisement through internet protocol address located in India;
- (ii) sale of data collected from a person who resides in India or uses internet protocol address located in India; and
- (iii) sale of goods or services using data collected from a person who resides in India or uses internet protocol address located in India.

This amendment will take effect from 1st April 2021. In respect of tax residents of the countries with which India has entered into a tax treaty, this amendment will be subject to the provisions of the relevant treaty.

4. Enlarging definition of 'Royalty' to include exhibition rights of cinema films

Under the existing provisions of Section 9 of the Act, income by way of 'royalty' payable to non-residents is deemed to accrue or arise in India even if they do not have a Permanent Establishment in India. The present definition of the term 'royalty' given in Explanation 2 to Section 9(1)(vi) specifically excludes 'consideration for the sale, distribution or exhibition of cinematographic films'.

The Finance Bill 2020 proposes to omit this exclusion. Therefore, consideration payable to nonresidents for sale, distribution or exhibition of cinematographic films will now become taxable in India as royalty. However, in respect of tax residents of the countries with which India has entered into a tax treaty, this amendment will be subject to the provisions of the relevant treaty.

5. Modification of conditions for exemption of offshore funds from 'business connection in India'

Existing provisions in Section 9A of the Act provide conditions under which certain offshore funds, whose fund managers are resident in India, are not regarded as having a 'business connection in India'.

One of the conditions requires that the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed five per cent of the corpus of the fund. In this regard, Finance Bill 2020 proposes that for the purpose of calculation of the aggregate participation or investment in the fund, directly or indirectly, by Indian resident, contribution of the eligible fund manager during first three years up to INR 250 million, shall not be taken into account.

One other existing condition requires that the monthly average of the corpus of the fund shall not be less than INR 1000 million except where the fund has been established in the previous year in which case, the corpus of fund shall not be less than INR 1000 million at the end of six months from the last day of the month of its establishment, or at the end of such previous year, whichever is later. Finance Bill 2020 proposes to extend the period of six months to twelve months from the last day of the month of establishment.

6. Aligning Tax Treaties with Multilateral Instrument (MLI).

India has entered into Double Taxation Avoidance Agreements (DTAA) with about 100 countries over the years. India has since also signed and ratified the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI) which is the outcome of G-20-OECD initiative on international taxation. As a result, MLI has come into force for India on 1st October 2019 and its provisions will be applicable on India's DTAA's from FY 2020-21 onwards.

Finance Bill 2020 now proposes to empower the Central Government to enter into agreements with governments of other countries to give effect to MLI for avoidance of double taxation of income but without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty-shopping arrangements aimed at obtaining reliefs for the indirect benefit of residents of any other country or territory.

7. Profit attribution rules for Permanent Establishments of non-residents

Safe harbour rules were introduced in 2009 via Section 92CB of the Act to provide conditions on satisfaction of which transfer price declared for international transactions between Associated Enterprises will be accepted. Similarly, provisions were introduced in the Act in 2012 empowering the Board to enter into Advance Pricing Agreements (APA) for determining Arm's Length Price of international transaction entered by a person with its Associated Enterprises.

Finance Bill 2020 now proposes to empower Board to frame rules for determination of profits attributable to the Permanent Establishment of a non-resident in India.

8. Relief for Branches of Foreign Banks operating in India

Thin Capitalization Rules introduced in the Act by Finance Act 2017 provide that where an Indian company, or a Permanent Establishment of a foreign company pays interest exceeding INR 10 million to an Associated Enterprises the deduction for interest shall be restricted to 30 % of EBITDA.

Finance Bill 2020 now proposes that this provision would not apply to interest paid in respect of a debt issued by a lender which is a Permanent Establishment of a non-resident engaged in the business of banking in India.

9. Exempting non-resident having royalty income from filing tax returns

Presently non-residents having income from dividend or interest are exempted from filing of returns of income if full TDS has been deducted on such payments by the payer.

Finance Bill 2020 proposes to extend this relief also to non-residents whose total income consists of the income by way of royalty or FTS and where full TDS on such income has been deducted by the payers.

10. Enlarging powers of Dispute Resolution Panel (DRP)

Under the existing provisions of Section 144C of the Act cases of transfer pricing and of foreign companies where variations to returned income are proposed by Assessing Officers are required to be referred to the taxpayer through draft assessment order who can raise objections to the proposed variations before the DRP. Final assessment order is passed in such cases as per the directions of the DRP.

Finance Bill 2020 proposes to extend the benefit of DRP process to all non-residents not being a company, or foreign companies. The DRP process will also apply to cases where return is not filed by such persons.

11. Concessional rate of Withholding tax on interest paid to non-residents

Concessional rate of Withholding tax of 5% on interest payable to non-residents on long term borrowings for infrastructure bonds and to FIIs, QFIs on Government securities, available under Section 194LC of the Act is now being extended to borrowings made up to 1st July 2023.

The rate of TDS will be 4% on the interest payable to a non-resident, in respect of monies borrowed in foreign currency from a source outside India, by way of issue of any long term bond or rupee denominated bond on or after 1 April 2020 but before 1 July 2023 and which is listed only on a recognized stock exchange located in any International Financial Services Centre (IFSC).

12. TDS on payments by e-commerce operators to e-commerce participants

A new provision is proposed to be introduced from 01.04.2020 (Section 194-O) requiring 'e-commerce operators' to deduct tax at source (TDS) at the rate of one per cent of the gross amount of the sale of goods or provision of service facilitated through their digital or electronic facility or platform. For this purpose, any amount paid by a purchaser of goods or recipient of services directly to an 'e-commerce participant', facilitated by the 'e-commerce operator', shall also be included in the gross amount of such sales or services for the purpose of TDS.

However, if the e-commerce participant is an individual or a HUF, then the TDS liability would arise only if the sum credited or paid during the previous year to him exceeds INR 500,000/- and he has furnished his Permanent Account Number (PAN) or Aadhaar number. In case the e-commerce operator is non-resident in India, the liability for TDS will be either on the person himself or any person authorized by him or the agent of such person in India including any person treated as an agent under section 163 of the Act.

For additional information or queries, please feel free to reach out to our tax partners:

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