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Global Tax Alert

India releases the 2020-21 Union Budget

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Executive summary

The Finance Minister of India presented the Union Budget for tax year 2020-21 (the Budget 2020) on 1 February 2020. The Budget 2020 includes proposals to abolish the Indian dividend distribution tax (DDT) and replace it with a conventional shareholder withholding tax, introduce lower withholding tax rates on certain debt instruments for nonresidents, defer the application of the significant economic presence (SEP) rules and introduce an attractive dispute resolution process for the settlement of existing tax litigation.

This Alert summarizes the key proposals.

Detailed discussion

Corporate tax rates

- The tax rates for Indian companies is proposed to remain unchanged given the recent significant reduction to 15% for new manufacturing companies and 22% for all other companies, subject to certain conditions. Companies not qualifying for the lower rates will continue to be taxed at either 25% or 30%, depending on revenue thresholds.[1]

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Key international tax proposals

- DDT currently applicable at a rate of 20.56% on dividends distributed by Indian companies, is proposed to be abolished. Nonresident shareholders will now be subject to tax at 20% on dividend income under domestic tax law. This rate may be reduced by a tax treaty. Interest expenditure is proposed to be tax deductible against dividend income, limited to 20% of the dividend income. Rules to mitigate a multiplying withholding tax impact by allowing the set-off of dividends distributed within multi-tiered structures are proposed, subject to conditions.
- Provisions originally introduced in 2018 to tax foreign companies with a SEP are proposed to be deferred to 1 April 2021, given the ongoing BEPS 2.0[2] deliberations by the OECD.[3]
- A lower withholding tax rate of 4% is proposed for interest payable to nonresidents on foreign currency denominated long-term bonds or rupee denominated bonds issued between 1 April 2020 and 1 July 2023. The bonds need to be listed on recognized stock exchanges located in an International Financial Services Centre.
- The existing lower withholding tax rate of 5% on interest payments made to nonresidents by an Indian company on foreign currency loans, long-term bonds (including long-term infrastructure bonds) and rupee denominated bonds is proposed to be extended to 30 June 2023.
- The existing lower withholding tax rate of 5% on interest payments made to Foreign Portfolio Investors (FPI) on rupee denominated bonds and government securities is proposed to be extended to 30 June 2023. This lower withholding tax rate is also proposed to be extended to interest payable between 1 April 2020 and 30 June 2023 on municipal debt securities.
- The domestic taxable presence rules are proposed to be expanded to tax income earned by nonresidents from (i) advertisements; (ii) the sale of data collected from a person residing in India or using an Indian internet protocol address; and (iii) the sale of goods or services using data collected from a person residing in India or using an Indian internet protocol address. Nonresidents entitled to tax treaty benefits may not be significantly impacted by the proposal.
- The definition of royalties under the domestic tax law is proposed to be expanded to include income from the sale, distribution or exhibition of cinematographic films.
- Nonresidents earning only specified interest income, dividend, royalty or fees for technical services from India are now exempt from filing income tax returns in India subject to conditions (previously this filing exemption was only applicable for nonresidents earning specified interest income or dividend income).
- The exemption from the application of the indirect transfer tax rules are now proposed to be offered to Category-I FPIs registered under the Securities and Exchange Board of India (SEBI) (FPI) Regulations, 2019 and Category I and II FPIs registered under the SEBI (FPI) Regulations, 2014.
- Conditions[4] relating to the safe harbor provisions (for exemptions from creating a domestic permanent establishment) applicable to eligible investment funds carrying on fund management activity through eligible fund managers in India are proposed to be relaxed.

Key corporate tax proposals

- The Budget 2020 proposes that eligible start-up companies be permitted to claim a 100% tax deduction[5] against profits earned from eligible businesses for any three consecutive years out of ten years from incorporation (previously seven years), if the turnover from the eligible business in the year of deduction does not exceed US$14.3m (previously US$3.57m).
- The deadline to receive an approval for housing projects to claim a 100% tax holiday on profits earned by real estate companies from developing and building approved housing projects is proposed to be extended from 31 March 2020 to 31 March 2021.
- A tax dispute resolution process is proposed[6] for the payment of disputed taxes with a complete waiver of interest and penalties, if (i) the payment of disputed taxes is made by 31 March 2020; or (ii) the payment of disputed taxes with certain additional amounts is made between 31 March 2020 and 30 June 2020. The process would cover cases where an appeal is pending at any appellate level.
- The threshold for companies to obtain a tax audit report from an accountant (in addition to the regular statutory audit) is proposed to be increased from US$0.14m to US$0.7m of total sales, turnover or gross receipts, subject to certain conditions.

- A 1% withholding tax is proposed to be introduced on payments made by an e-commerce operator to e-commerce participants for the sale of goods or provision of services facilitated through its digital or electronic facility or platform, subject to exemptions for individual e-commerce participants on fulfillment of certain conditions.
- The withholding tax rate on fees paid for technical services (other than professional services) to Indian residents is proposed to be reduced from 10% to 2% (aligned with the withholding tax rate currently applicable to works contracts).
- The due date for filing a tax return for taxpayers subject to a tax audit (other than taxpayers liable to transfer pricing compliance requirements) is proposed to be extended to 31 October (previously 30 September) following the relevant tax year.
- The due date for lodging a tax audit report, maintaining transfer pricing documentation and lodging a transfer pricing certificate is proposed to be advanced by one month (e.g., 31 October following the relevant tax year for taxpayers subject to transfer pricing regulations).
- The Government has proposed to develop an "e-appeal" process for the resolution of tax appeals at the first appellate court stage to impart greater efficiency, transparency and accountability in appellate process, and an "e-penalty" process to reduce human interface in tax penalty proceedings.

Key transfer pricing proposals

- The scope of the advance pricing agreement and safe harbor programs is proposed to be expanded to cover the determination of income attributable to a business connection[7] or a permanent establishment of a nonresident in India.

Endnote

1. Additional surcharge and cess is generally applicable to all rates mentioned in this Alert.
2. Base Erosion and Profit Shifting.
3. Organization for Economic Co-operation and Development.
4. Aggregate participation by Indian residents in the fund and cut-off date to satisfy the "monthly average of corpus of fund" conditions.
5. The deduction is equal to taxable profit.
6. The process was announced in the Budget speech but no specific provisions were introduced in the Finance Bill.
7. The concept is similar to a permanent establishment.

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