India 2020 budget: Impact on foreign investors and multinationals

February 13, 2020

In brief

The Indian Finance Minister presented the Union Budget 2020 of the Modi government on February 1. Budget 2020 includes measures aimed at making India a USD five trillion economy by 2024.

Budget 2020 was drafted around three principles – aspirational India, economic development, and caring society, focusing on 'ease of living' for all citizens. As expected, the Budget focuses on the agricultural sector, education and skills, infrastructure, rural economy, and climate change. Continuing previously enacted reform measures, the Budget's direct tax proposals focus on reforms to stimulate growth, simplify the tax structure, lessen the compliance burden, and reduce litigation.

Key tax proposals include a reduction in tax rates for lower-income individual taxpayers, abolishment of the dividend distribution tax (DDT), introduction of a safe harbor and Advance Pricing Arrangement (APA) to attribute profits, and a corporate tax litigation amnesty.

This insight highlights some key Budget 2020 proposals affecting foreign investors and multinational enterprises doing business in India. The proposals would take effect after the Budget passes both houses of Parliament and obtains Presidential assent.

In detail

Tax rates for companies, LLPs and firms

No changes are proposed to the existing tax rates in Budget 2020. India recently had reduced its corporate tax rate through an amendment (in September 2019), effective April 1, 2019.

New tax regime for individuals

The Budget proposes an option for an individual taxpayer to pay tax at the new tax rate provided the taxpayer does not claim certain exemptions, losses, or deductions. If a taxpayer intends to claim deductions or exemptions, the existing tax rates and slabs would continue to apply. The Budget also proposes certain changes to tax residency conditions for individuals.

Abolition of the DDT and taxation of dividends received by shareholders

Currently, dividends distributed by an Indian domestic company are subject to DDT, payable by the distributing Indian company. Such dividend is exempt from income tax in the hands of the nonresident shareholders.

The Budget proposes the taxation of dividends received by shareholders at the applicable rates. Correspondingly, the Indian domestic company would not be required to pay any additional tax on the income distribution.

The budget also proposes an interest expense deduction equal to 20% of such dividend income.

Companies are required to withhold tax on dividends paid at the following rates:

- to resident shareholders – 10%
- to non-resident shareholders – 20%, subject to tax treaty benefits

The rates exclude applicable surcharge and cess.

Concessional rate of withholding tax (WHT) for interest paid to nonresidents

Interest payable to nonresidents by an Indian company or business trust with respect to foreign currency borrowings under a loan agreement or long-term infrastructure bonds issued or Rupee Denominated Bonds (RDBs) issued up to July 1, 2020, is liable to withholding tax at a concessional rate of 5%.

To incentivize low-cost foreign borrowings, the Budget proposes to:

1. extend the period for borrowings to July 1, 2023, and
2. provide for a further concessional rate of 4% on interest payable to non-residents with respect to RDBs issued on or after April 1, 2020 but before July 1, 2023, and which are listed only on a recognised stock exchange in any International Financial Services Centre.

The rates exclude applicable surcharge and cess.

Concessional rate of WHT for interest paid to Foreign Institutional Investors (FIIs) and Qualified Foreign Investors (QFIs)

Interest payable to FIIs and QFIs on government securities and RDBs of an Indian company is subject to a concessional withholding tax rate of 5% for interest payable prior to July 1, 2020.

In order to attract further investment, the sunset date for payment of interest to avail the concessional rate of 5% has been extended to July 1, 2023.

Further, a 5% withholding tax would apply to interest paid to FII/ QFI up to July 1, 2023 on municipal debt securities.

The rates exclude applicable surcharge and cess.

Withholding tax on e-commerce

A proposal would levy 1% WHT on the proceeds paid by an e-commerce operator (marketplace entity) to an e-commerce participant (Seller) with respect to the gross amount of the sale of goods and services on the operator’s platform. However, a 5% WHT would apply to the proceeds if the Seller does not provide a permanent account number (tax registration number) or an Aadhaar (unique identification number).

Taxation of income from royalty

Currently, a nonresident’s royalty income is deemed to accrue or arise in India. The definition of royalty includes a transfer of all or any rights (including the granting of a licence) with respect to any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television, or tapes for use in connection with radio broadcasting. The definition of royalty does not include consideration for the sale, distribution or exhibition of cinematographic films.

The Budget would modify this definition to provide that the consideration for the sale, distribution, or exhibition of cinematographic films is included in the definition of royalty.

Business connection in India

A non-resident's income shall be deemed to accrue or arise in India if it arises from a business connection in India.

The Budget proposes that the scope of operations in India, for the purpose of profit attribution in case of a business connection, would be deemed to include:

- advertisements targeting customers resident in India or accessing advertisements through an internet protocol (IP) address in India
- the sale of data collected from a person resident in India or using an IP address located in India
- the sale of goods or services using such data.

Significant economic presence (SEP) provisions streamlined

SEP applicability is deferred to FY 2021-22, in light of the ongoing discussion in the G20-OECD BEPS project.

Alignment with the multilateral instrument (MLI)

India has amended the preamble of its tax treaties to align with the MLI, reiterating that tax treaties are not to be applied to create opportunities of non-taxation or reduction of tax through evasion or avoidance.

Tax return filing exemption

Currently, non-residents earning income only from dividends and interest on which an applicable tax has been withheld are not required to furnish a tax return.

The Budget proposes to extend the exemption for filing a tax return to non-residents whose total income consists only of royalty and fees for technical services (FTS) from India and for whom the applicable tax has been withheld on such payments per the domestic tax law rates. However, if tax withholding is based on a lower tax treaty rate, there would be a tax return filing requirement.

Exemption from limitation on interest payable to a nonresident's permanent establishment (PE)

The interest deduction for interest paid by an Indian company or PE of a foreign company to a nonresident associated enterprise currently is restricted to 30% of earnings before interest, tax, and depreciation and amortisation of the borrower entity, provided the annual interest expense exceeds INR 10 million (USD 143,000).

The Budget proposes that the above provisions of interest limitation would not apply to interest paid with respect to debt borrowed from the PE of a nonresident engaged in the business of banking in India.

Exemption to investments in Category I foreign portfolio investors (FPI) from overseas transfer provisions

Currently, the transfer of units of an FPI that are held by a nonresident by way of investment, directly or indirectly, in Category-I or Category-II FPI under the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 ('FPI Regulations 2014') are exempt from overseas transfer taxation provisions in India.

In view of the new Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019 ('FPI regulations 2019') announced in 2019 in supersession of the former FPI regulations 2014, the Budget proposes to amend the provisions restricting the exemption to investments in a Category-I FPI under the FPI regulations 2019.

The Budget proposes to grandfather investments by nonresidents in Category-I and Category-II FPIs registered under the FPI Regulations 2014, provided such investments were made before September 23, 2019.

Filing of objections before the Dispute Resolution Panel (DRP)

Under the current provisions, if the tax officer proposes to make any variation in the income or loss returned by an eligible taxpayer that is prejudicial to the assessee's interest, the eligible taxpayer may file objections to such variations to the DRP. Currently, an eligible taxpayer includes only a foreign company or a person who has received a transfer pricing (TP) adjustment from a TP officer.

The Budget proposes to include any nonresident that is not a company under the definition of eligible assessee.

Corporate tax amnesty *('Vivad se Vishwas')*

The Budget includes a proposal for settling existing direct tax litigation. Under the proposal, taxpayers would be required to pay the amount of the disputed taxes only. Further, there would be a complete waiver of interest and penalty where payment of disputed taxes is made on or before March 31, 2020. If the payment of disputed demand is made after March 31, 2020, but on or before June 30, 2020, a certain additional amount will be payable. Details are forthcoming.

Improving tax administration effectiveness (extending the scope of e-proceedings)

An e-audit scheme was rolled out by the Indian Government in 2018. This Budget proposes to extend the framework to e-appeals as well, with a view to bring in greater efficiency, transparency and accountability while eliminating interface with the appellate forum.

The Income Tax Appellate Tribunal has the power to keep the payment of a tax demand in abeyance for a period of 180 days based on specific merits of the case. It is now proposed that a deposit of 20% of the amount of tax, interest, penalty or sum payable by the taxpayer or furnishing a security for such amount is a mandatory pre-condition for grant of abeyance by the Tribunal.

Introduction of a taxpayer's charter

To build trust between the taxpayer and administration, and to enhance the efficiency of the delivery system, the Budget proposes a new provision empowering the Central Board of Direct Taxes (India's tax administrative body) to adopt and declare a taxpayer's charter. This charter's contents shall be notified in due course.

Due date for furnishing accountant's report and maintenance of TP documentation revised

The Budget proposes to move the due date for furnishing the accountant's report (Form 3CEB) and maintenance of transfer pricing documentation from November 30 to October 31, post the financial year-end.

Due date for filing of return

The Budget proposes to extend the due date for filing the income return to October 31 from September 30 for companies and persons (including firm) liable for tax audit.

Transfer pricing (TP) related

The Budget proposes that the APA and safe harbor provisions would cover the determination of income attributable to a business connection in India.

The takeaway

The Budget proposal focuses on widening the tax base with increased reforms in all sectors and provides a foundation for the Indian economy to become more resilient and to achieve a high growth rate. Abolishment of DDT will make equity investment attractive. Other proposals, such as extension of lower withholding tax rate of 5% for interest income, and corporate tax dispute resolution mechanism, are steps in the right direction.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact:

International Tax Services, India

Sriram Ramaswamy (Sri)
+1 646 901 1289
ramaswamy.sriram@pwc.com