Income-tax Bill, 2025 : Impact on Non-Residents

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Overview

In a major overhaul of tax regime in India, the government has proposed to repeal the existing tax law enacted over six decades back. The reform is based on three core principles: simplifying language and structure for improved coherence, maintaining existing tax policies, and avoiding any changes to tax rates

While no major changes have been proposed, in this article, we discuss the impact of language changes in the new bill on non-residents. We discuss the changes to the provisions in relation to scope of total income of non-residents, indirect transfer provisions, manner of carry forward of capital losses and changes to transfer pricing provisions. We also discuss the changes in relation to interpretation of terms used but undefined in tax treaties. Lastly, the article also elaborates on impact of repeal on past assessments/ audits and proceedings.

Introduction

The Income-tax Bill, 2025 (**"New Bill"**), was presented in Parliament on February 13, 2025, ushering in a significant reform aimed at simplifying the Income-tax Act, 1961 (**"Old Act"**) enacted over six decades back. This initiative seeks to enhance the clarity and accessibility of the Indian tax framework while ensuring continuity and predictability for taxpayers. The reform is based on three core principles: simplifying language and structure for improved coherence, maintaining existing tax policies, and avoiding any changes to tax rates[1].

The New Bill has effectively streamlined the Old Act, reducing its complexity and volume while preserving its essential principles. Substantive provisions in relation to tax rates, residency rules, scope of total income, computation and heads of income, the assessment and appeal procedures remain the same. Simplification changes have been made by reducing the word count, reducing number of sections, removing explanations and provisos, consolidation of related provisions at one place etc. This initiative underscores the Government's commitment to creating a more business-friendly environment with a clearer and more efficient tax system.

1. Press release dated 13.02.2025 on Executive Summary on the Comprehensive Simplification of the Income-tax Act, 1961

Although the New Bill largely retains the framework for taxation of non-residents in India, certain amendments (intended/ unintended) have been made, particularly in relation to provisions in relation to deemed accrual of income, withholding tax provisions, interplay between domestic law and Double Taxation Avoidance Agreements (**"DTAA"s**) etc. While the amendments seem minor, their full impact will be known only once they are implemented and tested before courts over time.

In this article, we discuss key provisions relevant from non-resident's perspective in the New Bill.

1. Residential status and scope of total income

Taxation in India varies for residents and non-residents, making it essential to determine the correct tax status of an individual or entity. Under the tax laws, individuals are categorized into three status categories: resident, non-resident, and resident but not ordinarily resident. The rules governing these categories remain largely unchanged, with the "182 days test" continuing to be the primary determinant for residency. However, the New Bill has simplified the language and streamlined the rules governing residential status, making them more reader friendly while retaining the existing criteria.

Similarly, for foreign corporations, the test for determining their residential status (i.e. the place of effective management (**"POEM"**)) remains unamended. The Central Board of Direct Taxes (**"CBDT"**) had previously issued circulars (example, POEM guiding principles[2] and threshold for applicability of POEM[3]) and notification in relation to POEM provisions. The question is whether these circulars/ notifications will continue to apply under the New Bill as well. The New Bill *inter-alia* provides that any instruction, notification, order or direction issued under any provision of the Old Act, so far as it is not inconsistent with the corresponding provisions of the New Bill, be deemed to have been issued under the corresponding provision of the New Bill[4]. Therefore, the notification issued under the provisions of the Old Act in relation to POEM should continue to apply.

Circulars are utilized to understand the scope and meaning of the provision to which they relate[5]. Courts have held that circulars issued by CBDT are binding under section 119 on tax authorities. Courts have also held that circulars issued by the CBDT must clearly take the form of an order, instruction, or direction to the income tax authorities[6]. If that is the case, one may argue that as per the repeal and savings clause, the circulars issued under the Old Act should thus continue to apply under the New Bill. One may also rely on section 24 of the General Clauses Act, 1897 which provides for continuance of any appointment, order, notification, rule, bye-law etc. made or issued under the repealed statute insofar as it is not inconsistent with the provisions

2. Circular No. 06 of 2017
3. Circular No. 08 of 2017
4. Section 536(2)(j) of the New Bill
5. *Yogendra vs. CWT 187 ITR 58, Ekonkar Transport vs. CBDT 219 ITR 511; CIT vs. the Statesman 198 ITR 582*
6. Section 119(1): *CIT vs. Central Bank 185 ITR 6, Janta Meal vs. ITO 186 ITR 458; Bhartiya Engineering vs. Deshpande, 130 ITR 442*

re-enacted[7]. However, an express clarification with respect to continuity of circulars issued under the Old Act will be useful to ensure certainty and avoid litigation.

In so far as scope of income of non-resident is concerned, the New Bill retains the old framework. Total income of a non-resident includes all income from whatever source derived which (i) is received or deemed to be received in India in that year by or on behalf of that person or (ii) accrues or arises, or is deemed to accrue or arise, to the person in India in that year[8].

2. Deemed to accrue or arise in India

Section 9 of the New Bill largely retains the old framework while prescribing incomes which will be deemed to accrue or arise in India. Any income accruing or arising (directly or indirectly) through or from (i) any asset or source of income in India (ii) any property in India (iii) any business connection in India or (iv) transfer of a capital asset situated in India is deemed to accrue or arise in India. In addition, income under head salaries payable under certain circumstances, any dividend paid by an Indian company outside India, interest/royalty/fees for technical services payable by resident/non-residents in certain cases is deemed to accrue or arise in India.

The changes in section 9 have been discussed below:

2.1 The Old Act provided that any income accruing or arising (directly or indirectly) 'through' transfer of a capital asset situated in India is deemed to accrue or arise in India. The New Bill now provides that income accruing or arising both 'through' or 'from' transfer of a capital asset situated in India is deemed to accrue or arise in India. The expression 'through' has been defined to mean and include 'by means of', 'in consequence of', or 'by reason of'. Addition of 'from' prior to transfer of capital asset situated in India may not have substantial impact.

2.2 The Old Act provided that royalty payable by a non-resident shall be deemed to accrue or arise in India if such royalty is paid in respect of any right, property or information used or services utilised for the purpose of:

a) A business or profession carried on by such person ***in*** India; or

b) Making or earning any income from any source ***in*** India

As such, royalty payment between two non-residents was deemed to accrue or arise from India in case where such royalty income was sourced from India. However, under the New Bill, payment of royalty between two non-residents can be deemed to accrue or arise in India even if royalty is paid in respect of right, property or information used or services utilised for the purposes of making or earning any income from any source ***outside*** India. This seems to be an unintended error and goes against the intent of section 9.

7. Supreme Court in case of *Poonjabhai Varmalidas vs. CIT [1990] 53 Taxmann 171* held that an order of income-tax officer under section 10(2)(xi) of the Income-tax Act, 1922 would continue by virtue of section 24 of the General Clause Act, 1897 under section 36(1)(vii) of the Old Act

8. Section 5(2) of the New Bill

2.3 Any income derived from a business connection in India is considered income deemed to accrue or arise in India. However, if the operations of the business connection are not entirely carried out in India, only the income that is "reasonably attributable" to the Indian operations is considered taxable in India. The New Bill refines the provision by replacing "reasonably attributable" with "attributable" when determining income derived from Indian operations. Rule 10 of the Income-tax Rules, 1962 (**"ITR**") provides that in case profit attributable to a business connection cannot be definitively ascertained, the tax authorities may resort to any of three methods namely percentage of turnover, proportionate or discretionary method.

Article 7 of Indian tax treaties states that only those profits of the non-resident enterprise shall be taxed in India which are attributable to the permanent establishment in India. Manner of attribution of profits has been a litigated matter historically. Courts have attributed profits based on different principles in different cases (FAR analysis[9], ad-hoc basis[10] or adopting a formulary approach[11]).

The change seems to reduce discretionary powers with tax authorities – however, considering Rule 10 and absent clear rules for profit attribution, uncertainty in relation to profit attribution may still remain.

3. Indirect transfer provisions

Indirect transfer provisions were added to the Old Act by Finance Act, 2012. Several amendments in form of explanations were made to the indirect transfer provisions in the Old Act – such explanations have now been converted to sub-sections. The overall framework for indirect transfer remains the same.

3.1 ***Scope of indirect transfer provisions***: The Old Act provided that an asset or capital asset being a share or interest in a company or entity registered or incorporated outside India, which derives substantial value from India, shall be deemed to be situated in India. However, few explanations used the terms 'share of, or interest in' instead of 'share or interest in'. This was leading to some confusion vis-à-vis interpretation of indirect transfer provisions. As per provisions of the Old Act, 'share' was being interpreted to be used in the context of a company incorporated outside India and 'interest' has been used in context of an entity, other than a company, registered or incorporated outside India.

The New Bill proposes to provide that an asset or capital asset, being a ***'share of, or interest in***', a company or entity registered or incorporated outside India, which derives substantial value from India, shall be deemed to be situated in India. The addition of comma after share and interest suggests that indirect transfer provision will apply to (a) share of a company registered or incorporated outside India or (b) share of an entity registered or incorporated outside India or (c) interest in company registered or

9. Morgan Stanley and Co Inc (Supreme Court)
10. Rolls Royce Singapore P. Ltd (Delhi High Court); *GE Energy Parts Inc vs. ADIT (Delhi High Court)*
11. E-funds Corporation (Delhi Tribunal), Convergys Customer Management Group Inc (Delhi ITAT)

incorporated outside India or (d) interest in an entity registered or incorporated outside India. Therefore, one will have to analyze whether put/call contracts, offshore derivative instruments, warrants etc. will come within the ambit of 'interest' to determine applicability of indirect transfer provisions.

3.2 ***Attribution of income arising from indirect transfer***: The Old Act provided that where all the assets owned, directly or indirectly, by an offshore company or, an offshore entity deriving substantial value from assets located in India, are not located in India, the income of the non-resident transferor, from transfer outside India of a share of, or interest in, such company or entity, deemed to accrue or arise in India, shall be only such part of the income as is 'reasonably' attributable to assets located in India. The New Bill proposes to remove 'reasonably' from attribution principle. This should not have much impact considering Rule 11UC of the ITR anyway provides for manner of determination of income attributable to assets in India.

3.3 ***Exemptions from indirect transfer provisions***: The New Bill retains the exemptions (small shareholder exemption, transfer from Category I Foreign portfolio investor etc.) provided under the Old Act in so far as applicability of indirect transfer provisions are concerned.

Several circulars have been issued by the CBDT to clarify aspects in relation to indirect transfer as well. An express clarification with respect to continuity of these circulars under New Bill will be useful.

The indirect transfer provisions were added in the Old Act with retrospective effect from April 1, 1962. The New Bill removes the language that share or interest in an offshore company or entity 'shall always be deemed to have been' situated in India in relation to retroactivity of indirect transfer provisions. In 2021, indirect transfer provisions in the Old Act were amended to revoke the retroactivity[12]. The amendments essentially provided the indirect transfer provisions would not apply to income accruing or arising as a result of an indirect transfer undertaken prior to May 28, 2012, subject to fulfillment of certain conditions. Considering the prospective applicability, the New Bill does not include these provisions.

4. Interplay between domestic tax law and DTAAs

Section 90 of the Old Act governs agreements with foreign countries or specified territories, while Section 91 ensures relief from double taxation in the absence of a DTAA. The New Bill has retained this framework through Sections 159 and 160. The principles in the New Bill largely mirror those in the Old Act, particularly the provision in Section 90(2) of the Old Act, which allows a non-resident taxpayer the option to apply provisions of the tax treaty or the domestic law, whichever is more beneficial. The New Bill retains the requirement for obtaining tax residency certificate for claiming relief under DTAA[13].

12. The Taxation Laws (Amendment) Act, 2021
13. Section 159(8) of the New Bill

The Old Act provided that if any term is not defined in the DTAA, then the meaning given under the Old Act should be referred to[14]. Further, if the term is not defined under the Old Act, the term will have the same meaning as given to it in the notification issued by the Central Government and will be effective from the date on which the tax treaty came into force[15]. Interpretation of terms in used but not defined in tax treaties has been a source of litigation – a question often arises as to what meaning is to be assigned to the said term, one which prevailed on date of signing the treaty (static approach) or the one prevailing on the date of application of treaty (ambulatory approach).

The New Bill clarifies India's tax treaty position in relation to terms used in such treaty. The proposed section 159(7) of the New Bill now provides as under:

a) If any term is used in the DTAA and defined both in the DTAA and the New Bill, it will have the meaning which is provided in the DTAA;

b) If any term is used in the DTAA but has not been defined in it, but is defined in the New Bill, it will have the meaning provided in the New Bill or in any explanation which is given to it by the Central Government, and the meaning will be applicable from the date of the DTAA;

c) If any term is used in the DTAA and is neither defined in the DTAA nor in the New Bill, it will have the meaning given to it in any notification issued by the Central Government, and such meaning will be applicable from the date of the DTAA;

d) If any term is used in the DTAA and is not defined in the DTAA or in the New Bill or in any notification, it will have the meaning given in any Act of the Central Government relating to taxes, or in its absence, in any other law of the Central Government, and such meaning will be applicable from the date of the DTAA.

The language proposed in the New Bill favors the ambulatory approach. This is in line with language of Article 3(2) of several Indian tax treaties wherein the expression 'under the laws of that State from time to time in force' has been used[16]. Having said this, one should bear in mind that ambulatory approach may be used for interpretating terms which are not defined in the tax treaty and cannot be used to expand the meaning of terms defined in tax treaty.

5. Transfer pricing provisions

Transfer pricing provisions require income arising from an international transaction to be computed at an arms' length price. 'International transaction' is inter-alia defined to mean transaction between two associated enterprises (**"AEs"**), either or both of whom are non-residents. Under the Old Act, the definition of AEs was divided into two sub-sections. Sub-section (1) contains a 'means' clause and defines the broad contours of the

14. Explanation 4 to section 90 of the Old Act. Important to note that Explanation 4 was not clear on following ambulatory approach for using the domestic law definition for giving meaning to undefined tax treaty term as it is made clear in Explanation 3 to section 90

15. Section 90(3) read with Explanation 3 to section 90 of the Old Act

16. For example, India's tax treaty with Australia, Luxembourg, Malaysia, South Africa etc.

term AE and is based on the participation in the management or control or capital of that enterprise. Sub-section (2) provides for circumstances when two enterprises will be deemed to be AEs.

Sub-section (2) was amended by the Finance Act, 2002 wherein the words *"for the purposes of sub-section (1)"* were added. The effect of this amendment was that unless the requirements of sub-section (2) were satisfied, sub-section (1) was not applicable. This interpretation is supported by the Memorandum to Finance Bill, 2002 which provided that *"It is proposed to amend sub-section (2) of the said section to clarify that the mere fact of participation by one enterprise in the management or control or capital of the other enterprise, or the participation of one or more persons in the management or control or capital of both the enterprises shall not make them associated enterprises, unless the criteria specified in sub-section (2) are fulfilled".*

Section 162 contains the definition of AEs in the New Bill. The New Bill proposes to amend the language of sub-section (2) to replace the words "for the purpose of sub-section (1)" with the words "without affecting the generality of the provisions of sub-section (1)". On a plain reading of the new section, it appears that general definition of AEs (as contained in sub-section (1)) is not limited by the specific scenarios provided in sub-section (2). Having said this, such a literal interpretation may lead to absurd consequences such that mere participation of one enterprise in another in form of insignificant shareholding may also result the enterprises qualifying as AEs. This does not seem to be intention of legislature in so far as transfer pricing provisions are concerned.

6. Carry forward of losses

As per Section 7 of the Old Act, bought forward long-term losses (**"LTCL"**) were allowed to be set-off against long-term gains only. This continues in the New Bill. However, the savings clause in the New Bill seems to allow carry forward and set-off of bought forward LTCL incurred upto March 31, 2026 against all future capital gains (including short-term capital gains (**"STCG"**)) from tax year 2026-27 onwards[17]. This seems to be an anomaly considering STCG is taxable at rate of 20% (in case of transfer of listed shares)/35% (in all other cases) whereas LTCG is taxable at rate of 12.5%.

7. Withholding Tax Provisions

The withholding tax provisions are scattered across multiple sections in the Old Act. Specifically, Section 195 of the Old Act deals with withholding tax on payments to non-residents. The New Bill proposes a comprehensive overhaul of these provisions by consolidating them into a single section, i.e., Section 393. Section 393 categorizes TDS provisions into three broad sections: TDS on payments to residents (Section 393(1)), TDS on payments to non-residents (Section 393(2)), and TDS on payments to any person (whether resident or non-resident). While the rates largely remain the same, the new provisions have been structured in a tabular format, offering clarity, ease of reference and reducing ambiguity for both taxpayers and administrators alike. Section 195 of the Old Act which imposed an obligation on any person making payment of a sum to a non-resident which is chargeable to tax under the Old Act to withhold tax on such sum at the rates in force remains the same.

17. Section 536(2)(n) of the New Bill

Further, the New Bill proposes to permit obtaining lower withholding tax certificates for all payments/receipts. The Old Act permitted obtaining lower withholding tax certificates only in certain situations.

8. Assessments and audits

The overall assessment procedure and timelines have been retained by the New Bill. The repeals and saving provisions under the New Bill provide that:

8.1 The provisions of Old Act shall continue to apply to any proceedings (including notices, assessments, re-assessments, rectification, penalty, reference, revision and appeals) in respect of any tax year prior to tax year 2026-27 i.e. proceedings until tax year 2025-26 shall be carried out as per provisions of the Old Act – therefore, past assessments/ proceedings will be completed as per provisions of Old Act.

8.2 Penalty proceedings for tax years until 2025-26 may be initiated and any may be penalty imposed under the Old Act.

8.3 Proceedings pending on commencement of New Bill before any income-tax authority shall be continued and disposed of as if the New Bill has not been enacted.

9. Presumptive taxation for non-residents

New Bill has introduced changes to the presumptive taxation regime, including for non-residents. The previous provisions of presumptive taxation, i.e., Section 44AD and 44ADA of the Old Act, have now been clubbed into one Section 58 of the New Bill. This provision consolidates the presumptive tax regime in a tabular format, making it easier for taxpayers to navigate. Exemptions provided to certain non-residents under section 10 of the Old Act have been incorporated at one place in Schedule IV of the New Bill.

Conclusion

The New Bill does not have major surprises in form of changes. The changes proposed are majorly to simplify language and increase readability from layman's perspective. Having said this, it is expected that few drafting anomalies identified by practitioners are corrected before the New Bill is passed. In addition, as discussed above, further guidance is expected on continuity of circulars issued under the Old Act.

The New Bill will take effect from April 1, 2026, allowing necessary time for stakeholder consultation. A Parliamentary Select Committee is required to submit its report on New Bill on the first day of the next parliamentary session, basis which revisions may be made to the New Bill. The New Bill has to be approved by both houses of Parliament, followed by assent from the President of India to become law.

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