Tax Hotline

March 25, 2020

AMENDMENTS TO THE FINANCE BILL, 2020

The Finance Bill, 2020 ("**Finance Bill**") was introduced at the time of presentation of the Union Budget for financial year ("**FY**") 2020-21 by the Indian Finance Minister on February 01, 2020. Our hotline containing a detailed analysis of the Finance Bill can be found here. Subsequently, certain amendments were proposed to the provisions of the Finance Bill through a notice of amendments passed by the Lok Sabha on March 21, 2020 ("**Amendment (s)**"). On the digital taxation front, some of the crucial Amendments include extending Tax Deduction at Source ("**TDS**") obligations imposed by the Finance Bill on e-commerce operators to all platform owners, expansion of the scope of equalization levy ("**EL**") and extension of lower withholding rate (made applicable for 'fees for technical services' under Finance Bill) to royalty payments as well. Other changes proposed by the Amendments include addressing inconsistencies in respect of certain measures introduced by the Finance Bill such as abolition of Dividend Distribution Tax ("**DDT**"), tax exemption to sovereign wealth funds ("**SWF**"), introduction of new tax residency rules, tax collection at source ("**TCS**") obligations on remittances under Liberalized Remittance Scheme ("**LRS**") etc. The Amendments are discussed in detail below:

1. AMENDMENT TO SECTION 194-O: TDS OBLIGATIONS ON E-COMMERCE OPERATORS

Section 194-O was introduced with a view to "widen and deepen" the tax net by bringing transactions facilitated by e-commerce operators within the ambit of TDS provisions under the Income Tax Act, 1961 ("**ITA**").

The draft provision originally proposed in the Finance Bill imposed an obligation on e-commerce providers to deduct tax at the rate of 1% of the gross amount paid to an e-commerce participant for the sale of goods or services through its platform by such seller. Importantly, a company had to be responsible for paying the sellers under such an arrangement for it to be considered an e-commerce operator (apart from either owning, managing or controlling an e-commerce platform or online or digital facility that enabled such sales by third party sellers). Additionally, the proviso to the main section set out the deeming fiction that even if the money paid to the sellers did not flow through the e-commerce operator, nevertheless, such operator was deemed to have paid the sellers such money and therefore obligated to withhold 1% on such sums as well.

What was a bad situation to start with, in terms of the obligation to comply with TDS being imposed on intermediaries (and arguably imposed on non-resident platform operators), has been unimaginably made worse. The original draft provision was worthy of criticism from a practical perspective since it is quite difficult for companies to comply with TDS obligations when the platform is not in control of the money or payments being made to the sellers who sell through its platform. In such a case, there is a serious cash flow issue for platform operators, not to mention that it becomes quite complicated to then do business while being a non-resident, as such an amount has to be recovered from the Indian resident sellers in one way or another. Only in cases where platforms operated cash on delivery models, was it possible for companies to be excluded from the definition of an e-commerce operator and therefore not be subjected to the draft provision. Further, the provisions are so widely worded that even if platforms bought goods or services for their own consumption through their platform (or other digital facility or proprietary software), potentially such transactions could also be covered, even though no third-party buyers were involved.

However, the Amendments have made it far worse by making all platform owners e-commerce operators, irrespective of whether they are responsible for making the payment or not. This change, read with the deeming fiction in the proviso to the section means that all platform operators appear to be covered and would be required to pay 1% of the gross value of all the sales through their platform, even though not a single rupee from such sales that are paid to the sellers passes through the platform or is under the control of the platform. In fact, while e-commerce platforms have had the choice of integrating payment aggregation as part of their platform (where the money flows through them to the sellers), instead of opting for the cash on delivery option, from 1st April, 2020, e-commerce platforms do not have that choice anymore. The Reserve Bank of India ("**RBI**") has introduced "*Guidelines on Regulation of Payment Aggregators and Payment Gateways* dated 17th March, 2020, coming into effect from 1st April, 2020, wherein e-commerce platforms are not allowed to undertake such online payments without a licence. To comply with the regulations and obtain a license many companies may have to hive out the payment aggregation or online payment facility into a new entity and separate it from the e-commerce business. Even assuming that a license is obtained, the regulations make it clear that the money collected from the customers shall be kept in an escrow account and paid to the seller. No debits can be made from that account for the purpose of paying TDS as that is not a transaction that is permitted under the guidelines. Hence, there is no possibility of the e-commerce platform ever having control of the money for the purpose of paying TDS, to effectively pay tax on behalf of the sellers. Further, it is important to note that the guidelines, quite sensibly, also expressly exclude cash on delivery situations. Keeping this in mind, it is clear that the amended section 194-O has not been harmonized with the requirements of the RBI guidelines. This clearly appears to be a case of inconsistency between regulators which needs to be rectified immediately.

Research Papers

India's Oil & Gas Sector– at a Glance?
March 27, 2025

Artificial Intelligence in Healthcare
March 27, 2025

Real Estate Tokenisation
March 27, 2025

Research Articles

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?
February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals
January 15, 2025

Key changes to Model Concession Agreements in the Road Sector
January 03, 2025

Audio

CCI's Deal Value Test
February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice
December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business
March 19, 2025

Laws requiring e-commerce operators, including foreign e-commerce operators, to abstain from collecting money from a regulatory side but nevertheless pay 1% as TDS under tax laws is a contradiction that will cause unnecessary complexity and is impractical on the face of it. The fact that such an issue arises at a time when online sales and supplies are the need of the hour in an unprecedented lockdown situation is unfortunate.

2. EXPANSION OF EQUALIZATION LEVY TO FOREIGN E-COMMERCE OPERATORS

The Equalization Levy (EL), introduced vide Finance Act, 2016 imposes a 6% tax on consideration in excess of INR 100,000 (approx. USD 1,500) for a 'specified service' received or receivable by non-residents from Indian residents or non-residents having a permanent establishment in India. At the time of its introduction, the EL was limited in its application to consideration received by a non-resident for provision of specified online advertising services. This was intended to 'equalize' or create an equal playing field for non-residents and residents. However, in practice the tax ended up being a burden on domestic businesses.

In addition to the changes to significant economic presence proposed by the Amendment, the Government has now sought to impose an additional equalisation levy on incomes earned from supply of digital goods and services which are provided directly by or facilitated by e-commerce platform owners.

With effect from April 1, 2020, the scope of the EL has been expanded to cover non-resident e-commerce operators making supplies in India or having a nexus with India by imposing a 2% EL on the amount of consideration received or receivable by an 'e-commerce operator' from 'e-commerce supply or services' made or provided or facilitated by or through it:

1. to a person resident in India; or
2. to a non-resident in the following circumstances:
   - sale of advertisement, which targets a customer who is resident in India or a customer who accesses the advertisement through an IP address located in India; and
   - sale of data, collected from a person who is resident in India or from a person who uses an IP address located in India; or
   - to a person who buys goods or services or both supplied by the 'e-commerce operator' using an IP address located in India.

For this purpose, the term 'e-commerce operator' is defined to mean "*a non-resident who owns, operates or manages digital or electronic facility for online sale of goods or online provision of services or both*".

The expression 'e-commerce supply or services' is defined to mean:

1. online sale of goods owned by the e-commerce operator; or
2. online provision of services provided by the e-commerce operator; or
3. online sale of goods or provision of services or both, facilitated by the e-commerce operator; or
4. any combination of activities listed in (i), (ii) or (iii) above.

The expansive language used to define 'e-commerce operator' and 'e-commerce supply or services' could potentially cover all sorts of digital transactions into India, including transactions between non-resident entities that have at best a tenuous nexus with India. It is doubtful whether transactions between two non-residents would create nexus with India merely because advertisements target Indian customers. Even under Goods and Services Tax ("**GST**") when mostly online services are provided to customers located in India, there are multiple criteria that needs to be satisfied as a matter of fact for nexus with India to be established. Such criteria is lacking in the new provisions except for the mention of IP addresses or that the customer is a resident in India. Mere accessibility of a website or advertisement is internationally still understood to be insufficient to create taxable nexus in a country and such a view is also supported by decisions of courts in India. Further, even the sale of data, relating to a person resident in India, between non-residents should not have any nexus with India. To that extent, the constitutional validity of parts of the above provision may come into question.

When applied, the provisions purport to tax sale of data between non-residents (and not other forms of use of data such as license or shared data), irrespective of when it was collected in the past and irrespective of its current location or ownership. Problems can also arise in determining the residency status of customers in India as a matter of fact and it is unclear what activities would constitute as 'targeting' a customer in India. It is further unclear whether mere accessibility of an advertisement is sufficient to trigger the provision or something more intentional is required. Even assuming a more intentional act is required the burden of proof should still lie on the tax department in such situations to prove that the intention of the advertisement was to target a person resident in India. While this may be clear in many cases, it is still possible to cause confusion in cases where the target market was for instance the USA, but such websites are accessible from India.

The expanded EL is also in furtherance of the Government's attempt to tax non-residents on business profits derived from India that would otherwise remain non-taxable in India on account of physical presence-based permanent establishment (PE) tests. Once implemented, the expanded EL could impact several global digital players and a variety of business models.

The application of the expanded EL to non-resident e-commerce operators is subject to certain *de minimis* thresholds, including a turnover threshold of INR 2 crore (USD 0.2 million approx.), which is significantly higher than the INR 100,000 (USD 1318 approx.) threshold applicable under the existing rules. If the sales, turnover, or gross receipts of the e-commerce operator from the e-commerce supply or services made or provided or facilitated is less than INR 2 crore in a given financial year, the expanded EL shall not be charged. In addition to this threshold, the EL shall also not be charged in cases where: (a) the e-commerce operator making or providing or facilitating e-commerce supply or service has a PE in India and such e-commerce supply or service is effectively connected with such PE; or (b) the e-commerce supply or service is subject to a 6% EL under existing rules.

Income of e-commerce operators on which the expanded EL has been paid would continue to remain exempt from income-tax in the same manner as under the existing rules for EL on specified services.

SIAC 2025 Rules: Key changes & Implications
February 18, 2025

How Cross Border M&A Will Shape the AI Age
February 13, 2025

A major point of departure between the expanded EL and the current rules relates to collection and recovery of EL. Whereas the EL on consideration for specified services in the nature of online advertising is to be deducted and paid to the Government by the Indian payer, no such obligation has been imposed on the person making payment to the e-commerce operator. Instead, the expanded EL shall be paid directly by the concerned e-commerce operator to the Government on a quarterly basis. Failure to pay the whole or any part of the EL renders the e-commerce operator liable to pay simple interest at 12% p.a. on the delayed payment and a penalty equal to the amount of EL that it failed to pay.

The proposed expansion in scope of the EL creates several ambiguities and challenges, including:

- **Ambiguity on determining tax base**: The proposal does not define the term 'consideration' for determining the base for levy of EL. On an expansive reading, the EL may possibly apply on gross consideration received by the e-commerce operator for e-commerce supply or services, while on a narrow (and correct) reading, the EL should only apply on the commission retained by the e-commerce operator (i.e., gross consideration less merchant payments and expenses). However, in situations where the e-commerce operator is selling services or goods on its own account then the tax base should be the gross consideration received for supply of such services or goods.
- **Inconsistency with existing law**: As stated above, IP addresses in India being considered the crucial fact establishing nexus is at variance with the tests set out under the GST laws for establishing whether online supplies are 'consumed' in India, which consider six different parameters out of which two non-contradictory ones need to be satisfied. Since GST also considers factors such as the registered address of the end consumer, it would be better to harmonise the approach between direct and indirect taxes with respect to digital supplies and how they are located or consumed in India.
- **Cascading taxes**: Online supplies of goods and services are already subject to customs duty and GST as applicable at varying rates. Adding a 2% EL on top of that will increase the effective tax rate on cross-border transactions and reduce the ease of doing business in or with India. Moreover, as the EL is outside the scope of GST, no input tax credit will be available in respect of the EL paid, which then becomes a pure cost to the payer.
- **Impracticality of nexus requirements**: It may be impractical or unfeasible for non-resident e-commerce operators to keep track of the IP address or the location of each customer or user whose data is collected, processed, aggregated or sold, or to whom advertisements are targeted or presented. It also raises questions regarding whether the IP address requirement is a sufficient, reliable and verifiable indicator of nexus in all cases. Tracking data flow and ensuring compliance with the law is likely to prove costly and impractical.
- **Ambiguity on scope of residence requirement**: The reference to persons 'residing' in India creates confusion on whether it requires ordinary residence or residence for tax purposes, where different tests are prescribed. If the reference is not linked to residence for tax purposes, it is unclear what tests non-resident e-commerce operators will apply to determine whether a person resides in India or not. Brightline tests in this regard are required to prevent unnecessary litigation.
- **Extra-territoriality and double taxation risks**: If data collected in India or from an Indian resident results in revenues from operations in a third jurisdiction, it would appear that expanded EL may seek to tax those revenues in India, which could result in complex triangular situations resulting in double or triple taxation of the same income in different countries with inability to claim tax credits. In fact, an expansive reading of the provision may mean that even indirect links to Indian user data, such as data acquired from a third party, could also increase Indian tax risks in an otherwise purely offshore transaction.
- **Ambiguity on availability of foreign tax credit**: Availability of foreign tax credit on the EL paid by an e-commerce operator may become a challenge and this may result in undesirable double taxation. As such, e-commerce operators will likely choose to gross up their fees so that Indian payers bear the cost. Small businesses with lower negotiating power will be forced to bear the cost of the expanded EL without a corresponding relief in the form of domestic input tax credit offsettable against local taxes.
- **Onerous compliance requirements**: While compliance obligations under existing rules are on the Indian payer, the expanded EL shifts the burden for compliance and reporting on to e-commerce operators, who will now be required to pay the EL on a quarterly basis, maintain and furnish a detailed annual statement in respect of all taxable e-commerce supplies or services, be subject to Indian tax assessment on the EL payable, and be compelled to utilise the Indian tax litigation framework to resolve any disputes relating to the payment of EL or maintenance of records. This will further harm the attractiveness and ease of doing business in India for being burdensome, time consuming and cost ineffective. In practical terms, it remains to be seen how these compliance obligations will be enforced on non-resident entities having no place of business, physical operations or representatives in India.

It should be noted that an expanded EL was not contemplated when the Union Budget was presented earlier this year but is likely intended to compensate for the expected shortfall in Government revenue on account of COVID-19 and the global economic slowdown.

Unlike the revised Significant Economic Presence rules, the expansion of EL will have an immediate impact on all foreign e-commerce operators irrespective of their state of residence or the availability of treaty benefits. Foreign e-commerce operators should therefore review their current operations in India or in relation to Indian customers or data and assess potential risks from the implementation of the expanded EL.

This also demonstrates the keenness on part of the Government to tax income derived from monetization of data collected from Indian residents since this expanded EL is in addition to other changes brought about to significant economic presence rules that also target similar income streams. In fact, while the Organization for Economic Co-operation and Development ("**OECD**") is finalising the position on taxation of digital transactions, the end result of these Amendments is that foreign digital players shall be required to pay taxes one way or another, either as EL or as income connected with a permanent establishment. Despite earlier criticisms that the introduction of the EL was an intentional treaty override, India continues to pursue taxation of such income streams through all means possible.

3. EXTENSION OF LOWER WITHHOLDING TAX RATES TO ROYALTY PAYMENTS

Section 194J of the ITA imposes a TDS obligation of 10% on certain payments, including fees for technical services ("**FTS**") and royalty, to be made to residents.

Taking note of the large number of pending cases on the characterisation of certain payments as FTS and the TDS rate to be consequently applied, the Finance Bill had proposed to amend section 194J to reduce the TDS rate in respect of FTS from 10% to 2%, while maintain a 10% TDS rate on all other payment specified in that section including 'fees of professional services' and 'royalty'.

It is now proposed to extend the lower TDS rate of 2% to payment of any sum by way of royalty, where such royalty is in the nature of consideration for sale, distribution or exhibition of cinematographic films. In all other cases, the 10% TDS rate will continue to be applicable.

While this extension of the lower TDS rate to royalty is a welcome move, its applicability in the context of outright sale of cinematographic films is nuanced. This is because an outright sale of Intellectual Property ("**IP**") is ordinarily characterised as transfer of a capital asset and any income arising therefrom is consequently taxed under the head 'capital gains'. On the other hand, the term 'royalty' usually refers to payments for the use or right to use (but not for the transfer of) any copyright, patent, trademark or other IP assets. Even under Indian copyright law, the ownership of copyright in IP assets (including a cinematographic film) can be transferred only through a written assignment agreement, and the assignee will be treated as the owner (and not the licensor) of the copyright to the extent it is assigned. Even under tax laws, the definition of royalty excludes situations that result in capital gains. To this extent, the proposed amendment to section 194J should be understood in light of the above when it comes to sales of cinematographic films.[1]

4. AMENDMENTS TO TAXATION OF DIVIDENDS – AN INCOMPLETE RESPONSE TO INDUSTRY CONCERNS

In a landmark step, the Finance Bill had proposed the abolition of the DDT– a 15% additional income-tax payable by Indian companies on amounts declared, distributed or paid by them as dividends and instead move to the classical system of taxing the shareholders on the dividends received. Several amendments were proposed to the ITA to provide a mechanism for taxation of dividends going forward, and to enable a smooth transition out of the DDT regime.

Amendments proposed to the Finance Bill provisions pertaining to abolition of DDT, with a view to clarify certain inconsistencies, are as follows:

- The Finance Bill had proposed to re-introduce Section 80M in the ITA to quell the cascading effect of the tax on dividends, by allowing an Indian company a 100% dividends received deduction ("**DRD**") in computing its taxable income. The DRD was limited to a deduction equal to 100% of dividends received from another Indian company, subject to a maximum of the dividend distributed by the first mentioned Indian company, and so long as the distribution by the first mentioned Indian company was made on or before one month prior to the due date of filing of return of income.

  The Finance Bill had not proposed any similar deduction in respect of dividends received by an Indian company from any foreign company – including a specified foreign subsidiary company, which is subject to a 15% tax under Section 115BBD of the ITA.

  The Amendment has sought to revise Section 80M by extending the DRD to 100% of dividends received from (i) a foreign company and from (ii) a business trust (defined under Section 2(13) of the ITA as being a real estate investment trust ("**REIT**") or an infrastructure investment trust ("**InvIT**")), in addition to a domestic company. The DRD is still limited to the amount of dividend distributed by the Indian company on or before one month prior to the due date of filing of return of income.

- The provisions of the ITA did not charge DDT on an Indian company distributing dividends out of its current income to a REIT or InvIT (where the company was an SPV held 100% by the trust); and such dividends were exempt in the hands of the REIT or InvIT, and also in the hands of the unit holders. The Finance Bill, along with abolition of the DDT and reinstating of the conventional method of taxing dividends, proposed amendments to retain the exemption to a business trust from being taxed on dividends received from the SPV, but rendered distributions received by unit holders taxable. The proposal was a cause of significant concern for existing investors in REITS and InvITs.
  The Amendment has revised the proposal to reinstate the exemption of distributions received by unit holders from business trusts (being of the same nature as dividends received by the trust from an SPV in which the trust holds controlling interest), but only for distributions from an SPV that has not elected to be taxed as per the provisions of Section 115BAA (at a concessional rate of 22% (excluding surcharge and cess) that Indian companies can avail subject to meeting conditions prescribed). In other words, if the SPV has elected to be taxed as per Section 115BAA, such distributions are taxable in the hands of unit holders.

  The revised exemption has also been aligned with changes to the withholding tax regime applicable to business trusts. Income in the nature of dividend distributed by a business trust to a unit holder is now subject to a 10% tax deduction at source. However, this deduction shall only apply if the underlying SPV has exercised the option to be taxed in accordance with section 115BAA of the ITA. If the underlying SPV has retained its existing corporate tax regime and has not elected for the concessional tax regime under section 115BAA, no tax is to be withheld on such distributions – in line with revised unit holder exemption.

  The revised exemption may be beneficial for investors in business trusts holding SPVs that have not elected to be taxed as per section 115BAA on account of having substantial MAT credit on their books, which is common among entities in the infrastructure sector. Dividends distributed by such SPVs should continue to remain exempt in the hands of both the trust and the unit holder.

- In the Budget 2019, the Finance Minister had announced a higher surcharge for individuals in higher tax brackets. After several industry representations, the higher surcharge was withdrawn to the extent applicable to long term and short-term capital gains tax on listed (i) equity shares; (ii) unit of an equity-oriented fund; and (iii) unit of a business trust.

  The Amendment goes a step further to exempt dividend income from the application of the higher surcharge and has made corresponding changes to the withholding and advance tax rates in the First Schedule. Resultantly, while the highest rate of tax for Indian resident individuals on dividend income and capital gains on certain listed securities stands at 35.88%, while other streams of income for such individuals is taxable at 42.74%. Correspondingly the highest rate of tax for non-resident individuals on dividend income is lowered to 23.92% from the earlier 28.49%.

- Where Section 10(34) of the ITA had earlier exempted the taxation of dividends received from Indian companies in the hands of shareholders where DDT was chargeable, the Finance Bill had added a proviso limiting the application of the exemption to dividends received prior to April 1, 2020. This created an incongruity in situations where shareholders receive dividends on which companies have already paid DDT, and on which the shareholder has paid additional income tax under Section 115BBDA of the ITA, where applicable; but since the receipt is after April 1, 2020 they cannot avail of the exemption under Section 10(34) and hence would be taxed on the dividend income again.

  The Amendment has cured this anomaly by also exempting dividends received by a shareholder on or after April 1, 2020; but on which DDT and additional income tax under Section 115BBDA, wherever applicable, has been paid prior to March 31, 2020.

The move in Finance Bill to abolish the DDT was a long-awaited change, one that industry participants had been hoping for years, considering the anomalies the DDT regime was creating particularly in the cross-border context – such as availing of foreign tax credit of the DDT by a non-resident shareholder. While the change was welcome, some unintended aspects created significant side-effects in hurting investor morale – particularly the incongruity in taxation of distributions by REITs and InvITs. The changes proposed now through the Amendments are largely corrective, indicative of a responsive government. However, the amendments partially reinstating exemption for distributions received by unit holders are bitter-sweet at best, considering the requirement of the underlying SPVs (particularly existing ones) to forego a number of deductions and allowances it can otherwise avail under the ITA.

5. AMENDMENTS TO TAXATION OF SOVEREIGN WEALTH FUNDS – HALF BAKED MEASURES

The Finance Bill had proposed a new provision in respect of exemption to SWFs. The provision provides exemption to SWFs from income which is in the nature of dividend, interest or long-term capital gains which is earned by SWFs when investment by the SWF is made in the infrastructure sector, subject to fulfilment of specified conditions. This was done with a view to encourage long term stable capital participation from SWFs into India's infrastructure space. Several suggestions were made to the Finance Ministry for amendments to the proposed exemption from the viewpoint of making it more effective.

Amendments proposed to the Finance Bill provisions pertaining to tax exemption granted to SWFs are as follows:

- *Narrowing down of the time period:* The exemption provided in the Finance Bill was for all investments made up to March 31, 2024. However, the Amendment has narrowed the time-period and provides that the exemption will be provided only if the investment has been made on or after April 1, 2020 and on or before March 31, 2024.

- *Extension of exemption to SWFs investing through units of business trusts and AIFs:* Finance Bill had provided exemption to SWFs when they invested directly in an entity engaged in infrastructure facility. However, rarely do SWFs make investments directly and a substantial portion of investments by SWFs is through InvITs and Alternate Investment Funds ("**AIF**"). The Amendment provides that investments made by SWFs through InvITs / REITs and AIFs shall also be provided the exemption as provided above. Clarification in this regard was necessary to determine the implication in case the SWF invested through a pass-through entity. Further Finance Bill had also proposed to remove the requirement for listing of units of InvITs and REITs for them to qualify as 'business trusts' – hence investments by SWFs into unlisted units of InvITs should also be covered. With respect to AIFs, the Amendment that has been brought about provides exemption to SWFs if their investment has been made through Category I / II AIFs which have 100 percent investment into entities engaged in 'infrastructure facility' as defined under Section 80-IA (4) of the ITA.

  The Amendment is a welcome move especially for allowing investments into InvITs as these are popular vehicles used for investments into infrastructure. Importantly, a blanket exemption has been granted to InvITs and is not restricted only to investments made by the InvITs into entities engaged in 'infrastructure facility' as defined under section 80-IA (4)(i) (which seemed to have been the scope of the exemption when originally introduced).

  However, for AIFs, the scope is still limited as the AIF should have invested 100% into entities engaged in 'infrastructure facility' as defined under Section 80-IA (4) of the ITA. Typically, an AIF will not invest 100% in such facilities and therefore the exemption may not be available thereby restricting SWFs / pension funds from making investments in AIFs. What, however, could have been allowed was a proportionate exemption in tax i.e. the proportion in which the AIF has invested into an infrastructure facility, the same proportion of income in the hands of the SWFs / pension funds investing through such an AIF should have been exempted thereby allowing more flexibility which would in turn result in more investment by the SWF / pension fund into AIFs.

  In this respect, it should also be noted that both InvITs and AIFs enjoy pass through status under the ITA. And therefore, even without the specific exemption that has been provided the SWFs income from investment made through such entities should have been exempt from tax under the ITA. However, unlike the tax pass-through status of AIFs (where unit holders are taxed as if the income had accrued to them directly from the investments), the tax pass-through status of 'business trusts'[2] is such where income is taxed in the hands of the unit holders as if the income is accrued to the business trust, and not to the unit holders. Accordingly, absent this amendment, while SWFs investing through AIFs would have been able to get the exemptions, SWFs investing through InvITs would not have.

  Further, generally under tax treaties, SWFs like ADIA, GIC etc. are anyway provided exemption from interest income and typically in investment in infrastructure projects, the return is in the form of interest and therefore even without the specific exemption, SWFs should have been able to get the tax exemption under the tax treaty.

- *Extension of exemption to Pension Funds:* Post introduction of Finance Bill, there was speculation as to why when SWFs were given exemption from tax, pension funds were not. This is because, just as SWFs, most pension funds are also government owned. The Amendment brings these speculations to rest and proposes to extend the exemption to pension funds which are: (i) created or established under the law of a foreign country including laws made by political constituents being a province, state or local body, by whatever name called; and (ii) is not liable to tax in such foreign country, amongst other conditions that may be imposed by Government. The Amendment comes as a welcome move. However, the categories of pension funds that can avail benefit of the exemption is broader in nature than for SWFs. This is because, the exemption is available to pension funds set up by provincial, state or local Governments. This raises the question as to whether similar exemption is also provided to SWFs which have been set up by state and local governments of a country.

While the Government has taken steps to reduce the ambiguity pertaining to availment of the exemption, there still exists a lot of ambiguity in certain aspects. For example, there is no definition of SWFs or pension funds, and question therefore arises whether entities recognized as SWFs / pension funds in their countries of existence should suffice for the purposes of this exemption. Further, the scope of 'infrastructure facility' for the purposes of this exemption is restricted to its definition under section 80-IA (4)) and hence very narrow. The Government should have extended it to all sectors classified as 'infrastructure' under the harmonized master list of infrastructure sub-sectors notified by the Department of Economic Affairs, Ministry of Finance. Further, there is no clarity yet on whether SPVs of SWFs / pension funds – including the ones located in other jurisdictions – should be covered. Technically, wholly owned SPVs set up by SWFs should also be given the same treatment as that of an AIF. Other than that, investment into a private equity fund by an SWF which invests into an infrastructure facility in India should have also been given the exemption.

The Amendment also provides powers to the Central Board of Direct Taxes ("**CBDT**") to issue guidelines for the purpose of removing difficulties that may arise and provides that such guidelines will be laid before each House of Parliament and shall be binding on the income-tax authority and the taxpayer. The Amendment further provides that if during the year the conditions provided to avail the exemption are not satisfied, the income shall become taxable and the exemption will not be available to the taxpayer in such circumstances.

6. AMENDMENTS TO RESIDENCY RULES UNDER THE ITA: FLIP FLOP ON RESIDENCY RULES FOR INDIVIDUALS

Finance Bill had introduced a slew of changes to expand the scope of Indian tax residency for individuals, primarily aimed at increasing the tax liability of Non-Resident Indians ("**NRIs**"), Person of Indian Origin ("**PIOs**") who spend substantial time in India. To summarize, these changes were as follows:

1. Firstly, for Indian citizens and PIOs on a visit to India, the current law provides a relaxation on the day count test according to which such individuals could travel to India for 180 days or more on a year on year basis without being treated as Indian tax residents. Under the Finance Bill, the threshold was reduced to 120 days. Therefore, as per the New Visit Test, PIOs and Indian citizens on a visit to India could become Indian tax resident if (i) they spend 182 days or more in a given financial year or (ii) they spend 365 days or more in the four years prior to the given financial year and 120 days or more in the given financial year ("**New Visit Test**").
2. Secondly, the Finance Bill introduced a new provision under which an Indian citizen shall be deemed to be an Indian tax resident if s /he is not liable to tax in any other country by reason of residence or domicile or criteria of similar nature i.e. in case s /he is a 'stateless person', irrespective of the days spent in India ("**Stateless Person Test**").

The Stateless Person Test appeared to target individuals who do not spend considerable amount of time in any country so as to be treated as tax residents of such foreign countries. Specifically, this proposed amendment garnered a lot of criticism from the NRI community, especially from persons working bona fide in a foreign jurisdiction like UAE, where individuals are not subject to income taxes.

To allay such concerns, the CBDT issued a clarification stating that the Stateless Person Test should not affect bona fide workers in other countries such as the Middle East and that such individuals will only be liable to tax on India sourced income.

In furtherance of the above, few more changes have been proposed to these provisions through the Amendments, as discussed below:

- In so far as the New Visit Test is concerned, the Amendment provides that the New Visit Test is applicable to all Indian citizens and PIOs having a total income (other than income from foreign sources), exceeding INR 15,00,000 during the previous year ("**Threshold**"). Further, income from foreign sources has been defined to mean income which accrues or arises outside India (except income derived from a business controlled in or a profession set up in India).
- On the other hand, the scope of the Stateless Persons Test has been limited through the Amendment, and shall only be applicable to such Indian citizens who meet the Threshold. Accordingly, all Indian citizens who fail to meet the Threshold, but are not subject to tax in any other jurisdiction, will not be considered as Indian tax resident.
- Lastly, an amendment has been carried out to the test for Resident but Not Ordinarily Resident ("**RNOR**") where two categories have been introduced i.e. such persons shall be treated as RNOR – (i) Indian citizens, PIOs who meet the Threshold and have been in India for a period of more than 120 days but less than 182 days i.e. those Indian citizens / PIOs who meet the New Visit Test; and (ii) Indian citizens who meet the Stateless Person Test. Accordingly, as anticipated, relief has been provided to all such PIOs, Indian citizens and Indian citizens who qualify as Indian resident owing to the New Visit Test and Stateless Person Test respectively. Consequently, as per section 5 of the ITA, such PIOs/ Indian citizens shall, at all times, be taxed only on their Indian sourced income and worldwide income that is derived from a business controlled in or a profession set up in India. This would mean that even where an Indian citizen qualifies as a tax resident under section 6(1) of the ITA owing to the New Visit Test, or Stateless Person Test he should still not be taxed on a worldwide basis (unless income is derived from a business controlled in or a profession set up in India), even if he does exceed the Threshold. This is of course a year on year test, where the day count and total income criteria has to be examined every financial year.
- Surprisingly, the proposed relaxation to the RNOR test proposed under the Finance Bill has also been scrapped. Previously, the Finance Bill proposed to further streamline the test for RNORs by simply providing that an individual shall qualify as an RNOR if such individual has been a non-resident in India for 7 out of the 10 years preceding the relevant previous year. The same amendment had also been proposed with respect to HUFs as well. This proposal was well received; however, the same has been scrapped through the Amendments.

The RNOR status granted to Indian citizens, PIOs abroad who do qualify for the Stateless Person Test or the New Visit Test is a well-intended move to protect the tax residency status of such individuals and ensure that the worldwide income of such persons is not taxed in India. However, the manner in which the new tests have been introduced and consequent granting of RNOR status is confusing, convoluted, and unnecessary as the proposed implications of being a resident by virtue of the New Visit Test and Stateless Person Test appear to be negated by the RNOR status introduced. The ultimate result of these amendments is to differentiate between PIOs and Indian citizens who meet the New Visit Test or Stateless Person test as the case maybe, and accordingly qualify as RNORs, as opposed to non-residents, which is the case when the Threshold is not met in each of the two tests. The difference between a 'non-resident' status and RNOR status is with respect to the taxation of income from a business or profession controlled from India in the hands of the RNOR. This is nothing but a theoretical distinction, and therefore in effect the Amendments make no change from the existing law. It is not clear what the intention was to do this flip flop, especially considering the issue raised in the Memorandum explaining the provisions to the Finance Bill regarding taxation of stateless persons who don't pay taxes in any jurisdiction is not being addressed.

Lastly, given the COVID-19 pandemic and consequent travel restrictions and country-wide lockdowns being put in place, it is difficult for non-resident individuals travelling to India or on a visit to India to return back to their home jurisdiction. An exemption for such a situation to count towards the day count test would have been a welcome move. The presence of such non-residents in India owing to the pandemic could also trigger Indian tax residency for companies and other legal entities incorporated outside India, and an exemption in this regard would have offered some comfort to the affected persons.

7. AMENDMENTS TO PROVISIONS RELATED TO TCS ON LRS REMITTANCES – AMBIGUITY PREVAILS

Section 206C of the ITA imposes a tax collection at source (TCS) obligation on specified persons in respect of profits and gains from business of trading in specified goods. Finance Bill had proposed to expand the scope of section 206C by introducing TCS on sale of overseas tour packages, sale of goods in excess of INR 5 million (USD 0.7 million approx.) and overseas remittance by a 'buyer' under the Liberalized Remittance Scheme (LRS).

As per the Finance Bill, the obligation of TCS on remittances under LRS was to be imposed on authorized dealer banks at the rate of 5 % on the aggregate amount of remittance. Importantly, the term 'buyer' was not defined which led to questions such as whether remittances made by individuals for purchase of non-trading capital goods such as overseas shares under the LRS should also be covered. Even if so, there was no clarity on whether it would cover primary or secondary purchase of shares, or both considering that a primary is not a sale and therefore there can be no seller or buyer.

The Amendments proposed to the Finance Bill provisions pertaining to TCS on LRS remittances are as follows:

1. It would be applicable only if the aggregate amount of remittance in a financial year exceeds INR 7 lakhs (USD 9000 approx.).
2. The 5 % TCS rate on LRS remittances would only be applicable on amounts exceeding INR 7 lakhs.
3. The TCS rate should be 0.5 percent (instead of 5 percent) in case of remittances made under LRS for payment of interest on loan obtained from specified financial institutions / charitable institutions for purposes of higher education abroad.
4. The TCS obligations on LRS remittances should only be applicable from October 1, 2020.

While these amendments have provided more clarity in respect of the newly introduced TCS obligation on LRS remittances, some important questions such as whether it is applicable on purchase of capital goods such as overseas shares (whether by way of primary or secondary transactions), particularly owing to the fact that the term 'buyer' for the purpose of TCS on LRS is still not defined, continue to remain.

- **International Tax Team**

You can direct your queries or comments to the authors

---

1 Please note that the language of the amended section as set out in the version of the Finance Bill, 2020 which is available on the Lok Sabha website appears to have a typographical error. The amended language may have been inserted at the incorrect place, resulting in the section referring to "professional royalty". We believe this to be a mistake and that it shall be corrected shortly.
2 Section 115U, ITA
