How international tax landscape changes in India from April 1, 2020

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India's Union Budget for the fiscal 2020-21 was announced in February 2020 and the tax proposals, after undergoing some important changes, were approved by the Indian Parliament and received Presidential assent on March 27, 2020. With this, the annual exercise of amending India's tax law was completed, and the tax changes are effective from April 1, 2020.

On the tax front, some significant amendments have been made – such as widening the scope of digital tax, abolition of dividend distribution tax, more stringent tax residency rules for non-resident Indians etc.

We have analyzed here the key international tax changes impacting non-residents (MNEs and others having Indian business or nexus).

Tax focus on digital economy

Over the past few years, India has been a front-runner when it comes to taxation of digital economy. With a huge consumer base, India does offer a large market to many digital businesses and hence, from the perspective of its tax revenue base, digital businesses could not be ignored.

Digital economy has become an important subject of tax discussions around the globe. The OECD, as part of its BEPS project, had identified tax challenges posed by digital economy and made certain recommendations for countries to consider. While most jurisdictions were still contemplating the best solution possible, India took concrete steps of introducing some of the suggested changes to its tax laws.

Like tax laws globally, Indian tax law provisions were best suited for traditional business models of brick and mortar structures and needed an overhaul, to ensure that its tax base is protected, and the value created digitally could be brought to tax. To this end, two significant amendments were introduced in Indian taxation laws in the recent past – introduction of equalisation levy of six percent on payments to non-residents for online advertisement and related services (popularly referred to as Google tax); and introduction of deeming fiction treating digital presence of non-residents as taxable presence in India (referred to as "significant economic presence"). Both these provisions have now been further amended in the following manner:

- Significant Economic Presence (SEP) test applicability deferred: While the principal provision was introduced in the year 2018, the same was subject to the user and revenue related thresholds which had to be prescribed. Given that the global consensus on these parameters is pending and the OECD's report on these aspects is expected by end of 2020, the applicability of SEP has been deferred to make it applicable for the year 2021-22 and onwards.
- Income attribution rules widened: While the applicability of SEP has been deferred, the scope of *'income of non-residents attributable to operations carried out in India'* if a non-resident is considered as having a taxable presence (in the form of a 'business connection' in India but not an SEP) has been widened simultaneously to cover the following incomes:
- Income from advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol (IP) address located in India;
- Income from sale of data collected from a person who resides in India or from a person who uses IP address located in India; and
- Income from sale of goods or services using data collected from a person who resides in India or from a person who uses IP address located in India.

With respect to the aforesaid amendment which essentially deals with income that could be attributed to a taxable presence of a non-resident in India (not being an SEP), it is unclear as to what is the nexus or taxable presence in India to which such income could be attributed. All these transactions may not necessarily require a presence in India (even in the form of servers etc.), these activities could be undertaken remotely. Therefore, it poses a question as to the impact of this change in a scenario where there is no presence or operations carried out by a non-resident in India. Further, if a tax treaty is applicable, the taxable presence (i.e. permanent establishment definition in the treaty) and attribution principles in the treaty would also need to be evaluated and if the same are beneficial to the taxpayer, the same should prevail – an analysis of the interplay between domestic law and tax treaties in this regard would be an interesting one.

- Scope of Equalisation Levy widened*:* With effect from 1 June 2016, India introduced an equalisation levy at the rate of six percent on payments received by non-residents (subject to conditions) for online advertising and allied services. Starting April 1, 2020, the scope of equalisation levy has been widened to also include consideration for any online supply of goods or services or facilitation of such sale or supply by a non-resident e-commerce operator to Indian customers (residents as well as persons using an Indian IP address) and the same will be subject to a two percent equalisation levy (subject to conditions). Importantly, this levy will also apply to arrangements between two non-residents involving sale of advertisements targeting Indian customers (or persons using Indian IP address accessing the advertisements) and sale of data collected from Indian customers (residents and persons using Indian IP address). The new equalisation levy is substantially wider in scope and covers B2B as well as B2C transactions. To name a few, businesses such as online marketplaces, subscription-based social media platforms, streaming services, online gaming, would attract the new equalisation levy. Hence, businesses based offshore and engaged in online supply of goods or services or even facilitation thereof through digital means must swiftly evaluate the impact of the new equalisation levy provisions and review business models to identify the best structures possible and update systems and processes to ensure compliance (which include deposit of equalisation levy on a quarterly basis and filing an annual return by the non-resident e-commerce operator).

Overhaul of dividend taxation scheme

Until 1 April 2020, companies were subject to an additional corporate tax (called dividend distribution tax (DDT)) at 21% on the amount of dividends distributed to shareholders and such dividends were exempt from any further tax in the hands of the shareholders (except certain resident non-corporate shareholders). Since DDT was a tax obligation of the distributing company, generally, it was not available as a credit to the shareholder. From 1 April 2020, the tax on dividends has shifted from the company to the shareholders. For non-resident shareholders, such dividend income would be taxable at 20% (plus applicable surcharge and cess) subject to a lower rate applicable under the relevant tax treaty and the company will be required to withhold the applicable tax. It is worth noting that under India's tax treaties, the withholding tax rate on dividends is generally capped at 5%, 10% or 15%.

For non-residents, the new scheme is a welcome change as the Indian tax cost would no longer be a sunk cost; the shareholder should be able to claim a credit for tax paid in India against the tax payable in its home jurisdiction.

Compliance burden eased (with riders)

Budget 2020 has exempted non-resident taxpayers from filing tax return in India if their income is in the nature of royalty or fees for technical services earned from India, so long as the tax has been withheld at source as per the rates mentioned under the domestic tax laws. This is a positive step in the direction of making India a jurisdiction providing *ease of doing business* and should provide non-residents with the administrative and procedural ease of investing in India. Importantly, if lower tax or nil tax is deducted due to relief under a tax treaty with India, the non-resident taxpayers would need to file their tax returns claiming treaty benefits. Until now, the exemption from filing tax return was available to non-residents only if their income comprised of certain specified investment income (such as dividend or interest income).

Red carpet welcome to Foreign Sovereign Wealth Funds, Foreign Pension Funds

In order to promote investment by sovereign wealth funds and foreign pension funds in India, Budget 2020 has provided tax exemption with respect to investment income in the nature of dividend, interest or long term capital gains at the time of exit provided that (i) the investment (in infrastructure facility) is made either by a foreign sovereign wealth fund or a foreign pension fund or a wholly owned subsidiary of the Abu Dhabi Investment Authority, (ii) the investment is made between 1 April 2020 and 31 March 2024, (iii) the investment is held for at least 3 years. This proposal accords a red-carpet welcome to foreign funds and would go a long way in inducting sustainable and long-term capital in India considering the tendency of such funds to lean towards long-term investments seeking long-term returns. However, with respect to foreign sovereign wealth funds, given that exemption would only be conferred to funds wholly owned and controlled by foreign government, funds where public has even a minority investment would not be attracted by the exemption.

Sunset clause extended for lower withholding tax rate on interest income

The Indian tax law has beneficial provisions with respect to certain interest income earned by non-residents which extend a concessional tax rate of 5% to such income (subject to conditions). These provisions had a sunset of 1 July 2020, which has now been extended to 1 July 2023. This should continue to make these investments an attractive mode of making funds available to Indian businesses. Further, since the domestic tax law itself has a beneficial rate and tax treaties do not generally provide for a lower rate (except that nil rate or exemption is provided to certain specified lenders / institutions), the non-resident lenders need not rely on treaties and justify substance in their structures so long as the debt investment itself is not doubted from a 'substance over form' perspective.

Summing up

On balance, Budget 2020 has brought about certain welcome amendments in the international taxation space. The exemption provided to foreign sovereign wealth funds / foreign pension funds and the extension of sunset clause for lower withholding tax rate on interest income will boost investments in India and abolition of DDT will make it easier for non-residents to have a tax efficient repatriation of profits from India. As regard the digital economy, large user-based market economies are updating their tax laws to tap this market and India's move in this direction could be seen as hasty but it was expected in some form or another to protect its tax base. Clear implementation guidelines and ease of compliance would pave way for a better investor confidence. Earlier last year, the Indian government had also rationalized the corporate tax rate applicable to Indian companies (from 30 percent to 15 percent/22 percent) – this was one of the most important and unprecedented tax measures adopted by the government in the recent past. These steps looked at in totality create a better tax environment in the country and do give rise to new structuring opportunities which one should evaluate in light of changing tax laws including substance requirements.

The views of the author(s) in this article are personal and do not constitute legal / professional advice of Khaitan & Co.

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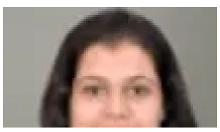

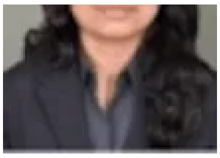

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