Government's Support To An Ailing Economy

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While the world battles forest fires and virus outbreaks, our economy has been suffering from ailments of its own. India's GDP growth took a sharp plunge in Q2 of this fiscal to come in at 4.5 per cent, with many experts voicing concerns about a prolonged slowdown period.

As the Finance Minister Nirmala Sitharaman (FM) rose in Parliament today to deliver her second budget speech, all of India looked to her with hope, expecting some big bang measures that would revive the "animal spirits" of the economy.

While not everyone's expectations were met, the FM did propose certain big-ticket changes to the income-tax law as a step towards completing the mammoth task of boosting the economy. Here are the game-changers from the Union Budget 2020.

1. Removal of Dividend Distribution Tax (DDT): DDT is payable by a company at the rate of 20 per cent at the time of declaration/ distribution of dividends to its shareholders. The dividends, so received, is exempt in the hands of the shareholders (except in case of certain resident non-corporate taxpayers). The FM today proposed to roll back this tax. But, notably, the dividend income would ultimately be taxable in the hands of the shareholders as per the applicable income-tax or slab tax rate. Essentially, the tax incidence has been shifted from the company to its shareholders. Further, the company distributing the dividend would need to deduct tax at the rate of 10 per cent if the shareholder is a resident and in case of non-resident shareholders at the rate of 20 per cent (plus applicable surcharge and cess), subject to relief under the tax treaty. Under the DDT era, for a foreign shareholder, DDT cost incurred by the distributing company was resulting in a sunk cost as the shareholder was usually unable to claim credit against the DDT in its home country. This shift of DDT to classical withholding tax-based system, will be commended by foreign shareholders.

For resident corporates, to mitigate any cascading effect of dividends there is a relief provided whereby in a multi layered structure, dividends would be taxed only once.

Interestingly, the shareholders may be able to offset interest expenses which were otherwise not allowed, subject to a cap of 20% of their dividend income.

While rolling back DDT would enable corporate India to have more funds for expansion activities and attract investment, given the tax incidence on the shareholders, one would need to explore the benefits of adopting different repatriation modes such as buyback, dividend etc or different forms of doing business (such as LLPs).

2. Sovereign funds income exempt from tax: The Government has proposed to not levy tax on investment income in the nature of interest, long term capital gains and dividends arising to a 'sovereign wealth fund' or wholly owned subsidiary of the Abu Dhabi Investment Authority (ADIA), by virtue of investment in certain Indian infrastructure companies, subject to certain conditions. It would be interesting to note that the existing India-UAE tax treaty did provide certain exemptions to ADIA, now extending to its wholly owned subsidiary, is a welcome move. Also, government owned funds, if it meets the test of 'sovereign wealth fund', can lead to gold rush for foreign owned sovereign funds to invest in India.

3. Postponement of taxation of ESOPs: Employees are taxed at the time when they exercise the options granted under an Employee Stock Option Plan (ESOP) and receive shares. This leads to a notional taxation in their hands and creates liquidity crunch as they are taxed upfront even though they have not realised any 'real' benefit. Perhaps, owing to this, many companies usually linked the exercise of options under ESOP with a liquidity event. Given that growth of start-ups, are inevitably hinged on talent and ESOPs are a tool for talent retention, the government has proposed postponement of ESOP taxation for employees of start-ups which would certainly provide a much-needed respite to them.

4. Stringent rules for determination of individual residency: Individual who is a citizen of India, would be deemed to be tax resident of India, if he is not liable to tax in any other country on account of his domicile, residence or other similar criteria. This will certainly have an adverse impact on the NRI community, and they would need to closely watch the developments in this regard to avoid any unintended Indian tax consequences.

5. Strengthening zero tolerance of tax harassment: In the budget speech, 'Vivad Se Vishwas' scheme has been proposed wherein a taxpayer is required to pay only the amount of the disputed taxes and is proposed to get complete waiver of interest and penalty provided, he pays the applicable taxes by 31 March 2020. Taxpayers in whose cases appeals are pending at any level can avail this scheme. This scheme would go a long way in reducing the tax harassment, one would hope that is implemented soon as it doesn't find its place in the fine print of the Finance Bill.

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