INDIA'S BUDGET 2019-20 – KEY HIGHLIGHTS

Introduction

India's Union Budget (the "**Budget**") was announced on July 5, 2019, and the Finance Bill, 2019 (the "**Finance Bill**") was tabled in Parliament. The Finance Bill will be discussed in Parliament before its enactment, and therefore, it is likely that the Finance Bill may be amended as a result of these discussions. Once enacted, unless specified otherwise, most of the income tax proposals in the Finance Bill will be effective from the financial year commencing on April 1, 2019. We have summarized below some of the key policy and income tax proposals made in the Budget.

Policy Proposals

- The Budget has announced a relaxation of the Foreign Direct Investment ("**FDI**") regime for aviation, media, insurance and single brand retail. The Budget does not specify the changes proposed, but states that the amendments will be discussed with the relevant stakeholders and enacted through changes to the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017.

- A regulatory road map will be implemented to make India a hub for aircraft financing and leasing activities.

- An action plan will be drawn up to deepen the market for long-term bonds, including corporate bond repos and credit default swaps, with a specific focus on the infrastructure sector.

- Foreign Portfolio Investors ("**FPI**") will be allowed to invest in listed debt securities issued by real estate investment trusts and infrastructure investment trusts.

- The existing Know Your Customer norms for FPIs will be rationalized to promote an investor-friendly environment. The Non-resident Indian ("**NRI**") portfolio investment scheme will be merged with the FPI scheme to simplify investment in Indian equities for NRIs.

- The regulatory authority and supervision of the Reserve Bank of India over non-banking financial companies will be strengthened.

- There will be a reduction in the net owned fund requirement from INR5,000 crore (approximately US$0.73 billion) to INR1,000 crore (approximately US$0.15 billion) for units of foreign reinsurance companies in the IFSC.

Tax Proposals

Corporate tax rate

The Finance Bill has proposed a tax rate of 25% on all Indian resident companies if their turnover or gross receipts is up to INR400 crore (approximately US$58.2 million) as against the earlier threshold of

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INR250 crore (approximate US$36.4 million). The lower corporate tax rate is in line with global trends and will cover 99.3% of all Indian companies.

Personal income tax

- In the case of an individual, a hindu undivided family, an association of persons or a body of individuals, whether incorporated or not, the Finance Bill has proposed an enhanced surcharge of 25% on taxable income exceeding INR2 crore (approximately US$0.29 million) up to INR5 crore (approximately US$0.73 million) and a surcharge of 37% on taxable all income exceeding INR5 crore (approximately US$0.73 million). Effectively, this will increase the tax rates for individuals, trusts (including funds that are set up as trusts) and other associations of persons in the income slab exceeding INR2 crore (approximately US$0.29 million) up to INR5 crore (approximately US$0.73 million) to 39% and for those in the highest income slab to 42.74%.

- The Finance Bill has proposed an additional income tax deduction of up to INR1.5 lakhs (approximately US$2,200) for loans taken by individuals from any financial institution for purchase of electric vehicles between April 1, 2019 and March 31, 2023.

- An additional income tax deduction up to INR1.5 lakhs (approximately US$2,200) will be provided for purchase of the first residential property, provided: (a) the loan is sanctioned between April 1, 2019 and March 31, 2020; and (b) the stamp duty value of the property does not exceed INR45 lakhs (approximately US$65,500).

Other tax considerations

Tax on buyback of shares

Previously, unlisted companies were alone liable for a buyback distribution tax. With effect from July 5, 2019, the Finance Bill has proposed to extend this obligation to listed companies as well. This will close an important avenue for listed companies to distribute excess cash to shareholders tax free.

Tax withholding on payments made by individuals to resident contractors and professionals

Currently, there is no obligation on an individual to withhold tax at source: (i) on payments made to a resident contractor or a professional service provider; or (ii) if the individual is carrying on a business or profession that is not subject to a tax audit requirement. The Finance Bill proposes to insert a new section 194M in the Income-tax Act, 1961 (the "**IT Act**") to provide for a tax withholding at the rate of 5% on the sum paid or credited in a year on account of contractual work or professional fees by an individual (who is not required to withhold tax at source under section 194C and 194J of the IT Act), if such sum exceeds INR50 lakhs(approximately US$0.073 million) in a year. From a compliance perspective, the individual will be allowed to deposit the withholding tax using his permanent account number and will not be required to separately obtain a tax deduction account number. This amendment will be effective from September 1, 2019.

Incentives for start-ups

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To facilitate the ease of doing business in the case of a closely held eligible start-up, the Finance Bill has proposed to amend section 79 of the IT Act so as to provide that any loss incurred in any year before the previous year can be carried forward and set off against the income of the previous year on the satisfaction of either of the following two (2) conditions: (a) if all the shareholders having 51% of the voting power (and who are beneficially owners of those shares) continue with the same shareholding pattern on the last day of the year or years in which the loss was incurred; or (b) the loss was incurred during the period of seven (7) years beginning from the year in which the company was incorporated.

The Finance Bill also proposes that start-ups will not be subjected to scrutiny in respect of valuations of share premium, if necessary declarations and filings are made. In addition, the Finance Bill also proposes to ensure that no scrutiny will be carried out by the tax assessing officer without obtaining the approval of his/her supervising officer. It is hoped that these changes will result in decreased scrutiny and harassment of entrepreneurs seeking to raise capital.

Tax on gifts made to persons outside India

Section 9 of the IT Act, *inter alia*, provides that non-residents are taxable in India if they have income that accrues or arises in India. Separately, section 56(2)(x) of the IT Act imposes a tax on a gift transaction (that could be money or property) in the hands of the donee except in certain circumstances. It has been reported that gifts are being made by Indian residents to persons outside India, which are treated as non-taxable on the basis that the income does not accrue or arise in India. In order to ensure that such gifts are brought to tax in India, the Finance Bill has proposed that, on or after July 5, 2019, any income earned or arising by virtue of any money paid, or as a result of the transfer of any property situated in India, by a person resident in India to a person outside India shall be deemed to accrue or arise in India. However, the existing exemptions on gifts to "relatives" living abroad shall continue. Where there is an applicable double taxation avoidance agreement, the beneficial provisions will continue to apply on such gift transactions.

Tax withholding at the time of purchase of immovable property

Section 194-IA of the IT Act relates to payment made on transfer of an immovable property (other than agricultural land) and levies a tax withholding of 1% on the amount of consideration paid or credited for the transfer of such property. The term "consideration for immovable property" has not been defined for the purposes of this section. Transactions involving a purchase of immovable property invariably involve payments for rights to access amenities (like club memberships, car parking, electricity and water facilities, maintenance services, etc.) in addition to the purchase consideration. Such payments are made by the buyer to the seller either under the sale agreement or under a different agreement. The Finance Bill proposes to define the term "consideration for immovable property" to include all charges in the nature of club membership fees, car parking fees, electricity and water facility fees, maintenance fees, advance fees, etc., which are incidental to the sale of the immovable property. Thus, the entire amount has to be considered when deducting the tax withholding amount. This amendment will be effective from September 1, 2019.

Mandating acceptance of payments through prescribed electronic modes

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In order to achieve a cashless economy, to reduce generation and circulation of black money and to promote a digital economy, the Finance Bill has proposed to add a new section 269SU in the IT Act that mandates every person who is carrying on a business to provide a facility for accepting payment through prescribed electronic modes, if his total sales, turnover or gross receipts of his business exceed INR50 crore (approximately US$7.28 million) during the immediately preceding previous year. Additionally, a new section 27IDB has been proposed in the IT Act, which provides that the failure to provide a facility for electronic payment shall attract a penalty of INR5,000 per day during which such failure continues unless the person proves that there were good and sufficient reasons for such failure. This amendment will be effective from November 1, 2019.

Mandatory filing of return of income by certain persons

Currently, a person, other than a company or a firm, is required to file a return of income only if his total income exceeds the maximum amount that is not chargeable to tax in India (INR250,000 or US$3,571 approximately), subject to certain exceptions. Thus, a person entering into high value transactions is not necessarily required to file a tax return if his income chargeable to tax does not exceed the foregoing threshold. However, as there are many individuals who enter into high value transactions but do not file tax returns, the Finance Bill has proposed that a person shall be mandatorily required to file his/her return, if during the previous year, he/she: (i) has deposited an amount or aggregate of the amounts exceeding INR1 crore (approximately US$0.15 million) in one or more current accounts maintained with a banking company or a co-operative bank; or (ii) has incurred an expenditure of an amount or aggregate amounts exceeding INR2 lakhs (approximately US$2,900) for himself or any other person for travel to a foreign country; or (iii) has incurred expenditure of an amount or aggregate amounts exceeding INR1 lac (approximately US$1,450) towards electricity consumption; or (iv) fulfils such other prescribed conditions as may be prescribed. This amendment will be effective from April 1, 2019.

Tax withholding on cash withdrawals to discourage cash transactions

In order to discourage cash transactions and move towards a cashless economy, the Finance Bill has proposed to insert a new section 194N in the IT Act to provide for levy of a 2% tax withholding on cash payments in excess of INR1 crore (approximately US$0.15 million) in aggregate made during the year, by a banking company, cooperative bank or a post office, to any person from an account maintained by such person. However, the Finance Bill has proposed to exempt payments made to certain recipients, such as the government, a banking company, a cooperative society engaged in carrying on the business of banking, post offices, banking correspondents and white label ATM operators, who are involved in the handling of substantial amounts of cash as a part of their business operations. This amendment will be effective from September 1, 2019.

Tax exemption on interest income earned by a non-resident subscriber of rupee denominated bonds

Under section 194LC of the IT Act, the interest income payable to a non-resident holder of long-term bonds, including infrastructure or rupee denominated bonds of a specified company, is subject to withholding tax at the rate of 5%. However, in order to incentivize low cost foreign borrowings through offshore rupee denominated bonds, the interest payable by an Indian company or a business trust to a

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non-resident, including a foreign company, in respect of such bonds issued outside India during the period from September 17, 2018 to March 31, 2019 will be exempt from the foregoing withholding tax. This amendment will be effective from April 1, 2019.

Incentives for Category II Alternative Investment Funds (AIFs)

Section 56 of the IT Act, *inter alia*, provides that where a private company receives any consideration for issue of shares from an Indian resident that exceeds the face value of such shares, the aggregate consideration that exceeds the fair market value of the shares will be charged to tax. A tax exemption exists only for Category I AIFs (e.g., venture capital or social impact funds), i.e., shares issued to a Category I AIF by a company for a premium, are not subject to the foregoing tax levy. The Finance Bill has proposed to extend this exemption to Category II AIFs as well. This amendment will be effective from April 1, 2019.

Pass through for losses in cases of Category I and Category II AIFs

Section 115UB of the IT Act, *inter alia*, provides for a pass through status to investors of all income other than business income (e.g., dividend or interest income) earned by a Category I or Category II AIF. However, a pass through of losses is not available under the existing regime, and losses have to be retained at the AIF level for carry forward or set off. In order to remove genuine difficulties faced by Category I and II AIFs, the Finance Bill has proposed the following:

- the business loss of the investment fund shall be allowed to be carried forward and be set-off, but shall not be passed on to the unit holder; and

- any loss (other than business loss) which is accumulated at the AIF level as on March 31, 2019, shall be deemed to be the loss of the unit holder. In this regard, the unit holder must have held the units for a period of twelve (12) months and should also be a record holder as on March 31, 2019. Such a loss can then be carried forward by the unit holder for the remaining period. The amendments will take effect from the April 1, 2019.

It is unclear how this will work. There can be cases where unit holders may not have held the units for a full twelve (12) month period.

Transfer pricing amendments

Section 92CE of the IT Act requires a tax payer who has entered into an international transaction subject to transfer pricing to make a secondary adjustment in certain cases. The purpose of these secondary adjustments is to reflect the actual distribution of profits between the two parties as per the primary adjustment determined under transfer pricing provisions, and thereby, eliminate any imbalance between the taxpayer's accounts and the actual profits. In an effort to make the secondary adjustment regime easier to implement, the Finance Bill has, *inter alia*, proposed to amend section 92CE of the IT Act in the following manner:

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- the requirement that interest (at the rates provided in Rule 10CB of the Income-tax Rules, 1962) shall be applicable on excess income not repatriated within the prescribed time limit has been further amended to provide the taxpayer with an option to pay additional income tax at the rate of 18% on such non-repatriated income.

- Section 92CE shall only be applicable where the primary adjustment has been determined by an advance pricing agreement entered into by the assessee under Section 92CC of the IT Act, and signed on or after April 1, 2017; however, no refund of taxes already paid till date shall be allowed.

<u>Prior to these amendments, one of the practical difficulties faced by stakeholders was repatriation of excess money from countries having restrictive foreign exchange regimes. The option of making a one-time payment of 18% additional income tax means that the taxpayer no longer has to worry about making year on year interest payments on excess money locked outside India. The 18% additional income tax may also be considered akin to a dividend distribution tax, which would typically have been applicable if the excess money had been directly transferred to the associated enterprise as dividend, instead of having arisen by way of adjustment</u>.

Our tax team is available to assist you or your clients on any clarifications or tax impact assessment.

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