Significant Proposals in Relation to Non-Residents

International taxation has never been as dynamic and emerging as it is now. There are global concerns over some of the prevailing international tax principles, framed decades back, not able to match with the speed and complexity of emerging businesses. Consequently, domestic tax laws and tax treaties that forms the basis for taxation of non-residents are evolving. There are several proposals under the Budget 2020 in respect of taxes on non-residents as applicable from 1st April 2020 (AY 2021-22) unless stated otherwise. Read on…

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Recently, Oraganisation for Economic Co-operation and Development (OECD) has proposed Multilateral Instrument (MLI) to bring out the change in tax treaties in efficient and quick manner. It has been signed by more than 90 countries. In addition to change in tax treaties countries are making change in domestic taxation as well to fulfill the gap between existing international taxation system and new forms of business to enable the countries to have their fair share of taxes. At the same time, there is competition among nations to attract foreign investment at maximum for development and growth of economy. Thus, where existing international tax principles are required to be strengthened on one hand, there should be policies to provide friendly and stable business environment on the other. India has recognised this need of the hour as is evident from the Budget 2020 presented by Hon'ble Finance Minister in the Parliament on 1st February 2020.

Significant Proposals

1. ***Safe harbor rules and Advance pricing agreement for determination of attribution of profit to business***

   Budget 2020 has made amendment to Section 92CB and Section 92CC of the Act to provide for determination of income attributable to business connection/ permanent establishment (PE) through Safe harbor rules and advance pricing agreement, respectively.

   Attribution of income has always been a litigative area lacking uniformity primarily due to Rule 10. Rule 10 grants wide and open powers to Assessing Officer to allocate income as it deems fit or considerable reasonable. The framing of Rule 10 has led to attribution profit in ad hoc manner by various Appellate Authorities and thereby creates uncertainty in the minds of foreign investors. Availability of Safe Harbor Rules (SHR) would surely provide certainty, subject to the approach that would be prescribed under safe harbor rules. Further, under Advance Pricing Agreement (APA) mechanism, allocation of income may be made through methods prescribed for determination of arm length price (ALP) under section 92C of the Act or method(s) as may be prescribed via supporting Rules.

2. ***Inclusion of income from advertisement and sale of data under income attributable to business connection in India***

   Taxing Digital economy is one of the top concern worldwide and countries are coming up with different forms of taxes to get their share of tax. Focus has shifted from physical

presence or value addition for taxing nexus to market presence over time because of the way technology is used in generating revenue. Though, OECD is working towards achieving consensus of nations to develop a common tax to tax digitalised world, countries have started adopting unilateral measures to protect their tax base. In same lines, India has also proposed to amend the source Rule by inserting Explanation 3A to Section 9 of the Act.

"Explanation 3A. –For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in *Explanation 1, shall include income from–*

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.";

(iv) after Explanation 3A as so inserted, the following proviso shall be inserted with effect from the 1st day of April, 2022, namely:

"Provided that the provisions contained in this Explanation shall also apply to the income attributable to the transactions or activities referred to in Explanation 2A."

Clause (i), clause (ii) and clause (iii) aims to tax the specified income earned by non residents who have PE in India, in addition to income that was attributable in pre budget provision. In pre budget provision, income arising from functions performed, assets utilised in India are only attributed to PE. It is now proposed to attribute revenue arising from following activities also to PE whether performed in or outside India:

- from sale of advertisement to customer residing in India or customers using internet protocol located in India
- from sale of data collected from a person who resides in India or uses internet protocol address located in India.
- From sale of goods and services using data collected as above.

This amendment aims to tax the revenue earned by non-resident through digital marketing, sale of data collected from India and also revenue from consequent sale of goods and services using such data. However, such business does not constitute PE under existing definition in DTAA in the absence of any physical activity/ form in India. Thus, proposed provision would not be of much effect unless definition of PE is amended in tax treaties.

Be as it may, non-residents having modest physical presence like the ones acting as market support service provider or warehouse in India, would be affected and proposal may lead to increase in tax base of such non-residents. Since, many tax treaties of India would be modified from 1st April 2020 because India has signed and ratified the MLI. This would have effect of lowering down of threshold of PE and change in application of preparatory and auxiliary exemption. Combined effect of MLI and proposed provision by Finance Bill would bring the revenue from sale by non-resident also under the net, who claimed to have minimal functions in India as of now and compensated on cost plus model.

3. ***Amendment in Section 94B***

Finance Act, 2017 has introduced Section 94B in the Act that provides for disallowance of interest paid by Indian company in excess of 30% of Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), if loan is availed from non-resident associated enterprise, in computation of taxable income of such Company. Budget 2020 has proposed an amendment to the Section through insertion of Section (1A).

Section 92A of the Act defines associated enterprise and as per one of the conditions given under section 92A(2) of the Act, when loan granted by one enterprise constitutes 50% or more of total assets of other enterprise, both the entities qualifies as associated enterprises. Further definition of enterprise includes Permanent Establishment under section 92F of the Act. Thus if branch of any foreign bank has granted loan in excess of 50% of book value of asset, it would constitute associated enterprise under section 92A. This would trigger Section 94B and interest paid by Company on loan taken from such branch would be disallowed in excess of 30% of EBITDA of the Company. Insertion of Section (1A) aims to exclude interest paid in respect of a debt issued by a permanent establishment of a non-resident in India and engaged in business of banking and insurance.

It is a welcome move to bring the foreign banks operating as subsidiary or as a branch at equal footing. Earlier, loan availed from subsidiary of foreign branch would not have attracted Section 94B of the Act while loan availed from branch of foreign bank may be disallowed. With proposed amendment, branch of foreign banks/NBFC would have major relaxation.

4. ***Amendment in Dispute Resolution Panel (DRP)***

Clause 70 of the Finance Bill

seeks to amend Section 144C of the Act relating to reference to dispute resolution panel (DRP). Currently, objection can be filed before DRP if there is variation in the returned income or loss of the taxpayer under Draft order issued by the Assessing officer (AO). It has now been proposed to make DRP route available to taxpayers even in cases where there is no variation in returned income/loss but otherwise prejudicial to the interest of the taxpayer. For example change in tax rate of taxpayer, tax credit.

Further, specified taxpayers are only allowed to file objection before DRP in current provision. The specified taxpayers are Foreign Company and any person in whose case transfer pricing adjustment have been made. Non-resident other than company like partnership firm, LLP, etc. were not eligible to adopt DRP route if adjustment is other than for transfer pricing issues. Now, it has now been proposed to include all non-residents under the ambit of specified taxpayer. It is applicable from 1st April 2020 and thus any adjustment made in the hands of any non-resident after such date can now be challenged before DRP. AO would therefore issue the draft assessment order first for adjustment made in the hands of non-resident prejudicial to its interest.

5. ***Aligning purpose of entering into Double Taxation Avoidance Agreements (DTAA) with Multilateral Instrument (MLI)***

MLI is an instrument designed by OECD with G20 nations to enable modification in tax treaties under the project to tackle base erosion and profit shifting (BEPS). India is also signatory to MLI and changes proposed under it are applicable on many tax treaties with India w.e.f April 1, 2020. One of the change proposed by MLI is to modify the preamble of tax treaties that define the scope and purpose of it. Currently, preamble does not prescribe prevention of non double taxation or tax evasion or treaty shopping as the purpose of entering into tax treaty. Purpose of all treaties is either prevention of fiscal evasion, double taxation or promotion of trade and investment. Supreme Court has also upheld in past that when prevention of treaty shopping is not defined as specific purpose, benefit of treaty cannot be denied if transaction is otherwise satisfying the purpose of treaty even if it is for tax evasion or treaty shopping.

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Article 6 of MLI would modify the Preamble of tax treaties now as :

"Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),"

Under the existing Act, Section 90 empowers Central Government to enter into tax treaty with following purpose:

- Granting tax credit in case of double taxation,
- Avoidance of double taxation,
- Exchange of information,
- Recovery of tax.

Since avoidance of non-taxation, fiscal evasion or treaty shopping are not listed in Section 90 of the Act, it may create legal challenge to amend tax treaties outside the scope of Section 90 and therefore it has been proposed to amend clause (b) of sub-section (1) of Section 90 of the Income Tax Act (herein after "the Act") so as to provide that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for, *inter alia,* the avoidance of double taxation of income under the Act and under the corresponding law in force in that country or specified territory, as the case may be, without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of any other country or territory).

Similar amendment has been proposed in Section 90A of the Act that empowers specified association in India to enter into an agreement with any specified association in the specified territory outside India after adoption by Central Government.

6. ***Exemption in respect of certain income of wholly owned subsidiary of Abu Dhabi Investment Authority and Sovereign Wealth Fund***

One of the most significant proposals in Budget 2020 to boost infrastructure sector in India is exempting income earned by Sovereign Wealth Funds in India including Abu Dhabi Investment Authority

(SWF). A new Section 10(23FE) has been introduced which will exempt income of SWF in the nature of dividend, interest or long term capital gains arising from an investment made in India on or before 31st March 2024.

Such exemption would be available if the investment is made in infrastructure companies or enterprises and investment is held for a minimum period of three years. India requires enormous money for all round infrastructural growth, this 100% tax exemption by India is expected to make India a darling country for investment within SWFs.

7. ***Modification in conditions for offshore funds' exemption from "business connection"***

Another modification which has been proposed to boost investments in India is relaxing conditions to qualify as business connection under section 9A of the Act. Section 9A of the Act is like a safe harbour provisions whereby an "eligible investment fund" is not regarded as having a "business connection" in India merely because an "eligible fund manager" undertaking fund management activities on its behalf is located in India until certain conditions listed in the said Section are satisfied. Currently Offshore Funds' are allowed to invest only up to 5% of the total fund corpus, now via Budget 2020, it has been proposed to allow Offshore Funds' upto ₹ 25 crore over three years from the start of the fund without 5% barrier.

Another proposal, which is more in the nature of rationalisation, is if the fund has been established or incorporated in the previous year, the condition of monthly average of the corpus of the fund to be at ₹ 100 crore shall be fulfilled within twelve months from the last day of the month of its establishment or incorporation.

8. ***Exempting non-resident from filing of Income-tax return in certain conditions***

Currently, Section 115A of the Act exempts non-residents from filing annual income-tax return, if the total income comprises only of dividend or interest, and TDS on such income has been deducted as required under the Chapter XVII –B of the Income-tax Act, 1961.

Now, it has been proposed to extend this benefit to those taxpayers whose income comprises only of royalty or fees for technical services (FTS).

Above proposal is a welcome move from the CBDT, however, the above benefit comes with a rider that the tax should have been deducted as per the provisions of Section 115A. Apparently, it seems wherein TDS is deducted at a lower rate (or nil) because of treaty benefit, in comparison to rate prescribed under section 115A, non-resident would be required to file Annual Income Tax Return in India, even if its income only comprises of Royalty and FTS.

9. ***Modification of residency provisions***

- *Reducing short exemption stay:* On many occasions it has been found that non-resident Indians visit India, stay here for good amount of period and manages their economic activity from India without paying taxes on their global income. In order to check such abuse of beneficial provision given in clause (b) of Explanation 1 of Section 6 of the Act, it has been proposed to decrease the period of 182 days to 120 days. As a result, wherein Indian citizen or person of Indian origin, who is also a non resident, comes on a visit to India for more than 120 days, he would now become Resident starting April 2020.
- *Taxing stateless residents*: In addition to above, another anti-abusive amendment proposed in Budget 2020 is to tax such Indian citizens who are not tax residents of any country. As per Memorandum explaining the finance bill, there are certain individuals, typically high net worth individuals, arranges their affairs in such a way that they do not become liable to tax in any of the Country. Such arrangements, contributes towards disequilibrium in the society. In order to catch such individuals, a new sub-section (1A) has been added in Section 6 of the Act, according to which an Indian citizen who is not liable to tax in any other country or territory shall be deemed to be resident in India.

  Memorandum explaining finance bill explains the rationale for amendment is to tax the stateless high net worth individuals who arrange their affairs in such a way that they escape the tax liability around the world. However, framing of provision created concern among genuine taxpayers who are based out in country with no taxes like UAE. To clarify, Government issued the press release very next day stating, *"purpose not intended to include in tax net those Indian citizens who are bonafide workers in other countries. In some*

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section of the media the new provision is being interpreted to create an impression that those Indians who are bonafide workers in other countries, including in Middle East, and who are not liable to tax in these countries will be taxed in India on the income that they have earned there. This interpretation is not correct. In order to avoid any misinterpretation, it is clarified that in case of an Indian citizen who becomes deemed resident of India under this proposed provision, income earned outside India by him shall not be taxed in India unless it is derived from an Indian business or profession. Necessary clarification, if required, shall be incorporated in the relevant provision of the law."

Clarification issued by government states that income of non-resident shall be taxed only if derived from an Indian Business or profession. This provision is same as it existed pre budget, thus purpose of proposed provision creates confusion. It is expected that some more clarification will come in the due course.

- *Relaxing condition to qualify as "Not Ordinary Resident"* - Currently, the Act lays two conditions to qualify as "Not Ordinary Resident", (a) Person is Non Resident in any 9 out of 10 preceding financial years, and (b) the aggregate stay in India during 7 preceding financial years is 729 days or less. Keeping in mind above two changes in Section 6 of the Act, because of which certain individuals may qualify as residents, it seems in order to avoid hardship condition to qualify as "Not Ordinary Resident" has been relaxed.

10. ***Removing dividend distribution tax (DDT) and moving to classical system of taxing dividend in the hands of shareholders/unit holders***

Budget 2020 has proposed that the provisions of Section 115-O the Act shall not be applicable on the dividend distributed after 31st March 2020 i.e., from FY 2020-21 onwards, domestic companies are not required to deduct and pay dividend distribution tax, instead dividend will become taxable in the hands of the shareholder. This sifting of taxability from the hands of company to the shareholder creates a beneficial scenario for non-resident shareholders.

In most of the tax treaties entered by India with other countries, the source country, i.e., India is allowed to tax dividend. However, tax rate in tax treaties is generally within the range of 5 -15%. So now wherein non-resident is able to claim treaty benefit, the effective tax rate would drop from 20.35% to 5-15%. For a non-resident this proposal is more in the nature of tax incentive instead of "rationalisation of provisions of the Act". There is, however, modification in tax treaties in respect of condition to make beneficial rate of tax available to receiver of dividend, through MLI – Article 8. This interplay of MLI with domestic provision needs to be analysed for determining the taxability in the hands of non-resident investor.

11. ***Applicability of Significant Economic Presence (SEP) deferred***

Finance Act, 2018, inserted an explanation 2A to Section 9(1)(i) to clarify that SEP of an Non-resident in India will constitute a "business connection" in India. However, since discussion on this issue is still going on in G20-OECD BEPS project and G20-OECD report is expected by the end of December 2020, the Finance Bill, 2020 has proposed to defer the applicability of SEP to assessment year starting from 2022-23.

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12. ***Change in the due date of filing Form No. 3CEB***

It has been proposed to change the due date filing of Form 3CEB from November 30th to October 31st. Thus for the financial year 2019-20, the due date of filing Form No. 3CEB is proposed to be 31st October 2020. The Memorandum explaining the Finance Bill, states that aforesaid amendment is primarily proposed to enable pre-filing of returns and hence, various reports such as accountant's report in Form no. 3CEB, tax audit report in Form no. 3CED, etc. shall be required to be filed by 31st October.

13. ***Levy of Withholding taxes on e-commerce transactions***

Section 194-O the Act is proposed to be inserted to levy withholding tax on e-commerce transactions w.e.f. April 1, 2020 @ 1%. It would be levied on sale of good or services by e-commerce participant using e-commerce platform operated, owned or managed by e-commerce operator. Apparently, it seems that this Section would also be applicable on non-residents e-commerce operators. ■