ANALYSIS

Budget 2020 - Key Tax Proposals

17 February 2020

This analysis covers:

The Finance Minister unveiled the Finance Bill, 2020 (**Budget/Bill**) for the financial year 2020-21 on 1 February 2020. Contrary to expectations of a broad fiscal stimulus of higher expenditure and lower taxes, the Budget surprised many for its focus on fiscal discipline. The tax proposals, barring a few impacting foreign investors, are largely tepid. Further, the Budget proposes an optional concessional tax regime for individual taxpayers who agree to forego various exemptions and deductions.

Earlier in the year, the government had boldly cut corporate tax rates to 22% for older companies and 15% for new manufacturing companies. The 15% tax rate is proposed to be extended to power generating companies as well. However, the emphasis of the Budget appears to be on attracting foreign investment – both equity and debt. For instance, the abolition of dividend distribution tax coupled with nil/reduced taxation on interest earned by foreign lenders/funds is likely to yield favourable results as far as foreign investment is concerned.

While the Finance Bill 2020 seeks to enhance effectiveness, transparency and accountability of tax administration, the proposals (barring a few) are largely tepid. While there is likely to be some respite for taxpayers with the introduction of amnesty schemes to settle litigation, it could also open new areas for litigation.

1 Direct Tax Proposals

1.1 Amendments Benefiting Foreign Investors

1.1.1 Deletion of dividend distribution tax (DDT)

Under the present tax regime, in addition to income-tax chargeable on the total income of domestic companies and mutual funds, any amount declared, distributed or paid by way of dividends is subject to DDT at an effective rate of 20.56%. Such dividend is then exempt in the hands of shareholders (or unitholders).

The Bill proposes to abolish DDT and instead tax dividends (or income from units) in the hands of shareholders (or unit holders). In other words, dividend income will be included in the total income of the shareholders/unit holders. The Bill also proposes that the deduction for expense in respect of dividend income would be restricted to 20% of the dividend or income from units, and such expense would be in the nature of interest only.

Other significant changes include:

a. Currently, a specific exemption for DDT is provided to special purpose vehicles in respect of dividends paid to a business trust (subject to certain conditions). Dividends paid by a business trust to unit holders are also exempt from tax. The Bill proposes that dividends received by a business trust from a special purpose vehicle would continue to be exempt. However, dividend income distributed by a business trust to a unit holder would be taxed in the hands of a unit holder.

b. The Bill proposes to insert a new Section 80M to remove the cascading effect of tax when dividend is received by a domestic company from another domestic company, and thereafter the recipient company also declares dividends. However, this would be subject to fulfilment of prescribed conditions. Further, the cascading effect of a domestic company's offshore investment has not been removed.

Amendments have also been proposed to withholding tax provisions. Domestic companies, business trusts and mutual funds would be required to withhold income tax on dividend income at the specified rates. Based on the wording of the law, it appears that withholding tax would apply to payment of dividend by a special purpose vehicle to a business trust even though such dividend income would be tax exempt in the hands of the business trust.This will however create an anomaly as such dividend income would be tax exempt in the hands of the business trust, as discussed above.

This amendment benefits multinational companies and foreign investors as this would improve the return on equity in Indian companies. Foreign investors were unhappy with the current DDT regime, particularly due to non-availability of DDT credit and concessional DDT rates (which vary between 5% to 15% in tax treaties), which led to multiple tax incidence. However, the change may have an adverse impact on domestic investors and promoters of Indian private-sector companies, who could end up paying additional tax on the same dividend income. For instance, promoters who are taxed at the highest rate could end up paying as much as 42.7% on the dividend they receive. This might result in alternative ways to repay shareholders such as buybacks.

1.1.2 Exemption for certain income of Sovereign Wealth Funds and wholly owned subsidiary of Abu Dhabi Investment Authority (ADIA)

In order to provide a boost to the infrastructure sector, the Bill proposes to introduce an exemption for income relating to investments made by sovereign wealth funds (that satisfy prescribed conditions) and wholly-owned subsidiaries of ADIA, in an enterprise carrying on the business of developing, or operating and maintaining, or developing, operating or maintaining specified infrastructure facilities. Specifically, dividend income, interest or long-term capital gains arising from such an investment would be tax exempt in the hands of the specified investor entities.

In order to be eligible for exemption, the investment is required to be made on or before 31 March 2024 and held for at least 3 years.

1.1.3 Extension of the concessional tax rate for Foreign Investors/Investments in long-term and rupee denominated bonds

Currently, a withholding tax at a concessional rate of 5% is applicable to interest paid by an Indian company or a business trust to a non-resident, for approved borrowings (between 1 July 2012 to 1 July 2020) in foreign currency from sources outside India (under a loan agreement or on issue of long-term infrastructure bonds). The concessional rate of 5% is also applicable for borrowings by a specified company or a business trust from a source outside India through issuance of rupee denominated bonds before 1 July 2020.

In order to attract fresh foreign investment in infrastructure and stimulate the economy with external commercial borrowings, the Bill proposes to extend the period of concessional withholding tax rate from 1 July 2020 to 1 July 2023.

a. **Further reduction of withholding tax rate to 4%**

The Bill proposes a further rate reduction to 4% for withholding tax on the interest payable to a non-resident, for borrowings in foreign currency from a source outside India, through the issuance of any long term bond or RDB (on or after 1 April 2020 but before 1 July 2023), which is listed on a recognised stock exchange located in any International Financial Services Centre.

1.1.4 Extension of eligible period of concessional tax rate for investments by Foreign Institutional Investors (FII) in debt instruments

Currently, a lower withholding tax rate of 5% is applicable for interest payable at any time on or after 1 June 2013 but before 1 July 2020 for investments by FIIs and Qualified Foreign Investors (**QFIs**) in Government securities and rupee-denominated corporate bonds.

In order to attract fresh investments from FIIs, the Bill proposes to extend the concessional rate of 5% for withholding tax from 1 July 2020 to 1 July 2023.

The Bill also proposes to extend the concessional withholding tax rate to interest payments on municipal bonds, as Foreign Portfolio Investors (**FPIs**) have recently been permitted by the Securities and Exchange Board of India (**SEBI**) and the Reserve Bank of India (**RBI**) to invest in such bonds.

1.1.5 Modification in conditions for exemption from 'business connection' for Foreign Investors/Funds

Currently, fund management activity carried out through an eligible fund manager acting on behalf of an eligible investment fund does not constitute business connection in India for the fund. Further, such eligible investment fund is not considered an Indian tax resident merely because the eligible fund manager undertaking fund management activities is located in India.

However, this benefit is available subject to the fulfilment of certain conditions. One such condition, which relates to the eligibility of the fund, is that the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India should not exceed 5% of the corpus of the fund. This condition is difficult to comply with because eligible fund managers, who are Indian tax residents, are required to demonstrate that they have '*skin in the game*' to attract investment. Accordingly, the Bill proposes that the contribution of the eligible fund manager of upto INR 250 million during first three years will be excluded from the calculation of the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India.

Another condition relating to the eligibility of the fund is that the monthly average of the corpus of the fund should not be less than INR 1 billion, except where the fund has been established in the same financial year as being assessed. In such a case, this condition is required to be fulfilled at the end of a period of six months from the last day of the month of its establishment, or at the end of such financial year, whichever is later. Therefore, there is a disparity in the period available for fulfilling this condition in the year of establishment, depending upon when the fund is established in the given financial year. A fund set up in the latter half of the financial year has a shorter period of time to comply with this condition as compared to a fund set up in the first half of the financial year. Accordingly, to remove this disparity, it is proposed that if the fund has been established in the financial year being assessed, the condition relating to monthly average of the corpus of the fund should be fulfilled within 12 months from the last day of the month of its establishment.

These amendments will apply in relation to financial year 2019-20 and subsequent years.

1.1.6 Exclusion of permanent establishments (PE) of foreign banks from the ambit of thin capitalisation provisions

Currently, the deductible interest or similar expenses exceeding INR 10 million of an Indian company, or a PE of a foreign company, paid to the associated enterprises (**AE**) is restricted to 30% of its earnings before interest, taxes, depreciation and amortisation or interest paid.

However, as per the existing provisions of the (Indian) Income Tax Act, 1961 (**ITA**), a branch of a foreign company in India is deemed to be a non-resident in India. Further, the definition of AE deems two enterprises to be AEs if, during the financial year, a loan advanced by one enterprise to the other enterprise is equivalent to 50% or more of the book value of the total assets of the enterprise taking the loan. Therefore, the interest payable for a loan from the branch of a foreign bank may attract provisions of interest limitation. Considering representations made by taxpayers to this effect, the Bill proposes to carve out the interest paid for a loan by a lender which is a PE of a non-resident person engaged in banking in India.

1.1.7 Exemption from filing returns for non-residents

Currently, there is an exemption from filing tax returns in India for a non-resident whose total income consists of certain dividend or interest income (as provided under the ITA), if tax is deducted at source at the applicable rate on such income.

The Bill proposes to extend this exemption to income earned by a non-resident as royalty or fees for technical services which is not effectively connected with a PE in India. However, non-residents who rely on treaties for lower withholding tax rate cannot avail this exemption.

This amendment will apply in relation to returns to be filed for financial year 2019-20 and subsequent years.

1.1.8 Modification of the definition of 'business trust' to include private unlisted InvITs

Currently, the term 'business trust' means a trust registered as an infrastructure investment trust (**InvIT**) or a real estate investment trust (**ReIT**) under the relevant SEBI regulations and whose units are required to be listed on a recognised stock exchange. Through amendments in April 2019 SEBI removed the requirement for units of an InvIT to be listed on a stock exchange.

In order to provide the same tax treatment to private unlisted units of InvITs, such as that provided to public listed InvITs, the Bill proposes to remove the requirement of listing the units of the business trust on a recognised stock exchange from the definition of 'business trust'.

1.2 Aligning Domestic Law with OECD's Base Erosion and Profit Shifting (BEPS) Project Recommendations

1.2.1 Amendments to provisions on accrual of income in India

a. Deferment of Significant Economic Presence (SEP) proposal

The Finance Act, 2018 clarified that SEP of a non-resident in India will constitute '*business connection*' in India. SEP, for this purpose, is defined as:

i. transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the payments for these transactions exceed a prescribed amount; or

ii. systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

The Bill proposes to defer the applicability of SEP to income arising in financial year 2021-22 and subsequent years, because SEP is still being discussed in the G20-OECD's BEPS project (as a result of which the threshold for the aggregate amount of payments arising from the specified transactions and for the number of users have not been notified in the Income Tax Rules, 1962 till now).

b. Extension of source rule to cover income from advertisement that targets Indian customers

The Bill has proposed that income attributable to operations carried out in India will include income from: (i) advertisement which targets a customer residing in India or a customer who accesses the advertisement through IP address located in India; (ii) sale of data collected from a person residing in India or from a person who uses IP address located in India; and (iii) sale of goods or services using data collected from a person residing in India or from a person who uses IP address located in India.

This amendment has been proposed to clarify that income from advertisement that targets Indian customers or income from sale of data collected from India or income from sale of goods and services using such data collected from India, is to be accounted for in the Indian revenue.

This amendment will apply to income arising in financial year 2020-21 and subsequent years.

However, when the income is attributable to operations in India due to the entity having an SEP, for such income related to the SEP, these amendments will apply in relation to the financial year 2021-22 and subsequent years when the SEP provisions discussed in the point above become applicable.

c. Rationalisation of the definition of royalty

Currently, the definition of royalty does not include consideration for the sale, distribution or exhibition of cinematographic films. Due to this, such royalty is not taxable in India even if the relevant tax treaty gives India the right to tax such royalty. The Bill proposes to amend the definition of royalty to include consideration for the sale, distribution or exhibition of cinematographic films.

1.2.2 Aligning the intent of tax treaties with the Multilateral Instrument (MLI)

The Central Government is empowered under the ITA to enter into tax treaties with other countries and adopt and implement an agreement between any specified associations of India and another country.

India has signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (**MLI**) which is effective for India on 1 October 2019 and its provisions will be applicable from financial year 2020-21 onwards. The MLI is applied alongside existing tax treaties and seeks to curb revenue loss through treaty abuse and base erosion and profit shifting strategies. Article 6 of the MLI provides that tax treaties intend to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance. Such opportunities include treaty-shopping arrangements aimed at obtaining relief under tax treaties for the indirect benefit of a resident of a third country.

In order to align the ITA with Article 6 of the MLI, the Bill proposes to amend the ITA to empower the Central Government to enter into tax treaties with other countries without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.

1.3 Amendments to Withholding Tax Provisions

1.3.1 Tax Deducted at Source (TDS) on e-commerce transactions

The Bill proposes to levy 1% TDS, by requiring e-commerce operators to deduct tax at the time of payment to its e-commerce participant, or at the time of credit of the amount of sale / service to the account of the e-commerce participant, whichever is earlier. However, if the total amount of remittance is upto INR 500,000 and the e-commerce participant has provided its Permanent Account Number or Aadhaar number to the e-commerce operator, TDS will not be applicable.

1.3.2 Reduction in rate of withholding tax on fees for technical services

Section 194J of the ITA provides that any person (not being an individual or a Hindu Undivided Family (**HUF**), who has to pay any fees for professional services, or fees for technical services, or any remuneration or fees or commission, or royalty or any sum referred to in Section 28(va) to a resident will deduct 10% of the amount as income-tax. Further, Section 194C of the ITA provides that any person responsible for paying any sum to a resident for carrying out any work (including supply of labor for carrying out any work) under a contract will deduct an amount equal to 1% in case the payment is made to an individual or a HUF and 2% in other cases.

There is substantial litigation on the issue of short deduction of tax for these sections – specifically, taxpayers withhold tax under section 194C, while tax officers claim that tax should have been withheld under section 194J. Therefore, to reduce litigation, the Bill proposes to reduce the withholding tax rate in section 194J in case of fees for technical services to 2% from the existing rate of 10%. The withholding tax rate in other cases under Section 194J (such as professional services and royalty) would remain 10%.

1.3.3 Amendment to the definition of 'work'

Section 194C provides for tax deduction at source for sums paid to a resident for carrying out any work under a contract. The definition of 'work' includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. However, it excludes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person other than such customer.

According to the Bill, taxpayers have been misusing this provision by getting the contract manufacturer to procure the raw material supplied through its related parties as a result of which a substantial amount of income escapes taxation. Therefore, to plug this leakage, the Bill proposes to amend the definition of 'work' to provide that, in a contract manufacturing scenario, raw material provided by the assessee or its associate will be included within the purview of the definition of 'work'.

1.4 Concessional Tax Rates for Electricity Generating Companies

The government introduced concessional tax rates in September 2019 for domestic companies, if they did not avail of certain specified deductions available under Chapter VI-A (except section 80JJAA).

The Bill proposes to provide the benefit of concessional tax rate to domestic companies engaged in the business of generation of electricity, which otherwise may not qualify as a manufacturer or producer of an article or thing.

This amendment will apply in relation to the financial year 2019-20 and subsequent years.

1.5 Incentivising Start-Ups

1.5.1 Rationalisation of provisions applicable to start-ups

Currently, a deduction of 100% of the profits and gains derived from an eligible business by an eligible start-up for 3 consecutive assessment years out of 7, at the option of the assessee is allowed. This is subject to the conditions that: (i) the eligible start-up is incorporated on or after 1 April 2016 but before 1 April 2021, and (ii) the total turnover of its business does not exceed INR 250 million.

In order to provide an impetus to start-ups, the Bill proposes to provide 100% deduction of the profits and gains to eligible start-ups for a period of 3 consecutive assessment years out of 10. Further, the deduction will be available if the total turnover of the business does not exceed INR 1 billion in any of the financial years beginning with the year of incorporation.

1.5.2 Deferring taxation for income from Employee Stock Option Plan (ESOP) of start-ups

Currently, the taxation of ESOPs is split into two parts - *one*, tax on perquisite as income from salary at the time of exercising the option and *two*, tax on income from capital gain at the time of sale. The tax on perquisite income is required to be paid at the time of exercising the option (i.e. before the liquidity event for the employee) which may lead to cash flow issues at such point of time.

Accordingly, to resolve such cash flow issues for employees of eligible start-ups, the Bill proposes to defer the taxation of the perquisite income. The eligible start-up employer would be liable to withhold tax on the value of perquisite within 14 days:

a. after the expiry of 48 months from the end of the relevant assessment year; or

b. from the date of the sale of such specified security or sweat equity share by the taxpayer; or

c. from the date on which the taxpayer ceases to be the employee of the start-up;

whichever is the earliest.

Tax would be withheld on the basis of rates in force for the financial year in which the specified security or sweat equity share is allotted or transferred.

1.6 Improving Effectiveness of Tax Administration

1.6.1 Provision for e-appeal and e-penalty

Currently, appeals can be filed before the Commissioner of Income Tax (Appeals) in electronic mode. However, the process after filing of appeal is neither electronic nor faceless. In accordance with the e-assessment scheme, the Bill empowers the Central Government to notify e-appeal scheme and e-penalty scheme to eliminate interface between the officer and the appellant in the course of appellate and penalty proceedings.

1.6.2 One-time dispute settlement cum amnesty scheme – 'Vivad Se Vishwas' Scheme

Similar to the *Sabka Vishwas* Scheme, 2019 (which was brought in as a dispute resolution-cum-amnesty scheme for settling pending disputes of service tax and central excise), the Government has proposed the introduction of a similar scheme to reduce direct tax litigation.

Under the proposed '*Vivad Se Vishwas*' scheme, a taxpayer would be required to pay only the amount of the disputed taxes and will get complete waiver of interest and penalty if it pays the disputed tax amount by 31 March 2020. Those who avail this scheme after 31 March 2020 will have to pay an additional amount. As per the Direct Tax Vivad se Vishwas Bill, 2020, the end date of the scheme is yet to be notified. Importantly, taxpayers in whose cases appeals are pending at any level can benefit from this scheme.

1.7 Amendment to the Powers of the ITAT to Grant Stay of Demand

The Bill proposes to curtail the powers of the Income Tax Appellate Tribunal (**ITAT**) by removing its exercise of discretion in granting stay and providing that stay may granted subject to the condition that the assessee deposits not less than 20% of the tax demand (including tax, interest, penalty and other sums payable under the ITA).

This condition of pre-payment of 20% also applies to cases of extension of stay of demand and, hence, would have an adverse impact on cases that come up for extension of stay where stay has been granted by the ITAT for less than 20%.

1.8 Other Key Proposals

1.8.1 Income tax rates for individuals/ HUFs

The Bill proposes to provide a new tax regime for individuals and HUFs. For income arising in the financial year 2020-21 onwards, an individual or HUF will have the option to pay tax at the following rates (plus surcharge and cess), subject to the fulfilment of prescribed conditions:

Taxable income	Current slab rates	Proposed Tax rates
INR 0 – INR 250,000	Exempt	Exempt
INR 250,000 – INR 500,000	5%	5%
INR 500,000 – INR 750,000	20%	10%
INR 750,000 – INR 1,000,000	20%	15%
INR 1,000,000 – INR 1,250,000	30%	20%
INR 1,250,000 – INR 1,500,000	30%	25%
Above 1,500,000	30%	30%

Similar to the existing regime, taxpayers earning up to INR 500,000 in a financial year would not be required to pay any tax by virtue of the additional rebate provided under Section 87A of the ITA.

The new regime will be optional for taxpayers and those opting for the new regime would have to forego most of the deductions and exemptions.

Therefore, it would be important for taxpayers to carry out an informed cost-benefit analysis to assess the impact of availing the proposed concessional rates of tax by foregoing the specified exemptions and deductions against paying taxes under the existing tax rates while availing the exemptions and deductions.

1.8.2 Increase in the safe harbor limit from 5% to 10% in case of transfer of immovable property

Currently, if the consideration determined by the parties on transfer of land or building, is less than the value adopted or assessed by stamp valuation authority, then the value mentioned in the ready reckoner (on which stamp duty is paid) will be deemed to be the value for the purpose of computing profits and gains from business and profession (if held as stock in trade) or capital gains (if held as a capital asset).

Further, if the recipient of any immovable property, receives any property for a consideration which is less than the stamp duty value (by an amount exceeding INR 50,000), the stamp duty value of such property as exceeds such consideration shall be charged to tax under the head income from other sources in hands of the recipient.

Further, there is a safe harbor of 5% i.e. relaxation from deeming stamp duty value as fair value for transfer if the difference between the stamp duty value and actual consideration does not exceed 5%.

The Bill proposes to increase the safe harbor limit to 10%. This relaxation will be helpful for taxpayers trying to sell their old, dilapidated property which does not fetch stamp duty value on transfer.

1.8.3 Extension of time limit for availing a deduction on the interest paid on a loan taken for the acquisition of an affordable residential property

Currently, a deduction is available on interest paid on loans sanctioned by a financial institution between 1 April 2019 and 31 March 2020 for acquisition of residential house property. The Bill proposes to extend the time limit from 31 March 2020 to 31 March 2021.

1.8.4 Extension of time limit for approval of affordable housing project for availing deduction on business profits arising from such projects

Currently, 100% deduction is available for profits and gains derived from business of developing and building affordable housing projects, if such housing projects have been approved by the competent authority between 1 June 2016 to 31 March 2020. The Bill proposes to extend the period for obtaining approval from the competent authority to 31 March 2021 (instead of 31 March 2020).

1.8.5 Rationalisation of tax treatment of employer's contribution to recognised provident funds, superannuation funds and national pension scheme

Currently, the contribution by the employer to the account of an employee in a recognised provident fund exceeding 12% of salary is taxable. Further, the amount of any contribution to an approved superannuation fund by the employer exceeding INR 150,000 is treated as perquisite in the hands of the employee.

Similarly, the taxpayer is allowed a deduction under National Pension Scheme (**NPS**) for 14% of the salary contributed by the Central Government and 10% of the salary contributed by any other employer. There is no combined upper limit for the purpose of deduction on the amount of contribution made by the employer.

The Bill proposes to provide a combined upper cap of INR 750,000 for employer's contribution in a year to NPS, superannuation fund and recognised provident fund and any excess contribution is proposed to be taxed in the hands of the employee.

1.8.6 Modification of residency provisions

a. **Amendment relating to citizens of India or persons of Indian origin who come to visit India**

Currently, one of the cases in which an individual is deemed to be an Indian resident for tax purposes in a year is:

i. if such individual has been in India for an overall period of 365 days or more within four years preceding that year, and

ii. such individual is in India for an overall period of 60 days or more in that year.

Further, an Indian citizen or a person of Indian origin is considered an Indian resident for tax purposes, if he is in India for 182 days (instead of 60 days) in that year. This provision provides relaxation to an Indian citizen or a person of Indian origin by allowing them to visit India for a longer duration without becoming a tax resident of India.

The Bill proposes to reduce this period of 182 days to 120 days. The amendment has been proposed to prevent misuse of this relaxation by individuals (being Indian citizens and persons of Indian origin) who are carrying out substantial economic activities from India but are managing their period of stay in India, so as to remain non-residents for Indian tax purposes.

b. **Amendments relating to citizens of India who are not liable to tax in any country**

An amendment has been proposed to the effect that an Indian citizen who is not liable to tax in any other country or territory shall be deemed to be a tax resident in India. This amendment has been proposed to deal with 'stateless persons' who arrange their affairs so that they are not liable to tax in any country or jurisdiction during a year. The CBDT has clarified that income earned outside India by such person shall not be taxed in India if such person is a bonafide worker working in other jurisdictions. However, more clarifications are likely to be brought in for this proposed amendment.

c. **Amendments relating to residents but not ordinarily resident persons (RNORs)**

Currently, a resident individual is deemed to be an RNOR if such an individual has been non-resident in nine out of the ten previous years preceding that year or during the seven previous years preceding that year, has been in India for an overall period of 729 days or less. There are similar provisions for HUFs.

The Bill proposes that a resident individual/HUF shall be said to be RNOR in India in a year if such individual/HUF has been a non-resident in India in seven out of ten previous years preceding that year.

1.8.7 Filing of statement of donation by donee to cross-check claim of donation by donor

Currently, a tax-exempt entity may accept donations for utilisation towards their objects and the donor gets a deduction for such donation while computing its taxable income. The Bill provides for amendments enabling one-to-one matching between donations received by the tax-exempt entity and the deduction claimed by the donor. The deductions to a donor will be allowed only if a statement is furnished by the donee for donations received and in the event of failure to do so, fee and penalty shall be levied on the donor.

This amendment will take effect from 1 June 2020.

1.8.8 Increase in threshold for tax audit

The Bill proposes to increase the monetary threshold for tax audit for persons engaged in '*business*' from INR 10 million to INR 50 million if the following conditions are satisfied:

a. Total cash receipts are less than 5% of the total receipts; and

b. Total cash payments (including payments for incurring expenditure) are less than 5% of the total payments

1.8.9 Rationalisation of certain due dates under the ITA

The Bill proposes that certain categories of taxpayers will be required to file income tax returns by 31 October of the assessment year (as against 30 September). These taxpayers are:

a. Companies;

b. Persons whose accounts are required to be audited; and

c. Working partners of firms whose accounts are required to be audited

In addition, the Bill proposes to remove the distinction between non-working and working partners of firms whose accounts are required to be audited. Accordingly, non-working partners of such firms can also file their income tax returns by 31 October.

However, the due date of 31 October will only be applicable to taxpayers who are not subject to transfer pricing provisions. Taxpayers subject to transfer pricing provisions will still be required to file their income tax returns by 30 November, as provided under the current provisions.

Further, the Bill proposes to enable pre-filling of returns in case of persons having income from business or profession by requiring that the tax audit report would have to be furnished by taxpayers at least one month prior to the due date of filing of return of income. The Bill has proposed similar amendments to all the provisions of the ITA which mandate the filing of specified reports along with the income tax return. This includes filings such as transfer pricing audit report (which would now be required to be filed by 31 October, instead of 30 November), MAT report, 10AA report, etc. All these filings will have to be completed one month prior to the due-date of filing the income tax return.

This amendment will apply in relation to returns to be filed for financial year 2019-20 and subsequent years.

1.8.10 Aligning exemption from taxability of FPIs on account of indirect transfer of assets with amended scheme of SEBI

The Finance Act, 2012 introduced the provisions for taxing indirect transfer of capital asset. However, the Finance Act, 2017 provided that the indirect transfer provisions shall not apply to an asset or capital asset, which is held by a non-resident by way of investment, directly or indirectly, in Category-I or Category-II Foreign Portfolio Investors (**FPIs**) under the SEBI (FPI) Regulations, 2014.

SEBI has notified SEBI (FPI) Regulations, 2019 which repeal the SEBI (FPI) Regulations, 2014. The 2019 regulations have done away with the broad basing criteria for the categorisation of portfolios and have reduced the number of categories from three to two.

Accordingly, the Bill proposes that the exception from applicability of indirect transfer provisions to an asset or a capital asset, held by a non-resident by way of investment in erstwhile Category I and II FPIs under the SEBI (FPI) Regulations, 2014, is to be grandfathered. Further, a similar exception is to be provided for investment in Category-I FPI under the SEBI (FPI) Regulations, 2019.

2 Indirect Tax Proposals

2.1 Customs

2.1.1 Insertion of new provisions pertaining to rules of origin under trade agreement

For reducing instances of alleged misuse of preferential rate of duty under trade agreements, a new chapter (Chapter VAA) is being proposed to be inserted in the Customs Act, 1962 (**Customs Act**). Earlier, under such trade agreements, the preferential rate of duty could be claimed by producing a certificate of origin issued by prescribed authorities in the exporting country. However, Chapter VAA proposes to introduce a new Section (Section 28DA) under which an importer, in addition to the certificate of origin, will be required to furnish sufficient documents to establish origin requirements of the product under import (such as regional value content and other product specific requirement), if directed by the customs officer.

Further, the importer will also be required to exercise reasonable care in relation to the truthfulness and accuracy of the information furnished. Consequently, the scope of Section 111 of the Customs Act dealing with confiscation of goods, would be expanded to cover goods imported in contravention of this new Chapter VAA.

This provision is likely to increase the compliance burden and could lead to import related disputes and related difficulties for the products imported under trade agreements.

2.1.2 New provisions pertaining to ledger for duty credit

The proposed Section 51B provides for issuance of electronic duty scrips in lieu of remission of customs duty, chargeable on material used in manufacturing, processing, or carrying operation on goods which are exported. Such electronic duty scrips can be used for making payment of duty under the Customs Act and Customs Tariff Act, 1975, by the person to whom it is issued or the person to whom it transferred.

Further, Section 51B also provides for creation of an electronic duty credit ledger in the customs system for maintenance of such electronic duty scrips. The scope of Section 28AAA dealing with recovery of duties, pursuant to fraudulent obtainment of duty scrips, has also consequently been expanded to cover duty scrips issued under Section 51B.

2.1.3 Substitution of a new section for Section 8B regarding safeguard measures

Section 8B of the Customs Tariff Act, 1975 is proposed to be amended to empower the government to impose tariff-rate quota besides the safeguard duty. Earlier, the government could impose safeguard duty on goods, if upon inquiry it was satisfied that import of such goods caused/threatened to cause injury to domestic industry.

Through the proposed amendment, the government can also impose tariff-rate quota on such goods. The tariff rate quota is a two-tiered tariff regime which combines import quota and tariff to regulate import of goods. In other words, tariff rate quota permits import of goods at a lower tariff rate up to a prescribed quantity, whereas a higher tariff is prescribed for import of such goods beyond the prescribed quantity. For example, a country may allow import of 10,000 X goods at tariff rate of 5%, and any import of X goods above 10,000 may be subject to tariff rate of 10%.

2.1.4 Health cess on imported medical devices

A levy of customs duty to be called 'health cess' is proposed to be introduced on the import of medical equipment and apparatus. The health cess will be levied at the rate of 5% of the value of the goods determined under the provisions of the Customs Act. Therefore, in terms of increase in value, it seems that there would be a direct 5% increase against the import invoice value of such goods (subject to other conditions of customs law).

2.2 Goods and Service Tax (GST)

2.2.1 Application of GST to Ladakh and other union territories

The government has proposed to amend the definition of 'Union Territories' to make GST laws applicable to the newly formed Union Territory of Ladakh and to the newly merged Union Territory of Dadra and Nagar Haveli and Daman and Diu.

Ladakh, prior to becoming a Union Territory, was a part of the State of Jammu and Kashmir. With effect from 31 October 2019, the State of Jammu and Kashmir was reorganised and the Union Territory of Ladakh came into being. Further, 'Dadra and Nagar Haveli' and 'Daman and Diu', prior to their merger, were separate Union Territories. However, with effect from 26 January 2020, the two Union Territories were merged to form the Union Territory of Dadra and Nagar Haveli and Daman and Diu.

2.2.2 Certain persons to be ineligible to pay GST under composition scheme

Section 10 of the Central Goods and Services Tax Act, 2017 (**CGST Act**) is proposed to be amended to extend the list of persons who will be ineligible to opt for the composition scheme for the payment of GST. Previously, only persons who were engaged in the supply of goods were ineligible. Now, with the amendments proposed to the relevant provisions, the following persons would also be excluded from opting for the composition scheme:

- persons engaged in intra-state supply of non-taxable services, or
- persons engaged in inter-state supply of services, or
- persons engaged in supply of services through an e-commerce operator.

2.2.3 Persons voluntarily registered under GST may seek cancellation of its registration

Amendments have been proposed to allow persons who are otherwise not required to obtain registration under GST but have registered themselves voluntarily, would now be eligible to have their registrations cancelled on their own accord. Currently, such persons are not allowed to seek cancellation of their registrations on a voluntary basis as it is barred under Section 29(1) of the CGST Act.

2.2.4 Extension of time for revocation of cancellation of GST registration

Currently, the person whose registration has been cancelled by the GST officer on his own motion can seek revocation of such cancellation within 30 days from the date of service of cancellation. There is no provision for extension of this period.

Now, the government proposes to empower the jurisdictional officers to provide an extension of up to 60 days to such persons, over and above the period of 30 days, where they are satisfied that the delay in filing for revocation is due to genuine reasons.

2.2.5 Penalties

Amendments are proposed to Section 122 of CGST Act to make the beneficiary of transactions of passing on or availing fraudulent input tax credit liable for penalty similar to the penalty leviable on the person who commits such offences.

Further, amendments are proposed to be made to Section 132 of CGST Act to make the offence of fraudulent availment of input tax credit without an invoice or bill a cognisable and non-bailable offence; and to make any person who commits, or causes the commission, or retains the benefit of transactions arising out of specified offences liable for punishment.

2.2.6 Retrospective exemption and reduction of tax rate

To reduce the burden on the agricultural sector, the government has proposed to retrospectively grant an exemption in respect of GST on certain goods (such as fishmeal) for the period 1 August 2017 to 30 September 2019. Further, the Government has retrospectively reduced the rate of GST on certain agricultural machinery (such as pulley, wheels and other parts) for the period 1 August 2017 to 30 September 2019. The exemption/reduced rates would be applicable on the fulfilment of prescribed conditions.