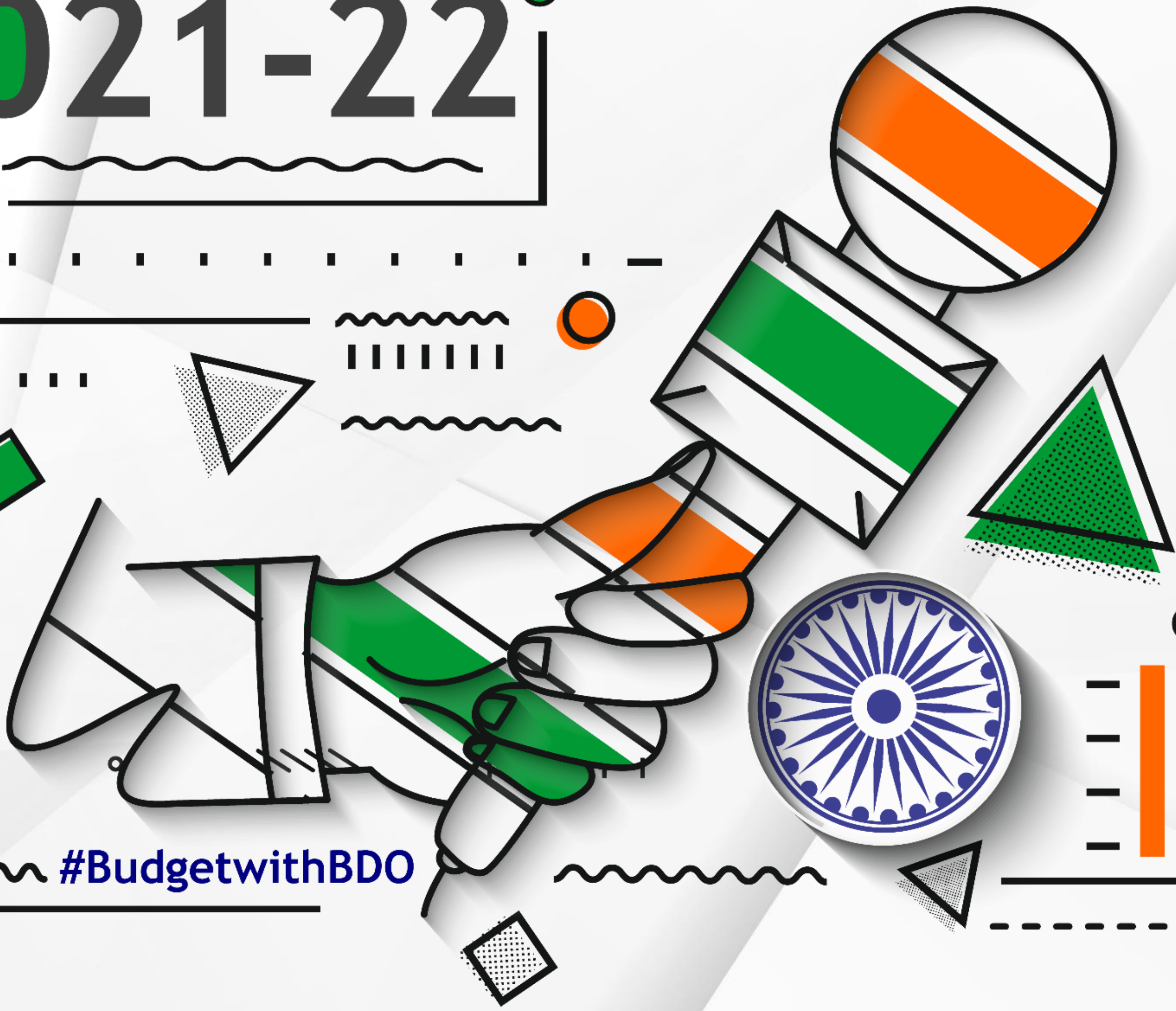
# INDIA UNION BUDGET 2021-22



#BudgetwithBDO

## KEY HIGHLIGHTS

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Amidst the uncertainties around the pandemic, the Finance Minister (FM) presented the India Union Budget 2021-22. The budgetary proposals rest on the following 6 pillars – a) Health and Well-being b) Physical & Financial Capital, and Infrastructure c) Inclusive development d) Human Capital e) Innovation and R&D and f) Minimum government and maximum governance, with the government focusing on spending heavily on the first two pillars. The Budget laid down significant emphasis on capital investment/ infrastructure development, with a proposed outlay of USD 75bn earmarked for capital expenditure.

While it was largely perceived that the burden on taxpayers would go up to facilitate government spending, it was welcoming to see that no such increase in direct taxes has been proposed in the Budget.

We are highlighting some of the key tax and regulatory proposals, relevant from an international investor's perspective.

### 1. International Financial Services Centre (IFSC)

In 2015, the Government, announced setting up of IFSC's in India, starting with Gujarat's GIFT city and has introduced several measures to support the development of a world class

Fin-Tech hub. Extending its measures, the Budget proposes that:

- **Relocation of funds:** Capital gains arising from transfer by an original fund to a relocated fund setup in an IFSC would be exempt from tax, subject to the prescribed conditions. Furthermore, investors in the relocated fund would also be exempted from any capital gains tax arising from sale of shares by the relocated fund, assuming capital gains were exempt had the fund not relocated.
- **Fund management:** The domestic tax law provides for certain conditions, which shall ensure that a foreign investment fund having a fund manager in India, shall not be regarded to have a permanent establishment in India. Such conditions are onerous for taxpayers to comply with. The Budget proposes that if the fund manager is located in an IFSC, some of these conditions so prescribed shall be relaxed.
- **Aircraft leasing activities:** Royalty income paid by an eligible unit in IFSC to a non-resident on account of lease of an aircraft, is exempted from taxes in India. Furthermore, any income arising from transfer of an aircraft or an aircraft engine by an eligible unit in IFSC to a domestic company shall be eligible for a 100% tax holiday.
- **Banking units:** Capital gains arising from transfer of prescribed capital assets arising to the investment division of an offshore banking unit located in an IFSC that has been granted a Category III Alternative Investment Fund registration shall be exempted from tax. Similarly, income arising to a non-resident from transfer of non-deliverable forward contracts to an offshore banking unit in an IFSC is exempted from tax in India.

The measures are aimed at attracting investments in such IFSCs.

### 2. Dividend income taxation

Budget 2020 had seen the abolishment of dividend distribution tax (DDT) and consequently, such income is taxable in the hands of shareholders. Further to the said reform, a clarificatory provision has been introduced to state that the provisions of the minimum alternate tax (presently at 15%) shall not apply to foreign investors receiving dividend income, which would be usually taxable at a lower rate under the applicable tax treaty. The Budget further proposes that dividend payments to REITs/ InvITs shall not be subjected to withholding tax.

### 3. Withholding on payments made to Foreign Institutional Investors ('FIIs')

The domestic tax law provided for withholding tax at a base rate of 20% while making payment to FIIs, which resulted in a mismatch between the withholding tax rate and the eventual tax liability of such FIIs in India. To align this, the Finance Bill proposes that withholding tax can be carried out at the applicable treaty rates, subject to the submission of a valid tax residency certificate by the FII.

### 4. Business structuring and Goodwill

Depreciation on goodwill arising on account of business structuring (i.e. amalgamations, demergers etc.) or outright purchase, has been a matter of considerable litigation. While tax authorities used to deny depreciation on such goodwill, the controversy was addressed to some extent by the Apex Court of India, which held that such goodwill is an eligible asset for depreciation. The Finance Bill now proposes that any form of goodwill i.e. whether purchased or generated as a result of business re-organisation would not be entitled to depreciation. However, taxpayers would be entitled to claim deduction of any costs that they have paid to purchase such goodwill, if eventually such goodwill is sold while computing capital gains income.

It remains to be seen as to how the rules to be prescribed deal with cases where taxpayers have already claimed depreciation on goodwill in the past years.

### 5. Restructuring the Authority for Advance Rulings (‘AAR’) mechanism

The domestic tax law provides for a mechanism to obtain certainty on transactions involving non-residents, by approaching the AAR. It is perceived that the AAR regime may not have achieved its desired objectives. In order to strengthen and streamline this important tax certainty mechanism, the Finance Bill proposes to replace the AAR with a Board for Advance Rulings. Consequently, all the pending cases before the AAR would be transferred to this Board, whenever formed. While more details are awaited in this regard, it appears that the rules would be framed in a manner which would enable taxpayers to approach this Board for expeditious decisions on their cases.

### 6. Period of limitation for revenue audits

The time limit for closing revenue audits is proposed to be further shortened from the existing 24 months to 21 months from the end of the financial year. Further, under the current regime, tax authorities were empowered to usually re-open revenue audits by issuing notices within 7 years from the end of the fiscal year. The Budget proposes that the time limit for re-opening revenue audits would be reduced to 4 years from the end of the fiscal year and only in high untaxed income cases (i.e. income greater or equal to INR 5mn), the time limit for re-opening gets extended to 11 years from the end of the fiscal year, subject to approval from the higher authorities.

By reducing period of limitation beyond which a case cannot be subjected to any revenue audit, the period of uncertainty for businesses would therefore collapse.

### 7. Equalisation levy

Equalisation Levy 2.0, as is commonly referred, introduced by the government last year on non-resident e-commerce operators from e-commerce supply or services, inter-alia, had the following concerns:

- Certain items of income would be subjected to tax both under the domestic tax laws as royalties/ fees for technical services and under the equalisation levy.
- While the levy of equalisation levy was made effective from 1 April 2020, the exemption of such income under the domestic tax laws was made effective only from 1 April 2021, thereby leading to a potential double taxation.

In order to ease such concerns, the Budget proposes the following:

- Clarify that transactions which are otherwise taxable as royalties or fees for technical services would not be subjected to this levy. This will ensure that taxpayers do not end up being doubly taxed - both under the corporate tax provisions and equalisation levy provisions
- Clarify that income which is subjected to equalisation levy would be exempt from taxation under the corporate tax laws since the time this levy was introduced i.e. w.e.f 1 April 2020

Definition of what constitutes e-commerce supply or services is wide enough to include several categories of e-commerce business models and thus businesses need to be mindful of its applicability to their businesses.

### 8. Higher withholding tax rate for non-filers of income tax returns

Domestic tax law provides for a penal withholding tax rate of 20% in case of non-residents who neither furnish their Indian tax identification number nor tax residency certificate. The Budget proposes for a special provision for withholding tax in case of non-filers of income-tax returns. Accordingly, payments made to any person, including a non-resident, who has not filed their income tax returns for two prior years would be subjected to a maximum withholding tax of twice the normal withholding tax rates. While non-residents not having a permanent establishment in India are excluded from the applicability of this provision, it remains to be seen as to how practically this provision gets implemented.

### 9. Start-ups

The last date to incorporate a start-up eligible for claiming tax holiday is extended by one more year. Accordingly, eligible start-ups incorporated on or before 31 March 2022 shall be entitled to claim 100% tax holiday for 3 years.

### 10. Production Linked Incentive (PLI) scheme

Increased emphasis on the PLI scheme for creation of global manufacturing champions in 13 identified sectors. Details awaited.

### 11. Customs duty rationalisation

As part of the government's initiatives to make India 'self-reliant' and 'resilient' and to strengthen domestic manufacturing, provide easy access to raw materials and export of value-added products, the following proposals are made:

- Reduction of import duties on certain parts and raw materials
- Increase in import duties on certain finished products
- Increase in import duties on parts of automobiles, mobile phones, solar inverters, and solar lamps
- Customs duty exemptions on 400 plus items are proposed to be reviewed in the next financial year and a revised rate would be introduced w.e.f., 01 October 2021, requiring all businesses with operations in India to re-evaluate supply chain and closely monitor development on the exemptions and relaxations
- Any new customs duty exemption will have validity up to 31 March, following two years from the date of its issue (until specifically extended), so that

  protection to domestic industry cannot continue endlessly and needs review at specified intervals
- A new cess, viz. Agriculture Infrastructure and Development Cess (AIDC) has been introduced on specified goods (fruits, pulses, certain alcoholic beverages, coal, fertilisers, gold, silver, etc.) at a rate not exceeding customs duty rate specified in First Schedule to the Customs Tariff Act for financing the agriculture infrastructure and other development expenditure. Basic Customs Duty in respect of such items have been lowered to neutralise the effect.

### 12. Time bound closure of cases and introduction of additional safeguards

Proposal to implement expeditious closure of proceedings within specified time limits and additional safeguards to protect revenue interest, where instances of wrongful claim refunds or remission of duties or any violations were experienced.

### 13. Zero-rate GST supplies

Zero-rate supplies (exports, supplies to export processing zone, etc.) with payment of IGST is proposed to be restricted to specified class of taxpayers or specified supplies of goods or services, as notified by the government. This is likely to impinge on the ability of exporters to expeditiously monetise the accumulated GST credits.

### 14. Self- certification of GST annual compliance statements

The taxpayers would be allowed to self-certify GST annual compliance statements and are not mandated to get their books of account audited and certified by an external professional.

### 15. Regulatory reforms

The FM also announced the following:

- Consolidation of several securities law into a rationalised single Securities Market Code
- Increasing of permissible foreign direct investment limit in the insurance sector from 49% to 74%, subject to meeting prescribed conditions
- Revising the definition of Small Companies under the Indian Corporate law, by reducing the capital and turnover thresholds to ease compliance requirements for such companies
- As a measure which directly benefits start-ups and innovators, the Budget proposes to incentivise incorporation of One Person Companies (OPCs) to grow without any restriction on capital and turnover and also allow Non-resident Indians (NRIS) to incorporate one person companies in India

## CONCLUDING REMARKS

The FM, in her speech, reckoned the budget as a moment in history, which is the dawn of a new era – one in which India is well-poised to truly be the land of promise and hope; and the proposals seem to be aimed towards living up to this very statement.

While the Budget seems to have received a positive response from businesses and investors, the key remains – 'Execution' ; which will help India achieve its much-promulgated sharp recovery.

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