

# TAX FLASH NEWS

11 February 2020

## India Union Budget 2020 - Foreign Portfolio Investors and Sovereign Wealth Fund

### Background

The Honorable Finance Minister of India had presented the Union Budget 2020 before the Parliament on 1 February 2020 and the highlights are:

### Exemption to Sovereign Wealth Fund for investments in companies carrying infrastructure development

In order to incentivize investments by Sovereign Wealth Fund (SWF) of foreign government in priority sectors, tax exemption on interest, dividend and long-term capital gains income in respect of investments made in specified infrastructure sector is proposed in Finance Bill, 2020.

The investment is to be made before 31 March 2024 either in form of debt or equity and with a minimum lock-in period of 3 years.

The following persons would be eligible for exemption:

- A wholly owned subsidiary of Abu Dhabi Investment Authority which is a resident of UAE and makes investments out of fund owned by Government of UAE.
- A SWF which satisfies following conditions:
  - It is wholly owned and controlled, directly or indirectly, by Government of a foreign country
  - It is set up and regulated under the law of the foreign country
  - Its earnings are credited either to the account of the Government of the foreign country or to any other account designated by that Government so that no portion of

the earnings inures any benefit to any private person;

- Its asset vest in the Government of the foreign country upon dissolution;
- It does not undertake any commercial activity whether within or outside India; and
- It is notified by the Central Government in the Official Gazette for this purpose

*The amendment to be effective from FY 2020-21.*

### Dividend Distribution Tax abolished; dividend to be taxed in the hands of investors

Presently, Indian domestic companies pay Dividend Distribution Tax (DDT) at the tax rate of 15 per cent (effective tax rate of 20.56 per cent) and dividend distributed is exempt in the hands of the shareholders/ investors.

The Finance Bill, 2020 has proposed to abolish DDT and tax the dividend income in the hands of the investor with effect from 1 April 2020. The income would be taxed at the following rates:

- For Foreign Portfolio Investors, dividend income and income on units of mutual funds to be taxed at the rate of 20 per cent and withholding to be at the rate of 20 per cent under the domestic law.
- Dividend received on GDR to be taxed at the rate of 10 per cent and withholding to be at the rate of 10 per cent under the domestic law.
- Dividend distributed by business trust to be taxed in the hands of the unit holder and taxes thereon to be withheld at the rate of 10 per cent under domestic law.

Surcharge and health and education cess to apply at applicable rates.

Earlier, the foreign investors could not claim any tax credit of DDT paid by the company. Under the new regime, the foreign investor can avail tax treaty benefits subject to conditions provided in their respective double tax avoidance agreements (DTAA) with India. The rates as mentioned in the DTAA range from 5 per cent to 25 per cent.

Further, dividend stripping would not apply in case of short-term capital losses as dividend income will no longer be exempt from tax.

*The amendment to be effective from FY 2020-21*

### **Benefit of pass through status extended to unlisted business trust**

Benefit of pass through status extended to unlisted business Trusts. The existent tax provisions contain special taxation regime (comprising of tax pass through and reduced tax rates) for business trusts [Infrastructure Investment Trust (InvIT) and Real Estate Investment Trust (REIT)] listed in accordance with the respective Securities and Exchange Board of India (SEBI) regulations. It has now been proposed to extend the said special tax regime to unlisted business trusts.

*The amendment to be effective from FY 2020-21.*

### **Indirect transfer to FPIs - alignment of exemption**

SEBI had notified SEBI (Foreign Portfolio Investor) Regulations, 2019 [SEBI (FPI) Regulations, 2019] on 23 September 2019 and re-characterized Category I, II and III FPIs under the SEBI (FPI) Regulation, 2014 to Category I and II FPIs under 2019 Regulations. Therefore, there was a need to align the indirect transfer provisions to factor the changes in FPI regulatory framework.

The Finance Bill, 2020 has proposed to exempt Category I FPIs registered under SEBI (FPI) Regulations, 2019 from applicability of indirect transfer provisions.

Further, it is proposed to grandfather exemptions with respect to investments made in Category I and Category II FPIs prior to repeal of SEBI (FPI) Regulations, 2014.

*The amendment to be effective from FY 2019-20.*

### **Exemption to non-residents from filing return of income**

Currently, non-residents, whose total income consists of only dividend or interest income on which tax is withheld at source, are exempt from furnishing Income-tax return.

The Finance Bill, 2020 proposes to extend this relief also to non-residents whose total income consists of only royalty or fees for technical services. However, the exemption from filing of return of income will apply only if tax has been withheld at the rates as prescribed under the domestic law.

In case any beneficial provision under the respective tax treaty is availed, then the non-resident would be required to file the return of income.

*The amendment to be effective from FY 2019-20.*

### **Modification in conditions for offshore funds exemption from business connection in India**

India tax law provides safe harbor rules for an offshore fund which can appoint an India based fund manager without being regarded to have business connection in India, if the offshore fund and India fund manager comply with certain conditions.

In this budget, the conditions qua an eligible Fund Manager have been modified as follows:

- For the purpose of calculating the aggregate participation or investment in the fund directly or indirectly by Indian residents to the extent of 5 per cent of the corpus of the funds, the contribution made by the eligible fund manager during the first three years of operations up to INR 25 crores shall not be accounted and
- The condition of monthly aggregate of the corpus of the fund not to be less than INR 100 crore for fund established or incorporated in the previous year to be fulfilled within 12 months from the last date of its establishment or incorporation as against the current period of 6 months.

*The amendment to be effective from FY 2019-20.*

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