



## India: Union Budget 2020-2021: highlights

The Finance Minister, Mrs. Nirmala Sitharaman, presented the [budget for the year 2020-2021](#) to the Parliament on 1 February 2020 in a context of economic slowdown and social unrest.

In continuation of the measures already taken so far, the tax proposals in the budget aim to stimulate growth, simplify tax structure, bring ease of compliance and reduce litigations.

Below is a brief summary of the main tax proposals covered in the budget.

### **1. Abolishment of Dividend Distribution Tax (“DDT”)**

Currently, companies are required to **pay DDT on the dividend paid to its shareholders** at the rate of 15% plus applicable surcharge and cess in addition to the tax payable by the company on its profits. Such dividend is exempt in the hands of the shareholders in India but might be subject to income tax depending on the tax residency of the shareholders.

It has been argued that the system of levying DDT results in increase in tax burden for investors. In addition, **non-availability of credit of DDT to most of the foreign investors in their home country** results in reduction of rate of return on equity capital for them.

In order to increase the attractiveness of the Indian Equity Market and to provide relief to a large class of investors, it is proposed to **remove the DDT from 1 April 2020 and adopt the classical system of dividend taxation in the hands of the shareholder at the applicable marginal rate**. From 1 April 2020, dividend income should be chargeable to tax as “income from other sources” under section 56 of the Income Tax Act, 1961 (“ITA”).

Further, in order to remove the cascading effect, it is also proposed to allow deduction for the dividend received by holding company from its subsidiary.

### **2. Reducing the rate of TDS on fees for technical services (other than professional services) (“FTS”)**

Section 194J of the ITA imposes a tax deduction at source (“TDS”) obligation of 10% on certain payment (such as fees for professional services, FTS, remuneration, fees or commission by whatever name called or royalty) to residents.

Section 194C of the ITA imposes a TDS obligation of 2% on payments to a resident for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract.

There are large number of cases where the assessee deducts tax under section 194C, while the tax officers claim that tax should have been deducted under section 194J of the Act.

To reduce litigation, it is proposed to reduce rate for TDS in section 194J in case of **FTS (other than professional services) to 2%** from existing 10%. The TDS rate in other cases under section 194J would remain 10%.

This amendment will take effect from 1st April, 2020

### **3. TDS on e-commerce transactions**

In order to widen and deepen the Indian tax net, it is proposed to insert a new section 194-O in the ITA so as to provide for a new levy of TDS at the rate of 1% with the following key points:

- The TDS is to be paid by e-commerce operator for sale of goods or provision of service facilitated by it through its digital or electronic facility or platform;
- E-commerce operator is required to deduct tax at the time of credit of amount of sale or service or both to the account of e-commerce participant or at the time of payment thereof to such participant by any mode, whichever is earlier.
- The tax at 1% is required to be deducted on the gross amount of such sales or service or both.
- Any payment made by a purchaser of goods or recipient of services directly to an e-commerce participant shall be deemed to be amount credited or paid by the e-commerce operator to the e-commerce participant and shall be included in the gross amount of such sales or services for the purpose of deduction of income-tax.

### **4. Start-ups**

Start-ups generally use Employee Stock Option Plan (ESOP) to attract and retain highly talented employees.

Currently, ESOPs are taxable as perquisites at the time of exercise. This leads to cashflow problem for the employees who do not sell the shares immediately and continue to hold the same for the long-term.

In order to give a boost to the start-up ecosystem, it is proposed to ease the burden of taxation on the employees by **deferring the tax payment by five years** or till they leave the company or when they sell their shares, whichever is earliest.

### **5. Deferring Significant Economic Presence (SEP) proposal**

Section 9 of the ITA contains provisions in respect of income which are deemed to accrue or arise in India. Sub-section (1) thereof creates a legal fiction that certain incomes shall be deemed to accrue or arise in India. Clause (i) of sub-section (1) deems the following income to accrue or arise in India: *“all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.”*

Finance Act, 2018, inter alia, inserted Explanation 2A to said clause so as to clarify that the "significant economic presence" ("**SEP**") of a non-resident in India shall constitute "business connection" in India and SEP for this purpose, shall mean:

(a) 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 aggregate of payments arising from such transaction or transactions

during the previous year exceeds such amount as may be prescribed; or

(b) 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.

Said Explanation further provided that the transactions or activities shall constitute significant economic presence in India, whether or not, the agreement for such transactions or activities is entered in India; or the non-resident has a residence or place of business in India; or the non-resident renders services in India. It was also provided that only so much of income as is attributable to the transactions or activities mentioned at para 2(a) and (b) shall be deemed to accrue or arise in India.

Therefore, for the purposes of determining SEP of a non-resident in India, threshold for the aggregate amount of payments arising from the specified transactions and for the number of users were required to be prescribed in the Rules.

However, since discussion on this issue is still going on in G20-OECD BEPS project, these numbers have not been notified yet. G20-OECD report is expected by the end of December 2020. In the circumstances, it is proposed to defer the applicability of SEP to starting from assessment year 2022-23.

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