Kluwer International Tax Blog

India's Budget 2023 – A move towards trust-based governance

Mukesh Butani, Seema Kejriwal (BMR Legal) · Friday, February 3rd, 2023

In the ruling administration's last full budget before India goes to the polls, India's Finance Minister, Ms Sitharaman, laid out the government's vision – "Making India a technology-driven and knowledge-based economy with strong public finances, and a robust financial sector."

She identified four transformative opportunities for India: (i) economic empowerment of Women (ii) upliftment of traditional artisans and craftspeople (iii) tourism and (iv) green growth efforts which will help in reducing carbon intensity of the economy.

As part of her Government's budget priorities, the budget speech quoted India's Prime Minister, Narendra Modi:

> *Good Governance is the key to a nation's progress. Our government is committed to providing a transparent and accountable administration which works for the betterment and welfare of the common citizen.*

With trust-based governance as its cornerstone, her budget speech was replete with examples to signify Government's resolve to enhance ease of doing business, with over 39,000 compliances being reduced and over 3,400 legal provisions being decriminalized.

Some of the major tax provisions impacting multinationals are:

Issue of shares at a premium

Issue of shares at a premium to non-residents was not considered a taxable event, unlike issue of shares to residents. Hence, companies, based on interpretation of a Bombay High Court ruling (which the revenue decided to not appeal), took a position that such transactions are not subject to transfer pricing. However, the law has now been amended to state that if shares of unlisted companies are issued at higher than fair market value, such excessive premium will be taxed.

Accordingly, such related party transactions will now be subject to arm's length principle.

Extension of relief from thin capitalisation

In 2017, India implemented thin capitalisation provisions to implement the measures recommended under Action Plan 4 of the BEPS Inclusive Framework. Exclusions were provided for insurance and banking companies – these have now been extended to notified non-banking financial companies (NBFCs). This is a welcome move – NBFCs are regulated when it comes to leverage.

Audits

The timeline for submission of transfer pricing documentation (in course of transfer pricing audit) has been reduced from 30 to 10 days. This continues to remain extendible by another 30 days at the discretion of the revenue.

Taxability of unitholders of business trusts

Under the extant law, business trusts are treated as a transparent entity wherein the income earned is taxable in the hands of the unit holders. Further, the law provides that income earned by the business trust shall retain the same nature in the hands of the unit holders.

Certain specified classes of income (in the form of dividends, interest and rental income) were taxable in the hands of the unit holders and for other income it was distributed to its unit holders as exempt income.

However, the Indian tax law did not deal with "repayment of debt" which was not taxable in the hands of the trust or the unitholders. As a result of which, this led to double non-taxation.

Budget 2023 has proposed that in case any such income which is not taxable in the hands of business trust shall be taxable in the hands of the unitholders.

Further, in case of redemption of units held by the unit holder, the taxable income will be the consideration received less cost of acquisition.

IFSC related amendments

Budget proposals have extended the timeline for offshore funds desiring to shift their operations in International Financial Services Centre/ GIFT City for two years i.e., up to March 31, 2025.

Exemption of ODI income earned by non-resident investors in IFSC**:**

-

Indian laws provide relief to the non-residents in relation to transfer of offshore derivative instruments entered with IFSC banking unit. However, in case of distribution of income to the non-resident ODI holders, such transaction suffered tax at the hands of the bank and as well as unit holders.

The Budget has proposed amendment to avoid double taxation and hence, such income would also be exempt in the hands of non-residents.

Legality of Derivatives contract issued by FPI in IFSC:

The Budget has proposed an amendment in the Securities Contracts (Regulations) Act wherein derivatives contract issued by a Foreign Portfolio Investors in IFSC shall be considered as legal and valid.

Relief under withholding provision for non-residents

Under the extant law, withholding tax obligation have been placed on the remitter of income at the rate of 20% upon payment of Mutual Fund income to non-residents. As a result, non-resident taxpayers were unable to claim treaty benefits if a lower tax rate was provided under the treaty. To address such concern, the Budget proposes to permit taxpayers to avail treaty benefits provided Tax Residency Certificate is furnished.

Right of the Revenue to file cross-objections against the Order of Dispute Resolution Panel (DRP)

To reduce transfer pricing disputes and disputes for non-residents, the Dispute Resolution Panel (DRP) was formed in 2009. Hence, prior to completion of final assessment, the Revenue has to issue a draft order laying out proposed additions. The taxpayers could file objections to such additions before the DRP, and the DRP had to adjudicate within nine months. Based on the DRP's order, the tax officer had to pass a final order. Orders passed by the DRP are not appealable by the revenue (barring a period of 2012 to 2016 when orders were appealable). The budget now provides a fresh opportunity for the revenue to file cross objections against the appeal. The law pertaining to cross objections will allow the objector to support the DRP's order as well as take new grounds against relief granted to the taxpayer. This effectively becomes a right for the Revenue to appeal against the DRP's order, thereby moving to the old regime.

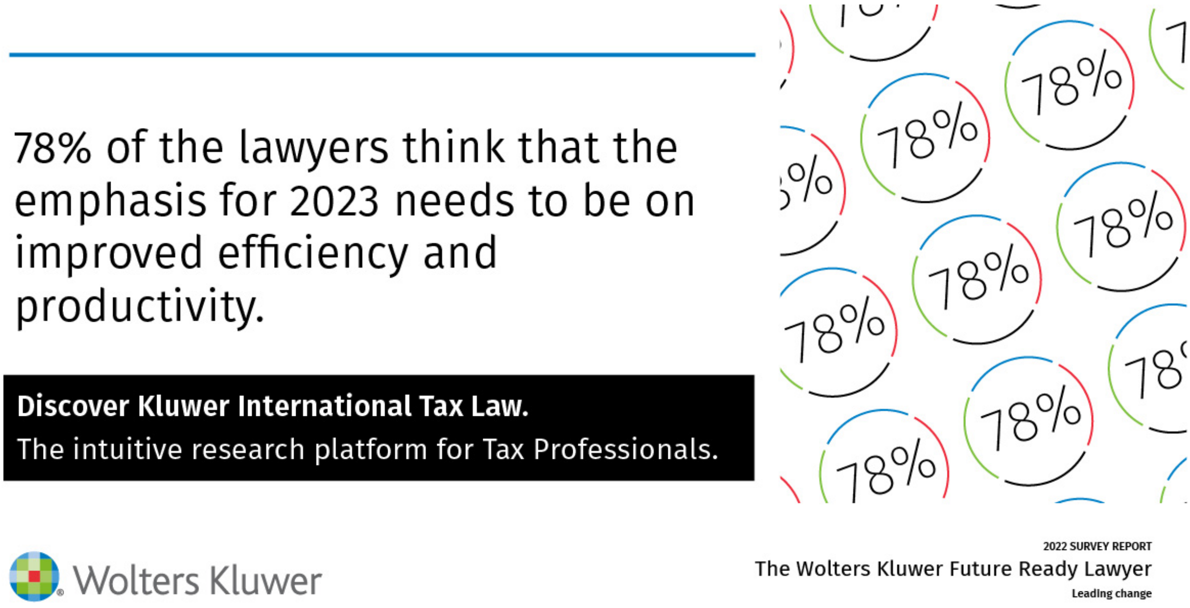
Whatever little certainty the taxpayer was getting, would now be open before the Tribunal for adjudication, should the revenue choose to file cross-objections. This will raise uncertainty for transfer pricing matters and non-resident taxpayers.

From an income-tax standpoint, did the budget walk the talk on trust-based governance? Watch this space for our detailed analysis on the topic.

To make sure you do not miss out on regular updates from the Kluwer International Tax Blog, please subscribe here.

content and practical tools to provide answers. You can easily access the tool from every preferred location. Are you, as a Tax professional, ready for the future?

Learn how **Kluwer International Tax Law** can support you.



This entry was posted on Friday, February 3rd, 2023 at 10:00 am and is filed under Budget, India, Trusts and Estates
You can follow any responses to this entry through the Comments (RSS) feed. You can leave a response, or trackback from your own site.