

1. Introduction

In this article, we will cover the amendments proposed by Finance Bill 2023 to the Income Tax Act, 1961 (the 'Act' or 'ITA') which affect taxation of non-residents pertaining to the following:

- i. Section 9(1) – Extending deeming provisions under section 9 to certain persons being not ordinarily residents (*Clause 4 of the Finance Bill 2023*)
- ii. Section 56(2)(viib) - Bringing the non-resident investors within the ambit of the section (*Clause 32 of the Finance Bill 2023*)
- iii. Section 92(D) – Reducing time provided for furnishing TP report (*Clause 46 of the Finance Bill 2023*)
- iv. Section 44BB and 44BBB – Prevention the misuse of section 44BB and 44BBB (*Clauses 18 & 19 of the Finance Bill 2023*)
- v. Tax Incentives to International Financial Services Centre (*Clauses 5, 21 & 59 of the Finance Bill 2023*)

2. Extending deeming provision under section 9 to gift to 'Not-ordinarily resident' ('NOR')

Under the Income Tax Act, any income that is deemed to accrue or arise in India is taxable in India. Sub-section (1) of section 9 of the Act is a deeming provision providing the types of income deemed to accrue or arise in India.

Finance (No. 2) Act, 2019 inserted clause (viii) to sub-section (1) of section 9 of the Act to provide that the any sum of money exceeding fifty thousand rupees, received by a non-resident without consideration from a person resident in India, on or after the 5th day of July, 2019, shall be income deemed to accrue or arise in India. Sum of money is referred to in section 2(24)(xviiia) of the Act

2.1. Extract of the relevant portion of the existing provisions:

- 2.1.1. Section 9(1) provides, inter alia, that the following type of income shall be deemed to accrue or arise in India:- *Section 9(1)(viii) - income arising outside India, being any sum of money referred to in sub-clause (xviiia) of clause (24) of section 2, paid on or after the 5th day of July, 2019 by a person resident in India to a non-resident, not being a company, or to a foreign company.*
- 2.1.2. *Section 2(24) (xviiia) - any sum of money or value of property referred to in clause (x) of sub-section (2) of section 56*
- 2.1.3. *Section 56(2)(x) - where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,—*

- (a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;
 - (b) any immovable property,—
 - (A) without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property;
 - (B) for a consideration, the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely:—
 - (i) the amount of fifty thousand rupees; and
 - (ii) the amount equal to ²⁰[ten] per cent of the consideration:
- Provided that where the date of agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of agreement may be taken for the purposes of this sub-clause*
- (c) any property, other than immovable property,—
 - (A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
 - (B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

2.1.4. Non-residents are taxable in India in respect of income that accrues or arises in India or is received in India or is deemed to accrue or arise in India or is deemed to be received in India. Gift received by non-residents from residents was falling outside the purview of income accruing and arising in India and was therefore not taxed in India. However, with the insertion of subsection (viii) to Section 9(1) by the Finance Act, 2019, all the gift of money or property (as explained above) is taxed in the hands of non-resident donee, except for certain exemptions provided in clause (x) of sub-section (2) of section 56.

2.2. Proposed Amendment under Finance Bill 2023

2.2.1. The existing provision was only applicable to non-residents for gifts received from residents. However, Not Ordinarily Residents ('NORs') were still outside the ambit of the above amendment and were receiving gifts from residents but not paying tax on it. Moreover, the definition of NOR has been widened by Finance Act 2020. Therefore, to widen the scope, this amendment is proposed in order to widen and deepen the tax base and as an anti-abuse provision.

2.2.2. Accordingly, it is proposed that Section 9(1)(viii) shall be substituted as follows:

“(viii) income arising outside India, being any sum of money referred to in sub-clause (xvii) of clause (24) of section 2, paid by a person resident in India —
(a) on or after the 5th day of July, 2019 to a nonresident, not being a company, or to a foreign company;

or

(b) on or after the 1st day of April, 2023 to a person not ordinarily resident in India within the meaning of clause (6) of section 6.”

(Applicable from

01-04-2023)

2.3. Comments and Implications

The number of people falling under the NOR category have significantly increased after the amendment to the definition of residence in India brought in by FA 2020. An NOR is also not required to pay taxes on their foreign income except for income which accrues or arises outside India from a business controlled in or a profession set up in India.

Thus, an NOR had the best of both worlds, i.e. no taxation of foreign income and also no requirement to stay outside India for more than 245 days or reduce the income in India to less than INR 15 lakhs.

With the increase in the number of people falling under the NOR category, it was considered necessary to put the NOR category under the provisions of Section 56(2)(X) as well to plug the leakage of tax revenue and bring NORs on par with non-residents so far as taxation of gifts from residents is concerned.

3. Section 56(2)(viib) – Inclusion of non-residents within its ambit

3.1. Extract of current Provisions and Analysis:

3.1.1. Section 56(2) provides, inter alia, that the following type of income shall be chargeable to income-tax under the head "Income from other sources"- Section 56(2)(viib): *where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares*

3.1.2. Rule 11UA of the Income-tax Rules provides the formula for computation of the fair market value of unquoted equity shares for the purposes of the Section 56(2)(viib) of the Act where by either the Net Asset Value method (i.e. Book value method) or the Discounted Cash Flow method (based on future cash flows) may be adopted.

3.1.3. This Section is applicable to Companies, other than those where the public are substantially interested. The term “company in which public are substantially interested” has been defined in section 2(18) of the Income Tax Act. This broadly includes public companies which are listed on stock exchanges, or subsidiaries of listed public companies.

3.1.4. Equity and Preference shares both are covered under this section.

3.1.5. The tax is payable on the amount received against issue of shares by such a Company from residents, to the extent it exceeds the fair value of the shares.

- 3.1.6. Clause (viib) of sub section (2) of section 56 of the Act was inserted vide Finance Act, 2012 to prevent generation and circulation of unaccounted money through share premium received from resident investors in a closely held company in excess of its fair market value

3.2. Proposed Amendment and intent reflected in Memorandum

- 3.2.1. In order to bring the non-resident investors within the ambit of section 56(2)(viib) and to prevent generation and circulation of unaccounted money through share premium, it is proposed to include the consideration received from a non- resident for issue of shares in excess of Fair Market Value as income under the head 'Income from other sources' in case of company receiving such Premium

- 3.2.2. Accordingly, it is proposed by Finance Bill 2023 that Section 56(2)(viib) will read as under:

“where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person ~~being a resident~~, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares” (Applicable from 01-04-2024)

- 3.2.3. The amendment will apply to money received by a Company for issue of shares at a premium from anybody, regardless of their residential status.

3.3. Comments and Implications

The proposed amendment will impact start-ups and other Small and Medium Enterprises (SMEs) looking for rapid growth as they are thinly capitalized and depend upon foreign investors for their funding. Such funding is normally at a substantial premium as the underlying assets of the startup do not support a higher fair market value. As a result, such funding normally depends on future prospects of the company rather than the current value of the assets of the company. Currently, such funding by non-residents did not involve valuation under Section 56(2)(viib) as it was not applicable to non-residents, though it could be argued that such cases were otherwise covered under Section 56(2)(x) which required fair valuation to be considered in all cases where a person receives money or property from any other person, except exempt cases as provided therein. It appears that with this proposed amendment, the regulatory loophole is being inadvertently plugged.

Notwithstanding the above proposed amendment, investment by non-residents in shares of Indian companies was subject to pricing guidelines under FEMA, unless such investment was on non-repatriation basis. So, in most cases, valuation as per internationally accepted methods was required and the shares were issued at or above such computed fair value as required under FEMA. With this proposed amendment, in cases where shares are issued above the fair value to non-residents, such a difference will now be taxed whereas earlier it was not being taxed as the section applied only to subscription by residents.

Further, It may be noted that Startups can take resort to the CBDT notification 13/2019 dated 5th March, 2019, which exempts Startups from the applicability of the provisions of Section 56(2)(viib), provided the conditions mentioned therein are fulfilled by the Startups.

4. Reducing time provided for furnishing TP report – Section 92D(3)

4.1. Current Provisions and Analysis

4.1.1. Section 92D(1) provides that: *Every person, —*

(i) who has entered into an international transaction or specified domestic transaction shall keep and maintain such information and document in respect thereof as may be prescribed;

(ii) being a constituent entity of an international group, shall keep and maintain such information and document in respect of an international group as may be prescribed.

4.1.2. Section 92D(3) provides that - *The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person referred to in clause (i) of sub-section (1) to furnish any information or document referred therein, within a period of thirty days from the date of receipt of a notice issued in this regard:*

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of thirty days by a further period not exceeding thirty days.

4.1.3. Section 92D of the Act, provides that every person who has entered into an international transaction or a specified domestic transaction shall keep and maintain the information and documents as provided under rule 10D of the Income-tax Rules, 1962

4.2. Proposed Amendment by Finance Bill 2023

4.2.1. It has been represented that in several instances due to limited time available for Transfer Pricing proceedings, it may not be practically possible to provide minimum 30 days for producing these information or documents which in any case is already in possession of the assessee. Accordingly, the time period allowed for submission of information or documents in respect of international transactions or a specified domestic transaction is required to be rationalised so as to provide the Assessing Officers a reasonable amount of time to examine the information / documents submitted and complete the pending proceedings.

4.2.2. In view of the above, it is proposed to amend sub-section (3) of section 92D of the Act to provide that,-

(i) The Assessing Officer or the Commissioner (Appeals) may, in the course of any proceeding under this Act, require any person referred to in clause (i) of sub-section (1) to furnish any information or document referred therein, within a period of ten days from the date of receipt of a notice issued in this regard:

Provided that the Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the period of ten days by a further period not exceeding thirty days.

(Applicable from 01-04-2023)

4.3. Comments and Implications

The amendment is aimed at making more time available with the Assessing Officer ('AO') to complete the assessment within the time limits specified in Section 153 of the Act. The information that may be sought from the assessee is already likely to be available with the assessee given the fact that he is obligated to maintain the information and documents as specified in Rule 10D of the Income Tax Rules, hence reduction of period for submission may not make material difference to the assessee.

As required under Section 92CA(3A), in cases where reference has been made by the AO to the Transfer Pricing Officer ('TPO') under Section 92CA(1) for computation of arms-length price, the TP order should be issued at least 60 days prior to the due date for completion of assessment as provided in Section 153 of the Act.

Relevant extract of Section 92CA(3A) of the ITA is as follows: *.....an order under sub-section (3) may be made at any time before sixty days prior to the date on which the period of limitation referred to in section 153, or as the case may be, in section 153B for making the order of assessment or reassessment or recomputation or fresh assessment, as the case may be, expires.*

Accordingly, the AO has a limited time period of 60 days to conclude and issue the draft Assessment Order. In case he requires any further additional information, then under the existing provision a period of 30 days is available for the assessee to submit the same which may be extended by further 30 days thereby leaving no time for the AO to conclude the assessment. In view of same, the amendment is proposed whereby the time available to the assessee for submission of the required information is reduced to 10 days with further extension of 30 days thereby enabling the AO with sufficient days to complete the assessment within the overall period specified in Section 153 of the Act.

5. Prevention of misuse of section 44 BB and 44 BBB- presumptive Scheme

5.1. Current Provisions and Analysis

- 5.1.1. Section 44BB of the Act provides for presumptive scheme in the case of a non-resident assessee who is engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils. Under the scheme, a sum equal to 10% of the aggregate of the amounts specified in sub-section (2) of the said section is deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

- 5.1.2. Section 44BBB of the Act provides for presumptive scheme in the case of a non-resident foreign company who is engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government. Under this scheme, a sum equal to 10% of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning is deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".
- 5.1.3. Both sections provide that an assessee may claim lower profits and gains than the profits and gains specified if he keeps and maintains such books of account and other documents as required under sub-section (2) of section 44AA of the Act and gets his accounts audited and furnishes a report of such audit as required under section 44AB of the Act.

5.2. Proposed Amendment by Finance Bill 2023

- 5.2.1. It is seen that taxpayers opt in and opt out of presumptive scheme in order to avail benefit of both presumptive scheme income and non-presumptive income. In a year when they have loss, they claim actual loss as per the books of account and carry it forward. In a year when they have higher profits, they use presumptive scheme to restrict the profit to 10% and set off the brought forward losses from earlier years. Conceptually, if assessee is maintaining books of account and claiming losses as per such accounts, he should also disclose profits as per accounts. There is no justification for setting off of losses computed as per books of account with income computed on presumptive basis.
- 5.2.2. To avoid such misuse, it is proposed to insert a new sub-section to section 44BB and to section 44BBB of the Act to provide that:
- Notwithstanding anything contained in subsection (2) of section 32 and sub-section (1) of section 72, where an assessee declares profits and gains of business for any previous year in accordance with the provisions of presumptive taxation, no set off of unabsorbed depreciation and brought forward loss shall be allowed to the assessee for such previous year (Applicable from 01-04-2024)***

5.3. Comments and Implications

The intention of law when introducing the presumption schemes of taxation under Section 44BB and Section 44BBB (which provided for lower taxation) was to pay minimum taxes after considering all the expenses on deemed basis and hence not to provide for the benefit of carry-forward and set-off of losses. However, due to the manner in which the said Sections were framed, such a loophole came into being which was exploited by the tax payers. The proposed amendment is therefore aimed at discouraging such an abuse of law.

6. Tax incentive to the International Financial Services Centre (IFSC)

In order to further incentivize operations from IFSCs, the following changes are proposed by the Finance Bill 2023

6.1. Proposed Amendments by Finance Bill 2023

- 6.1.1. Section 47 (viiad) - Finance Act 2021 provided incentives in case of relocation of funds to IFSC if the relocation had taken place on or before 31 March 2023. It is proposed to extend the sunset clause in case of relocation from 31st March 2023 to 31st March 2025.
- 6.1.2. Accordingly, It is proposed to amend clause (b) of the Explanation to clause (viiad) of section 47 of the Act to extend the date for transfer of assets of the original fund, or of its wholly owned special purpose vehicle, to a resultant fund in case of relocation to 31st March, 2025 from current limitation of 31st March, 2023.
- 6.1.3. Section 10(4)(E) - Income of non-residents on transfer of Offshore Derivative Instruments (ODI) entered into with IFSC Banking unit is exempt under section 10 (4E) of the Act. Under the ODI contract, the IFSC Banking Unit (IBU) makes the investments in permissible Indian Securities. Income earned by the IBU on such investments is taxed as capital gains, interest, dividend under section 115AD of the Act. After the payment of tax, the IBU passes such income to the ODI holders. Presently, the exemption is provided only on the transfer of ODIs and not on the distribution of income to the non-resident ODI holders, hence this distributed income is taxed twice in India i.e. first when received by the IBU and second, when the same income is distributed to non-resident ODI holders.
- 6.1.4. Therefore, in order to remove the double taxation, it is proposed to amend clause (4E) of section 10 of the Act, to also provide exemption to any income distributed on the offshore derivative instruments, entered into with an offshore banking unit of an International Financial Services Centre as referred to in sub-section (1A) of section 80LA, which fulfils such conditions as may be prescribed. It has also been provided that such exempted income shall include only that amount which has been charged to tax in the hands of the IFSC Banking Unit under section 115AD.
- 6.1.5. The IFSCA (Fund Management) Regulations, 2022, went into effect on May 19, 2022. To include the reference to the said regulation in the Income Tax Act's provisions, it is proposed to amend the definition of "Investment Fund" (as provided in Explanation 1, in clause (a) to Section 115UB) to include the reference to the IFSCA (Fund Management) Regulations, 2022
- 6.1.6. The amendments referred to in paragraphs 6.1. and 6.3. will take effect on April 1, 2023, and will apply to assessment years 2023-24 and onwards. The amendment in paragraph 6.2. will take effect on April 1, 2024, and will apply to assessment years 2024-25 and onwards.

6.2. Comments and Implications

Several tax breaks have been granted to units located in the International Financial Services Centre (IFSC) under the Income Tax Act in recent years in order to make it a global financial services hub. Over the years, the Government has made tremendous effort in making policies, regulatory changes and providing tax incentives that are conducive for setting up presence in IFSC. The Economic Survey 2022-2023 mentioned that GIFT IFSC is now emerging as a preferred jurisdiction for international financial services. Recognising the growing

significance of IFSC, the Global Financial Centres Index, London Report (March 2022) put IFSC in GIFT City at the top, among 15 centres globally.

The amendments proposed in the Finance Bill 2023 are in continuation of the pursuit of the Government to make IFSC an attractive destination for setting up operations and attracting investments.