

Tax Hotline

March 28, 2020

TAXATION OF BUSINESS TRUSTS – AN IMPORTANT UPDATE

The Finance Bill, 2020 (“**Finance Bill**”) was introduced at the time of presentation of the Union Budget for financial year (“**FY**”) 2020-21 by the Indian Finance Minister on February 1, 2020. Our hotline containing a detailed analysis of the Finance Bill can be found [here](#).

Subsequently, the Finance Minister tabled several amendments to the Finance Bill through a notice of amendments on March 21, 2020. These amendments were approved and the Finance Bill was passed by the Lok Sabha on March 23, 2020. Our hotline containing a detailed analysis of these amendments, including a key amendment to the regime for taxation of business trusts can be found [here](#).

On March 27, 2020, the President of India assented to the Finance Bill and the Finance Act, 2020 (“**Finance Act**”) was notified on the same date.

Importantly, the Finance Act has made further amendments to the regime for taxation of business trusts and in particular, the scheme for taxing income in the nature of dividend distributed by a business trust to its unit holders under the Income-tax Act, 1961 (“**ITA**”).

Prior the introduction and passage of the Finance Bill, dividends distributed by an Indian company out of its current income to a business trust, where the company was a special purpose vehicle (“**SPV**”) held 100% by the trust, were exempt from dividend distribution tax (“**DDT**”) at the SPV level and also exempt from tax at both the trust level and the unit holder level.

At the time of its introduction, the Finance Bill proposed to remove the tax exemption granted to unit holders in order to align the tax treatment of distributed income in the nature of dividend with the classical system for taxation of dividend, which was reintroduced with the abolition of the DDT. If implemented, these amendments would have resulted in such income becoming taxable in the hands of unit holders with effect from April 1, 2020. The proposal was therefore a significant cause of concern for existing unit holders of business trusts, who had structured their investments with a specific tax impact in mind.

Taking note of these concerns, the proposed removal of the unit holder exemption was reconsidered and the Finance Bill as passed by the Lok Sabha reflected a revised exemption: with effect from April 1, 2020, distributed income in the nature of dividend received by a unit holder from a business trust would be exempt in the hands of the unit holder, **provided** the underlying SPV had elected to be taxed as per the provisions of section 115BAA of the ITA. For reference section 115BAA, introduced by the Taxation Laws (Amendment) Act, 2019 provides domestic companies with the option to be taxed at a lower rate of 22% (exclusive of surcharge and cess) in exchange for foregoing certain specified deductions, allowances and tax credits.

The Finance Act has reversed this position. Now, with effect from April 1, 2020, distributed income in the nature of dividend is exempt in the hands of the unit holder only if the underlying SPV **has not** exercised the option under section 115BAA of the ITA. In other words, such income is exempt in the hands of the unit holder if the underlying SPV has elected to retain its existing corporate tax regime **and has not migrated** to the concessional tax regime under section 115BAA of the ITA.

When read with amendments made to the withholding tax regime applicable to business trusts, the net effect of the amended unit holder exemption is as follows:

- If the SPV **has** exercised the option under section 115BAA:
 - A 10% withholding tax applies on income in the nature of dividend distributed by the trust to the unit holder; and
 - Such dividend income is **taxable** in the hands of the unit holder.
- If the SPV **has not** exercised the option under section 115BAA:
 - No withholding tax applies on income in the nature of dividend distributed by the trust to the unit holder; and
 - Such income is **exempt** in the hands of the unit holder.

It is unclear what power was utilized by the Central Government to modify the language used in the Finance Bill as passed by the Lok Sabha. Under India’s constitutional framework, neither the President of India nor any other body has the power to alter the text of a Bill after its passage by the Houses of Legislature. No corrigendum, errata or order was issued by the Central Government or the Houses of Legislature reflecting the changed language prior to the notification of the Finance Act.

We have also updated our hotline on amendments made to the Finance Bill in order to reflect the above change in law.

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