AMCHAM Post-Budget Memorandum 2021 - 22

Direct Tax

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AMCHAM Post-Budget Memorandum
Recommendations for Union Budget 2021-22

Direct Tax

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A. Direct tax

1. Involuntary stay in India owing to lockdown restrictions should be excluded for determining Residential status and Permanent Establishment

2.

With the announcement of a nation-wide lockdown in March 2020, and the suspension of international flights in India and other countries, many non-residents on limited duration visits to India, have had to involuntarily stay in India and also meet their employment duties from India.

Issue/ rationale

With restrictions continuing in many parts of the world, there are concerns in the mind of the taxpayers if they will become tax residents in India this year and thus subject to tax in India even on their foreign incomes. This shall further increase their compliance burden in India and in the home country, as tax credits for payments made in India and the home country would have to be claimed in respective tax returns.

Additionally, operations from India by such individuals may create PE exposure for their employers, despite the fact that such operations from India were not a requirement of either the employee or the employer.

Recommendations/Suggestions:

(i) Internationally, Organisation for Economic Co-operation and Development (OECD) as well as multiple countries have already released a guidance to treat the present situation as 'exceptional and temporary' and clarifying that extended stays during this period should not trigger a change in residency or PE status. A Similar clarification should be issued by the Indian Government. This should include a clarification that the Place of Effective Management ('POEM') rules should not apply during such period.

(ii) Clarifications issued by Central Board of Direct Taxes CBDT (vide Circular No. 11/2020 dated 8 May 2020) in respect of residential status of individuals for the Financial Year ('FY') 2019-20 was a welcome step. It helped in clearing the ambiguity on residential status of individuals by taking into cognizance the concerns of such individuals who could not return back to their home country until 31st

March 2020. Considering that the lockdown continued in many parts of the country for much of 2020-2021 also, it would be useful to have a similar clarification either by way of a separate notification or amendment in Section 6 itself for FY 2020-21 as well.

Further, certain exemption (short say and ship stay) in various Sections [e.g. Section 10(6)(vi) and 10(6)(viii) also have days of stay as a condition. It would be useful if the above clarification on counting the days of stay is extended to these exemptions as well.

3. Special relief for expenses incurred under Work from Home (WFH) / remote working

WFH or remote working have become the new normal for most organisations due to the pandemic. With the Government relaxing the rules for the IT/ ITeS industry and increasing number of employers extending work from home for the long run, there is a sizeable population of employees working remotely in India. Employers have extended remote working even after the lockdown was lifted, considering employee health and safety and to some extent considering the associated costs.

Recommendations/suggestions:

It is recommended that the government may provide some relief to taxpayers to compensate for the higher cost incurred while working from home, like deductions of expenses borne by the employer as an additional cost during the pandemic.

4. Clarification on allowability of some exemptions in the hands of employees

Current provisions of the Income-tax Act read with Rules provides for many exemptions with respect to allowances received by the employees from their employers, subject to certain specified conditions. Some of these exemptions relate to allowances towards meal, transport, etc. with fulfillment of specified conditions. Further, there are provisions relating to taxability of perquisites relating to chauffer driven car used for personal as well as official purposes.

Amidst the nation-wide lockdown and employees still following WFH model or remote working for safety reasons, it was/ is not possible for the employees to satisfy all the conditions specified under the Rules to be eligible to claim exemption towards these allowances. Further, WFH or remote working being a new normal, there is no clarity as to how these exemptions will be available to the employees going forward.

Recommendation/suggestion:

It is requested that a clarification be issued on allowability of such allowances / taxability of perquisites, given the fact that satisfaction of all the conditions specified therein may not be possible.

5. Withdrawal of exemption enjoyed on interest earned on provident fund contributions over INR 2.5 Lakhs (Section 10(11) and Section 10(12))

The Finance Bill '21 has proposed that interest accruing on contributions made in excess of INR 2.5 Lakhs to a Provident Fund account shall be taxable with effect from 01 April 2021. While the intention of the government to remove practices of making huge contributions to these funds for earning tax exempt income is understandable, withdrawal of the tax exemption may cause certain hardships and unintended consequences and thus, requires a reconsideration.

Issue/ rationale

PF funds are retirement corpus of employees and most of the time, the only saving that they depend on, post retirement. Provisions seeking to tax a portion of PF returns will reduce the attractiveness of PF as an investment option. It needs to be appreciated that even though there is interest accrued, the money remains invested and is not withdrawn until a long time. These are long term funds in nature and provide capital for government investments in infrastructure development related projects. Earlier, the government encouraged more contribution to PF fund for the same reasons.

With the new rules to be implemented w.e.f. from April 1, 2021, requiring the basic to be 50% will get more employees under its net, thereby further reducing the take home salary. Further, it appears that "The Code on Social Security, 2020" enacted by the government permits an employee to contribute to the provident fund in excess of the contribution made by the employer. The relevant provision is contained in section 16, which reads:

"16. (1) The Central Government may, for the purposes of— (a) the Provident Fund Scheme, establish a Provident Fund where the contributions paid by the employer to the fund shall be ten per cent of the wages for the time being payable to each of the employees (whether employed by him directly or by or through a contactor), and the employee's contribution shall be equal to the contribution payable by the employer in

respect of him and may, if any employee so desires, be an amount exceeding ten per cent. of the wages, subject to the condition that the employer shall not be under an obligation to pay any contribution over and above his contribution payable under this section ….”

Currently the economy needs higher disposable income to boost demand. With taxation of interest, salaried class would be required to shell out taxes from their other incomes, as this interest on PF would be received only on withdrawal.

The contribution to provident funds has been a source of long-term funds for driving government spending. The proposed taxation may restrict the voluntary contribution towards PF which will limit the cash flows for Government of India. Considering the larger objective, the threshold limit of INR 2.5 Lakhs imposed is very low.

Additionally, the newly introduced provisions do not address some critical aspects, such as:

(i) Whether taxes are to be paid on accrual basis or at the time of withdrawal.

(ii) Whether in subsequent years (say FY 2021-22), interest on contribution made in excess of INR 2.5 Lakhs in FY 2020-21 will also be subject to tax.

(iii) Whether the mandate of tax withholding on such interest be a responsibility of the employer. If, yes how would such information be made available to the employers as the quantum of interest earned on PFs’ provident funds may only be known to the employees.

Recommendations/ suggestions:

(i) The current need of the economy is increase in demand, and imposition of such taxes will only lead to reduction in take home salaries of the salaried class and loss of long-term funds for the government. **Accordingly, there is a need to reconsider these provisions in light of results sought to be achieved from a macro-perspective.**

(ii) It is recommended that in line with the provisions of the Social Security Code, 2020, employees should be allowed to contribute to the provident fund in excess of the contribution made by the employer, hence no amendment may be made in the Income-tax Act in respect of proposed provisions.

(iii) It is pertinent to mention that sections 17(2)(vii) and 17(2)(viia) provides that the employer contributions to Provident Fund / NPS / superannuation fund in excess of INR 750,000 are taxable as perquisite along with interest thereon. Accordingly, in alignment with limit of INR 7,50,000, instead of INR 250,000, interest on employee contributions above INR 750,000 during the year should be made taxable.

(iv) Alternatively, it should be clarified that:

- Accumulated balance as on 31 March 2021 and any accretions thereto may be grandfathered. Thus, effectively no income-tax consequence on accumulated balance and accretions thereon.
- Taxability of interest should be only at the time of withdrawal and not on accrual basis
- Party which shall bear the obligation to withhold taxes on such interest should be the PF authorities and not the employer. Since, the PF authorities have the requisite data, such responsibility should ideally be borne by the PF authorities and not the employers

(v) Further clarifications be issued on:

- Taxability of accrued interest on contributions made in Year 1 in the subsequent year

(vi) Taxpayers may not be able to correctly compute the taxable interest component. The PF portal/ Form 26AS should indicate such taxable quantum of interest, for taxpayers to keep a track of interest subjected to tax.

(vii) Also, the limit on Public Provident Fund ('PPF') as notified under Section 10(11) of the Act is INR 150,000 and hence, it should be clarified that the budget change will not be having any impact as far as contribution to PPF is concerned.

6. Disallowance of expense on delay in payment of employee's contribution to a fund on or before due date specified in the respective law

The Finance Bill 2021 has proposed to disallow deduction of employee's contribution collected under PF / superannuation fund or any other fund set-up for welfare of the employees as an expense in the hands of employer, if the same is not deposited within the due date prescribed under the respective statute. This has been done to ensure that there is no loss of interest for the employees on such contributions.

As per the Explanatory Memorandum, such changes will come into effect from 1 April 2021 and will apply to the assessment year 2021-22 and subsequent years. However, the language used in the amendment – specifically the phrase '*and shall be deemed never to have been applied for the purposes of determining the due date'* is capable of being read in a manner that gives the amendment retrospective effect.

Issue/ rationale

While the proposal clearly states that insertion of the amendment is with effect from 1 April 2021, the language of the memorandum indicates that the intention of disallowance has always existed i.e. gives scope to retrospective application.

Recommendation/suggestion:

Considering the Government's stated position on retrospective amendments, and the specific insertion of the amendment with effect from 1 April 2021, it should be clarified that these provisions will not apply for earlier assessment years.

Without prejudice to the above, where the provisions are given retrospective effect, immunity from interest and penalties are granted to taxpayers who have acted as per binding judicial precedents.

7. Revocation of depreciation allowance on goodwill (Section 32 of the Act)

It is proposed in the Finance Bill'21 that goodwill will no longer be considered as an intangible asset and hence no depreciation shall be allowed from 01 April 2020. Based on the memorandum explaining the Union Budget proposals, the tax department is of the view that Goodwill as an asset class is primarily not a depreciable asset, rather the value of it appreciates over time.

Further, in a case where goodwill is purchased by a taxpayer, the purchase price of the goodwill will continue to be considered as cost of acquisition for the purpose of computation of capital gains under Section 48 of the Act. Any depreciation claimed and obtained by the taxpayer for prior years up to AY 2020-21 shall be reduced from the purchase price of goodwill (section 55). Also, Goodwill forming part of block of assets in the prior years is no longer eligible for tax depreciation.

Issue/ rationale

a. The proposed change will impact the goodwill recognized in case of business acquisitions where a premium has been paid for acquiring business - Goodwill is an important intangible asset arising in Mergers and amalgamation ('M&A') and is duly recognized by commercial terms, accounting standard and judicial precedence. Various Courts & Tribunals (including Supreme Court) have affirmed that depreciation can be claimed on Goodwill and such consistent findings are commercially factored in M&A deal valuations. Moreover, undisputed M&A deals involve payment of consideration over and above the fair value of the accounted net-assets.

b. The assertion in the Memorandum that goodwill cannot depreciate is not borne out in the business world. Businesses routinely face challenges arising from various factors, that has the effect of their goodwill being eroded. Accordingly, treating goodwill akin to an asset which only see appreciation may not be correct. A plethora of examples are available where large corporates has taken impairment of goodwill in their books.

c. The above proposal will impact past M&A deals concluded after considering the prevailing law based on the Supreme Court ruling of Smifs Securities, as companies will lose tax deduction of the remaining Written Down Value (WDV) of Goodwill, making some of the deals unviable and which also runs against the fundamental of providing tax certainty.

d. There are enough safeguards in current law to attack those cases, where there is artificial goodwill recognized by some of the taxpayers.

e. Retrospective amendment could lead to delayed advance tax for no fault of taxpayer's and consequential implication thereof.

f. The amendment will also lead to double taxation as tax is paid by seller on entire consideration (including Goodwill premium) whereas such Goodwill premium cannot be claimed as depreciation in the hands of purchaser. If business is being acquired by way of slump sale / non-tax neutral merger, the seller would pay tax on such transaction. In such cases, if the buyer is denied depreciation on the Goodwill component of the consideration paid, this would end up affecting the economics behind many deals.

Recommendations:

(i) Goodwill is an important intangible asset arising in M&A and should be duly recognized by commercial terms, accounting standard and judicial precedence. Various Courts & Tribunals (including Supreme Court) have affirmed that depreciation can be claimed on Goodwill and such consistent findings are commercially factored in M&A deal valuations.

(ii) A distinction should be made between Goodwill arising on tax neutral mergers and acquisition of business through either slump sale / non-tax neutral merger. Goodwill arising in the books of buyer on slump sale of business / non-tax neutral merger should be allowed for depreciation claim.

(iii) Without prejudice, in the interest of equity, it should be clarified for depreciation claims on Goodwill forming part of the block of assets in the prior years to continue to be eligible for tax depreciation. We recommend introduction of grandfathering provisions for prior years on the principles of ensuring tax certainty.

(iv) In any event, the provisions should be made applicable prospectively i.e. from AY 2022-23 onwards.

8. Higher tax withholding and collection on payments to non-tax filers (Section 206AB and Section 206CCA)

The Finance Bill'21 has proposed Section 206AB and Section 206CCA which provides for levy of Tax Deducted at Source (TDS) and Tax Collected at Source (TCS) at a higher rate of i) twice the rates in force or ii) 5%, on transactions with non-filers of Income-tax returns. Non-filers are persons who have not filed their tax returns in the previous two financial years, where the due date of filing a return under section 139(1) has elapsed. There is another condition that the aggregate of tax deducted at source and tax collected at source in his case is INR50,000 or more in each of these two previous years.

Issues/ rationale

a. Currently there is no mechanism or functionality prescribed on how to validate the Tax return (ITR) filing status.

b. There is also no clarity on how to validate the condition, that deductee' s aggregate TDS/ TCS should exceed INR 50,000.

c. The new provision would lead to significant increase in compliance and administrative costs for the taxpayers, owing to the increased additional responsibility casted.

d. A taxpayer would be required to keep a regular track of its vendor's tax filings and seek additional volume of data which may include acknowledgment of tax filings, Form 26AS, declaration that tax return for past year has been filed within the due date etc.

e. Moreover, certain situations would require specific clarification, such as

- Applicability of this provision to newly set up entities.
- Applicability of this provision to taxpayers who are not required to file their tax return.
- Applicability of this provision and corresponding interest provisions where taxes were withheld at the applicable rate based on a confirmation from the vendor, but at a later stage it so transpires that the vendor has defaulted in the filing of income-tax return.
- Applicability of provisions where the income-tax return filed is subsequently held as defective.

Recommendations/suggestions:

(i) The details of TDS/TCS made in past years and status of tax filing of a taxpayer are already being monitored by the government using various applications like Non-filers Monitoring System (NMS). While the intent of tax administration is understandable, it is bound to cause much heavy burden and confusion at the end of tax deductors, as they need to continuously update records related to ITR filing by their suppliers, leading to increased compliance costs. Thus, it is strongly urged that the proposed provision of Section 206AB and Section 206CCB be dropped from the final legislation

(ii) Without prejudice to the above, the Government should provide a tech-based solution to validate tax returns filings and TDS/ TCS undertakings. Under GST, authorities have enabled Application Program Interface (APIs') for validating GST return filing status of vendors using the GST registration number. A similar API-based mechanism similar to PAN validation facility provided by National Securities Depository Limited (NSDL) should be explored for validating income-tax returns through a PAN based identifier. Also, similar set up is already available for TDS under section 194N.

(iii) It is also recommended that the Government prescribes clear mechanism to be followed by the taxpayer for validating the tax filing status. In the absence of a specific mechanism, there may be disputes on the determination of filing status. Possible mechanism may include:

- **Short term** - Obtaining a declaration from the vendor confirming filing status and status of aggregate TDS/ TCS amounts.
- **Long term:** Tech solution through an API functionality to validate the tax filing status and status of aggregate TDS/ TCS amounts.

(iv) Based on the validation mechanism adopted, taxpayers would be required to build technical systems to ingest the additional requirements in an automated manner so that TDS/TCS calculations and compliances are undertaken timely and accurately. Considering the time and significant efforts required for such technology build up, we recommend that the provision be deferred to **April 1, 2022**, so that there is adequate time to clarify the validation mechanism, which will also provide tax payers the necessary time to adapt to the technological changes.

9. TDS on purchase of goods (Section 194Q)

Finance Act, 2020 had introduced TCS provision (Section 206C(1H)) with effect from 01 October 2020 to collect taxes on sales transactions. Sellers (where turnover in past year exceeds INR 10 Crore) were liable to collect TCS @ 0.1% of the receipts in excess of INR 50 Lakhs from a buyer.

Now, FB, 21 has proposed TDS on virtually the same transactions which were covered by TCS provisions and require TDS @ 0.1% by a buyer (with past annual turnover exceeding INR 10 Crores) at the time of purchase/ payment (whichever is earlier) in excess of INR 50 Lakhs, from a resident.

Further, it has been clarified that TCS provisions under section 206(1H) are not applicable to transactions subject to TDS under the newly introduced provisions.

Issues/ rationale

a. **Complexity** - In the previous budget, provisions related to TCS were introduced and assesses struggled to incorporate the same in their ERP/accounting environment. The new section 194Q related to TDS purchase of goods will override Sec 206C (1H) that relates to TCS on sale of goods and therefore making it complex from a compliance standpoint.

b. Further, coupled with the requirement to obtain PAN (Section 206AA) and validating tax return filing status of the sellers (Section 206AB), this section imposes disproportionate compliance requirement on the buyers, compared to the underlying taxes involved

c. **Demands significant time and resources** - TDS on goods is being proposed for the first time and this is likely to impact trading businesses heavily considering the number of transactions which would need to be subjected to this compliance. Accordingly, implementing a TDS mechanism for such transactions, along with the necessary technology implementation and process changes for accurately complying with this provision will again entail significant time and resources, negatively impacting the ease of doing business in India.

d. TDS provisions under section 194Q trigger on accrual or payment whichever is earlier. However, TCS provisions trigger on payment basis. If a transaction has suffered TDS under section 194Q, then TCS provisions will not apply on such transaction. This implies that the seller needs to first ascertain whether the buyer of goods would undertake TDS compliances under section 194Q, if not then again test the transaction for applicability of TCS provisions. Such an obligation on taxpayers is extremely cumbersome to comply with.

e. It is practically difficult to comply and reconcile provisions of Section 206C(1H) and Section 194Q on account of the above complexities and may lead to disputes between the buyers and sellers.

f. Additionally, it is unclear whether:

- TDS is applicable on gross sales or net sales i.e. after considering sales returns, discounts etc.
- Shares/securities qualify as "goods" for the purpose of applicability of provisions of Section 194Q.
- the provisions extend to non-resident buyer
- TCS provisions would apply, where there is a TDS default by the buyer

- TCS provisions would apply where a nil withholding tax certificate is obtained for non-applicability of TDS provisions

Recommendations/suggestions:

(i) With existing TCS provisions and GST laws, the government already has capabilities to monitor purchase transactions and collect taxes thereon in a timely manner. Hence, this new provision is merely burdening the traders with additional compliance requirement and hence, it is strongly urged that the Government should withdraw and drop Section 194Q from the final legislation

(ii) Without prejudice to the above:

a) The provisions be deferred by 9 months i.e. made effective from 01 April 2022, so that Enterprise Resource Planning (ERP) capabilities may be installed. It may be noted that the tax-payers were given a time period of 8 months for complying with TCS provisions relating to sale of goods as well, and thus, considering the complexity and significant tech efforts involved in the process, the provisions should be deferred by at least 9 months.

b) The provisions of TCS under section 206C(1H) be withdrawn as the objective of tax collections and tracking of high value transactions are now achieved by introducing Section 194Q.

c) That the threshold of INR 50 Lakhs be increased to INR 10 Crores to reduce compliance burden

d) Certainty be brought in the minds of the taxpayers:

- Confirming exclusion of all shares/securities (listed and unlisted) from the ambit of Section 194Q
- Definition of 'goods' need to be clarified for the purposes of Section 194Q and Section 206(1H).
- Confirming application of circulars/clarifications issued with respect to other TDS provisions (e.g. No TDS is to be made on the GST component)
- Confirming non-payment of TDS on discounts, sales returns, price adjustment etc.
- It must also be clarified that where Section 194Q is applicable to a transaction, but the buyer has defaulted in deducting TDS, the seller should be absolved from undertaking TCS compliances on such transaction. The term ***"and has deducted such amount"*** under Section 206(1H) should be removed.

- Confirming that where nil withholding tax certificate is obtained, TCS provisions will not apply

e) To facilitate ease of doing business, it must be clarified that if a transaction is subject to Section 194Q, then the same transaction need not be tested for applicability of TCS provisions.

f) Taxpayers must have the ability to obtain a lower / nil withholding certificate under section 197 in respect of section 194Q also.

10. Clarifications on the scope of tax withholding under Section 194-O

Finance Act, 2020 had introduced Section 194-O effective from 01 October 2020, requiring e-commerce operators to withhold taxes on payments to e-commerce participants (whether resident or non-resident). The provisions require TDS to be made on gross amount of sale or services which also includes payments which are not routed through the e-commerce operators but exchanged directly between the consumers and the e-commerce participant.

Issues/ rationale

a. **Widely worded-** The provisions are widely worded i.e. amount of sales has not been defined in terms of what relevant items it should include.

b. **No exclusion for sales return -** In case of sales of goods, sales returns are very common in both retail and wholesale scenarios. In categories like fashion merchandise, the returns can be as high as 25% of the sales. TDS on gross level adversely affects the working capital of the e-commerce participant. The provisions of Tax Collection at Source ('TCS') on e-commerce operators under Goods and Services Tax ('GST') specifically provides for a reduction of "taxable supplies returned to the suppliers through the e-commerce operator" from the sales value to arrive at the 'net value of taxable supplies' on which the provisions of TCS are applicable. The suggested change aligns the TDS provisions at par with GST provisions for sales returns.

c. **No exclusion for actual charges-** In addition to the sale of the goods or service, incidental charges such as delivery or transport charges, packing charges, gift wrap charges, convenience fee etc. are charged by sellers to customers and form part of the invoice raised by the sellers. These are actual

expenses incurred for providing services, but currently are getting covered by these provisions, as they form part of the invoice

d. **Threshold limit of INR 5 lakhs is irrelevant -** As per the provisions of section 194-O an exemption of INR 5 lakhs is provided to Individual and HUFs on the gross sales in a financial year. However, once the amount exceeds INR 5 lakhs, TDS is required to be deducted on the entire amount during the financial year.

e. **Practical difficulty may lead to unwarranted penal charges-** In the context of an online marketplace, it is inherently difficult, at the start of the year, to forecast whether the cumulative sales of a particular small and medium seller will cross INR 5 lakhs during the year and start applying TDS from the first sale itself – also, given increasing digitization, a lot of new small and medium sized sellers are getting on boarded which will amplify this situation and impact these sellers. An interest of @1% per month will also be unfairly triggered on deducting TDS for the sales below INR 5 lakhs once the sales cross INR 5 lakhs.

f. The proposed levy covers sale of all goods and services through digital or electronic means. Since the term 'goods' is not defined and services is defined in an inclusive way, pre-paid instruments such as gift cards, which are essentially money's equivalent, may be inadvertently interpreted to be covered

g. Many Indian businesses use e-commerce channels to export products outside of India. TDS under section 194-O will add to the working capital burden of the e-commerce participant who usually operate on very thin margins.

Recommendations/suggestions:

(i) It may be clarified that sales returns or cancellations be excluded while computing the 'gross amount' for the purpose of section 194-O of the Act and the withholding applies to the net amount of sales, similar to GST.

(ii) It may be clarified that incidental charges, charged to end customers by e-commerce participants, represent the actual expenses incurred for availing services from the e-commerce operator. Accordingly, such incidental charges should not be subjected to TDS, where separately shown on the invoice.

(iii) It is requested that the exemption threshold for TDS deduction be increased to at least INR 40 lakhs for individuals and HUFs, aligned with the threshold for GST registration prevailing in a majority of the states. Further, it may be clarified that the withholding tax under section 194-O for individuals or HUFs, being e-commerce participants shall apply only on the incremental amount exceeding the minimum threshold during the financial year.

(iv) It may be clarified that pre-paid instruments (such as gift vouchers etc.) are excluded from the definition of goods and services.

(v) It may be clarified that provision of section 194-O will not apply when the e-commerce operator facilitates sale of goods or services by a resident seller to a customer outside India i.e. only sales to customers in India are covered under the provisions

(vi) E-commerce transactions allows payment by the buyer at the time of delivery in cash and such consideration does not flow through the e-commerce operator. Therefore, an e-commerce operator may only be required to make withholding on the component of consideration which is routed through the e-commerce operator.

(vii) Exclusion may be awarded to cases where the buyer is a non-resident of India to encourage exports from India.

(viii) The threshold for non-application of TDS in case of an individual or HUF e-commerce participant is low and also requires withholding on the full amount in cases where the revenues exceed INR 5 Lakhs. It is requested that such limit be increased to INR 40 Lakhs (akin to GST registration limit in many states) and tax withholding may only be applicable on amounts exceeding INR 40 Lakhs.

(ix) Clarifications may be issued confirming:

- Non-applicability of Section 194-O in case of a non-resident seller as Section 195 already covers such transactions.
- Non-application of TDS on quantum of sales return.
- Non-application of TDS until actual sales (in case payments are made through a pre-paid voucher).

- Non-application of TDS on packaging, transportation charges as TDS is made to payments to such intermediaries under section 194C of the Act.

11. Issuance of clarifications on Significant Economic Presence ('SEP')

Finance Act 2020 introduced SEP provisions and made it effective only from FY 2021-22 i.e. from 1 April 2021. However, there is presently no clarity on the applicability of the SEP provision as it is widely worded and extends to all transactions in goods, services and property.

Issues/ rationale

a. There is no clarity on phrases such as "carried out in India", "systematic and continuous soliciting of business", "engaging in interaction" and "download of data or software in India".

b. Thresholds are not yet prescribed. Given the volatility involved in ascertaining an accurate user base, the methodology dependent on user base is likely to be unreliable and may lead to incoherent economic outcomes. This may therefore lead to significant hardship for companies and make its compliances burdensome.

c. Further, determination of user participation would be expensive, highly unreliable, could alienate users and may contravene data privacy laws. In India, under various circumstances, multiple or fake user accounts are created. Thus, while determining the thresholds, it is pertinent that only 'active users' should be considered while calculating the threshold.

Recommendations/suggestions:

(i) With the expanded scope of Equalisation Levy provisions already in operation, the SEP provisions may be omitted and be reintroduced after a global consensus on taxation of digital economy is achieved.

(ii) Without prejudice, SEP provisions may be deferred and be applied prospectively once the trigger threshold are notified and suitable guidance for applying such triggers are provided to the taxpayers.

(iii) Appropriate guidance in form of FAQ(s), guidance document may be issued after public consultation covering the following aspects:

- Coverage of "carried out in India"
- Meaning and scope of "systematic and continuous soliciting"
- Meaning and scope of "engaging in interaction"
- Meaning and scope of "download of data and software in India"

(iv) Determining SEP, based on the user participation should be removed. Without prejudice to this, threshold of number of users should be determined with reference to 'active users. Difference should be carved out between 'active users' and 'passive users'.

(v) That rules for attribution of Income be issued in accordance with internationally accepted principles with detailed guidance to taxpayers and tax officials.

12. Equalisation levy ('EL') provisions

We understand the rationale for the Government's intent and initiatives for taxation of the digital economy. The government has had first move advantage, with the introduction of the equalization levy in 2016 on advertisement services, followed with a domestic business connection rule of significant economic presence in 2018 and now the expanded scope of the equalization levy to all e-commerce operators. However, the expanded scope of EL (*vide.* Finance Act 2020 coupled with the proposed amendments pose certain difficulties and concerns for the industry at large. The **difficulties/ Issues** are:

a. **Burden of obtaining PAN** : While income-tax laws requires non-resident to obtain PAN only in case they have taxable income in India, payment of EL and filing compliance returns under EL would require the non-resident e-commerce operator as well an authorized signatory(s) to obtain PAN in India.

b. Compliance burden in India : In order to deposit EL, a non-resident required to have a bank account in India i.e. even in cases where the e-commerce operator does not have any other business transaction in India, the non-resident is forced to meet KYC norms of Indian banks. Moreover, the due date of payment of EL for the quarter ending March has been kept a 31 March itself, which may be impracticable. It may be noted that even in case of residents, timelines for making compliances in the month of March are higher than for other months. For e.g. TDS for March is to be deposited by 30 April.

c. **Clarity on application of EL in matters pending litigation :** The current and the proposed EL provisions provide that EL shall not be payable on transactions effectively connected to a permanent establishment or to a transaction taxable as fee for technical services or royalties as per the provisions of the Income-tax Act read with the treaty. There is high uncertainty among the taxpayers whether the EL shall be paid by them when they contest a No-PE position or contest that software payments made are not royalties. Moreover, there is fear of an alternate position being adopted by the tax officials.

d. **Highly expansive definition of 'online sale of goods' and 'online sale of services'**: The proposals provide that where any of the specified activities are conducted digitally, the transactions shall be considered as **'online sale of goods'** and **'online sale of services.** The specified activities even include '**payment of consideration**' which is omnipresent in all international transactions.

e. **Undefined terms:** The EL provisions contains words which have been expansively defined or not defined even under the Income-Tax Act. This is causing undue hardship to the tax-payers, as this leaves considerable scope of differential interpretations and in absence of any scheme for advance ruling/ appeals (other than for penalty), this may lead to burden of interest and penalty on tax-payers where their interpretations do not align with interpretation of the tax officials.

f. **Coverage of B2B transactions with foreign groups with presence in India -** Foreign groups establish physical presence in India by way of subsidiaries, branches etc. for rendition of IT services or establishing Reseller/ Distributor arrangements. In such cases, the consideration payable by the Indian presence to foreign group is taxed in India under the Customs law, GST law and also a fair share of activities conducted in India are brought to tax owing to transfer pricing provisions. Therefore, such transactions are already at a level playing field with the domestic players and application of EQL on such transactions would result in increased taxations and costs for such groups.

g. **Absence of appellate scheme and scheme for advance ruing –** The government has been pro-active in bringing certainty to taxpayers and adapting measures to reduce litigation. EL provisions however, neither contain any scheme for appeal against determination of EL liability by the assessing officer nor does it provide any scheme for advance ruling.

h. **Scope of EL beyond India** – EL currently applies on consideration receivable from any Internet Protocol (IP) address in India. This may include cases where a non-resident on temporary visit to India

uses the internet for a transaction, use of Virtual Private Network (VPN) by a person outside India for entering into a transaction. In such cases, the e-commerce operator as well as the buyer would be non-residents engaging for a transaction not intended to be covered by EL. Hence appropriate guidance for applying EL based on Indian IP address is required.

i. **Exemption from EL on royalty/ FTS is governed by its taxability and not chargeability**- The proposed amendment states that EL provisions would only be applicable if the consideration is not taxable in India as royalty or FTS under the provisions of the Act read with the relevant DTAA. Accordingly, a transaction is first required to be tested for characterization as royalty/ FTS. If the same is taxable as Royalty/FTS under the provisions of the Act read with the DTAA, EL provisions shall not apply.

j. Considering that certain DTAAs' provide for a more restrictive definition of Royalty/FTS *vis-à-vis* the Act, there may be a situation where a transaction is taxable as Royalty/FTS under the Act but not taxable as per the relevant DTAA provisions. This would create a situation where a similar payment may or may not be subject to EL depending on the jurisdiction from which the service is rendered. This would not only create an anomaly in terms of application of the law by the taxpayers but also seems to unilaterally override the provisions of DTAA.

k. **Applicability of EL on the accrued revenue-** Marketplace platforms follow different practices for accruing revenue. For instance:

- In some models, the marketplace platform retains its margin on the gross consideration received from the customer, before remitting the balance (gross receipts less e-commerce operator's fee/ commission) to the ultimate seller/service provider.
- In another model, the ultimate seller/service provider receives the full consideration directly from the customer and the seller subsequently pays the marketplace platform its service fees for the online facilitation services.

In both scenarios, the consideration for the marketplace platform is only the listing fee or facilitation fee or commission (by whatever name called) related to the facilitation services and not the gross amount received by the sellers. The value of underlying goods or services facilitated by the marketplace entity belongs to the ultimate seller/service provider and not the marketplace entity.

Online marketplace platforms typically work on very low margins. Thus, an EL on the gross consideration would place immense burden on the cash flow position of these entities.

Recommendations/suggestions:

(i) The requirement to obtain PAN in India has been reduced under various provisions including requirement to obtain PAN of authorized signatory to tax return, and also by courts in matters relating to application of Section 206AA of the Act. Mandating a PAN requirement to a Non-Resident employee of a foreign company merely for the purpose of filing the annual statement creates unnecessary procedural burdens on the individual. Further, in special circumstances where the person verifying the annual statement is unavailable and a different Non-Resident employee is appointed in his/her place, the PAN process would need to be redone for this new Non-Resident employee, leading to further administrative hassles. We humbly request for a clarification that it is not mandatory for the Non-Resident employee verifying the annual statement of a Non-Resident e-commerce operator to obtain and furnish PAN. This would also be aligned with the current practice under the Income-tax laws[1] and Corporate laws[2] which have clarified that NR employees of foreign companies are not required to obtain PAN.

(ii) The following acts may be taken by the government for ease in compliance with EL provisions

- Date of payment for EL of quarter ending March be extended to 30 April
- A separate scheme for payment of EL be allowed to e-commerce operators allowing payments to be made through specified bankers

(iii) The following ambiguities in EL provisions be removed to ensure accuracy in interpretation:

- Terms like "E-commerce operator", "owns, operates or manages", "data", "digital facility", "electronic facility", "platform", be defined in absolute terms with appropriate guidance by way of a detailed examples and FAQ(s).
- Terms like 'other form of digital or telecommunication network' be defined in absolute terms by excluding e-mails, telecom and fax from the scope.

[1] Finance Act 2018 had initially amended Section 139A to require all directors to obtain PAN and it was subsequently clarified that it was not applicable for foreign companies;
Also refer to the FAQ released by CBDT https://www.incometaxindiaefiling.gov.in/eFiling/Portal/Registration_FAQ_Company_Firm.pdf

[2] MCA circular 12/14 dated 22 May 2014 also clarifies PAN is not required for corporate filings by foreign companies (Form INC 7) where PAN is not required to be obtained by directors.

- The definition of 'online sale of goods' and 'online sale of services' currently proposed is highly expansive and covers cases where mere remittance is made digitally. There is a need to revisit this inclusion as international transactions cannot be undertaken without digital remittances.
- The term 'online payment' may be explained to exclude remittances through banking channels
- That it be clarified in absolute terms that EL would be payable at the time of receipt of consideration and not at the time of accrual
- Appropriate scheme for advance ruling may be introduced to avoid uncertainty,
- Appropriate scheme for appeal be introduced against the order made by the assessing officer under section 168 of the Finance Act, 2016

(iv) Detailed guidelines/ clarifications may be issued for the taxpayers as well as tax-officials in order to avoid payment of EL, as well as tax withholding/ income-tax on transactions disputed to be royalties/ fees for technical services or transactions effectively connected to an alleged PE in India. Intra-adjustment of TDS and EL shall also be allowed in cases of such litigation.

Further, no interest and penalty should be imposed on the Non-Resident with respect to such tax demand, given the lack of clarity in the law regarding the applicable grounds for taxation of the Non-Resident.

(v) Exclusions from application of EL may be provided to

- Intra-group transactions, wherein the foreign group has already set up physical presence in India
- Sale of goods or services, where there is no nexus between the e-commerce platform owned and the sale of goods/ provision of services.
- Payment gateways, where EL on consideration relating to sale of goods/ provision of services
- The facilitation fee earned by e-commerce operators from exports from India
- Sale of goods involving physical delivery of goods and service which are not provisioned online.

(vi) EL may apply to transactions entered by Non-Residents while temporarily in India. Such transactions may be excluded from ambit of EL.

(vii) Government should provide guidance and clarity on the manner of determination of use of IP address in India and allocation of revenues based on purchases made through such IP addresses to ensure there are no varied interpretation.

(viii) Government should provide clarity on nature of EL being taxes of income thereby allowing credit of such EL, in their home countries.

(ix) Considering the intent of Section 163 of FA 2016 (being a unilateral measure under the domestic tax laws of India) and the clarity intended by this amendment, it is recommended that the EL provisions exclude only such consideration which is chargeable to tax as royalty or FTS under the provisions of the Act. In other words, taxability of the transaction as per the provisions of the DTAA should not impact the applicability of EL.

The revised provision could read as under:

"Provided that the consideration received or receivable for specified services and for e-commerce supply or services shall not include the consideration, which are chargeable to tax as royalty or fees for technical services in India under the Income-tax Act".

(x) Transactions in goods, services or property done overseas with no nexus with India may be excluded from scope of EL.

(xi) It is recommended that the proposed amendment be reconsidered, and a clarification be issued to the effect that:

- EL will apply only on the fees earned by such marketplace for the online facilitation services or commission received by an e-commerce operator where sale of third-party goods or services are facilitated on its platform;

- Only net margin earned/ commission/ facilitation fee charged by such entities shall be considered for the purpose of INR 2 crore threshold for determining applicability of EL.

Without prejudice to the above, where it is intended to apply EL on total gross receipts/ consideration in marketplace models, the third-party seller of goods/ provider of services should be subject to EL, instead of the marketplace entity.

13. Rationalisation of provision of transfer of capital asset to partner on dissolution or reconstitution of the partnership firm

Transfer of capital asset to partners pursuant to dissolution of a firm or reconstitution of the partnership firm / Association of Person (AOP) / Body of Individual (BOI), renders the firm, AOP or BOI taxable on capital gain under the present provisions in the Act. For computing the capital gain, the Fair Market Value (FMV) of the asset on the date of transfer is regarded as the 'full value of consideration'.

The Finance Bill 2021 aims to clear the ambiguity with reference to capital gains implication with regard to self-generated assets of the entity, and situations where assets are revalued, such that distributions to partners are in excess of their capital contributions.

It is proposed to substitute the existing provisions with new sections for taxation of dissolution and reconstitution of such entities wherein the balance in the capital account of the person (calculated without considering increases due to revaluation of assets or due to any self-generated assets) will be deemed to be the cost of acquisition for the purpose of computation of capital gains.

However, while computing the period of holding to determine whether the gain is short term or long term, there is no clarity on whether the period of holding should be considered from the date of introducing capital in the firm (which is forming part of capital balance at the time of dissolution or reconstitution) or the date of admitting the partner to the firm. Date of introducing capital (for period of holding computation) would pose practical challenges, as capital account is a moving account, involving infusion and withdrawal.

As per the proposed provisions, the balance in the capital account of the exiting partner at the time of dissolution or reconstitution is deemed to be the cost of acquisition. No clarity is available on whether any indexation benefit is available on such deemed cost of acquisition.

The provisions prescribe value of money or fair market value of other assets as on date of receipt to be the full value of consideration for the purpose of capital gains computation. However, no clarity is provided on how to compute the cost of acquisition, in cases where the part of the consideration payable is deferred to a different FY.

Recommendation/suggestion

- Suitable provision in the relevant sections [for e.g. section 45(4A)] may be provided to prescribe period of holding starting from the date of admission of the partner.
- Suitable provision in the relevant sections (for e.g. section 48) may be provided to clarify that indexation benefit would be available for deemed cost of acquisition. Further, computation mechanism for cost of acquisition may be provided in case part of the consideration is deferred to a different FY.

- The amendment, if proposed, should be made on prospective basis and should apply to the new transaction with effect from the financial year 2021-22 & onwards.

14. Transfer pricing

The Finance Bill 2021 has amended Section 115JB to provide that pursuant to signing of an APA or on account of secondary adjustment, if there is an increase in the book-profits of a previous year due to inclusion of income pertaining to earlier year/s, the Assessee may make an application to the Assessing officer to recompute the book profits of the respective earlier year/s for the calculation of Minimum Alternate Tax (MAT). The time period of 4 years for rectification, shall be reckoned from the end of the financial year in which the said application is received by the Assessing Officer (AO). This amendment will take effect from 1 April 2021 and will accordingly apply to the assessment year 2021-22 and subsequent assessment years.

The amendment is proposed to be made applicable from AY 2021-22, and hence, the taxpayers having APAs concluded in earlier years or having secondary adjustments effected in earlier years will be deprived of the MAT rationalization benefit.

Recommendation/suggestion

It is suggested that at the option of the taxpayer, the proposed amendment should also be made applicable to APAs concluded in earlier years or secondary adjustments effected in earlier years.

15. Withdrawal of exemption to maturity proceeds from high premium Unit Linked Insurance Policy (ULIP) (Section 10(10D))

Currently maturity proceeds from a life insurance scheme (including unit linked schemes) are tax exempt. The Finance Bill'21 has however proposed that the exemption be denied to new unit linked schemes issued after 01 February 2021, provided the premiums paid are in excess of INR 2.5 Lakhs.

Issues and recommendations

The salaried middle class in India in unorganized and semi-organized sectors do not have any social security / unemployment benefits / health insurance in India and relies on Provident Funds and insurance schemes to ensure its future financial security post retirement/ unemployment in case of uncertainty.

The imposition of taxes on the maturity proceeds may take away the benefit of the schemes for the salaried class, driving away investments and corresponding inflow of monies into the capital market. The Indian economy currently requires an increase in demand. **The proposed withdrawal of taxes on ULIP maturities may therefore be revisited.**

16. The Board for Advance Rulings

It is proposed to discontinue the existing Authority for Advance Ruling (AAR) mechanism and constitute a new Board for Advance Ruling (BAR). Every such BAR shall consist of two members, each being an officer not below the rank of Chief Commissioner, as nominated by CBDT.

Further, it has been proposed that BAR rulings will not be binding on the applicant or the tax department. If aggrieved, the applicant or the tax department may appeal against the ruling or order passed by the BAR before the High Court.

Issue/rationale

a. AAR being a quasi-judicial authority was a preferred choice to obtain tax certainty. However, the members of the BAR would be Revenue officials (not below the rank of Chief Commissioner). This would imply that the advance rulings would now be pronounced by revenue authorities exercising quasi-judicial powers. The absence of external / independent members may lead to the BAR not being perceived as a forum for obtaining fair and impartial rulings.

b. It is proposed that BAR rulings will not be binding on the applicant or the tax department and can be appealed to the High Court. This may lead to prolonged litigation , thus contradicting the very purpose of setting up the mechanism of obtaining advance rulings, whose prime objective was to provide certainty to taxpayers and curtail protracted litigation.

Recommendations/ Suggestions

(i) It is suggested that in addition to Revenue Officials, the BAR should comprise of one retired / serving ITAT member and one outside expert. The retired / serving ITAT member could act as the Chairperson.

(ii) Further, since the BAR is comprised of senior revenue officials, its rulings should be binding on the department. This would help reduce litigation and make the advance ruling scheme more attractive

17. The Faceless Income-tax Appellate Tribunal (ITAT) Scheme

The Finance Bill 2021 has introduced the concept of a faceless ITAT scheme with a view to reduce human interface from the system, reduce cost of compliance for taxpayers, increase transparency and work distribution in different benches, resulting in best utilization of resources.
The Finance Minister while presenting the Budget in the Parliament mentioned that the personal hearing, if needed, shall be conducted through video conference.

Issue/rationale

An opportunity of being heard in an appeal is a fundament right of the appellant and if such right is denied, then it may result in violation of principles of natural justice. Hence, the opportunity of hearing should be available to appellants in each and every case as is available under the existing regime.

ITAT is the final fact-finding authority and hence, if adequate opportunity is not granted at this stage, the same may lead to infringement of the principles of natural justice

Recommendation/ Suggestion

It is suggested that the opportunity of hearing should be provided to the appellant in each and every case.

18. Income escaping assessments and search assessments

It is proposed to amend Section 148 and 149 to provide that in specific cases where the Assessing Officer (AO) has in his possession evidence which reveals that the income escaping assessment, represented in the form of asset, amounts to or is likely to amount to 50 lakh rupees or more, notice can be issued beyond the period of 3 year but not beyond the period of 10 years from the end of the relevant assessment year. The Finance Minister in her budget speech mentioned that in serious tax evasion cases too, only where there is evidence of 'concealment' of income of INR 50 lakh or more in a year, the assessment can be re-opened up to 10 years. However, in the Finance Bill as well as in the Memorandum, there is no reference to the term 'concealment'.

Recommendations/ Suggestions

(i) Extension of time period from 6 years to 10 years to reopen specified cases is a very long-time frame. It is suggested that the maximum time frame should remain as it is i.e. maximum period of 6 years to reopen the cases.

(ii) Without prejudice to the above, it is suggested that the provisions of reassessment extending the time period of reopening in specific cases up to 10 years should be amended to specifically provide that the 10 year period should be applicable only where there is evidence of 'concealment' of income of INR 50 lakh or more in a year.

19. Reassessment in survey cases

The Finance Bill 2021 proposes to launch a new procedure of assessment or reassessment or re-computation of income escaping assessment and the assessment of search related cases. Under the proposed new procedure, before issuance of notice, the AO shall conduct enquiries, if required, and provide an opportunity of being heard to the taxpayer. However, these mandatory requirements shall not apply to search and seizure cases. In search, survey or requisition cases initiated or made or conducted, on or after 1 April 2021, it shall be deemed that the AO has information which suggests that the income chargeable to tax has escaped assessment.

Recommendation/ Suggestion

The objective of survey is not the same as that of search or seizure under section 132 of the Act. Survey is different from search cases; therefore, an opportunity of hearing should be provided in survey cases before initiating the reassessment of income.

20. Belated or revised return

As per the existing provisions of Section 139(4) and (5), the belated or revised returns are to be filed before the end of the assessment year or before the completion of the assessment, whichever is earlier. It is proposed that the last date for filing of belated or revised returns of income, as the case may be, be reduced by three months. Thus, the belated return or revised return could now be filed three months before the end of the relevant assessment year or before the completion of the assessment, whichever is earlier.

Issue/rationale

There is massive technological upgradation in the Tax department, where the processes are moving towards becoming faceless and jurisdiction-less and the time taken to conduct and complete such processes has significantly reduced, however, the compliance requirement to file returns remains on the taxpayer. The time provided to file the belated return or revised return was already reduced over a period of time from one year from the end of the assessment year to the end of the assessment year. With the present proposal, the last date for revised / belated returns will reduce by a further 3 months. This would mean that for say AY 2021-22, the last date for filing the revised / belated return would be 31 December 2021. Given that the last date for filing the return itself would be 30 November 2021 for many assesses, this would give just one month's gap between the original and the revised return causing undue hardship.

Recommendation/ Suggestion

It is suggested that the time to file belated or revised return should not be reduced and should be kept as is.

21. Applicability of Sections 10(4D) and 115AD of the Act to investment division of an offshore banking unit ('OBU') located in an International Financial Services Centre ('IFSC')

Issue/rationale

It has been proposed in the Finance Bill' 21 to amend Sections 10(4D) and 115AD of the Act to extend applicability of the aforesaid sections to investment division of an OBU which is located in an IFSC. As per the proposed amendment to Section 10(4D), the expression 'specified fund' would include under its purview the investment division of OBU which has been granted a Category III Alternative Investment Fund ('AIF') registration under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and Exchange Board of India ('SEBI') Act, 1992, and fulfils other conditions to be prescribed.

Further, the proposed amendment to Section 115AD has reference to investment division of an OBU registered as a Category III portfolio investor under the SEBI (Foreign Portfolio Investors) Regulations, 2019 made under the SEBI, 1992. In this regard, it may be noted that the SEBI has notified SEBI (Foreign Portfolio Investors) Regulations, 2019 (New FPI Regulations) on 23 September 2019, repealing the earlier SEBI (Foreign Portfolio Investors) Regulations, 2014 (2014 FPI Regulations). Under the New FPI Regulations, SEBI has re-categorized FPIs into only 2 categories - Category I and II (instead of 3 categories as per the earlier FPI Regulations), and Category III portfolio investors have been done away with. Thus, there appears to be an incongruity in the proposed provisions.

Additionally, considering that FPIs already hold an FPI license, the requirement of a separate Category III AIF registration appears excessive.

Recommendation/ Suggestion

It is suggested that reference to (i) Category III AIF registration for the investment division of an OBU in Section 10(4D) of the Act and (ii) Category III FPI registration in Section 115AD of the Act be removed.