Pre-budget interaction with Mr. Kamlesh Varshney, Joint Secretary, Central Board

of Direct Taxes, Ministry of Finance on 23 November 2021

The US-India Strategic Partnership Forum (USIPF) in collaboration with KPMG India had organized a pre-budget industry consultation with Mr. Kamlesh Varshney, Joint Secretary (TPL-1), Central Board of Direct Taxes ('CBDT') on 23 November 2021.

Mr. Varshney shared his insights and personal views on various issues in relation to Equalisation Levy, Significant Economic Presence, Tax Deducted at Source, Safe Harbour rules, Dispute resolution etc. The discussions are summarized as under:

Equalisation Levy ('EL')

India's position on withdrawal of EL provisions

The OECD statement released on 8 October 2021, reflecting the agreement reached by 136 of the 140 OECD/ G20 Inclusive Framework member jurisdictions on BEPS two-pillar project, provides a clear indication that the Multilateral Convention ('MLC') will require removal of all Digital Services Taxes ('DSTs') and a commitment not to introduce such measures in the future.

Further, the statement mentions that no newly enacted DSTs or other relevant similar measures shall be introduced from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC.

What is your initial perspective on India's position on withdrawal of EL provisions?

Mr. Varshney's comments

• By agreeing to the OECD statement released on 8 October 2021, India has committed to withdraw the existing DST, i.e., EL as per the timelines to be decided by the OECD G20 Inclusive Framework and to not introduce such measures in the future or change the existing provisions.

• India's position with respect to the withdrawal of EL is that such withdrawal should coincide with the introduction of new digital tax as per the BEPS two-pillar project.

• These issues are still being deliberated at the OECD level and India will abide with the consensus solution.

Interim measures to address unilateral digital tax levies

In October 2021, five countries - Austria, France, Italy, Spain and UK released a Joint Statement along with US, describing a transitional approach agreed for the interim period before new Pillar One rules come into effect, allowing credit of DSTs collected in excess of future tax liability under Pillar One.

Is there any thinking at this point regarding India’s position on such arrangements in the interim period?

Mr. Varshney’s comments

• The five countries have entered into bilateral arrangements with US for a transitional approach. US and Turkey also released a joint statement, agreeing to the same terms that apply under the Unilateral Measures Compromise entered into between US, Austria, France, Italy, Spain and UK for the interim period.

• Such arrangements are completely bilateral.

• India’s international position is that we should wait for the introduction of new digital tax and withdrawal of unilateral tax should coincide with the date from which such new tax comes into effect.

Note: The Ministry of Finance, India, vide press release dated 24 November 2021, has announced that India and US have agreed that the same terms that apply under the October 21 Joint Statement shall apply between United States and India with India’s 2% Equalisation levy. The final terms of the Agreement shall be finalised by 1 February 2022.

Issues arising from EL provisions

The term “e-commerce operator” as currently defined (a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both), seems to bring into the ambit of EL provisions companies who are using digital facilities or platforms for not necessarily undertaking transactions, but acting as intermediaries.

These may include financial service providers, payment processing gateways, telecom companies, companies just using technology like email, Zoom, Teams or a web-based technology. Such companies are not really in the business of providing digital services. In a number of countries, intermediaries have been excluded from the purview of DST.

What are your thoughts on the scope and coverage of EL?

Mr. Varshney's comments

• These issues have been discussed earlier in the Ministry and the general view has been to not bring out too many changes in EL, since it has to be ultimately withdrawn. There is also a dilemma as to whether any clarification provided would lead to an interpretation of increase in tax, which would go against the Inclusive Framework agreement.

• These are ongoing discussions, as to the extent to which clarifications can be provided or changes be brought into EL and can be again considered this year.

3

Applicability of EL to intra-group transactions

In case of intra-group transactions, Indian company is already paying tax, and, in some cases, such transactions are subject to withholding tax. Are such transactions also subject to EL?

Mr. Varshney's comments

EL being a levy on non-residents, its incidence cannot be looked at from the perspective of the transaction being intra-group or the fact that the Indian entity is paying taxes. To avoid double taxation, the Government has also now clarified that where a transaction is subject to Royalty/ Fees for Technical Services ('FTS'), EL will not apply.

Credit/refund of EL on change in income characterization

While Finance Act ('FA') 2021 amended Section 163 of FA 2016 and Section 10 of the Income-tax Act to provide some clarity on the interplay between EL and Royalty/FTS, there are still matters which are not yet finally settled, for instance, process royalty, equipment

royalty and FTS interpretation under certain treaties. There may be situations where the taxpayer would have paid EL on the premise that the income is not taxable as Royalty/FTS in India and subsequently, in the course of tax proceedings, the payments are held to be taxable in India as Royalty/FTS. In such cases, there could be dual incidence of tax.
How does the Government intend to address such cases?

Mr. Varshney's comments

• Where a transaction is characterized as Royalty/FTS, EL is not levied. Only one of the two (Royalty/FTS or EL) will apply and there is no overlap.
• In cases where there is lack of clarity on taxability, such position can always change basis the views of the judiciary. While this is a valid concern, it does not require amendment in the law. Such situations can be addressed later by way of an executive clarification for synergy between income-tax and EL, and credit of taxes.

Remedy for EL related interpretational issues

While the right to appeal against a penalty order is provided under the EL provisions, there is no mechanism provided to contest other interpretational issues.

Mr. Varshney's comments

Noted, this will be examined during the budget exercise.

Coverage of Permanent Establishment ('PE') for EL

In the existing EL legislation, an exception is provided for income earned by non-resident through a PE in India, if the income is effectively connected with such PE. The definition of

PE under the EL provisions is same as that under the Income-tax Act and does not give reference to tax treaties, hence narrowing the definition of PE.
An aspect that emerges for consideration is whether PE under the EL legislation also covers within its ambit Service PE, Agency PE and Construction PE. It is requested that a clarification be provided to the effect that all such PEs are covered under the exception provided in EL

legislation.

Mr. Varshney's comments

Noted for internal discussion.

Significant Economic Presence ('SEP')

Changes to SEP regime

Taking a cue from BEPS Action Plan 1, SEP was initially introduced in 2018 to tax business profits derived by enterprises through there digital presence in India. The intent of SEP provisions on plain reading seems to be broader than as envisaged under Pillar One, in terms of scope.

Considering the consensus on Pillar One, is there any thought on withdrawal or modification of SEP provisions?

Mr. Varshney's comments

• SEP is probably not a unilateral measure since it does not apply in treaty situations. It respects the permanent establishment concept under treaties and does not override the treaty agreements.

• If Pillar One is to be implemented, every country would need an enabling domestic provision like SEP to tax non-residents.

• It could be that SEP needs modification, since finer points are still being worked out. For example, in case a country with which India does not have a tax treaty, joins the Inclusive Framework. For such countries, India's domestic law allows taxation even without PE, so long as there exists a business connection in India. Accordingly, it needs to be determined if in such situations, Pillar One is to be applied, or is it possible to tax more than Pillar One.

PE attribution rules

In 2019, the CBDT released a draft report wherein Rule 10 of Income-tax Rules was proposed to be amended to provide a computation method for PE income attribution. However, the draft rules have not yet been finalised while SEP is now a part of the statute.

How is the attribution issue going to be addressed in the current scheme of things?

Mr. Varshney's comments

The existing Rule 10 is still applicable. The committee recommendations on PE income attribution have not yet been legislated. Once legislated, the same would apply to situations other than those covered under Pillar One, i.e., where a PE exists, but Pillar One is not applicable.

Tax Deducted at Source ('TDS')

Compliance related aspects

• TDS is a pain point since huge time and cost is spent in tracking payments and complying with the various TDS provisions. To ease the compliance burden, there is a need for simplification of TDS on all services and consolidation of related TDS sections (such as 194I, 194J, 194C, etc.). Further, transaction level information can be leveraged from the e-invoicing information already available with the Central Board of Indirect Taxes and

Customs (CBIC).

• Dissemination of quarterly TDS certificates is a huge compliance burden, especially in cases where lakhs of TDS certificates are to be sent in a quarter. Such certificates are generated basis the information already submitted with the Government in TDS returns, and the same information is available to the deductees in Form 26AS. A software solution can be developed for dissemination of the TDS certificates by the Government, rather than the deductor, to ease the compliance burden and reduce duplication of data.

• The current compliance structure for making foreign remittances involves too much of compliance hassles, with excessive cost and efforts involved in processing each foreign remittance. To alleviate the compliance burden, a quarterly compliance mechanism may be evolved, rather than a transaction-based compliance in Forms 15CA and 15CB. Such compliance can be consolidated with the quarterly TDS return compliance in Form 27Q.

Mr. Varshney's comments

The Government is apprised of these practical challenges. However, individual taxpayers are not comfortable with filing Tax returns without TDS certificates; accordingly, it may not be possible to completely do away with TDS certificates.

While it may require some changes to the portal, in times to come, one may look at issuance of TDS certificates directly by the Government.

Section 194-O related aspects

• Explanation to Section 194-O(1) requires an e-commerce operator to undertake compliances even with respect to payments that are not routed through the e-commerce operator. This becomes onerous where the sale of goods or provision of service takes place directly between the buyer and seller, and the e-commerce operator does not have visibility over the transaction, pricing of the goods/services, conclusion of the contract, etc. Can any sort of relief be expected for such situations?

6

• In situations where an e-commerce operator merely lists the products of various other online sellers or e-commerce operators and customer is redirected to another e-commerce platform for purchase, whether both the e-commerce operators will be liable for compliance under Section 194-O?

Mr. Varshney's comments

• The purposes of Explanation to Section 194-O(1) is to cover transactions which are actually routed through the e-commerce operator, but payment is concluded directly. The Explanation does not intend to cover transactions otherwise not culminated on the e-commerce platform. The CBDT is currently working on a circular, which may address this situation.

• In situations where an e-commerce operator merely lists the products of other online sellers or e-commerce operators, only the platform where sales are culminated would be required to comply with the provisions. Other aspects

Safe Harbour Rules

Safe Harbour rules were amended in 2017 and revised thresholds were provided for different categories of transactions. Given that transfer pricing provisions have been in place for close to two decades and considering the experience from Mutual Agreement Procedure (‘MAP’) and Advance Pricing Agreement (‘APA’) perspective, could there be a revisit of the Safe Harbour provisions and thresholds provided?

Mr. Varshney’s comments

• **Policy perspective**: Applicability of Safe Harbour provisions is supposed to be restricted basis specified thresholds. The margins provided under Safe Harbour would always be slightly higher than that agreed under APAs, since APAs are entered after due deliberation and are more pin pointed basis Function, Assets and Risk (FAR) analysis of taxpayer. Such margins cannot be applied to a broader basket as required for Safe Harbour.

• **Practical perspective**: Earlier, Safe Harbour margins were revisited after 3 years, however, the same are now being revisited every year due to unpredictability on account of COVID. A committee, including field officers working on APAs, recommends the margins basis which the Government comes out with Safe Harbour rules. The committee examined the margins considering COVID situation and recommended to retain existing margins for the current assessment year. These margins can however be changed in future.

Dispute Resolution

7

In terms of dispute settlement, while we have seen the success of various settlement schemes introduced, can we anticipate any sort of new dispute resolution scheme or mechanism coming in, like mediation, which would provide an avenue for settling disputes faster from a long-term perspective?

Mr. Varshney’s comments

All suggestions for tax certainty would be given due consideration and top officers do look at suggestions for reducing litigation.

Tax treaty eligibility documentation

Foreign Portfolio Investors (‘FPIs’) are now allowed the benefit of lower withholding tax rate under the applicable tax treaty with respect to dividend income. While this is certainly a welcome amendment, there are several operational challenges in availing tax treaty benefit due to absence of a standard format for beneficial ownership declaration.

Considering the large volume of FPI investments in Indian entities, it is very difficult to consolidate declarations as custodians as the format of declaration acceptable to one payer may not be acceptable to another.

It is suggested that the existing Form 10F be amended to incorporate a standard format of beneficial ownership declaration as an Annexure. This will go a long way in easing out administrative issues faced by FPIs, as well as the dividend issuers.

Mr. Varshney's comments

Noted for internal discussion.

Profit determination mechanism

Rules for calculating profits of Investment division of Offshore Banking Units have not been released yet. It is requested if the same can be finalised and released at the earliest possible.

Mr. Varshney's comments

The rules have been finalised and are being put up for approval.

General Anti-Avoidance Rule ('GAAR') implications on GIFT International Financial Services Centre ('IFSC') units

GIFT IFSC has been set-up mainly to bring onshore all financial services transactions related to India that were till now being carried out offshore. The Income-tax Act provides various tax incentives for GIFT IFSC units including capital gains tax exemptions.

Since it is possible that one of the main purposes of moving to GIFT IFSC may be the tax exemption, there is a concern that GAAR provisions can be invoked against taxpayers who have set up a unit in GIFT IFSC and are eligible for tax incentives.

An exception, similar to that provided under Rule 10U with respect to non-applicability of GAAR on FPIs not claiming treaty benefits, may be provided for exempting GIFT IFSC units from applicability of GAAR.

Mr. Varshney's comments

• This issue has been discussed with IFSC authorities as well, and the prima facie view is that GAAR is not applicable on mere shifting to an IFSC and availing the tax benefits provided to IFSC units under the Income-tax Act.

• Unlike the specific concession for FPIs under Rule 10U, it is very difficult to give a blanket exemption to IFSC units from applicability of GAAR due to the various tax incentives available to such units.

• On being pressed further on the need for certainty on this issue, Mr. Varshney mentioned that he would relook at the GAAR circular in this regard.

Dividend withholding rates

India has agreed in various treaties lower tax rate for dividends. However, under the domestic law, the tax rate for dividends is quite high. It is requested if the domestic dividend tax rate can be lowered or aligned with the treaty rates.

Mr. Varshney's comments

This would be looked into. However, the current rates do not pose much challenges on this aspect.

WFH related implications

Given that Work from Home ('WFH') has become a new reality and a hybrid working model is the future, can some clarity be provided in terms of eligibility for Section 10AA benefit where there exists a direct and intimate nexus of development of software done by employees on WFH basis with the eligible unit?

Mr. Varshney's comments

This is being examined by the Commerce Ministry.

Thin capitalization rules applicability

Currently, banks and insurance companies are exempted from the applicability of Section 94B keeping in view the special nature of these businesses Can it be considered to extend the exemption to Non-Banking Financial Companies (NBFCs)?

Mr. Varshney's comments

Noted for internal discussion.

For further details please reach us here