US·INDIA
STRATEGIC PARTNERSHIP FORUM

Budget 2021-22 - KEY DIRECT TAX PROPOSALS

1. No changes in corporate and other tax rates

The Budget does not bring about any changes in the tax rates or taxation regime applicable to companies as well as other categories of taxpayers.

2. Equalization Levy (EQL)/ DST

Government of India (GOI) through Finance Act, 2020 had enacted a legislation to levy a 2 percent EQL on the gross revenue earned by non-resident e-commerce operators from supply of goods or services through online platforms (earlier the levy was restricted to online advertisements only). The EQL on e-commerce transactions is slated to have a significant impact on non-resident providers of digital supply or services, especially given the fact that the definition of the terms 'e-commerce operator' and 'e-commerce supply or services' is fairly wide in scope. Further, in the absence of much clarity on what could amount as "online sale of goods" and "online provision of services", there was much uncertainty relating to the kind of transactions that could be covered in the net of EQL.

Amendments vide the Finance Bill 2021

i. *Definition of online sale of goods/ provision of services*

In the Finance Bill of 2021, the terms "online sale of goods" and "online provision of services" have been ascribed an inclusive definition, and are to include one or more of the following activities:

a. acceptance of offer for sale; or

b. placing of purchase order; or

c. acceptance of the purchase order; or

d. payment of consideration; or

e. supply of goods or provision of services, partly or wholly.

The above mentioned amendment could bring into the scope of EQL a wide range of transaction that happen on an online portal e.g. even though a purchase order is placed on an online portal for a physical delivery of goods, the transaction could be covered by EQL.

ii. ***Income-tax implications of amounts chargeable to EQL***

- The EQL on digital transactions was made applicable from April 1, 2020. Correspondingly, the Indian income-tax law was amended in 2020 to provide that any amount chargeable to EQL shall be exempt from Indian income-taxes with effect from April 1, 2021. This had led to a conclusion of double taxation of the relevant amounts in the financial year (FY) 2020-21 (1 April 2020 to 31 March 2021). This anomaly has not been rectified, and the income-tax law has been amended to provide that any amount chargeable to EQL shall be exempt from Indian income-taxes with effect from April 1, 2020

- The introduction of EQL also brought about another controversy i.e. taxability of those amounts which are otherwise taxable as royalty or fees for technical/ included services (FTS). There are various services that are provided through online platforms, which before the introduction of EQL were offered to tax as royalty/ FTS, or were alleged by the Indian tax authorities to be taxable as royalty/ FTS. The introduction of EQL brought about a question as to whether these income would continue to be taxed as royalty/ FTS or should be subject to EQL, and where one stance was chosen, whether the tax authorities could allege otherwise.

  Finance Bill 2021 provides that any amounts which are taxable as royalty/ FTS under the Indian income-tax law read with the applicable tax treaty, should not be subject to the EQL. However, this does not settle the uncertainty on whether where a non-resident pays EQL @ 2% on any income, the income-tax authorities could allege it to be subject taxable as royalty/ FTS or vice versa. Also, in such cases, whether credit of EQL paid would be available against alleged income-taxes is yet uncertain.

3. Amendments relating to M&A transactions

i. ***No depreciation to be allowed on goodwill***

M&A transactions generally give rise goodwill in the books of the acquirer / merged entity. The term “goodwill” in the context of an intangible asset has not been defined in

the Indian income-tax law. Given this, most taxpayers considered acquired goodwill as part of their intangible assets, and claimed a depreciation expense thereon. This led to a significant amount of litigation with tax authorities denying such depreciation claim, and various court rulings with opposing conclusions. This controversy has now been put to rest, and goodwill for business or profession has specifically been excluded from the definition of depreciable intangible assets under the income-tax law.

ii. ***Amendment related to business transfers/ slump sale***

Under the Indian income-tax law, the transfer of a business undertaking/ business unit as whole by way of sale for a lump sum consideration (also known as slump sale) is taxable as per a special computation mechanism provided in this regard. The provision defining slump sale has now been widened for the transfer to mean any form of transfer (e.g. exchange, gift without consideration, etc.) and not just be restricted to a transfer by way of sale for monetary consideration

4. <u>Other direct tax amendments relating to withholding tax, book profit taxation, etc.</u>

i. ***Withholding tax (WHT) on purchase of goods exceeding INR 5 million*** - Last year, a new provision for tax collection at source was introduced, providing sellers of goods to collect 0.1% tax from buyers on sale of goods exceeding INR 5 million (import and export transactions were excluded from this levy). This year, a new withholding tax provision has been introduced, providing buyers of goods exceeding INR 5 million to withhold tax @ 0.1% on payments made to resident sellers. A buyer has been defined to mean a person whose total sales, gross receipts or turnover from the business carried on by him exceed INR 100 million during the FY immediately preceding the FY in which the purchase of goods is carried out.

ii. ***Higher rate of WHT and tax collected at source (TCS) in cases where opposite party does not file Indian income-tax returns*** - The law as on date provides that where any payments are subject to WHT, and the recipient thereof does not furnish an Indian Permanent Account Number (PAN), tax is to be withheld at the applicable rate of 20%, whichever is higher.

A new provision is now proposed to be introduced, which provides that the WHT rate shall be double the applicable rate where the recipient of such payment has not filed their tax return for two (2) years preceding the year of the payment, and the aggregate of WHT credit and TCS credit available to them for each of those years exceeds INR

50,000. This provision shall not apply in case the recipient is a non-resident not having a fixed place of business/ fixed place PE in India. Thus foreign companies not having a PE in India are outside the purview of this amendment

A similar provision is also introduced for applying a higher rate of TCS, where the payer has not filed tax returns.

iii. ***Withholding tax on certain incomes of Foreign Institutional Investors (FII)*** - Pursuant to certain provisions of the law governing taxability of FII's income from India, and a ruling of the Supreme Court of India, there was uncertainty on applicability of lower tax treaty rates on such incomes as opposed to higher domestic tax law rates. Due to this, taxes were being withheld at higher rates as per the domestic tax law. This uncertainty has not been put to rest with a specific clarification to provide benefit of lower tax treaty rates while withholding tax on such incomes of FII's.

iv. ***Book profit taxation for foreign companies*** - Indian tax law provides for minimum alternate tax (MAT) on book profits of companies, without any specific exclusion for foreign companies earning income from India. This was remedied by excluding any interest, royalty or FTS income that non-residents derived from India while computing book profits of such foreign companies. This essentially provided relief to foreign companies who only receive such passive incomes from India from MAT. Dividend income was made taxable in the hands of shareholders from last year, and has now been included in the list of exclusions along with interest, royalty and FTS.

v. ***Delay in deposit of employees contribution to social security schemes*** - It has been clarified that the where an employer collects any contribution from its employees for deposit in social security schemes (such as provident fund, labour welfare fund, etc.), and does not deposit such amount in the relevant fund by the due date prescribed in the law concerning the respective scheme/ fund, such amount shall be added to the employer's taxable business income. This clarification has put to rest a controversy which stemmed from some Courts' interpretation of the law that such amounts should not be added to the employer's income so long as the employer deposited them up to the due date of filing their tax return (which is much later than the due date under the respective laws).

vi. Various new incentives have also been introduced for units in International Financial Services Centre (IFSC), especially for investment division of offshore banking units and

entities engaged in aircraft leasing business, to make the IFSC more attractive to investors.

II. AMENDMENTS TO DIRECT TAX AUDIT AND LITIGATION PROVISIONS

1. Dispute resolution amendments

i. ***Board for Advance Ruling (BFAR)*** – A BFAR is proposed to be introduced in lieu of the existing Authority for Advance Rulings (AAR), to expedite the process of obtaining advance rulings. The BFAR to have Chief Commissioners of Income-tax on the board to decide matters, as opposed to retired judges High Court/ Supreme Court.

ii. ***Dispute Resolution Committee (DRC)*** – Proposal to set up a DRC for small and medium taxpayers having returned income below INR 5 million and variation in income below INR 1 millions

iii. ***Faceless Tribunal Appeals*** – Similar to audits and first level appeals, it is proposed to make appeal proceedings before Income-tax Appellate Tribunals electronic and faceless

2. Proposal for change in re-assessment provisions

i. Time limit to re-open tax audits/ assessments has been reduced from seven (7) years from the end of the FY to four (4) years from the end of the FY. Time-limit to be eleven (11) years from end of FY if there is evidence that income of more than INR 5 million has escaped tax in the form of asset, that too with permission from Principal Chief Commissioner of Income-tax

ii. Changes in procedural aspects to re-open tax audits/ assessments have been prescribed

III. CHANGES IN INCOME-TAX REATED DUE DATES AND PROCEDURAL ASPECTS

1. Due dates to file income-tax returns

i. In case of partner of firm, which is liable to furnish transfer pricing report, due date is extended to 30 November following the FY (i.e. same as applicable to the firm)

ii. Revised and belated tax returns must be filed within nine (9) months from end of FY. e.g. revised/ belated tax return for FY 2021-22 must be filed by December 31, 2022 (due date for filing original return is October 31/ November 30, 2022) .

2. **Timeline to issue notices for initiating assessments** – Three (3) months (earlier 6 months) from end of FY in which the tax return is filed e.g. Tax return of FY 2021-22 shall be filed in FY 2022-23, hence, notice must be issued by June 30, 2023.

3. **Timeline to conclude assessments** – Nine (9) months from end of FY in which the tax return is filed e.g. Tax return of FY 2021-22 shall be filed in FY 2022-23, hence, assessment must be concluded by December 31, 2023. However, where a transfer pricing reference is made, timeline shall be extended by twelve (12) more months i.e. December 31, 2024.