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BANKING SECTOR

SECTION I

Rationalisation of corporate tax rates for foreign banks

Background

1. Most of the foreign banks in India are set-up in the form of branches and are duly regulated by the RBI. As per the provisions of section 2(31) of the Act, a definition of a person includes the below:
   (i) an individual,
   (ii) a HUF,
   (iii) a Company,
   (iv) a firm,
   (v) an association of persons or a body of individuals, whether incorporated or not,
   (vi) a local authority, and
   (vii) every artificial juridical person, not falling within any of the preceding sub-clauses.

   The above definition does not cover a branch within its purview and thus, for India tax purposes a branch will be subject to tax in India basis the constitution (i.e. corporate form) and residential status of its HO. Given that almost all foreign banks who have set-up operations in India operate under a branch mode of presence, the branches of such foreign banks would also be treated as non-resident in India.

2. The income earned by such branches from its banking operations carried out in India is considered to be in the nature of business income and accordingly, the profits from the banking business conducted in India is taxed at the rate of 40% (plus applicable surcharge and health and education cess) bringing the effective tax rate to 43.68%.

3. As per paragraph H (vi) of RBI Master Circular No 7/2015-16 dated 1 July 2015 (attached as Annexure A), Branch Offices are permitted to remit outside India profit of the branch net of applicable Indian taxes, on production of the following documents to the satisfaction of the Authorised Dealer through whom the remittance is effected:

   a) A Certified copy of the audited Balance Sheet and Profit and Loss account for the relevant year

   b) A Chartered Accountant's certificate certifying:
      - the manner of arriving at the remittable profit;
      - that the entire remittable profit has been earned by undertaking the permitted activities; and
      - that the profit does not include any profit on revaluation of the assets of the branch.

   The format specified by the RBI for arriving at the remittable profit is enclosed as Annexure B.

4. Recently, the Hon'ble Finance Minister announced the promulgation of Taxation Laws (Amendment) Ordinance, 2019 (Ordinance) on 20 September 2019. The same was repealed

and replaced by the Taxation Laws (Amendment) Bill, 2019 in the Parliament (Amendment Bill) which received Presidential assent on 11 December 2019. As per the Taxation Laws (Amendment) Act, 2019, the tax rates for domestic companies including Indian banking companies have been reduced to 22% (plus applicable surcharge and health and education cess) subject to certain conditions prescribed under section 115BAA. The effective tax rate for companies opting for being governed by section 115BAA is 25.17%.

Additionally, where a domestic company opts for the reduced rate of 22%, the provisions of section 115JB of the Act (i.e. MAT provisions) shall not be applicable to such companies.

The banks cannot distribute profits to shareholders beyond a certain limit of their post-tax profits. Assuming the same limit as their domestic counterparts, if the foreign banks were to distribute 40% of their post-tax profits, the effective tax rate (including the impact of DDT) is 31.32%. A working of the same is tabulated below:

Particulars	Tax rate (%) – domestic banks	Tax rate (%) – foreign banks
Income	100.00	100.00
Less: Corporate tax (A)	(25.17)	43.68
PAT (B)	74.83	56.32
40% of PAT (C)	29.93	22.53
Less: DDT at 20.56% (D)	(6.15)	-
Net amount available for distribution (B-D)	68.68	56.32
Total tax outflow (A+B)	31.32	43.68

5. The above reduction in the corporate tax rate now creates a significant disparity between foreign companies and domestic companies specifically when the manner of computation of profits for domestic companies and non-residents operating in India under a branch route is ordinarily identical except for certain restrictions imposed on branches of foreign banks (e.g. deduction for HO expenses, etc).

6. Based on news reports, even the proposed DTC 2.0 which was submitted by the WG to the Government in August 2019 had suggested reduction in corporate tax rate for foreign companies at par with domestic companies.

7. The reduction in corporate rate cut for such foreign companies will provide a level playing field as compared to domestic companies and improving the overall investor sentiment and confidence.

Recommendation

8. Globally, the general practice is to provide tax rate parity across all companies. Examples are all BRICS countries other than India, and majority of OECD countries (UK, Japan, New Zealand, etc.) as well as countries like Singapore and Hong Kong. Streamlining corporate tax rates for domestic as well as foreign companies would align global practices across all BRICS countries and majority of OECD countries.

9. It is therefore recommended that corporate tax rates for branches of foreign companies be reduced to bring them at par with domestic companies. The Government may additionally consider levying an additional tax on remittance of profits by branches to its HO similar to DDT such that there is a level playing field between domestic companies and foreign companies. If remittance tax is introduced for foreign companies, then before remittance of profit outside India, the branch offices may be asked to pay the remittance tax on the remittable profit certified by the Chartered Accountant.

SECTION II

Tax rate on INR ECB

Background

1. Under the erstwhile ECB route, non-resident banks were only allowed to lend in FCY to resident Indian entities. Indian clients would typically borrow in FCY and swap to INR to hedge the exchange risk.

2. On 3 September 2014, the RBI allowed all non-resident lenders to also extend loans directly in INR under the ECB framework (A.P. DIR Series Circular No.25). All other aspects of the ECB policy such as eligible borrower, recognised lender, all-in-cost, average maturity period, etc. remained unchanged.

3. Subsequently, the RBI issued a revised ECB framework on 30 November 2015 (A.P. DIR Series Circular No 32) with a view to providing a more liberal regime for INR-ECBs where the currency risk is borne by the lender. The RBI relaxed the end-use criteria (only a limited negative list) and permitted a wider group of borrowers to avail INR-ECBs. Further, the RBI imposed certain restrictions in case of FCY ECBs in terms of higher average maturity, permitted end uses, borrowers' eligibility etc. This generated a considerable interest from clients for availing INR loans under the ECB route.

4. On 16 January 2019, RBI issued a new ECB framework vide A.P. DIR Series Circular No. 17 simplifying the ECB provisions and has subsequently made certain changes to the same. The new ECB framework inter-alia removes track-based ECB classification, requires that the overseas lender be a resident of FATF or IOSCO compliant country, etc. The revised framework has also enhanced the limit of borrowing to USD 750 million or equivalent per financial year.

5. However, the impact of withholding tax on INR-ECBs continues to act as a limiting factor, since the applicable tax rate of 40% (subject to tax treaty relief, if any) on the interest income arising from INR-ECBs is significantly higher than the concessional rate of 5% under section 194LC of the Act which is applicable to monies borrowed in FCY. The INR coupon (~9-10%) will generally be higher than a FCY coupon (~3-4%), but the higher withholding tax makes the INR-ECBs uncompetitive, as eligible borrowers achieve the same result at a lower cost through a FCY ECB plus hedge as compared to INR-ECB.

6. Additionally, it should be noted that there has not been significant market uptake in respect of INR ECBs. If the beneficial tax rate of 5% is made applicable in respect of INR-ECB, it would help garner additional revenues for the exchequer compared to non-INR denominated ECB, as the coupon rate for INR-ECBs is higher.

Recommendation

7. INR denominated ECBs and FCY denominated ECBs are both borrowing in FCY. In case of FCY denominated ECB, the currency is converted into INR by the borrower and the risk of fluctuation in exchange rate is also borne by the borrower. Whereas in case of INR denominated ECBs, the conversion as well as the risk is borne by the lender. However, in both cases the FCY is brought in India. Hence, the tax treatment should also be identical. Hence, it

is recommended that the scope of provisions of section 194LC of the should be extended to include INR denominated ECBs as well and should be subject to tax at the rate of 5%. Similarly, appropriate amendments should also be made in the provisions of section 115A(1)(a) of the Act.

8. We have provided below the suggested text for amendment on taxability of interest income from INR-ECBs:

- Section 194LC of the Act should be amended to provide for the withholding tax rate on INR-ECBs by inserting clause (ib) as follows:

  (1) ....

  (2) The interest referred to in sub-section (1) shall be the income by way of interest payable by the specified company or the business trust –

  (i)........................; or

  (ia)......................; or

  (ib) from providing lending in Indian Rupees to Indian corporates under the Indian Rupee Denominated External Commercial Borrowing route of Reserve Bank of India before the 1st day of July 2020, and

  (ii)....................

- Section 115A(1)(a) of the Act should be amended to provide for chargeability of interest income from INR-ECBs by inserting clause (iiad) and amending clause (BA) as follows:

  (1) Where the total income of—

  (a) a non-resident (not being a company) or of a foreign company, includes any income by way of—
  ....

  (iiad) for the avoidance of doubt, interest received from providing lending in Indian Rupees to Indian corporates under the Indian Rupee Denominated External Commercial Borrowing route of Reserve Bank of India; or
  ....

  the income-tax payable shall be aggregate of –
  ....

  (BA) the amount of income-tax calculated on the amount of income by way of interest referred to in sub-clause (iia) or sub-clause (iiaa) or sub-clause (iiab) or sub-clause (iiac) <u>or sub-clause (iiad)</u>, if any, included in the total income, at the rate of five per cent; ....

SECTION III

Submission on provisions relating to thin capitalisation envisaged under section 94B of the Act

Background

1. In order to prevent MNEs from cross-border shifting of profits through excessive interest payments, and thus protecting India's tax base, the Hon'ble Finance Minister introduced a new section 94B in the Act vide Finance Act, 2017 in line with OECD's recommendations in the BEPS AP 4 on interest deduction.

2. Based on a reading of the language of the said provisions, there are certain aspects of these provisions, which in our view need clarity from the Government of India; these concerns have been briefly outlined below:

A. Applicability of the provisions to funds borrowed from a third party

3. Section 94B(1) of the Act stipulates the applicability only to the funds borrowed from a non-resident AE. Further, in the proviso to section 94B(1) of the Act, the provisions are made applicable to the funds borrowed from third parties and guaranteed by an AE.

4. However, while referring to the funds borrowed from third parties and guaranteed by an AE, the proviso to section 94B(1) of the Act does not make any reference to the residential status either of the third parties or of the AE.

5. As per the Memorandum to the Finance Bill, 2017, the basic intent of the introduction of thin capitalisation provisions in Section 94B, is to prevent MNEs from cross-border shifting of profits through excessive interest payments, and thus to protect India's tax base.

6. In line with the aforesaid intent, section 94B(1) of the Act stipulates the applicability of this section to the funds borrowed from non-resident AEs and does not extend its applicability to funds borrowed from resident AEs, since there is no loss of tax base in such cases.

Recommendation

7. A suitable amendment/ clarification in the form of a new definition of lenders should be introduced which should define a lender as a non-resident lender.

B. Applicability of section 94B to NBFCs and Primary Dealers

8. As per section 94B(3) of the Act, banks and insurance companies are excluded from the purview of these provisions on account of the special nature of these businesses and also as they are highly leveraged companies.

9. It is relevant to note that there is parity between banks and NBFCs and Primary Dealers on the regulatory aspects since NBFCs and Primary Dealers are also highly leveraged companies incurring significant interest expenditure as a result of its business activities. Currently, the provisions of section 94B are applicable to NBFCs and Primary Dealers.

Recommendation

10. A suitable amendment should be introduced so as to exclude NBFCs and Primary Dealers from the ambit of the thin capitalisation provisions.

C. Meaning of expression 'total interest' and 'interest paid or payable to associated enterprise' appearing in section 94B(2) of the Act

(i) Meaning of 'total interest'

11. Section 94B(1) of the Act indicates that any interest expenditure incurred on account of funds borrowed from non-resident AEs shall be subject to the limit on deduction stipulated under section 94B(2) of the Act.

12. Section 94B(2) of the Act provides that the disallowance with respect to interest expenses claimed by a taxpayer shall be lower of the following:

- 'total interest' paid or payable in excess of 30% of EBITDA of previous year; or
- 'interest paid or payable to AE' for the previous year

13. As indicated above, section 94B(2) refers to the term 'total interest' and 'interest paid or payable to AE' for computing the limit on deduction of such interest.

14. In this regard, there is an ambiguity regarding the computation of total interest, i.e., whether the 'total interest' paid by the taxpayer to both AEs and third parties should be considered for computing the limit of deduction of interest, or the 'total interest' paid to only non-resident AEs should be considered.

15. While the intent of the section is to restrict the deduction of interest expenses paid or payable to a non-resident AE, the use of the expression 'total interest' may lead to a confusion as to whether the third party interest expenses are also required to be included while computing the limit. In case the said interpretation is adopted, it can lead to adverse implications on interest deduction, wherein the interest paid to non-resident AEs may be disallowed even in situations where the interest to non-resident AEs is within the limit of 30% of EBITDA.

16. Further, India, in its legislative wisdom, has implemented the OECD recommendation in a restricted manner by allowing the application of fixed ratio rule only if interest payment is in respect of debt issued by non-resident AE. The following extract from Explanatory Memorandum to Finance Act, 2017 support that the disallowance under section 94B of the Act is only in respect of debt issued by non-resident AE and hence the context may require "total interest" to be construed as interest to non-resident AE:

"Para B: "In view of the above, it is proposed to insert a new section 94B, in line with the recommendation of OECD BEPS AP 4, to provide that interest expenses claimed by an entity to its associated enterprises shall be restricted to 30% of its EBITDA or interest paid or payable to associated enterprise, whichever is less."

Para C: "The provision shall be applicable to an Indian company, or a permanent establishment of a foreign company being the borrower who pays interest in respect of any form of debt issued to a non-resident or to a permanent establishment of a non-resident and who is an 'associated enterprise' of the borrower."

17. In addition to the above, the Institute of Chartered Accountants of India has, in the implementation guide to the amendments to the Tax Audit Report, supported that the above view is a better view, i.e. "total interest" should be construed as interest to non-resident AE.

18. The impact of the ambiguity in the interpretation of the term 'total interest' has been provided below:

		Amount (Rs. in lacs)
Particulars	Total interest includes payment of interest to AEs and third parties	Total interest includes payment of interest to AEs
EBITDA	100	100
Limitation on interest deduction, i.e. 30% of EBITDA	30	30
Interest paid or payable to non-resident AE	15	15
Interest paid or payable to third parties	35	35
Disallowance	Lower of: ► Excess of <u>total interest</u> over 30% of EBITDA (i.e. excess of 50 over 30 = 20); or	Lower of: ► Excess of <u>interest to non-resident AE</u> over 30% of EBITDA (i.e. excess of 15 over 30 = Nil); or ► Interest paid to non-resident AE (i.e. 15)

Amount (Rs. in lacs)		
Particulars	Total interest includes payment of interest to AEs and third parties	Total interest includes payment of interest to AEs
	► Interest paid to non-resident AE (i.e. 15) Hence, disallowance under section 94B of the Act is 15.	Hence, disallowance under section 94B of the Act is Nil.

Recommendation

19. The language of section 94B(2) should be amended to clarify that the expression 'total interest' refers to the total interest paid or payable to non-resident AEs.

(ii) Meaning of 'interest paid or payable to AE'

20. Further, there is also an ambiguity in relation to the 'interest paid or payable to AE' for computing the limit on such deduction. In this regard, an uncertainty arises as to whether the interest paid or payable by the taxpayer to both resident and non-resident AEs should be considered, or only the interest paid or payable to non-resident AEs should be considered.

21. The impact of such ambiguity in the language has been provided below:

Amount (Rs. in cr)		
Particulars	Total interest includes payment of interest to resident and non-resident AEs	Total interest includes payment of interest to only non-resident AEs
EBITDA	100	100
Limitation on interest deduction, i.e. 30% of EBITDA	30	30
Interest paid or payable to non-resident AE	20	20
Interest paid or payable to resident AE	55	55
Total interest	75	75
Disallowance	Lower of: ► Excess of total interest over 30% of EBITDA (i.e. excess of 75 over 30 = 45); or	Lower of: ► Excess of total interest over 30% of EBITDA (i.e. excess of 75 over 30 = 45); or

Amount (Rs. in cr)		
Particulars	Total interest includes payment of interest to resident and non-resident AEs	Total interest includes payment of interest to only non-resident AEs
	► Interest paid to resident and non-resident AE (i.e. 75) Hence, disallowance under section 94B of the Act is 45.	► Interest paid to non-resident AE (i.e. 20) Hence, disallowance under section 94B of the Act is 20.

Recommendation

22. The language of section 94B(2) should be amended to clarify that the expression 'interest paid or payable to associated enterprise' refers to the interest paid or payable to non-resident AEs since the intent of the introduction of these provisions is to prevent MNEs from cross-border shifting of profits through excessive interest payments, and thus protect India's tax base, as stated above.

D. Utilisation of brought forward interest

23. As per section 94B(4) of the Act, interest expenditure not wholly deducted in Financial Year can be carried forward for 8 subsequent years and a deduction for the same can be claimed to the extent of 'maximum allowable interest' as per Section 94B(2).

24. Section 94B(2) refers to 'excess interest' and not 'maximum allowable interest'. Hence, a definition for 'maximum allowable interest' should be introduced to avoid interpretation issues.

25. For example, the year in which there is no interest payable to non-resident related entities, the limits specified in Section 94B(2) should not apply and a deduction of the brought forward AE interest should be permitted, subject to 30% of EBITDA. This is in line with basic intent of the introduction of thin capitalisation provisions as described in Memorandum to Finance Bill 2017, which was to prevent excessive interest payments to non-resident related entities.

E. Residential status of the AE providing guarantee in case of funds borrowed from third party lender

26. As stated above, the proviso to section 94B(1) states that the provisions are made applicable to the funds borrowed from third parties and guaranteed by an AE.

27. Based on the reading of section 94B(1) and Memorandum to the Finance Bill 2017, the intent seems to be that the section ought to apply only in the case of a non-resident AE. However, a level of uncertainty exists on whether, based on the proviso, it could be contended that the

funds borrowed from third parties and guaranteed by a resident AE would also be covered under this provision.

Recommendation

28. An amendment should be made such that the provisions shall apply only in case of funds borrowed from third party lenders and guaranteed by non-resident AEs in view of the intent of the introduction of these provisions and the language of section 94B(1) as stated above.

F. Applicability of the provisions to cases where the AE has provided an implicit guarantee

29. As per proviso to section 94B(1) of the Act, this section will apply in cases where the funds have been borrowed from third parties, and these funds have been either explicitly or implicitly guaranteed by an AE.

30. In this regard, the proviso to section 94B(1) of the Act does not restrict its applicability only to explicit guarantee but also extends to implicit guarantee.

31. The term 'implicit guarantee' is a broad term and the exercise of determining the existence of an implicit guarantee is subjective. This can have a far reaching impact on all the third party borrowings by the affiliates of MNEs and may include genuine third party borrowings, where any implicit guarantee is not present.

32. For instance, as per the current provisions, a view may be taken that, since the ICo is part of an MNE group, therefore, by reason of its affiliation, an implicit guarantee has been issued by the AE. Thus, these provisions may be made applicable to third party borrowings without any guarantee being actually provided by the AE. Similarly, these provisions may also be made applicable where a comfort letter is provided on at least 51% shares being held by the parent or financial statements of the parent has been provided to the lender of funds.

33. Further, the extended applicability of this section to the funds guaranteed by AEs may hamper the growth of companies, which are set up in India in their gestation period. In order to comply with the proposed limit on interest deduction, such companies may not have an option but to borrow with a guarantee, which may otherwise adversely impact their cost of borrowing and risk to lenders.

34. In this regard, the taxpayers may face certain challenges to prove the non-existence of an implicit guarantee in case of funds borrowed from third parties.

35. Accordingly, in order to remove the uncertainty in case of third party borrowings, the implicit guarantee should be kept out of the purview of this section.

Recommendation

36. A suitable amendment should be made to restrict the applicability of proviso to section 94B(1) to cases where the funds borrowed from third party lenders have been explicitly guaranteed by the non-resident AE.

G. Computation of EBITDA

37. As per the provision stipulated in section 94B, the deduction of interest expenses, while computing the income chargeable to tax under the head 'Profit and gains of business or profession', shall be restricted to 30% of EBITDA.

38. However, the said provision does not discuss the manner of computation of EBITDA. An issue may arise as to whether the EBITDA should be considered as per books of accounts or as per taxable income.

39. In the context of Fixed Ratio Rule, as applicable to entity, BEPS AP 4 acknowledges that EBITDA is the right measure of determining ability of the company to service interest. It acknowledges that in the context of interest limitation rule, most countries have preferred use of tax measure of EBITDA. However, in respect of Group Ratio Rule, accounting EBITDA according to the consolidated financial statements is preferred.

40. The working of taxable income would be reflective of an artificial figure of EBITDA. There may be additions which do not represent actual earning, whereas, there may be disallowance which do not dilute the measure of commercial earning. Also, there may be exempt income which, though constituting income as per commercial understanding, may not be included in the taxable income. The measure adopted in the books provides a fair certainty of ascertainment.

41. Further, as per section 94B(2) of the Act, the disallowance has to be computed on the basis of the EBITDA of a previous year. In this regard, the OECD discusses that, rather than linking an entity's ability to deduct net interest expense to economic activity in a single year, the impact of short-term volatility could be reduced through the use of average figures of EBITDA.

Recommendation

42. A circular may be issued to notify the manner of computing EBITDA stating that EBITDA should be computed on the basis of books of accounts.

43. Further, the taxpayer should be allowed to use an average of the EBITDA for a specified number of years to reduce the short-term volatility rather than linking the entity's ability to deduct interest expense to economic activity in a single year and the same would be in line with the OECD's BEPS AP 4 on interest deduction.

SECTION IV

Removal of cap on deduction for provisions for bad and doubtful debts under Section 36(1)(viia) of the Act

Background

1. The banking system in India is regulated by the RBI, through the provisions of the Banking Regulation Act, 1949. Accordingly, a bank incorporated in India or a branch of a foreign bank is governed by the guidelines and prudential standards prescribed by the RBI. In this regard, to prescribe a uniform and consistent approach for classification of assets by banks and to ensure an adequate level of provisioning on those assets on the basis of an objective criteria, the RBI has issued Master Circular[1] which inter-alia provides the norms for provisioning pertaining to advances made by the banks. The guidelines provide for making provision towards various category of assets (such as sub-standard, doubtful and loss assets etc.).

2. Banks are required to follow prudential norms prescribed by the RBI, which are considered as minimum provisioning requirement. Deduction in respect of provision made for bad and doubtful debts is presently governed by section 36(1)(viia) of the Act [introduced by the Finance Act, 1976] laying down certain ceiling limits (to the extent of 5% of the adjusted total income in respect of foreign banks, 10% in respect of rural branches and 8.5% in respect of scheduled bank or a co-operative bank). In case of most of the banks, the amount of NPA provision made in accordance with the RBI norms exceeds the deduction presently available under the current tax laws, which results in disallowance of a substantial portion of provisions made for NPAs.

3. Currently the banking sector is facing a huge burden of NPAs worth over INR 8 .97 lakh crore as of June 2019[2] that has impacted their profitability. Banks with high level of NPAs effectively have lesser funds to advance i.e. lesser funds on which they can potentially earn interest income.

Recommendation

4. In view of the above critical situation faced by banks in respect of recovery of NPAs and given that such provisions for NPAs are made by banks as per the guidelines prescribed by the RBI, provisions made by banks towards NPA should be allowed in full while computing total income of all the scheduled commercial banks without any restriction.

5. In this regard, we wish to state that as per the current provisions under the Act, deduction of bad debts written off as irrecoverable in the books of account can be claimed by banks only after setting off the provisions for bad debts previously allowed under section 36(1)(viia) of the Act. In this context, where full provision for bad debts as per the RBI regulations is allowed to banks under the tax law, the deduction for actual write off of bad debts will be allowed only after considering the aforesaid provisions already allowed. Accordingly, there would not be any incremental deduction which would be claimed by banks.

[1] (Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances)
[2] http://www.careratings.com/upload/NewsFiles/Economics/NPAs%20Q1%20FY20.pdf

6. The overall economic scenario and increasing NPAs pose a deep challenge to the banking sector. Accordingly, the deduction of the amount of provision made towards NPAs without any restriction would reflect the true position of tax cost of the banks. Further, this will help them in allocating more funds for achieving the operational efficiency, which may improve the health of the banking economy in India.

7. Alternatively, where the aforesaid relief of full deduction of provision of bad debts is not allowed, the deduction should be raised to 8.5% as an alternative relief for foreign banks as currently the provision for bad and doubtful debts for banks is capped at 8.5% of tax profits for domestic banks and 5% of tax profits for foreign banks. This would also bring about parity in the tax treatment between domestic banks and foreign banks.

SECTION V

Removal of cap on deduction for HO expenses under Section 44C of the Act

Background

1. Principally, when a non-resident has a 'PE' or a 'fixed base' in a source country, the profits which are attributable to such PE or fixed base is considered as taxable in the source country, as typically laid under the relevant domestic tax laws or DTAAs, if any. While determining the profits of such PE or fixed base, the net profits earned is to be arrived at after deducting the expenses which are incurred for the purposes of the business of the PE or a fixed base from the gross income earned by such PE or a fixed base, in the source country. Thus, even if the expenses are incurred by the non-resident in its home country, so long as, such expenses are incurred for the purposes of the business of the PE or a fixed base situated in the source country, the same qualifies/ ought to be considered as an eligible deduction while computing the taxable business income of a non-resident in the source country.

   In this regard, there could be two types of HO expenses incurred for the business of branches in India, namely,

   (a) Specific expenses (Where an expenditure is identifiable as being specifically incurred for the purposes of the branches in India) – Deductibility of which is presently governed by section 37(1) of the Act and

   (b) General and administrative expenses – Deductibility of which is presently governed by section 44C of the Act [Introduced by the Finance Act, 1976 laying down ceiling limits (to the extent of 5% of the adjusted total taxable income) for the deduction of HO expenses in the nature of executive and general administration expenditure incurred]

2. At the assessment level, the practical difficulty has always been around the scrutiny and verification of claims for aforesaid expenses incurred by the HO and there has been a huge litigation on the deductibility of HO expenses. For instance, in the foreign banks' context, many large tax payers have pro-longed litigation on the matter with issues pending for more than a decade. Given this, foreign companies are facing tough challenge in doing business in India. In this regard, we have tabulated below the typical reasons for the denial of the claim for HO expenses and our views in respect of the same:

Sr. No.	Reasons for denial of deduction for HO expenses by tax officers	Our comments
1	HO expenses are not debited to Indian books of account of branches in India	It is a judicially settled principle[3] that the allowance of expenditure as a deduction does not depend upon its accounting in the books of a tax payer
2	No payment has been made by Indian branches/ no invoice/ debit note has been raised on the Indian branches	As already discussed above, what is required is that the HO expenses should be incurred for the purposes of the business of the branches in India; Principally, payment by the Indian branches to the HO cannot be a pre-condition to claim the deduction
3	Specific expenses: Need/ Benefit / Stewardship test not satisfied or HO expenses alleged as duplicative	Indian transfer pricing rules are well-equipped to verify these tests. Duplicative evaluation of same under section 37(1) is unwarranted.
4	Executive and general administration HO expenses: A particular expenditure incurred by the HO falls outside the scope of executive and general administration expenses under section 44C of the Act	While the Act defines 'HO expenditure' under section 44C, the ambit and scope of executive and general administrative expenditure has been a matter of debate and litigation.

Thus, fundamentally, there are two major concerns on the legislative framework for deductibility of HO expenses i.e.

3. Principally, non-residents ought to be allowed full deduction of HO expenses incurred outside India for the purpose of the business of the branches in India whether specific or general/administrative (i.e. no ceiling limit should apply).

4. There should be a clear guidance/ certainty on allowability of the claim to avoid any litigation on the subject matter.

With this background, we have provided below our recommendation in respect of legislative framework for deductibility of HO expenses.

[3] Kedarnath Jute Mfg Co Ltd v CIT [1971] 82 ITR 363 (Supreme Court)
Addl CIT v Buckau Wolf Engineering Co Ltd [1984] 157 ITR 751 (Bombay HC)
British Bank of Middle East v Jt CIT [2005] 4 SOT 122 (Mumbai ITAT)
Bank of America NT and SA [2008] ITA No. 5241/2005 (Mumbai ITAT)

Recommendation

5. Any HO expenses (whether specific or general and administrative) should be fully allowed under section 44C of the Act on producing the certificate from the auditors of HO in the foreign country.

6. Deduction for any HO expenses should not be denied on the ground that:

   - Expenses are not debited to Indian branches books of account or
   - No payment has been made by Indian branches/ no invoice/ debit note has been raised on the Indian branches

SECTION VI

Clarification with respect to taxability of interest income under section 115A of the Act for banking units located in an IFSC

Background

1. The Government of India had notified India's first IFSC in Gujarat at GIFT city which was followed by relevant tax/regulatory amendments to enable its functioning.

2. In order to constantly promote and develop the IFSC, there has been constant efforts of the Government to bring them at par with IFSC located in other countries.

3. The Finance (No 2) Act, 2019 introduced the following welcome amendments for an IFSC unit of a foreign banking company:

   a) Deduction of 100% of income for 10 consecutive years, at the option of the assessee, out of 15 years under section 80LA of the Act;
   b) Exemption on income by way of interest payable to a non-resident by a unit located in IFSC in respect of monies borrowed on or after 1 September 2019

4. In view of provision of section 115A of the Act, banking unit of foreign banks in IFSC can be said to be liable to pay tax at the rate of 20% or 5% on gross interest income earned on FCY borrowings or debt granted to Government or Indian concerns. This is because, as per section 115A of the Act, neither expenses or allowances under section 28 to 44C of the Act can be claimed as deduction against such income nor deduction under chapter VIA (which includes section 80LA of the Act) can be claimed against such income.

5. In case of an Indian bank, which has set up a banking unit in IFSC that lends FCY borrowings to ICo, it will still be eligible for deduction under section 80LA of the Act, as section 115A does not apply to resident assessees.

6. Owing to this peculiarity, section 115A of the Act provides a tax arbitrage between domestic and foreign banks, although this was not its intention. Thus, there is a need to make a suitable amendment in section 115A of the Act to ensure consistent treatment to Indian banks and foreign banks operating out of IFSC for the interest income earned on FCY borrowings to ICo.

Recommendation

7. It is recommended to amend section 115A of the Act to exclude the income earned by banking unit of IFSC of foreign banking company from the scope of section 115A of the Act. This can be achieved by inserting sub-section (6) in Section 115A of the Act:

   "Nothing contained in sub-section (1) shall apply in relation to any income by way of interest received by a non-resident (not being a company) or a foreign company from Government or the Indian concern on monies borrowed or debt incurred by Government or the Indian concern in foreign currency, if such interest is attributable to the operations of a unit of an International Financial Centre referred to in Section 80LA or to the operations of a branch situated in India of a banking company."

8. An alternative would be to suitably amend the provisions of section 115A(1)(a) by introducing the words "other than loans granted by a Unit of an International Financial Centre referred to in section 80LA".

   - Further, in order to provide complete tax exemption to an IFSC branch, it is recommended that MAT provision should not be applicable to an IFSC branch in a year where deduction under section 80LA of the Act is claimed.

CAPITAL MARKETS

SECTION VII

<u>No withholding of taxes on dividend as well as interest income and taxes to be discharged by way of advance taxes/ on repatriation (similar to capital gains)</u>

Background

1. The Finance Bill, 2020 which proposed to abolish DDT and re-introduce the classical system of dividend taxation with effect from 1 April 2020, was passed by the Parliament with certain amendments and, received the Presidential assent, on 27 March 2020.

2. Prior to 1 April 2020, dividend income was exempt in the hands of the shareholder under section 10(34) of the Act subject to the Indian company paying DDT at the rate of 20.56%. Further, intent to revive the classical system of dividend taxation i.e. the Memorandum to the Finance Bill, 2020 indicated that the dividend is income in the hands of the shareholders and not in the hands of the company and thus, should be taxable in the hands of the recipient. Accordingly, the current provisions are considered as iniquitous and regressive. Further, the said provisions were also leading to increase in compliance burden for the Indian companies. Thus, to collect tax at a single point, the said classical system of dividend taxation was proposed to be re-introduced.

3. With effect from 1 April 2020, dividends are taxable at the rate of 10% for resident shareholders and 20% in case of non-residents (subject to treaty relief, if any).

4. The above proposal shall impact FPIs who are specifically governed by the provisions of section 115AD of the Act. As per section 115AD of the Act income from securities is chargeable to tax at the rate of 20% (plus applicable surcharge and health and education cess).

5. Additionally, it is to be noted that currently, section 196D of the Act creates an obligation to withhold tax at the rate of 20% on the person responsible for making payment of income on securities referred to in section 115AD(1) of the Act (except for interest income under section 194LD) to a FPI, at the time of credit or payment, whichever is earlier.

6. Accordingly, any interest and dividend paid to FPI (which was hitherto subject to DDT under section 115-O of the Act), is subject to withholding at the rate of 20% under section 196D of the Act. Given that the withholding tax rate of 20% is a higher rate, it causes undue hardship to FPIs specifically where under a tax treaty the FPI is taxable on interest and dividend income at a lower rate.

7. Withholding of tax which is higher than the final tax liability is unwarranted and against the principle of taxation. This may not be intended by the legislature. Further, while tax payer can claim refund of higher taxes withheld, it may result in undue hardships and practical difficulty e.g. cash flow management issues.

Recommendation:

8. In order to facilitate ease of doing business in India and prevent any undue hardships to FPIs, we wish to recommend as under:

Alternatives	Rationale for recommendation
Alternative I: Rate of withholding on dividend paid to FPIs under section 196D of the Act to be amended to 'rates in force' (akin to section 195 of the Act) instead of prescribed rate of 20%	As indicated above, withholding of taxes under the Act at the rate of 20% (plus applicable surcharge and cess) creates undue hardships and difficulties for FPIs specifically where the final tax liability is to be determined as per the rates prevailing under a tax treaty which could be lower than the rate of 20%. Thus, it is recommended to amend the provisions of section 196D(1) of the Act to enable withholding at "rates in force" in place of "20%" in line with the provisions of section 195 of the Act to enable application of lower DTAA rate, wherever applicable, and avoid unnecessary hardship to FPIs. Further, it is also recommended to amend the definition of section 2(37A)(iii) of the Act to include reference to section 196D of the Act.
Alternative II: Alternatively, FPIs be permitted to obtain certificate under section 197 of the Act	Section 197 of the Act permits a taxpayer to file an application to obtain lower withholding tax certificate for the tax to be deducted payment to be made to such taxpayer. This permits taxpayers, especially non-resident taxpayers to have taxes deducted at a lower rate based on the analysis of the case by the tax officer and is a provision which ensures greater administrative convenience for a taxpayer. Currently, section 196D is not covered within the purview of the withholding related provisions for which an application can be filed under section 197 of the Act. Also, from a procedural perspective, a taxpayer is required to file an application in Form no. 13 which requires the applicant to provide for the details of each of the payers and estimated amount of income/ sum to be received by the applicant from each such payer. An exception to this is provided in the proviso to Rule 28AA(4) of the Rules which states that where the number of persons responsible for deducting the tax is likely to exceed 100 and the details of such persons are not available at the time of making application, the certificate for deduction of tax at lower rate may be issued to the person who made an application for issue of such certificate, authorising him to receive income or sum after deduction of tax at lower rate. As per Rule 28AA(5) of the Rules, the certificate is valid only with regard to the person responsible for deducting the tax and named therein unless the application falls under proviso to Rule 28AA(4)

	of the Rules in which case the certificate shall be valid with regard to the person who made the application. FPIs invest in several portfolio companies and keep trading their portfolios, and therefore, it may practically not be possible for the FPIs to provide details of all their portfolio companies at the time of making the application. Therefore, where an application is made by an FPI for lower tax withholding, an exception from providing party wise details of estimated income for FPIs would be required. It is therefore recommended that the provisions of obtaining a lower withholding tax certificate by way of an application under section 197 of the Act be extended to FPIs as well, with respect to taxes withheld under section 196D of the Act. Further, Rule 28AA(4) of the Rules could be amended to introduce another proviso which could state that in case of applicants being FPIs, the certificate for deduction of tax at lower rate may be issued to the FPI making the application authorising it to receive income or sum after deduction of tax at lower rate without the obligation of providing details of the payer(s) and the estimates of dividend likely to be received/earned.
Alternative III: Alternatively, notification be issued under section 197A (1F) of the Act whereby for dividend/ interest income for FPIs, WHT to be done at treaty rates	An exemption be provided from withholding of taxes on dividend/ interest income paid to FPIs (similar to capital gains). Currently, as per the provisions of section 196D(2) of the Act, there is no requirement to withhold taxes on capital gains earned by FPIs in India. To ensure that appropriate taxes are paid into the Government treasury, FPIs are required to discharge their tax liability on capital gains prior to repatriation of funds. Further, the custodians in India are obligated to verify such payment of taxes by FPIs, based on a certificate obtained by the FPIs from a Chartered Accountant, prior to remitting the proceeds outside India. This above process of discharging taxes has been followed for more than 20 years. Given that the above process has worked seamlessly in respect of capital gains income of FPIs, we therefore, recommend that a similar approach should be extended in respect of dividend/ interest income earned by FPIs in India. This would enable the FPIs to avail of lower tax rates on dividend/ interest

	income as specified in the tax treaty applicable to them at the time of paying advance taxes and would also obviate the need to claim a refund of excess tax deducted on dividend/ interest income at the time of filing their tax returns This approach will also not result in a loss of revenue to the Government, and on the contrary, will reduce the administrative burden. We recommend that a notification be issued by the Central Government by exercising its powers conferred by section 197A(1F) of the Act stating that no taxes should be withheld on dividend/ interest income earned by FPIs or alternatively, that taxes be withheld at treaty rates on dividend/ interest income to be paid to FPIs.

9. In order to enhance the proposition of making India an attractive investment jurisdiction and to promote ease of doing business by avoiding the hassle of claiming excess taxes withheld through the return of income, we recommend that one of the above alternative approaches be adopted by the Government.

SECTION VIII

Clarification to be provided as to 'securities' would not fall within the definition of the term 'goods' with respect to the TCS provisions.

Background

1. Section 206C of the Act provides for collection of TCS on specified category of goods/ items. Hitherto, section 206C of the Act covers several transactions under TCS like sale of alcoholic liquor for human consumption, tendu leaves, scrap, minerals being coal or lignite or iron ore, motor vehicles of value exceeding INR 1 million.

2. To expand the tax collection mechanism of section 206C of the Act and deepen the tax net, the Finance Act 2020 with effect from 1 October 2020, introduced a new sub-section (1H) in section 206C to provide for TCS at the rate of 0.1% on sale of goods over annual threshold limit of INR 5 million.

   The relevant extract has been reproduced below:

   "(1H) Every person, being a seller, who receives any amount as consideration for sale of any goods of the value or aggregate of such value exceeding fifty lakh rupees in any previous year, other than the goods being exported out of India or goods covered in sub-section (1) or sub-section (1F) or sub-section (1G) shall, at the time of receipt of such amount, collect from the buyer, a sum equal to 0.1 per cent. of the sale consideration exceeding fifty lakh rupees as income-tax:"

3. The provisions of section 206C(1H) of the Act shall not apply if the buyer is liable to withhold taxes under any other provision of the Act on the goods purchased by him from the seller and such taxes have been deducted by the buyer.

4. While the Explanation to section 206(1H) of the Act defines the terms 'buyer' and 'seller', the term 'goods' has not been defined in section 206(1H) of the Act. In absence of definition of the said term, reference may be made to its definition in various other laws. The relevant extract of the same has been reproduced below:

   - Sale of Goods Act, 1930 states that:

     "goods" means every kind of moveable property other than actionable claims and money; and includes stock and shares, growing crops, grass, and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale;

- The Central Sales Tax Act, 1956 states that:

  "goods" includes all materials, articles, commodities and all other kinds of movable property, but does not include newspapers, actionable claims, stocks, shares and securities.

- CGST Act 2017 states that:

  "goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;

5. Accordingly, in the light of the above discussions, it is relevant to note that the term 'goods' as per the Sale of Goods Act, 1930 includes shares and securities whereas the Central Sales Tax Act, 1956 and the CGST Act 2017 defines 'goods' to mean movable property other than shares and securities.

6. Thus, presently there is ambiguity on whether for the purposes of levy of TCS under section 206(1H) of the Act, the definition of 'goods' should include shares and securities. This ambiguity is further amplified in light of the CBDT Circular No 17/2020 dated 29 September 2020 which has clarified that the provisions of TCS shall not apply in case of transaction in securities which are traded through recognized stock exchange.

7. We highly appreciate the relaxation from the applicability of TCS provisions to transactions in respect of shares and securities traded on a recognized stock exchange. However, in absence of clarification, presently there is uncertainty on whether transactions of securities undertaken other than on a recognised stock exchange shall attract the levy of TCS where the aggregate sale consideration exceeds INR 5 million.

8. We request you to address this uncertainty by clarifying that even transactions in respect of sale of securities undertaken other than through a recognized stock exchange shall not be subject to TCS provisions.

9. This is a significant area of concern for private equity funds who primarily invest in unlisted shares and securities of Indian companies, as this will increase the compliance burden for them.

Recommendation

10. It is recommended that relaxation from the levy of TCS be extended to securities which are traded other than on a recognised stock exchange.

SECTION IX

Clarifications on the applicability of the PPT Rule provided in AP 6 issued by OECD under BEPS and corresponding articles in the MLI

Background

1. In 2012, the OECD and G20 countries initiated the BEPS project to close the gaps in the existing international rules that allow corporate profits to be received or artificially shifted to low or no tax jurisdictions, where companies have little or no economic activity. Out of the various Aps developed under the BEPS framework, AP 15 indicated that an MLI should be developed to modify bilateral tax treaties.

2. On 7 June 2017, the first signing ceremony of the MLI was held in Paris where 68 jurisdictions, including India, signed the MLI. Further, as on 30 September 2019, 89 jurisdictions have signed MLI. The Indian Government deposited the ratified MLI to implement tax treaty related measures to prevent BEPS on 25 June 2019 with OECD. The MLI will operate to modify tax treaties between two countries on the principles of matching of their choices and will be applied alongside the existing tax treaties.

3. Of the various minimum standards, which were agreed as part of the BEPS final package, AP 6 – Prevention of Treaty Abuse, is one of the most important aspects of the BEPS concern. The treaty abuse provisions as envisaged under AP 6 are contained in Part III[4] of the MLI i.e. Article 6 to Article 11. These articles are meant to change the provisions of a tax treaty between two countries.

4. To address treaty abuse, AP 6 indicates adoption of the following minimum standards by countries:

   - Having a clear title and preamble in a tax treaty – avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance including through treaty-shopping arrangements (Article 6 of MLI).

   - Insertion of a GAAR in the treaty i.e. PPT Rule – not granting treaty benefits if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit (Article 7(1) of MLI).

5. The MLI has entered into force for India on 1 October 2019. The entry into effect of MLI will depend upon when the other contracting country deposits the ratified copy with OECD. With respect to countries like UK, Australia, Japan, Singapore, the MLI related changes will enter into effect from 1 April 2020.

6. Once the MLI comes into effect, it will need to be read alongside the existing tax treaties and shall either supplement, complement, supersede (by replacement of an existing provision or

[4] AP 6 lays down various ways in which a Treaty may be abused i.e. through treaty shopping, dividend transfer transactions, abuse of provisions of a tax treaty by location of a PE of an enterprise in a third jurisdiction, etc. We have for the purposes of our submission, provided our comments only with respect to abuse of a tax treaty through treaty shopping (i.e. Articles 6 and 7 of the MLI).

by inserting a non-obstante provision) or modify the application of the tax treaties thereby bringing them in line with the measures set out in the BEPS AP to address base erosion.

7. On the PPT clause, India has adopted PPT as an interim measure and has indicated its desire to undertake bilateral negotiations to incorporate stricter limitations of benefit provision. Till the time such bilateral negotiations are concluded, the PPT provisions will be incorporated in tax treaties entered into by India with other countries.

Issue

8. Currently, there is no guidance provided with respect to the manner in which the PPT Rule has to be applied and thus, the same would result in the following issues:

- Whether the PPT Rule will be applicable to all transactions or only transactions beyond a threshold limit shall be impacted.

- Whether the PPT Rule would be applied to arrangements/ transactions undertaken before the PPT Rule is made effective (i.e. whether any grandfathering would be provided for arrangements made prior to the PPT Rule being made effective).

Recommendation

9. The PPT Rule provided in AP 6 and the GAAR provisions as stipulated in the Act are very similar in nature.

10. Given that GAAR and PPT Rule are both anti-abuse provisions, with a similar intent and object (specifically in the context of FPIs), the safeguards and procedures already existing for invoking GAAR should be mirrored for invoking the PPT Rule.

11. Certainty and clarity in tax laws are two important elements for foreign investors investing into India. Hence, it is imperative that the following aspects should be considered by the Government:

A. Guidance along with examples to be issued by the Government on how to interpret the PPT Rule – especially on what would constitute 'one of the principal purposes'.
B. A taxpayer should not be subject to both – GAAR and PPT Rule. It should be clarified that only one of the two should be invoked.
C. Administrative guidance on the manner in which the PPT Rule is to be invoked is required to be specified. E.g. a minimum threshold should be provided for invoking the PPT Rule, seeking approvals of the relevant authorities, etc. Given that PPT and GAAR are similar in nature, the guidance provided in respect of GAAR should also be applicable for PPT.
D. Arrangements/ transactions undertaken before the PPT Rule is made effective should be grandfathered. Alternatively, transactions entered on or before 31 March 2017, i.e. before the GAAR provisions became applicable should also be grandfathered.
E. It should be provided that the exceptions as provided to application of GAAR provisions under Rule 10U of the Rules would also be applicable for invoking the PPT Rule i.e the PPT Rule would not be invoked for:

- An arrangement where the tax benefit does not exceed INR 3 crores in aggregate in an AY to all the parties
- An FPI that does not claim benefits under a tax treaty
- A non-resident that has made investments, directly or indirectly, by way of offshore derivative instruments in an FPI
- Transfer of investments before 1 April 2017

Rationale

12. As indicated above, the PPT Rule states that benefits of a tax treaty would be denied to a taxpayer when <u>one of the principal purposes</u> of any arrangement or transaction entered into by him is to obtain a tax benefit. Thus, obtaining benefit under a tax treaty need not be the sole or dominant purpose of a particular arrangement or transaction.

13. While the proposed Commentary to OECD MC provided in AP 6 has sought to interpret various terms of the PPT Rule i.e. benefit, arrangement or transaction, what can be considered to be one of the principal purposes, etc, the explanation provided is very broad and subjective and does not offer conclusive guidance to taxpayers. The proposed Commentary to OECD MC provided in AP 6 has also provided 10 examples wherein the application of the PPT Rule is explained. However, most of the examples are such that the outcome thereof would not seem to be in doubt (i.e. they are obviously right or blatantly wrong).

14. Based on the above, it appears that the burden of proof to demonstrate the legitimacy of a transaction lies on the taxpayer and not on the tax authorities.

15. This creates a significant amount of uncertainty for investors investing into India more so as tax officers, especially at the lower levels may seek to invoke the PPT Rule in absence of any clear guidance and supervision.

16. Specifically, in the context of FPIs, it is relevant to note that FPIs access the Indian capital markets in a regulated environment and their activities are governed by SEBI. Most transactions of FPIs [(except in certain limited cases such as buy-back of shares (which are anyway subject to buy-back regulations)] are carried out on the stock exchanges, undertaken by registered stock brokers, settled by regulated depositories and assets custodised with registered custodians and authorised banks. The regulations instituted by SEBI ensure that there is transparency in the capital market transactions undertaken by FPIs.

17. Given the unique nature of the industry, it is very important for foreign investors to invest in jurisdictions where there is complete clarity on taxation; otherwise despite the attractiveness of a jurisdiction from an investor perspective, they may be constrained in investing in that jurisdiction. Lack of clarity on key provisions like whether treaty benefits will be available (given that MLI will now override existing tax treaties once it is effective) will result in foreign investors undertaking a significant risk.

SECTION X

Issues arising out of amendments made to the IM Treaty and IS Treaty

Background

1. The IM Treaty entered into force on 1 April 1982. Further, India and Mauritius on 10 May 2016 signed a protocol to amend the IM Treaty.

2. Similarly, the IS Treaty entered into force from 1 April 1994 and was subsequently amended by protocols dated 18 July 2005 and 1 September 2011. Further, a third protocol was signed by India and Singapore on 30 December 2016 to amend the IS Treaty.

3. The IM Protocol and the IS Protocol seek to amend a number of provisions of the IM Treaty and IS Treaty, respectively, for enhancing source country taxation rights including source country taxation rights on capital gains from transfer of shares.

4. In the context of capital gains earned by a Mauritian/ Singaporean resident from alienation (transfer or sale) of shares of an ICo, the amended provisions under the IM Treaty/ IS Treaty are as follows:

   - Removal of exemption on capital gains arising from alienation of shares in the source state from 1 April 2017 onwards.
   - Gains arising on transfer of shares acquired upto 31 March 2017 are grandfathered (i.e. gains arising is exempt in the source state). However, the said benefit is subject to LOB clause in case of the IS Treaty.
   - Rate of tax on capital gains arising from transfer of shares acquired on or after 1 April 2017 and sold upto 31 March 2019 (Transitory Period) shall not exceed 50% of the tax rate applicable in the source state.
   - Benefit of reduced taxation on capital gains arising during the Transitory Period shall be available subject to meeting the LOB clause.
   - Source based taxation in India at full domestic tax rates if the transfer of shares is effected on or after 1 April 2019, regardless of whether the shares are acquired during Transitory Period or are acquired on or after 1 April 2019.

   We have reproduced the Article on capital gains and Article on LOB of the IM Treaty and the IS Treaty at Annexure C.

5. As one would note from above, the IM Protocol and the IS Protocol make it clear that shares acquired till 31 March 2017 will be grandfathered (i.e. the gains arising on transfer thereof shall not be chargeable to tax in India), irrespective of the date of sale. However, in respect of shares acquired on or after 1 April 2017, the gains arising on transfer thereof shall be chargeable to tax in India.

6. In this regard, there is lack of clarity and certainty on whether grandfathering benefit would be available in respect of shares that come into existence on or after

1 April 2017 as a consequence of the investment made by the investor on or before 31 March 2017. The reason for the ambiguity is because grandfathering benefits under the IM Treaty and IS Treaty are available only for shares 'acquired' before 1 April 2017. As per various dictionary meanings[5], the term 'acquire' means to obtain possession or control or ownership of something.

7. Our recommendation is that shares brought into existence/ which come into the possession of the investor post 31 March 2017 due to any corporate action, (specifically conversion of a compulsorily convertible instrument/ ADR/ GDR into shares, merger, demerger, bonus) on an investment made on or before 31 March 2017 ('grandfathered investment') should also be grandfathered under the IM Treaty and the IS Treaty. These shares have essentially come into the possession of the investor owing to a corporate action on a grandfathered investment, as opposed to an active act of investing, and hence should be accorded the same treatment as the original grandfathered investment.

8. It is relevant to note that in the context of GAAR, the CBDT has issued clarifications vide Circular No 7/2017 dated 27 January 2017. Question No 5 of the said Circular states that grandfathering from GAAR under Rule 10U(1)(d) of the Rules shall be available to shares acquired on or after 1 April 2017 in respect of the following investments made before 31 March 2017:

- CCDs and CCPS;
- Shares brought into existence by way of split or consolidation of holdings;
- Bonus shares;
- GDRs.

9. Our detailed submission on the above is discussed below.

Conversion of compulsory convertible instruments

10. Convertible instruments such as CCDs and CCPS are commonly used instruments for the purposes of investing in companies as they provide the flexibility to structure the investor's participation in the investee company's equity capital based on business performance or other commercial parameters. There could be other commercial benefits that may warrant the raising of capital through convertible instruments (for e.g. deferral of equity dilution).

[5] Black's law dictionary, Tenth edition, Lexis Nexis, tax law dictionary, P. Ramanatha Aiyar's ' The Law Lexicon', 2nd edition

11. A question arises as to whether grandfathering of investments made until 31 March 2017 shall apply to convertible instruments where the conversion and subsequent sale of shares received on such conversion takes place post 1 April 2017.

12. The conversion covenant in a convertible instrument is typically exercised close to the point when there is a plan to take the investee company public (i.e. IPO) or otherwise transfer the shares to a financial investor or strategic buyer.

13. The concern with not grandfathering investments made using convertible instruments under the IM Treaty and IS Treaty has been explained using a CCD investment.

    In the context of CCDs, the conversion of CCDs into equity shares is regarded as a tax neutral transfer under the provisions of section 47(x) of the Act. Further, as per Rule 8AA of the Rules, the period of holding of the shares received on conversion is required to take into account the period for which bond, debenture, debenture-stock or deposit certificate, as the case may be, was held prior to conversion. Also, for the purpose of computing capital gains on the transfer of the shares received on conversion, the cost of the acquiring the CCDs is deemed to be cost of acquisition of the shares.

14. Similarly, in the context of CCPS, as per the provisions of section 47(xb) of the Act, any transfer by way of conversion of preference shares of a company into equity shares of the company is tax neutral.

15. Accordingly, should the investments made prior to 1 April 2017 in CCDs/CCPS not be grandfathered, it shall lead to a situation where the investor could become taxable in India under the Act on the capital gains derived on sale of the shares received on conversion despite the investment in the Indian investee company having been made prior to 1 April 2017.

<u>Our Recommendation</u>

16. In view of the above, it is our recommendation that grandfathering should apply to shares issued pursuant to the conversion of CCDs and CCPS if the convertible instruments are issued prior to 1 April 2017.

<u>Partly paid up shares</u>

17. As per the provisions of the Cos Act, a company may issue partly paid-up shares wherein a portion of face value of shares is paid at the time of subscription/ allotment and the balance on further calls subsequently made by the company. The calls are generally made depending upon the funding requirements of the company.

18. An issue may arise as to whether grandfathering provisions shall apply to the partly paid up shares issued prior to 1 April 2017 where call amounts are paid post

31 March 2017.

19. With respect to partly paid-up shares, it is relevant to note that the shares were acquired by the shareholder/ allotted by the company before 1 April 2017 and it is merely the payment of calls which happens post 31 March 2017. The investor has already committed for the payment of balance sums at the time of application/ allotment.

Our Recommendation

20. Given that the investment in shares are made prior to 1 April 2017 and it is only the payment of calls which is deferred, hence it should be clarified that such shares should be grandfathered and be eligible to claim exemption on capital gains in India post 1 April 2017.

Bonus shares

21. Bonus shares are additional shares issued to shareholders pursuant to the capitalization of reserves of the company. These bonus shares come into the possession of the investor owing to a corporate action on a grandfathered investment, as opposed to an active act of investing.

22. The entitlement to bonus shares is based on original shares with no option provided to the shareholder for non-receipt of such bonus shares. Thus, the issue of bonus shares is intrinsically linked with the original shares being held. No payment is made by the shareholder.

23. Upon the bonus issue, while the total number of shares held by the investor increases, the total value of the investment remains unchanged. This is because there is no change in the value of the company. Rather, as the number of shares increases, there is a simultaneous proportionate decrease in the value of the shares. Further, the cash balance of the company declaring bonus shares does not get impacted by distribution of bonus shares. This is merely a mechanism adopted by companies to increase the number of shares outstanding. Capitalization of reserves has no impact on the value of the company or its cash holdings.

No Tax Arbitrage

24. The company issuing bonus shares is not transferring any wealth from the company to the investor, either directly or indirectly. We note that when a company does any form of distribution, it is subject to tax in India under section 2(22) of the Act.

25. Tax arbitrage could happen if a company issues bonus shares and subsequently transfers cash to investors via buying back the shares. In this manner, the company could essentially distribute its cash or other assets to investors without paying the DDT, and the investor would have changed dividend income into capital gains. However, this lacuna in the law was addressed by inserting section 115QA of the Act, whereby any buyback of shares is subject to buy back distribution tax of 23.072% (including surcharge of 12% and education cess of 3%), which is higher than the DDT of 20.36% (after grossing up the tax rate and including surcharge of 12% and education cess of 3%). With the introduction of this provision, there is no longer any opportunity for tax arbitrage by issuing bonus shares.

26. While it is true that an investor may sell the bonus shares it receives for cash, this is no different than simply selling the investor's existing shares. To illustrate, let's assume an investor holds 100 shares with a market price per share of INR 100 prior to a bonus issue. Now lets compare a scenario where the Company declares a 1:1 bonus issue, versus a scenario where no bonus shares are issued. The investors sells half of the holdings in the market,

Particulars	Original Shares (no bonus shares issued)	Bonus Shares Issued
Number of Shares	100	200 (100 original – 100 bonus)
Price per Share	100	50
Shares Sold	50	100
Proceeds Realized	500	500
Shares Remaining	50	100
Value of Remaining Shares	500	500

In both scenarios, the investor is selling half their holdings for INR 500, and the value of the remaining shares held remain the same in the bonus vs. no bonus scenario.

Inherent Inequity

27. Tax Due Even Without Any Gain: Bonus shares are treated as having an acquisition cost of nil. There is no allocation of a proportionate amount of the original shares acquisition cost to the bonus shares. Thus, any sale of a bonus share will result in tax even where the investment, as a whole, results no gain or even a loss.

Particulars	No. of Shares	Average Cost per Share	Value of Holding (INR)
Original Shares	100	100	10,000
Issuance of Bonus shares (1:1)			
Original Shares	100	100	5,000
Bonus Shares	100	Nil	5,000
Total	200	50	10,000

Where the entire holding is transferred at the rate of INR 50 per share (immediately after the bonus issue), the capital gains would be computed as under:

Particulars	Original Shares (100) (INR)	Bonus Shares (100) (INR)	Total/Net (INR)
Sale Consideration	5,000	5,000	10,000
Cost of Acquisition	10,000	Nil	10,000
Gains/(Loss)	(5,000)	5,000	NIL

28. Exempt Long Term Investment Changed to Taxable Short Term: Bonus shares are treated as acquired as of the date of their issuance. The holding period of the original shares do not carry over to the bonus shares. This results in changing the potential long-term nature of investments, which are exempt from CGT, into short term gains and subject to CGT. This is a significant issue, because ICo regularly issue bonus shares.[6]

29. Rather than any tax arbitrage, bonus shares impart a significant tax disadvantage to investors.

Comparison with Stock Splits

30. We believe bonus shares should be viewed in the same light as stock splits. Other than the conversion of reserve into capital, they are essentially the same. The total number of shares to an investor increases without an increase in the value of the company or investment given the corresponding decrease in value of each of the shares.

31. Stock splits, however, do not result in the inequity of bonus shares. This is because the "acquisition date" is related back to the date of the original shares. Thus, there is no issue regarding grandfathering or holding period being changed from long term to short term.

32. In a stock split, the cost basis in the shares is split in proportion to the share split. I.e., where a share that is acquired for 100 and subsequently undergoes a 1:2 stock split, each share is treated as having a cost basis of 50. Thus, a sale of one of the shares does not automatically result in a taxable "gain."

[6] Note this is not an issue in many countries, because retained earnings (i.e., reserves) are treated as capital, so there is no distinction. Unlike India, companies in most other countries do not frequently and regularly issue bonus shares.

33. A comparison between bonus shares and stock splits is depicted in the below table. We assume a share was acquired at a price of INR 100, and compare where there is a 1:1 bonus issue versus a 1:2 stock split (each share becomes two shares), and one of the shares is sold at INR 50 for no overall net gain.

Particulars	Bonus Shares	Stock Split
Acquisition Date	Date of allotment of bonus shares	Date of acquisition of original shares
Cost Basis	Nil	50
Grandfathering Eligibility	??	Yes
Long Term converted to Short Term	Yes	No
Taxable Gain	50	Nil

Our Recommendation

34. It should be clarified that bonus shares issued based on the shares held by a shareholder on 31 March 2017 should be grandfathered and be eligible to claim exemption on capital gains in India post 1 April 2017 under the IM Treaty and the IS Treaty.

Corporate reorganization

35. Corporate reorganization may take place in several Indian and multinational companies for various reasons including better efficiency, synergy benefits etc. Generally, it requires approval from judicial authorities and/or regulatory bodies.

36. In case of corporate reorganization (either domestic or foreign), in addition to other assets and liabilities, the shares of an ICo may also get transferred to the resultant company. The transfer of shares of an ICo is pursuant to the re-organization and is not voluntary and independent transfer of such shares.

37. Certain reorganizations are tax neutral where the same are undertaken in accordance with the provisions of section 47 of the Act subject to fulfilment of conditions stipulated therein, such as onshore/ offshore amalgamations / demergers, etc.

    For example: where there is an amalgamation of two foreign companies and one of them is holding shares of an ICo, the amalgamation shall not be chargeable to tax in India if certain conditions are met. Similarly, transfer of a capital asset by an amalgamating company to the amalgamated company shall not be chargeable to tax if the amalgamated company is an ICo.

38. It is presently unclear as to whether grandfathering provisions shall apply to shares of an ICo which are transferred post 31 March 2017 and have been acquired by a taxpayer pursuant to corporate reorganization which is otherwise tax neutral as per the provisions of section 47 of the Act.

Our Recommendation

39. It should be clarified that shares received/ issued pursuant to corporate reorganisations (including shares in the amalgamated company in case of an amalgamation, and the resulting company in case of a demerger) on or after 1 April 2017, where the transfer pursuant to such reorganisation is not taxable as per the provisions of section 47 of the Act should also be grandfathered and should be eligible to claim exemption on capital gains in India on transfer thereof post 1 April 2017.

GDRs/ ADRs

40. As per the Cos Act, "Global Depository receipt" means any instrument in the form of a depository receipt, created by a foreign depository outside India and authorized by a company making an issue of such depository receipts.

41. As such a GDR/ ADR issued against shares of an ICo represents for the holder a beneficial interest in a certain number of shares in the ICo. The shares acquired by a taxpayer on account of conversion of the GDR/ ADR merely results in him obtaining the underlying Indian shares.

Our recommendation

42. GDRs/ ADRs are merely title receipts and do not represent assets which are different from underlying shares. Hence, it should be clarified that grandfathering provisions should apply to equity shares received pursuant to the redemption of GDRs/ ADRs acquired on or before 31 March 2017.

Sub-division/ consolidation of shares

43. As per the provisions of section 61 of the Cos Act, any company having share capital inter-alia may[7]:

- Sub-divide its shares, or any of them, into shares of smaller amount;
- Consolidate and divide all or any of the company's share capital into shares of a larger amount than its existing shares[8].

44. We wish to submit that whenever a company undertakes a sub-division of its existing shares, the shareholders receive higher number of shares compared to the shares held by them before the sub-division. However, sub-division does not, in any manner, affect the interest of the shareholder in the company or his relationship with the company.

The rationale explained above in case of sub-division squarely applies to the scenario

[7] After altering the memorandum of the company in the General Meeting.
[8] A consolidation and division which results in change in voting percentage of shareholders will not have effect unless an approval of the company law tribunal is obtained.

where shares of a company are consolidated.

Based on the above, it can be construed that if the original shares are acquired before 1 April 2017, then the shares received on sub-division or consolidation should be considered to have been acquired before 1 April 2017.

Recommendation

45. It should be clarified that shares received by a taxpayer due to sub-division/ consolidation on or after 1 April 2017, should be grandfathered where the original shares were acquired by the taxpayer before 1 April 2017.

SECTION XI

Availability of 5% tax rate on interest income arising to a FPI from investments in a securitisation trust

Background

1. In a typical securitisation structure, an originating entity (typically banks, FIs or NBFCs) identifies a pool of assets and sells it to a SPV, generally set up as a trust and managed by the ARC.

   For the purpose of raising funds to purchase assets, the SPV formed by the ARC raises funds by issuing security receipts to QIBs, including FPIs.

2. The Finance Minister as per the Union Budget 2016-17 indicated that FPIs would be allowed to invest upto 100% of each tranche in security receipts issued by ARCs, subject to sectoral caps. It was also announced as part of the same budget that the investment basket of FPIs would be expanded to include Pass Through Securities issued by SPVs.

   To further enhance capital flows into the securitisation industry, the Finance Minister in his speech while presenting the Union Budget of 2017-18 stated that listing and trading of security receipts issued by a securitisation company or reconstruction trust shall be permitted on RSE.

3. In this regard, the RBI has vide circular[9] amended FEMA (Transfer or Issue of Security by a Person Resident outside India) (Twelfth Amendment) Regulations, 2000 (RBI Circular), allowing FPIs to invest inter-alia in securitized debt instruments.

   The SEBI also amended the 2014 Regulations vide SEBI (FPI) (Second Amendment) Regulations, 2017 (FPI Amendment Regulations) vide circular[10] permitting FPIs to invest inter-alia in securitized debt instruments.

4. As per the RBI Circular and SEBI Circular, securitised debt instruments have been defined as under:

   - any certificate or instrument issued by a SPV set up for securitisation of asset/s where banks, FIs or NBFCs are originators; and/or

   - any certificate or instrument issued and listed in terms of the SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

5. The aforesaid amendment was made with an intention to increase investments in the securitisation sector and ease strain on the stressed banking system with foreign investments being an option.

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[9] Circular No. A.P. (DIR Series) Circular No.19 dated 17 November 2016
[10] Circular No. SEBI/HO/IMD/FPIC/CIR/P/2017/16 dated 28 February 2017

6. Currently, as per section 115TCA read with section 194LBC of the Act, an investor in a securitisation trust shall be chargeable to tax on income earned by him from the securitisation trust and the securitisation trust is required to deduct taxes thereon. In case of non-residents (including FPIs), taxes have to be deducted at the rates in force.

   The income of a FPI is chargeable to tax as per section 115AD of the Act. As per the said section, interest income earned by a FPI is taxable at the rate of 20% other than interest income referred to in section 194LD of the Act which is chargeable to tax at the rate of 5%.

7. When FPIs make investments through a securitisation trust, they are essentially investing in underlying debt.

8. In this connection, it is pertinent to note that section 194LD of the Act provides for concessional withholding tax rate of 5% on interest income earned by FPIs from investments in bonds of an ICo or Government securities.

   The intent behind providing a concessional rate of taxation under section 194LD of the Act was to encourage greater off-shore investment in the debt market by FPIs[11].

9. However, the higher withholding rate of 20% on interest income on securitised debt instruments acts as a deterrent for FPIs as against the concessional rate of 5% provided under section 194LD of the Act for bonds of an ICo or Government securities.

Recommendation

10. In view of the above discussions and given that the intent of permitting FPIs to invest in securitised debt instruments was to increase investments in the securitisation sector and ease strain on the banking system, a concessional tax rate of 5% as provided under section 194LD of the Act should be provided to FPIs investing in security receipts to provide an incentive to FPIs to invest in securitized debt instruments.

    Clause (iii) to sub-section 2 of section 194LD and clause (d) to explanation to section 194Ldof the Act should be inserted text of which is as follows:

    "(1) ....

    (2) The income by way of interest referred to in sub-section (1) shall be the interest payable on or after the 1st day of June, 2013 but before the [1st day of July 2020] in respect of investment made by the payee in–

    (i).........................; or

    (ii)......................; or

    (iii) a securitization trust:

    Provided.. behalf.

[11] Press Release dated 20 May 2013

Explanation.–For the purpose of this section,-

(a)..:

(b)..;

(c)..;

(d) Securitisation Trust shall have the meaning as assigned to it in clause (d) of explanation to section 115TCA."

SECTION XII

Levy of differential STT on FPIs in lieu of CGT on Listed Securities

Background

1. India is the one of the fastest growing economies in the world. Increasing the ease of doing business in India is critical to continue this growth trajectory by attracting foreign investment and creating a vibrant Indian economy.

2. In line with this, to make the Indian capital markets more attractive, increase the inflow of foreign investments in India and boost its economy, the need for predictable tax treatment in transactions on the stock exchanges is of paramount importance and common around the world. The capital markets require a higher degree of tax certainty as compared to other industries given that millions of capital market transactions are effected every day affecting multiple market participants (funds, fund managers, financial institutions, custodians, brokers, etc). The markets will operate efficiently only if each and every trade has a predictable result for investors and for the market participants and hence the need to review the existing inefficiencies with respect to taxation of FPIs.

3. FPIs are foreign investors that invest in Indian listed securities and derivatives pursuant to and within the scope of the guidelines provided by the SEBI. FPIs are regulated by SEBI and the scope of investments is limited to portfolio investments. SEBI rules prevent Indian nationals from using FPIs, thus prohibiting any round tripping. Private equity/mergers and acquisitions types of transaction fall out of the permitted investment scope of FPIs.

4. The institutional investors that invest in Indian securities via FPIs include pension funds, endowment funds, sovereigns, life insurance companies, corporates, and individuals. A collective investment vehicle (the Fund) is required to gather and pool the funds for investments. The Fund outsources the management of investments to a fund manager (Fund Manager). Generally, investors are free to come in and out of the Funds, and therefore the investors in the Funds change over time.

5. Many of the Funds are public market funds, and tax certainty is absolutely essential for the Funds and the Fund Managers to make their decisions since they need to calculate daily NAV of the units taking into account the tax applicable on the transaction. Similarly, cross border investors in the Funds, who enter and exit a Fund at varying times at varying prices, also need to calculate the NAV of their shares/ units (both realized and unrealized under financial accounting principles), taking into account the tax applicable to the transactions.

6. Lack of ability to determine an accurate NAV (as a result of tax uncertainty) impedes decision making for the Fund Managers as well as the investors in the Funds. Thus, it is imperative that there is complete clarity on the taxation of the investments.

7. Further, many FPIs such as banks and financial institutions issue ODIs to Funds in accordance with the regulations set forth by SEBI. As such, the Funds are able to gain economic exposure to the Indian market without having to deal with the significant operational difficulties of transacting directly and also obtain leverage. The FPIs, in turn, hedge their exposure under the ODIs via various means, including transacting in the reference Indian securities. The

overhang of the GAAR and uncertainty in their application in the context of cross border transactions where double tax treaty relief is sought, and imposition of CGT on their hedging transactions will pose significant challenges to these FPIs, and they will not be in a position to practically manage or retain the (uncertain) tax risk in the Indian securities.

Current Indian tax framework for FPIs in India in respect of capital gains and issues arising therefrom

8. There exists a concessional income-tax framework for FPIs in India introduced under section 115AD of the Act since the Finance Act, 1993 read with section 111A and section 112A of the Act. However, the capital gains tax regime in India is complex compared to other global markets and there are various aspects of the tax system which, as outlined below, make investing into India more onerous relative to other markets.

a) Complex CGT regime under the Act

We illustrate below certain complex provisions of capital gains tax regime applicable to FPIs:

- Different tax rates and period of holding (to qualify as long-term) for different types of securities i.e., equity, mutual fund units, debt securities, futures, etc.
- Computation of capital gain under First-In-First-Out method
- FPIs are required to track transactions resulting into dividend stripping/ bonus stripping to determine capital loss, if any, not allowable
- Restrictions on set-off of capital losses under specific situations
- Requirement to pay quarterly estimated taxes and file detailed annual tax forms and be subjected to scrutiny audit
- Refund of excess taxes paid can take years to obtain (long after the investors in the Fund has changed from when the tax was incurred).

b) GAAR and MLI Uncertainty

GAAR is applicable in India with effect from 1 April 2017. GAAR has the power to override DTAAs. FPIs have been investing in India availing the benefits of the applicable DTAA. Currently, there is no clarity on how GAAR will apply to FPIs availing of DTAA benefits. While India's DTAA with Mauritius and Singapore has been amended to remove CGT exemption on shares, the respective DTAAs continue to provide benefits for gains on non-share investments (e.g., bonds, listed derivatives, etc.) and India has DTAAs with a number of other countries that provide for CGT exemption on shares.

The potential for GAAR to be invoked to override the provisions of a DTAA and impose CGT, interest, and penalties of up to 200% causes significant uncertainty for FPIs causing barriers to investment and negatively impacting the ease of doing business in India. While many countries have some form of GAAR, it has not been an issue for foreign portfolio investors in other countries, because they do not impose CGT on listed securities transactions. Therefore, GAAR becomes irrelevant. Given the unique features of the listed securities market and the tremendous volumes of transactions completed on a daily basis, GAAR together with CGT is ill suited.
Further, the MLI which is an outcome of BEPS AP 15 of the OECD intends to offer solutions for Governments of various countries to plug loopholes in international tax treaties by

transposing results from the BEPS project into bilateral tax treaties worldwide. India is a signatory to the MLI and for approximately 21 of DTAA's entered into by India with various countries (i.e. Australia, France, Japan, Luxembourg, Netherlands, Singapore, UK, etc), the MLI is effective from 1 April 2020. Currently, there is no guidance on the manner in which MLI will be applied. Given the lack of clarity on the manner in which anti-abuse provisions (i.e. GAAR and MLI) would be applicable to FPIs, a further layer of uncertainty and complexity is added for FPIs in investing in India.

c) High Cost of Trading

In India, the cost of trading includes several levies like brokerage, service tax, stamp duty, STT, SEBI turnover fees, exchange transaction fees and custody fees. These costs, coupled with high tax administrative and compliance costs, result in the overall cost moving upwards. In fact, India is 8th most expensive out of 46 countries in levying market charges (both tax and non-tax) globally. Attached as Annexure 1[12] is a comparison table of the market charges. The addition of capital gains tax on this would change the result further.

d) Repatriation of Funds & Secondary Tax Liability of Custodians

FPIs need to repatriate the proceeds from the disposal of their investments on a frequent basis, with many requiring daily repatriations. As with other markets, they do not leave idle proceeds in a foreign currency when they should be redeploying it to other investments and managing their FX risk.

Coupled with this is the obligation that Indian custodians face to set aside taxes when they permit repatriation of funds to FPIs and the potential risk of being treated as representative assesses. They will require provision of tax certification from a certified accounting firm prior to allowing repatriation of funds and will deduct and remit to the Government an amount for taxes on gains. This is problematic in (i) hindering the free flow of funds in and out of India, and (ii) FPIs will need to go through the long and difficult tax refund process at the end of the tax year when the total taxes deducted from the FPIs exceed the actual tax is owed (e.g., subsequent losses can offset earlier gains). When the FPIs obtain a refund years later, the investors in the Funds would have changed.

e) Double Taxation

Imposition of CGT on FPIs can result in double taxation to foreign investors. This is because the FPIs will be subject to Indian CGT on their investments in the Indian securities, and then the investors in the FPIs (i.e., the investors in the Funds) can be taxed again in their home countries when they receive distributions. Further, foreign tax credits (i.e., CGT paid by FPIs to be used as credits to off-set taxes on the investors in the investors home country) are often not available or difficult to obtain in practice. This is due to (i) the nature of the way investments are typically made (i.e., investments via Funds), and (ii) complex foreign tax credit regimes.

[12] As of 2016

f) As just one example, India is a case in point on the difficulties of utilizing foreign tax credits. While India permits foreign tax credits to offset Indian income taxes, it is not available where the Indian resident makes the investment via a fund that invests in foreign securities. This is because the foreign CGT would be assessed on the fund and not directly on the Indian investor in the fund.

International practice on taxation of capital gains on portfolio investments by FPIs

Globally, most countries do not impose CGT on listed security transactions of foreign investors on their portfolio investments. In fact, no G20 country imposes capital gains tax on portfolio investment. Following is an illustrative list of countries[13] that do not impose capital gains tax on portfolio investments in listed securities[14]:

Asia Pacific	Australia, China[15], Hong Kong, Indonesia, Japan, South Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan
Europe	Austria, Belgium, Cyprus, Denmark, France, Finland, Greece, Germany, Hungary, Ireland, Italy, Luxembourg, Norway, Netherlands, Poland, Portugal, Russia, Spain, Switzerland, Sweden, Turkey, UK
Americas	Brazil, Canada, Chile, Colombia, Peru, US

Countries in Asia that impose capital gains tax are limited. To raise revenue, many countries have adopted a transaction-based tax, such as STT or stamp tax on listed securities transactions. These types of taxes are simpler and easier to administer. They achieve the twin goals of (i) raising revenue, and (ii) providing tax certainty and efficient functioning of the capital markets. Countries generally do not impose both transaction taxes and CGT. Following is an illustrative list of countries[16] that have STT or stamp tax:

Asia Pacific	China, Hong Kong, Indonesia, South Korea, Malaysia, Philippines Singapore, Taiwan
Europe	Bulgaria, Cyprus, Greece, Ireland, UK
Americas	Brazil, Chile, Colombia, Peru

Globally, India is one of the very few countries that imposes CGT on foreign portfolio investments in listed securities, and even rarer amongst countries that impose both CGT and STT, placing them with countries such as Pakistan and Bangladesh (Pakistan and Bangladesh imposes both CGT and STT on FPIs).

We have tabulated below the cost comparison in relation to levy of capital gains tax and other levies on listed securities for FPIs:

[13] As of 2016
[14] Various countries have maximum percentage holding thresholds for the purpose of capital gain tax exemption
[15] China, when they opened up their market to trade via the Hong-Kong Shanghai Stock Connect ("Stock Connect") route in 2014, made the decision to not impose capital gain tax. The Stock Connect route is open to both institutional and retail investors.
[16] As of 2016

Particulars	India	Singapore	Hong Kong	Malaysia	Indonesia	US
Sale consideration	115					
Cost of Acquisition	(100)					
Capital Gains	15					
Tax	(2.69)	0	0	0	0	0
Other levies[17]	(0.43)	(0.52)	(0.24)	(0.34)	(0.21)	(0.002)
Total taxes and levies	(3.12)	(0.52)	(0.24)	(0.34)	(0.21)	(0.002)
Net Proceeds	11.88	14.48	14.76	14.66	14.79	14.99

Based on the above, taxes and other levies in India vis-à-vis other countries is high by about 22%-27% thereby reducing the net proceeds to be received by investors.

Further, we have tabulated below the year wise levy of tax on LTCG and STCG and STT in India:

Year	Rate of LTCG	Rate of STCG	Rate of STT
Pre 2004	10%	30%	No STT
2004	Nil	10%	0.075%
2006	Nil	10%	0.125%
2009	Nil	15%	0.125%
2012	Nil	15%	0.1%
2017	10%[18]	15%	0.1%
2018 – 2019	10%	15%	0.1%

The above table indicates that progressively the Government has increased the rate of STCG tax and also introduced LTCG tax while continuing to levy STT, thereby increasing the cost of investing and impacting the attractiveness of Indian capital markets.

Recommendation

1. <u>Industry Recommendation</u>

In view of the above and in line with the international tax practice, we recommend that FPIs be exempted from CGT. The same is also in line with the recommendation of the Expert Committee on GAAR headed by Dr. Parthasarathi Shome.

If warranted, however, a differentiated STT rate between domestics and FPIs can also be considered in lieu of the CGT. That is, a higher STT be levied on FPIs vis a vis domestic taxpayers and an

[17] Other levies include average rates of STT, statutory charges, stamp duties, stock exchanges levies, and other local levies where applicable in each jurisdiction.
Source: EY Analysis – July 2019

[18] Exemption under IM and IS Treaty was withdrawn. Almost all FPIs became taxable in India

exemption be granted for CGT levied under the Act on income earned by FPIs in the Indian capital market. We note that many countries impose CGT on domestic taxpayers while exempting foreign portfolio investors (even without imposing a differentiated STT or no transaction taxes at all), so this differentiation is not out of the ordinary (e.g. Australia, China, Japan, Korea, Taiwan, Brazil, etc).

Without prejudice to the above, we recommend that capital gains arising on transfer of shares of companies forming part of the S&P BSE 500 index of the Bombay Stock Exchange should be exempt from tax in the hands of FPIs.

2. Benefits of Utilizing STT in Lieu of CGT

The imposition of higher STT in lieu of CGT on FPIs dramatically improves the ease of doing business in India and should:

- Provide tax certainty, predictability, and ease of operation so critical to FPIs
- Lead to a smooth, cost effective and efficient tax collection mechanism
- Create a level playing field for all FPIs investing from any jurisdiction
- Reduce litigation for FPIs
- Free up the resources of the Revenue due to simplification resulting in ease of administration, and allow tax officials to focus on other important areas
- Increase investment flows and liquidity into the Indian capital markets
- Allow corporate India to raise equity resources at higher valuations[19], lowering funding costs, and improving the Indian economy
- Increase tax revenues[20]

We believe the elimination of the complexity and uncertainty of CGT on FPIs will result in significant increase in STT revenue. This is not just due to an increase in the STT rate. Rather, it will be due to significant increase in investments into and trading in the Indian capital markets. The change will increase the ease of doing business in India, increase the investment and trading from existing FPIs, and encourage new FPIs that have previously been hesitant to invest in the Indian capital markets.

[19] Levy of CGT would likely be imputed by investors into their investment decisions in Indian equities. Different investors may impute different estimates towards CGT, thereby creating an uncertainty for Indian companies using the Indian Stock Exchanges for their capital raising process. Indian issuers would likely need to lower their IPO/rights issue prices. In the secondary market, price discovery level of domestic participants would also change, as foreign investors take into CGT impact on account sale/buy legs of trades

[20] As described below, we expect revenue from STT will significantly increase due to increased investment/ trading.

OTHER ISSUES

SECTION XIII

Submission on provisions relating to secondary adjustment envisaged under section 92CE of the Act

Background

1. Transfer pricing seeks to ensure that there is a correct allocation of taxable profits amongst tax jurisdictions. In cases where an international transaction is not undertaken at arm's length (i.e. expense is more than arm's length, or income is less than arm's length), a primary adjustment is made to the taxable profits of the taxpayer to align the transfer price with the ALP. This primary adjustment may be made by the tax payer (suo-moto) or by the tax authorities during the course of assessment/ APA/ MAP/ safe harbour proceedings.

2. As per the Indian tax laws prior to Finance Bill, 2017, any adjustment lead to increase in only the taxable income of the taxpayer and did not address the issue of cash settlement of the difference between the transfer price and the ALP. In effect, a primary adjustment resulted in the AE retaining the excess/ differential funds between the transfer price and ALP.

3. Section 92CE of the Act was introduced by the Hon'ble Finance Minister vide Finance Act, 2017 to remove the imbalance between the cash account and the actual profits of a taxpayer. Further, the CBDT has, vide its notification dated 15 June 2017, notified rules relating to computation of interest pursuant to secondary adjustment vide Rule 10CB of the Rules. Further, Hon'ble Finance Minister vide Finance Act, 2019 has introduced one-time tax settlement option in relation to amount to be repatriated to India.

4. Based on a reading of the language of the said provisions and rules, there are certain aspects, which in our view need clarity from the GOI; these concerns have been briefly outlined below:

A. Whether the secondary adjustment shall be subject to MAT in the year of receipt?

5. As per the provisions relating to secondary adjustment, if a taxpayer is required to make a secondary adjustment on account of the primary adjustment made in its case, then the said secondary adjustment shall entail the repatriation of funds into India by the AE. In the year of receipt of such funds in India, the taxpayer will be required to recognise the revenue in its books of accounts. It is possible that, in the year of receipt, the said revenue may not pertain to the said year, but towards the prior years.

6. In this regard, as per the income-tax provisions relating to MAT, the book profits as per the books of the taxpayer is taken into consideration for computing the liability towards MAT. In case of a scenario described above, since the revenue pertaining to prior years is also recorded in the books in the year of receipt, it needs to be determined whether the MAT liability will have to be computed by considering such prior period income as well.

7. Section 115JB of the Act, does not provide for a specific downward adjustment in relation to amount received on account of a secondary adjustment pertaining to prior years, and

accordingly, the same may be subject to double taxation once in the year to which the said revenue pertains to (under normal tax provisions or under MAT, whichever is applicable) and again in the year of receipt under the MAT provisions.

Recommendation

8. A specific downward adjustment should be provided under MAT provisions in relation to the prior period income recorded on account of secondary adjustment.

B. Option for payment of one-time settlement tax before expiry of prescribed time limit

9. As per section 92CE(2A) of the Act, where the excess money or part thereof has not been repatriated within the prescribed time, the taxpayer may pay additional income-tax (i.e. one-time settlement tax) on such excess money or part therefore.

10. In a scenario, where the taxpayer is certain that such excess money shall not be repatriated to India within the prescribed time limit and thus, wishes to opt for one-time settlement, based on a plain reading of section 92CE(2A) of the Act, the option for one-time settlement does not trigger until the expiry of prescribed time limit.

11. In such a case, pursuant to section 92CE(2D) of the Act, the taxpayer shall be required to pay interest on account of non-repatriation of excess money from the date of primary adjustment till the date of payment of one-time settlement tax.

12. Consequently, the taxpayer will face undue hardship by paying interest from the date of primary adjustment till the date of expiry of prescribed time limit, if such an interpretation of the provisions is adopted.

Recommendation

13. A suitable clarification/ amendment should be made to the Act in order to enable assessee to make one-time settlement tax payable before the expiry of prescribed time limit, such that the assessee shall not be made liable to secondary adjustment till the date of payment of one time settlement tax.

C. Netting off of income-tax refund due against the one-time settlement tax

14. There is an ambiguity regarding whether the taxpayer has an option to net off the refund due with the amount payable under one-time settlement option under section 92CE(2A).

15. Intent of section 92CE of the Act is to treat such taxes as final payment in lieu of excess money lying with its associated enterprise, without granting any further credit to the taxpayer.

16. However, section 92CE(2A) characterizes such payment as "additional income-tax", which should be allowed to net off the said tax against the refund due to the taxpayer.

Recommendation

17. A suitable clarification should be issued to allow the set-off of refund against the one-time settlement tax.

D. Time period for levy of interest

18. As per section 92CE read with rule 10CB, interest is levied if the excess money or part thereof, is not repatriated to India within 90 days from the prescribed dates as specified in the rule 10CB, until the deemed advance is repatriated to India. Further, rule 10CB specify the date from which the interest is to be computed in relation to deemed advance. However, the upper time limit for which the interest would be levied has not been prescribed.

19. This may lead to a situation where the aggregate of the interest levied year on year on account of secondary adjustment may exceed the value of primary adjustments which would cause unnecessary hardship to taxpayer.

Recommendation

20. A suitable amendment/ clarification in the provisions or rules should be notified to the effect that the period for levy of interest should not exceed a date, post which such interest becomes equivalent to the amount of deemed advance.

E. Clarification of the term 'relevant previous year'

21. Further, while prescribing the rates for imputation of interest in the notified rules, the applicable rate is to be considered as on a prescribed date of the relevant previous year.

22. Based on the current reading of the rules, there is an ambiguity as to what is meant by the term relevant previous year. For instance, if a primary adjustment is made in the return of income pertaining to AY 2017-18 and the cash is not repatriated within the prescribed time limit, whether for the imputation of interest, the relevant previous year will be AY 2017-18 i.e. the year to which the return of income pertains/ the year for which interest is computed or AY 2018-19 i.e. the year when the return of income is filed.

23. Similarly, in a case where a primary adjustment in relation to AY 2017-18 has been made by the Transfer Pricing Officer in AY 2020-21, which has been accepted by the Assessee in AY 2022-23. In this regard, whether the relevant previous year for imputation of interest should be AY 2017-18 or AY 2020-21 or AY 2022-23.

Recommendation

24. A suitable clarification should be issued stating that the relevant previous year would refer to the year in which the primary adjustment is made.

F. Whether the imputed interest needs to be repatriated and in case, the same is not repatriated, whether the interest needs to be imputed on such non-repatriated interest pertaining to previous years

25. The intent of the secondary adjustment provisions is to align the economic positions of the entities with the arm's length position as determined pursuant to primary adjustment. In other words, the main intent of the provision is repatriation of the excess funds available with the AE. If the excess funds are not repatriated, the excess funds would be deemed as loan and interest imputation would follow.

26. In this regard, an issue may arise as to whether the imputed interest on account of non-repatriation of funds also needs to be repatriated into India.

    Further, where there is a failure to repatriate imputed interest into India, there is another issue that may arise as to whether interest is to be imputed on the non-repatriated interest pertaining to the previous years until such interest is repatriated to India.

27. The intent of these provisions is not to consider the interest as an advance if the same is not repatriated to India. If such an interpretation is made, there would be a cascading impact on the interest amount if the same is not repatriated into India. The intent of these provisions is to offer such imputed interest to tax in India in case of non-repatriation of funds to India.

Recommendation

28. A suitable clarification should be issued stating that the imputed interest is not required to be repatriated to India, and accordingly there shall not be any imputation of interest on non-repatriated interest pertaining to the previous years.

SECTION XIV

Roll back of MAT credit utilization

Background

1. The Taxation Laws (Amendment) Act, 2019 which received Presidential assent on 11 December 2019 has introduced Section 115BAA of the Act providing concessional corporate tax rate of 22% (plus applicable surcharge and cess) to all domestic companies which satisfy specified conditions. Further, as an additional benefit, such companies which opt to be governed by Section 115BAA are immune from applicability of levy of MAT with effect from AY 2020-21.

2. Similarly, section 115BAB has been introduced to provide for concessional corporate tax rate of 15% (plus applicable surcharge and cess) for manufacturing companies which are setup and registered on or after 1 October 2019 and which fulfil certain conditions. Such companies are also immune from levy of MAT with effect from AY 2020-21.

3. Considering the fact that immunity has been provided to such companies from applicability of MAT, ambiguities had arisen with regard to the entitlement of such companies to claim set-off of MAT credit against normal taxable income computed under Section 115BAA/ section115BAB of the Act.

4. There are a number of companies which have hitherto deposited minimum alternative tax in the expectation that MAT was in the nature of advance tax to be eventually adjusted when there is normal tax liability.

5. In this behalf, the CBDT has clarified on 2 October 2019 vide Circular No. 29/ 2019 that, in the view of CBDT, a taxpayer who opts for concessional tax regime will not be eligible to set-off MAT credit against his future tax liability. The same has now been legislated in the Amendment Bill.

6. The rationale for the above as provided in the Circular dated 2 October 2019 is that with section 115JB of the Act becoming inapplicable to the company, MAT credit should not be available to such a company.

7. It is submitted that such interpretation is not borne out from the language of the section and hence we urge the Government to re-consider its view on the above aspect. In this behalf, our submissions on plausible interpretation of the provisions are as under:

    a. The income tax provisions provide the right to a taxpayer to claim set off of such MAT credit in the year when tax payable arises under normal provisions of the Act. MAT credit has always been treated akin to "advance tax". In this regard, reference may be given to decision of Delhi HC in the case of CIT v Jindal Exports Ltd (314 ITR 137) affirmed by Supreme Court in CIT v Tulsyan NEC Ltd (330 ITR 226) (SC). Thus, similar to set off available for entire advance tax against tax payable, MAT credit may also be eligible for set off in entirety against normal tax payable.

b. There are numerous examples where a company which has deposited MAT may have negative book profit in subsequent year leading to Nil MAT liability. The company may still have normal tax liability. Such a company will be granted MAT credit which is equivalent to the entire amount of normal tax which is payable. The difference between normal tax liability and MAT liability (which is Rs. NIL) is considered to be the amount of entitlement. Thus, the mechanism of determining MAT credit can be applied even in case where MAT payable in a subsequent year may be NIL.

c. The provision which grants MAT credit viz. section 115JAA has been very correctly, protected and preserved. The inapplicability of provisions of MAT does not extend to section 115JAA. Thus, it is not the legislative intent that MAT credit should be denied.

d. Section 115JAA permits credit of an amount which is equal to:

(A) normal tax liability in accordance with law; in excess of
(B) applicable MAT liability under section 115JB in the relevant year.

8. The taxpayers opting for 115BAA/ 115BAB are required to sacrifice benefits of tax deductions and incentives. Such taxpayers should not be further penalized by taking away the benefit of MAT Credit arising from minimum taxes paid by such taxpayers with an assurance of availing MAT credit against normal taxes in subsequent years.

9. The taxpayer has vested right to claim MAT credit in the year when such MAT is paid by the taxpayer. Set off takes place in subsequent years when normal tax is higher than MAT. If the MAT credit set off is not allowed against normal tax by construing MAT payable as Nil then it may lead to forced retrospective revocation of right granted to the taxpayer in prior years to claim set off of such MAT credit in future. This is neither anticipated by taxpayer nor desired by the Government.

Recommendation

10. The Government should consider permitting taxpayers to avail of MAT credit even when it opts for being governed by section 115BAA. Alternatively, MAT credit outstanding as at the beginning of the year of exercise of option under section 115BAA of the Act may be granted over a period of 3 years in equal instalments. The above will help achieve fairness and also make the concessional tax regime option attractive for taxpayers with immediate impact.

SECTION XV

Exemption for UN organisations/ agencies from the provisions of section 194N of the Act

Background

1. With an objective of discouraging cash transactions and moving towards a cashless economy, FA, 2019 has inserted a new provision [section 194N of the Act] in the Income-tax law to provide for withholding of taxes on cash withdrawals.

2. This provision is applicable to Banking Company[21], Co-operative societies carrying on banking business and Post offices (hereinafter referred as deductor entities).

3. As per section 194N of the Act, the deductor entity is required to withhold taxes at the

   rate of 2% on aggregate cash withdrawals exceeding INR 10 million by any person (hereinafter referred as recipient) from one or more account maintained by him with deductor entities during a tax year.

4. In this connection, CBDT had issued a press release dated 30 August 2019 clarifying that no tax withholding is required on cash withdrawals which took place during 1 April 2019 to 30 August 2019. However, for determining the threshold limit of INR 10 million, cash withdrawals from 1 April 2019 to 30 August 2019 would be considered.

5. However, the provisions of section 194N of the Act, are not applicable to payments made to the following persons:

   a. the Government;
   b. any banking company or co-operative society engaged in carrying on the business of banking or post office
   c. any business correspondent of a banking company or co-operative society engaged in carrying on the business of banking in accordance with the guidelines issued in this regard by the RBI under the RBI Act, 1934;
   d. any white label automated teller machine operator of a banking company or co-operative society engaged in the carrying on the business of banking in accordance with the authorization issued by the RBI under Payment and Settlement Systems Act, 2007;
   e. such other person or class of persons, which the Central Government may, by notification in the official gazette, specify in consultation with the RBI.

6. While we appreciate the Government's approach to discourage use of cash, there are certain class of persons (such as international bodies) whose income, assets and property are exempt from tax in India. Illustratively, these organizations include the IFC, IMF, IDA, UN, etc.

[21] Any banking company (including banks and Banking Institutions) to which Banking Regulation Act 1949 is applicable

7. There are specific statues governing the above organizations i.e. The IFC (Status, Immunities and Privileges) Act, 1958, The IMF and Bank Act, 1945 and The IDA (Status, Immunities and Privileges) Act, 1960, the UN (Immunities and Privileges) Act, 1947 which are applicable to India and which provide that the entities/ corporation, its assets, property, income and its operations and transactions, shall be immune from all taxation and from all customs duties.

8. Given that the aforementioned entities are exempt from taxation and the withholding tax levied under section 194N of the Act also forms part of 'direct taxes', it can be argued that withdrawals made by the above entities may be exempt under the provisions of section 194N of the Act. In other words, an exemption from direct taxes includes not only an exemption from the chargeability of direct taxes but also an exemption from the applicability of related compliance/ mechanical provisions thereon.

9. Further, section 194N of the Act provides that "Every person, being …. Who is responsible for paying any sum…". The meaning of the expression 'person responsible for paying' is outlined in section 204 of the Act as follows:

   For the purposes of the foregoing provisions of this Chapter and section 285, the expression "person responsible for paying" means—
   (i)……..
   (ii)……….
   (iia)………..
   (iib)………..
   (iv) in the case of credit, or, as the case may be, <u>payment of any other sum chargeable under the provisions of this Act</u>, the payer himself, or, if the payer is a company, the company itself including the principal officer thereof;………………

   Accordingly, only where the payment is chargeable under the provisions of Act, the payer is required to deduct tax thereon. Where the entities receiving the payment are eligible for certain benefits as provided above, it may be argued that there is no sum chargeable to tax under the Act and consequently, the person responsible for paying [for the purposes of section 194N read with section 204 of the Act], may not be required to withhold taxes on withdrawals made by such international organizations.

10. Additionally, we wish to submit that section 4(2) of the Act provides that in respect of income chargeable to tax, income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of the Act. Accordingly, it can be inferred that where the income earned by the aforesaid entities is exempt from Indian direct taxes, there is no 'income chargeable' under the Act and consequently, there may not be any requirement to withhold taxes thereon.

Recommendation

11. In this connection, it is recommended that a clarification should be issued specifying the non-applicability of provisions of section 194N of the Act with respect to the cash withdrawals made by aforesaid entities.

SECTION XVI

Excluding trading in equity share as being speculative business

Background

1. The provisions of section 73 of the Act provide that losses incurred in respect of a speculation business cannot be set off or carried forward and set off except against the profits of any other speculation business.

2. Prior to the amendment made by FA, 2014, the explanation to the provision of section 73 of the Act read as under:

   'Explanation-Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.'

3. The above resulted in absurd tax consequences for taxpayers whose principal business was trading in shares and derivatives on the recognized stock exchange on account of the fact that the same was deemed to be speculative in nature and accordingly any income derived from such trading in shares and derivatives was considered as income from speculative business.

4. Hence, the above Explanation was amended vide FA, 2014 to include companies whose principal business is trading in shares. The amended provisions of Explanation has been re-iterated below:

   'Explanation.—Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company the principal business of which is the business of trading in shares or banking or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.'

5. However, on account of the above amendment, where a tax payer who is not in the principal business of trading in shares, the resultant income or loss is considered to be speculative in nature. The above explanation is not applicable to derivative transactions undertaken and hence, profits or loss from such transaction are considered as 'non-speculative'. Due to above disparity, a tax payer cannot set-off the speculative income on shares against non-speculative derivative loss or vice versa. Sub-section (5) of section 43 of the Act exempts from the definition of speculative transaction, inter alia, transaction in respect of trading in derivatives on a RSE subject to satisfaction of the below conditions:

a. Transaction being carried out electronically on screen based system;
b. Transaction supported by a time stamped contract note indicating a unique client identity number and permanent account number; and
c. Transaction carried out over a RSE.

6. Accordingly, there is a need to revisit the provisions of Explanation to section 73 of the Act.

Recommendation

7. It is recommended that the trading in shares should not be deemed to be speculative business. In this connection, the provisions prior to the amendment made vide FA, 2014 should be reinstated which is as under i.e. business of trading in shares should be deleted:

'Explanation.—Where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads "Interest on securities", "Income from house property", "Capital gains" and "Income from other sources", or a company (the principal business of ~~which is the business of trading in shares or~~ banking) or the granting of loans and advances) consists in the purchase and sale of shares of other companies, such company shall, for the purposes of this section, be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.'

SECTION XVII

Equalization levy exemption to banking and financial services

Background

1. In the course of the enactment of the FA 2020, the scope of EL has been expanded to introduce a 2% levy on consideration received/ receivable by NR EOP for providing or facilitating ESS to certain specified persons. The ESS EL is applicable w.e.f. 1 April 2020. In this regard, an amendment to Chapter VIII of the FA 2016 has been enacted.

2. As per the amended provisions of the FA 2016, some of the key definitions in connect with the ESS EL have been provided below:

   - E-commerce operator means 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

   - E-commerce supply or services means:

     - Online sale of goods owned by the e-commerce operator; or
     - Online provision of services provided by the e-commerce operator; or
     - Online sale of goods or provision of services or both facilitated by the e-commerce operator;
     - Any combination of above activities

   - Online means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network

3. Additionally, following specific exclusions have been provided from the levy of ESS EL:

   a. where the EOP has a PE in India and ESS is effectively connected with such PE;
   b. where the transaction is already subject to EL under erstwhile provision (applicable to transactions for online advertising and related services);
   c. where sales, turnover or gross receipts of EOP from ESS is less than INR 2 crore in a previous year.

4. However, the current provision of ESS EL do not provide for any industry or sector specific exclusion from EL at the current stage. The way the provisions are worded, these are

extremely wide and could have undesired consequences especially for certain sectors. One such sector is financial services. Given the way the financial services entities operate in India and given that they in almost all cases are required to be both regulated and have a presence in India to operate in India, ESS EL should not apply to the financial services industry.

5. The purpose of this representation is mainly to highlight the need to carve out financial services industry such as banks, non-banking financial companies, primary dealers, AMCs, insurance and re-insurance companies, broker dealers and their back-office entities from the applicability of ESS EL. This exclusion is especially relevant for financial organisations that have access to customers in different jurisdictions i.e. multinational financial institutions across the banking, asset management, insurance, etc.

6. As part of AP 1 of BEPS and in furtherance of global efforts, it is expected that concerns arising from new form of digital businesses - particularly in the area of nexus, data and characterisation will be addressed. As part of BEPS 2.0 Pillar 1, a framework has been agreed and work is in progress to allocate taxing rights to market jurisdictions.

7. The above work is expected to achieve global consensus by the end of 2020. In the recent report released by the OECD post coronavirus outbreak[22], it is acknowledged that the increased use of digital services and the need to expand revenue raising in such pandemic and lockdown situation could provide new impetus to efforts to reach agreement on BEPS Pillar 1 issues internationally. The OECD further states that policy makers could work to avoid the risks of unilateral action in the digital taxation area and the disruption of the international tax and trade agenda that could result from failing to reach a consensus-based outcome on digital taxation. Thus, the OECD is mindful of the approaching deadline and is likely to push consensus by end of 2020 as committed.

8. The efficacy of such global measure is highly dependent on uniform approach to be adopted by each member country. Any unilateral measure is not only inconsistent with global agenda but is also likely to result in undesirable multiple taxation of same income without any tax credit or an effective opportunity of eliminating such multi taxation.

9. There are various factors which distinguish the functioning of the financial services industry from the other sectors and thereby necessitates the need for a specific carve out from the scope of ESS EL. We have summarized below, few of key factors:

[22] OECD report titled "Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience" released on 15 April 2020

a. Financial sector players are highly regulated by various financial sector regulators. The regulators oversee the functioning of the financial services industry, clientele, sources of earning income, movement of funds within/ outside India, accounting and reporting requirements, etc. Thus, there is already an added layer of regulatory supervision on their service offerings and income generated in India.

b. Given the nature of services rendered by the financial sector players, they are typically structured as subsidiaries or locally recognised branches of foreign players. Where a customer of a particular jurisdiction is onboarded, the regulations require the initial relationship to be through a local entity i.e. either a subsidiary or a local branch. Thus, even where the services are rendered digitally, the relationship continues to be with the local entity resulting in profits of these service offerings being taxed in the local jurisdiction.

c. Even for providing digital services, customers can be onboarded only after carrying out necessary due diligence, KYC checks, Anti-Money Laundering, etc. Thus, due to already existing extensive tax reporting obligations, the income from such services is appropriately recognised and taxes are discharged timely in the jurisdiction of the customers.

d. In respect of institutional businesses, inter-branch activities and inter-company transaction agreements are extremely common in the industry. They are extensively undertaken to ensure that the financial risks are centralised, the operations are conducted basis the global brand and quality requirements by the branches/ subsidiaries across jurisdiction. These services are duly compensated within the group due to regulatory and taxation requirements of each jurisdiction.

e. A large portion of the digital services rendered by offshore financial services entities are rendered to their Indian Group companies. These are subject to GST (under the reverse charge mechanism) and in many cases even withholding tax. A levy of EL will further increase the cost of rendering services from India. Further for banking entities given that only fifty percent credit is available for GST this is a significant cost increase.

10. As you would appreciate, tax on digital services is a matter of global debate at various forums. Various consultations were made by the financial service industry across jurisdictions and were duly considered by the Governments, thereby providing exclusions to financial services industry from DST. An exclusion has been provided by United Kingdom to financial services industry from the levy of DST. The rationale provided by UK HM Treasury for exclusion of financial services industry from the levy of DST has been provided below:

a. The highly regulated nature of financial services means financial services marketplaces will often be closed environments, which are only open to other highly regulated market participants. As a result, the marketplace does not generate significant value by seeking to maximize the number of other users on the platform.

b. There are also strict rules and limitations about how financial services businesses/marketplaces interact with users, including restrictions on the products and services they can offer.

c. Similarly, financial services businesses often bear significant risk. This is sometimes the case even when they are not contractually a party to a transaction. The wider macroeconomic risks financial institutions inherently present to the economy mean financial services businesses are typically required to hold capital against these risks and their direct or indirect exposure to other market participants. This means there can be significant additional costs involved in increasing the number of users on the platform, which distinguishes them from other marketplaces.

d. Finally, the regulated nature of the financial services sector means that much of their activity is localized to the markets they operate, something already reflected in the unique treatment of a banking group under existing transfer pricing rules. This means a concern about unrecognized value creation due to the nature of current international tax rules applies less strongly in these cases.

11. Similar exclusions for financial services industry have been provided by other countries too which include the likes of France, Italy, Spain and New Zealand. We have provided a synopsis of the same at Annexure D.

12. As ESS EL was enacted under unprecedented circumstances with no memorandum and object statements supporting the intend of the levy, the same has been susceptible to various conclusions which has led to ambiguity around the interpretation, scope and magnitude of levy.

13. In lights of the above, it is imperative to have a specific exclusion from the provisions of ESS EL for financial services industry without which there will be a significant impact on the financial services sector.

Recommendation

14. It is recommended that banks, non-banking financial companies, primary dealers, insurance and reinsurance companies, broker dealers, AMCs and their back-offices in India be exempt from the levy of EL given the reasons enumerated above.

SECTION XVIII

<u>No PE on account of employees working from India and no adverse personal tax implications in the hands of the employees currently working from India due to COVID-19</u>

Background

1. The global pandemic of COVID-19 has resulted in international travel bans, immigration suspensions, lockdowns and restrictions on movement of people working across the globe. This has also temporarily halted the cross-border movement of employees. However, for business continuity, employees of MNCs have been working remotely on their projects from their home countries, host countries or a country, where they may be stranded due to travel restrictions.

2. The above has resulted in tax implications for both employees and employers from immigration, social security, tax, labour and employment law perspective.

3. From a tax standpoint, for the employers (i.e. MNCs) there is a potential issue that a PE of the foreign enterprise could be constituted in India while such employees continue to work from their residence/ home premises.

4. Some of the countries like Ireland, Australia, UK, Singapore, US have provided certain clarifications and relaxations on applicability of tax rules in the current environment.

5. Countries like Ireland and US have given a blanket relaxation stating that presence of an individual in their country for temporary period under compulsive circumstances would be disregarded to evaluate tax implications for the foreign enterprise for which such individual acts as an employee, director, service provider or agent.

   Australia, UK and Singapore have also clarified that holding of board meetings or presence of key managerial personnel in their respective countries which is on account of the prevailing situation will not be considered as exercising of central control and management from such a country.

6. Also, these countries have clarified that in case where the presence of employees is only due to travel restrictions and if there was no PE before the pandemic and there are no economic changes then in such a case any presence during such crisis would not be considered as resulting in a PE.

7. The Government of India has not released such clarifications till date. This has led to a lot of uncertainty among MNCs given that there could be a situation where their employees are stranded in India due to global travel restrictions.

8. Further, employee stranded in India on account of COVID-19 lockdown could be subject to payroll tax in India.

Recommendation

9. Accordingly, in the light of the above, it is recommended that specific clarification be issued in this regard to state that where owing to the pandemic (COVID-19), employees undertaking core activities on behalf of the foreign enterprise which would otherwise be undertaken outside India would not constitute a PE of the foreign enterprise in India.

10. Further, it is also recommended that employees stranded in India due to COVID-19 should not be subject to payroll tax on account of their presence in India.

SECTION XIX

Taxability of interest on G-Secs to be traded on ICSD under the FAR route

Background:

1. The Finance Minister, Mrs. Nirmala Sitharaman while presenting the Union Budget, 2020 announced that in order to achieve an aspirational growth rate, India would require flow of capital into the financial system. Towards this end, various measures were announced which, inter-alia, included fully opening up investment in certain specified G-Secs to non-resident investors without any restrictions, apart from being available to domestic investors.

2. Subsequent to the above announcement, the RBI in consultation with the Government of India issued circular[23] dated 30 March 2020 notifying the FAR for non-resident investors to enable them to invest in specified G-secs without being subject to any investment ceilings. The investment is to be made through the ICSD platform.

3. As per the above- mentioned circular, any non-resident investor could invest in specified G-secs without having to obtain registration as an FPI.

4. Currently, taxation of income earned by FPIs with respect to their India investments is governed by a special tax code – section 115AD of the Act. As per the said section, interest income arising to FPIs from investing in G-secs is chargeable to tax at a concessional rate of 5% (plus applicable surcharge and cess).

5. Given that under the FAR, any non-resident investor can invest in specified G-secs, the concessional tax treatment available for interest income arising to FPIs should also be applicable to non-resident investors other than FPIs.

6. Providing a concessional tax rate on interest income for investments made under FAR shall increase the attractiveness of FAR. Also, investors accessing a wide range of securities on the ICSD platform require standardisation, including implementation of international best practices from a tax perspective.

Recommendation:

7. It is recommended that the beneficial rate of 5% (plus applicable cess and surcharge) be extended to interest income received by non-residents (including FPIs) from investment in G-secs made through an intermediary dealing in settlement of securities (i.e. ICSD). This would level the playing field for non-residents not registered as FPIs, who wish to invest in these specified G-secs. This would attract a new set of non-resident investors to invest in Indian G-secs through the ICSD platform.

[23] RBI/2019-20/200 A.P. (DIR Series) Circular No. 25 and RBI/2019-20/201 FMRD.FMSD.No.25/14.01.006/2019-20

Glossary

Abbreviation	Full Text
2014 Regulations	SEBI (FPI) Regulations, 2014
Act	Income-tax Act, 1961
ADR	American Depository Receipts
AEs	Associated Enterprises
ALP	Arm's Length Price
AMCs	Asset Management Companies
AP	Action Plan
APA	Advanced Pricing Agreement
ARC	Asset Reconstruction Company
AY	Assessment Year
BEPS	Base Erosion and Profit Shifting
BRICs	Brazil, Russia, India, China and South Africa
CBDT	Central Board of Direct Taxes
CCDs	Compulsory Convertible Debentures
CCPs	Compulsory Convertible Preference Shares
CGT	Capital Gains Tax
CGST	Central Goods and Service Tax
CIT	Commissioner of Income-tax
Cos Act	Companies Act, 2013
COVID-19	Coronavirus Disease 2019
DDT	Dividend Distribution Tax
DST	Digital Service Tax
DTAAs	Double Taxation Avoidance Agreements
DTC	Direct Tax Code
EBITDA	Earnings before interest, tax, depreciation and amortisation
ECB	External Commercial Borrowings
EL	Equalisation Levy
EOP	E-Commerce Operators
ESS	E-commerce Supply or Services
FA, 2014	The Finance (No.2) Act, 2014
FA 2016	Finance Act 2016
FA, 2019	The Finance (No.2) Act, 2019
FA 2020	Finance Act 2020
FAR	Fully Accessible Route
FATF	The Financial Action Task Force
FCY	Foreign Currency
FEMA	Foreign Exchange Management Act
FIs	Financial Institutions
FPIs	Foreign Portfolio Investor
FX	Foreign Exchange
G20	Global Twenty
GAAR	General Anti-Avoidance Rule
GDR	Global Depository Receipts
GIFT City	Gandhinagar Fin-Tech City
G-Sec	Government Securities
HC	High Court
HO	Head Office
HUF	Hindu Undivided Family

ICSD	International Central Securities Depositories
Ico	Indian Company
IDA	International Development Association
IFC	International Finance corporation
IFSC	International Financial Services Centre
IM Treaty	India Mauritius Tax Treaty
IMF	International Monetary Fund
IM/ IA	Investment Manager/ Investment Advisor
INR	Indian Rupee
IOSCO	The International Organization of Securities Commissions
IPO	Initial Public Offer
IS Treaty	India Singapore Tax Treaty
KYC	Know Your Customer
LOB	Limitation of Benefit
MAP	Mutual Agreement Procedure
MAT	Minimum Alternate Tax
MC	Model Tax Convention
MCA	Ministry of Corporate Affairs
MLI	Multi-lateral Instrument
MNEs	Multinational Enterprises
MNCs	Multi-national companies
NBFCs	Non-Banking Financial Companies
NCLT	National Company Law Tribunal
NPA	Non Performing Asset
NR	Non Resident
ODI	Offshore Derivative Instruments
OECD	The Organisation for Economic Co-operation and Development
OTC	Over The Counter
PAT	Profit after tax
PE	Permanent Establishment
PPT	Principal Purpose Test
QIB	Qualified Institutional Buyer
RBI	Reserve Bank of India
Rules	Income-tax Rules, 1962
RSE	Recognised Stock Exchange
SEBI	Securities and Exchange Board of India
SPV	Special Purpose Vehicle
STT	Security Transaction Tax
TCS	Tax Collected at Source
UK	United Kingdom
UN	United Nations
US	United States
USD	US Dollar
WG	Working Group

Annexure B

Name of the Bank
Statement of Remittance of Profit to HO

SN	Particulars	Amount in Rs
i.	Financial Year	
ii.	Income of the bank during the year	
iii.	Expenditure in India [including HO expenses charged]	
iv.	Net profit as per the Profit and Loss Account	
v.	HO expenses charged to Profit and Loss Account	
vi.	Allowable expenses under section 44C of the Act	
vii.	Taxable HO expenses [v - vi]	
viii.	Actual Provisions made for tax including deferred tax	
ix.	Other provisions (beyond tax allowable ceilings)	
x.	Taxable surplus [iv + vii + viii + ix]	
xi.	Provision for tax calculated at full rate on the entire amount of surplus i.e. on (x)	
xii.	Transfer to Statutory Reserves under section 11(2)(b) of the Banking Regulation Act, 1949	
xiii.	Adjusted towards outstanding tax liabilities of previous year, if any [provision/ (write back)]	
xiv.	Amount, if any, retained in India for meeting capital to risk weighted assets ratio (CRAR) requirements	
xv.	Remittable surplus[(x) - (vii + ix + total of xi to xiv)]	
xvi.	Amount of remittable surplus remitted to HO and the rate of exchange applied	
xvii.	Date of remittance	
xviii.	Capital funds on date of remittance	
xix.	Capital to risk weighted assets ratio on the date of remittance – Basel III	

Annexure C

Article on Capital gains and Article on LOB under IM Treaty

ARTICLE 13 - CAPITAL GAINS

"1. Gains from the alienation of immovable property, as defined in paragraph (2) of article 6, may be taxed in the Contracting State in which such property is situated.

2. Gains from the alienation of movable property forming part of the business property of a PE which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a PE (alone or together with the whole enterprise) or of such a fixed base, may be taxed in that other State.

3. Notwithstanding the provisions of paragraph (2) of this article, gains from the alienation of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

3A. Gains from the alienation of shares acquired on or after 1st April 2017 in a company which is resident of a Contracting State may be taxed in that State.

3B. However, the tax rate on the gains referred to in paragraph 3A of this Article and arising during the period beginning on 1st April 2017 and ending on 31st March 2019 shall not exceed 50% of the tax rate applicable on such gains in the State of residence of the company whose shares are being alienated;]

4. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 3A shall be taxable only in the Contracting State of which the alienator is a resident.]

5. For the purposes of this article, the term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States."

ARTICLE 27A - LOB

"1. A resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention if its affairs were arranged with the primary purpose to take advantage of the benefits in Article 13(3B) of this Convention.

2. A shell/conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of Article 13(3B) of this Convention. A shell/conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

3. A resident of a Contracting State is deemed to be a shell/conduit company if its expenditure on operations in that Contracting State is less than Mauritian Rs. 1,500,000 or Indian

Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

4. A resident of a Contracting State is deemed not to be a shell/conduit company if:

(a) it is listed on a recognized stock exchange of the Contracting State; or
(b) its expenditure on operations in that Contracting State is equal to or more than Mauritian Rs. 1,500,000 or Indian Rs. 2,700,000 in the respective Contracting State as the case may be, in the immediately preceding period of 12 months from the date the gains arise.

Explanation: The cases of legal entities not having bona fide business activities shall be covered by Article 27A(1) of the Convention."

Article on Capital gains and Article on LOB under IS Treaty

ARTICLE 13 - CAPITAL GAINS

"1. Gains derived by a resident of a Contracting State from the alienation of immovable property, referred to in Article 6, and situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a PE which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent
personal services, including such gains from the alienation of such a PE (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.

3. Gains from the alienation of ships or aircraft operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.

4A. Gains from the alienation of shares acquired before 1 April 2017 in a company which is a resident of a Contracting State shall be taxable only in the Contracting State in which the alienator is a resident.

4B. Gains from the alienation of shares acquired on or after 1 April 2017 in a company which is a resident of a Contracting State may be taxed in that State.

4C. However, the gains referred to in paragraph 4B of this Article which arise during the period beginning on 1 April 2017 and ending on 31 March 2019 may be taxed in the State of which the company whose shares are being alienated is a resident at a tax rate that shall not exceed 50% of the tax rate applicable on such gains in that State.

5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4A and 4B of this Article shall be taxable only in the Contracting State of which the alienator is a resident."

ARTICLE 24A – LOB

"1. A resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement if its affairs were arranged with the primary purpose to take advantage of the benefits in the said paragraph 4A or paragraph 4C of Article 13 of this Agreement, as the case may be.

2. A shell or conduit company that claims it is a resident of a Contracting State shall not be entitled to the benefits of paragraph 4A or paragraph 4C of Article 13 of this Agreement. A shell or conduit company is any legal entity falling within the definition of resident with negligible or nil business operations or with no real and continuous business activities carried out in that Contracting State.

3. A resident of a Contracting State is deemed to be a shell or conduit company if its annual expenditure on operations in that Contracting State is less than S$200,000 in Singapore or Indian Rs.5,000,000 in India, as the case may be:

(a) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;
(b) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.

4. A resident of a Contracting State is deemed not to be a shell or conduit company if:

(a) it is listed on a recognised stock exchange of the Contracting State; or

(b) its annual expenditure on operations in that Contracting State is equal to or more than S$200,000 in Singapore or Indian Rs.5,000,000 in India, as the case may be:

(i) in the case of paragraph 4A of Article 13 of this Agreement, for each of the 12-month periods in the immediately preceding period of 24 months from the date on which the gains arise;
(ii) in the case of paragraph 4C of Article 13 of this Agreement, for the immediately preceding period of 12 months from the date on which the gains arise.

5. For the purpose of paragraph 4(a) of this Article, a recognised stock exchange means:

(a) in the case of Singapore, the securities market operated by the Singapore Exchange Limited, Singapore Exchange Securities Trading Limited and The Central Depository (Pte) Limited; and

(b) in the case of India, a stock exchange recognised by the SEBI.

Explanation: The cases of legal entities not having bona fide business activities shall be covered by paragraph 1 of this Article."

Annexure D

Instances of exclusions for financial services industry in other jurisdictions

<table>
<tr><th>Country</th><th>Synopsis of the exclusion for financial services industry</th></tr>
<tr><td>France</td><td>In March 2020, the French Tax Authorities (FTA) issued new draft guidance with respect to the DST. As per the guidelines, there are two categories of taxable services, namely, digital intermediation and targeted advertising (which includes the sale of data for the purpose of targeted advertising).

The guidelines also provided for certain exclusions from the scope of digital intermediation which inter-alia included the following financial services:

• Interbank settlement systems or systems for the settlement and delivery of financial instruments
• Trading platforms and trading systems of “systematic internalisers”
• Participating investment advisory activities and intermediation services in participatory finance
• Other networking systems that are listed by decree (note that no decree was issued on 31 December 2019 for 2020).

The draft guidance is subject to public consultation and thus, there may be revisions before the guidance is issued in final form. However, the guidance is already binding on the FTA, so that a taxpayer that follows this draft guidance will not be subject to reassessment by the FTA.</td></tr>
<tr><td>Italy</td><td>With the 2020 Budget Law, the Italian government reshaped Italy's DST to mirror it to the EU Commission proposal of March 2018. The revised version of the Italian DST is in force effective 1 January 2020.

As per the revised version of the Italian DST, the making available of a digital interface utilized to manage certain banking and financial services as well as the transmission of data from the providers of such services do not qualify as digital services and are accordingly, excluded from the scope of DST</td></tr>
<tr><td>Spain</td><td>In February 2020, the Spanish Government resumed its initiative to enact a unilateral DST after its failure to pass the bill drafted in 2019.
Apart from the other exclusions, the Spanish DST pursuant to the Bill proposes to inter alia exclude Regulated financial services rendered by regulated financial entities and Income derived from the transfer of data by regulated financial entities.

The Bill has been sent to the Parliament for a vote and awaits its approval</td></tr>
<tr><td>New Zealand</td><td>In July 2019, the Government came up with a Discussion Document putting forth a proposal for New Zealand DST. Basis the public comments, it was likely to be introduced in the Parliament in 2020. Based on the discussion paper, DST is proposed to be narrowly targeted to certain highly digitalised supplies and thus, does not apply to ‘Standard financial services’ and ‘Electronic funds transfer at point of sale (EFTPOS)’.</td></tr>
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