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TDS in respect of purchase of goods

Background

1. The Finance Bill, 2021 proposes to insert a new provision i.e. Section 194Q to levy withholding tax on purchase of goods at the rate of 0.1% with effect from 1 July 2021. As per this provision, a buyer while making payment to resident seller for purchase of goods having value exceeding INR 5 million in a financial year is required to withhold taxes at the rate of 0.1%. Deduction shall be at the time of credit of such sum to the account of the seller or at the time of payment by any mode, whichever is earlier. The provisions are attracted even if the amount is credited to a 'suspense account'.

2. Explanation to section 194Q(1) of the Act defines the term 'Buyer' as a person whose total sales, gross receipts or turnover from the business carried on by him exceed INR 100 million during immediately preceding financial year in which the purchase of goods is carried out.

3. The provisions of the aforementioned section would not apply in the following scenarios:

   - a transaction on which tax is deductible under any provision of the Act; and
   - a transaction, on which tax is collectible under the provisions of section 206C of the Act other than transaction to which sub-section (1H) of section 206C of the Act applies

4. Thus, if on a transaction TDS or TCS is required to be carried out under any other provision, then it would not be subjected to TDS under this section. There is one exception to this general rule. If on a transaction TCS is required under section 206C(1H) of of the Act as well as TDS under this section, then on that transaction only TDS under this section shall be carried out.

5. Additionally, where a buyer does not furnish a valid PAN, TDS would be deducted at a higher rate of 5% in accordance with the amendment proposed in section 206AA of the Act.

6. The Finance Act, 2020 had introduced TCS on sale of goods [section 206C(1H) of the Act] with effect from 1 October 2020 to widen and deepen the tax net. The provisions of section 206C(1H) of the Act require a seller to also collect TCS at 0.1% at the time of receipt of consideration.

7. While the Explanation to section 206(1H) of the Act had defined the terms 'buyer' and 'seller', the term 'goods' has neither been defined in section 206(1H) of the Act nor in the proposed section 194Q. Thus, 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;

8. 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.

9. Thus, presently there is ambiguity on whether for the purposes of levy of TDS under section 194Q, the definition of 'goods' should include shares and securities.

10. Additionally, it is pertinent to consider that with respect to section 206(1H) of the Act, the CBDT has on 29 September 2020 issued Circular 17/2020 specifying inter-alia that TCS provisions shall not be applicable to transactions in securities and commodities which are traded through recognised stock exchanges or cleared and settled by the recognised clearing corporation, including recognised stock exchanges or recognised clearing corporation located in an IFSC. However, a similar exclusion has not been provided with respect to the newly proposed section 194Q.

Recommendations

11. It is recommended that meaning of "goods" be clearly defined for better clarity of applicability of this provision. We recommend that the term 'goods' for the purpose of proposed section194Q of the Act be defined as under:

'Goods' means every kind of movable property other than money, actionable claims and securities.
For this purpose, securities should have the same meaning as under:

i. securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956;
ii. securities as defined in clause (e) of section 45U of the Reserve Bank of India Act, 1934; and
iii. derivative as defined in clause (a) of section 45U of the Reserve Bank of India Act,1934.

12. It is also recommended that exemption be granted to all transactions in shares, securities, actionable claims and foreign currency since there is ambiguity on whether these items are at all included within the definition of 'goods'. Generally, these items are traded in well-regulated financial markets and there is no need for imposing TDS by virtue of section 194Q when the relevant information can be easily obtained from financial intermediaries. Also, PE/VC funds are sophisticated investors, who duly report their securities transactions in the tax returns.

13. Further, all exemptions which are currently provided in the CBDT Circular no 17/2020 dated 29 September 2020 with respect to TCS provisions be made applicable to TDS under proposed section 194Q.

Withdraw deduction/collection of tax at a higher rate in case of non-filers of Income Tax Returns

Background

1. With the intent to ensure filing of tax returns by persons who have been subjected to reasonable amount of TDS/ TCS, the Finance Bill, 2021 proposes to introduce with effect from 1 July 2021 section 206AB and 206CCA as a special provision providing for higher rate for TDS/ TCS, respectively for non-filers of income-tax returns.

2. As per the proposed section 206AB, any person (deductor) making payment to a 'specified person' (deductee) will be required to deduct tax on amount paid, or payable or credited, at higher of the following rates:

   - at twice the rate specified in the relevant provision of the Act; or
   - at twice the rate or rates in force; or
   - at the rate of 5%.

3. The term 'specified person' has been defined as any person who meets the following two conditions viz:

   a) who has not filed tax return for two financial years immediately prior to the financial year in which tax is required to be deducted and for which the time limit to file return under section 139(1) of the Act has lapsed; and

   b) the aggregate amount of TDS and TCS in his case exceeds INR 50,000 or more in each of these two preceding financial years.

4. Further, where any person does not have a PAN, TDS would be deducted at higher of the rates prescribed in section 206AA of the Act or the proposed section 206AB.

5. The proposed new section is not applicable if TDS is required to be deducted under the following sections:

   - 192/ 192A – TDS on salary/ payment of accumulated balance due to an employee;
   - 194B – TDS on winning from lottery or, crossword puzzle
   - 194BB – TDS on winnings from horse race
   - 194LBC – TDS on income in respect of investment in securitization trust
   - 194N - TDS on payment of certain amounts in cash

6. Similar to section 206AB, section 206CCA is proposed to be introduced in context of TCS.

7. The proposed provisions would put additional compliance burden on taxpayers to verify ROI filing compliance by the deductees / collectees and accordingly calibrate the rate of TDS/TCS. Default in compliance with the new TDS/TCS provisions would lead to litigation, additional demands, interest, penalty and prosecution risk which would adversely impact the agenda of 'ease of doing business' in India.

8. The proposed provisions are similar to section 194N of the Act (as introduced byFinance (No 2) Act, 2019) which provides for deduction of tax from cash withdrawals if the taxpayer has not furnished the tax return for a specified period. To determine the rate for deduction of tax under section 194N, the CBDT launched a tool on the e-filing platform to check the applicable TDS rate under section 194N of the Act.

9. We wish to state that the functionality to identify specified persons laid down by CBDT for TDS on cash withdrawals under section 194N of the Act is extremely cumbersome since the verification is required to be made for each individual deductee. Also, the complications would further increase due to different due dates for different classes of taxpayers.

10. Additionally, there is also an ambiguity with respect to interpretation of the second condition i.e. whether deductor needs to check aggregate TDS/ TCS of INR 50,000 deducted by all parties on the payment to the payee or deducted by the payer himself.

Recommendation

11. Having said the above, we recommend that the above proposal should be withdrawn as it would result in unreasonable compliance burden on the taxpayers.

Exemption from tax on dividend distributed by a unit in IFSC

Background:

1. Prior to the Finance Act, 2020, a domestic company declaring, distributing or paying dividends was subject to additional income tax at the rate of 15% (excluding surcharge and cess) and the said dividend income was not taxable in the hands of the shareholder.

2. To provide tax incentive on dividend income distributed by the units in IFSC, section 115O(8) was introduced by the Finance Act, 2016. The dividend declared, distributed or paid by an IFSC unit was not subject to DDT and also exempt in the hands of shareholders under the Act.

3. The Finance Act, 2020 provided for the sunset of DDT regime and effective 1 April 2020, dividend income is taxable in the hands of shareholders. Hence, the Finance Act, 2020 shifted the incidence of tax from the payer to the recipient of dividend.

4. However, no specific carve out/ exemption was provided for the dividend income earned by shareholders of the company, being an IFSC unit.

5. The operations of IFSC are at a very nascent stage and it is only recently that they have started picking up scale. At this juncture, the exemption of dividend income distributed or paid by an IFSC unit, in the hands of shareholders would be very critical.

6. The success of an IFSC depends upon it being on par with other International Financial Centres located in Dubai, Singapore, etc., where dividend is not subject to DDT and also exempt from tax in the hands of shareholders.

7. In order to provide tax incentives on dividend income distributed by the units in the IFSC and to offer a level playing field comparable with offshore financial jurisdictions, the earlier exemption should be restored with respect of dividend income in hands of shareholder of a company, being an IFSC unit.

Recommendation:

8. We recommend that an exemption be provided to shareholders receiving dividend income from companies set-up in IFSC to further boost the IFSC.

Tax incentive for units located in the IFSC

1. The Honourable Finance Minister in her Budget Speech expressed the intent to make the IFSC in GIFT city a global financial hub. Further, the Honourable Finance Minister also provided for various direct tax proposals to boost the IFSC. One of the key proposals introduced by the Finance Bill, 2021 is with respect to providing tax incentives to foreign funds relocating in the IFSC.

2. The Finance Bill, 2021 proposes to introduce a new provision i.e. section 10(23FF) to exempt any income in the nature of capital gains, arising or received by a non-resident, which is on account of transfer of share of a company resident in India by the resultant fund and such shares were transferred from the original fund to the resultant fund in relocation, if capital gains on such shares were not chargeable to tax had that relocation not taken place.

3. Further, a consequent amendment is proposed to be made to the provisions of section 47 of the Act so as to provide that any transfer, in relocation, of a capital asset by the original fund to the resultant fund shall not be considered as transfer for capital gain tax purpose.

4. The terms ‘original fund’, ‘resultant fund’ and ‘relocation’ are proposed to be defined as under:

“Original Fund is proposed to be defined as a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit and fulfils the following conditions, namely:—

(a) the fund is not a person resident in India;
(b) the fund is a resident of a country or a specified territory with which an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A has been entered into; or is established or incorporated or registered in a country or a specified territory notified by the Central Government in this behalf;
(c) the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident; and
(d) fulfils such other conditions as prescribed;

Resultant fund is proposed to be defined as a fund established or incorporated in India in the form of a trust or a company or a limited liability partnership, which-

(a) has been granted a certificate of registration as a Category I or Category II or Category III Alternative Investment Fund, and is regulated under the Securities and Exchange Board of India (Alternative Investment Fund) Regulations, 2012, made under the Securities and exchange Board of India Act, 1992 (15 of 1992); and

(b) is located in any International Financial Services Centre as referred to in sub-section (1A) of section 80LA

Relocation is proposed to be defined as transfer of assets of the original fund to a resultant fund on or before the 31st day of March, 2023, where consideration for such transfer is discharged in the

form of share or unit or interest in the resulting fund to the shareholder or unit holder or interest holder of the original fund in the same proportion in which the share or unit or interest was held by such shareholder or unit holder or interest holder in such original fund"

5. While the proposed law to exempt gains on the transfer of securities by the original fund to the resultant fund is a welcome move from the Government to promote IFSC, it is also important to consider the taxation of gains form transfer of securities by the resultant fund and whether the resultant fund is put in the same tax position as if the migration has not happened. .

6. In this context, based on a plain reading of the proposed section 10(23FF), exemption is provided to income received by non-resident investors in the resultant fund and not to the resultant fund. Accordingly, where the resultant fund is registered as a Category III AIF, the income arising from transfer of share of a company resident in India (where capital gains on such shares were not chargeable if the relocation had not taken place) cannot be claimed as exempt from tax by the Category III AIF. In comparison, where similar income was arising to a Category I or Category II AIF (where income is taxable in the hands of the investors of such AIF on a pass through basis), an exemption is proposed to be provided to the non-resident investors of such AIF.

Recommendation:

7. In the light of the above, we recommend your goodself to provide the benefit of exemption to Category III AIFs in order to incentivize FPIs located in favourable tax treaty jurisdiction such as Mauritius to migrate to Category III AIF in IFSC.

Equalization levy exemption to banking and financial services

Background

1. In the course of the enactment of the Finance Act, 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 Finance Act, 2016 has been enacted.

2. As per the amended provisions of the Finance Act, 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

     Further, the Finance Bill, 2021, with retrospective effect from 1 April 2020, proposes to insert an explanation to define the terms "online sale of goods and "online provision of services" to include on or more of the following activities taking place online:

     a) Acceptance of offer for sale;
     b) Placing the purchase order;
     c) Acceptance of the Purchase order;
     d) Payment of consideration; or
     e) Supply of goods or provision of services, partly or wholly

     Additionally, it is also proposed to amend section 165A of the Finance Act, 2016 to provide that consideration received or receivable from e-commerce supply or services shall include:

     i. consideration for sale of goods irrespective of whether the e-commerce operator owns the goods; and
     ii. consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator.

   - **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, the Finance Bill, 2021 also proposes to clarify that consideration received or receivable for specified services and consideration received or receivable for e-commerce supply or services shall not include consideration which are taxable as royalty or fees for technical services in India under the

Income-tax Act read with the agreement notified by the Central Government under section 90 or section 90A of the Income-tax Act.

4. Further, 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.

5. 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.

6. 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.

7. 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.

8. 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[1], 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.

9. 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.

10. 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:

[1] 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.

11. 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 UK 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.

12. 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 **Appendix.**

13. 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.

14. 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

15. 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.

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 section 94B to NBFCs and Primary Dealers

3. 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.

4. 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

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

B. 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'

6. 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.

7. 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

8. 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.

9. 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.

10. 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.

11. 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."

12. 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.

13. 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

Amount (Rs. in lacs)		
Particulars	**Total interest includes payment of interest to AEs and third parties**	**Total interest includes payment of interest to AEs**
Disallowance	Lower of: ► Excess of <u>total interest</u> over 30% of EBITDA (i.e. excess of 50 over 30 = 20); or ► Interest paid to non-resident AE (i.e. 15) Hence, disallowance under section 94B of the Act is 15.	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) Hence, disallowance under section 94B of the Act is Nil.

<u>Recommendation</u>

14. 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) <u>Meaning of 'interest paid or payable to AE'</u>

15. 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.

16. 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:	Lower of:

		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**
	► Excess of total interest over 30% of EBITDA (i.e. excess of 75 over 30 = 45); or ► Interest paid to resident and non-resident AE (i.e. 75) Hence, disallowance under section 94B of the Act is 45.	► Excess of total interest over 30% of EBITDA (i.e. excess of 75 over 30 = 45); or ► Interest paid to non-resident AE (i.e. 20) Hence, disallowance under section 94B of the Act is 20.

Recommendation

17. 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.

Glossary

Abbreviation	Full Text
Act	Income-tax Act, 1961
AEs	Associated Enterprises
AIF	Alternate Investment Funds
AMC	Asset Management Companies
AP	Action Plan
AY	Assessment Year
BEPS	Base Erosion Profit Shifting
CBDT	Central Board of Direct Taxes
CGST	Central Goods and Service Tax
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 Taxes Depreciation and Amortization
EL	Equalisation Levy
EOP	E-Commerce Operators
ESS	E-commerce Supply or Services
EU	European Union
GST	Goods and Service Tax
IFSC	International Financial Services Centre
INR	Indian Rupee
KYC	Know Your Customer
MNEs	Multinational Enterprises
NBFCs	Non-banking Financial Companies
NR	Non-Resident
OECD	The Organisation for Economic Co-operation and Development
PAN	Permanent Account Number
PE	Permanent Establishment
Rules	Income-tax Rules, 1962
TCS	Tax Collected at Source
TDS	Tax Deducted at Source
UK	United Kingdom
UN	United Nations
US	United States
USD	US Dollar

Appendix

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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