Rationalization of Equalization Levy & Other Measures Affecting International Taxation, Relief to Start-ups, Affordable Rental Housing

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1. Proposed Rationalization of provisions of Equalization Levy

1.1 Background:

1.1.1 Equalisation Levy ("EL") was introduced in India in 2016, with the intention of taxing the digital transactions i.e., the income accruing to foreign e-commerce companies from India. It was aimed at taxing business to business transactions and was applicable to consideration received or receivable for specified services provided.

1.1.2 The provisions of EL are contained in Chapter VIII (containing Section 163 to Section 180) of the Finance Act, 2016 ("FA 2016"), as a separate, self-contained code, not forming part of the Income-tax Act, 1961 ("ITA"). It is therefore not covered by double taxation avoidance agreements (DTAAs). Consequently, non-residents subjected to EL cannot claim relief under DTAAs and will not be entitled to credit for EL paid in India in their country of residence.

1.1.3 Under Section 165 of FA 2016, the charge of equalisation levy shall be at the rate of 6% of the amount of consideration for any specified service received or receivable by a person, being a non-resident from:

i. a person resident in India and carrying on business or profession; or

ii. a non-resident having a permanent establishment in India

The following conditions are to be met to be liable to equalisation levy under Section 165:

i. The payment should be made to a non-resident service provider

ii. The annual payment made to one service provider exceeds ₹ 1,00,000 in a financial year.

1.1.4 Under Section 165A of FA 2016, from the 1st of April, 2020, equalisation levy shall be charged at 2% of the amount of consideration received/receivable by a non-resident e-commerce operator from e-commerce supply or services made, provided or facilitated by it:

i. to a person resident in India

ii. to a non-resident in the 'specified circumstances'

iii. to a person who buys such goods, services or both using internet protocol address located in India

Specified circumstances as mentioned in the 2nd point means:

i. sale of advertisement, which targets a customer, who is a resident in India or a customer who accesses the advertisement though internet protocol address located in India; and

ii. sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India

An E-Commerce Operator is a non-resident who owes, operates or manages a digital or electronic facility or platform for online sale of goods or online provision of services or both.

E-Commerce Supply or Services means (i) online sale of goods owned by the e-commerce operator, or (ii) online provision of services provided by the e-commerce operator, or (iii) online sale of goods or provision of services or both facilitated by the e-commerce operator or (iv) any combination of the above.

The equalisation levy under Section 165A shall not be charged—

i. where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;

ii. where the equalisation levy is leviable under section 165; or

iii. sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated as referred to in sub-section (1) is less than two crore rupees during the previous year.

Similar transactions are sought to be taxed under ITA when Non-Resident has a business connection or Permanent Establishment in India.

It may be noted that as the EL leads to obligation on US companies to pay additional taxes, undertake costly compliances and subjects them to double taxation without regard to international tax principles, the Office of the United States Trade Representative ("USTR") has found the EL to be actionable under the Trade Act of 1974. An India-USA trade deal which is stuck in the pipeline may also be impacted. The amendments proposed by the Finance Bill do little to help India's case before the USTR as they create more uncertainty and potentially increase the tax impact on non-resident e-commerce operators.

1.2 Budget 2021 changes:

In last year's Finance Act, 2020, the Government had expanded the scope of the EL to cover non-resident e-commerce operators making supplies in India. The provisions as they were introduced were ambiguous and created a lot of confusion among stakeholders. Recognising this, Budget 2021 has sought to provide some clarifications such as defining 'online sale of goods' and 'online provision of services', and removing from its scope the income that is already taxed as royalty or fees from technical services. The Memorandum to the Finance Bill, 2021 ("Finance Bill") notes that the Government felt the need to provide certain clarifications to correctly reflect the intention of certain provisions of the Expanded EL. However, the changes have brought with them further questions and potentially unintended consequences as discussed here under:

1.2.1 Proviso is proposed to be inserted in Section 163 (Extent, commencement and application) to clarify that consideration received or receivable for specified services and for e-commerce supply or services shall not include consideration 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. Accordingly, royalty & fees for technical

services would still be taxed at a higher rate of 10%.

1.2.2 Explanation to Section 164(cb) *(Definitions) (Certain Activities to constitute e-commerce supply or service)* is proposed to be inserted to define activities taking place online to be considered as "online sale of goods" and "online provision of services, such as

i. acceptance of offer for sale, or

ii. placing of the purchase order, or

iii. acceptance of the purchase order, or

iv. payment of consideration, or

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

The clarification seems to suggest that EL would even cover any businesses that have an e-commerce model, pure e-commerce model, marketplace model and an intermediary as well. Offline transactions that may have even a minor digital element, could be potentially covered. There are doubts regarding whether the scope of the EL now covers situations where even a communications platform or a payment aggregator could be covered within its scope, even though no commission is earned by it. For example, if a non-resident platform enables users to message each other and two parties agree to sell a tangible good, it is not clear whether such platform would be required to deduct EL at 2% even though it provides free services to the users and it may not even be aware of the transaction and in any way the platform is not responsible for collecting or settling payments between the users.

1.2.3 Section 165A (Charge of Equalization Levy)(Meaning of Consideration received or receivable inserted) is proposed to be amended by inserting sub-section (3) to provide that consideration received or receivable from ecommerce supply or services shall include:

i. consideration for sale of goods irrespective of whether the e-commerce operator owns the goods;

ii. consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator

In case of marketplace e-commerce operators, whereby the e-commerce operator is merely facilitating the sale of goods or provision of service between the seller and buyer on its platform in lieu of commission from the registered seller or buyer or both, it was unclear whether the EL would apply on the entire consideration of the transaction or only on the commission earned by the e-commerce operator. This can have a significant impact on marketplaces as it is likely to create cash flow issues for the e-commerce operators. Further, it is unclear whether EL will be applicable in situations wherein marketplaces facilitate sale of goods or provision of service without charging any commission from either the buyer or seller.

These amendments to EL are proposed to take effect retrospectively from 1 April, 2020.

2. Amendment to Section 10(50) of ITA to give effect to EL amendments

Last year's Finance Act, 2020 had expanded the scope of EL provision under Section 165A of FA 2016 effective AY 2020-21. However, Section 10(50) exempted such income from AY 2021-22. This raised apprehension of double levy i.e. under the Act as well as under EL.

Finance Bill 2021 seeks to remove this anomaly by providing exemption from AY 2020-21.

It is also proposed to clarify that the income referred to in this clause shall not include and shall never be deemed to have included any income which is chargeable to tax as royalty or fees for technical services in India under the said Act read with the agreement notified by the Central

Government under Section 90 or Section 90A.

These amendments will take effect from 1st April, 2021 and will, accordingly, apply in relation to the assessment year 2021-2022 and subsequent assessment years.

3. Proposed insertion of definition of "Liable to tax" (Section 10(29A) of ITA)

The term 'liable to tax' is used in Section 6, Section 10(23FE) and in various tax treaties entered by India.

Therefore, Section 2(29A) is proposed to be inserted to define liable to tax as: The term 'liable to tax' in relation to a person means that there is a liability of tax on such person under any law for the time being in force in any country, and shall include a case where subsequent to imposition of tax liability, an exemption has been provided.

The new provision requires analysis of domestic tax law of country of residence to reach conclusion whether non-resident meets requirement of liable to tax. This is so because liability to taxation is not the same as payment of tax. Liability to taxation is a legal situation whereas payment of tax is a fiscal fact.

It may be noted that Explanation 4 to Section 90 provides that where any term is not defined in DTAA but is defined in the Act, it shall have same meaning as defined in the Act. However, Article 3(2) of DTAA permits reference to domestic law for undefined terms in DTAA only when context otherwise requires.

This amendment is proposed to take effect from Assessment year 2021-22 and subsequent assessment years.

4. Addressing mismatch in taxation of income from notified overseas retirement fund [Section 89A]

Proposed section 89A seeks to provide relief from double taxation due to mismatch of taxation on income from withdrawal of retirement benefit account maintained by a specified person in a notified country on account of the amount being taxable in the notified State on receipt basis while being taxable in India on accrual basis (*"Specified Account"*). The details of the application of the provision are to be prescribed by the Central Government.

This may relieve the problem of paying tax in India on an accrual basis, whereas taxes paid in foreign country on cash basis in future by a person will result in payment of the taxes again. Tax paid in India on current/accrual basis will not be given as credit due to year of tax in India vis-à-vis year of taxation in foreign country being different.

This amendment is proposed to take effect from 1st April, 2022 and will accordingly apply to assessment year 2022-23 and subsequent assessment years.

5. Rationalisation of the provision concerning withholding on payment made to Foreign Institutional Investors (FIIs) [Section 196D]

Section 196D prescribed flat withholding rate of 20% (plus surcharge and cess). Unlike Section 195, reference to 'rates in

force' was missing resulting in TDS rate from 20.8% to 23.92% depending upon dividend income and categorization of FII.

Therefore, a proviso is being inserted to Section 196D providing for possibility of considering treaty rate for withholding purposes. Accordingly, it is proposed to provide that in case of a payee to whom an agreement referred to in 90(1) or 90A(1) applies and such payee has furnished the tax residency certificate referred to in section 90(4) or section 90A(4) of the Act, then the tax shall be deducted at the rate of 20% or rate or rates of income-tax provided in such agreement for such income, whichever is lower. Both the conditions need to be satisfied, mere tax residency certificate will not suffice.

This amendment is proposed to take effect from 1st April, 2021

6. Constitution of the Board for Advance Ruling

The Authority for Advance Rulings (AAR) is proposed to be substituted by the Board for Advance Ruling. The Board to consist of two members, each being officer not below the rank of Chief Commissioner of Income Tax, which will ensure continued functioning. This and other proposed changes are stated to impart greater efficiency, transparency and accountability.

This proposed change is anticipated to create a concern that executives will henceforth decide the matter instead of the judiciary.

These amendments are proposed to take effect from 1st April, 2021.

7. Proposed insertion of new section 206AB

Budget 2021 proposes to insert new Sections 206AB and 206CCA to motivate tax payers to file income tax returns. Accordingly, these new provisions provide higher rates of withholding tax (in the form of TDS or TCS, respectively) in instances where the person entitled to receive the sum of money:

i. has not filed the returns of income for both of the two assessment years relevant to the two previous years immediately prior to the previous year in which tax is required to be deducted,

ii. has an aggregate of tax deducted at source and tax collected at source of INR 50,000 or more in each of these two previous years; and

iii. for whom the time limit of filing return of income under Section 139(1) has expired.

It is further clarified that these provisions shall not apply, inter-alia, to non-residents who do not have a permanent establishment in India (i.e. a fixed place of business in India through which the business of the enterprise is wholly or partly carried on).

In view of the above proposal, a non-resident would be required to take extra precaution while determining whether it has a permanent establishment in India or not as an adverse determination by the tax authority could lead to default due to non-compliance with the aforesaid withholding tax provisions.

8. Relief to Start-ups

The existing provisions of Section 80-IAC of Income-Tax Act, 1961 provide for a deduction of an amount equal to 100% of the profits and gains derived from an eligible business by an eligible startup for three consecutive assessment years out of 10 years at the option of the assessee subject to the condition that the total turnover of its business does not exceed ₹ 100 crore for an eligible startup

incorporated on or after the 1 April 2016 but before 1 April 2021.

The Budget now proposes to extend the period of incorporation of such eligible start-ups till 1 April 2022. This amendment will take effect from the 1st April, 2021.

Further, in order to incentivize funding for the startups, the Budget proposes to extend the capital gains exemption for investment in startups that is available under Section 54GB by one more year to March 31, 2022.

The government has also proposed to incentivize incorporation of one-person companies, a move which will benefit startups and innovators. This move will allow such firms "to grow without restriction on paid-up capital and turnover, allowing conversion into any other type of company at any time, reducing residency limit for an Indian citizen to set up an OPC from 182 days to 120 days, and allow also non-resident Indians to incorporate OPCs in India," as per the budget speech.

The paid-up capital of small firms has also been increased to ₹ 2.50 crore from ₹ 50 lakh.

According to the Economic Survey 2020-21, as of the last week of December, there were 41,061 govt-recognised startups in India. Of this, over 39,000 startups accounted for 4,70,000 jobs. With as many as 38 unicorns, with 12 of them coming up last year, India's startup ecosystem is currently the world's third-largest.

9. Measures for Affordable Rental Housing

Budget 2021 has proposed Tax Incentives for Affordable Housing and Affordable Rental Housing Project. In order to incentivize purchase of affordable houses, it is proposed to extend the eligibility period for claim of additional deduction under Section 80-EEA for interest of ₹ 1.5 lakh paid for loan taken for purchase of an affordable house to 31st March 2022.

Further, in order to increase the supply of affordable houses, it is proposed to extend eligibility period by one more year for claiming tax holiday under Section 80-IBA for affordable housing project approved by the competent authority after 1st day of June, 2016 but on or before 31st March, 2022 by amending clause (a) of sub-section (2). It may be noted that the provisions of sub-section (1) of the said section provides for 100% deduction of the profits and gains derived from the business of developing and building affordable housing projects subject to certain conditions.

To promote supply of Affordable Rental Housing for the migrant workers, it is also proposed to allow a new tax exemption for the notified Affordable Rental Housing Projects. Accordingly, it is proposed to insert sub-section (1A) in the said section so as to provide for 100% deduction of the profits and gains derived from the business of developing and building affordable rental housing projects. It is also proposed to insert a new clause (da) in sub-clause (6) to define the expression "rental housing project" which means a project which is notified by the Central Government in the Official Gazette under this clause on or before the 31st day of March, 2022 and fulfills such conditions as may be specified in the said notification

These amendments will take effect from 1st April, 2022 and will, accordingly, apply in relation to the assessment year 2022-2023 and subsequent assessment years.

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