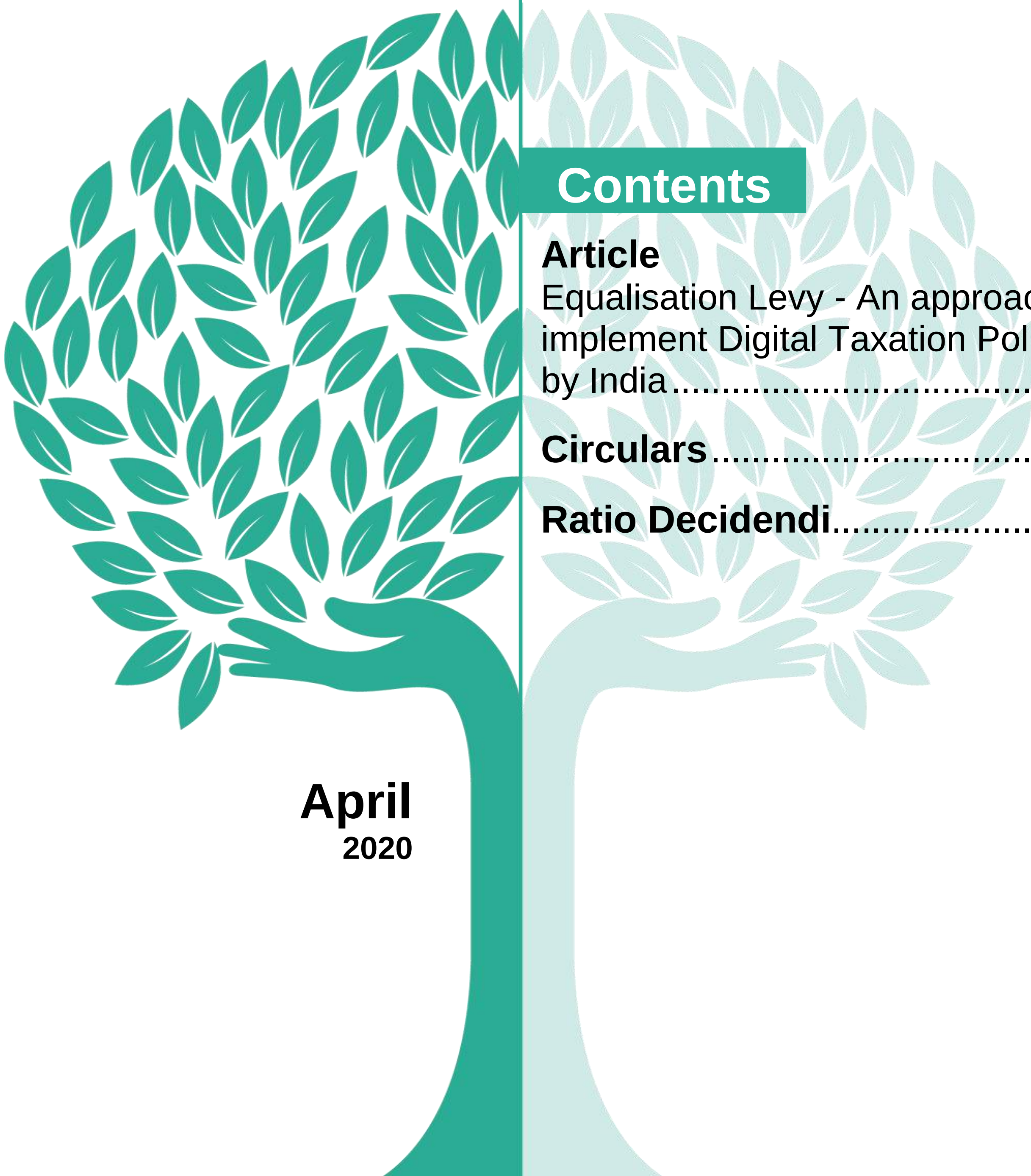
Lakshmikumaran & Sridharan attorneys

Direct Tax

amicus

An e-newsletter from
Lakshmikumaran & Sridharan, India

April 2020 / Issue–67



Contents

April
2020

Article

Equalisation Levy - An approach to implement Digital Taxation Policy by India

By **Harshit Khurana**

Introduction

Business environment has undergone a drastic change i.e. from the traditional 'physical system' to the modern 'digital system'. With user/ consumer facing Countries devising measures to tax digital businesses, the International tax landscape is certainly undergoing a renovation.

It was in this backdrop, that the BEPS project, an initiative by OECD and G20, *inter-alia,* released the Action Plan 1, which though fell short of providing a concrete solution, provided probable measures which may be taken by countries to tax digital businesses.

Since then, OECD has been steadily progressing towards building a 'Unified Approach' for taxing digital economy and is expected to come up with a Global solution by December 2020, which considering the present scenario of pandemic, may get delayed even further. The time taken by OECD has tested the patience of the consumer/ user facing countries, so much so that they probably thought it best to come up with unilateral measures to tax companies having digital presence. The measures recommended in the Action Plan 1 have acted as a guiding tool for these countries to structure their tax laws in this regard.

India was one of the first countries to implement a digital tax levy called the 'Equalization levy' in the year 2016. Soon, countries such as France, UK, Italy etc., also followed India, to implement a similar levy in their jurisdictions. Being the leader, one could have certainly expected India to remain one step ahead of its followers. By broadening the scope of equalization levy (being the subject matter of discussion in this article) in its Finance Act, 2020, India has certainly lived up to those expectations.

How has India progressed to introduce Equalization Levy?

Drawing an inference from BEPS Action 1, India had introduced Equalization levy in the year 2016 (**'2016 Levy'**). This levy was limited to only non-resident companies engaged in providing specified service (i.e. online advertisement, digital advertising space). The obligation to pay taxes was interestingly (similar to reverse charge mechanism in indirect taxes) cast on the service recipient, although he was permitted to deduct the same from the payments made to non-resident providing specified services.

With Finance Act, 2020, the scope of 2016 Levy has been broadened with effect from 1st April 2020. Though the implementation of '*Significant Economic Presence*' was deferred in sync with OECD's timelines, no whisper about introduction of anything in its place could be heard at the time of Budget proposals. However, much to the surprise of everyone closely tracking developments on tax front, the new levy has silently made its way as part of changes to Finance Bill before it was passed by the Parliament.

What is the new Equalization levy all about?

A Levy of 2% has been imposed on the ecommerce operator who receives any consideration for e-commerce supply or services (greater than INR 2 Cr in aggregate) from:

i. Indian Resident;
ii. Person using Indian IP Address for buying such supplies or services;
iii. Non-resident – only in the following cases:
    - Sale of advertisement – targeting Indian Resident or Indian IP User
    - Sale of data – collected from Indian Resident or Indian IP User

Unlike the 2016 levy, in this new levy, the responsibility to pay levy has been casted upon the non-resident ecommerce operator. For any non-payment, the non-resident will be liable to pay interest @ 1% per month and penalty equal to the amount of equalization levy that remains unpaid. Penalty may be waived if ecommerce operator proves that there was reasonable cause for such failure.

Being a levy introduced, not through the Income Tax Act, rather through the Finance Act, 2016, any amount paid by a non-resident ecommerce operator would remain cost to him, which shall not be eligible for any credit in its country of residence.

Is the scope of the levy too wide?

To ensure that no stone remains unturned to tax digital transactions, the levy seeks to cover all those e-commerce transactions that seem to have some nexus with India. Also, the meaning of 'e-commerce operator' and 'e-commerce supply or services' as coined by Taxman further vindicates the intent to tax anything and everything happening over the digital space.

'E-commerce operator' has been defined to mean 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' covers online sale of goods or services owned or facilitated by the e-commerce operator.

The aforesaid definitions not only cover operators who act as facilitators for an online transaction, but also covers ecommerce players who are resellers or manufacturers or service providers. If any transaction is taking place through a digital platform/ electronic facility which is owned, managed or operated by e-commerce operator, all such transactions are included in the ambit of this new equalization levy. Interestingly, even such transactions where the buyers and sellers happen to be Indian residents, and the goods are sold online through digital platform of non-resident ecommerce operator, will also be covered by the new levy.

The term 'digital or electronic facility or platform' has not been defined and so is the term 'online'. A question arises as to whether any sale through emails, telephone, etc., would also be covered within the ambit of this new levy. Similarly, if a manufacturer is habitually concluding contracts only by mail, can it be said that he has an 'electronic facility or platform for online sale of goods or provision of services?

Although no discussion in this respect is there in the newly introduced provisions, guidance can be taken from BEPS Action Plan 1, which is one and probably the only source of inspiration for enactment of equalization levy.

The Action Plan discusses on the digital transactions that can be said to be taking place through digital platform. It seeks to cover specifically those transactions where conclusion of a contract for the sale is effectuated through a digital platform, <u>where the contract conclusion primarily relies on automated systems</u>. Orders concluded through email, or over telephone, where there is human intervention, are kept out of the purview of transactions happening over digital platform.

Food for thought

Taking cue from the Action Plan, it can be said that the intention of Indian Taxman may also be to cover only such automated transactions as discussed in Action Plan and not anything and everything happening online. However, as we all know, the interpretations that may be given or the arguments that may be put forth taking guidance from the Action Plan can only have persuasive value before the Indian tax authorities. One cannot rule out that tax authorities may take on the mantle, to apply the levy to every transaction where there is an element of digital dealing. It is suggested that taxpayer seeks clarification in this respect from the taxman for clearer future.

It will also be interesting to see how the authorities in India ensure recovery of taxes from the non-residents, who do not have any physical presence in India? By enacting a unilateral measure, India may certainly not expect Government of non-resident country to share information. Will they target the Indian subsidiaries of non-residents for enforcement of this new levy? What about cases where the non-resident does not have any subsidiary, can they target the customers of the non-residents?

One has to wait and see as to how the Indian taxman goes about interpreting and enforcing the new levy.

[The author is a Senior Associate in Direct Tax Team, Lakshmikumaran & Sridharan Attorneys, New Delhi]

Circulars

TDS deduction when employee opts for concessional rate of tax under Section 115BAC

CBDT has clarified that employee, having income other than the income under the head “profit and gains of business or profession” and intending to opt for the concessional rate under Section 115BAC of the Income Tax Act, may intimate the deductor (employer) of such intention and the deductor shall compute his total income, and deduct TDS thereon in accordance with the provisions of Section 115BAC. In case such intimation is not made, the employer to deduct TDS without considering the provision of said section. Circular C1 of 2020, dated 13th of April, 2020 further states that this intimation, however, would not amount to exercising option in terms of sub-section (5) of Section 115BAC and the employee shall be required to do so along with the return to be furnished under sub-section 139(1) for that previous year. The Circular also clarifies that in case of a person who has income under the head “profit and gains of business or profession” also, the intimation to the employer for subsequent previous years must not deviate from the option under Section 115BAC once exercised in a previous year.

Deduction of TDS/TCS when rates of surcharge increased by Finance (No.2) Act, 2019 with effect from 1-4-2019 – Clarifications

Clarifying on short deduction of TDS/TCS due to increase in rates of surcharge by Finance (No.2) Act, 2019 with effect from 1-4-2019, the

Central Board of Direct Taxes (CBDT) has clarified that a person responsible for deduction/collection of tax under any provision of the Income Tax Act will not be considered to be an "assessee in default" in respect of transactions where such transaction has been completed and entire payment has been made to the deductee/payee on or before 5th July, 2019 (when Finance (No. 2) Bill, 2019 was laid before the Parliament) and there is no subsequent transaction between the deductor/collector and the deductee/payee in the financial year 2019-20 for collection of any shortfall. According to Circular No. 8/2020, dated 13-4-2020 which also lays down conditions for this benefit, TDS/TCS should have been deducted/collected as per provisions in force prior to Finance (No. 2) Act, 2019 and deposited by due date. Further, the benefit of this circular is not available even if the TDS/TCS statement is not furnished by due date.

Ratio Decidendi

Redeemable debentures issued to a sister-concern cannot be equated to loan for the purposes of deemed dividend under Section 2(22)(e)

The Assessing Officer treated the sum received by the Assessee from its sister-concern for the issue of redeemable debentures as loan and therefore, invoked the provision of Section 2(22)(e). On an appeal to the Tribunal, it was noted that the Assessee had issued the debentures and during the concerned year had exercised the option of redemption as well. The Tribunal held that the transaction involving issue of securities, being separate scrips having standalone capital liability, cannot be equated with a loan transaction which is a current liability. Accordingly, the applicability of Section 2(22)(e) was rejected by the Tribunal in the facts of the case. [*ACIT* v. *Jasubhai Engineering Pvt. Ltd*. - ITA No. 7519/Mum/2016, Order dated 06-03-2020, ITAT Mumbai]

Amount received on account of reduction in profit share in a partnership firm does not attract capital gains tax

The Assessing Officer made an addition of Rs. 4 crores under the head 'capital gains', on account of compensation received by the Assessee for reduction in its profit sharing ratio in a partnership firm. On an appeal to the Tribunal, it was noted that it was neither the case of dissolution of the firm nor payment on retirement of the partner, rather it was a case of reconstitution of the firm. It was further highlighted that for the applicability of Section 45(1) of the Income Tax Act, one of the pre-conditions is that the transfer of a capital asset should have taken place. Amongst others, the Tribunal heavily relied on the judgment of the Karnataka High Court in the case of *CIT v. P.N. Panjawani* [356 ITR 676], wherein it was held that since the property was not owned by the erstwhile partners (as it was owned by the firm, being a separate legal entity under the income-tax law), it cannot be said that they transferred certain percentage of their shares in favour of incoming partners and that any amount represents the consideration received for such transfer as there was no transfer of the capital assets. It was also observed that there is no provision for levying capital gains on such consideration received for reduction of the share in the partnership firm. Accordingly, the Tribunal held that mere re-adjustment of profit-sharing ratio between partners does not amount to 'transfer' under Section 2(47), and therefore rejected the applicability of Section 45(1). [*Anik Industries Ltd.* v. *DCIT* - ITA No. 7189/Mum/2014 & ITA No. 5234/Mum/2016, Order dated 19-03-2020, ITAT Mumbai]

Refund cannot be withheld under Section 241A without the conditions mentioned therein being fulfilled

The Petitioner had filed a writ petition before the High Court challenging the order passed under Section 241A of the Income Tax Act, withholding the refund due under Section 143(1). On a bare perusal of the Section, the High Court noted that the refund due can be withheld, *inter alia,* if the Assessing Officer is of the opinion that revenue would be adversely affected in case of grant of refund. In the facts of the instant case, however, from the impugned order and the record, the Court noted that there was no reason recorded for concluding that grant of refund is likely to adversely affect the revenue. The Court was also of the view that mere pendency of proceedings under Section 143(2) or likelihood of demand being created is not sufficient enough to cover a case under Section 241A. [*Huawei Telecommunications (India) Pvt. Ltd.* v. *Union of India* - CWP No. 2698 of 2020, Order dated 06-03-2020, Punjab and Haryana High Court]

Salary, being taxable on accrual basis, is exempt from taxation in India if same is received by non-resident in India for services rendered outside India

The Assessee was seconded on overseas assignment for the purpose of employment to the Australian branch of his employer. The Assessee received the salary in his Indian bank account with respect to services rendered in Australia. Since the Assessee was a non-resident for the assessment year under consideration, such salary income was claimed as exempt in India under Article 15(1) of India-Australia DTAA. The Indian tax authorities however denied the Assessee the benefit of the Treaty and brought the salary to tax on receipt basis in terms of Section 5(2)(a) of the Income Tax Act.

On appeal, the Tribunal observed that Section 5(2) is subject to other provisions of the Act and as per the Act, the regular salary paid to any assessee is chargeable to tax in terms of Section 15(a). From a reading of Section 15(a), it could be concluded that the salary is always taxable on accrual basis. Further, Section 9(1)(ii), which deals with income deemed to accrue or arise in India, states that salary income could be deemed to accrue or arise in India, only if it is earned in India in respect of services rendered in India. The Tribunal in this regard also noted that the Treaty benefit shall be applicable to the residents of both, India as well as Australia. Having said so, the Tribunal held that the Assessee's case is covered under Article 15 of the Treaty, according to which the salary income shall be taxable only in Australia, in case of an individual who is a resident of Australia. Therefore, the treaty benefit was allowed to the assessee for salary earned in Australia with respect to services rendered in Australia. [*Paul Xavier Antony Samy* v. *ITO* - ITA No. 2233/Chny/2018, Order dated 28-02-2020, ITAT Chennai]

Dividend income received under Section 115BBD is eligible for set-off against business loss

The Assessee filed an appeal to the Tribunal against an order passed under Section 263, disallowing the set-off of loss against the dividend income received from specified foreign company under Section 115BBD. On a perusal of Section 115BBD, the Tribunal held that there is no provision in the Section to eliminate the dividend income from specified foreign company before setting off of loss unlike Section 115BBE. That is, the Legislature never intended to exclude dividend income earned from specified foreign company from the applicability of Section 71. It further held that taxable income has to be computed by first computing the total income based on Chapter-IV and then applying Chapter-VI (Aggregation of income and set off of losses) and VIA (Deductions). After determining the taxable income by applying the said Chapters and if still there is profit, then such taxable profit has to be taxed according to the prevailing rates as per the various applicable provisions of the Act. Accordingly, the Tribunal rejected the contention of the Revenue of taxing the dividend income separately and set aside the order passed under Section 263 in favour of the assessee. [*Tata Motors Ltd.* v. *DCIT* - ITA No. 3424/Mum.2019, Order dated 06-03-2020, ITAT Mumbai]

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail :lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail :lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURUGRAM
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurugram-122001
phone: +91-0124 - 477 1300
Email: lsgurgaon@lakshmisri.com

PRAYAGRAJ (ALLAHABAD)
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.R)
phone . +91-0532 - 2421037, 2420359
Email:lsallahabad@lakshmisri.com

KOCHI
First floor, PDR Bhavan,
Palliyil Lane, Foreshore Road,
Ernakulam Kochi-682016
Tel: +91 (0484) 4869018; 4867852
E-mail: lskochi@laskhmisri.com