

ASSOCIATION OF COMPETITIVE TELECOM OPERATORS

*Pre - Budget proposals
for
Union Budget (2019-20)
to
Ministry of Finance
(Department of Revenue)*

*22nd May 2019
New Delhi*

Introduction

- ❖ ACTO is an industry association, registered under Societies Registration Act, 1860.
- ❖ Our members provide enterprise data services to multi-sited corporations, Indian BPO/KPO, outsourcing and ITES sector operating global networks under appropriate telecom licenses accorded by Government of India.
- ❖ ACTO is committed to further India's pro-competitive policies and to partner closely with Ministry of Communications & Information Technology, Ministry of Finance and other Ministries , Government Bodies to enhance the stakeholder's engagement with the specific needs of the enterprise segment.
- ❖ Our members:



Transfer Pricing Issues

Issue – Deemed international transaction, Coverage of Safe Harbor Provisions and additional compliances for Foreign Affiliates when they receive amount from Indian Resident.

Rationale/ justification – Presently there is no clarity in relation to quadrangular arrangements since present regulations only talks about triangular arrangements between associated enterprise and such other person (Resident). Furthermore Telecom Sector has been excluded from Safe Harbor provisions. Also amount paid by Indian entity to its foreign affiliates in the form of Royalty or other similar nature of payments are subject to long-drawn litigation basis the presumption of tax authorities that Indian taxpayer has not obtained any benefit from use of such trademark and the royalty payment is not justified.

Foreign entity has to file its Tax return in India being income accrued/arisen in India. Section 92(1) of the Act requires that any income arising from an international transaction be computed having regard to the arm's length price. Further, allowance for any expense or interest arising from an international transaction shall also be determined having regard to the arm's length price. Given the above, and read with the decision held in the case of Instrumentarium Corporation Ltd [TS-467-ITAT-2016], both the Indian taxpayer as well as the Foreign taxpayer are required to prepare separate transfer pricing documentation to demonstrate the arm's length price for the same transaction.

Considering that any downward adjustment to the expense in the hands of the Indian taxpayer will increase the income of the foreign affiliate or any upward adjustment in the income of the foreign affiliate will result in decrease in expense claimed as deduction in the hands of the Indian taxpayer As such, the overall income base for India is expected to remain the same.

Recommendation – Specific guidance should be issued on kind of arrangements that should get covered as deemed international transactions with specific directions on revenue neutral transactions. Furthermore clarification may be provided that separate transfer pricing documentation of the foreign affiliate is not required where the transaction is already benchmarked in the hands of the Indian taxpayer.

Direct Tax Issues

Issue – Domestic as well as cross-border payments made by Indian telecom operators to other telecom operators, in respect of a wide array of telecommunication services, are under litigation on account of retrospective amendment in the definition of ‘Royalty’ [by way of insertion of Explanation 5 and 6 to section 9(1)(vi) of the Act] made vide Finance Act, 2012, which intends to bring within the purview of royalty, use of equipment irrespective of any actual possession or control of rights, properties or information and transmission by satellite, cable, optic fibre, or similar technology.

Rationale/justification– The traditional jurisprudence has been that telecommunication services were standard services and hence, fee for same cannot be taxed as royalty under the provisions of the Act and also the DTAA signed by India with other countries. The tax authorities have now started taking a position that payments made by telecom companies, even for standard telecom services, are in the nature of royalty, resulting in protracted litigation not only in relation to taxation of the payments in the hands of the recipient foreign operators but also in relation to tax deduction at source by the paying Indian telecom operators.

Recommendation – Definition of the term ‘royalty’ under the provisions of the Act may be amended with retrospective effect to exclude standard service such as IUC.

Clarification should also be issued that amendments made to the definition of Royalty under section 9(1)(vi) of the Act [vide insertion of Explanation 5 and 6 to section 9(1)(vi) of the Act] shall not be read into the DTAAs, as has also been held in numerous judgments by the Indian judiciary.

Direct Tax Issues

Issue – Initiation of withholding tax proceedings against resident payers where reasonable due diligence was exercised while making payments to non-residents.

Rationale/ justification – The present provisions do not provide any safeguard for the payers who make payments to non-residents even where reasonable due diligence was exercised (eg: collection of No PE declaration, TRC and Form 10F). This is particularly where tax department allege PE of the non-resident recipients in India.

Recommendation – Reference to No PE certificate should be incorporated in the Income-tax Rules and where the deductor is able to prove that due diligence was exercised while making the remittance, assesses should be not held as assesses in default for non-deduction of tax at source from payments made to the non-residents.

Tax Holiday U/s 80 IA

Issue - The Tax holiday enjoyed by the Telecom Industry U/S 80 IA has been withdrawn and is no longer available if the operations of the Telecom Service Provider has started after the 1st April, 2005.

Rationale/ justification

Telecom Industry has already been granted the status of an infrastructure Industry and the benefits under Section 80IA has been restricted only for the telecom services.

Recommendation

It is recommended that the restrictions on the telecom services under Section 80 IA should be removed.

Direct Tax Issues

Issue –Return of Income ('ROI') compliances in India for Foreign companies

Rationale/ justification – Foreign companies deriving royalty and FTS income from India are required to pay taxes in India and file ROI. ROI is required to be filed by the Foreign companies for royalty/ FTS income even where the taxes have been duly withheld by the payers of income. Further, no-filing of the ROI in such cases also results in levy of penalty on income assesses in the hands of the Foreign Companies (despite the fact that tax liability thereon stands discharged by way of tax deduction by the payer). This leads to unnecessary ROI and other compliances burden for the Foreign companies in India.

Recommendation – It may be provided that in cases where taxes have been duly withheld on payments in the nature of Royalty / FTS to a foreign company, such foreign company should not be required to file ROI in India or undertake other compliances (For e.g. Form 3CEB filing).

Rationalization of DDT

Issue – Reduction in Dividend Distribution Tax ('DDT') rate.

Rationale/ justification – Increased DDT rate reduces the dividend distribution ability of the domestic companies and the uncertainty with respect to its credit in overseas jurisdiction impacts the non-resident shareholders adversely.

Recommendation – DDT rate should be reduced to 10% from current effective rate of around 20%.

Direct Tax Issues

Issue - Indirect transfer tax provisions introduced vide Explanation 5 to section 9(1)(i) of the Income-tax Act, 1961 ('Act'), which deem shares of a foreign entity deriving substantial value from India to be located in India.

The said amendment is also being interpreted to have overriding and contradicting effect on the definition of "Royalty" as contained in the Double Taxation Avoidance Agreements.

Rationale/ justification - Retrospective application of the rules could lead to re-opening of settled matters/ cases, resulting into long drawn litigation in respect of completed transactions, including withholding tax proceedings for the acquirer.

Recommendation –Indirect transfer tax provisions should be applied prospectively from the date of introduction thereof.

Direct Tax Issues

Issue – Receipt of shares by shareholders in an overseas merger (satisfying prescribed conditions) should be exempt from levy of capital gains tax in the hands of the shareholders.

Rationale/ justification – Similar to the exemption granted to shareholder(s) of an Indian merging company in a tax neutral merger of Indian entities, specific exemption from applicability of indirect transfer tax provisions should be granted to the shareholders of an overseas merged entity in case of an overseas merger.

It may be noted that transfer of shares of an overseas entity (deriving substantial value from assets located in India) held by the merging overseas entity to the merged overseas entity has been made exempt. However, similar exemption has not been provided to the shareholders.

Recommendation – Exemption should be provided to the shareholders in an overseas merger.

Direct Tax Issues

Issue – Section 276B of the Act - Clarification w.r.t. initiation of prosecution proceedings where tax and interest has been paid in full.

Rationale/ justification - Prosecution proceedings under section 276B of the Act, for default in payment of taxes, should not be initiated where the assessee has made good the default by depositing the amount (along with requisite interest) and also in cases where the assesseees are not repetitive defaulters. This shall encourage the compliance of law in a time bound manner and avoid litigations.

Recommendation – Prosecution proceedings should not be initiated where tax and interest has been paid in full.

Direct Tax Issues

Issue – Applicability of withholding tax provisions on year-end accruals

Rationale/ justification – Withholding tax obligations arise at the time of payment or credit to the account of the payee, whichever is earlier. Though there are judicial precedents in favour of the taxpayers, at present tax authorities disallow entire year-end accruals (even where the parties are not identified), resulting in creation of demands and protracted litigation.

Recommendation – It should be clarified that withholding tax provisions should not be applicable to year-end provisions where the recipients are not identified. Recommended amendments would put an end to past litigation and also eliminate the risk of any future litigation on this issue.

Direct Tax Issues

Issue – Allowability of Corporate Social Responsibility ('CSR') expenditure

Rationale/ justification – Presently expenditure incurred in the normal course of business towards CSR obligation of the company is not allowed as a deduction under section 37 (except deduction to the extent allowed under Chapter VIA based on eligibility).

Expenditure incurred in the normal course of business towards CSR should be allowed as a tax deductible expense, as the expenditure is incurred for the purpose of business of the company and is also mandated by the Companies Act 2013.

Recommendation – It should be provided that CSR expenditure is fully allowed as tax deductible expenditure under section 37 to the taxpayers.

Clarity on Intra Group Services

Issue— Intra group services – Guidance on supporting documentation

Rationale/ justification – Currently there is no clarity on kind of supporting documentation to be maintained for intra group services.

Recommendation – Specific guidance should be issued on kind of documents that should be maintained by tax payers as in the absence of adequate documentation tax authorities tend to disallow such expense.

Limitation Under Section 94B

Issue– Limitation on Interest on debt extended or guaranteed by AE

Rationale/ justification –Section 94B was introduced from 1 April 2017 to limit deduction on account of interest incurred in certain cases where debt is borrowed from an AE being a non-resident or where the debt is borrowed from a non-AE (subject to implicit or explicit guarantee provided by AE to the lender).

The interest deduction is restricted to 30% of earnings before interest, taxes, depreciation and amortization ('EBITDA') of the borrower.

It is pertinent to note that all the taxpayers' products/ services would not be undergoing the same phase of business life-cycle as others, some may be in the initial phases of product development or product promotion where significant resources are deployed by the company to develop, commercialize and promote the product.

Such extensive use of resources would be associated with high costs resulting in low profits even at EBITDA level.

The limitation of interest deduction for such companies with high operating expenditure will result in higher tax cost which is an additional burden for such taxpayers.

Recommendation – Section 94B on companies which have incurred significant operating expenditure resulting in low EBITDA along with requisite guidelines.



Thank you !!

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