ASSOCIATION OF COMPETITIVE TELECOM OPERATORS

Pre - Budget proposals
for
Union Budget (2020-21)
to
Ministry of Finance
(Department of Revenue)

02nd December 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:

at&t BT verizon orange Business Services TELSTRA GLOBAL पावरग्रिड रेलटेल RAILTEL

Transfer Pricing Issues

Issue – Deemed international transaction - Guidance on kind of arrangements that should get covered as deemed international transactions , Coverage of Safe Harbor Provisions To increase coverage for additional sectors/ transactions (including transaction involving payment of trademark royalty) and additional compliances for Foreign Affiliates in relation to related party transactions undertaken with group entity in India (that are also subject to transfer pricing compliances in the hands of the Indian taxpayer).

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). Currently transactions in telecom sector is not covered under safe harbor provisions. Further, the current regulations do not provide a safe harbor for transactions involving payment of trademark royalty. Payment of royalty has been 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. In case of transactions, such as payment of trademark royalty by Indian taxpayer to its foreign affiliate, the expense is claimed as a business expenditure in the tax-return of the Indian taxpayer. Further, the foreign affiliate is also required to file a tax return in India as the income received from the Indian taxpayer is taxable in the hands of foreign affiliate. 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 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, the overall income base for India is expected to remain the same. This results in additional compliance burden for multi-national groups in India.

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. Could serve as an additional dispute resolution mechanism for tax payers in telecom sector (including transaction involving payment of trademark royalty). A 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.

Transfer Pricing Issues

Issue– Range concept - Use of inter-quartile range

Rationale/ justification – The current rules proposing narrow range does not address the concern of the tax payers. Also, use of inter-quartile range would ensure consistency with international transfer pricing principles and minimize risk of economic double taxation merely on account of difference in use of statistical tools.

Recommendation – Use of inter-quartile range could be considered instead of 35th to 65th percentile range as per current rules for computation of Arm's Length Price

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.

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).

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 - 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.

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 assessees 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– Deduction of Employees' Contribution to Provident Fund etc. under section 43B

Rationale/ justification – Section 43B of the Act allows deduction towards employer's contribution to PF/ any other fund for the welfare of the employees if the same is deposited up to the date of filing the return of income. However, deduction for employees' contribution to such welfare fund is governed by Section 36(1)(va) of the Act which mandates that the employees' contribution should be credited to the relevant fund by the due date specified under the relevant Act, rule, order or notification governing that fund.

Differential tax treatment for employees' contribution and employer contribution to the same fund is discriminatory and has led to unwarranted litigation.

Recommendation – Suitable amendment should be made in the Act so as to bring the provisions relating to allowability of deduction for employees' contribution towards employee welfare funds in line with the employer's contribution towards such funds.

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.

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 rate of 15%.

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 – An exception may be created for applicability of the provisions of Section 94B on companies which have incurred significant operating expenditure resulting in low EBITDA along with requisite guidelines.

Thank you !!

Association of Competitive Telecom Operators (ACTO)

UGF-74, World Trade Centre, Babar Road, Connaught Place
New Delhi-110 001
Tel. No. +91-11-43565353, +91-11-43575353,
e-mail: info@acto.in web: www.acto.in