taxsutra All rights
reserved

taxsutra

Section 194-O – Whether Applicable to Non-Resident E-Commerce Operators?

Date: July 02,2020

Avnish Arora (Chartered Accountant)

Dhaval Jariwala (Chartered Accountant)

There has been a constant effort on the part of the Government to enhance the scope of withholding tax provisions either by amending the provisions enshrined in Chapter XVII-B of the Income-tax Act, 1961 (Act) or by introducing new withholding tax provisions from time to time.

It is believed that withholding tax provisions or TDS (tax deducted at source) provisions help in earlier collection of tax and consequently in bridging the gap in tax collection due to tax evasion. Also, since the responsibility of TDS has been cast on the taxpayer, it is believed that the cost of collection of tax is also reduced.

As per some estimates TDS contribute approx. 43% of direct tax revenues[1].

Keeping up this philosophy, the Finance Act, 2020 has introduced a new Section 194-O[2] in the Act which deals with TDS on payment of certain sums by e-commerce operator to ecommerce participant, in order to widen and deepen the tax base. In fact, the introduction of the above provisions was being contemplated by the tax officials in its 16th TDS conference[3].

In this article we are sharing our observations and our understanding of some of the nuances relating to Section 194-O of the Act.

As per Section 194-O of the Act, where sale of any goods or provision of any services of ane-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator, at the time of credit of amount of sale or services or both to the account of an e-commerce participant or at the time of payment thereof to such e-commerce participant by any mode, whichever is earlier, deduct income-tax at the rate of 1% of the gross amount of such sales or services or both.

Explanation to Section 194-O of the Act defines:

- 'e-commerce participant' to mean a ***person resident in India*** selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce.
- 'e-commerce operator' to mean a person who owns, operates or manages digital or electronic facility or platform for electronic commerce.
- 'electronic commerce' to mean the supply of goods or services or both, including digital products, over digital or electronic network.

It is interesting to note that the definition of e-commerce participant specifically mentions that e-commerce participant to whom payment is being made should be 'resident in India' but the definition of e-commerce operator is silent on this aspect i.e. it does not mention whether e-commerce operator should be 'resident in India' or not.

Thus, the question arises as to what is the scope of Section 194-O of the Act i.e. whether it is applicable only to resident e-commerce operators or also to non-resident e-commerce operators? In other words, can one say that Section 194-O of the Act has an extra-territorial operation, or not?

In this regard, at the outset, we would like to draw the reader's attention to the decision of the Hon'ble Supreme Court of India (SC) in the case of Vodafone International Holdings B.V. v Union of India [2012] [TS-23-SC-2012-O] (SC) wherein the SC had referred the constitution of India to determine whether Section 195 of the Act that provides for withholding of taxes by any 'person responsible for paying' to non-residents, has an extra-territorial operation, or not, so as to bring within its ambit non-residents who are making payments to other non-residents. The relevant extract of the decision is reproduced as under:

taxsutra All rights
reserved

“***183. Article 246 of the Constitution gives Parliament the authority to make laws which are extra-territorial in application. Article 245(2) says that no law made by the Parliament shall be deemed to be invalid on the ground that it would have extra territorial operation. Now the question is whether Section 195 has got extra territorial operations. It is trite that laws made by a country are intended to be applicable to its own territory, but that presumption is not universal unless it is shown that the intention was to make the law applicable extra territorially***. *We have to examine whether the presumption of territoriality holds good so far as Section 195 of the Income Tax Act is concerned and is there any reason to depart from that presumption*.

184. A literal construction of the words "any person responsible for paying" as including non-residents would lead to absurd consequences. A reading of Sections 191A, 194B, 194C, 194D, 194E, 194I, 194J read with Sections 115BBA, 194I, 194J would show that the intention of the Parliament was first to apply Section 195 only to the residents who have a tax presence in India. It is all the more so, since the person responsible has to comply with various statutory requirements such as compliance of Sections 200(3), 203 and 203A.

185. The expression "any person", in our view, looking at the context in which Section 195 has been placed, would mean any person who is a resident in India*. This view is also supported, if we look at similar situations in other countries, when tax was sought to be imposed on non-residents. One of the earliest rulings which paved the way for many, was the decision in Ex Parte Blain; In re Sawers [1879] LR 12 ChD 522 at 526, wherein the Court stated that "if a foreigner remain abroad, if he has never come into this country at all, it seems impossible to imagine that the English Legislature could ever have intended to make such a person subject to particular English Legislation." In Clark (Inspector of Taxes) v. Oceanic Contractors Inc. [1983] 1 ALL ER 133, the House of Lords had to consider the question whether chargeability has ipso facto sufficient nexus to attract TDS provisions. A TDS provision for payment made outside England was not given extra territorial application based on the principle of statutory interpretation. Lord Scarman, Lord Wilberforce and Lord Roskill held so on behalf of the majority and Lord Edmond Davies and Lord Lowry in dissent. Lord Scarman said:*

"*unless the contrary is expressly enacted or so plainly implied as to make it the duty of an English court to give effect to it, United Kingdom Legislation is applicable only to British subjects or to foreigners who by coming into this country, whether for a long or short time, have made themselves during that time subject to English jurisdiction.*"

The above principle was followed in Agassi v. Robinson [2006] 1 WLR 2126……….”

One can observe that the SC has very clearly said that Section 195 of the Act does not have an extra-territorial operation and will only apply to residents and not to non-residents.

However, in our view, this decision of the SC appears to have been more driven by the fact that if non-residents are required to comply with Section 195 of the Act and consequently are required to withhold taxes from the payments made to other non-residents then it would lead to absurd results because such non-residents will then be required to comply with Section 200(3)[4], Section 203[5] and Section 203A[6] of the Act, which will be very difficult specifically in a situation when such non-residents have no presence in India and such non-residents have never subjected themselves to the Indian tax jurisdiction.

Thus, it seems that focus of the SC was also on the practical difficulties faced by such non-residents having no presence in India, in complying with the withholding tax provisions under the Act, as a result of which, the SC had arrived at such a conclusion.

In any case, it's worth noting that pursuant to this decision of the SC, the Finance Act, 2012 had amended Section 195 of the Act to include the new Explanation 2 with retrospective effect from 1 April 1962, which clarified that withholding tax obligation under the said Section applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not, the non-resident has a residence or place of business or business connection in India or any other presence in any manner whatsoever in India.

Hence, after this specific amendment clarifying the scope of the withholding tax provisions under Section 195 of the Act, can one say that this amendment has negated the impact of the aforesaid decision of the SC?

Now, we would further like to draw the reader's attention to the Advance Ruling - P. No. 13 of 1995, in the case of ABC, In re [1997] [TS-5004-AAR-1995-O] (AAR - New Delhi).

In this case, ABC was a company incorporated in France with affiliates in several countries and was engaged in the business of engineering and construction management as well as providing project development services and construction of industrial plants. It was proposing to enter into an agreement with the Indian

taxsutra All rights
reserved

company XY for providing complete project services on single point responsibility basis starting from technology transfer to the commissioning of the plant and for that, it was proposing to operate from its head office (HO) in France as well as a Project Head Office (PHO) and a Project Site Office (PSO) in India. Now, for rendering services to XY, it was proposing to acquire goods, services and technologies from its suppliers abroad (including its affiliates, sub-contractors and third-parties) and consequently make payments to them in the form of royalties or fees for technical services. To get a complete clarity on the tax implications with the respect to the contract that ABC was proposing to enter into, it made an application for advance ruling as per Section 245Q of the Act wherein it sought an advance ruling on the following question with respect to withholding of taxes from payment of royalty and fees for technical services outside India to its suppliers (including affiliates, sub-contractors and third-parties).

"*12. Whether the HO of ABC would be liable to withhold taxes under the Act of India in respect of payments made to foreign suppliers (including ABC affiliates and sub-contractors) of goods, services and technologies*."

The Authority of Advance Ruling (AAR) held as under:

"*18. This is a very interesting question and the answer to it requires careful consideration. The question is whether ABC's H.O. would be liable to deduct taxes under the Act in respect of the payments which it may have to make to its suppliers abroad (including its affiliates, sub-contractors and third parties) in payment of goods, services and technologies acquired from them. Applicant's counsel suggests that since ABC is a non-resident foreign company for the purposes of the Act, the provisions regarding tax deduction at source in the Act will not be applicable to it. This is not correct. It is generally true that tax deductions at source envisaged in respect of certain types of payments made by residents to other residents and particularly non-residents as a convenient mode of collection when the moneys pass hands rather than await an assessment on, and recovery from, the payee in due course.* ***But the language of the relevant provisions comprehensively covers 'any person' responsible for paying any sums chargeable to income-tax. Foreign or non-resident companies and persons cannot, therefore, be considered outside the scope of these provisions of the Act though it is true that there may be some practical difficulties in enforcing these obligations on such persons unless they have a representative or agent who can be made vicariously liable in this regard****....*"

One can observe that the AAR has clearly said that withholding tax provisions under the Act are also applicable to non-residents contrary to what the SC had said though admitting the practical difficulties faced by non-residents having no agent or representative in India, in complying with the withholding tax provisions under the Act, similar to what the SC had also observed.

It may not be out of place to mention here that this ruling of the AAR was not brought to the notice of the SC as a result of which, the observations of the AAR were never discussed and deliberated upon by the SC while arriving at its conclusion.

We would also like to draw the reader's attention to Circular No. 726 dated 18 October 1995 (Circular) titled as 'CLARIFICATIONS REGARDING PAYMENTS TO PERSONS RESIDENT IN INDIA BY FOREIGN COMPANIES OR FOREIGN LAW FIRMS THAT HAVE NO PRESENCE IN INDIA'. The relevant extract of the Circular is reproduced as under:

"*1. Representations have been received from some law and accountancy firms that are receiving fees for professional services from foreign companies or foreign law and accountancy firms saying that the latter find it very difficult to comply with the requirement of tax deduction at source under section 194J of the Income-tax Act and its payment to Central Government in the prescribed manner and within the prescribed time in the absence of any agent or business connection or permanent establishment in India. They have, therefore, requested that the provisions of section 194J of the Act may not be made applicable to the fees for professional services paid by foreign companies or foreign law and accountancy firms to persons resident in India*.

2. After carefully considering the practical difficulties involved, it is felt that, any fees paid through regular banking channels to any chartered accountant, lawyer, advocate or solicitor who is resident in India by the non-residents who do not have any agent or business connection or permanent establishment in India may not be subject to the provisions of tax deduction at source under section 194J of the Income-tax Act.

3. However, foreign companies or foreign law and accountancy firms are required to send a quarterly statement, indicating the name and address of the person to whom the payments are made, to the Deputy Secretary, Foreign Tax Division, CBDT, Department of Revenue, Ministry of Finance, New Delhi. The first quarterly statement would be from the quarter ending 31st December, 1995."

taxsutra All rights
reserved

Our reading of the aforesaid circular seems to suggest that as per the apex tax body, though withholding tax provisions are applicable to non-residents having no presence in India, but, however due to practical difficulties the apex tax body allowed a relief to such non-residents from compliance. Though the above circular is in the context of Section 194J of the Act whether the principle laid out by this Circular should equally apply to Section 194-O of the Act?

It is pertinent to mention here that the above Circular was not brought to the notice of the SC as a result of which the Circular was never discussed and deliberated upon by the SC while arriving at its conclusion. Also, it needs to be noted that this Circular was issued post the passing of the above ruling i.e. ruling of the AAR was passed on 23 August 1995 whereas the Circular was issued on 18 October 1995.

But interestingly, similar to the observation of the SC and the AAR, even this Circular acknowledged the practical difficulties faced by non-residents having no agent/ business connection/ permanent establishment in India in complying with the withholding tax provisions under the Act, as a result of which necessary relaxation was provided to foreign companies and law firms, from withholding taxes as per Section 194J of the Act while making payment of professional fees to chartered accountants, lawyers, advocates and solicitors who were resident in India.

In light of the above, can one fairly say that withholding tax provisions under the Act are also applicable to non-residents i.e. withholding tax provisions under the Act have an extra-territorial operation which means that Section 194-O of the Act is also applicable to non-resident e-commerce operators?

Let's also discuss what are the practical difficulties faced by the non-residents in complying with the withholding tax provisions under Act and whether having a presence in India in the form of an agent/ business connection/ permanent establishment helps these non-residents in mitigating such practical difficulties, or not, as even non-resident e-commerce operators may face such practical difficulties - does this mean that non-resident e-commerce operators are not required to comply with Section 194-O of the Act? Let's understand:

To comply with the withholding tax provisions under the Act, the first thing that the non-resident will have to do is obtain the tax deduction and collection account number (TAN) as per Section 203A of the Act read with Rule 114A of the Income-tax Rules, 1962 (Rules) by making an application in Form No. 49B on www.tin-nsdl.com. While filling up this Form No. 49B itself, non-resident who has no presence in India in the form of an agent/ business connection/ permanent establishment, will have to overcome two major difficulties due to some peculiar features of www.tin-nsdl.com:

a) identifying the Assessing Officer who will have the jurisdiction: because www.tin-nsdl.com allows applicants to identify such Assessing Officer, only based on the city in India; and

b) specifying its address: because www.tin-nsdl.com allows applicants to only specify the address in India.

(Please refer Appendix for the screen shot of www.tin-nsdl.com evidencing the above)

Such non-resident can overcome the difficulty (a) by obtaining the Permanent Account Number (PAN) from the tax authorities because once the PAN is obtained then such non-resident will also know the Assessing Officer who will have the jurisdiction. In fact, such non-resident will have to anyways obtain the PAN as the same is mandatory for filing the withholding tax returns under the Act. Nonetheless, difficulty (b) still remains i.e. which address should such non-resident specify.

Whereas, on the other hand, if non-resident has a presence in India in the form of an agent/ business connection/ permanent establishment then both the difficulties are resolved because such non-resident will anyways know the Assessing Officer who will have the jurisdiction given that such non-resident will have the PAN obtained from the tax authorities with respect to the activities of such agent/ business connection/ permanent establishment in India and will also be able to specify the address of its presence in India.

Now, in an e-commerce business model, there is a possibility that non-resident e-commerce operator may not have any presence in India because they generally engage independent third-party e-commerce service providers in India like storage and logistics service providers, cash-on-delivery service providers etc. to assist e-commerce participant in sale of goods and provision of services on their e-commerce platform.

Thus, for non-resident e-commerce operator to obtain the TAN to comply with Section 194-O of the Act, the question remains as to which address should such non-resident e-commerce operator specify in Form No. 49B. Can such non-resident e-commerce operator specify the address of any of the independent third-party e-commerce service provider in India?

May be to overcome all such difficulties, the Finance Act, 2020 has also amended Section 204 of the Act that

taxsutra All rights reserved

defines the expression 'person responsible for paying' (being the person who has the obligation to withhold taxes under the Act), by introducing the following Clause (v)[7], so as to bring within the ambit of the withholding tax obligations of non-resident, even the person authorised by such non-resident and the agent of such non-resident including the agent under Section 163 of the Act.

"*(v) in the case of a person not resident in India, the person himself or any person authorised by such person or the agent of such person in India including any person treated as an agent under Section 163*."

Accordingly, pursuant to this Clause (v), non-resident e-commerce operator may have to consider authorising any person in India or appointing any person in India as an agent to comply with Section 194-O of the Act and obtain the TAN, in the absence of which, challenges will be galore.

Also, it is very difficult to envisage at this stage as to how such person or such agent in India will comply with Section 194-O of the Act when non-resident e-commerce operator will be the person collecting money from the customers of resident e-commerce participant and consequently the person paying such money to such resident e-commerce participant.

Taking all the above aspects into consideration, we believe that though the law postulates a scenario that non-resident e-commerce operators having no presence in India will have to comply with Section 194-O of the Act but will have to face practical difficulties discussed above.

Finally, we would like to conclude by dropping a question in the reader's mind with respect to consequences of non-compliance with Section 194-O of the Act. If non-resident e-commerce operator fails to comply with Section 194-O of the Act, then whether tax authorities can go after third-party e-commerce service providers in India to recover the withholding tax, or not, OR where non-resident e-commerce operator has authorised any person in India or has appointed any agent in India to ensure compliance with Section 194-O of the Act and such person or such agent fails to comply with Section 194-O of the Act, whether tax authorities can go after such person or such agent in India to recover the withholding tax, or not? If 'Yes' then what are the recourses available to tax authorities i.e. whether tax authorities can initiate action under Section 163 of the Act or under Section 201 of the Act or may be both?

We feel it's worth giving a thought to these questions, because going forward, given the complexity of e-commerce business models, we may see litigations on this front.

This further makes it difficult to specify the foreign address like for e.g. the address of the United States of America.

---

[1] CBDT Taxalogue Volume 1 Issue 2 October-December 2019, page 119

[2] With effect from 1 October 2020

[3] CBDT Taxalogue Volume 1 Issue 2 October-December 2019, page 122

[4] Duty of the person withholding tax - to file Form No. 24Q, 26B, 26Q, 27A and 27Q as per Rule 31A of the Rules

[5] Issue of certificate for taxes withheld

[6] Obtaining Tax Deduction and Collection Account Number

[7] With effect from 1 April 2020