Equalisation Levy – A Level Playing Field or More Disparity? [Part I]

May 10, 2021

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Digital Economy (DE) has transitioned the marketplace into a much smaller world. It may not be inappropriate here to state that DE has shrunk the world and made it smaller for us than the kids were made to look in the famous Hollywood flick *'Honey, I shrunk the kids'*. Though the accidently shrunk kids did find their way back to normalcy, the digital transformation in the present day scenario would change not only the way of doing business but altogether change the way we would be leading our lives through the concepts of Artificial Intelligence (AI); cloud computing; Internet of things (IoT) and many more.

The Organisation for Economic Co-operation and Development (OECD) in its final report in 2015 on Base Erosion and Profit Shifting (BEPS) Action Plan 1 in the context of digitalization observed that as the digital economy was becoming the economy itself, it was difficult to ring-fence the digital economy from the rest of the economy for tax purposes. It was also acknowledged that the digital economy was in a continuous state of evolution and there was a need to evaluate the impact of the said developments on tax systems. In the backdrop of OECD's analysis of the impact of digitalization on tax matters in the BEPS Action Plan 1, several options were evaluated to tackle the direct tax challenges arising out of digitalization, however, no specific recommendations were made. Beginning with the report issued on BEPS Action Plan 1 by OECD way back then, till date, there has been no consensus agreed upon by the 130 plus countries/members of the BEPS Inclusive framework on the manner in which digital transactions should be taxed, however, OECD expects to reach a consensus soon.

The history of the Equalisation Levy (EL) traces its roots to OECD's BEPS Action Plan 1. India was the front runner in introducing the BEPS measures when it introduced the EL in 2016. The Memorandum to the Finance Bill, 2016 stated that digital economy is growing at ten per cent per year, significantly faster than the global economy put together as a whole. Since businesses in digital domain did not seem to occur in any physical location but instead takes place in the nebulous world of cyberspace, these new business models created new tax challenges. The EL introduced was chargeable at the rate of 6 per cent of the amount of consideration for specified services received or receivable (being advertising and other specified services) by a non-resident not having a Permanent Establishment (PE) in India, from a resident in India who carries out business or profession, or from a non-resident having PE in India.

The EL introduced in 2016 did not form a part of Income-tax Act, 1961 (the Act). While the manner in which EL was introduced in the statute has till date been argued by some to be

unconstitutional and at the same time, the fact that credit may not be allowed under the tax treaty for the EL paid in the source country goes against the basic premise of the BEPS Action Plan 1 options evaluated by OECD and makes it an additional cost to the business. To add to this, the fact that there was no credit mechanism, resulted in double taxation across jurisdictions, once when it is levied in the source country and second when it is denied as a credit in the country of residence since the payment was not covered under the relevant provisions of the tax treaty.

Taking further cues from the OECD's BEPS Action Pan 1, India introduced the provisions of a new nexus rule in the form of Significant Economic Presence (SEP) in the Act through the Finance Act, 2018. Though the objective was to cover the digitised businesses which did not require physical presence of itself or any agent in India, the manner in which the provisions were drafted, it seemed that the provisions also contemplated to cover the physical transactions within the ambit of SEP. It appears that, since there was no global consensus and with the ongoing discussions at OECD, India decided to defer the SEP provisions to be made applicable from AY 2022-23. The thresholds for the trigger of the SEP provisions, have now been notified. The threshold of INR 20 million for the payments made to non-residents and 0.3 million users for the trigger of SEP provisions seems to have been set on the lower side since it would normally apply to non-residents with a non-treaty jurisdiction as against a non-resident of a treaty jurisdiction who can take recourse to the beneficial tax treaty provisions unless and until an amendment is made to the tax treaty. Thus, the impact of the threshold applying only to non-residents with a non-treaty jurisdiction would have to be analysed. Further it would be interesting to see what consensus would be formed at the OECD-G20 platform.

Thereafter, Finance Act, 2020 expanded the scope of the EL by including within the ambit a levy of 2 per cent on the amount of consideration received/receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it. The introduction of the EL applicable to e-commerce transactions seemed to be a last-minute insertion as it did not find place in the original Bill and was only introduced through the amendments that were introduced subsequently in the Lok Sabha. There was no rationale discussed for introducing the levy of EL at the rate of 2 per cent.

It seems that the government, in a constant endeavour, has been introducing amendments to address the issue of taxation of digital transactions when it comes to protecting the country's tax base. The Finance Act, 2021 has made some more amendments in regard to the EL provisions introduced last year. The Finance Act, 2021 has now clarified that any income chargeable to tax as 'Royalty' or 'Fees for Technical Services' under the provisions of the Act read along with the tax treaty shall not be included for the purpose of determining the chargeability under EL provisions. This has provided clarity that the amount under consideration is to be examined under the Act read with tax treaty that whether the same would constitute 'Royalty' or Fees for Technical Services' as aforesaid, and if not, only then it may be considered for examining the chargeability under the EL provisions.

Another issue that was litigated for several years on the taxability of software has been finally put to rest by the Supreme Court in the case of *Engineering Analysis Centre of Excellence Private Limited v. CIT* , [TS-106-SC-2021] where the Supreme Court held that software payments do not constitute 'Royalty' under the relevant tax treaties.

In light of the above developments, there is a now a likely possibility that the software payments of the kind dealt in the case of Engineering Analysis Centre of Excellence Private

Limited would not get covered under the ambit of Royalty under the Act read with relevant tax treaty and therefore it would be interesting to see whether the tax officers will apply the provisions of new EL (2 per cent) on non-resident operators where the off-the shelf software is offered for sale on their platforms/websites by procuring them from the software developers.

While the EL provisions introduced by the Finance Act 2020 were made applicable on or after 1 April 2020, exemption from tax was provided from 1 April 2021, resulting in overlap which resulted in dual taxes on e-commerce transactions during the FY 2020-21. Though this anomaly has been addressed by the Finance Act, 2021 by making the exemption applicable with effect from 1 April 2020, one may have to analyse the impact of the transactions undertaken during the FY 2020-21 when there was a dual levy both under the EL as well as Royalty or Fees for Technical Services under the Act read along with the relevant tax treaty.

Let us take a look at some of the finer aspects of the EL provisions which may lead to an uncertain environment, The amendment to the term ‘online sale of goods’ and ‘online provision of services’ now seems to suggest that even if there is no simultaneous transfer of title to the property, it would still be construed to be an online sale of goods by an e-commerce operator. The manner in which the term ‘consideration received or receivable’ has been defined, it may seem to suggest that even in case of facilitation services, EL would apply on the entire consideration and not only on the commission component.

Further, in view of the scope of the facilitation services provided by the non-resident e-commerce operator, the fact that the supplier of the goods or the service provider is a non-resident or not should make a difference to the scheme of the EL levy as the consideration that is sought to be taxed is received by the non-resident e-commerce operator from the e-commerce supply or services to the specified persons. Similarly, EL should apply in case of supply/provision of service is made to a non-resident buyer provided he is covered under the specified circumstances. Even in case if the non-resident buyer has purchased goods or services by using an internet protocol address in India, EL should apply.

In the context of e-commerce operators using third party platforms such as Zoom, Skype, etc., the mere use or access to the platform belonging to the third party may not tantamount to the non-resident seller/service provider being regarded as operating or managing the platform for the purpose of bringing it under the ambit of EL provisions as they do not have the ability to operate or manage the platform which still rests with the owners of the platform. Moreover, the aforesaid platforms are means of communicating and transmitting data in general and the service provider in the instant case only avails the facility and does not necessarily provide any service so as to qualify as an e-commerce operator. Further, since the scope of ‘online supply of goods’ and ‘online supply of services’ is very widely defined, EL may apply even when one of the parts of the supply/ service value chain is via digital means.

Though India has come a long way since 2016 with the implementation of EL provisions and issues emanating therefrom, only time will tell whether the EL provisions have helped the domestic players in having a level playing field or whether the provisions have aggravated the situation by making the domestic players worse off than they earlier were. While we dealt with the EL related issues on the domestic tax front, there has been a surge of initiatives implemented by various countries across the world which we would be dealing with those in the follow-up to this article.

Click here to read Part II of the Article.