

Equalisation Levy Budget -2016

Date: 29th February, 2016.

Background:

Finance Minister has proposed Equalisation Levy (EL) through Finance Bill, 2016, Chapter VIII.

E-commerce companies like Face Book, Google, etc. are earning substantial revenues and some of them are avoiding Income-tax in the Country of Source (COS) as well as Country of Residence (COR). E-commerce business is growing at the fastest rate globally and no Government in the world can allow this business to go tax free.

It is now admitted by OECD and other concerned authorities that under the present rules of international taxation, E-commerce companies can escape taxation. The main reason is that - under the existing rules, COS can tax a non-resident providing E-commerce services only if the non-resident has a permanent establishment (PE) in the COS. And a PE is defined as a fixed place of business. E-commerce companies do not need PE in any COS. They can set up the companies in tax havens and avoid COR tax also. For the last few years, there was strong public criticism - in Britain and other European countries - of these companies escaping taxation. In the light of the American and European financial crisis, G20 countries asked OECD to come out with recommendations for necessary modifications in the existing rules so that E-commerce companies also can be taxed.

BEPS Action Report No. 1 on Digital Commerce has discussed these issues. It has not made any specific recommendation. However, it has given three different options. One of the options is Equalisation Levy. When a company resident in COS earns revenue from E-commerce business, that company has to pay indirect taxes as well as Income-tax. However, when a non-resident company provides E-commerce services, it escapes Income-tax. Equalisation Levy tries to make a level playing field for both - Resident & Non-Resident.

In India, CBDT appointed "E-commerce Committee" to study the subject and to recommend appropriate law for taxing NR E-commerce entities. Committee has given its report & Finance Minister has made proposal for Equalisation Levy to tax E-Commerce companies.

Finance Act Proposals:

1. Only Non-Resident earners:

Equalisation Levy is proposed to be **charged only on non-residents** of India. Its very purpose is to protect Indian Residents. Hence Indian E-commerce companies like Flipkart, Snap Deal etc. are not liable to

Equalisation Levy. If a company is non-resident today and it opens a subsidiary or a PE in India to provide E-commerce services in India; it will be liable to normal Indian Income-tax and it will escape Equalisation Levy.

2. **Only Services:**

Equalisation Levy is charged only for services. There is no such tax on goods sold through E-commerce. Simple reason is: Somehow, the rules of international taxation have distinguished goods and services. This weakness in the system continues at present. Finance Minister is not trying to remove a global weakness through his budget proposals. The impact is: Even after the budget is passed, if someone purchases goods on E-commerce platforms, he will not have to deduct EL at source.

3. **No Characterisation, No PE:**

EL is so designed that there is no characterisation issue. One does not have to determine whether it is a business income, royalty, or FTS or any other category of income. There is no need to determine Permanent Establishment or any other nexus to India. Simply because a non-resident earns **revenue from India** he is liable to Equalisation Levy.

4. **Independent Tax: No DTA:**

This is not Income-tax. Chapter VIII of Finance Bill does not become part of the Income-tax law. Like STT, it will remain a separate tax. Hence Double Tax avoidance Agreements are not applicable to EL.

5. **Compliance:**

5.1 Ideally, the responsibility to pay tax and file EL returns should be on the non-resident. However, enforcing these obligations on a non-resident requires a lot of ground work. Best method of ensuring compliance by Non-Residents who have no PE in India would be – to ask all banks, credit card companies and Payment Gateways to deduct EL before making the remittance abroad. However, at present, there is no mechanism under which EL can be deducted by credit card companies from payments made through credit cards. The E-Commerce Committee had a discussion with Reserve Bank of India. And RBI confirmed that at present, it will not be possible to impose TDS through credit cards. (Note: In this article, by the term “TDS” we mean Deduction of Equalisation Levy at Source.) In the circumstances, the only mechanism available to the Government of India was to recover the tax from the **Indian resident payer**.

This will mean: the burden of tax may fall on the Indian resident payer. The non-resident service provider may refuse to bear the cost of EL. There can be different situations. Large consumer goods companies - that advertise on media & net - have strong bargaining power. They can refuse to bear the cost. And any online company hosting the advertisement may have to bear the cost of EL for advertisements received from such strong companies. Very small payers – paying less than Rs. one lakh will not be

liable to deduct EL. Payers falling between the two categories, may have to suffer the burden of EL. Even these persons may have choices in some cases. If there is competition, they will go to an alternative where the payer does not have to suffer the EL. Hence the force of market competition may make the NR receiver to bear the cost of EL.

It may be noted that the present proposal is a **work-in-progress**. A lot of work needs to be done. Government in collaboration with Reserve Bank of India may work out a mechanism whereby any payment from an Indian resident to a non-resident can be separated if it is an E-commerce payment. Once this step is implemented, EL can be deducted by credit card companies, banks and all payment gateways. Until this is done, a compromise has to be accepted. This is what the Finance Bill proposes. The onus of compliance is on Resident Payers.

Under the Finance Bill proposal Indian resident payers will deduct EL at source and pay to the Government of India. Whole mechanism for charging of tax, payment of tax, filing of returns and assessments - all can be completed on internet. The tax deductor may not have to meet Income-tax department.

5.2. **Business:**

Only persons carrying on business or profession and making payment for specified services to non-resident E-commerce companies are liable for deducting EL at source and paying to Government of India. The payment mechanism is simple. From all the payments to a non-resident, tax may be deducted throughout a month. It has to be **paid** to the Government of India on or before 7th day of next succeeding month - Section 163.

This responsibility to deduct EL is cast upon - (i) Indian resident business entity; as well as (ii) a Non-resident's permanent establishment in India - if it is carrying on business in India and makes payments for specified services.

A return of EL needs to be filed after the end of the year on or before a date to be prescribed by EL rules.

If the Indian resident assessee does not pay tax to the Government of India, he will be liable to tax, interest and penalty under Chapter VIII of the Finance Act. He will also be liable to disallowance of expenditure from his business income under Section 40 (a) (ib).

5.3 **Non-resident - No compliance:**

At present, the **non-resident has no responsibility under the law**. He does not have to file any tax return nor pay anything. If a resident payer does not deduct EL at source and does not pay to the Government

of India, it does not mean that the non-resident receiver is then liable to pay the tax. This is also work-in-progress and needs to be improved.

6. Administration:

Equalisation Levy will be administered by the **Income-tax department**.

7. Scheme of the tax: Chapter VIII:

In a very small chapter all the provisions for charging of tax, scope of revenues liable to tax, collection machinery, assessment, penalty, prosecution and appeals – everything is provided. This chapter is an **independent & complete chapter by itself**.

7.1 Its connections with Income-tax Act are as under:

- (i) Words not defined in this chapter will take their meanings from Income-tax Act.
- (ii) If the Indian Resident does not deduct EL, the expenditure will not be available at a deduction under ITA Section 40 (a) (ib).
- (iii) Once a payment is chargeable to EL, it will be exempted ITA Section 10(50).
- (iv) Appeal & similar other provisions of ITA will apply to EL also. EL Section 175.

Except for these issues, the Income-tax Act concepts are not applicable to EL.

7.2 Listing of Sections:

Section 160 provides for the jurisdiction comparable to Section 1 of Indian Income-tax Act (ITA).

Section 161 provides for definitions.

Section 162 provides for the charge of tax (Section 4 of ITA), Scope of tax (Section 5 of ITA), and the assessee [Section 2 (7) of ITA].

Section 163 provides for TDS.

Section 164 provides for filing of annual return.

Section 165 provides for assessment.

Other sections are for interest, penalty, prosecution & appeals.

8. Home Consumer is exempt:

Millions of home consumers and small business consumers utilise internet services like Google, Face Book, What's App etc. Most of us do not make any payment to the service provider. Hence we are not liable to deduct any tax at source.

Assuming some home consumer makes payment for any specialised services, he will still not be liable to deduct any tax. This is specifically provided in the charging section - 162 (1) (i). This means that millions of consumers are not at all affected by EL.

Even for business payers, the TDS is applicable only if his payment for specified services to non-resident service provider exceeds Rs. 1,00,000 during a financial year. Section 162 (2) (b). Thus assessee making small payments are exempted from TDS compliance. One Non-Resident may receive - say Rs. 99,000 from ten Indian assesses. Still, he will not suffer any EL. Similarly, one resident may pay Rs. 99,000 to ten non-residents. He will not be liable to deduct EL. It may be noted that the NR E-commerce MNCs earn from Rs. 100 crores to Rs. 5,000 crores from India. For these target companies, the thresholds of Rs. 1,00,000 are so small that any manipulation by increasing the number of companies won't be worthwhile.

It may be noted that there are two way thresholds:

- (i) If the **non-resident** service provider receives less than Rs. 1 lakh, he is not liable to EL - section 162 (2) (b).
- (ii) If the **resident** payer is paying less than Rs. 1 lakh, he is not liable to deduct EL at source - Section 163 (1).

9. **No Double Taxation within India:**

Once a non-resident's income is chargeable to tax under chapter VIII of Finance Bill, 2016, it is exempted from Indian Income-tax under Section 10 (50). Thus, there will be no double taxation of the same income within India. It may be better for the non-resident to be covered under EL rather than under ITA.

10. **No Grossing Up:**

Under Indian Income-tax Act, Section 195 etc. provide for deduction of Income-tax at source from payments made to non-residents. There are cases when the non-resident insists that the tax should be borne by Indian resident. In such a situation, the Indian resident has to gross up the tax and suffer more. Section 195 A. For illustration, if the TDS rate is 10%, in this situation, Indian resident payer will have to suffer 11% tax.

Section 163 of Chapter VIII provides for deduction and payment of EL. Section 163 (3) provides that even if Indian resident payer does not deduct EL, he has to make payment of EL to Government of India. Thus, consider that the Indian resident has made a payment of Rs. 100 to the non-resident, he has not deducted any tax at source. He will simply pay Rs. 6 to the Government of India and close the chapter.

11. **Tax Rate:**

The rate of tax under EL is only 6%. This is much lower than the normal TDS rates of 10% to 15%. This is an attraction for the non-residents.

Instead of suffering a higher rate of tax under Income-tax, they can bear the EL and pay lower tax. Further, there will be no further controversy about characterisation of payment, determination of PE etc. The whole scheme will be simple in administration by the department and compliance by the assessee.

The lower rate compensates for the fact that most assesseees will not be able to claim **credit of EL** under the Double Tax Avoidance Agreements. They can of course claim the EL as an expenditure suffered by them but not the relief of full tax adjustments.

12. Specified Service:

Section 161 (h) defines specified service as – online advertisement, provision of digital advertising space etc. and includes **any other service as may be notified by the Government.**

It may be noted that E-commerce is a constantly developing business. There are so many technologies which together make it possible to do global business without PE in COS. Some of them can be listed as: computers, internet, television, mobile phones, satellites, cables, telephones; and a convergence of all these technologies. Each technology in the field of science keeps developing. Convergence of developing technologies provide a huge constantly changing mechanism for developing new businesses. Today traditional businesses conduct their business with new technologies. And completely new businesses are developing.

In this situation, defining anything as E-commerce would be incorrect. Today's definition in the law will require an amendment within a few years. Recognising this fact, OECD had earlier published its reports under the title – "E-commerce". Present BEPS action reports are calling the same business as "Digital Commerce". Sometime back E-commerce could be conducted only through computers. At that time, no one could imagine international business transacted through telephones. Today, international business through mobile phones has become a reality. It is eminently possible that in three years' time, there will be another way of doing international business which is not considered today.

Recognising these facts of modern life, the budget proposal defines the services as "Specified Service". This definition can always be expanded by the Government. Thus the law provides for flexibility in line with the kind of business proposed to be taxed.

On the whole, Finance Minister has made an efficient and simple proposal to tax giant MNC.

Author - CA Rashmin Sanghvi - Introduction:

Author is a practising chartered accountant from Mumbai. He was a member in both committees appointed by CBDT for E-commerce: the High Powered Committee of 1999-2000; and the E-commerce Committee of 2015-16.

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