



# Critical Areas of Response to the Imposition of Equalisation Levy on E- Commerce Operators Under Finance Act, 2020

Submission by The Dialogue

## INTRODUCTION

With more than half a billion internet subscribers, India is one of the largest and fastest-growing markets for digital consumers. As digital capabilities improve and connectivity becomes omnipresent, technology is poised to radically transform nearly every sector of India's economy. This in turn is likely to create significant economic value for India. India is one of the largest and fastest-growing markets for digital consumers, with 560 million internet subscribers in 2018, second only to China. Indian mobile data users consume 8.3 gigabits (GB) of data each month on average, compared with 5.5 GB for mobile users in China and somewhere in the range of 8.0 to 8.5 GB in South Korea, an advanced digital economy. Indians have 1.2 billion mobile phone subscriptions and downloaded more than 12 billion apps in 2018. A 2018 study by McKinsey suggests that by 2025, core digital sectors such as IT and business process management, digital communication services, and electronics manufacturing could double their GDP level to \$355 billion to \$435 billion. Newly digitising sectors, including agriculture, education, energy, financial services, healthcare, logistics, and retail, as well as government services and labour markets, could each create \$10 billion to \$150 billion of incremental economic value in 2025 as digital applications in these sectors help raise output, save costs and time, reduce fraud, and improve matching of demand and supply. It is also expected that knowledge intensive industries are to be more susceptible to accept the technologies, rather than asset based industries which have been slower to adopt these technologies. The rapid extent of digitalization of business models today has been one of the major drivers of growth and innovation, and is considered as one of the most important developments of the economy.

India is not far behind in this wave; it has tapped into the advantages of digitalization to boost its economy. It is now among the top countries globally on various

dimensions of digital adoption. The potential of application of technology in India is diverse. On one hand, India is attempting to close the gap between 'haves' and 'have nots', by providing basic services to all through technological interventions in a move to empower its citizens. At the same time India is also utilising emerging technologies in a bid to boost its economy. At present, India is the world's fastest growing e-commerce market. India's e-commerce sector has experienced exponential growth in the last decade, up from \$3.8 billion in 2009 to \$38 billion in 2017. The growth is expected to continue in the near and long term. The e-commerce market is expected to reach \$64 billion in 2020 and \$200 billion by 2026. Within a short period in the recent past, the significance of economic activities in the digital space has grown substantially, both globally and in India. The contribution of data flows to global GDP continues to increase and the size of the digital economy in India is expected to grow substantially in the near future. Vast opportunities by way of job creation, productivity improvement and enhanced consumer choices will result from these developments. However, for India to fully benefit from the opportunities, The Government of India has realised that it is important that their policy measures are contemporaneous with the underlying challenges of the digital ecosystem and are forward looking in nature.

The emergence of new technologies and its application in a variety of systems has also led to challenges with respect to regulation for many Governments, including India. Digital taxation has been among the most difficult to solve of these challenges. As digitization has been making its way into all sectors, the international community has recognised the need to address the tax challenges presented by digitalisation of the economy at a multilateral level. The Organisation for Economic Co-operation and Development ('OECD') has been working for several years to arrive at a consensus based solution for the digital economy. OECD, however, does not recommend any unilateral or short term measures by individual countries as a placeholder

mechanism while it develops a solution on the basis of international cooperation.

In 2016 however, India became the first, among very few countries, to have resorted to unilateral measures in the form of an equalisation levy on the import of online advertising services. India further expanded the scope of this levy in 2020, to apply to all e-commerce businesses not having a permanent establishment in India charged at 2% of the gross revenue.

The expanded equalisation levy casts a wide net of applicability. It covers online marketplaces, service providers of all kinds, retailers and manufacturers offering goods and services to India within its ambit. Though some other Nations have resorted to unilateral measures to introduce similar levies, the levy imposed by India is significantly broader. These expanded provisions also represent a fundamental shift in India's taxation system, as it taxes revenue based on the number of users of a digital service rather than taxing revenue based on activities performed in a particular jurisdiction. The provision also presents a low exemption threshold, in comparison to the 2016 legislation, by setting the threshold at roughly INR 20 Million, and therefore, is applicable to many non-Indian companies, even those with a relatively small number of Indian customers.

Another major concern with the imposition of the equalisation levy by the Indian Government, is that the levy is not in consonance with the BEPS suggestions of the OECD. The OECD has not recommended any unilateral or short-term tax measures, as such a move would undermine their efforts to develop a permanent solution for the issue at an international level, with consensus from all members. The OECD expects to reach a conclusion to its discussions at the end of 2020, a hasty measure in the interim would not bode well for India at an international level and could impact our trade relations negatively. Such measures may invite retaliatory trade sanctions against India for being discriminatory in nature against non-resident actors. Recently the US Government in a report on trade barriers, criticized the equalisation levy imposed by

India. As per the report, such a move represented a shift from internationally accepted principles that called for digital taxation regulations to be developed on a multilateral level, with consensus, to tackle the issue of double taxation.

Even at the national level, the expanded levy has received criticism. Stakeholders criticized the levy for being implemented with the complete lack of any form of stakeholder consultation or discussions with the industry bodies despite being a nuanced area of regulation. It was felt that there was a lack of clarity on critical aspects of the expanded provision, which will lead to implementation challenges. Coupled with a shortage of time to conform to the updated regulations many industries are struggling to comply with the levy in the prescribed time period.

In light of the ongoing global crisis owing to the COVID-19 outbreak, questions are also being raised regarding the timing of imposition of such tax reforms. At a time when industries are already being placed under immense duress and are facing challenges regarding business continuity along with various compliance difficulties. The imposition of this levy coupled with pre-existing concerns, would be a significant and far-reaching change for the industry to cope with and make requisite changes in due time. E-commerce companies are already working to adapt to new models put in place due to the global outbreak and aid both the public and private sector in coping with the dynamic shifts in existing models.

Thus, we at The Dialogue, recommend and request a rethink of the need for this levy to be further expanded in scope and recommend that the enforcement of the equalisation levy is deferred and fresh discussions are undertaken by the Government before any such decision regarding the implementation of these rules is taken. As a part of our official submission in this regard, we have enumerated the key issues we have identified with the provision implementing a 2% equalisation levy on all e-commerce service operators.

## ACTION POINTS AND RECOMMENDATIONS

1. The equalisation levy should be withdrawn owing to its impact on the small businesses, start-ups, consumers and the negative effect on the ease of doing business in India.
2. Due to the economic slowdown because of COVID-19, it is necessary that the government should ease the burden from the companies and relaxations should be given in the tax rates till the time the economy gets back on track.
3. India should honor its commitments towards the OECD's goal of achieving a multilateral consensus on such a critical issue. Any unilateral measure would undermine India's relationship with other countries as well showcases the lack of confidence in OECD's multilateral process.
4. An extensive and thorough public consultations process should be undertaken on the subject matter before any decisions are made on this issue. We recommend that a legal and economic analysis (cost-benefit analysis) is conducted by a special committee of experts before the policy is introduced once again.
5. There is a need to revisit the digital taxation system in India in order to ease the investment barriers and increase investments.

## Issue 1: Ambiguity in the Provision of the Finance Act enabling equalisation levy

Finance Act, 2020 (Act) has brought in a new form of equalisation levy for the digital ecosystem amid the worldwide economic slowdown. The provision imposes a 2% equalisation levy on all considerations received by an "e-commerce operator from e-commerce supply of goods or services" which does not have a permanent establishment in India. There are various issues with this provision right from ambiguity in its drafting to the definition of e-commerce operators as given in the Act itself. This ambiguity in the provisions have led to the confusion in the applicability of the provision. Following are some of the issues arising out of the provision:

### 1.1. Definition of E-commerce Operator and Online Services

Per the Act, an e-commerce operator means a non-resident who owns, operates or manages a digital or electronic facility or platform for online sale of goods or online provision of services or both.<sup>1</sup> The current definition of e-commerce operator is significantly wide which could cover many businesses who sell goods and services to Indian resident customers over the Internet such as retailers, manufacturers, banking or insurance companies, payment processing / payment facilitation companies, telecom, etc.

The broad scope of the rules as currently drafted results in the imposition of a tariff on all sales of goods

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<sup>1</sup> Section 165A, Finance Act 2020; Deloitte Tax Alert, 28th March 2020, Retrieved from:

<https://www2.deloitte.com/content/dam/Deloitte/in/Documents/tax/Global%20Business%20Tax%20Alert/in-tax-gbt-alert-equalisation-levy-on-e-commerce-supply-or-services-noexp.pdf>

by foreign business to Indian residents that take place over the internet. This current definition covers a broad array of service providers including several internet intermediaries such as banking and insurance companies, and even cloud service providers, It needs to be understood that all internet intermediaries cannot be considered as e-commerce platforms. The diversity of internet business precludes the one size fits all criteria that the government has opted for.

Further, the term online under section 164(f) of the Finance Act is defined as a “*facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.*” This term has again a wide application. It could even cover correspondences over mail, online purchase orders, etc. The wide ambit given to the term online would even include those sales where only the orders are placed online, but elements such as price negotiation, enquiry takes place offline. Due to this ambiguity it is likely that traditional brick and mortar businesses could also come under the definition if their sales processes are covered online.

The current definition of e-commerce operation also covers intra-company transactions including IT/ ITES services, management support services, support services etc. provided by foreign companies to its entity in India. Further, the definition also covers non-resident companies who are reselling their product through an Indian establishment. It is pertinent to note that Indian establishments already pay taxes on their income. The imposition of equalisation levy would act as an additional tax on the same income.

## 1.2. Dual imposition of Equalisation Levy

Companies which are involved in the business of digital advertising as well as e-commerce have to face the double brunt of the equalisation levy. The definition fails to take into account the overlapping businesses of a company. Entities which are providing a platform for advertisement as well as selling e-commerce might

have to pay a levy of 6% under section 165 as well as 2% under section 165A of the act. Even though the exclusions are provided in Section 165A of the amended provisions, it again is not clear whether the companies paying taxes under section 165 are completely excluded or are excluded for only those products for which digital advertisements have been shown. The provision excludes the following from their ambit:

1. where the e-commerce operator has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;
2. where the equalisation levy is leviable on online advertisement and related activities;
3. sales, turnover or gross receipts, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated is less than INR 20 million) during the financial year.

As it can be seen, the second exclusion does not specifically clear the above raised doubts. Per the current definition, a company that is involved in both digital advertising and provides digital services could receive a double whammy of paying 6% as well as 2% equalisation levy. The vaguely drafted exclusion provision does not make it clear as to whether the companies operating in both the sphere of digital advertising as well as e-commerce are excluded from the application of this act or only that e-commerce supplies and services are excluded for whom the company has shown digital advertisements.

Therefore, due to the lack of clarity in the provisions, certain companies might have to pay both the taxes i.e. 6% as well as 2% which would put them under added pressure. There is a need to clear the vagueness and ambiguities attached with this provision and make sure that the taxes are extracted from the intended entities without causing collateral damage.

## 1.3. Turnover Threshold

The current threshold for a company to pay equalisation levy has been kept at Rs. 20 Million (2 crores) on the sales, turnover or gross receipts of the e-commerce operator from the e-commerce supply or services. This low threshold will affect a large number of small businesses given that OECD discussion revolves around criteria of global turnover of EUR 750 Million. The current low threshold will create additional economic strain for small businesses who seek to provide goods and services to Indian customers by increasing their costs. These cost increases may require them to pass on the additional costs to their customers operating in India.

#### **1.4. Tax Base for e-commerce operators**

The new equalisation levy fails is ambiguous with regard to whether the levy would be applicable on the entire value of good/services sold or the fee that is levied by the e-commerce businesses because the nature of the e-commerce is such that they provide a platform where buyers and sellers meet. The purchase amount given by the buyer goes directly to the seller after deducting the fees of the platforms. Further, it also does not clarify whether such amount on which the levy would be applicable will be inclusive or exclusive of GST.

#### **1.5. Sale of Goods and Services between Non-residents based on IP address located in India**

Section 165(A)(1)(iii) of the Finance Act, 2020 also encompasses transactions by those customers who are non-residents but are merely using an internet protocol (IP) address located in India. Unlike GST, the current provision does not contain any criteria that needs to be satisfied to establish direct nexus with India. Art. 13 of the IGST Act, 2017 includes billing address of the customer, location of bank account etc

as preconditions. The new provision does not mention any of the conditions other than the IP address or that the customer is a resident of India. It is important that to exclude unintended transactions, this provision may be aligned with the current GST laws.

#### **1.6. Interplay of Equalisation levy with GST and TDS**

The imposition of equalisation levy also raises concerns over its interplay with the current GST norms. The new levy seems to be in addition to the GST which stands at 18% for the digital services. This will increase the cost burden for the entities who might transfer this additional burden to the consumers in this already stressed economy.

Further, section 194-O of the Finance Act also imposes TDS which the e-commerce operator is required to deduct for facilitating any sale of goods and services through an e-commerce participant. Firstly, this section will increase the compliance burden on such e-commerce operators who are not responsible for making a payment to the e-commerce participant. Secondly, there are various ambiguities with regard to its operation when a non-resident e-commerce operator is involved as the interplay between equalisation levy and TDS still raises several concerns that needs to be clarified.



## Issue 2: Need for Stakeholder Consultations

A pertinent issue with the imposition of the expanded equalisation levy provisions through the Finance Act, 2020 was the accelerated manner in which they were introduced and implemented. The expanded provisions did not form a part of the Hon'ble Finance Minister's speech on the Union Budget 2020 or the Finance Bill, 2020 that was introduced in the Lok Sabha on the 1st of February 2020. These provisions were inserted through the amended Finance Bill, 2020 that was introduced in the Lok Sabha on the 23rd of March, 2020, only days before the new provisions were required to be enforced. Notably, no consultations were held on the amendments with impacted stakeholders, despite these having far reaching consequences.

This particular amendment Bill was passed without debate and deliberation in both houses of the Parliament. This manner of introduction is in sharp contrast to the introduction of the equalisation levy, first done by the Government, through the Finance Act, 2016. An approach of due debate and deliberation was undertaken in that instance. Moreover, the imposition of equalisation levy could lead to double taxation and has the potential to affect the growth of the digital economy. The sudden imposition of the levy in late March, without any mention in the Union Budget speech by the Government had left the industry with barely any time to prepare themselves to accommodate such changes, especially in light of poor market conditions owing to the global outbreak of COVID-19.

The lack of knowledge regarding the functioning of online businesses, owing to their technical nature, has also come to surface in light of these provisions. Issues regarding the identification of relevant products and services that will be subject to the equalisation levy and

the promotion of understanding of the transactions that will be covered under this provision have cropped up since they were announced. As per the Finance Act 2020, the definition of the e-commerce operators covers a significantly large scope of businesses. Per this definition any such enterprise which is involved in the business of providing digital services falls within the scope of an e-commerce operator. With respect to the current provision on equalisation levy, there has been no clear distinction as to which operators fall within the scope of the provision. This is proving to be a major hurdle during implementation, which has already begun as of 1st April 2020.

The lack of any consultations being undertaken with stakeholders to understand the basis of such taxation, the implementation hazards of such a provision and the impact it is likely to have on the industry, are sharply being felt at the moment. Even the EU Commission undertook an impact assessment before recommending Corporate tax reforms to deal with significant digital presence as a basis. The industry is reeling with interpretation and implementation issues in the light of the imposition of the equalisation levy from the 1st of April, which has only been aggravated by the stress placed on the economy due to the global outbreak of COVID-19.

The Dialogue recommends that the Government reconsider and defer the imposition of such provisions. We urge the Government to undertake a thorough and extensive consultation process with stakeholders to consolidate the industry view. **The Dialogue recommends a collaborative discussion with stakeholders on the need for this levy. Revisiting and undertaking fresh deliberations on this issue would also provide the Government an opportunity to reconsider certain aspects in light of changing business models in the aftermath of a global pandemic and account for the adverse unintended consequences of this levy to small and medium businesses and Indian consumers.**

## Issue 3: Impact of Equalisation levy on Start-ups and SMEs

The equalisation levy imposed in the Finance Act, 2020 is seen as the tax for non-resident companies. However, the impact of this levy may likely be borne by Indian start-up and small businesses, who rely on a variety of cutting edge digital services to run their business. The wide definition given to e-commerce operators in the Finance Act, 2020 is the broadest framing of a unilateral tax = by any country. This definition encompasses all digital transactions involving goods and services sold by foreign companies to Indian residents as it does not limit itself with hard boundaries or specific activities.

While the levy aims to target only non-resident firms, this distinction may still end up affecting local SMEs, given the fact that resident SMEs often use international platforms and their services for back end operations and in order to reach customers within India as well. As the levy is of the nature of a tariff, foreign platforms may be incentivized to transfer costs onto the firms that list on their platform as they shall be unable to claim the cost themselves under an input tax credit. In fact, start-ups and small businesses might succumb to the burden of added costs given that their businesses are already suffering from COVID-19.

Moreover, it is more than likely that the levy borne by e-commerce operators under the definition of Finance Act, 2020 will be passed on to Indian consumers, including the SMEs, in the form of increased prices. This, again, at a time when many Indians are becoming jobless and cash-strapped due to the ongoing global economic crisis. According to the unemployment tracker survey released by the Centre for the Monitoring of Indian Economy (CMIE), the unemployment rate in India stood at 24% as of 12 April 2020, a steep rise from an unemployment rate that ranged between 7 and 8 per cent in the preceding year.

At this juncture, higher online retail prices will only hurt Indian consumers, many of whom have lost their jobs and are in dire straits, further retarding consumer spending in the Indian economy. Even before the impacts of the pandemic were felt, reporting by the Business Standard suggested that consumer spending had fallen for the first time in more than four decades. The veracity of such reporting is further boosted by the decision of the Ministry of Statistics and Programme Implementation to withhold the results of the Consumer Expenditure Survey done over the 2017-2018 period. Furthermore, the current levy hits digital businesses when they are to play a critical role of restoring distribution channels amidst the pandemic.

It arrives at a time when Indian firms are struggling with demand shocks and dwindling sales. Local firms need to seek new markets in order to survive. According to a report by the Indian Export Organisation, more than 15 million jobs could be lost in India's export sector. Cancellations and postponement of shipments have eroded packing credits and impacted exporters' fund-liquidity positions while cash flows have dried up. Taken together with the fact that India's export competitiveness has been on a declining path in the last decade, an additional levy targeting foreign businesses who export goods and services to India, would certainly undermine and sabotage the recovery efforts of smaller firms who are already being strangled by COVID-19.

The impact of the 2016 Equalisation Levy was borne by SMBs and Start-Ups whose costs went up by a whopping 40%, for a revenue collection of Rs 400 crore. The Dialogue therefore recommends that a thorough cost benefit analysis of the imposition of the Levy be conducted before further action on implementation is considered. This will ensure that the adverse unintended consequences of higher costs are not borne by smaller businesses and consumers, at a time when they are already under considerable strain.



## Issue 4: Geopolitical impact of imposing Equalisation Levy

The impact of imposing unilateral equalisation levy is not limited only to a specific country. It goes on to the very root of international trade relations. Unilateral measures by one country often result in a retaliatory or countermeasure from another country. In the era of globalisation, where the digital boundaries have long been crossed, taking unilateral measures is not a wise option. While OECD is working on building consensus among the countries to allocate taxing rights, such unilateral measures will undermine the authority of this organisation and the ultimate success of achieving a multilateral solution.

The new levy is likely to be counterproductive to the Indian government, if other countries also start imposing additional taxes on the services provided by Indian companies in foreign jurisdictions.

Currently, Digital trade in India enables ₹226 Thousand Crore economic impact within the domestic economy and we have the potential to reach ₹3,331 thousand Crore by 2030.<sup>2</sup> The current export value of virtual goods and services enabled by the digital economy is \$58 billion. If India's export market is supported by greater cross border data flow, it is estimated that the market could grow to \$197 Billion. If other countries pursue retaliatory measures, this growth could be heavily affected. In the time of pandemic, it could cause other countries to implement similar schemes which would ultimately affect India's digital export growth.

Further, we have already seen the US-China trade war which has caused significant damage to both the nations, and we cannot let that happen in our country. In recent times, trade between the US and India is

already going through a stressful period, so imposing extra taxes on the companies based in the US could further strain the relationships. US companies have already approached the United States Trade Representatives to raise strong concerns against the levy. If the Indian government does not take this equalisation levy back, it might open the route for the US to take countermeasures which India cannot afford right now.

Further, with India blocking a direct route for China's FDI investments, there is a need to seek greater investment opportunities in order to run the economy of the country, where China is a major source. Now with that investment being blocked for the near future, **we should keep our policies investment friendly and imposing an equalisation levy is not one of them. India needs to attract foreign investment and for that it needs investment friendly regulations and tax reforms is the need of the hour.**

## Issue 5: Impact of COVID-19 and greater cost of doing business

Businesses around the world are suffering because of the outbreak of COVID-19 pandemic. It is causing greater inconvenience as well as putting additional burdens on the company which are already working with half of their employees. These circumstances are extremely challenging and imposing an equalisation levy at this point of time does not send the right messages to the investors. Due to the limited capacity, the companies may not be able to scope and build the systems, IT Infrastructure and processes, mechanisms for tracking IP addresses and linking the revenue from customers, etc. from 1 April 2020 for complying with the applicable provisions resulting in unintentional defaults by stakeholders.

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<sup>2</sup> AIMAI, Henrich Foundation and Alpha Beta, *The Data Opportunity: The Promise of Digital Trade For*

India, Retrieved From  
[https://www.alphabeta.com/wp-content/uploads/2019/08/digitrade\\_india.pdf](https://www.alphabeta.com/wp-content/uploads/2019/08/digitrade_india.pdf)

While implementing the compatible mechanisms, significant amounts of hardship would be needed to identify the systems which are impacted across several countries. These impacted systems would range from marketplace, support services, upstream and downstream payment, financial reporting and billing systems etc. Identifying all these systems across countries would be a herculean task and would require workforce as well as dedicated time devoted to it.

It has to be borne in mind that the post-covid world would not be the same. Share prices of the companies around the world are already falling while revenues of these companies are taking immense hit as they are not able to function at their full capacity. Maximum efforts would be needed by the government and the private sector in order to restore normalcy. The drop in revenue is going to put additional cost burden on these companies which could result in layoffs and will contribute to the already existing unemployment. This unemployment will create a deficit in the purchasing power of the Indian customers as already is.

Due to these difficult times, it is necessary that the equalisation levy even if implemented be delayed. This pandemic has brought global recession along with it and companies have been losing all their money. The share prices of the majority of the companies have fallen tremendously making them vulnerable to foreign company's takeover. In these times, where the entities have to survive from going bankrupt and from falling prey to hostile takeovers, this equalisation levy is not appropriate.

Further, this will send wrong messages to the future and current investors that the government is not supporting the entities at this difficult time. It will create a negative sense in the company as to while they are trying their best to tackle the situation as well as helping the government with their state of the art technologies, the government is cutting them loose at this crucial time. By necessary implication this would mean that the government is cutting the legs on which they are standing on. Digital services companies are playing a crucial role in this COVID lockdown by enabling

delivery of essential items and providing cloud enabled video conferencing platforms for smooth business flow. These barriers should not be put up when digital services are needed the most than any other time. These services have been the key enabler of the successful operation of work from home and study from home concepts. Technology has been a key driver of the economy in these unprecedented times. However, putting additional burden on them would not help the cause. Instead, new investment opportunities should be looked into in order to earn revenue.

In order to revive the economy, it is important that purchasing power is improved for an average Indian as it is the only way to add tax revenue and close the fiscal deficit. In order to achieve it, business costs must be minimised in the post-covid world. There is a need for a liberal tax regime for a minimum of 2 years so that the companies could cover up the losses. **Therefore, it is important that equalisation levy should be quashed in order to ease the burden of the digital companies and if not, due time be given for its implementation.**

## Issue 6: Contrary to the commitments of OECD

OECD has been deliberating on this issue since they proposed the Base Erosion and Profit Sharing Action Paper in 2015. OECD has been leading multilateral efforts in this direction and has been working to build a consensus towards allocation of taxing rights in the international community. Any unilateral measure defeats the effort of OECD and will be against the very spirit of this multilateral process. The issue needs a greater consultation rather than seeking for a unilateral measure as it also jeopardises India's image at the international forum.

Currently, the core principles of international taxation heavily rely on the factors of physical presence and do not account for the technological advancements. In 2015, OECD acknowledged that the concept of taxing

the digital economy required a holistic evaluation of the principles of international taxation which required global consensus. India was one of the front runners in this initiative and has been helping OECD since then.

Though, the OECD's Action Report 2015 did not put forth any recommendations as such. The report enumerated certain actions that could be taken to tax the digital economy as an interim measure. It was at this time, India along with other countries took unilateral measures in 2016 wherein they imposed equalisation levy on revenue earned by the companies from the digital advertisements. At that time, other countries also took some measures in this regard as the deliberation by the OECD was still in the initial phases. While most of the countries that took unilateral measures kept the rates of taxes low, India put a 6% equalisation levy.

Now, again India has imposed an additional 2% of equalisation levy even though OECD have made significant developments in this regard and is about to come up with the recommendations this year. We can understand that the 6% equalisation levy was a dire need and it was OECD themselves that planted the seed for taking this measure. The current levy does not come under any of the above mentioned situations. While 138 countries have trusted OECD, India joins a small number of countries who have imposed taxation on e-commerce companies.

These unilateral measures taken by India are contrary to the very commitment and trust they showed towards OECD. These measures would put OECD in a situation where countries might not take their recommendations seriously and the trust in this organisation might erode. India is one such country upon which other South Asian countries look to for guidance. These measures would create a sense of distrust towards the efforts of OECD among the smaller South Asian nations and they could also start taking unilateral measures. **Therefore, it is necessary that India does not take any measures until OECD come up with their own recommendations and build an international consensus over the issue which would help**

**prevent any countermeasures, sense of distrust in OECD and will not impact the trade relations.**

## Issue 7: Losing out on economic opportunities

At present, India's unilateral measures are being criticised for being contrary to the principles of the OECD. However, the shortcomings of such a legislation are not limited to falling back on our international obligations. One of the major shortcomings of this legislation is its contribution to the loss of economic opportunities as a result of an unattractive tax provision such as the imposition of the equalisation levy on all e-commerce operators. Usually, taxation policies at a global level encourage competitiveness and cooperation among various nations, as oppose to taking a restrictive approach.

India's decision to implement expanded provisions with respect to the imposition of the equalisation levy on e-commerce operators across the board is being viewed in the same light. Many international companies have expressed their displeasure over the provision and the urgent manner in which it was implemented. The levy has been considered discriminatory in nature and its ambit has been criticised for being too wide.

However, one of the most poignant concerns regarding the levy has been how such a restrictive provision would serve as a deterrent for international investment or for international businesses to consider India as an attractive destination for the provision of their goods and services. The levy would impact even those players (e-commerce operators) that do not own any goods/services in India and conduct sales through a third party. It is expected to impact a large set of businesses and serve as a reason for such companies to refrain from investing in India. The expanded scope of the provisions, will lead to a significant number of foreign businesses being liable to pay the levy and existing businesses to resort to passing on the levy to the Indian consumer.

Over the recent past and especially now, in light of the global outbreak of COVID19, many businesses and governance systems in India are harnessing the opportunities provided by the internet. They have also been using capacities of non-Indian digital suppliers such as software providers, app stores, cloud services, infrastructure to name a few to derive benefits from international technology at competitive prices. These provisions may discourage such providers from reaching out and helping Indian entities for the fear of being susceptible to the revenue based taxation. Such a scenario would largely diminish the ability of a large number of Indian service providers to continue to deliver their services and goods to their customers, that comprise of MSMEs, students, social media users, etc at attractive costs. This could lead to the stifling of customer choice and place barriers on the growth of micro, small and medium enterprises (as mentioned earlier). At a time, when the world's reliance on tools such as cyber security, artificial intelligence, machine learning, translation, storage, etc to provide services, these provisions are depriving Indian entities of that opportunity and may force them to lag behind in comparison to their international counterparts.

Over the last few years, India's focus has been on improving its global ranking with respect to the ease of doing business. As per the rankings released by the World Bank in 2019, India moved ahead 14 positions to arrive at the 63<sup>rd</sup> rank among 190 nations. This success was largely attributed to sustained business reforms over the past several years. In the upcoming years, India is expected to continue to try and improve the environment on ease of doing business in the country. The Department for Promotion of Industry and Internal Trade (DPIIT), under the Ministry of Finance, is focusing on 11 criteria while preparing the ease of doing business report to be submitted to the World Bank. Among these, paying taxes is an important criterion. If India intends to meet its target of breaching the top 50 countries in terms of ease of doing business, it must focus on creating collaborative and competitive regulations that place obligations on foreign entities as opposed to restrictive provisions. At present, the focus

of the Government should be to increase the purchasing power of consumers, which will help augment both sectors – online and offline. It is not wise to restrict the e-commerce sector, especially during the economy's recovery period post COVID19 as the sector is expected to play a major role in revival of the economy and injection of finances during the extended phases of social distancing that are expected to follow easing of lockdown regulations.

## Conclusion

It is clear that at present, India is at the lift-off phase of digital adoption. New and emerging technologies are significantly enhancing and impacting processes in important sectors such as agriculture, education, healthcare and commerce. It is important that India continues to harness technologies to the best of its capabilities. Among such endeavours, digitalization has given the Indian economy a much needed boost in the past few years. It is imperative that the Government continue this momentum in order for it to achieve its target of a trillion dollar digital economy by the year 2026. In furtherance of this vision, E-Commerce and digital businesses have proved to be one of the biggest drivers of the digital economy and show immense potential for growth in the near future. At such a juncture, it is necessary that the Government tread carefully and ensure that policy decisions in this space are competitive at an international level and attractive to foreign investors while protecting our own strategic interests at the same time. Nuanced and informed policy making will ensure that we are able to tap the full potential of the digital economy.

The inherent ambiguity in the provision itself and its impact on start-ups and small businesses as well as on the geo-political relations with other countries demands that the imposition of equalisation levy is withdrawn. It is important that India honor its commitments given to the OECD and make any decisions only after there is an international consensus.

Additionally, in light of the COVID19 outbreak, economies worldwide will be taking a hit. It is imperative that at such a juncture Governments make an effort to cushion any blow that may be felt by sunshine sectors that have the potential to help in revival of the economy.

It is with such concerns in mind that, we at The Dialogue, make the following recommendations with respect to India's digital taxation policy and specifically

the imposition of an equalisation levy on all e-commerce businesses:

1. We request that the implementation of the said levy is deferred.
2. We request that an extensive and thorough public consultations process is undertaken on the subject matter before such a measure is considered by the Government. We recommend that a legal and economic analysis (cost-benefit analysis) is conducted by a special committee of experts before the policy is introduced once again.
3. We request you to honor the commitments given to the OECD and wait for an international consensus on this critical issue.
4. To revisit the taxation system for improving the ease of doing business in India.

## About The Dialogue

The Dialogue is an emerging public-policy think-tank with a vision to drive a progressive narrative in India's policy discourse. Founded in 2017, we believe in facilitating well-researched policy debates at various levels to help develop a more informed citizenry, on areas around technology and development issues.

Our aim is to enable a more coherent policy discourse in India backed by evidence and layered with the passion to transform India's growth, to help inform on public-policies, analyse the impact of governance and subsequently, develop robust solutions to tackle our challenges and capitalise on our opportunities.

To achieve our objectives, we deploy a multi-stakeholder approach and work with Government, academia, civil-society, industry and other important stakeholders.

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