



Equalisation Levy 2020

Virtual Stakeholder Consultation

September 9, 2020

INTRODUCTION

The Dialogue, a New Delhi based Think-Tank, held a virtual stakeholder consultation on ‘Equalisation Levy 2020’ on September 9, 2020. We hosted the following panelists:

- Mr. Mukesh Bhutani - Managing Partner, BMR Legal
- Mr. Meyya Nagappan - Leader, Digital Tax and Social Finance at Nishith Desai Associates
- Ms. Stella Joseph - Associate Partner, Economic Law Practices
- Mr. Aatman Shah - PA to the Hon’ble Minister of State of Finance and Corporate Affairs.

The Finance Act, 2020, brought multiple changes in the taxation regime of India. One such change was the insertion of section 165A in the Finance Act, 2016, which prescribes an equalisation levy at 2% on the non-resident e-commerce operators. The provision was inserted through an amendment just before the first Covid-19 induced lockdown and was not deliberated upon in the parliament. Further, this decision was taken without any consultation or deliberations with the industry, as a result of which the provision was filled with ambiguity and vagueness. Contributing to existing difficulties, the government has yet not come up with any clarifications or FAQs even after the date for payment of the first installment has crossed, leading to confusion and default in payments.



During the discussion, the panel attempts to decrypt this provision and evaluate its implication on the various companies, small businesses and geo-political relationships. The consultation was a step towards giving the government a food for thought with regard to the implications that a unilateral imposition of equalisation levy could have on the country and the present state of the economy.

Pursuant to the Chatham House Rules, the views and observations of the speakers have been summarised and not quoted. The discussion raised some extremely pertinent questions around the following themes:

1. Issues with the provision enabling Equalisation Levy

a. Equalisation Levy 2016 v. Equalisation Levy 2020

The first time equalisation levy was legislated in 2016 which was brought in pursuant to the committee that was set up by the Ministry of Finance. At that time the debate on digital taxation was in its initial phase at the international level and India was among the first countries to bring this levy which was subsequently brought by a number of other countries as well. However, what has happened now in 2020 is that the scope of this levy has been expanded significantly. 2016 levy was focused on three important elements i.e. applicable on B2B transactions, the responsibility for the levy was on the recipient of the services and not the provider and most importantly did not touch the consumers. On the contrary, the new levy not only imposes obligations on the non-resident but is also applicable on B2C transactions.

b. Lack of clarity on definition of the terms involved and the tax base

Panelists observed that various terms in this levy have been left undefined and have been invented. Some of the terms mentioned in this law have not been defined in such a manner as to even give a harmonious interpretation of law. For example - there is no definition given of the word “facilitating”. Without a concrete definition of this word it could even cover the order made on a mail. Similarly, the use of the term “managing digital and electronic facility” or



“advertisement which targets a customer resident in India” are also vague in nature. It is also not clear from the provision as to whether the levy is applicable on the gross amount of the product or the commission left with the e-commerce operator.

c. Issues with use of IP address

Panelists observed that there are technological challenges in locating the IP address. The bypass tools such as VPNs also fiddle with the enforcement of the law if it dwells on the IP registration in India because the same can be altered. The panelist observed that due to the sheer magnitude of transactions it is impossible for operators to track and tax. Therefore, it puts up a very tough challenge in front of the businesses.

d. Law does not have a dispute resolution mechanism

One of the panelists noted that this law does not have either a dispute resolution system or an appeal mechanism. One also cannot take an advanced ruling or refunds. Thus, it is important to observe if it complies to the fundamental Rule of Law itself.

e. Absence of clear target for the levy

The panelist observed that if the intention of the provision was to cover only e-commerce then the same should have been defined simply and precisely instead of allowing the definition to be open ended. For example, EU laws mention the exclusions in their definitions for greater clarity as there will be many transactions that will get caught in this web if left unresolved and not streamlined enough.

2. Constitutional Challenge to this Levy

The panelists noted that the present levy could also be unconstitutional owing to the lack of legislative competence, extra-territorial applicability of the provision as well as the

circumvention of the GST council in the provision. The panel observed that the provision in its present form seeks to impose levy on the transactions between two non-resident entities insofar as it targets the Indian customers. However, to the extent that it seeks to target transactions that originate and conclude wholly outside India would be beyond the powers of Art. 245 of Constitution of India.

Additionally, the original power to impose the levy was from entry 92C and 97 of the union list of the seventh schedule of the Constitution. However, 92C has been omitted after the 101st amendment and this type of levy is already covered under the Art. 246-A (powers of centre and state to make laws with respect to GST) of the Constitution of India under which OIDAR services are already taxed. Therefore, the legislative competence to make this law also seems misplaced now.

3. Geo-political Challenges

The world views India as amongst the highest tax rates applicable on digital taxation and even otherwise as well. This levy would also affect the frequency of cross border transactions. The panelist observed that the present law has not been drafted appropriately and is contradictory to the Pillar I of the BEPS framework. On the USTR front, compared to international tax law, under trade law, it applies on a de facto basis. So in effect, if countries that are disproportionately affected, they can claim damages. Therefore, India is technically at a disadvantaged position in this investigation.

Apart from the bilateral relationships, this provision also undermines the OECD framework in which India has immensely contributed. Countries imposing unilateral levy would undermine the previously understood global tax regime which could make a parallel system that will cause issues. One of the panelists observed that there is a lot of work that needs to be done and there is a need for a greater and more in depth understanding of how the digital models work. Thus OECD reports might take more time. Further, he also observed that enforcement of the pillar system internationally too is an issue and governments are on two ends of the spectrum in this



scenario. In his opinion, bilaterally negotiating it with the USA or any other country might be a better way to address the issue. We can retain the levy but solving the issue bilaterally would work towards a more rationalized view of taxation by looking inwards and not outward.

4. Impact on businesses and other sectors

One business that stands out in terms of performance, utility or its impact on the small and medium businesses in India is the digital businesses. The panelists observed that since this levy is also applicable on the B2C transactions, the companies might push the burden on to the consumers. This has previously happened with DST in EU countries. The panelist noted that there are many facets to digital businesses such as e-commerce, payments, intermediate in services, due to its broad nature. This levy might be applicable on all of them. In an already cash strapped economy, where the businesses are looking to reduce their operational costs by subscribing to these digital services such as external cloud storage, may get hit by this levy. The small businesses do not have the required capital to put these assets and therefore rely on these services.

Panelists observed that startups always try to minimize costs of their operation, therefore, they shift services to the digital space. Any increase in the taxation will have a cumulative effect on their ability to access the space given that this levy is in addition to the GST taxes which are already in place. The cumulative and cascading effect of GST as well as equalisation levy would cripple the small businesses. One of the panelists noted that in the case of the digital space, there are multiple small companies that facilitate the entire e-commerce system including people that shouldn't be taxed, therefore, they ought to have a framework agreement which is inclusive in nature and, given that it is a global issue, there is a need to have a multilateral agreement on this issue. This tax does not only have an affect on e-commerce but allied sectors as well. It can be applied as the pass through tax where the cost can be transferred to the end user. In that case, sectors which take any digital services from a non-resident company could come under the ambit of this levy.



One of the very pertinent questions raised during the discussion was whether the education sector will be affected by the implementation of equalisation levy. To this, panelists observed that under the current circumstances, if an education service is provided on an e-commerce platform then it will be covered. Owing to the lack of exclusions and FAQs, these services may also come under the purview of the levy. Therefore, in order to avoid such unintended inclusions, there is a need for clarity.

ACTION POINTS AND WAY FORWARD

- 1. Clarifications on the issue:** Panelists were in consensus that there is a need for clear clarification and FAQs on this issue. The government must release the clarifications so that unintended businesses or transactions do not come under the ambit of this levy.
- 2. Revisit the provision:** The panelists agreed that the provision is filled with ambiguity and vagueness. The terms used in the provision does not have clear definitions and as a result any kind of services could be covered under this levy.
- 3. Stakeholder Consultation:** The panelists observed that without a thorough deliberation with the industry and with the experts, this law should not be implemented. In its current form, this law requires stakeholder consultations in order to be more nuanced and target the services as intended
- 4. Wait for OECD deliberations to get over:** The panelists stressed upon the need for a multilateral consensus on the taxation issues. Unilateral tax measures would only create issues and undermine the OECD process.