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EQUALISATION LEVY 2020

THE NEED TO REVISIT INDIA'S NEW DIGITAL TAX

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EXECUTIVE SUMMARY

India's digital ecosystem is a critical component for the economy. However, it has often been stymied by imposing excessive tax burdens. The Finance Bill 2020 was an instance where the government came up with a last minute addition to impose an equalisation levy of 2% on the e-commerce operators. **The consequence of this last minute addition without having any stakeholder consultation was an ambiguous provision.** With no clarifications in place, companies who might not have intended to come under this provision may also end up paying the levy.

The rush in imposing the levy created several unaddressed gaps in the provision. *Firstly,* **the definition given to the term e-commerce operator is wide that it can include any business running online.** *Secondly,* the tax base **is not clear as to whether it is based on the gross value of the product or the ultimate commission e-commerce businesses receive.** This raises issues in determining the scope and quantum on which the 2020 equalisation levy applies.

Thirdly, **the provision does not take into accounts the impact of this levy on inter-group transactions and its interplay with Digital Services Tax (DST) where this could lead to double taxation**. *Fourthly,* levy based on IP address is challenging and may seem to cover use cases which are externalities.

Fifthly, **the law also may not be able to stand the test of constitutionality** owing to lack of legislative competence, extra territorial applicability and circumvention of GST Council. *Sixthly,* **the imposition of equalisation levy will come as an additional cost burden for the Indian start up ecosystem.** 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. 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.

Seventhly, **the imposition of this levy may also affect the trade relations of India with other countries.** With the United States already putting India in the list of countries they are investigating for adopting digital tax, this move could impact the bilateral relationship. This levy is also a concern because companies around the globe are working on half capacity and implementing a complex system to comply with this provision is going to take time. Announcing it on such short notice will only lead to implementational hazards.

Lastly and most importantly, with the ongoing **Organisation for Economic Cooperation and Development ("OECD") deliberations, India's Equalisation Levy must be re-visited.** It was always viewed as an interim measure but now **it may be seen as India moving away from OECD and multilateral process as a whole.** International tax is a matter between tax administrations and that is why OECD has been deliberating upon it for the last 5 years. It is important to reach a global consensus on this issue otherwise unilateral measures on tax would create trade imbalances on unprecedented levels.

Therefore, it is important to revisit the levy keeping in mind the impact on digital service providers and their consumers, its effect on the efforts of the government towards digitisation, impact on the MSMEs and subsequent cost overburden on them that too in these testing times when the global pandemic has severely impacted revenues of all the businesses and MSMEs and are facing a threat of closing down.

In addition to the equalisation levy, the government has also introduced an amendment in tax challan wherein the non-resident e-commerce operators are mandatorily required to quote PAN. This new addition has no statutory backing and does not provide enough time to comply with the provision in the midst of the pandemic and consequent lockdown.

Recommendations

1. Issue urgent clarifications on the issues in order to exclude unintended businesses and transactions out of the scope of this levy.
2. The equalisation levy should be deferred and reconsidered pursuant to a detailed stakeholder consultation, understanding its impact on the small businesses, startups, consumers and the negative effect on the ease of doing business in India.
3. Due to the economic slowdown because of COVID-19, it is necessary that the government ease the burden on companies and defer the new equalisation levy.
4. India should honour its commitment towards 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 as showcase a lack of confidence in OECD's multilateral process.
5. An extensive and thorough public consultation 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) should be conducted by a special committee of experts before the policy is introduced once again.

LIST OF ABBREVIATIONS

BEPS	Base Erosion Profit Shifting
DST	Digital Services Tax
EL	Equalisation Levy
EODB	Ease of Doing Business
GATT	General Agreement on Trade and Tariffs
GDP	Gross Domestic Product
GST	Goods and Services Tax
IP	Internet Protocol Address
MNC	Multi National Corporation
MSME	Micro, Small and Medium Enterprises
OECD	Organisation for Economic Cooperation and Development
OIDAR	Online Information Database Access and Retrieval Services
SEP	Significant Economic Presence
TFDE	Task Force on Digital Economy

[1] 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.

Growing digital economy

Growth in digital technologies are 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. 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 digitised sectors, including agriculture, education, energy, financial services, healthcare, logistics, retail, as well as government services and labour markets, could each create $10 billion to $150 billion of incremental economic value in 2025.[5] It is also expected that knowledge intensive industries are to be more susceptible to accept the technologies during this time. The rapid extent of digitalisation 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.

[5] FE Bureau (2019), *Digital Economy could Create 65 Million Jobs by 2025,* Financial Express, Retrieved from: https://www.financialexpress.com/opinion/digital-economy-could-create-up-to-65-million-jobs-by-2025/1539712/

Harnessing digital technologies in India

India has started tapping into the advantages of digitalisation 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 'have' and 'have nots', by providing basic services to all through technological interventions. At the same time India is also utilising emerging technologies in a bid to boost its economy.**

India's e-commerce capabilities

India is the one of the world's fastest growing e-commerce markets. 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 in India 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, it is important that the government's policy measures are contemporaneous with the underlying challenges of the digital ecosystem and are forward looking in nature.

Regulatory challenges with respect to taxation of digital transactions

The emergence of new technologies and its application in a variety of systems has 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 digitisation has been making its way across multiple sectors, the international community has recognised the need to address the tax challenges presented by digitisation of the economy at a multilateral level.** The 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.

Equalisation levy

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 to be charged at 2% of the gross revenue.

Challenges with the new levy

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 countries 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**, 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.

Geopolitical impact of the levy

Another major concern with the imposition of the equalisation levy is that **its levy is not in consonance with the Base Erosion Profit Shifting (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 by mid 2021, hence, a hasty measure in the interim might impact India's international standing and trade relations.

Even at the national level, the expanded levy has received criticism. Stakeholders criticised the levy for being implemented without any form of stakeholder consultation or discussions with the industry bodies despite being a nuanced area of regulation. **There was a consensus on the lack of clarity on critical aspects of the expanded provision, which may lead to implementation challenges**. Coupled with shortage of time to conform to the updated regulations, many industries are struggling to comply with the levy in the prescribed time period.

Need to reconsider the levy

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 along with pre-existing concerns would have a significant and far-reaching impact on 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 to aid both the public and private sector in coping with the dynamic shifts in existing models.**

[2] CHARTING THE LEGISLATIVE HISTORY OF THE EQUALISATION LEVY IN INDIA

The equalisation levy in India from June 1, 2016, is a presumptive tax on some specified services provided by non-residents in the digital sector. In 2016, India constituted a committee on taxation of e-commerce ("2016 Expert Committee") to examine tax issues arising from the digital economy. Post the committee's recommendations, the Government imposed a 6% equalisation levy on online advertisement revenue generated by foreign enterprises from Indian residents. Admittedly, equalisation levy was designed as a levy outside of the Income-tax Act, 1961, to best justify India's unilateral approach.

A new chapter VIII titled '***Equalisation Levy***' was inserted in the Finance Bill of 2016, which took effect from June 1, 2016, to provide for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment ('PE') in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

With the introduction of the equalisation levy, the government has been indirectly able to tax the global advertising companies. In 2018, India introduced a nexus-based taxation approach in the domestic tax law, deeming a Significant Economic Presence (SEP) for non-residents (to which appropriate income would be attributed) in certain scenarios.

These scenarios specified are payments made to a non-resident for goods, services or property, including download of data and software exceeding a prescribed threshold; or soliciting of business activities or interaction with a prescribed number of users using digital means. The relevant thresholds and the number of users are yet to be prescribed by the Indian tax administration.

There is a consensus in the country that a unilateral levy would only be a cost to business, require separate administrative intervention/compliance and make the taxation system more burdensome.

[2.1] Reason For Introduction of Equalisation Levy

In 2016, an expert committee was constituted wherein they recommended an equalisation levy to the tune of 6% to 8%. The committee emphasised on the lack of tax neutrality between the foreign companies and Indian companies which can be observed from the following excerpts:

"the asymmetry in tax burden faced by purely domestic and multi-national enterprises can have distortionary impact on the market competition and can adversely affect the development of purely domestic enterprises. The clear tax advantage faced by foreign enterprises over their Indian counterparts also creates strong incentives for Indian enterprises to either locate themselves in a low tax jurisdiction outside India or sell their businesses to such an enterprise." [6]

The committee further expressed their concern as to the applicability of the present set of rules relating to nexus and characterisation of income on taxing cross border digitised transactions. Additionally, the committee mentions that:

[6] Report of the Committee on Taxation of E-Commerce, "Proposal For Equalization Levy On Specified Transactions"; Retrieved From: https://incometaxindia.gov.in/News/Report-of-Committee-on-Taxation-of-e-Commerce-Feb-2016.pdf (Last Accessed: 15th July 2020)

"The continuing ambiguity related to nexus and characterisation of the payments have the potential of giving rise to tax disputes, particularly in countries like India, where the tax treaties allocate taxing rights to the source jurisdiction position of OECD, which does not prefer allocating taxing rights to source jurisdiction on royalty and fee for technical services payment and developing countries like India, which have tax treaties providing such rights to source jurisdictions are taken as an indication, it may be difficult, if not impossible, for the international community to arrive at a consensus on these issues, anytime soon. The resultant ambiguity, uncertainty and unpredictability can develop as a significant constraint for the expansion of digital economy in India. This makes an important case for finding a solution to all these issues, in the form of a simple, clear and predictable tax rule that unambiguously defines the tax liability of digital enterprises, thereby facilitating their business planning, reducing their tax risk and contingent liabilities, while also reducing compliance costs, disputes and administrative burden." [7]

The Levy was purportedly brought in as a reaction to the OECD BEPS recommendations, particularly in Action Plan 1.

[2.2] Salient Features

Equalisation Levy is a direct tax, which is withheld at the time of payment by the service recipient. The two conditions that needs to be met to be liable for equalisation levy:

- The payment should be made to a non-resident service provider;

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[7] *Id.*

- The annual payment made to one service provider exceeds Rs. 1,00,000/- in one financial year.

There are exemptions, though:

- If the non-resident providing the digital service has a permanent establishment in India and the service provided is effectively connected with that permanent establishment – (i.e.) if the service provider is a taxable Indian entity.
- If the payment for services is not for the purposes of carrying out a business or profession – (i.e.) advertising for personal reasons.

[2.3] Non Compliance With The Levy Rules (Section 170-172)

Non compliance with the levy rules may result in the following penalties:-

- Interest @1% for every month of part of the month for delayed payment of levy.
- Additionally, penalty of amount equivalent to equalisation levy for failure to deduct may be imposed.
- Penalty of Rs. 1,000 for every day, or amount of equalisation levy, whichever is lower, may be imposed in case of failure to pay the levy after deduction.
- Penalty of Rs.100 for each day may be imposed for failure to furnish statement until such failure continues.

The equalisation levy has been a very lucrative tax boost to the government's collection with a year on year growth rate at 59.2% in FY19.[8]

[8] Gireesh Chandra Prasad, *'Govt gets tax bonanza from online ads on Google, Facebook'*, LiveMint, September 8th, 2019 accessed at https://www.livemint.com/news/india/govt-gets-tax-bonanza-from-online-ads-on-google-facebook-1567962399431.html

[2.4] Pertinent Judicial Developments

a. **Yahoo India (P) Ltd vs DCIT[9]:** In 2011, the Mumbai bench of the Tribunal held the validity of payments made by the assessee to Yahoo Holdings for an advertisement of the Department of Tourism of India's website on its portal. In this case, the income was not taken under the definition of 'royalty' as defined by the Income Tax Act,1961, but rather taken as 'business profits' and due to Yahoo's non PE status, not chargeable to tax in India.

b. **ITO vs Pubmatic India (P) Ltd[10]:** Just like the Yahoo holdings case mentioned above, the Mumbai bench of the Tribunal ruled that remittance made to a US company towards purchase of advertisement space fell under Article 7 of India-USA DTAA and in absence of a PE of such company in India, income was not taxable in India. This same ruling has been used in cases such as the **Pinstorm Technologies (P) Ltd vs. ITO[11]** case and **eBay International AG vs. DDIT[12]**case.

c. **ITO vs. Right Florists[13]:** The assessee, a florist carrying out business in India, for the purpose of generating business used online advertisement services of Google Ireland and Yahoo USA, both of which didn't have Permanent establishments in the country. Placing reliance on the Mumbai Tribunal's order in the case of Yahoo India and Pinstorm Technologies, the Tribunal held that

[9] 140 TTJ 195
[10] 60 SOT 54
[11] (2012) 154 TTJ 173
[12] (2012) 151 TTJ 769
[13] 154 TTJ 142

payments made for online advertisement were not in the nature of *'royalty'* both under the Income tax Act and the relevant Double Tax Avoidance Treaty.

Attempts by the authorities to bring tax payments for online advertisers within the ambit of tax by applying the existing provisions of the Indian Income Tax Act and the Double Tax Treaty, were not successful before the Tax Tribunals.

It is also important to note that these are 'Pre-levy' imposition cases and are stated in this document to establish precedent.

[2.5] Criticisms Pertaining To The 2016 Levy

The 2016 Equalisation Levy was heavily criticised on various aspects as listed below:

a. The levy, being introduced outside the scope of the existing Income Tax law, raised questions as to the departure of the Indian State from maintaining the 'Centralised Mechanism' of India's tax regime.

b. A major issue pointed out by the Task Force on Digital Economy (TFDE), established by the Committee on fiscal affairs of the OECD, published a report where they categorically mentioned that most countries (including India) function on following Treaties over their domestic statutes (Income Tax Act, 1961, Section 90(2)) and the same becomes an issue where domestic law, as may be passed by the central government through notification, may not be in consonance with its international tax obligations under statues such as the General Agreement on Trade Tariffs (GATT).[14]

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[14] OECD, 'Addressing the Tax Challenges of the Digital Economy, Action 1-2015 Final Report', OECD/G20 base Erosion and profit shifting Project, OECD Publishing, August, 2015

Tax treaties signed between signatories to the Vienna Convention are governed by the interpretation principles enshrined in the Convention. While India is not a signatory to the Convention, however, on principles of fairness, these should be applied to Indian tax treaties also in good faith. Indian courts have consistently upheld treaty provisions. While Article 18 of the convention[15] provides that a state party to the convention must refrain from committing acts that defeat its purpose, Article 27[16] is more explicit in stating that a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty. All while being subject to Article 46 and its benefit of doubt to parties when they act in good faith 'objectively'.[17]

c. Government levies such as the equalisation levy are a unilateral mandate of countries. If countries decide to tax on a unilateral basis without any sort of co-ordination or agreement with the corresponding state, the same income may get taxed more than once. The state of residence would not be obliged to provide relief under the applicable tax treaty. Since it is not an income tax, if a non-resident company supplying the 'specified service' (which in this case were online advertisements) and paying equalisation levy is also paying income tax in its residence country, it will not be able to claim income tax credit for the equalisation levy paid and this will result in double taxation. It is also important to note that online advertising services are separately subject to service tax on a reverse charge basis which is to be collected and discharged by the Indian service recipient.

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[15] United Nations, V*ienna Convention on Law of Treaties,* May 23rd 1969, 1155 UNTS 331
[16] *Id.*
[17] Mukesh Butani, Sumeet Hemkar, '*Indian Equalisation Levy- Progressive or Regressive?',* Kluwer International Tax Blog, June 27th, 2016, accessed at http://kluwertaxblog.com/2016/06/27/indian-equalisation-levy-progressive-regressive/?doing_wp_cron=1591161039.9763250350952148437500

Additionally, certain digital activities were also covered under Online Information Database Access and Retrieval Services (OIDAR Service) which are taxed at 18% GST where the obligation is on Non Resident service providers facilitating B2C supplies to the Indian customers. The new levy will operate parallel to the OIDAR service and will increase the consumption cost. This will amount to increase in the cost of consumption by 1/5th of the basic cost of digital supplies.[18]

d. The final cost of the added 6% levy was also rumoured to be hurting the customer reliant on social media houses for advertisements more than the conglomerates it aims to tax. Due to the dependence of startups and other initiatives taking form and in nascent stages dependent on social media houses for outreach, the levy was predicted to hurt the consumers more as they would now have to pay spiked up prices alongside the taxes introduced by the GST bill and other existing taxes. A new startup or a business which does not have a significant share in the market needs advertising to reach to the consumers. The decisions regarding how much is to be invested for advertising and decisions for new business initiatives may be influenced as the cost of advertising will increase for the businesses. Hence, while the government may benefit from extra inflow in the form of tax revenue, Indian businesses, especially the startups and the MSMEs would be significantly impacted with an increase in their marketing cost.

[18] ASSOCHAM and BMR Legal; "Equalisation Levy 2.0: India's Digital Service Tax in Making", (2020) Last accessed: 18th July 2020.

[3] UNDERSTANDING BUSINESS MODELS IN THE EMERGING DIGITAL ECONOMY

Over the course of a decade, the digital ecosystem has seen the evolution of new business models which did not exist before. Due to the evolution of business, digital transactions have also evolved and have found themselves at every corner of services. Even though the current equalisation levy is proposed for e-commerce services, by extension of its definition all the below given services where a non-resident company is involved could come into its ambit.

Figure No. 1

Apart from the above mentioned specific services, there are certain business models that could be described in the digital ecosystem. Enterprises may define their business models based on factors such as method of value creation, their revenue stream etc. However, it is possible that a single enterprise may be involved in several different business models. For example, a company could be involved in e-commerce, digital advertising and social media and might have to face a dual brunt of equalisation levy.

This paper attempts to categorise business models in order to ensure targeted policy decision making and avoidance.

The business models could be categorised under six broad themes which are as follows:

[3.1] Online Marketplaces/E-commerce

Electronic commerce has been defined broadly by the OECD Working Party on Indicators for the Information Society as "the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or service do not have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organisations"[19]. E-commerce comprises within itself broad arrays of business models such as:

a. **Business to Business:** Majority of the businesses run on the transactions between two or more businesses with regard to goods and services. Business-to-business transactions are common in a process of a supply chain, as companies purchase components and products such as raw materials in order to use it in the manufacturing processes. In an e-commerce setup, business to business model functions have emerged as a major source of transaction.

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[19] OECD (2011), OECD Guide to Measuring the Information Society 2011, OECD Publishing, Paris. Retrieved From: https://www.oecd.org/sti/ieconomy/oecdguidetomeasuringtheinformationsociety2011.htm, *See Also*, OECD (2014), Addressing the Tax Challenges of the Digital Economy Action - 1,74, Retrieved From: https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1592545968&id=id&accname=guest&checksum=B48F5F1449C779435222548542F02C99

Services such as deployment, hosting, and management of packaged software from a central facility, outsourcing of support functions, content management services, for the facilitation of website content management and delivery could be considered as some of the examples of business models function on business to business transactions.

b. **Business to Consumer:** This model is the earliest form of business for the e-commerce companies. A business following a B2C business model sells goods or services to individuals outside the scope of businesses who require the product and are willing to pay consideration. It allows the customer to directly engage with the seller who will then deliver the product or services to the desired place.

c. **Consumer to Consumer:**_Consumer to consumer business has been rapidly evolving in the digital space. Businesses involved in Consumer to Consumer models act only as an intermediary helping the consumer to sell or rent their assets and facilitating the transactions.

[3.2] Online Advertising

With the majority of the consumer base shifted towards online space, online advertisement has emerged as a separate business model which uses the internet as a medium to target and deliver marketing messages to customers. As OECD puts it, "online advertising involves a number of players, including web publishers who agree to integrate advertisements into their online content in exchange for compensation, advertisers- who produce advertisements to be displayed in the web publisher's content and advertising network intermediaries who connect web publishers with advertisers seeking to reach an online audience”[20]. Internet advertisements have gained tremendous popularity making it the first area to be taxed by the majority of the countries.

[3.3] Payment Services

Businesses involved in facilitating payment between two consumers act as an intermediary between online purchasers and sellers, accepting payments from purchasers through a variety of payment methods, including credit card payments or bank-based payments like direct debit or real-time bank transfers, processing those payments, and depositing the funds to the seller’s account. Various businesses have now been involved in the payment facilitating process which has become a full-fledged business.

[3.4] Subscription Based Business Models

Subscription based model functions on the theme of recurring payments in exchange of goods or services at a regular interval. From music-streaming business models to subscription access to products such as online newspapers, video streaming sites, these business models are becoming increasingly prevalent in the B2C space.[21]

[3.5] Aggregators

Aggregator business model runs as a platform which is owned and managed through a software application and connects the customer and person providing the service which is required by the customer through an application.

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[20] *Id.*

[21] Organisation for Economic and Cooperation Development (May 2019), ‘Unpacking E-commerce Business Models, Trends and Policies’, Retrieved from: https://www.oecd.org/going-digital/unpacking-ecommerce.pdf, Last accessed January 10, 2020

[3.6] Participative Network Platforms

A participative networked platform acts as an intermediary and enables the users to collaborate and contribute to developing, extending, rating, commenting on and distributing user-created content.[22] A range of different distribution platforms have been created, including text-based collaboration formats such as blogs or wikis, group-based aggregation and social bookmarking sites, social networking sites, podcasting, and virtual worlds.[23] Social media platforms are the perfect example to explain this type of business.

This diverse nature of businesses often overlaps with each other and is affected by the policy decision making due to non-segregation or limited knowledge available to the policy makers. Even though a policy is made for a specific business model, the nature of internet business is so inter-linked that one policy affects all of them. Therefore, it is important to revisit the digital tax policies in order to address the larger issues around the digitisation. Given the homogenous nature of the models in the digital economy, it is important to ensure that the policies are not drafted in such a way that there is an overlap in terms of its implementation. It is the need of the hour to address the emerging tax issues in the digital ecosystem and have technology friendly policies in order to foster innovation and growth.

Further, it is pertinent to note here that work on tax and digitalisation has been a key aspect of the BEPS Project since its inception and it has been recognised that **it would**

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[22] OECD (2014), Addressing the Tax Challenges of the Digital Economy Action - 1,74, Retrieved From: https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1592545968&id=id&accname=guest&checksum=B48F5F1449C779435222548542F02C99

[23] *Id.*

be difficult to ring-fence the "digital economy" from the rest of the economy for tax purposes.[24] The report further mentions that **"**attempting to isolate the digital economy as a separate sector would inevitably require arbitrary lines to be drawn between what is digital and what is not."[25] In other words, the report argued that there was no such thing as a "digital economy", but rather that the economy itself had become digitalised and that this trend was likely to continue. In such an event, it will be very difficult to isolate the digital economy and the basic difference will also erode.

[24] OECD (2014), Addressing the Tax Challenges of the Digital Economy, Action 1 Deliverable. https://www.oecd-ilibrary.org/docserver/9789264218789-en.pdf?expires=1595391549&id=id&accname=guest&checksum=64A55102C27660314888 27F190B3D1D4
[25] *Id.*

[4] ANALYSIS OF THE EQUALISATION LEVY *VIS-A-VIS* THE FINANCE ACT, 2020

[4.1] Technical Analysis

Even though the central government has imposed an equalisation levy through the Finance Act, the provision seems vague and rushed through. The inherent ambiguity in the provision points towards the lack of discussion and deliberation over the matter. The law in its current form runs with various ambiguities with regard to its application. Before delving into the specific issues with regard to the provisions, it is important to go through the important definitions included in the Finance Act.

Firstly, **"e-commerce operator"** has been defined to mean "a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both"[26]. *Secondly,* **"e-commerce supply or service"** has been defined as:

1. Online sale of goods owned by the e-commerce operator;
2. Online provision of services provided by the e-commerce operator;
3. Online sale of goods or provision of services or both facilitated by the e-commerce operator;
4. Any combination of the above activities. [27]

Thirdly, the new **Section 165A of Income Tax Act** states that "there shall be charged an equalisation levy at the rate of 2% of the amount/ of consideration received or

[26] Section 194-O, Finance Act 2020, Retrieved from http://egazette.nic.in/WriteReadData/2020/218938.pdf
[27] Section 153(ii), Finance Act, 2020, Retrieved from http://egazette.nic.in/WriteReadData/2020/218938.pdf

receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it:

1. to a person resident in India; or
2. to a non-resident in the specified circumstances,
3. to a person who buys such goods or services or both using internet protocol address located in India"[28].

Fourthly, Finance Act provides that **even if the service receiver is a non-resident, equalisation levy is payable in India** under the following circumstances:

1. Sale of advertisement which targets a customer who is resident in India or a customer who accesses the advertisement through internet protocol address located in India; and
2. Sale of data collected from a person who is resident in India or from a person who uses an internet protocol address located in India.

Fifthly, the provision also carves out following **three exceptions** under which equalisation levy will not be applicable:

1. where the e-commerce operator making or providing or facilitating e-commerce supply or services 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 under section 165; or
3. sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or

[28] Section 153(iv), Finance Act 2020, Retrieved from http://egazette.nic.in/WriteReadData/2020/218938.pdf

facilitated as referred to in sub-section (1) is less than two crore rupees during the previous year.[29]

[4.1.1] Broad Scope

According to the definition mentioned above, an e-commerce operator is 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.[30] 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.

In the absence of any rules and regulations or clarity with regard to the functioning of this provision, it covers wide arrays of transactions that are not even related to e-commerce. The broad scope of the rules as currently drafted results in the imposition of a tariff on all sales of goods 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.

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[29] *Id.*
[30] 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

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 again has 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 lack of information around these critical issues has led to industry being clueless as to whether they come under this provision or not resulting in companies failing to pay the equalisation levy. It is pertinent to note here that a legislation which has been made in such a hurry cannot answer such an important question.

[4.1.2] Tax base and Consideration

The provision mentions that an equalisation levy will be charged on the consideration received by the e-commerce companies. However, it fails to acknowledge whether this consideration will be charged on the gross value of the product or on the ultimate commission received by the e-commerce service provider. The provision fails to take into account the fact that e-commerce acts as an intermediary or a marketplace where a buyer and seller exchange products upon paying the consideration. The money received by the e-commerce platform is not the whole gross value of the product but only the sum that is charged as a commission while the rest goes to the seller. Therefore, charging the levy on the gross value of the product seems unnecessary. For example, a customer pays Rs. 500/- for a product that s/he purchases on the e-commerce platform. The platform keeps Rs 10/- as the commission and pays the remaining Rs. 490/- to the seller. Therefore, ultimately the e-commerce platform is earning only Rs. 10/- on the product. However, the provision is unclear whether the tax would be applicable on Rs 500/- or Rs 10/-. If it is applicable on Rs. 500, it will lead to adverse implications for the business.

There are different practices for calculating the gross margin which varies from business to business. In certain business models, the e-commerce company retains its margin on the gross consideration from the customer before sending the balance to the sellers. In other models, the seller receives full consideration / receipts from customers through e-commerce operators and remunerates the margin service fees to the e-commerce entity. Under the current provisions, there is no clarity on the meaning of "consideration" which would be subject to the equalisation levy. An equalisation levy on the gross consideration for online marketplaces/ aggregators with very low margins would place immense burden on the cash flow position of these entities.

It cannot be emphasised enough that there is a need for clarification on various aspects. In the meantime, this provision cannot be imposed on the companies. As the base is unclear there is the possibility of double taxation if the platform needs to pay the equalisation levy on the full amount while the underlying seller is also required to pay the levy.

[4.1.3] 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.

As it can be seen from the exclusions provided above, the second exclusion does not specifically clear the above raised doubts. As 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.

[4.1.4] Effect on Inter-Company/Inter-Group Transactions

The current definitions of e-commerce operator, supply and services and the meaning given to the term “online” also covers inter-company transactions which might not originally be intended. Inter-group services such as IT/ITES services, management support services, support services etc. provided by foreign group companies to its group entity in India may also come under its ambit given the wide coverage of scope of equalisation levy.

[4.1.5] Interplay with DST - Leading to double taxation

Based on Equalisation Levy 2020

The implication of the difference in design of the tax levied by various jurisdictions, under the pretext of either DST or Equalisation levy is that they inadvertently tax the same chargeable income under two or more countries owing to the transaction being international in nature. Under the new levy, a non-resident e-commerce operator also has to pay the equalisation levy in case it facilitates a service to another non-resident if they are providing the specified service[31] targeted to an Indian resident. The implication of this provision is such that it is bound to impose double taxation on the same consideration under multiple jurisdictions. To illustrate: An Indian tourist visits Malaysia and an advertiser based in that country books an advertisement with a European e-commerce operator targeting the Indian tourists. Such an advertisement would come under the specified services mentioned in the Finance Act, 2020, which will be in addition to the tax that is being paid under the Malaysian DST by the same company on the same consideration.[32]

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[31] Specified service as the the Finance Act, 2020 here is:
(i) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and
(ii) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.';

[32] ASSOCHAM and BMR Legal; "Equalisation Levy 2.0: India's Digital Service Tax in Making", (2020) Last accessed: 18th July 2020.

Based on Equalisation Levy 2016

It is pertinent to note that few countries such as Austria, France and the UK charge DST based on the users in a particular jurisdiction. Considering that inadvertently India is levying Equalisation Levy based on users who are resident outside India on which other countries are levying DST, this could lead to double taxation under equalisation levy and DST, in addition to corporate tax paid in the country of residence of the online advertisement service provider. According to the table given below, in the third situation where the advertiser is from India and the target customer is in the UK, application of both Equalisation Levy and DST is leading to the situation of double taxation. Therefore, in such a situation where the target customer is not in India (i.e. in the third situation), Equalisation Levy should not be levied otherwise it may lead to double taxation.

Advertiser	Viewer/Target Customer	Application of Equalisation Levy	Application of DST
India	India	Yes @ 6%	No
United Kingdom	India	Yes @ 2%	No
India	United Kingdom	Yes @ 6%	Yes
United Kingdom	United Kingdom	No	Yes

Figure No. 2

[4.1.6] Transaction Based on IP Address

Section 165(A)(1)(iii) of the Finance Act, 2020, encompasses transactions by those customers who are non-residents but are merely using an internet protocol (IP) address located in India, which should not be the case. 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.

The new levy not only covers transactions with Indian residents but with any person who uses an Indian IP address. Tracking the IP addresses accurately could be a challenge due to the possibility of use of by-pass tools such as VPN, proxy sites, etc. by the users. Similar is the position with 'bots', which are difficult to track. The existence of Virtual Private Networks (VPNs) makes the process of enforcement and administration of equalisation levy significantly harder as VPNs have now become an integral part. The most recent Global Web Index identified that an average of twenty-six percent of internet users globally used a VPN in the past month (including 18% in Europe and North America and thirty 30% in the Asia-Pacific region).[33] India's share of VPN users out of their total internet users was 38% in 2017 which is the shared number 1 spot with Indonesia.[34]

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[33] Global Web Index, '*VPN Usage Around the World,*' 2018, https://blog.globalwebindex.com/chart-of-the-day/vpn-usage-2018/

[34] Global web Index, '*VPN Usage Around the World,*'Q2 2017 https://cdn2.hubspot.net/hubfs/304927/Downloads/VPN-Usage-Around-the-World-Infographic.pdf

Further, using IP address as the mode to track the facilitation of services would also include cases which should not be there. For example, a foreign traveller visiting India for a holiday may visit a foreign e-commerce website to buy a product to be delivered to his foreign home may also come under this levy.

Apart from implementational hardships, tracking IP addresses requires significant technical / workforce resources and planning for the purpose of building new systems or re-engineer existing systems. Any new systems the non-resident operators build will need to be integrated and tested to ensure that errors are minimised and the systems are correctly able to capture the relevant data needed for compliance. In the event clarifications are issued, the non-resident operators will need to revisit their systems to align them with the official guidance. Ultimately, the entire exercise could be a time-consuming process and unlikely to be achieved within a short compliance window.

In view of the above, a levy based on using an Indian IP address is not a workable solution and should not be a measure to determine its application. It would be more appropriate to look at the location of sales or information on sales, such as billing address, bank account or payment information rather than tracking the IP address. More importantly, it ensures that such measures apply to a real tax base grounded in fundamental tax principles like realisation and recognition of income.

Transactions Between Two Non-Resident Companies

The provision enabling the equalisation levy under the Finance Act, 2020, extends it applicability to a transaction between two non-residents in cases where the sale of advertisement is targeted towards a resident customer of India. However, the lack of clarity on the term "target" and "customer" creates ambiguity in this provision. It is pertinent to note here that transactions in the digital space happen non-linearly. A targeted advertisement by a non-resident to another non-resident may or may not lead to a sale to an Indian customer. The current framework, in the absence of any clarification, could also cover unintended situations which may not generate any revenue associated with advertiser's activities in India. For instance, a non-resident advertiser targeting customers in India may require that the advertisement be followed through purchase, rather than simply being viewed /clicked.

Similarly, there is no clarification as to how it will determine whether a person is 'resident' in India under the new levy. Will it be determined on the basis of existing tax rules that require de-minimis physical stay in India, and if the answer is yes, how will the e-commerce operator obtain and confirm such information. A similar challenge would also arise in the context of sale of data, while determining the residency of a person whose data is sold as per the new levy.

Further, as mentioned above, identifying location of the customer targeted by an advertiser can be based on a number of factors not controlled by the non-resident operators due to presence of VPNs, self-declared location may not be accurate etc. As such, the tax base should focus on actual realised income, rather than being associated with any particular activity that may very likely not generate any revenue associated with the advertiser's activities in India.

[4.1.7] Timeline for exemption under Section 10(50) of Income Tax Act

In the 2016 Equalisation Levy, Section 10(50) was introduced under the Income-Tax Act, 1961 ('IT Act') which exempted income arising from 'specified services' on which the

Equalisation Levy was applicable. This exemption was applicable from the date of implementation of the EL. However, the expanded scope of equalisation levy in 2020 provides for that exemption to be started from the first day of April 2021 rather than the first day of April 2020.

Therefore, owing to this provision, the implication is that the transaction of the company will be charged with Equalisation Levy **at the rate of 2%** and additionally liable for income-tax under the provisions of the IT Act for the Financial Year 2020-21 which will amount to double taxation for the FY 2020-21. This could have a significant bearing on the applicability of withholding tax on payments/credits due from April 2020 itself and taxpayers could end up facing both withholding taxes as well as Equalisation Levy on the same transaction in the absence of any clarifications.

[4.2] Analysing the Constitutional Validity of Equalisation Levy

[4.2.1] Legislative Competence

It has been made clear that Equalisation Levy is not the tax on income but a tax on gross amount of transaction or payments made for the digital services.[35] Per the report committee on taxation of e-commerce, the union government derives the power to impose this levy from entry 92C and 97 of the List I of the seventh schedule of the Constitution of India.[36] However, it is pertinent to note that entry 92C has never been

[35] Report of the Committee on Taxation of E-commerce, CBDT, Retrieved From: https://irp-cdn.multiscreensite.com/a521d626/files/uploaded/Report-of-Committee-on-Taxation-of-e-Commerce-Feb-2016.pdf

[36] *Id.*

notified and was later omitted by The Constitution (One Hundred and First Amendment) Act, 2016.[37]

Further, this levy is already covered under article 246-A which deals with the power of the central government to make laws with respect to the Good and Services Tax (GST) and such digital services are taxed under OIDAR services. Therefore, the parliament cannot derive the power from entry 97 as well which talks about the residuary powers as there is a specific law that covers the taxation power.

[4.2.2] Circumventing the GST Council

Even though Article 246-A gives power to the parliament to make GST laws for exported and imported goods/services, as per article 246-A(2) it is subject to the checks and balances of the GST council. This process was completely circumvented due to the fact that the levy was enacted through the Finance Act. Considering that the provision from which powers were derived do not stand, there is a need for due process to be followed.

Further, it is also pertinent to note that the share of Equalisation levy will not be shared with the states as is the case with GST. The states are represented in the GST council which have been circumvented and the states have been devoid of their constitutional rights to express their opinion on this levy.

[37] The Constitution (One Hundred and First Amendment) Act, 2016, Retrieved From: http://legislative.gov.in/sites/default/files/Cons.amend%20101-060717.pdf

[4.2.3] Extra-territoriality

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. In the case of GVK Industries v. Union of India, it has been held that extra territorial application of a law will only be valid if the said Act has an impact or nexus with India. 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.

[4.3] Implementation And Administrative Challenges

[4.3.1] Lack Of Stakeholder Consultations And Limited Time Frame For Implementation

The Finance Act, 2020, that introduced the expanded equalisation levy provisions, was both introduced and passed in an accelerated manner in the Parliament. **The Hon'ble Finance Minister's speech on the Union Budget 2020-21[38] that took place on February 1, 2020 or the original Finance Bill 2020 that was introduced in Parliament on that day contained no mention of such a provision with respect to e-commerce operators**. This expanded levy was introduced during the last week of the Parliamentary session, before the nation went into lockdown owing to the COVID19 pandemic, as a part of a series of amendments to the Finance Bill, 2020.

The lack of debate and deliberation in both houses of the Parliament with regards to the imposition of such a levy and its possible impact were likely a consequence of circumstances owing to the COVID19 pandemic, but what is alarming is the lack of

[38] Union Budget Speech 2020-21, Ministry of Finance, https://www.indiabudget.gov.in/doc/Budget_Speech.pdf

public or stakeholder consultation undertaken by the Government. **The approach taken by Government differs from that taken during the imposition of the levy in the year 2016, they had then acted based on the recommendations of a committee of the Income Tax Department that was studying the topic of e-commerce taxation[39].** Contrary to the intention behind it, the nature of this decision deprived businesses of the chance to prepare for the application of these provisions, especially in light of the prevalent market conditions.

Aside from the hurried approach to legislating with regards to expanding the scope, the lack of any consultations being undertaken with stakeholders to understand the basis of such taxation, the implementational hazards of such a provision and the impact it is likely to have on the industry, are sharply being felt at the moment. As per the Finance Act 2020, the definition of the e-commerce operators covers a significantly large scope of businesses. As 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 April 1, 2020. [40]

Nine associations representing global MNCs and startups, including the US-India Business Council, DigitalEurope and Japan Electronics and Information Technology

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[39] Nair Ramya, "*More Digital transactions may come under equalisation levy's ambit*", 30th March 2016, LiveMint, https://www.livemint.com/Politics/zDvUWWLeBVxsIbvSd60WXO/Ambit-of-equalization-levy-likely-to-cover-more-digital-tran.html

[40] Bhalla Kriti, "*Ecommerce Firms, Global Tech Giants Recommend Changes In India's Digital Tax*", 5th May 2020, Inc42.com
https://inc42.com/buzz/ecommerce-firms-global-tech-giants-recommend-changes-in-indias-digital-tax/

Industries Association **have sought a delay with the Ministry of Finance with respect to the implementation of the levy along with appeals to ensure formal consultations with stakeholders regarding the expansion of the scope of the levy.**[41]

It is imperative that stakeholder consultations are undertaken while envisioning policy for matters as nuanced as this wherein there are so many vexatious issues that need to be taken into account. The EU Commission undertook an impact assessment before dealing with taxation reforms that defined and regulated taxation on the basis of significant digital presence as a basis.[42]

A collaborative effort with stakeholders before formalising guidelines in this regard would largely help ease the implementational hazards that are arising as a consequence of its hasty implementation. By revisiting and undertaking fresh deliberations on this issue would also provide the Government with an opportunity to reconsider certain aspects in light of changing business models in the aftermath of a global pandemic as well. **In light of present events, it is ideal for the Government to undertake a thorough and extensive consultation process with stakeholders to consolidate the industry view on this matter after deferring the implementation of the said provision to a later date to enable the process.**

[41] Aulakh Gulveen, "*Global MNCs and startups seek delay of equalisation levy*", April 30 2020, ET Rise https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/global-mncs-and-startups-seek-delay-of-equalisation-levy/articleshow/75446524.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst

[42] Butani Mukesh, "*Expansion of equalisation levy - why its not well timed*". March 30th 2020, Financial Express, https://www.financialexpress.com/industry/expansion-of-equalisation-levy-why-its-not-well-timed/1912985/

[4.3.2] Impact of the COVID-19 Pandemic

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 and an equalisation levy at this point of time does not send the right message to the investors. Due to the limited capacity, the companies may not be able to cope and build the systems, IT Infrastructure and processes, mechanisms for tracking Internet Protocol (IP) addresses and linking the revenue from customers, etc. from April 1, 2020, for complying with the applicable provisions resulting in unintentional defaults by stakeholders.

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, seller support, 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.

Further, adding to the foes of the levy, the tax challan had also been amended on July 3, 2020, where it was made mandatory for the non-resident e-commerce operators to quote PAN. It is pertinent to note here that such obligation is without any statutory rules and comes at a time when the whole nation is under lockdown and working at minimum capacity. Giving one business day to process the PAN card is not enough. Obtaining PAN for a non-resident is a time-consuming process, since documents required for PAN need to be apostilled or notarised by the respective overseas Indian

Embassies. This entire process is creating hindrance for the non-resident companies to survive in India which will be recorded in India's Ease of Doing Business (EODB) rankings.

It has to be borne in mind that the post-covid-19 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.

[5] IMPLICATIONS OF THE EQUALISATION LEVY ON THE E-COMMERCE AND THE STARTUP ECOSYSTEM

In recent years, the e-commerce ecosystem has blossomed and contributed largely to the e-commerce economy. **The Indian e-commerce industry has been on an upward growth trajectory and is expected to surpass the US to become the second largest e-commerce market in the world by 2034.**[43] Technology enabled innovations like digital payments, hyper-local logistics, analytics driven customer engagement and digital advertisements will likely support the growth in the sector.[44]

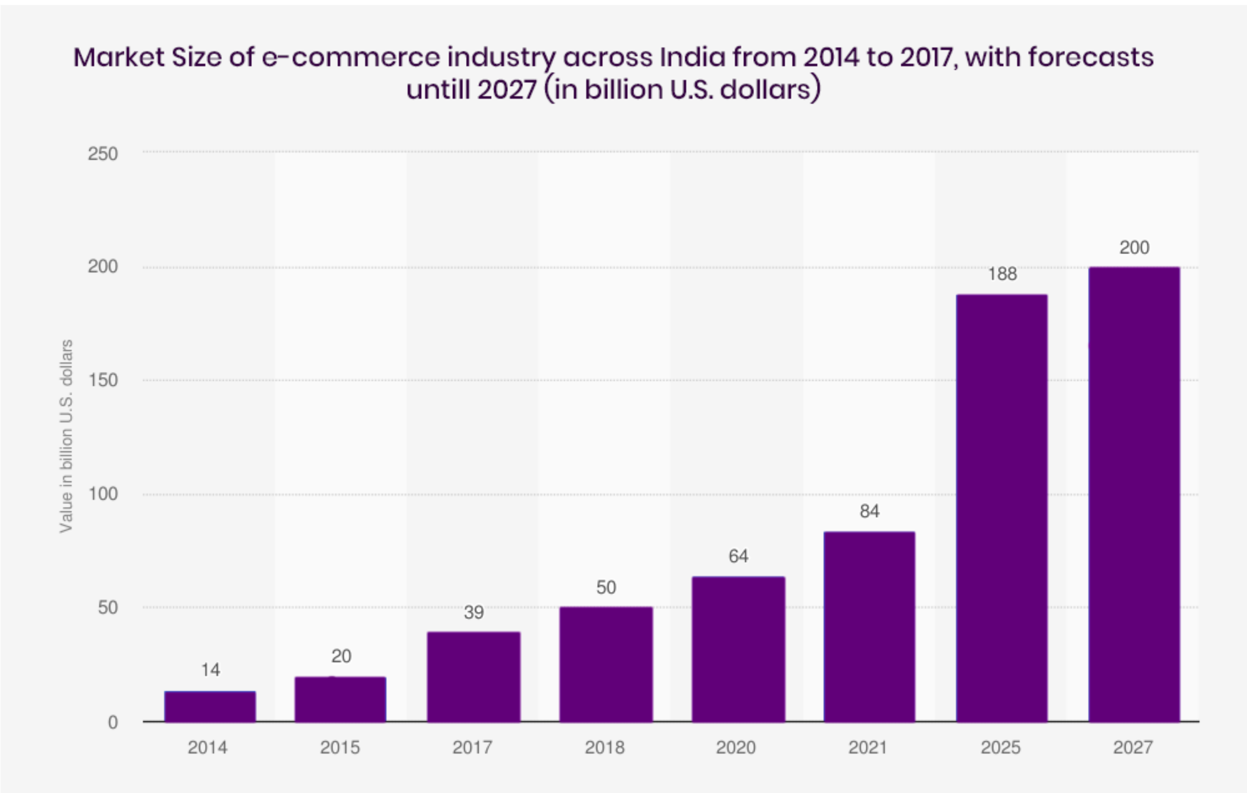

Figure No. 3[45]

[43] E-Commerce Industry in India, India Brand Equity Foundation, https://www.ibef.org/industry/ecommerce.aspx
[44] *Id.*
[45] Market size of e-commerce industry across India from 2014 to 2017, with forecasts until 2027, Statista, Retrieved from: https://www.statista.com/statistics/792047/india-e-commerce-market-size/

The e-commerce industry is intertwined with the MSME in India in a myriad of ways and they directly complement each other. **The impact of regulations on the e-commerce industry also affects the growth and future of the MSME sector, of which startups play a major role in India at present.** Evidenced through its huge potential for economic growth since the era of liberalisation and enhanced by a flourishing e-commerce market, India is proving to the world that it is a major destination for startup incubation. There are many Indian startups in the e-commerce industry that are proof of such potential such as FlipKart, BigBasket, Dunzo, PayTm, MyUpchaar, Delhivery to name a few. A major shortcoming of this legislation would be its contribution to the potential loss of economic opportunities in the startup ecosystem.

As a result of the imposition of the equalisation levy on all e-commerce operators, we are creating an unattractive taxation provision that may prove to be an impediment to this sector. Usually, taxation policies at a global level encourage competitiveness and cooperation among various nations, as opposed 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, as a more restrictive than collaborative move. **The levy has been criticised on many accounts, as illustrated in this paper, however, one of the most poignant concerns regarding the levy has been how it 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 broad and vague scope of the levy, with no directive guidance from the Government regarding the interpretation of e-commerce with respect to this provision further adds to the issue.

Such a concern is alarming for the Indian economy, especially in light of the coronavirus pandemic. **Especially the startup ecosystem, that is struggling with revenue declines in light of the pandemic, will be subjected to a second blow.** The numbers in the sector at present are disheartening with around 62% of all startups reporting a revenue decline of 40%, while 34% startups are reporting a revenue decline of more than 80%.[46]A recent survey by Praxis Global Alliance concluded that 37% of the Indian startup CEOs interviewed only had 6 to 12 months of cash reserves left in their bank. [47] **Such declines, coupled with a curb on investments from China, would be hard-hitting on the startup ecosystem, thereby stressing on the need to ensure that no further burden is placed on the ecosystem by virtue of imposition of the equalisation levy.**

At present, many business in India are harnessing opportunities provided by the internet, truly bringing the e-commerce ecosystem and its importance to the forefront of matters. Now and over the recent past, they have also begun 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. **The implementation of such an expanded equalisation levy, that**

[46] Mahima Kapoor, Azman Usmai, Startup Street: State Of India's Startups Amid Covid-Hit Economy, Bloomber Quint, May 24, 2020, Retrieved From: https://www.bloombergquint.com/business/startup-street-state-of-indias-startups-amid-covid-hit-economy
[47]Sandeep Singh, COVID-19 Impact on the Indian Startups: Threat and Opportunities, Inc42, April 30, 2020, Retrieved From: https://inc42.com/datalab/covid-19-impact-on-the-indian-startups-threats-and-opportunities/

impacts the ecosystem, may discourage such providers from reaching out and helping Indian entities for the fear of being susceptible to the revenue based taxation. The resulting 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 would eventually lead to the stifling of customer choice and place barriers on the growth of MSMEs. **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.**

[6] GLOBAL TRADE IMPACT OF IMPOSING UNILATERAL 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. The OECD has made significant efforts and is not far from reaching a global consensus.

Currently, Digital trade in India enables Rs. 226 Thousand Crore economic impact within the domestic economy and we have the potential to reach Rs. 3,331 Thousand Crore by 2030.[48] 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.

[48] 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

[6.1] Ongoing OECD Deliberations

On January 31, 2020, the OECD/G20 Inclusive Framework on Base Erosion Profit Sharing published a statement in which it affirmed its support for the OECD's two-pillar approach to dealing with the challenges arising from the digitalisation of the economy. It endorsed the 'Unified approach' set out in Pillar One as the basis for the negotiations of a consensus-based solution to be agreed in 2020, and welcomed the progress made on Pillar Two. The proposal has 137 member countries, endorsing its "Pillar One" approach to taxing the digital economy and approved an architecture for finalising the Pillar One principles by the end of 2020.[49]

While much work remains, the Inclusive Framework on BEPS members (IF) endorsement of high-level Pillar One principles was a significant accomplishment, considering that this approach promises the most extensive changes to the international tax system in a century. While the same isn't without its own set of issues, it is imperative we understand the proposed Pillar system:

[6.1.1] Pillar One: Taxation of the digital economy a 'Unified Approach'

The Unified Approach would give countries the right to tax profits of international businesses (regardless of whether they have a base in the country or not) based on calculating up to three separate pots of profit. This moves away from the long established principle of "profit where the business has physical presence" which has been the cornerstone of the international framework, and represents arguably the most significant change in the international tax architecture in 100 years.

[49] Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy (January 2020), www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf.

[6.1.2] Pillar Two: Global Anti-Base Erosion (GloBE) Proposals

The Pillar Two proposals are designed to counter profit-shifting by multinationals who are subject to low or zero taxation. This is particularly an issue with intangibles but is also seen more broadly in entities that generate profits from intra-group financing.

With OECD months away from coming out with their report, the imposition of an additional 2% of equalisation levy will act as a barrier and an egotistic move in the already bad phase for the global economy. 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.

[6.2] Challenges of Taking Unilateral Measures

While the sheer size of the Indian market may convince conglomerates to pay these taxes, other relatively smaller companies will not be able to survive in the longer run thereby, over a period of time, giving a state assisted monopoly to the biggest company to the detriment of other players. A conclusion that cannot be stopped even by the 'non-resident' clause of the Indian law. Thus, unilateral approaches to tax Tech Multinationals (MNEs) need to be converted to a multilateral approach.

Some of the pertinent issues with a Unilateral imposition of levy is that first and foremost, it requires burdensome compliance because it will require MNEs subject to equalisation levy to design and implement new systems to track user activity by IP address (as given in the current provision) and/or to develop alternative ways to identify the geolocation of end users based on the requirement of the country.

Further, As mentioned earlier, equalisation levy may have a disproportionate impact on high-investment and low-margin businesses, and thus run contrary to the governments' policy aims to provide for growth-friendly tax rules. Equalisation Levy is likely to result in significant double taxation of income already subject to corporate income tax in other jurisdictions. As purely unilateral domestic measures, disputes regarding the imposition of equalisation levy, including their double-tax effect, are likely to be outside the scope of both the Mutual Agreement Procedure of existing treaties as well as the dispute resolution provisions of any MLI that may be implemented as a result of Pillar One thereby restricting MNEs to domestic legal recourse only.

As was the case in the implementation of the 2016 Equalisation levy, the cost to the MNEs may be passed onto the consumer.[50]

[50] Jason Osborn, Michael Lebovitz, and Astrid Pieron, *'Unilateral Taxation of the Digital Economy - The fight is not over yet—it's only beginning'* Tax executive, May 12, 2020 available at https://taxexecutive.org/unilateral-taxation-of-the-digital-economy/

[7] CONCLUSION AND RECOMMENDATIONS

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 proven 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 deferred. 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 in this whitepaper with respect to India's digital taxation policy and specifically the imposition of an equalisation levy on all e-commerce businesses.

- **a.** We advise that the implementation of the said levy is deferred.
- **b.** We recommend 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.
- **c.** We advise that the Government honor the commitments given to the OECD and wait for an international consensus on this critical issue.
- **d.** We recommend revisiting the taxation system for improving the ease of doing business in India.