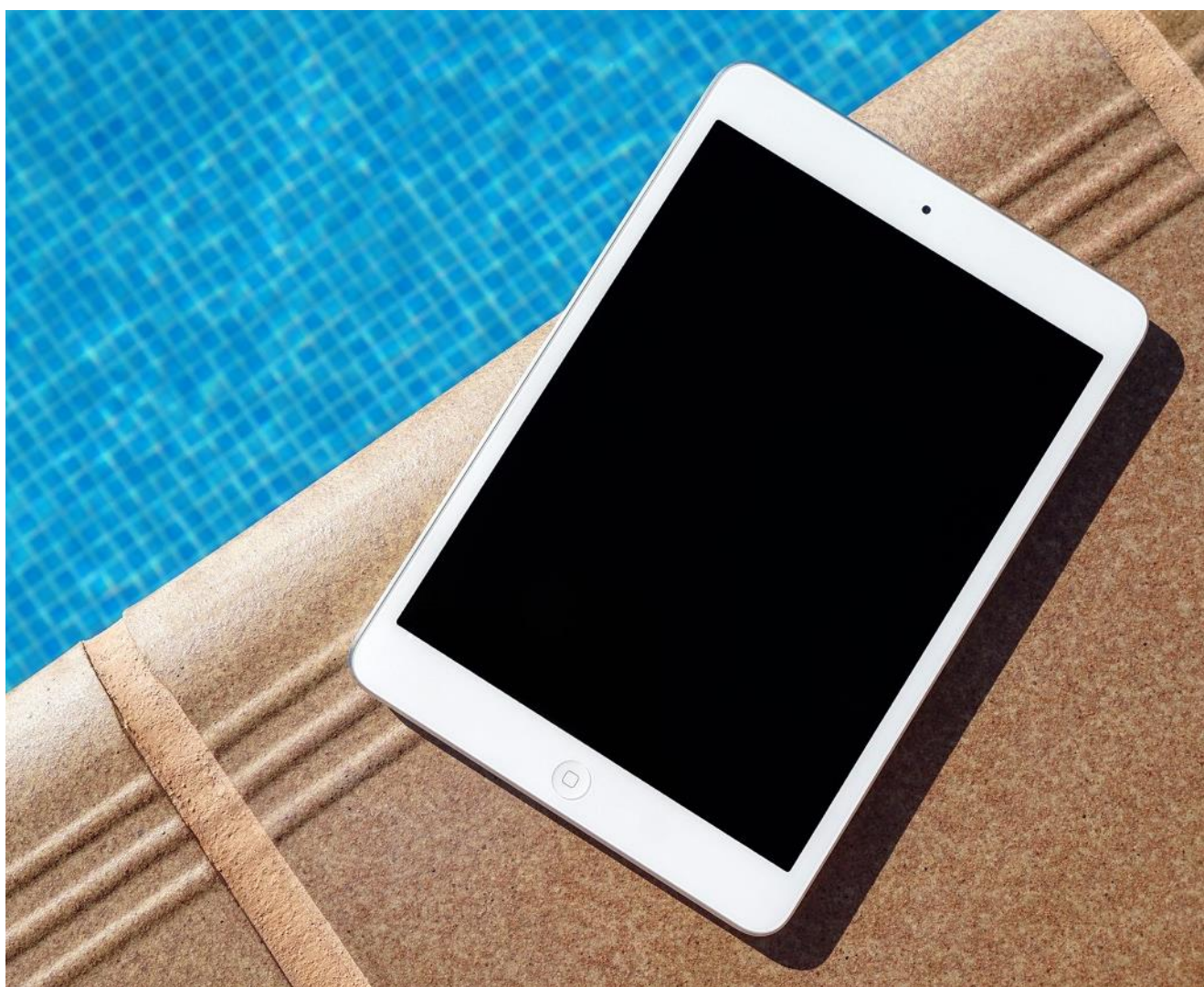


WTS Tax Update for the Digital Economy

India: Taxing cross-border e-commerce transactions



May 2020

1. Executive Summary

As an interim measure to tax transactions arising in a digital economy, India, inter-alia, introduced 'Equalisation levy' in the year 2016. This levy was applicable on the gross consideration received by a non-resident for online advertisement, digital advertising and related services from specified persons.

In the year 2020, the scope of equalisation levy was extended to cover non-resident e-commerce operators within its ambit. As per the expanded provisions, consideration received by a non-resident e-commerce operator from e-commerce supply or service is liable to equalisation levy. It is pertinent to note that the scope and coverage of these provisions is very wide and can have potentially far-reaching implications for transactions which may not be regarded as in the nature of e-commerce as understood in common parlance. For instance, even intra-group transactions placed over an intranet/ ERP could get covered.

Further, the way the provisions are worded seem to suggest that the equalisation levy applies to the entire gross amount of consideration received by the e-commerce operator and not just on the commission or service fee retained by it.

There may also be a situation where the same transaction is subjected to equalisation levy and also to tax in India as royalty or fees for technical services. Also, given that the levy is not in nature of an income-tax, getting credit of the same in foreign jurisdiction seems uncertain. The Multinational entities would need to evaluate the implications of this levy on their business and operating models.

2. Background

Taxation of the digital economy is undoubtedly one of the most significant areas being dealt with as part of the Organisation for Economic Co-operation and Development ('OECD') project on Base Erosion and Profit Shifting ('BEPS'). In this regard, although various measures were considered in the preparation of BEPS' Action 1 (Addressing the Tax Challenges of the Digital Economy) final report¹, none were recommended due to the expectation that other measures developed in the BEPS project will mitigate some of the tax challenges posed by the digital economy.

The BEPS project was followed by the OECD Secretariat's proposed "OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy" to comprehensively deal with the taxation of the digitalized economy².

Whilst a consensus-based solution with respect to the Two-Pillar Approach is expected by the end of 2020, several countries (including India) have announced interim measures in their domestic tax laws seeking to tax transactions arising on account of modern-day digital commerce.

Over the years, India has made significant changes to its domestic tax law in order to ensure that it receives its due share of tax with respect to the digital economy. In the Indian context, the e-commerce market is expected to grow to \$200 billion by 2027³ and thus significance of India's due share of e-commerce tax cannot be over emphasized. Some of the key changes include the amendment to the definition of royalty in 2012, the introduction of the equalisation levy in 2016, the amendment to the definition of business connection to include a 'significant economic presence' in 2018, and the introduction of withholding tax on domestic e-commerce transactions in 2020.

3. India extends the scope of equalization levy

Recently, India expanded the scope of equalisation levy to include cross-border e-commerce transactions. According to the new provisions, any e-commerce operator who is engaged in e-commerce supply or services is liable to pay 2% of the amount of consideration as equalisation levy to the Indian exchequer. The definitions of e-commerce operator and e-commerce supply or services are very wide and can have potentially far-reaching implications for transactions which may not be regarded as in the nature of e-commerce as understood in common parlance.

For ease of reference, the key contours of the equalisation levy, as applicable to non-resident e-commerce operators, are tabulated below:

Applicability	» Applicable to a non-resident e-commerce operator who is engaged in e-commerce supply or services (see below).
Applicable to a non-resident e-commerce operator who is engaged in e-commerce supply or services (see below).	» A non-resident who owns, operates or manages a digital or electronic facility or platform for the online sale of goods or online provision of services, or both.

¹ <https://www.oecd.org/tax/beps/beps-actions/action1/>

² <https://www.oecd.org/tax/beps/statement-by-the-oecd-g20->

³ <https://www.cnbc18.com/retail/ecommerce-sector-to-touch-200-billion-by-2027-now-morgan-stanley-2331681.htm>

Specified services on which equalisation levy applies	<ul style="list-style-type: none"> » Online sale of goods owned by the e-commerce operator; » Online provision of services provided by the e-commerce operator;
	<ul style="list-style-type: none"> » Online sale of goods or provision of services (or both), facilitated by the e-commerce operator; » Any combination of the activities listed above.
Service recipient	<ul style="list-style-type: none"> » Any person resident in India; » Any person who buys goods or services (or both) using an IP address located in India; » Any non-resident in respect of offshore purchases of advertisements which target Indian customers; » Any non-resident to whom data is sold which is collected from an Indian resident or from a person who uses an IP address located in India.
Rate of equalisation levy	» 2%.
Person responsible for paying equalisation levy in India	» Non-resident e-commerce operator
Exemption from equalisation levy	<p>Exemption is currently provided, inter alia, in the following cases:</p> <ul style="list-style-type: none"> » Non-resident e-commerce operators with a Permanent Establishment ('PE') in India and where the e-commerce transaction is effectively connected to a PE in India; » Cases where the aggregate value of consideration for the specified transactions does not exceed INR 20 million (approx. USD 265,000) in a year.

It should be noted that the equalisation levy provisions cast an obligation on the non-resident e-commerce operator to pay equalisation levy within the applicable due dates on a quarterly basis. They are also required to file an annual statement in respect of all such transactions conducted on or before 30 June following the end of the Indian financial year which runs from April to March. Failure to comply with the provisions (such as failure to deduct or pay the equalisation levy) attracts interest and penal consequences. Prosecution proceedings can also be invoked by Indian Revenue in certain circumstances.

The practical challenges posed by the implementation of equalisation levy have been exacerbated because there is currently very limited guidance available in statute on a number of issues. For instance, in a marketplace model, the way the provisions are worded seems to suggest that the equalisation levy applies to the entire gross amount of consideration received by the e-commerce operator and not just on the commission or service fee retained by it.

Secondly, what constitutes a digital or electronic facility/ platform is left open for interpretation. Indian Revenue could even argue that advice provided by a non-resident via email or telephone would also constitute digital or electronic facility or platform for supply of goods or services or both and would fall within e-commerce supply or services, hence being liable for equalisation levy.

Thirdly, while the levy applies with effect from 1 April 2020, the corresponding exemption from income tax in the hands of non-resident applies only from 1 April 2021. Given the same, there could be a potential double whammy where the same transaction is subjected to equalisation levy and also to tax in India as royalty or fees for technical services.

Furthermore, there is no exemption provided for inter-company transactions. Thus, a back-to-back purchase order placed on an intranet / ERP software by a subsidiary or a distributor of a non-resident operator could also be subjected to equalisation levy. The provisions seem to focus more on how the contracts are entered into rather than how it is delivered to the end consumer.

Based on the current provisions, transactions/ contracts entered into and concluded in physical form would not be covered but the same contracts entered into and concluded through a digital platform would potentially be covered in the ambit of equalisation levy.

Another example which could potentially attract this levy could be that of a non-resident (while on a visit to India) purchasing goods online (which are to be delivered at his residence overseas) using an Indian IP address.

4. Indirect tax issues

Whilst the purported intent of introducing the equalization levy is to bring the digital economy within the purview of income tax, the way it is being administered means that it acquires the character of an indirect tax levy.

There could be several other areas of overlap with the indirect taxes, some of which may require detailed scrutiny. For example, any goods which are purchased online and shipped to India, will attract customs duty. Thus, the purchase of goods could be subject not only to customs duty but also equalization levy.

It could also have a bearing on questions of valuation for customs duty purposes – i.e whether or not equalization levy be a part of import value.

Some other questions which arise from an indirect tax perspective are whether filing of equalization returns by non-residents necessitates obtaining registration under goods and services tax and triggers compliances under such laws.

There are agreements on tax treatment of the digital supply of goods within the framework of the World Customs Organisation; whether equalization levy be seen violating those agreements is a question to be considered.

Is the government likely to introduce concepts and rules similar to place of supply rules to determine whether or not any transaction should be subject to equalization levy?

5. Implications

The OECD's BEPS Action 1 Final Report stated that any interim measures which may be implemented by any country ought to be in compliance with their international obligations, including tax treaties.

However, given that equalisation levy is not a part of India's domestic tax law (it was introduced as a separate chapter in the Finance Act), non-residents would not be entitled to tax credit in their home jurisdiction.

From an operational point of view, there is a need to carefully segment the financials related to the in-scope transactions in order to comply with this new expansion of the levy.

Furthermore, the scope has been expanded significantly to cover a wide range of sale, service and facilitation transactions that are conducted online through a digital or electronic facility or platform. The provisions are drafted in a manner which targets not only highly digitalised business models, but also a number of routine transactions of a multinational group and their inter-group transactions.

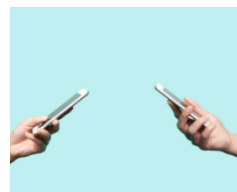
Further, the threat of reprisals in form of trade barriers, sanctions, etc. from the United States of America cannot be ruled out. In the recent past, we have seen US proposing similar restrictions on France after the latter introduced digital tax; which then forced France to postpone the levy till the end of 2020.

Indeed, digitalisation has disrupted businesses by providing opportunities for modern businesses and evolving business models. The digital economy is swiftly becoming intertwined with the traditional economy, thus making it harder to clearly delineate the digital economy's true meaning. India has been at the forefront in terms of taxing the digital economy and the factors mentioned are becoming the new norm for taxing digital economies.

Globally, several countries (such as the United Kingdom, Australia, Italy, Brazil, etc) have introduced similar tax proposals (such as digital service taxes) for the taxation of the digital economy. Also, it will be interesting to see how and when this levy is removed once a consensus is built up within the OECD on the taxation of digital transactions.

Whilst tax law continues to evolve, businesses will need to constantly reassess their operating models in order to assess impact, identify risks, explore planning opportunities, and meet their obligations.

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