Equalisation Levy – A Tax to Tax the Untaxed

The Finance Bill 2016 has introduced a new levy on payments made to foreign e commerce companies for consideration received on provision of certain services. This is one of the steps aimed at tapping the e commerce companies that have largely gone untouched as a result of provisions in the tax laws of many countries that have outlived their utility. The article makes an attempt to explore the levy at the rate of 6%, which is applicable from June 1, 2016.

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The digital age has erased the geographical boundaries for communication and information transfer. Companies operating on the digital and e-commerce space have fast overtaken their traditional counterparts that have been in existence for decades. Market capitalisation of companies like Google at approximately $500 bn, Facebook

$300bn & Amazon $270 bn , which are in existence for around a decade are miles ahead of traditional companies like IBM at $130bn and General Motors at $50bn which have been in business for over a century now. E-commerce with its explosive growth has transformed the way business is conducted and rendered the traditional legal and fiscal frameworks of many countries irrelevant and caused the need for reforms in the legislation.

Traditional provisions in the taxation have not been able to catch up with the digital models which these companies have invented for reduction/ shifting of tax liabilities across the borders. Countries across the globe have realised that e commerce companies have been using the gaps in the tax frameworks to escape taxation and shift tax bases and sometimes end up in double non-taxation scenario. The traditional concept of Permanent Establishment (PE) based taxation, established a time when internet was not in existence, fell through in the virtual world. The nexus between the quantum of business carried and the physical presence in the country of revenue source has virtually vanished. Google used an innovative model to maintain lower tax rates by using subsidiaries in Ireland and managing to pay lower taxes. It has faced criticism from both regulators and general public in countries like UK and agreed in January 2016 to pay approximately £ 130 mn as settlement with the UK tax authorities covering taxes since 2005. It is known to utilise a model called Double Irish Dutch Sandwich which involves managing taxes using two Irish companies and a company based in Netherlands to minimise taxes, where profits pass from one Irish company to a Dutch company and in turn back to another Irish company and finally to a tax heaven country.

Indian tax laws were not adequate to tax the profits of these companies in the absence of PE in India. The business model of these companies does not necessitate PE in India to carry their business. The transactions are effected through Internet. Certain litigations by the tax department for tax deduction in respect of payments made to these companies have been decided in favour of the assessees. The Mumbai Tribunal in case of *Yahoo India Pvt Ltd (ITA No.506/Mum/2008)* where payment was made in respect of advertising services to Yahoo Holdings (Hong Kong) Ltd, held it was not in the nature of royalty as it did not involve use or right to use by the assessee of any industrial, commercial or scientific equipment and no such use was granted by the foreign company to the assessee. The amount was held to be in the nature of business profits which in the absence of PE in India of Yahoo HK does not give rise to tax liability in India.

The issue was again decided in the favour of the assessee in the case of *Pinstorm Technologies Pvt Ltd Vs ITO (ITA No.4332/Mum/2009).* The assessee has paid certain amounts to Google Ireland Ltd for buying space on the Internet for advertising on behalf of its clients. Mumbai Tribunal following its earlier ruling in this aspect of Yahoo discussed above, has decided the matter in favour of the assessee ruling this revenue to be in the nature of business profits and is not taxable in the absence of PE in India. It reversed the order of the first appellate authority which ruled the payment to be in the nature of royalty u/s 9 (1)(iv) of the act. Another such judgement was delivered by Kolkata Tribunal in the case of *ITO v. Right Florists Pvt Ltd (ITA No. 1336/Kol/ 2011)* against the revenue where the issue was discussed at length by the tribunal, whether these services would constitute as Fees for Technical Services (FTS)u/s 9(1)(vii) of the act. The tribunal applying *"noscitur a sociis"* (The doctrine under which the meaning of a word may be known from the accompanying words) in interpreting the meaning of technical services u/s 9(1)(vii) held that no human intervention involved and hence the payment does not fall in the ambit of FTS and are business profits which are untaxable absent a PE in India.

To address this challenge, the OECD in its Base Erosion and Profit Shifting (BEPS) project has worked on Action 1– *Address the tax challenges of the Digital economy*. The action plan has noted that income can artificially be segregated from the activities that generate it. E-commerce companies interact with the customers in another country virtually without any physical establishment. The tax laws of many countries still are based on companies having some kind of physical presence to tax them. These companies are able to allocate functions, assets and risks to low tax jurisdictions to minimise the tax liabilities and allocate incomes to these countries. BEPS Actions 6 and 7 are also aimed at preventing treaty abuse and artificial avoidance of PE by the companies. To address the tax challenges of the

Internet age BEPS action plan 1 suggested measures aiming at,

- Extending the PE concept to classify that an enterprise engaged in fully de-materialised digital activities would constitute a PE if it maintained a significant digital presence in another country.
- Classify as PE when an enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.
- Levying a withholding tax on payments for digital goods or services which a foreign e-commerce company provides or an equalisation levy on consideration received by a non-resident not having a PE in the country.

BEPS task force under Action 1, felt that to avoid difficulties from new rules to attribute profits among other options, an "Equalisation Levy" could be considered as an alternate to address the challenges of the digital economy. Though is not of recommendation in nature, this levy can serve as a way to tax the non-resident entity's significant economic presence in a country. It opined that the levy could be imposed on the gross value of the goods or services provided and paid by the users. It has also mentioned that the levy so imposed could create a situation in which a non-resident entity may suffer levy in the revenue source country and also subject to income tax in the country of residence as the levy may not likely be adjustable against tax payable. As such it was felt necessary to impose the levy at a very low rate.

Equalisation Levy as per Finance Act 2016

Finance minister Shri Arun Jaitley has proposed the introduction of "Equalisation Levy" (Levy) in India through Chapter VIII of the Finance Bill 2016. This levy will attempt to garner revenues from the transactions which have the source of revenues in India but hitherto were not contributing to the exchequer of the nation. The levy is only on non-resident companies of the likes of Google, Facebook, LinkedIn etc. and not on the domestic companies. It is also not applicable to companies that have a PE in India.

The levy has been inserted through a separate chapter (Chapter VIII) in the finance act and not clubbed with Chapter III where amendments and insertions to the Income Tax Act 1961 have been made. It appears to be the intention of the government to keep this as a separate tax and not make it a part of income tax so as to exclude it from the preview of tax treaties. As such this levy is not subject to the DTAAs in force as of now. Also the chapter contains all the machinery and compliance provisions for the levy making it a self-contained code. However, the administration of this levy shall rest with the Income Tax department.

Chapter VIII, Clause 162 of the Finance Bill 2016 in which the levy is mentioned reads as *"On and from the date of commencement of this Chapter, there shall be charged an equalisation levy at the rate of six per cent. of the amount of consideration for any specified service received or receivable by a person....."* The bill only mentions online advertising as specified service. However, this may in future be expanded to cover others in types of services in its ambit. An interpretation of the wording shows that the levy is proposed to be charged only on services, which means purchase of goods from sites like Amazon or Alibaba from the global portals will still be exempt from levy. Further the wording mentioned is "Consideration" and not income which shows that there is no need to determine which types of amounts are subject to consideration, there is no subjectivity involved and no need to classify whether the payment is in the nature of royalty, business profit or FTS. The moment an amount is payable/ paid to the non-resident for provision of services the levy is attracted.

It also appears to be the thought that this levy has to be kept simple for interpretation and application. Notable is the fact that there is no exemption from levy in respect of services availed for the use in business or profession carried outside India or for earning any income from a source outside India. This may perhaps be a

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It may also happen that the current form 15CA–CB may be modified to include the levy to be filed at the time of effecting the payment. Any amount on which the levy is not deducted but paid out of India is disallowed under section 40(a)(ib) of the Income-tax Act, 1961. Further non deduction of levy will make the payer liable to payment of levy, interest and penalty as per the chapter.

The new levy will likely provide revenues to the tax authorities for opening new avenues for collection of taxes. As the threshold is quite low it may not be feasible for assesses to try and bypass by tweaking the agreements or route the spend through multiple entities. The final impact needs to be seen in the days to come where most of the non-resident companies may request Indian customers to gross up the amount and make a payment. ■