Equalisation Levy: Prevailing Issues

What is the issue?

Due to the amendments made in the Finance Act 2021 to widen the equalisation levy provisions, various interpretational issues have arisen.

What is Equalisation Levy?

- **Equalization Levy 1.0** –Commonly known as **Google Tax**, EL 1.0 was introduced in 2016 as a withholding tax.
- It covered only services and is introduced via part of Finance Act and not by way of amendment to the Income Tax Act 1961.
- It charged an equalisation levy at the **rate of 6%** of the amount of consideration for any specified service received or receivable by a - resident from a person resident in India or a non-resident having a permanent establishment in India.
- **Equalization Levy 2.0** - Commonly known as the **Amazon Tax**, EL 2.0 was introduced in 2020 which is directly levied on the Non-resident.
- EL 2.0 covered e-commerce supply or services and was made by way of amendment to Finance Act 2016.
- It charged an equalisation levy at the **rate of 2%** of the amount of consideration received or receivable by an e-commerce operator (non-resident) from e-commerce services to a person resident in India or a non-resident or a person who buys goods and services using internet protocol address located in India.
- EL 2.0 is applicable to e-commerce operators (ECO) having sales, turnover, or gross receipts of Rs20 million in a financial year.

What amendments were made in the Finance Act 2021?

- Any foreign company providing services/goods in India through a digital platform could be within the scope of the levy.
- Given the expanded definition of ‘online sale of goods’, a mere payment that is made through an online mode can potentially be subject to the transaction to equalisation levy.
- The compliance obligation to discharge the levy in India is on the non-resident company.

- Pure traditional brick and mortar businesses that use a fair degree of digitisation, (website, digital payments) may also come under the net of EL 2.0.

What issues need to be addressed under EL 2.0?

- **Interplay between EL and Royalty/Fees for Technical Services (FTS) -** The classification of income as royalty/FTS/business income has been a subject matter of prolonged litigation.
- Royalty and FTS are subject to withholding tax on gross basis but if an enterprise has a Permanent Establishment in other country then such income is taxable as business profits on net basis.
- The present provisions are silent on the treatment of EL already paid by the taxpayer.
- There is a lack of clarity on whether the EL paid by the enterprise shall be allowed as credit against the tax liability arising on account of taxability as Royalty/FTS or refunded to the taxpayer and if it is to be refunded what is the mechanism to claim such refund.
- **Non-availability of foreign tax credit (FTC) -** The question whether the ECO will be eligible to claim the FTC of EL paid will depend on the local tax laws in home jurisdiction.
- The taxes covered under the respective Double Taxation Avoidance Agreements (DTAA) between India and foreign countries generally do not cover the EL and it is likely that the tax credit may not be available for the EL paid in India.
- With countries with which India does not have a DTAA , if the home country jurisdiction of ECO recognises EL as a type of direct tax and entitles the ECO, the ECO may be able to claim the tax credit.
- **Applicability to inter company transactions and reseller arrangements -** The EL 2.0 provisions do not provide any exemption for inter-company/ intra-group transactions.
- The present scope of EL 2.0 is widely worded and could cover such inter-company transactions provided they qualify within the definition of 'ECO' and 'e-commerce supply or services' as provided in EL laws.
- **Technological challenges in locating IP address -** Transactions between two non-residents where either the marketplace is in India or the IP address is located in India have been brought under the ambit of the EL 2.0**.**
- This could cover transactions of a non-resident tourist purchasing goods or services on a non-resident operated e-commerce platform using an Indian IP address which may pose a challenge for various stakeholders.

- **Meaning of the term ‘digital or electronic facility or platform’ -** Neither the EL law nor the Income Tax Act defines or explains this term.
- In the absence of any definition, the term is capable of being interpreted in different ways and can potentially cover ubiquitous digital communication tools like emails or calls.
- **Definition of the term ‘goods’ and ‘services’ -** The term ‘goods’ and ‘services’ have neither been defined under the Finance Act nor the Income Tax Act leading to interpretational issues.

How does the future of EL 2.0 look?

- The future of EL 2.0 depends on the adoption of OECD Pillar 1 and 2 amendments by India.
- Foreign companies need to factor in these levies as part of their global tax planning as it is likely to increase the cost of doing business in India without the ability to claim the tax credit in the home country.
- It is now necessary to assess the implications of EL 2.0 and currently it requires clarity.

References

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