

Taxation of digital economy

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Developments in digital era

- **Digital presence replacing physical presence**
- **Avoidance of BC/DAPE by form over substance in case of prohibited activities**
- **Inappropriate use of POA exemptions for core economic activities**
- **Fragmentation of core economic activities into multiple places of business [self or across related parties] and abuse of POA exemptions**

Developments in digital era

- **Fragmentation of projects between closely related parties to avoid triggering of Project PEs**
- **Cross-jurisdictional scale without local mass**
- **Heavy reliance on intangible assets, especially intellectual property (IP)**
- **Importance of data, user participation and their synergies with IPs**

Consequences

- **Renders existing rules of BC/PE redundant**
- **Results in abuse of DTAA provisions**
- **Results in erosion of tax base from the source countries**
- **Results in stashing wealth in low tax jurisdictions and tax havens**
- **Keeps the ownership and control opaque**

E-
Commerce

Taxation of digital
economy

Taxation of digital economy

- BEPS Action Plan 1 and further developments
- Indian initiative
- Digital Service Tax by EU countries

E-
Commerce

Action Plan 1

OECD BEPS/G20 INITIATIVE

- Action 1, Addressing the Tax Challenges of the Digital Economy, undertook to consider the tax challenges (both direct and indirect taxation) arising from the digital economy and digitalization.
- To carry out this work, the Task Force on the Digital Economy (TFDE) was established as a subsidiary body of the Committee on Fiscal Affairs (CFA), with the participation of more than 45 countries including all OECD and G20 members. India is one of the participants in the TFDE.

AP1

- None of the following options analysed by TFDE is recommended at this stage
 1. New nexus rule by way of SEP
 2. Withholding tax on certain types of digital transactions
 3. Equalisation levy
- Reasons for non recommendation:
 1. Measures adopted in BEPS Project will have substantial impact on BEPS issues previously identified in digital economy
 2. Certain BEPS measure mitigate some aspects of the broader tax challenges
 3. Consumption tax will be levied effectively in the market country

AP1

- Countries could, however, introduce any of these three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties.
- Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments.

AP1

- Amongst the mandate given the TFDE was providing the Inclusive Framework of BEPS project an interim report on challenges arising from digitalization by the end of 2018 followed by a recommendation of further actions in a final report by the end of 2020.
- TFDE has published its interim report on 16 March 2018

Highly digitalized business - HDBs

- The three key factors prevalent in HDBs and potential problems:
 1. **Cross-jurisdictional scale without local mass:** It would impact the distribution of taxing rights over time by reducing the number of jurisdictions where a taxing right can be asserted over the business profits of the MNE.
 2. **Heavy reliance on intangible assets, especially intellectual property (IP):** Significant progress under BEPS project, but often difficult to determine how to allocate income from intangibles among different parts of MNE group.
 3. **Importance of data, user participation and their synergies with IPs:** If considered a source of value creation, could pose challenges. Also, the concept of value creation is not captured by the existing tax framework.

Existing uncoordinated country measures

- The said uncoordinated and unilateral actions have been grouped into four categories as under:
 1. alternative applications of the PE threshold;
 2. withholding taxes;
 3. turnover taxes; and
 4. specific regimes targeting large MNEs.

- The examples identified by the TFDE under the above categories are as under:

Alternative threshold	PE	Withholding taxes	Turnover taxes	Specific regimes for large MNEs
<ul style="list-style-type: none"> • Significant Economic Presence test (e.g. Israel, India) • Virtual Service PE (E.g. Saudi Arabia) 	<ul style="list-style-type: none"> • Broader royalty definition. • Technical service fees. • Online Advertising 	<ul style="list-style-type: none"> • Sectoral taxes, for such as for advertisement (E.g. Hungary) • Levy on Digital Transaction • Equalisation Levy (E.g. India) 	<ul style="list-style-type: none"> • Diverted Profits Tax (e.g. UK and Australia) • BEAT (US) 	

INDIAN INITIATIVE – HPC ON ECOMMERCE

- CBDT also set-up a committee on e- Commerce Taxation during 2001 under the Chairmanship of Sri. Kanwaljit Singh.
- The committee felt that 'there is no case for exemption of e-Commerce from Direct Taxes'.
- It felt that concept of PE should be abandoned and an alternative to PE should be found
- It also recognized that with respect to cross-border e-Commerce, there is a need to examine the 'Incidence of Tax including a mechanism to levy and collect the same'.
- It felt that the Professor Richard L Doernberg's 'base erosion' approach that requires taxation of any payment to a foreign enterprise, if it is tax deductible in the hands of a taxpayer in the source country, may offer a solution

HIGH POWERED COMMITTEE

- The Technical Advisory Group set up by the OECD (“TAG”) had examined 28 categories of transactions in its final report.
- The Committee examined each of these categories of transactions in light of the provisions of the Act as also the DTAs entered into by India with UK and US, as an illustration. The judicial pronouncements, wherever available, were also considered.
- In 15 categories, the characterisation by the OECD and the views of the Committee match.
- In 1 category, the views match in terms of the DTAs and not the Act.
- In the remaining 12 categories the views of the Committee differ from the views of the OECD

Committee on Taxation of e-Commerce

- After 15 years, again, in 2015, CBDT set-up another committee on Taxation of e-Commerce under the Chairmanship of Akhilesh Ranjan
- The said Committee on Taxation of e-Commerce has submitted its report on 21st March 2016.
- Committee's key observations were –
 1. Redundancy of physical presence in other tax jurisdictions,
 2. characterizing the payments for digital goods and services,
 3. significant challenges to levy taxes in the source jurisdiction,
 4. unfair advantage over domestic players and
 5. the necessity of withholding tax on digital transactions, Equalization Levy among others.

INDIA IMPLIMENTATION

- Equalisation levy on specified services vide FA 2016
- Amendment to section 9 vide FA 2018 : Introduction of Explanation 2A [SEP] to section 9(1)(i)
- Amendment to section 9 vide FA 2020 : Introduction of Explanation 3A to section 9(1)(i) and amendment to Explanation 1(a) and substitution of Explanation 2A [SEP]
- Extension of EL to e-Commerce supply or services

Business
connection

Significant Economic
Presence

Explanation 2A to section 9(1)(i)

- Section 9(1)(i) – Income from Business Connection
- Finance Act, 2018 inserted Explanation 2A w.e.f 01.04.2019: Significant Economic Presence (SEP) shall constitute BC
- SEP Determination: Based on threshold of ‘revenue’ and the ‘users’ in India, to be prescribed by the Board

Explanation 2A to section 9(1)(i)

- As discussion is still going on in G20-OECD BEPS project, the numbers have not been notified by the Board
- G20-OECD report is expected by the end of December 2020
- Therefore:
 - Current Explanation 2A is omitted from AY 2021-2022
 - New provision will take effect from 01.04.2022 i.e. from AY 2022-2023
- New provision is inserted with certain changes

Explanation 2A to section 9(1)(i)

Explanation 2A – Existing

For the removal of doubts, it is hereby **clarified** that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction in respect of any goods, services or property carried out by a **non-resident in India** including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

Explanation 2A - Proposed

For the removal of doubts, it is hereby **declared** that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction in respect of any goods, services or property carried out by a **non-resident with any person in India** including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

Explanation 2A to section 9(1)(i)

Explanation 2A – Existing

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of **users as** may be prescribed, **in India through digital means:**

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Explanation 2A - Proposed

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of **users in India**, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Proviso to Explanation 2A to section 9(1)(i)

Explanation 2A – Existing

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Explanation 2A - Proposed

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.’;

Explanation 2A to section 9(1)(i)

Explanation 2A(a):

- Earlier phrase ‘carried out by a *non-resident in India*’ is replaced by ‘carried out by a *non-resident with any person in India*’
- Makes the scope very wide and does not require the activities to be carried out in India
- As long as the customer is in India, all exports of goods/services made by NR are covered
- Only a thin line of Territorial nexus i.e. ‘customer in India’

Section 9(1)(i) – Comments

- Explanation 2A(b):
 - ‘soliciting of business activities or engaging.... *in India*’ replaced with ‘soliciting of business activities or engaging *with such number of users in India*’
 - Meaning – actual soliciting/engaging may take place outside India as long as the users are in India
 - Scope expanded by omitting the words ‘*in India, through digital means*’

Explanation 2A to section 9(1)(i)

- 'Business in India' is replaced with 'Business with India'
- Business in India –continues to be covered by Explanation 1 (a)
- Ishikawajma Harima heavy Industries Ltd. [2007] 288 ITR 408 (SC) undone
- All EPCs/turnkey contracts are hit
- Can you overcome Explanation 2A by avoiding contract with Indian customers where you deal with a global conglomerate?

Explanation 2A to section 9(1)(i)

- Can you overcome Explanation 2A by carrying out transactions with a non resident in India?

Explanation 2A v. PE

- India has DTAAAs with about 94 out of 195+ jurisdictions
- Out of 94 DTAAAs, 60 are CTAs as per MLI
- Out of 60 CTAs, about 23+7 have come into effect on 1.4.2020
- Explanation 2A would not apply in respect of 94 DTAAAs where taxation triggers on account of PE
- However, it may apply in respect of 60 CTAs if MLI 7/GAAR is invoked and CTA benefit is denied
- Explanation 2A would apply to balance 101+ jurisdictions

Proviso to Explanation 2A v. PE

- The benefit of Explanation 1 (a) is no more applicable to BC by way of SEP
- Proviso to Explanation would limit the attribution to transactions and activities specified in Explanation 2A
- However, there is no further splitting of income from such transactions and activities on the basis of operations carried out in India
- This would imply that the place where operations are carried out is irrelevant
- Example : Total turnover is USD 100 mn and India turnover is USD 30 mn. Entire income in respect of USD 30 mn is taxed in India.

Business
connection

New norms of profit
attribution

Taxation of digital economy - Explanation 3A

“*Explanation 3A.*—For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in *Explanation 1*, shall include income from—

(i) such advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.”;

Explanation 3A - Proviso

- Provided that the provisions contained in this *Explanation* shall also apply to the income attributable to the transactions or activities referred to in *Explanation 2A*

Explanation 3A

- W.e.f. 01.04.2021 (AY 2021-22/PY2020-21)
- M = 25, 26 & 27
- Section 9(1)(i): Business Connection
- Explanation 1 provides for exception to Clause (i)
- Explanation 1(a) provides for income attribution to the extent of operations carried out in India

Explanation 3A

- Such income attribution, is now proposed to include income from the following 3 activities viz.:
 - ❑ income from advertisement that targets Indian customers or
 - ❑ income from sale of data collected from India or
 - ❑ income from sale of goods and services using such data collected from India
- Explanation 3A expands the attribution which is otherwise limited by Explanation 1 (a) and thus interferes with the latter

Explanation 3A

- Overall scheme & object – makes very tough domestic provision, forces use of DTAA and makes DTAA subject to MLI to achieve the APs
- Section 92CB amended to provide safe harbor rule to income declared under Section 9(1)(i)
- Section 92CC amended to provide for APAs in respect of determination of income under section 9(1)(i)
- Section 295(2)(b)(iia) & (iib) introduced

Explanation 3A & 92CC(1)(b)

- It appears that language of section 92CC(1)(b) makes APA inapplicable to SEP under Explanation 2A read with Explanation 3A

- Section 92CC(1)(b) provides APA for determining

*income referred to in clause (i) of sub-section (1) of section 9, or specifying the manner in which said income is to be determined, as is reasonably attributable to **the operations carried out in India by or on behalf of that person, being a non-resident***

- The above would cover generic business connection under section 9(1)(i) read with Explanation 1(a)

- Language of Explanation 2A does not support **'the operations carried out in India bya non-resident'**

Explanation 3A would apply to SEP also

- Explanation 3A: Preamble
 - Main body of Explanation 3A applies to Explanation 1 (a)
 - Proviso to Explanation 3A makes it applicable to Explanation 2A
 - Meaning Explanation 3A applies both to Explanation 1 (a) and Explanation 2A

Explanation 3A goes beyond 'operations carried out in India'

- Language 'Shall include'
 - Not 'shall also include'
 - 'shall include' v 'consists'
 - Expansive v. Exhaustive
- Language 'Shall include income from'
 - Makes it very wide
 - Ideally it should be 'shall include income reasonably attributable to activities from'
 - May make entire income from sale of data [clause (ii)], and sale of goods/services [clause (iii)] attributable to and taxed in India

Explanation 3A: Clause (i)

- Income from such advertisement targeting customers in India/accessing advertisement through Indian IP address [Indian customer]
- Income from such advertisement v. Income derived from such advertisement
- Example:
 - Microsoft, USA advertises MS office through Google, Ireland targeting Indian customers
 - Google pays tax under this Clause and Microsoft pays under Clause (iii)
- The prefix 'such' in the phrase 'such advertisement'
 - May remotely connect to Explanation 2A(b)
 - But may not connect to Explanation 1(a)

Explanation 3A: Clause (ii)

- NR 'A' collects data from 'B' & Sells it to NR 'C'. C sells goods to B:
 - A is covered by E-3A(ii)
 - C is covered by E-3A(iii)
 - Location of B or B using IP Address located in India is relevant only at the time of collection of data and not thereafter
- When A sells to C, he is covered by (ii) above [Even all subsequent sales will also get covered]
- When A sells such data to an Indian customer – hit by Explanation 2A(a)
- Applies irrespective of how Indian Data protection law works

Explanation 3A: Clause (iii)

- Overlaps with Explanation 2A(a)
- May go beyond Explanation 2A(a) as it does not insist sale to customers in India

SEP v. Explanation 3A

- A NR with SEP may consider to trigger a DAPE through Explanation 2
- In such case, he is safely covered by Explanation 3 and would not get covered by Explanation 3A
- A NR who has a potential SEP, may deal with a NR's PE in India and overcome Explanation 2A(a) – An aggressive view
- A NR who is liable to EL in respect of SS or ESS need not worry about SEP and Explanation 3A due to exemption under section 10(50).

Equalisation Levy

Introduced by finance act, 2016

And as amended by finance act, 2020

Introduction of Equalisation Levy

- In pursuance to Action Plan 1 of OECD, in order to tackle the challenges in taxation in respect of digital transactions, equalisation levy was introduced by the Finance Act, 2016
- Chapter VIII of the Finance Act, 2016 deals with 'Equalisation Levy' consisting of Section 163 to Section 180
- Section 10(50) was introduced to exempt income arising from any specified service provided on or after the date on which the provisions of Chapter VIII of the Finance Act, 2016 comes into force and chargeable to equalisation levy under that Chapter.

EL as originally introduced

•Important Sections:

- Section 164: Definitions
 - Clause (e): 'equalisation levy'
 - Clause (f): 'online'
 - Clause (g): 'Permanent Establishment'
 - Clause (i): 'specified service'
- Section 165: Charge of equalisation levy
- Section 166: Collection and recovery of equalisation levy

Section 164: Definitions

- Clause (d) defines 'equalisation levy' as under:

"equalisation levy" means the tax leviable on consideration received or receivable for any specified service under the provisions of this Chapter;

- Clause (f) defines 'online' as under:

"online" means 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;

- Clause (g) defines 'permanent establishment' as under:

"permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on;

Section 164: Definitions

- Clause (i) defines 'specified service' as under:

"specified service" means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf;

- Clause (j) :

words and expressions used but not defined in this Chapter and defined in the Income-tax Act, or the rules made thereunder, shall have the meanings respectively assigned to them in that Act.

Section 165: Charging Section

- Section 165 provides for:
 - charge of equalisation levy at the rate of 6%
 - of the amount of consideration for any specified services
 - received or receivable by a person, being a non-resident from:–
 - a person resident in India and carrying on business or profession; or
 - a non-resident having a permanent establishment in India.

Section 165: Charging Section

•Equalisation levy under Section 165(1) shall not be charged, where

(a) the non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;

(b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a permanent establishment in India, does not exceed one lakh rupees; or

(c) where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

Section 166: Collection and Recovery

- Section 166 provides for collection and recovery of equalisation levy by
 - a person, being a resident and carrying on business or profession or
 - a non-resident having a permanent establishment in India
- by way of deduction from the amount paid or payable to the non-resident
- in respect of specified services.
- The amount of equalisation levy so deducted by the payer has to be paid to the credit of the Government by 7th day of the month following the month in which the equalisation levy is collected.

Amendments by Finance Act 2020

Scope expanded to
e-commerce

Amendments by the Finance Act, 2020

152. The provisions of this Part shall come into force on the 1st day of April, 2020.

Amendment to Section 164: Definitions

(ii) in section 164,—

(A) after clause (c), the following clause shall be inserted, namely:—

'(ca) "e-commerce operator" means 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;

Amendment to Section 164: Definitions

(cb) "e-commerce supply or services" means—

- (i) online sale of goods owned by the e-commerce operator; or
- (ii) online provision of services provided by the e-commerce operator; or
- (iii) online sale of goods or provision of services or both, facilitated by the e-commerce operator; or
- (iv) any combination of activities listed in clause (i), (ii) or clause (iii);;

Charge of equalisation levy on e-commerce supply or services

'165A. (1) On and from the 1st day of April, 2020, there shall be charged an equalisation levy at the rate of two per cent. of the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

(i) to a person resident in India; or

(ii) to a non-resident in the specified circumstances as referred to in subsection (3); or

(iii) to a person who buys such goods or services or both using internet protocol address located in India.

New Section 165A: Charge of equalisation levy on e-commerce supply of services

(2) The equalisation levy under sub-section (1) shall not be charged—

(i) 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;

(ii) where the equalisation levy is leviable under section 165; or

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

New Section 165A: Charge of equalisation levy on e-commerce supply of services

(3) For the purposes of this section, "specified circumstances" mean—

(i) 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

(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.;

Collection and recovery of equalisation levy on ecommerce supply or services.

"166A. The equalisation levy referred to in sub-section (1) of section 165A, shall be paid by every e-commerce operator to the credit of the Central Government for the quarter of the financial year ending with the date specified in column (2) of the Table below by the due date specified in the corresponding entry in column (3) of the said Table:

Section 166A: Collection and recovery of equalisation levy on ecommerce supply or services.

Serial number	Date of ending of the quarter of financial year	Due date of the financial year
(1)	(2)	(3)
1.	30th June	7th July
2.	30th September	7th October
3.	31st December	7th January
4.	31st March	31st March

Amendment to Section 174: Appeal to Commissioner of Income-tax (Appeals).

(xv) in section 174, in sub-section (1), for the word "assessee", the words "assessee or e-commerce operator" shall be substituted;

Amendment to Section 175: Appeal to Appellate Tribunal.

(xvi) in section 175,—

- (i) in sub-section (1), for the word "assessee", the words "assessee or e-commerce operator" shall be substituted;
- (ii) in sub-section (3), for the word "assessee", the words "assessee or e-commerce operator" shall be substituted;

Amendment to Section 178: Application of certain provisions of Income-tax Act.

(xvii) in section 178, for the word and figures "sections 120" the word and figures "sections 119, 120" shall be substituted;

Amendment to Section 10(50) :

(IV) in clause (50), with effect from the 1st day of April, 2021, for the words “comes into force”, the words, figures and letters “comes into force or arising from any e-commerce supply or services made or provided or facilitated on or after the 1st day of April, 2021” shall be substituted.

Equalisation Levy – MULTIPLE TAXATION

- Internal double taxation

- a) Equalisation levy

- b) IGST on online information and database access or retrieval services [defined in sec 2(17) of IGST Act

- Cross border double taxation

- a) Taxed in India

- b) No FTC in the residence jurisdiction

Equalisation Levy is income tax - Yes

- It is kept in the Finance Act only to indicate its interim existence till the final outcome of TFDE
- Is in pursuance to recommendations dealing with challenges arising in respect of direct taxes
- AP1 allows levy of EL as one of interim measures but subject to treaty obligations
- Interim Report of TFDE also recognises EL as one of the interim measures

Equalisation Levy is income tax - Yes

- Section 10(50) exempts income where EL is levied
- No EL is if the service provider has a PE in India
- Ecommerce supply or services defined in sec 164(cb) and chargeable to EL under sec 165A could also trigger SEP under Explanation 2A to section 9(1)(i) subject mutual exclusivity brought in by section 10(50)
- Ecommerce supply or services covered by section 165A(3) are also dealt with by Explanation 3A to section 9(1)(i) subject mutual exclusivity brought in by section 10(50).
- It cannot be a tax on supply of services as at present there is already an IGST on supply of services vide section 14 of IGST Act

Equalisation Levy is income tax - Yes

- Placement of section 40a(ib) along with section 40a(i)/(ia) and not with section 43B
- Assessing officer means ITO/ACIT/DCIT/JCIT/Add CIT authorised by CBDT – sec 164(b) and Board means CBDT – sec 164(c)
- Appeal against levy of penalty lies to CIT(A)/ITAT
- Definitions from IT Act are borrowed – sec 164(j)

Equalisation Levy is income tax - Yes

- Budget Speech to FB 2016 – para 151 : In order to **tap tax on income** accruing to foreign e-commerce companies from India, it is proposed that a person making payment to a nonresident, who does not have a permanent establishment, exceeding in aggregate `1 lakh in a year, as consideration for online advertisement, will withhold tax at 6% of gross amount paid, as Equalization levy. The levy will only apply to B2B transactions

Equalisation Levy is income tax - Yes

- Memorandum explaining levy of EL in Finance Act, 2016
- ❑New business models have created new tax challenges.
- ❑The **typical direct tax issues** relating to e-commerce are the difficulties of characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction, the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.
- ❑The digital business fundamentally challenges **physical presence-based permanent establishment rules**.
- ❑If **permanent establishment (PE) principles** are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality.

Equalisation Levy is income tax - Yes

- ❑ OECD has recommended, in Base Erosion and Profit Shifting (BEPS) project under Action Plan 1, several options **to tackle the direct tax challenges which include modifying the existing Permanent Establishment (PE) rule** to include that where an enterprise engaged in fully de-materialized digital activities would constitute a PE if it maintained a **significant digital presence** in another country's economy.
- ❑ It further recommended **a virtual fixed place of business PE in the concept of PE** i.e creation of a PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction and carries on business through that website.
- ❑ It also recommended to impose of **a final withholding tax on certain payments for digital goods or services** provided by a foreign e-commerce provider or **imposition of a equalisation levy** on consideration for certain digital transactions received by a non-resident from a resident or from a non-resident having permanent establishment in other contracting state.

Equalisation Levy is income tax - Yes

- ❑ Considering the potential of new digital economy and the rapidly evolving nature of business operations it is found essential to address the challenges in terms of taxation of such digital transactions as mentioned above.
- ❑ In order to address these challenges, it is proposed to insert a new Chapter titled "Equalisation Levy" in the Finance Bill, 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.
- ❑ **In order to avoid double taxation**, it is proposed to provide exemption under section 10 of the Act for any income arising from providing specified services on which equalisation levy is chargeable.

Equalisation Levy is income tax - No

- It is levied through the Finance Act
- As per report of committee on ecommerce of CBDT, it is not intended to be regarded as income tax

Equalisation Levy – Constitutional validity

- Territorial nexus - Relevant nexus v. sufficient nexus
- GVK 332 ITR 130 SC
- Is taxing a person doing business with India a relevant nexus
- Levy of EL undermines treaty obligations : violates Articles 26, 27, 31 and 53 of Vienna Convention
- AP1 says when you levy EL as an interim measure, respect the treaty obligations
- SC in Ramjethmalani's case on reliance on Vienna Convention

Equalisation Levy – Constitutional validity

- Entry 92C v. Entry 97
- Article 246A overrides Article 246
- Levy of IGST under section 14 on Online information and database access or retrieval of services
- Aspect theory : Revenue to establish that EL and IGST are on different aspects

Equalisation Levy – Constitutional validity

- Directive Principles of State Policy : **Article 37. Application of the principles contained in this Part.**—The provisions contained in this Part shall not be enforceable by any court, but the principles therein laid down are nevertheless fundamental in the governance of the country and it shall be the duty of the State to apply these principles in making laws
- Article 51(c) : The State to endeavour to foster respect for international law and treaty obligations

Equalisation Levy – Other features

- No appeal against levy of EL and interest
- Appeal lies to CIT(A) and ITAT in respect of levy of penalty under sections 171 [failure to deduct/pay EL] and 172 [failure to file statement]
- Further appeals to HC and SC are facilitated through referential incorporation of relevant sections of IT Act vide section 178

Electronic commerce [eCommerce]

- 'E-commerce' is not defined in FA. Section 164(ca) defines 'e-commerce operator'
- *Para 117 of AP1 :*
 - ❑ "the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of 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**.
 - ❑ E-commerce can be used either to facilitate the ordering of goods or services that are then delivered through conventional channels (**indirect or off-line e-commerce**) or to order and deliver goods or services completely electronically (**direct or on-line e-commerce**).

Electronic commerce [eCommerce]

- *Explanation(a)* below section 194-O : “electronic commerce” means the supply of goods or services or both, including digital products, over digital or electronic network;
- Section 164(f) defines ‘online’ : 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
- Section 164(ca) defines ‘e-commerce operator’ as a non-resident who owns, operates or manages an digital or electronic facility or platform for online sale of goods or online provision of services or both
- Section 164(cb) defines ‘e-commerce supply or services’

Section 165A(3)

- 'Specified circumstances' mean
 - ❑ Sale of advertisement targeting resident customer or a customer using Indian IPA
 - ❑ Sale of data collected from a resident or a person using Indian IPA
- However, such sale of advertisement or data should qualify as 'e-commerce supply or service' as per sec 165A(1) read with 164(cb) which requires such sale to be online
- Therefore, offline sale of such advertisement or data would not be covered

Section 165A(3)

- Sale of advertisement targeting resident customer or a customer using Indian IPA
1. Meaning of sale of advertisement
 2. Will ad payments made to Y-tube, facebook, google etc. get covered?
 3. Income from advertisement referred to Explanation 3A(i) v. sale of advertisement

Section 165A(3)

- Sale of data, collected from a person : Would it consist of only data collected or would it include even
 1. Personal data observed (for example, by recording Internet browsing preferences, location data, etc.)
 2. Personal data inferred based on analysis in combination with other data
 3. Non personal data : E.g., traffic density, climate etc.
 4. Data collected from a public source
 5. Sale of raw data v. sale of highly processed data

Specified service v. Ecommerce supply or service

Before Amendment

"specified service" i.e. online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf;

After Amendment

"specified service or e-commerce supply service"

Specified service v. Ecommerce supply or service

- Similarity

1. Both are charged under FA
2. Both deal with 'online'
3. Both are levied on non residents

Specified service v. Ecommerce supply or service

- Differences

- SS is a collection and ESS is a payment

- SS is 6% and ESS is 2%

- SS is B2B [personal payments are excluded] and ESS may be B2B, B2C and C2C

- SS would apply in respect of consideration received from a Resident or non resident having a PE whereas ESS would apply to consideration received in respect of ecommerce supply or services to a Resident or a non resident [in two circumstances] or any buyer using Indian IP address

- Time limits for remittance are different for SS and ESS

Specified service v. ESS

- Threshold limit

	SS	ESS
Value of limit	Rs.1 L	Rs.2 Cr
Nature of limit	Aggregate consideration for specified service in a PY from a person	Sales, turnover, gross receipts of e-commerce operator from e-commerce supply or services referred to in sec 165A(1)

Specified service v. ESS

Consideration for SS received or receivable from	Consideration received or receivable from ecommerce supply or services to
Resident	Resident
Non resident having a PE	NA
NA	Non resident : From sale of advertisement targeting a resident or customer using Indian IPA
NA	Non resident : From sale data collected from a resident or a person using Indian IPA
NA	Buyer using Indian IPA

Specified service v. ESS

- SS and ES are mutually exclusive
- In terms of priority, SS comes first : Section 165A(2)(ii)

Compliance

- Can an Indian law expect compliance of its domestic law from a non resident who does not have any residence or place of business in India
- Vodafone 341 ITR 1 SC [Justice Radhakrishnan's observations] and consequent insertion of Explanation 2 below section 195(1)
- Section 166A requires March quarter EL to be discharged by 31st March.
- This is impractical and impossible

One year gap between EL and IT

- EL on e-commerce supply or service would begin from 1.4.2020
- Corresponding exemption under section 10(50) is in respect of e-commerce supply or services made or provided or facilitated on or after 1.4.2021

Likely targets

- Google, Facebook etc., in respect of services other than specified services
- Amazon, Flipcart, Wallmart
- Google Pay etc.,
- Netflix, Hotstar, iTunes
- Urban clap and similar service providers
- Zoom cars, OYO, AirBnB
- Foreign stock exchanges, commodity exchanges
- 99 Acres, Nobrokers
- eLearning platforms like Khan Academy, Biju's
- Zoom subscriptions

Likely targets???

- Cloud services
- Cloud storage services
- Web hosting charges
- Foreign banks providing services
- Interconnect charges levied by foreign telecom companies
- Centralized cloud servicing facility availed by corporate head and made available to group companies across the globe
- International E-journals
- Professional services like legal advise by an expert team of e-journal

Likely targets???

- Voice calls through internet
- Foreign Government websites where various services are available over internet upon payment of fees
- Online auctions
- Online lottery
- Online games
- Ecommerce sale or supply to an Indian resident on a visit to a foreign country using local IPA – how to track this?
- Likewise, ecommerce sale or supply to a non resident visiting India using local IPA?

Likely targets???

- Twitter – payment made to reach larger audience
- Tweet ads
- Purchase of cloud space in gmail
- Payments made by credit card issuing bank to Visa/mastercard/amex
- Payments made by cable operators to foreign TV channels

ESS v. Explanations 2A & 3A

- An ecommerce operator liable under section 165A is not concerned with Explanations 2A & 3A due to section 10(50)
- However, where an ecommerce operator facilitates online supply or service made or provided by other NRs, such other NRs could be covered by Explanations 2A and 3A
- EL on ESS would be only in respect of online sale or services made or provided or facilitated by ecommerce operator to a resident or PE of a NR or NR [in respect of sale of advertisement or data]
- Explanation 2A would apply to transaction in goods, services or properties carried out with a person in India

ESS v. Explanations 2A & 3A

- An ecommerce operator may have transactions covered by EL as well as other transactions
- In respect of all offline supplies to a person resident in India and certain online transactions not covered by EL, enquiry into Explanation 2A may be necessary in the case of non treaty country
- In such case, for the purpose of revenue threshold of Explanation 2A, whether the transactions covered by EL also would be reckoned?

Explanation 2A v. EL on ESS

	Explanation 2A	EL on ESS
Person	All NR	NR e-commerce operator
Mode of Activity	Both online and offline	Only online transactions as specified in section 165A(1)
Type of Threshold	Revenue or User	Revenue
Amount of threshold	Yet to be prescribed	Rs. 2 Crores
Income attribution	Proviso to Explanation 2A and Explanation 3A	NA
Tax	Net basis	Gross
Withholding	Yes	No
DTAA	Yes	No?

ESS v. 3A : Activities comparision

Explanation 3A	ESS	Covered by
Income from such advertisement targeting a customer residing in India or a customer using Indian IPA	Sale [online] of advertisement targeting an resident customer or a customer using Indian IPA	165A(3)
Income from sale of data collected from a person residing in India or a person using Indian IPA	Sale [online] of data collected from a person resident in India or a person using Indian IPA	..do..
Income from sale of goods or services using data collected from a person residing in India or a person using Indian IPA	Online sale of goods or provision of services made or provided or facilitated to a person resident in India or a person who buys goods/services using Indian IPA	165A(1)

Other aspects

- Can a NR eCommerce operator (A) interpose a third party NR (B) who shall have a PE in India
 - ❑ A makes/provides/facilitates supply or service to B
 - ❑ B in turn makes/provides/facilitates supply or service to Residents or customers using IPA
 - ❑ A is not liable to EL as he provides services to B who is a NR
 - ❑ B is not liable to EL as he has a PE in India
 - ❑ B may be liable on the net profits he makes and is subject to DTAA
 - ❑ GAAR/MLI etc do not apply to EL

Other aspects

- Can a NR eCommerce operator consider having a PE in India
 - ❑ He is not liable to EL as he has a PE in India
 - ❑ He may be liable on the net profits he makes and is subject to DTAA
 - ❑ Explanation 3A may be avoided by falling back upon article 7 of the DTAA

Questions for consideration

- Does DTAA apply to EL
- What if ecommerce supply or services made or provided or facilitated by ecommerce operator consist of income by way of royalty or FTS
- Whether orders placed with call centre or through email covered?
- What is the meaning of 'online' sale of goods or 'online' provision of services
- Whether rental of goods is online sale or online service
- Whether licensing of data amounts to sale of data?

Questions for consideration

- What is the meaning of the expression ' data collected from a person'?
- Where data is not collected from a person resident in India but is collected by a person (resident or non-resident) in India, whether EL applies? For instance, Google Maps collects data of the traffic conditions on Indian roads through Street View. Such data is not 'collected from a person' nor is such data personal.
- Where the consideration is not in money, whether EL applies? An example could be the time share industry where the customer deposits 'days' in consideration of booking a holiday room.
- Where a non-resident e-commerce operator collects Rs. 100 from an Indian resident customer, retains Rs. 10 with him and pays Rs. 90 to the seller of the goods, whether EL would apply on Rs. 100 or Rs. 10?
- Is it possible to obtain an AAR on whether the services of NR E-comm operator are liable to tax in India as royalty, FTS, business income or EL?

Section 194-O

**TDS on e-Commerce
transactions**

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

84. After section 194N of the Income-tax Act, the following section shall be inserted, namely:—

194-O. (1) Notwithstanding anything to the contrary contained in any of the provisions of Part B of this Chapter, where sale of goods or provision of services of an e-commerce participant is facilitated by an e-commerce operator through its digital or electronic facility or platform (by whatever name called), such e-commerce operator shall, at the time of credit of amount of sale or services or both to the account of an e-commerce participant or at the time of payment thereof to such e-commerce participant by any mode, whichever is earlier, deduct income-tax at the rate of one per cent. of the gross amount of such sales or services or both.

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

Explanation.—For the purposes of this sub-section, any payment made by a purchaser of goods or recipient of services directly to an e-commerce participant for the sale of goods or provision of services or both, facilitated by an e-commerce operator, shall be deemed to be the amount credited or paid by the e-commerce operator to the e-commerce participant and shall be included in the gross amount of such sale or services for the purpose of deduction of income-tax under this subsection.

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

(2) No deduction under sub-section (1) shall be made from any sum credited or paid or likely to be credited or paid during the previous year to the account of an e-commerce participant, being an individual or Hindu undivided family, where the gross amount of such sale or services or both during the previous year does not exceed five lakh rupees and such e-commerce participant has furnished his Permanent Account Number or Aadhaar number to the e-commerce operator.

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

(3) Notwithstanding anything contained in Part B of this Chapter, a transaction in respect of which tax has been deducted by the e-commerce operator under sub-section (1), or which is not liable to deduction under sub-section (2), shall not be liable to tax deduction at source under any other provision of this Chapter:

Provided that the provisions of this sub-section shall not apply to any amount or aggregate of amounts received or receivable by an e-commerce operator for hosting advertisements or providing any other services which are not in connection with the sale or services referred to in sub-section (1).

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

(4) If any difficulty arises in giving effect to the provisions of this section, the Board may, with the approval of the Central Government, issue guidelines for the purpose of removing the difficulty.

(5) Every guideline issued by the Board under sub-section (4) shall be laid before each House of Parliament, and shall be binding on the income-tax authorities and on the e-commerce operator.

(6) For the purposes of this section, e-commerce operator shall be deemed to be the person responsible for paying to e-commerce participant.

Section 194-O – Payment of certain sums by e-commerce operator to e-commerce participant

Explanation.—For the purposes of this section,—

- (a) “electronic commerce” means the supply of goods or services or both, including digital products, over digital or electronic network;
- (b) “e-commerce operator” means a person who owns, operates or manages digital or electronic facility or platform for electronic commerce and is responsible for paying to e-commerce participant;
- (c) “e-commerce participant” means a person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce;
- (d) “services” includes ‘fees for technical services’ and fees for ‘professional services’, as defined in the *Explanation* to section 194J.’.

Section 194-O – Comments

- W.r.e.f. 01.04.2020 (AY 2020-2021/PY 2019-20)
- M = 18
- Section 194-O: Payment of certain sums by e-commerce operator to e-commerce participant

Section 194-O

Electronic Commerce
(EC)

Supply of goods/services/both

Including digital products

over

Digital/electronic network

E-commerce operator
(ECO)

A person who

Owens/operates/manages

Digital/electronic
facility/platform

For EC

And is responsible for paying
ECP

E-commerce Participant
(ECP)

Person resident in India

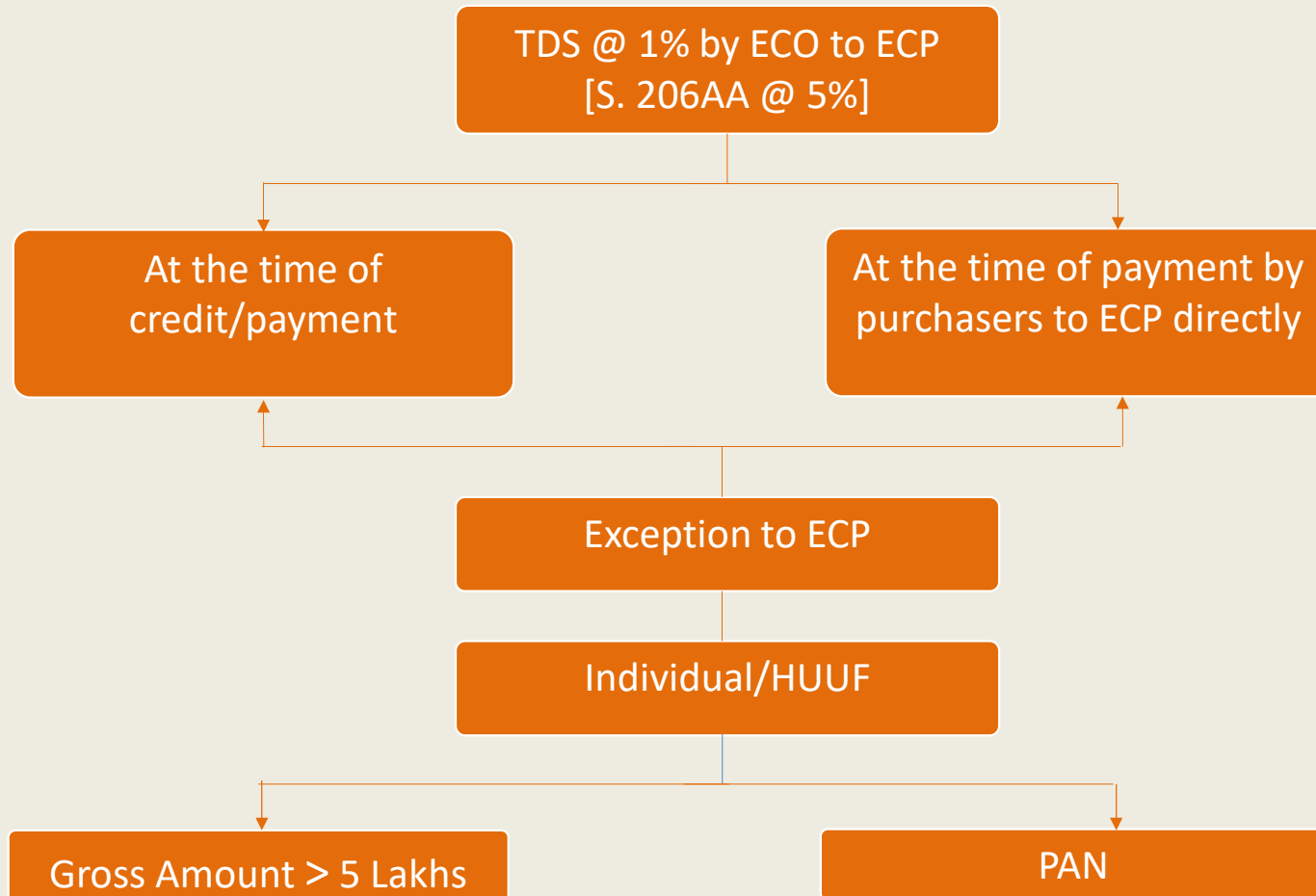
selling

Good/services/both (including
digital products)

through

Digital/electronic
facility/platform

For EC



Note: Lower rate u/s 197 is facilitated by amendment to Section 197(1)

Section 194-O – Comments

- Deductor: e-Commerce operator , resident or non resident
- Deductee: e-Commerce participant, resident
- Rate of TDS: 1% on the gross amount of such sales or service or both
- Tax to be deducted:
 - At the time of credit of amount of sale or service or both to the account of e-commerce participant or
 - at the time of payment thereof to such participant by any mode
whichever is earlier.

Section 194-O – Comments

- Deemed payment: Any payment made by purchaser of goods or recipient of services directly to e-commerce participant, is deemed to be made by e-commerce operator to e-commerce participant
- Exception:
 - Any sum paid credited or paid or **likely to be** credited or paid
 - To the a/c of e-commerce participant, being individual or HUF
 - Where gross amount of sale or service does not exceed Rs. 5 Lakhs and
 - E-commerce participant has furnished his PAN or Aadhaar no. to e-commerce operator

Section 194-O – Comments

- Once TDS made under this Section, no further TDS liability under any other provisions of Chapter XVII –B

Section 194-O – Comments

- Section inserted to widen and deepen the tax net by bringing participants of e-commerce within tax net
- Gross sales/services includes:
 - Commission
 - Shipping fees
 - Listing fee etc