INDIA'S NEW EQUALIZATION LEVY, 2021: ITS IMPACT ON DIGITAL BUSINESSES AND CROSS-BORDER E-COMMERCE

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ABSTRACT

This article examines the impact of India's new Equalization Levy (EL) introduced in 2021 on digital businesses and cross-border e-commerce. It analyses the key provisions of the levy, its implications for various stakeholders, and potential challenges and opportunities arising from its implementation. The Equalisation Levy 2016 was first introduced by the Finance Act of 2016 only for online advertisement services, added some provisions to control digital advertising space, and in the Levy, we can say all the provisions or statutes were enacted only for the facility or service for online advertisement. Further, the scope of the Equalisation Levy has been extended by the Finance Act 2020 to all the e-commerce supplies and services made/ provided/ facilitated on or after 1st April 2020. An E-Commerce operator charged a levy of 2% from the consideration either received or receivable for the supply under e-commerce. 'The Central Government may also specify any other service on which such levy shall be chargeable. Any income chargeable to equalisation levy is exempt from income tax under Section 10(50)'[1]. 'Equalisation levy is charged at the rate of 6% from the consideration paid or payable for services like online advertisement, provision for digital advertising space, and any other facility or service for online advertisement'[2]. The topic aims to provide firstly the overview of the equalization levy, secondly is to focus on the negative aspects of the e-commerce industry and thirdly the most important is to focus on the impacts of India's new equalization levy 2021 on digital businesses and cross-border e-commerce.

INTRODUCTION

The Finance Act 2016 introduced an Equalization Levy in the year 2016 itself. And later on, some of the provisions were added to the levy by the Act of 2020. This levy was introduced only to control the online market, and provisions that were added by the act of 2020 were all about how e-commerce supplies work and in which manner services will be provided. The

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[1] https://incometaxindia.gov.in/Pages/equalization-levy.aspx

[2] https://incometaxindia.gov.in/Pages/equalization-levy.aspx

main aim of the levy is to avoid double taxation and ensure an equal distribution of digital economy tax. It is a kind of direct tax that is levied directly on online transactions made to non-citizens for providing particular services to an Indian citizen. It covers all the transactions that are being made through advertisement. Before the Finance Act 2020, the equalization levy covers only online and advertisement-related services. However, after the provisions added to the equalisation levy 2021 more phrases related to including consideration received by e-commerce operators from any of e-commerce supply and services. All of these services are being taxed at the rate of 2% under the equalisation levy but now the equalization levy is being taxed at the rate of 6% of the consideration.

The equalisation levy statement is to be filed annually by the from-1 on or before the 30th of June every year. 'As we have witnessed many things during the COVID-19 pandemic, all information technology has increased many times, and the dependency on various new technologies or business models has become heavily reliant on digital and telecommunication networks. The Govt. of India already sensed the importance of the IT Sector and also had a sense of the social marketing technology increment; hence it was a great opportunity for the government to start collecting taxes so they introduced the Equalization Levy earlier in 2016.'[3] The buyer from the country makes an online payment to the non-resident for getting the services through the digital method will come under the context of the Equalisation levy.

WHERE DOES THE CONCEPT OF EQUALIZATION LEVY COME FROM?

The concept of EL came from the roots of the Organization for Economic Co-operation and Development (OECD) in 2015. The meeting in the OECD was around digitalized taxation. OECD in its final report on Base Erosion and Profit Sharing (BEPS) Action Plan-1 concerning market digitalization, to date, no recommendations were made in the context of digital tax. EL was introduced to aim for business-to-business transactions. India was one of the 130-plus countries that followed the BEPS measures by adopting the Equalisation Levy in 2016 by the Finance Bill,2016, as it states that the digital market was growing 10% annually in the year 2015 and it was growing more and more which can be equal to all member states globally in together. India introduced many provisions of EL from the finance bill many times (2016-2021) and so on. The Equalisation Levy was formed as part of the Finance Act instead of part of the Income Tax Act.

[3] https://icmai.in/TaxationPortal/upload/DT/Article/60_1903_21.pdf

APPLICABILITY OF THIS LEVY

The Equalisation Levy – a direct tax liable to be paid by the service provider only when Two conditions are to be met as follows –

- Citizens of India.
- A non-citizen having a permanent establishment (PE) in India.
- Individuals who purchase goods or services by using different IP addresses located within India
- Payment or transaction to be made only to non-resident e-commerce operators or service providers.
- Where an annual payment of Rs.1,00,000/- is made to the service provider then will be liable to pay the tax as a levy.

NEGATIVE IMPACTS IN CASE OF DELAYED PAYMENTS

- If the payment is delayed then 1% will be charged to the outstanding EL every month where payment is delayed.
- Penalty for non-payment – 1000/per day will be charged till the EL payment to be failed.
- Penalty for failure to file a statement of compliance – Rs.100/day for each day till the non-filing of the compliance.
- If a false statement has been filed by the assessee then the assessee will be liable for punishment which is imprisonment up to 3 years or a fine as prescribed under the rules.

EXCLUDED FROM THE CONTEXT OF EQUALIZATION LEVY

The non-citizen service provider or e-commerce operator who does not have any PE(Permanent Establishment) in the country will not come under this levy. If an e-commerce operator has PE in the country and made a transaction through a digital platform but does not exceed rs.1,00,000/- will not fall into the context of this levy. One of the exemptions is also provided to service providers to avoid double taxation as per the provisions given under section 10(50) of the said for any transaction made out of the service provided on which EL is chargeable. All the income incurred by the transactions made as any professional fees or royalties for software services will not be counted as income under the EL.

EQUALISATION LEVY (AMENDMENT) RULES 2020-

Some Amendments were made and added by the Central Board of Direct Taxes (CBDT) in the year 2020. The rules are amended to include e-commerce transactions in the context of equalization levy.

They are as follows:

Adding the definition of the term 'electronic verification code' by inserting Rule2(aa) which means - "A code generated for the electronic verification of the person who is furnishing the statement of specified services as per the data structure/ standards laid down by the Director General of Income Tax (Systems) or the Principal Director General of Income Tax (Systems)."[4]

Added the provisions relating to the payment of equalization levy in Rule 4 which provides the guidelines to the e-commerce operator/ service provider so they get the things about where they have to pay or whom they are liable to pay this levy or tax. Some of the authorities are RBI, SBI, or Any Authorized Bank where they will be liable to pay challan.

Added the provisions relating to the statement of specified services in Rule 5 which states as under -

- The statement maintained by the service providers or e-commerce operators should be filed in form no.1 as per the provision given under sections 167(1) or 167(2).[5]
- The service providers or e-commerce operators can furnish the information in form No. 1 electronically by the ways of using a digital signature or using electronic verification code.[6]
- According to s 167(1), Form No.1 should be filed and furnished before the 30th of June annually.
- The Director General of Income Tax and Principle General of income tax has been appointed to assess every furnished information in form no. 1 filed by the e-commerce operators or service providers.
- There are in total 3 forms substituted to work out the process of levying the tax – Form 1, Form No.3, and Form No.4.

[4] https://www.indiafilings.com/learn/equalisation-levy-amendment-rules-2020/
[5] https://www.indiafilings.com/learn/equalisation-levy-amendment-rules-2020/
[6] https://www.indiafilings.com/learn/equalisation-levy-amendment-rules-2020/

- The term ‘assessee’ has been replaced by the term ‘assessee or e-commerce operator’ under rules 7 and 9.

IMPACT OF EQUALISATION LEVY ON DIGITAL MARKET

The impact of the Equalisation levy on the digital market is a complex and multifaceted issue, with both potential benefits and drawbacks. Here's a breakdown of some key points: -

Potential benefits:

Increased tax revenue: The Equalisation levy aims to capture taxable income generated by foreign digital companies that operate in a country without a physical presence. This can help governments collect taxes that might otherwise go unpaid, raising much-needed revenue for important public services.

Leveling the playing field: Domestic companies face corporate taxes within their home country, while foreign digital companies often operate tax-free. The Equalisation levy can help create a more level playing field for domestic businesses by subjecting foreign companies to similar tax burdens.

Promoting local innovation: By increasing the cost of operating in a market, the Equalisation levy can incentivize foreign companies to establish a local presence and invest in local infrastructure and talent. This can benefit the domestic digital ecosystem by fostering local innovation and talent development.

Potential drawbacks:

Increased cost for consumers: The Equalisation levy can be passed on to consumers in the form of higher prices for online services and goods. This can disproportionately impact lower-income consumers and stifle the growth of the digital economy.

Burden on small businesses: Complying with the Equalisation levy can be complex and burdensome for small businesses, especially those that sell products or services online. This can hinder their ability to compete with larger, multinational companies.

Trade disputes and instability: The unilateral implementation of the Equalisation levy by some countries has raised concerns about potential trade disputes and international instability. This could ultimately harm the global digital economy.

Other considerations:

The effectiveness of the Equalisation levy depends on its specific design and implementation. Factors such as the levy rate, the scope of covered services, and the administrative procedures can significantly impact its impact on the market.

International cooperation is vital for finding a long-term solution to the taxation of the digital economy. Multilateral agreements that establish a common framework for taxing digital companies could help avoid trade disputes and create a more predictable and stable business environment.

Overall, the impact of the Equalisation levy on the digital market is mixed. While it has the potential to generate tax revenue, level the playing field, and promote local innovation, it can also increase costs for consumers, burden small businesses, and jeopardize global economic stability. Careful consideration of these factors is necessary when evaluating the Equalisation levy and its potential impact on the digital market. We have seen an increment in business transactions since the equalization levy was introduced in 2016 under the Finance Bill 2016, known as 'Equalisation Levy 1.0'. After the amendments made and new equalization levy was introduced in the finance bill 2020 also known as 'Equalisation Levy 2.0'. The EL 1.0 applied the rate of 6% on non-resident e-commerce operators whose gross revenue exceeds Rs.1,00,000/- annually from online advertisements by citizens and non-citizens who have their PE in India. Recently, in the year 2020, the Government has expanded the scope of the equalization levy after adding some amendments to Finance Bill 2020, i.e., EL 2.0. The EL 2.0 is now levying the 2% rate of tax on the gross revenues received by non-citizens (e-commerce operators) with a PE in India. The Term 'e-commerce operator' is widely defined to include all the establishments that maintain an electronic stage to sell either goods or services online via online transactions. The threshold limit has been set as Rs.20,00,000 to be an e-commerce operator under the equalization levy 2.0.

SEVERAL IMPACTS OF THE EL ON THE AREAS ARE

Extensive impact on the industry: - The Equalisation Levy 2.0 has this much expansion which impacts various business models whether that particular business is a type of e-commerce model or not. Any international company providing such services or goods within the country via a digital platform is part of the industry within the scope of the equalization levy.

Transactions: - The transactions described as royalties or a fee for technical services have been exempted from the Equalisation Levy. As equalization levy only applies to the services or goods sold by the non-resident having PE in India to the citizens of India.

GST V/S Equalisation Levy: - GST applies on the aspects where the equalization levy still needs to be assessed. Both are separate kinds of taxes from each other.

JUDGEMENTS REGARDING THE ROYALTY TO BE INCLUDED OR NOT IN THE EQUALIZATION LEVY

Supreme court order on the payment as royalty that "payments made to non-resident for services by the distribution of software should not be part of royalties which given to a resident of India by the non-resident who's having PE in the country. Indian domestic market has defined the term 'Royalties' in a broader sense that includes the transactions of selling the computer software licenses."[7] Supreme Court clearly states that when a transaction occurs by a non-resident whose income cannot be counted as part of an income tax treaty then that transaction will be liable for equalization levy instead of liable under the Income Tax Act. This decision of the Supreme Court will be binding on the authorized departments.

RATE OF TAX UNDER THE EQUALIZATION LEVY

Now, after the amendments made in the finance bill,2020, the Equalisation levy charges the tax at the rate of 6% of the total consideration by e-commerce operators or service providers.

Illustration –

Aman has advertised on any one social media application either it be Facebook or Instagram to expand his business. Then, in consideration, he has to pay fees for the services worth 2,00,000/- to Facebook or Instagram for advertising services in the previous year 2022-2023. In return, Facebook or Instagram will make a bill for aman of rs.2,12,765.9/-. Aman will deduct the 12,765.9/- and pay the rest of the amount i.e., 2,00,000/- to the service provider.

[7] https://www.kroll.com/en/insights/publications/transfer-pricing/transfer-pricing-times-first-quarter-2021/expansion-of-indias-equalisation-levy-impact-tech companies#:~:text=Supreme%20Court%20decision%20on%20royalty

CHALLENGES AND OPPORTUNITIES AFTER THE EQUALISATION LEVY CAME

The EL has emerged as a controversial yet it has been an increasingly popular way for the government to capture tax revenues generated from the multi-national companies which operate within the boundary but without the physical appearance or without having a permanent establishment in the country. The EL also faces several problems that need to be addressed for effective implementation and smooth integration into the context of the global landscape.

Challenges –

Defining scope and nexus: - Precisely defining the scope of the levy and establishing a clear nexus between the digital activity and the jurisdiction can be complex. Terms like "digital services" and "significant economic presence" require clearer and internationally agreed-upon definitions to avoid double taxation and unfair burdens on businesses.

Administrative burden:- The compliance requirements, record-keeping, and reporting obligations associated with the EL can be cumbersome, especially for smaller businesses. Streamlining compliance procedures and leveraging technology can alleviate this burden.

International consensus:- The effectiveness of the EL depends on international cooperation to avoid trade disputes and double taxation. Multilateral agreements under the OECD's Pillar One proposals offer a promising path towards a global solution.

Impact on innovation and growth: - While aiming to collect tax revenue, the EL should not stifle innovation or impede the growth of the digital economy. Careful calibration and targeted implementation are crucial to ensure these objectives are balanced.

Potential double taxation: - Overlapping EL implementations by different countries can lead to double taxation for MNCs, posing a deterrent to cross-border trade and investment. Coordination and harmonization of national ELs are essential.

Opportunities:

Increased tax revenue: - The EL is a potential source of significant tax revenue for governments, enabling them to invest in public services and infrastructure. This can benefit citizens and promote economic growth.

Leveling the playing field: - The EL creates a more level playing field for domestic businesses that are subject to corporate taxes within their home country. This can foster fair competition and encourage local innovation.

Transparency and accountability:- The EL can increase transparency and accountability for MNCs operating in the digital economy, ensuring they contribute their fair share of taxes to the jurisdictions where they generate revenue.

Promoting local investment: - The EL can incentivize MNCs to establish a local presence to manage the levy burden and gain greater market access. This can create jobs and contribute to local economic development.

Driving global tax reform: - The EL, along with other national measures, can put pressure on traditional tax frameworks to adapt to the evolving digital economy. This can ultimately lead to fairer and more efficient global tax systems.

The Equalisation Levy (EL) has a profound impact on cross-border e-commerce, affecting both consumers and businesses alike. Here's a closer look at its potential consequences:

Impact on Consumers:

Price increases: The EL adds to the cost of doing business for e-commerce platforms, which may be passed on to consumers in the form of higher prices for online goods and services. This could dampen cross-border e-commerce growth and limit consumer access to imported products.

Reduced product variety: Platforms might adjust their product offerings to minimize EL liabilities, potentially leading to a decrease in the variety of available goods, especially for lower-value items with smaller profit margins.

Changes in delivery options: Cross-border e-commerce platforms might adjust their delivery options, potentially favouring domestic sellers through faster or cheaper shipping options to avoid triggering the EL on imported goods.

Impact on Businesses:

Increased tax burden: The EL creates an additional tax liability for non-resident e-commerce operators exceeding a certain revenue threshold in a country. This can significantly impact their profit margins and pricing strategies.

Compliance costs: Adapting to the EL's compliance requirements, including record-keeping, reporting, and potential audits, can be costly and administratively burdensome for businesses, especially smaller ones.

Competitive disadvantage: The EL disadvantages non-resident e-commerce operators compared to domestic businesses already subject to corporate taxes. This can create an uneven playing field and hinder competition.

Overall, the Equalisation Levy's impact on cross-border e-commerce is a complex and multifaceted issue. While it aims to ensure fair taxation and generate revenue for governments, it can also lead to higher prices for consumers, reduced product variety, and challenges for businesses. However, it also presents potential opportunities for local businesses and digital transformation. Carefully assessing the implications and exploring collaborative solutions will be crucial for mitigating negative impacts and fostering a sustainable and thriving cross-border e-commerce ecosystem.

India: Interpreting The India-US Interim Agreement On Equalisation Levy 2020

"The most important area of this agreement was to stop double taxation on the services provided by e-commerce operators or service providers via digital platforms. A joint statement has been issued between the US and Austria, France, Italy, Spain, and the United Kingdom, namely 'Unilateral measures compromise'. This agreement also directs the US Govt. to not initiate any action prescribed under section 301 of the pact.

Now, there's also an existing agreement between the US and India as an interim agreement till the next agreement is put in place.

During the recent visit of the US Trade Representative to India, the agenda of this interim agreement has been taken up and govt. of India ensures that the statement will be followed as per the agreement held between the other nations. There are many terms and conditions agreed upon by both sides:-

While one awaits the final text of this interim arrangement, certain aspects are worth considering:

Interim Period as per financial year: The understanding of "Interim Period" under the Unilateral Measures Compromise is different from that under the India-US Interim Arrangement. The "Interim Period" under the Unilateral Measures Compromise begins on January 1, 2022, and ends on the date the Pillar 1 multilateral convention comes into force or December 31, 2023 (whichever is earlier). The "Interim Period" under the India US Interim Arrangement will be April 1, 2022, till the implementation of Pillar One or March 31, 2024, whichever is earlier. This takes into account the concept of "financial year" as recognised in India.

The agreement only covers a 2% levy: While the Unilateral Measures Compromise defines "Unilateral Measures" widely as "Digital Services Taxes and other relevant similar measures", the India-US Interim Agreement only covers the 2% Equalisation Levy of 2020. This is logical since the USTR action was initiated only about the 2% Equalisation Levy and thus this Interim Agreement speaks of a commitment from the US to not initiate any trade measure to such 2% Equalisation Levy.

WHAT DOES THIS MEAN FOR TECH MULTINATIONALS?

For the entities that will be covered under Pillar One (whose global turnover crosses the threshold of € 20 billion, with a profitability of above 10%) i.e. about 100 ultra-profitable MNEs, will be required to pay a 2% Equalisation Levy on e-commerce supply of services made to Indian customers (and to non-residents in certain situations) during the Interim Period. If the quantum of this Equalisation Levy exceeds the "Amount A" computed under Pillar One, then such an entity would be eligible to take credit of the same (as per the prescribed prorated manner) and its corporate income tax in India arising from the new taxing right under Pillar 1 would get reduced to that extent.

- For entities other than the above, i.e. for a majority of the MNEs, a 2% Equalisation Levy will continue to apply to the e-commerce supply of goods and services, until the implementation of Pillar One. Thereafter, in terms of India's commitment to the October Statement, the said Equalisation Levy should ideally be withdrawn for all companies.

- Since the US-India Interim Agreement does not speak generally of "Digital Services Taxes and other relevant similar measures" but only of "2% equalization levy on e-commerce supply of services", it does not impact the 6% equalization levy which was imposed in 2016 on online advertisements. Thus, as regards the 6% Equalisation Levy, the ultra-profitable MNEs covered under Pillar One would not be able to avail of any interim credit once Pillar One gets implemented. The other MNEs would in any case continue to pay the 6% Equalisation Levy till Pillar One is implemented.
- Once Pillar One is implemented, whether the 6% Equalisation Levy will be withdrawn will have to be seen. Since the October Statement speaks of withdrawal of "all Digital Services Taxes and other relevant similar measures", it should ideally also result in the withdrawal of a 6% Equalisation Levy on online advertisement services."[8]

CONCLUSION

The Equalisation Levy (EL) of 2021 in India stands as a landmark yet controversial attempt to capture tax revenue from the booming digital economy, particularly from non-resident e-commerce players. With significant implications for consumers, businesses, and the government itself, its journey unveils a tangled web of challenges and opportunities. Unlike its 2016 iteration targeting online advertising, the 2021 EL cast a wider net, encompassing e-commerce transactions exceeding 20 million INR in annual revenue. This brought global internet giants squarely under the Indian tax radar, shaking up the previously comfortable landscape of cross-border e-commerce. Recognizing the burgeoning e-commerce sector, the 2021 EL adopted a differentiated approach. While online advertising faced a 6% levy, e-commerce transactions were subjected to a lower 2% rate. This reflected a cautious balancing act between generating revenue and nurturing the nascent e-commerce ecosystem. This simplified collection for the government but added a new layer of administrative complexity for platforms, impacting their operational costs and potentially influencing pricing strategies. Consumers, the ultimate end users, were not immune to the levy's impact. The possibility of platforms passing on the cost burden through higher prices loomed large, raising concerns about affordability and access to imported goods. Additionally, a reduction in product variety

[8] https://www.mondaq.com/india/international-trade-amp-investment/1138536/interpreting-the-india-us-interim-agreement-on-equalisation-levy-2020

might occur as platforms adjust their offerings to minimize their EL liabilities. For non-resident e-commerce operators, the EL added a new layer of operating costs and impacted profit margins. Some might choose to absorb these costs, while others might pass them on to consumers. The levy also incentivized some larger players to consider establishing a local presence in India, potentially creating jobs and boosting investment. The 2021 EL's impact is still unfolding, with several challenges and opportunities yet to be fully realized. Efficient administration, clear definitions of taxable transactions, and global collaboration are crucial for success. As the journey continues, the levy's effectiveness in achieving a fair and sustainable tax system for the digital age remains to be seen.