

Equalisation Levy- Explained!

1. Backdrop:

The US Government has proposed to impose retaliatory tariffs up to 25 per cent on a wide variety of Indian products ranging from shrimps and basmati rice to gold and silver items in response to the digital tax imposed by India on non-resident e-commerce operators¹.

Why US Government has proposed to impose such heavy retaliatory tariffs on Indian Goods? Well, if you're not following the news related to the digital tax saga, here is the simplified version for you.

2. What is Digital Tax aka Equalisation Levy?

Traditionally your physical place of business determines your tax jurisdiction. But, in the current era of the digital economy, your physical place is now immaterial for conducting business anywhere across the globe, this has created new problems for the policymakers, that how to tax this type of businesses? Many digital giants, may not have a physical location in India, but they large consumer based in India and they create great wealth out of it and they don't pay their due share to the Indian exchequer. While the Organisation for Economic Co-operation and Development (OECD) is working towards achieving a global consensus-based solution to the tax challenges arising from the digitalisation of the economy. India was one of the first countries in the world to introduce a 6% equalisation levy in 2016, but the levy was restricted to online advertisement services, which is explained below:

2.1. Equalisation levy as introduced in Finance Act, 2016:

- Chapter VIII (Section 160 to 177) of the Finance Act, 2016 deals with the Equalisation levy. As per Section 165 of Finance Act, 2016, if a non-resident person receives

¹ <https://www.thehindubusinessline.com/news/us-proposes-retaliatory-tariffs-up-to-25-on-select-indian-products-in-response-to-equalisation-levy/article34175457.ece>

consideration for providing services of **online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement** from resident Indian or non-resident having a permanent establishment in India, then this transaction is subject to the Equalisation levy @ 6%, **subject minimum threshold limit of Rs. 1 lakhs for aggregate payment during the year by each payee.**

- Note that, in the above transaction, the payer i.e. resident Indian or non-resident having a permanent establishment in India need to deduct the Equalisation Levy @ 6% while making payment to a non-resident. Consider this example, M/s ABC Limited wants to advertise its products on Instagram. For this, M/s ABC Limited has paid Rs. 2,00,000/- to Instagram Inc, USA. Now, M/s ABC Limited need to deduct Rs. 12,000/- as the Equalisation Levy and pay to the Indian exchequer.
- However, if the payer doesn't deduct or deducted but failed to deposit the Equalisation Levy to the credit of the Indian exchequer, then the whole expenditure will not be allowed as deduction u/s 40(a)(ib) of the Income Tax Act, 1961 while computing the total income. In the above example, if M/s ABC Limited fails to deducted Rs. 12,000/- as Equalisation Levy, then whole amount i.e. Rs. 2,00,000/- will not be allowed as a deductible expenditure while computing total income. Additionally, the payer is liable for the following penalties:

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| fails to deduct the whole or any part of the equalisation levy | A penalty equal to the amount of equalisation levy that he failed to <i>deduct, will be charged.</i> |
| having deducted the <i>equalisation levy</i> , fails to pay such levy credit of the Indian exchequer | A penalty of one thousand rupees for every day during which the failure continues, so, however, that the penalty under this clause shall not exceed the amount of equalisation levy that he failed to pay, <i>will be charged.</i> |

- In the hands of the payee, said amount will be exempted under Section 10(50) of the Income Tax Act, 1961.

2.2. Scope expanded in Finance Act, 2020:

- Finance Act, 2020 had amended Chapter VIII of Finance Act, 2016 and inserted new Section 165A, as per the said Section, if non-resident e-commerce operator receives consideration from **e-commerce supply or services** made or provided or facilitated by it to following persons:
 - To a person resident in India, irrespective of his IP address.
 - To a non-resident,
 - For sale of advertisement, which target a customer, who is resident in India or accesses the advertisement through IP address located in India.*
 - Sale of data, collected from a person who is resident in India or from person who uses IP address located in India.*
 - To a person who buys such goods or services using IP address located in India.

Then, the above transaction is subject to an Equalisation levy @ 2%.

- **What constitute e-commerce supply or services?**
 - (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);]
- Note that, unlike Section 165 wherein the payer needs to deduct levy while making payment to the payee, **in Section 165A onus is on the payee to deposit directly to the credit of the Indian exchequer.** Consider this example, if Netflix earns Rs. 10 Crores as subscription income from the resident Indians, then Netflix need to deposit Rs. 20 lakhs as Equalisation Levy to the credit of Indian Government.

- If the sale, turnover or gross receipts of the e-commerce operator from the e-commerce supply or services is less than two crore rupees, then Equalisation Levy will not be charged.
- **It is pertinent to note that, Equalisation levy is not the part of Income Tax Act, 1961 hence non-resident e-commerce operator will not get the credit of the same in their home county.**
- If an e-commerce operator fails to deposit the Equalisation Levy, then a penalty equal to the amount of equalisation levy that he failed to deposit, will be charged.
- In the hands of the payee, said amount will be exempted under Section 10(50) of the Income Tax Act, 1961.
- **Further scope expended by the Finance Act, 2021:**
- **Equalisation levy to be charged on Gross amount:**
Finance Act, 2021 has clarified that consideration received or receivable from e-commerce supply or services shall include consideration for the sale of goods or consideration for the provision of services irrespective of whether the e-commerce operator owns the goods or services are provided or facilitated by the e-commerce operator. However, that it shall not include e consideration for the sale of such goods or provision of services which are owned by a person resident in India or by a permanent establishment in India of a person non-resident in India.

Consider this example, Mr A (resident Indian) orders goods worth \$1000 from Amazon.com, and those goods are owned by Mr B (US resident) then Amazon.com needs to pay the Equalisation Levy on \$1000, even if Amazon.com earns only \$10 as commission.

If Mr A (resident Indian) orders goods worth Rs. 75,000 from Amazon.in, and those goods are owned by Mr C (resident Indian) than Amazon.in needs to pay the Equalisation Levy only on commission income earned.

- Finance Act, 2021 further amended Chapter VIII of Finance Act, 2016, wherein it was clarified that if the consideration received for advertisement services (Section 165) or for e-commerce supply (Section 165A) are taxable as royalty or fees for technical services as the Income Tax Act, 1961, it will not be subjected to the Equalisation Levy.

3. US-India Conflict:

Equalisation Levy as introduced through Finance Act, 2020 has created a lot of buzz in the media. The US announced its intent to crack down on digital tax as introduced by six countries i.e. Austria, India, Italy, Spain, Turkey, and the United Kingdom, which it claims discriminated against US digital companies and were “inconsistent with principles of international taxation”. For that, the US had initiated an investigation under Section 301 of the U.S. Trade Act, 1974.

Further, against, the said digital tax, the US has announced to impose tariffs for each of the six countries who adopted digital tax that would roughly total the amount of tax revenue each country is expected to get from the US digital companies. The cumulative annual value of the duties comes to \$880 million, according to the Bloomberg news calculations².

What do you think, should India withdraw its digital tax or should India continue to impose digital tax until OECD achieves a global consensus-based solution to the tax challenges arising from the digitalisation of the economy? Share your views/feedback on satish93.mail@gmail.com

² <https://www.bloomberg.com/news/newsletters/2021-04-05/supply-chains-latest-u-s-readies-880-million-defense-on-digital-taxes>