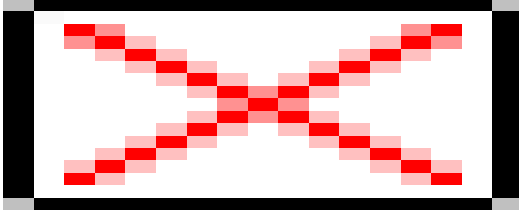


Equalization Levy - Simplified or Amplified?

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Background

INDIA

was amongst the first set of major economies to introduce Digital Services Tax ('DST') in the form of Equalisation Levy (EQL) in 2016. The scope of EQL was initially restricted to provision of digital advertising space by non-resident. The liability to discharge the EQL and undertake compliances was on the Indian residents making the payment to such non-residents, and hence, the EQL did not affect most of non-residents due to its restricted applicability and also because of the fact that practically the cost of EQL was passed on to Indian service receivers.

In the last Budget, the scope of EQL was significantly widened to cover online sale of goods as well as online sale of services. However, there were quite a few interpretation issues and the industry was grappling with the same.

Budget proposals on EQL

The government in Budget 2021 has proposed certain clarifications on controversial issues to simplify the tax administration and reduce litigation. Amongst others, Budget 2021 has proposed the following amendments to rationalize the provisions of EQL:

- EQL shall not apply on consideration which is taxable as 'royalty' and as 'Fees for Technical Services (FTS)' under the Income-tax Act, 1961 (the Act) read with the tax treaty
- Scope of **"online sale of goods"** and **"online provision of services"** is explained to include one or more of the following activities taking place online:
 - a) acceptance of offer for sale;
 - b) placing the purchase order;
 - c) acceptance of the purchase order;
 - d) payment of consideration; or
 - e) supply of goods or provision of services, partly or wholly
- EQL to apply on consideration received by E-Commerce Operator ('ECO') even if goods are not owned by ECO or services are not provided by ECO (i.e., services are merely facilitated by ECO).

The above amendments will take effect retrospectively from April 1, 2020 and will accordingly apply from the assessment year 2021-22 onwards.

Key takeaways

Non-applicability of EQL provisions on income taxable as royalty/ FTS provides much relief to non-residents from double taxation and settles the ambiguity revolving around the same. Pertinent to note that non-residents may still need to test the provisions of EQL especially in cases where the transaction is not taxable as royalty/FTS.

Unexpectedly, Budget 2021 has proposed very wide definition for 'online sale of goods/services' which seems to cover in its ambit all online transactions for sale of goods/services without any exemption. It may be interesting to note that the Digital Service Tax regime in European Countries provides exemption for various services such as intra-group transactions, communication services, regulated financial services, etc. and the Industry at large was also expecting similar relaxation in India, which unfortunately has not come through.

The United States Trade Representative (USTR) initiated investigation in June, 2020 under Section 301 of the US Trade Act of 1974 with respect to DST adopted by India, amongst other countries claiming that the digital tax imposed unilaterally by the countries is unfair and discriminatory as it is targeted majorly at digital companies in the US. India participated in these investigations and defended the EQL by stating it is not 'unfair' as it is applicable across all non-residents.

On January 6, 2021, USTR issued findings in the investigations of DST adopted by India concluding that India's DST discriminates against U.S. digital service companies, unreasonably contravenes international tax principles, and burden or restricts U.S. commerce and thus is actionable under section 301. The USTR has also highlighted EQL as having the largest scope in comparison with other DST.

USTR is not taking any specific actions in connection with the findings at this time but will continue to evaluate all available options. US being an important trade partner for India, it will have to be seen as to how expanded EQL impacts the trade relationship between the two countries. Only time will tell and test India's DST journey.

[The views expressed are strictly personal.]

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