
Digital Economy - Service Tax - A 'TRIP' worth caring for!

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digital economy has become a powerful driver of economic growth. Although the entities operating in the digital space have some distinctive characteristics such as unhindered cross-border transactions through internet and the coverage of global value chains in which large enterprises integrate their worldwide activities but the OECD's Base Erosion & Profit Shifting (BEPS) Report notes that it would be difficult to **'ring-fence'** the digital economy from the rest of the economy for tax purposes. However, the Report underlines the need to put an end to the phenomenon of so-called stateless income. But it does not recommend a **fresh distribution of taxing rights**

as it may hurt the monopolistic grip of the US internet-based companies dominating the global e-space. While making several other observations not necessarily relating to the core issue, it also notes that the collection of VAT/GST on cross-border transactions is a serious issue.

The Indian story is no different. In the past few years the Indian digital economy has also grown into a giant sector which can certainly be **'ring-fenced' by applying a set of broad parameters for taxation purposes.**

It would be pertinent here to refer to the PIL filed by Govindacharya before the Delhi High Court where he sought recovery of taxes from internet-based entities like Google and Facebook from their operations in India. It was revealed during the hearing that since they are foreign based companies having no PE in India they need not pay income tax.

With respect to Service tax the court was informed that although Google India pays service tax but Facebook does not as it has its office in a SEZ from where it exports services to the DTA areas. There are several examples of large internet-based companies operating in India but not paying either income tax or short-paying indirect tax because of aggressive tax planning.

Aggressive tax planning which has emerged as a large industry in India in the past one decade, by definition, revolves around **tax avoidance.** Although a catena of judicial pronouncements have established that tax avoidance is **not illegal** but it is certainly not ethical. The examples of aggressive tax planning are aplenty and much sharper in the domain of digital space. In many cases such tax planning has gone awry and investigating agencies have construed them as cases of tax evasion.

One recent example which has extensively been reported in the media is that of MakeMyTrip.com (MMT). It is a Nasdaq-listed company which offers online facility of booking flight tickets and also hotel rooms. The Directorate General of Central Excise Intelligence (DGCEI) has booked this company for the alleged service tax evasion of **Rs 83 Crore**

. Although the company insists that it operates on commission basis but the excise sleuths have alleged that it has **principal to principal agreement** with more 30,000 hotels where rooms are booked in advance for a particular price and the same is provided to online consumers at a mark-up on which service tax is collected by allegedly camouflaging the same as **'MMT tax'**

. In other words, the demand has been raised against the services of **'renting of hotel room'**
. The DGCEI has alleged that the accused company has been making profit by offering the rooms booked at lower prices at much higher prices and it cannot be described as the commission model of the business. In other words, the service tax is being allegedly paid at much lower prices than the price being pocketed by the accused company which has also been accused of not showing the service tax component separately - the same being camouflaged as 'MMT Tax'!! What is that other tax which the accused is paying is **not yet clear**
. The DGCEI officials have also claimed that in a report submitted by the MMT to the United States Securities and Exchange Commission (USSEC), downloaded from the MMT website, it has been claimed by the company that **hotels allocate rooms directly to MMT** which makes it clear that they do not simply book rooms on behalf of hotels but allocate rooms to their clients.

The other allegation against the MMT is that apart from pocketing the mark-up money and the service tax on the differential amount (the difference between the sum collected from customers and the sum paid to hotels) the accused company has also been claiming 90%

abatement in the category of 'tour operator'. The DGCEI believes that MMT does not qualify as a 'tour operator' and is not eligible to claim such abatement. When the investigators called for records, on the ground of non-cooperation, the Vice-President (Finance), Mr M K Pillai, was arrested and granted bail only after huge deposits under 'protest' were made. MMT also moved the Delhi High Court which has not stayed the bail order of the lower court laying down several conditions to be complied with.

Another interesting fact which has come out during investigation is that out of 30,000 hotels with which MMT has entered into agreement, an inquiry was conducted against 490 hotels and as many as 212 hotels are not even registered with the service tax department. If that is true, who has been pocketing the service tax collected from customers - **MMT or hotels?**

If it is the commission model of business as being claimed by MMT, service tax must have gone to hotels which are not depositing the same in the government account? Or, if the MMT has directly been booking the customers and allocating rooms to them, the service tax paid to hotels would be **input credit** for them. But if the hotels which collected service tax but did not deposit the same with the Department, the CENVAT credit availed by MMT would ultimately be denied to it

. All such complexities in this case seemingly indicate that it is not devoid of shades of serious tax planning.

Let's now visit another case where the DGCEI has recently arrested the Director of a company operating in the digital space. This company was allegedly engaged in providing "Online information and database access service and/ or retrieval service through computer network" but allegedly camouflaged itself into "Tour Operator", without changing its activities. This Noida-based company in the e-space was selling their e-educational packages which were accessed by their customers by using login and password. However, in order to allegedly enjoy exemption of 90% available to tour operators, they rechristened their e-education package as "eBiz Holiday Accommodation Packages". Interestingly, they had allegedly booked a few hotel rooms only in last few years to claim their services covered under tour operator. Both these packages, i.e. ebiz education package or eBiz Holiday Accommodation Packages were available at a fix price of Rs. 10830/- (inclusive of all taxes). As per DGCEI, the company was allegedly evading Service Tax on e-educational packages under the garb of naming it as "ebiz Holiday Accommodation Package" and claiming deduction of 90% available in the category of 'Tour Operators'.

DGCEI further claims that investigations have revealed that the company had shown more than 40% of its business from holiday packages, on which they were taking abatement of 90% under the category of "Tour Operator". Further during the year 2011-12, the income from e-education package was 63% of the total income, which gradually decreased to 27% during 2015-16, where share of income from 'holiday package' increased from 15% during 2011-12 to 59% during 2015-16. During the year 2014-15 alone, instead of paying Service Tax on Rs. 84.93 Crore, the company had paid Service Tax on Rs. 52.54 Crore only by claiming the abatement on tour operator service. It was also allegedly found that although the company had claimed income from tour operator service to the tune of more than Rs. 40 Crores during F.Y. 2014-15, **their expenditure towards hotel bookings during 2014-15 were only Rs 3.62 lakh.**

The total service tax evasion is estimated to be Rs 15 Crore.

All these recent examples of alleged tax evasion clearly indicate that there was aggressive tax planning which bordered on the contours of tax evasion. More interestingly, more than the income tax the digital economy has become a much more serious challenge for the indirect tax administration in India. Although service tax is a domestic legislation where cross-border transactions are treated as export of services and the same gets various incentives from the Government but aggressive tax planning is also a ground reality which policy makers need to factor in for fair tax collections. Even for thousands of start-ups which are going to operate in the digital economy, these two cases are a good example for doing their homework properly and not to err on the wrong side of the tax laws!