Taxation and Digitalization-
Tax policy Options-
Equalisation Levy

CENTRAL BOARD OF DIRECT TAXES
MINISTRY OF FINANCE
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BACKGROUND

- The technological advances in Information & Communication Technology (ICT) and internet has brought into existence new business models that were not envisaged when the existing rules of physical presence based nexus for taxing business income were developed.
- The emergence of a new digital economy that relies largely on activities in the virtual world, and does not require any physical presence anywhere has made the physical presence based nexus rules completely redundant.
- This severely impacts the ability of States to collect tax on the profits made by digital enterprises, and facilitates tax avoidance.
- It also leads to unfair tax advantage to digital enterprises and violates the basic principle of tax neutrality.

BACKGROUND.....

- In BEPS project under Action Plan 1, the following options have been identified to address these tax challenges arising from digital economy –
  - ✓ modifying the existing Permanent Establishment (PE) rule by including "Significant Economic Presence"
  - ✓ Final withholding tax on certain payments for digital goods or services; or
  - ✓ imposition of Equalisation Levy on consideration for specified digital services received by a non-resident.

BACKGROUND……

- In India, a Committee was set up to examine the tax matters relating to e-commerce, including experts from within and outside the Government.
- Equalisation Levy was recommended by the Committee. The Committee relied extensively on the observations made in Final Report on Action 1 as well as work of renowned international experts.
- The Committee noted that Equalisation Levy was recognized as a potential option in Chapter 7 of Action 1 Report & though none of the three options detailed there were recommended, Chapter 9 concluded that any of these options could be adopted under domestic laws.

Equalisation Levy (EQL)

- To address tax challenges arising from digital economy, India introduced equalisation levy:-
  - ✓ To ensure tax neutrality between specified services provided from within India and outside India
  - ✓ To achieve minimal disruption for enterprises, without creating multiple or excessive taxation, and with minimal costs of compliance and administration; and
  - ✓ To ensure that options are available for enterprises to pay either tax on income from specified services on net basis under the existing laws (by adjusting their business model), or tax on specified services on gross payment

EQL: TAX DESIGN

- **Tax on Specified services**
  - Introduced by Chapter VIII of Finance Act, 2016 : a self contained code unrelated to any other tax
  - Rate of tax: 6% of the gross payment
  - Till now only Online Advertising- power of notification
  - Charged on consideration for specified services received or receivable by a Non-resident
  - from a person resident in India and carrying on business and profession in India or a Non-resident having PE in India
- **No EQL if**
  - Recipient has PE in India & payment is effectively connected with PE
  - If aggregate payment from a person in a year is less than Rs. 100,000
  - B2C transactions

EQL: TAX DESIGN

- **Exemption from tax for income from Specified Services**
  - To avoid multiple taxation, income from specified services chargeable to EQL have been exempted under the Income-tax Act, 1961
- **Collection of Equalisation Levy**
  - EQL to be deducted if payment > Rs. 100,000 p.a.
  - Interest of 1% every month for delay in payment of EQL
  - Penalty for failure to deduct EQL : 100% of EQL payable
  - Payment of EQL where due is introduced as a condition for claiming deduction of expenses in the Income-tax Act, 1961

EQL: Response & Options in Future

- **Still Early Days**
  - As per reports EQL is being deducted and paid to Government.
  - The collections are in tune with expectations.
- **Option for getting taxed on Net income is inherent in tax design of EQL**
  - The tax design enables an enterprise to avail of the option of getting taxed on net income instead of being subjected to EQL on gross receipt, by establishing PE in India
- **Possible Options in Future**
  - Expansion of scope of specified service

Need for Further Action

- **The Way Forward…..**
  - Need for continuing the work initiated in Action 1 of BEPS for addressing tax challenges arising from digital economy.
  - Modifying the nexus rules in the tax treaties & recognize ‘Significant Economic Presence’ as sufficient nexus for taxing profits.
  - Provide options in tax treaties for withholding tax, for ease of compliance and administration.
  - Arrive at international consensus at the earliest to prevent the need for unilateral actions, which can lead to multiple taxation and raise costs of compliance.

Any Questions?

THANK YOU