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# EQUALISATION LEVY: AN ANALYSIS OF DIGITAL TAXATION

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## **I. Introduction**

With the ever-evolving Information Technology, the nations across the globe have initiated advancement to pace up with the digitalization of economy. This global exponential expansion of the Information Technology has led to an increase in the demand and supply of digital services. In light of the same, new business models have been set up globally relying on the telecommunication and digital networks. The Digital Economy constitutes of various evolving business models such as e-commerce, online advertising, app stores, online payment modes and social media. This is a global phenomenon, strongly evident in India as well. India is one of the fastest growing e-commerce markets in the world, home to some of the giant players such as Flipkart, Paytm, Amazon, etc. What makes it successful? - advanced, evolving, cheaply accessible internet connectivity and technology solutions, which are the main enablers for the global success of this industry and increasing popularity of digital economy, challenging international physical borders and outpacing the principles of traditional economy.

India's private sector has given a major momentum to digital based activities, and the Indian government, through its Digital India programme and several related initiatives, is rapidly expanding the scope and basis of digital transactions in India. The ability to provide services from any location facilitates inclusiveness and generates conditions for positive network effects for creating multiplier effects for economic and social transactions. The potential in India is huge, both, because of the growth in digital technologies and the significant segment of population that is yet to become an active part of this growth.

In furtherance of the same, the Indian government vide budget 2016 introduced Equalisation Levy with the aim and motive to take cognizance of the digital transactions taking place from India to foreign e-commerce. This was started to give effect to one of the BEPS recommendations. As per the 'Committee for Taxation of E-commerce Transactions' report, "the word 'equalization' represents the objective of ensuring tax neutrality between different

businesses conducted through differing business models or residing within or outside the taxing jurisdiction.” Equalisation Levy is a direct tax that is withheld at the time of the payment by any service recipient. It is applicable on services like online advertisements, digital advertising space or facilities are subject to this form of tax.

## II. History and Development of Equalisation Levy- From 2016 to 2021

The Organisation for Economic Co-operation and Development i.e., OECD addresses to the tax challenges of the Digital Economy via its Action Plan 1 of the Final Report on 'Base Erosion and Profit Shifting' (BEPS). The OECD sought to address to this issue in response to growing concerns raised by the political leaders, media outlets and civil society across the globe about the aggressive tax planning by multinational corporations that makes use of loopholes in the tax laws in order to artificially reduce their tax liabilities. BEPS Action Plan 1 identifies and analyses various tax models in relation to transactions in the Digital Economy, such as modification to Permanent Establishment (PE) related Rules to include significant economic presence, withholding tax on digital transactions and equalisation levy. In light of the aforesaid developments, the Central Board of Direct Tax (CBDT), had constituted a 'Committee for Taxation of E-commerce Transactions' to suggest an appropriate mechanism, for taxation of e-commerce transactions. The Committee, taking into consideration the BEPS Action Plan 1, suggested adoption of a new levy, viz., 'Equalisation Levy', which is independent of the domestic income tax provisions. The equalisation levy was thus introduced through the Finance Act, 2016 and was made applicable w.e.f. 1<sup>st</sup> June 2016.

- i. **Equalisation Levy 2016-** The Government of India via the Finance Act 2016, introduced an equalisation levy of 6% applicable “...to consideration received or receivable for specified services provided on or after the commencement of this Chapter.”<sup>1</sup> It applied only on business-to-business (B2B) transactions. The Finance Act clarified that 'specified service' means online advertisement and any provision for digital advertising space or any other facility or service for the purpose of online advertisement.<sup>2</sup> It also provided that such specified services include any other service as may be notified by the Central Government in this regard. The levy applies to

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<sup>1</sup> The Gazette of India, Extraordinary, Part II, dated May 14, 2016. <http://www.cbec.gov.in/resources//htdocs-cbec/finact2016.pdf;jsessionid=86D93EE8B8EE9D549BFE78A773DF79D>

<sup>2</sup> Section 164(i) of the Chapter VIII of the Finance Act, 2016

specified services for more than Rs. 100,000 supplied by non-residents not having permanent establishments (PE) in India. The levy has to be deducted by a recipient, who is resident in India or has a PE in India, “from the amount paid or payable to a non-resident in respect of the specified service” and paid to the Central Government by the seventh day of the month immediately following the calendar month in which the sum has been deducted. The levy came into force from June 1, 2016.<sup>3</sup> The main contention was that the Multi-National Companies are not liable to pay direct taxes in India as they do not have Permanent Establishment in India and by offering this service of advertisements they were not liable to pay any tax. Hence, such a decision of levying equalisation levy over such services was desirable in the light of the BEPS Action Plan.

- ii. Equalisation Levy 2020-** The Finance Act, 2020 widened the scope of Equalisation levy. It provided that the e-commerce supplies and services shall also include online sale of goods owned by e-commerce operator, online provision of services by e-commerce operator, online sale of goods or provision of services or both mediated by e-commerce operator, any combination of these activities. It was also prescribed that a 2% levy shall be applicable if the e-commerce supplies or service is received by Indian resident customers or any customer whose IP address is located in India. It was also clarified that this shall not be applicable on the non-resident supplier that has a PE in India and where the aggregate value of consideration for a specifies transaction doesn't exceed two crores.
- iii. Equalisation Levy 2021-** The Union Budget 2021 brought in further clarifications and modification in order to remove the ambiguities. It inserted an explanation to the Section 164 of the Finance Act 2016 and provided that the online sale of goods or provision for services shall also include “*acceptance of offer for sale, placing the purchase order, acceptance of purchase order, payment of consideration or the supply of goods or provision of services partly or wholly.*” It was also provided that Section 165 A of the Finance Act be amended and the consideration received or receivable from e-commerce supply or services shall include; “*the consideration for sale of goods irrespective of whether the e-commerce operator owns the goods; and the*

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<sup>3</sup> See notification on May 27, 2016.

<http://www.incometaxindia.gov.in/communications/notification/notification372016.pdf>

3 <http://incometaxindia.gov.in/news/report-of-committee-on-taxation-of-e-commerce-feb-2016.pdf>. P.75

*consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator.” It is pertinent to note that through this the Equalisation Levy has shifted from a B2B to B2C model and the burden of this tax liability will be ultimately passed onto the buyers and the consumers.<sup>4</sup>*

While such clarifications and amendments were much needed, however, there are several other aspects on which there is no clarity given by the government or the legislations. For eg., what shall be the applicability of the levy in cases wherein only a part of the transaction shall be processed online? Considering the wide and vast scope of the bill, it might also attract business transactions taking under the associated companies involving a meagre amount of digital transactions out of the total transaction.

### **III. A Unilateral Measure**

The OECD was planned towards attaining a multilateral consensus on an inclusive framework of the taxation of digital economy. This was to be sought till the end of 2020, however the pandemic had extended the deadline to mid 2021. However, amid this tussle, several countries have either introduced (like India, Australia, Italy) or are in a process of implementing (like the European Union) a unilateral measure which might undermine the initiatives taken by OECD. In India, the implementation of Equalisation levy and the further enactment via the Finance Bill 2020 was more of a surprise since the India has been a known active participant in the OECD's BEPS 2.0 Pillar 1 Project which aimed to build and draw a global consensus on the taxation of the digital economy. Therefore, such a unilateral measure which was given out without any prior consultation or any detailed memorandum led to significant anxiety within the taxpayers. Not on this, this levy also caught an international attention and countries like US also announced for an investigation under the Section 301 of the Trade Act, 1974 against such possible discrimination against the US companies.

It was observed that the slow pace of multilateral negotiations and an increases agitation regarding the inability of governments to tax the profits resulting of the digital giants led to this

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<sup>4</sup> Desai, Tithee. 2021. "Equalisation Levy- The transition from 2016 to 2021". *TaxGuru*. <https://taxguru.in/income-tax/equalisation-levy-transition-2016-2021.html>.

proliferation of unilateral measures in the taxation of digital economy by various nations.<sup>5</sup> Additionally, various nations are implementing such a digital taxation to cope up with the damages and to overcome the foregone revenues as a result of the COVID-19 Pandemic and the consequential lockdown.

It is pertinent to underscore that arriving at a unanimous and global consensus, wherein different economies and policies are involved is an extremely tedious task, especially when it is related to the adoption of a form of taxation. Having said that, it must also be accounted that the taxation of digital economy is a complex and sensitive matter which requires a multilateral consensus rather than a rushed unilateral action via a levy implemented by India. These unilateral developments by various nations would make the functioning of cross border trades more difficult for multinational enterprises. Thus, there is a dire need to seek a multilateral solution pertaining the issues of digital taxation as soon as possible so that these issues do not go beyond control and any further complication amid trade could be avoided. Moreover, it should also be noted that any unilateral measure must be fair and equitable to the taxpayer, meaning that, such a burden of tax liability must provide a level of certainty to the taxpayer, ensure that no double taxation is levied on the same income or transaction, provide an easy administrable and consistent compliance mechanism.

#### **IV. Impact of Levying Digital Taxation**

With the globalisation of the economy, rapid development of technology and increasing digital off-shore business, it is imperative to take cognizance of these digital business from the tax revenue's base perspective. The mass acceptance and digitalisation of the business models has posed complexities and issues against the prevalent taxation and regulatory system. It was observed that the extant taxation laws were inefficient to bring in the virtual entities under the ambit of tax liability. Therefore, there is a need to resort to a taxation framework in order to ensure that adequate taxation of tech giants is sought with the capitalisation and global expansion of global economy.

The implementation of Equalisation Levy is the one sided command of the nation, which is at the cost of businesses and has complicated the taxation framework even more and thus

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<sup>5</sup> Kapoor, Nikhil. 2021. "The Missing Fine Print in the 2020 Equalisation Levy on Digital Transactions in India". *Vidhi Centre for Legal Policy*. <https://vidhilegalpolicy.in/blog/the-missing-fine-print-in-the-2020-equalisation-levy-on-digital-transactions-in-india/>.

required administrative compliance. Such a unilateral introduction of digital taxation is and shall further impact various players in different ways. Before we delve into tackling the issue, it is imperative to understand the issues and impacts as the result of such a levy.

- a. **Overlap with GST-** It must be taken into account that the introduction of Equalisation Levy has led to an additional tax burden on tech enterprises and advertising or companies performing activities online as they were already subject to pay GST before the levy against the sale of goods and services. The current GST law includes the category of Online Information Database Access and Retrieval (OIDAR) services, namely those facilitated by information technology via the internet or an electronic network. The overlapping burden of tax has manifold impact on digital businesses where margins are lean, and businesses are operating under losses due to stiff competition which might promote the companies to consider passing the burden onto the consumers. Therefore, there exists an interrelationship between equalization levy and GST with respect to certain cross-border electronic supplies of goods/ services which are made by non-resident e-commerce operators.<sup>6</sup> This may give rise to double taxation, and since the equalization levy and GST are separate and independent levies, one may not be credited against the other.
- b. **Foreign Trade-** Equalisation levy is expected to discourage multinational enterprises to conduct business or any economic activity in India as a result of issue of double taxation since they might not be able to avail deductions in their home country unless a global consensus is derived.
- c. **Start-Ups & SME's-** Equalisation levy leads to an additional cost burden on the small and medium scale enterprises (SME's) or new businesses which spend huge costs for advertising and promotion in order reach a wider public since the digital advertising is additionally being taxed. This acts as a barrier and hinderance in advancing the customer base for start-ups and their preliminary growth and expansion in general. This implies that this system of taxation is contrary to the growth-friendly rules of tax as they might have a disproportionate impact of low margin businesses ad high-investment businesses.

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<sup>6</sup> Ezez. 2021. "Deloitte | tax@hand". Taxathand.com.

<https://www.taxathand.com/article/15552/India/2020/Overview-of-interaction-of-equalization-levy-and-GST-on-certain-e-commerce-supplies>.

- d. **Unclear Tax Collection Rules-** Amidst the absence of clear rules regarding the consistent collection of tax by the CBDT, there is an added perplexity and added shift of burden on the Tax administration as well.
- e. **Compliance Burden on Enterprise-** The present rules add a compliance burden on multinational corporation or the non-resident e-commerce entity to keep a track of the IP address as well as the residence of the end user in order to determine the taxability. This would require the MNC's to design and implement a system which is compatible to track user activity via the IP address of the end user. This adds a compliance burden onto them for which many enterprises might not be industrially equipped.
- f. **No Scope of Evasion-** Companies which only had digital presence and no physical presence in India, earlier easily escaped the scope of taxation framework, however, with the implementation of this equalisation levy which might be called the interim measure will disable the companies which earn revenue from India and do not have a physical presence from evading tax liability.

Apart from the above mentioned impacts of implementation of the levy, it is pertinent to also note that over and above these impact, there lies an issue of double taxation which is completely against the principles of tax law. The adoption of the levy is likely to result into significant double taxation of income derived from digital businesses that are already subject to other corporate income tax in multiple jurisdictions. Although, it must also be noted that in case of lack of such a digital taxation, some businesses are not getting taxed in the remote jurisdiction or in the nation they are rooted which might lead to a situation of double non taxation and loss of revenues for nations.

## V. Suggesting A Way Forward

As the need for having a digital taxation cannot be denied, it is imperative that the some common standards and principles should be applied in order to make sure that even the unilateral measures which are interim till a global consensus is sought are just, fair and equitable to a taxpaying individual or entity. Some of the recommendations are:

- a. **Provide Certainty to Taxpayer** – The provision of Equalisation Levy as it stands today is very widely worded and covers a wide variety of transactions and businesses that deal

in online sale of goods and services to Indian resident customers. Given its wide scope, it also covers transaction that are not related to e-commerce which leads to ambiguous interpretation of the provision and makes difficult for the business to determine their tax liability. Additionally, it must be accounted that equalisation levy is applicable not only to e-commerce retailers or the marketplace operators, but also to the businesses which operate under the brick-and-mortar model with a fair or minimal degree of digitisation.<sup>7</sup> Therefore, in order to tackle with this issue a definitive list shall be provided with specific and clear list of activities under the array of tax and those which do not fall within the scope of taxation. This shall help to avoid unintended leakages, ring fencing and thus provide clarity to the taxpayers.

- b. **Provide credit in case of Double Taxation** – As long as countries across the world continue to resort to such unilateral measure, the problem of double taxation can only be done away if all countries envision a proper mechanism for the treatment of revenue which is subject to multiple taxation. In other words, all countries that are residence jurisdictions must allow for deduction of digital taxes as an expense while calculating their corporate tax liability. Another aspect to this can be that, if India enters into negotiations with the home countries of the digital/ tech giants which are conducting business in India like Facebook, Google etc., and amend the DTAA's and develop a multilateral instrument as provided under the Action Plan 15 of BEPS Action Plan.
- c. **Provide easy administrable and compliance mechanism** – The reason for the admission of digital taxation is to ensure that the user country must gain the fair share of tax and sufficient income from tax revenue which is deserves and therefore, there must be a common and coherent parameter or mechanism adopted to define the end user so that there is no additional cost of compliance levied on MNC's and also to avoid anomalies.

## VI. Conclusion

India has taken an aggressive and bold step in levying this digital tax, which is likely to face resistance from foreign companies. The implementation of such a taxation will be a challenge,

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<sup>7</sup> Kapadia, Rishi & Jha, Saurabh. 2021. "Indian Finance Bill 2021 appears to expand scope of the equalisation levy". *International Tax Review*. <https://www.internationaltaxreview.com/article/b1qsfng38gy128/indian-finance-bill-2021-appears-to-expand-scope-of-the-equalisation-levy>.

until a global resolution is reached under the OECD initiatives. Moreover, in light of the recent global status and the economic crisis amid the COVID-19 Pandemic, it might be thought that an addition or implementing a digital taxation while the world is already struggling is not feasible and blatant, however such an amendment to the international taxation is of utmost importance. The economies in the world are in dire need of revenues, the e-commerce is flourishing as a result of lack of physical trade and amid drastic shift from conventional to remote methods of work, the developing nations like India where revenue of taxation made from the country plays a crucial role in the development of the economy. Hence, with a view to capitalise on the changing in working and buying patterns of people, this shall be a step forward in the right direction at the given point of time. Thus, the goal shall be to develop a framework that shall aid in regulating a framework which provides a 'fair' share of taxes from the revenues generated by such businesses to the nation building and to overcome from the ill-effects of pandemic.

Having said that, it is equally important to take into account that once a global consensus is sought under the Pillar One and Two of the OECD Project, the Indian Equalisation Levy must be withdrawn and the present levy must be considered to be an interim measure, although it might take several months to arrive at such a consensus. In other words, the Indian Levy might be expected to be moderated or dovetail it into the final consensus approach. However, the delay and the cumbersome process of deliberation to arrive at global consensus might result in the adoption and implementation of such unilateral measure of a digital taxation service by many countries.