IFA News Letter
India Branch - Western Chapter

September 2016

We are pleased to bring to you this September 2016 edition of the newsletter of IFA India Branch - Western Region Chapter.

What's in?

IFA News

1 Day Conference on International Tax Budget Proposals of 2016

IFA held a 1 day Conference on International Tax Budget Proposals of 2016 on 29th April 2016 at YBC, Mumbai. The Conference was well attended.

2 Day Conference on International Tax Planning & Structure - Post BEPS

IFA organized a Two Day Conference on 17th & 18th June 2016 at Hotel St. Regis, Mumbai on International Tax Planning & Structure - Post BEPS considering that OECD's work on Base Erosion Profit Shifting (BEPS) is in spot light of worldwide taxation.

Members of the Judiciary, the Revenue Authorities, eminent Tax Counsels/Advisors and leading Industry Tax Directors shared their experience with the delegates over the two days.

The discussion at the conference facilitated in identifying various challenges and action points expected of the multinationals towards implementation of BEPS. The discussion centered around Indian legal provisions and existing Indian judicial precedents. The highlight of the Conference was the Moot Court Session, which was thoroughly enjoyed by the Participants.

IFA Team

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<tr><td>Pranav Sayta</td><td colspan="2" rowspan="6">About IFA
The International Fiscal Association (IFA), established in 1938 with its headquarters in the Netherlands, is the only non-governmental and non-sectoral international organisation dealing with fiscal matters. IFA has played an essential role both in the development of certain principles of international taxation and in providing possible solutions to problems arising in their practical implementation. The membership of IFA now stands at more than 12,000 from 106 countries. In 62 countries, including India, IFA members have established IFA Branches. For further information on IFA and its activities, please visit the website www.ifaindia.in. Your feedback / suggestions are welcome. Please write at ifaindiabranch@gmail.com</td></tr>
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Taxpayer rights – the Indian experience

CA Parul Jain[1]
Senior Tax Professional

Introduction

He (the King) should take from the kingdom, fruits as they ripen, as from a garden, avoiding taking unripe fruits, for that will beself-destructive, and cause an uprising against him.

-Kautilya 5.2.70[2]

India's first tryst with tax laws dates back to ancient times. Manu, an ancient sage stated in his script '*manusmriti*' that the king could levy taxes and taxes should be related to the income and expenditure of the subject. In the Indian landscape, the business/ investors deal with host of laws and administrations at the Central, State and Local level. Multiplicity of complex laws and associated compliances often dampen the entrepreneurial spirit and hence, it is imperative for the policy makers to carefully weigh consequences of each legislative action from investment standpoint.

Increasingly Governments across globe are embracing the philosophy of 'taxpayer rights' whilst framing the tax policies and procedures. Traditionally, the term taxpayer right encompasses following dimensions –

- Right to be informed, assisted and be heard
- Right to pay correct tax
- Right to certainty
- Right to appeal
- Right to privacy and confidentiality

In India, aforesaid rights emerge from either the Constitution, or from the specific statute (ie, Income-tax Act, 1961), or from supporting laws (such as Evidence Act, Right to Information Act).

Engaging taxpayers in law making

Article 245 of the Constitution empowers the Parliament to make laws for the whole of India. The law making process in India for fiscal matters falling under the Union List and the Concurrent List of the Constitution (i.e. direct taxes and majority of indirect taxes) consists of the Ministry of Finance making amends to respective statutes, traditionally as part of annual Finance Bill. Whilst the law making is a fairly simple process, the ambiguities embedded in provisions lead to alternate interpretations by taxpayers and the tax administration. Inadequate supplementary legislation in the form of timely administrative guidelines adds to woes of taxpayers. Interpretational issues could be largely avoided by instilling adequate focus at the drafting stage to ensure that language of the provision is unambiguous and consistent with the intent. This could be achieved by seeking feedback from independent experts on the proposed language and modifying the language accordingly. For instance – in recent years, the Ministry

[1] The views expressed in this article by the authors are personal views.
[2] *Kautiliya's Arthashastra* Book 5, Chapter 2, Sloka 70

of Finance has sought public comments and participation in drafting administrative guidelines for introduction of GAAR and 'indirect transfer tax'. In long run, such initiatives would secure the right to certainty and information for the taxpayers and help build positive investor confidence.

Selection of return for audit – objective and risk based

The Indian Income-tax Act, 1961 ("Act") provides for annual tax return filing requirement, providing limited dispensation in case of taxpayers (other than corporates and firms), based on level of income. Tax return disclosures are one of the primary sources of information for Indian tax authorities. As a process, tax returns filed are electronically processed by the Centralised Processing Center of the Department of Income Tax to point out any arithmetical discrepancies and clerical errors. For significant number of taxpayers such electronic processing serves as the limited validation of tax positions adopted in the tax return. Finance Bill, 2016 proposes to enlarge the scope of processing to review of additional aspects. This proposal shall ensure that basic anomalies in taxpayers' claims are detected electronically, rather than through the course of scrutiny proceedings.

Cases are selected for scrutiny proceedings (a detailed examination of tax positions adopted by the taxpayer) by tax authorities through Computer Aided Selection System ("CASS") which is based on sole application of quantitative filters (and not qualitative filters)[3] on the database of tax returns filed by the taxpayers. It is encouraging to note that filters adopted in CASS are such that probability of selection of a small taxpayer for scrutiny assessments is relatively low. On the other hand, it is important to mention that the manual selection of cases also exists. In August 2015, the CBDT released instruction[4] for manual selection of cases for scrutiny for the financial year 2015-16.

Selection of cases for detailed scrutiny should be based on objective blend of select filters, quantitative as well as qualitative. It is imperative that scrutiny guidelines are closely reviewed such that small taxpayers are kept out of the scrutiny process, key risk areas are reviewed and government resources are employed optimally. It is heartening to note that the CBDT has resonated Government's view regarding keeping small taxpayers out of the complex net of scrutiny, provided the particulars in the tax returns are duly filled.

Promoting non-adversarial audits

Internationally, many countries have developed multiple tiers of audits, like, in-depth comprehensive audit, less-detailed desk audit, specific audit, etc. The nature of audit applicable in case of the particular taxpayers depends on presence, or otherwise, of specific factors identified for examination. Such factors are determined using risk assessment information[5]. In comparison, the type of tax audits envisaged under the Act are rather limited, ie scrutiny assessment, best judgement assessment and reassessment. The stereotype approach followed by Indian tax authorities further impacts the qualitative quotient of audits. Year on year, the tax authorities release laundry list of questions to taxpayers seeking voluminous data and information from the taxpayers, without having regard to the nature of industry, scale of operations and class of transactions relevant to the case. Seeking data which is already available in government databases (such as, periodic filings made by taxpayers with government agencies) merely adds to compliance burden of taxpayers. A simple step such as building a more sophisticated and relevant list of questions for each taxpayer could significantly enhance quality of assessment as well as ease the burden on taxpayer and tax authorities.

[3] Refer TARC
[4] Instruction No 8 of 2015 dated August 31, 2015
[5] Page 292 of First Report of the Tax Administration Reform Commission dated May 30, 2015

Considering that the contribution made by tax collections to Government's revenue coffers[6], it is important that the tax authorities approach taxpayers with 'customer satisfaction' ideology than 'likely culprit' mind-set. Standard operating procedures for audit should be developed on following aspects –

- Tax officer to seek limited and relevant information; information available in public domain to not be sought.

- Audit hearings to be evenly spread over the timeline provided under the Act to aid smooth completion of audit.

- In case additions are made to the returned income, reasonable opportunity for submission of counter-arguments shall be provided to the taxpayer.

- Taxpayer's submissions to be duly considered and in case tax officer is not agreeable, the clear points of difference, supported with legal principles/ jurisprudence, to be articulated. This could help reduce the otherwise avoidable, appellate, revisionary or rectification proceedings.

- Cases involving upward adjustments beyond a certain monetary threshold shall be subjected to an objective peer review to prune personal biases.

In September 2014, the CBDT issued instruction[7] addressing key concerns pertaining to the manner in which tax audits are conducted. The CBDT instructed tax officers to limit initial scope of assessment proceedings to factors which formed basis for selection of the case. The instruction also requires tax officers to ensure that audit proceedings are concluded in a timely manner with minimum hearings. If during audit it is determined that potential income of INR 1 million[8] is escaping tax on account of other issues, comprehensive scrutiny may be undertaken subject to the approval of the prescribed authority[9]. Supervisory officers have been directed to play a more pro-active role in monitoring and guiding assessments towards ensuring that high-pitched assessments without proper basis are not made and that lengthy questionnaires or summons without due application of mind are avoided[10]. Recent addition to the series of instructions for selection of scrutiny assessment by CASS is the Instruction 19/ 2015 issued on December 29, 2015, which proposes to run CASS system in advance, giving sufficient time to the tax authorities to go through the tax returns for identifying issues which require examination. Further, the said instruction directed the tax authorities to seek specific information/ document in the questionnaire to avoid ambiguity and undue hardship on the taxpayers. Following the cue, the Central Action Plan of the CBDT for financial year 2015-16 mandated fixation of quarterly targets for completing scrutiny proceedings.

To ease compliance burden on taxpayers, in 2015 the CBDT initiated a pilot project[11] for conducting audit through electronic means. The draft report[12] of the Income Tax Simplification Committee constituted under the chairmanship of Justice RV Easwer also emphasized usage of electronic medium for completing most of tax procedures. Acknowledging the success and benefits associated with e-audits

[6] As per the report issued by Comptroller and Auditor General of India ("CAG") for the year ended March 31, 2015, direct tax receipts (INR 6957.92 billion) constituted 11.69 percent of total receipts of the Government (59492 billion)
[7] Instruction No 7 of 2014 dated September 26, 2014
[8] For non-metro cities the prescribed limit is INR 0.5 million
[9] Principal Commissioner of Income Tax or Directorate of Income Tax
[10] CBDT press release dated November 7, 2014
[11] Letter [F.NO.225/267/2015-ITA.II], dated October 19, 2015
[12] Released on January 2016

Government is contemplating revamping the audit procedure through use of e-medium. Necessary rules and notifications[13] to fill in the procedural gaps in relation to the same have also been prescribed.

As the next step towards addressing concerns of small taxpayers, the Government should make available services of a standing counsel or a chartered accountant at nil or concessional costs to such taxpayers to ensure that common man gets sufficient opportunities and resources to defend their claims.

Insofar as reassessment proceedings are concerned, the tax officer is required to record his reasons prior to issuing a notice for initiation of such proceedings. Approval of prescribed supervisory authority[14] is a pre-requisite for issuance of such notice. Protocols (or safeguards) with respect to initiation of reassessments emerge from the provisions of the Act and judicial precedents[15] pronounced in this regard. In multiple cases, the Courts have held the reassessment to be void where tax officer failed to record his reasons prior to issue of notice to the taxpayer, or where the reasons recorded did not construe sufficient ground for tax officer to believe that the income chargeable to tax has escaped assessment. High Courts in certain circumstances have entertained writ petition (under Article 226 of the Constitution) from taxpayers on grounds pertaining to lack of jurisdiction to initiate proceedings.

In addition to audit proceedings, the Act also provides framework for tax authorities to conduct search and seizure proceedings in case of a taxpayer person[16], pursuant to issuance of a valid warrant in this regard by senior officers. Such proceedings broadly involve seizure of books of account, documents, valuable articles or things found as a result of search, imposing restraints on owner or person in immediate possession of books of account, documents, valuable article or other assets to remove, part or otherwise deal, trying a person under oath in relation to the search proceedings.

Given the intensive and bearing nature of search/ seizure proceedings there can often emerge conflicts between provisions of the Act and fundamental rights endowed under the Constitution of India. In multiple such instances, the fundamental rights of taxpayers have been upheld by courts[17]. In a particular case[18] where interrogation under search/ seizure proceedings continued for extensively long period of time without any breaks, actions of the Indian tax authorities were held to be in violation of the Human Rights Act, 1993. The Court further mentioned that implementation of specific laws (like tax) should conform to the internationally accepted standards of basic human rights.

Implementing reforms to protect taxpayers' right to speedy trial

Dispute resolution in India is often cumbersome and protracted. The situation is similar for income-tax disputes. The stringent tax collection targets set as part of budgetary exercise act as catalyst for arbitrary approach of tax administration, resulting often in difference of opinion between taxpayers and tax officers. Whilst the Act provides for a fairly evolved appellate hierarchy, the ground reality is – clogged appellate forums/ judiciary, protracted litigation, use of right to appeal as a matter of reflex, etc. The

[13] Notification dated December 2, 2015 and Notification No 2 of 2016 dated February 3, 2016
[14] In cases where notices are being issued after expiry of four years from the relevant assessment year
[15] GKN Driveshafts (India) Limited vs ITO (2003) 259 ITR 19 (SC)
[16] Search and seizure proceeding can be initiated where the tax officer, basis information in their possession have reasons to believe that:
-Person to whom a summon or notice for production of any documents or books of accounts has been issued has failed to produce or cause to produce such documents or books of account
-Any person to whom a summon or notice for production of any documents or books of accounts might be issued would not produce or cause to produce such documents or books of account
-Such person is in possession of money, bullion, jewellery or other valuable articles which represents income or property which has not been and would not be disclosed to the tax authorities / offered to tax under the Act.
[17] ITO vs Seth Brothers (1969) 74 ITR 836 (SC), Pooran Mal vs Director of Inspection (1974) 93 ITR 505 (SC)
[18] CCIT vs State of Bihar (2012) 250 CTR 304 (Patna High Court)

statistics of tax cases pending before the Income Tax Appellate Tribunal, High Court and the Supreme Court as on March 31, 2015 fare out as below:

S No	Authority before which case is pending	Number of cases	Amount locked up (in INR billion)
1	Income Tax Appellate Tribunal	37,506	1,455.35
2	High Court	34,281	376.84
3	Supreme Court	5,661	46.55
	Total	**77,448**	**1,878.74**

Source: Report issued by CAG for the year ended March 31, 2015

At one hand, whilst the relationship of taxpayers and tax authorities is strained on account of trust deficit, the situation is further worsened when tax authorities seek to challenge pro-taxpayer outcomes without having regard for merits of the case. In multiple instances, Indian Courts have expressed a critique on the manner in which Government (and its departments) pursue litigation, posing a serious question towards the Government regarding whether they enjoy being the biggest litigants[19]. It is ironical that the National Litigation Policy[20] formulated by the Ministry for Law and Justice advocates principle of 'think before act (of filing appeal)'. To address the deploring litigation landscape, it is essential to put in place a thorough and objective cost-benefit analysis for validating department's decision to pursue dispute before higher authorities. The first report of Tax Administration Reform Commission ("TARC") noted that credibility of the tax administration of a country depends largely on the credibility of its dispute resolution mechanism.

Arguably, the new Government's reformative measures in past 20 months have contributed to salvaging the situation. Tax policy decisions, such as, abstinence from retrospective tax legislations as announced by the Finance Minister in 2014 Budget, Chairperson, CBDT accepting the Bombay HC decision on share issuance transaction[21] , appointment of Justice AP Shah committee to address applicability of MAT on FIIs and FPIs and accepting the committee's recommendation, 2015 Budget amendment to defer the GAAR, enhanced consultation with economists and experts by PM chaired NITI Aayog for formulating budget proposals, etc, seem to have arrested the negativity amongst the investors to certain extent. In recent past, the CBDT has also taken cognizance of the criticality of an efficient tax dispute identification/ resolution mechanism, and has set in motion multiple steps to this effect, for example, formulating Central Action Plan directing the tax officers to map out timeline for speedy disposal of cases, issuing instructions *re* SOP on filing of appeals to the ITAT, HCs and SC, etc.

Maintaining confidentiality

Respecting taxpayer's confidentiality is one of the most fundamental taxpayer right. Tax officers happen to receive wide range of information from taxpayers, or other sources, during various compliances under provisions of the Act. The information often is confidential in nature and hence, deserves to be used/ accessed with highest degree of sensitivity.

The provisions of section 137, as originally enacted in the Act in the year 1961, provided comprehensive protection to the taxpayer from disclosure by tax officer of any information contained in income-tax records except in case of information sought from a Commissioner vide application under section 138.

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[19] State of Punjab vs Geeta Iron and Brass Works Ltd (1978) 1 SCC 68 (SC); Chief Conservator of Forest vs Collector (2003) 3 SCC 472

[20] Draft document, June 23, 2010 Available at: http://pib.nic.in/newsite/erelease.aspx?relid=62745

[21] No 2/2015 [F.NO.500/15/2014-APA-I], January 29, 2015; Press release, January 28, 2015

With time amendments were introduced in section 138 of the Act, and section 137 was omitted[22]. Provisions of section 138 were amended to enable general exchange of information between income tax and other regulatory authorities. Further the Commissioner was permitted to disclose information relating to audit of a taxpayer by way of an application, subject to the Commissioner's satisfaction that disclosure of information is in public interest. In multiple judicial precedents[23], it has been held that that post omission of section 137 of the Act, there are no fetters placed on court's power to summon documents filed by the taxpayer before income-tax authorities. However, tax authorities have the right to claim privilege in respect of any document or record summoned by a court under section 123 and section 124 of the Indian Evidence Act, 1872. The court has the discretion on whether or not to grant such privilege.

Section 138(2) of the Act empowers Government to restrict disclosure of any document or information by a public servant in respect of such matters relating to such class of taxpayers, or except to such authorities, as may be prescribed. Failure on part of the public servant with section 138(2) of the Act could attract fine and imprisonment[24]. In past, the Government has exercised this power in relation to disclosure of information relating to banking companies having regard to practices and usage customary among them[25].

In 2015, the CBDT released an office memorandum[26] reiterating that 'privacy of taxpayer must be respected as the information respecting an assessee is held in fiduciary capacity and maintaining its confidentiality is a statutory obligation of the Department.'. The memorandum was issued in light of certain instances where taxpayer information was published in media with specific reference to sources within the Income-tax department.

Article 26 of the OECD Model Tax Convention (2014) deals with Exchange of Information ("EOI") between contracting states. Article 26 allows the Competent Authority of a contracting state to request its counterpart to obtain information which is foreseeably relevant for administration and enforcement of domestic tax laws, carrying out the provisions of the bilateral agreement, subject to specific terms of tax treaties/ agreement between the contracting states. The condition regarding foreseeable relevancy of information is placed to restrict roving queries by contracting states. Article 26 of the OECD Model Tax Convention (2014) also requires that information obtained under EOI shall be treated at par with information obtained under domestic laws of the relevant contracting state, thus ensuring confidentiality. Article 26 contemplates exchange of information on request in relation to specific case (manual EOI), automatic EOI or spontaneous EOI.

Governments across the globe have realised the potential of EOI to counter tax evasion and avoidance practices, resulting in active participation by countries in such collaborative efforts[27].Significant measures to make EOI more effective such as uniform reporting standards[28] are also being contemplated. India has been an active participant in global EOI activity.

India has a wide network of bilateral/ multilateral tax collaboration agreements[29], with around 130 countries, which cover/ allow EOI. The increased EOI activities shall entail sharing of information of taxpayers with tax authorities of other countries, without any specific consent by the taxpayer in this

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[22] In 1964
[23] Dagi Ram Pindi Lall vs Trilok Chand Jain (1992) 60 Taxman 551 (SC)
[24] Prosecution requires prior sanction of Central Government
[25] Notification No SO 2048 dated June 23, 1965
[26] Office memorandum F. No. Dir.(Hqrs.)/Ch.(DT)/29/2014 dated January 1, 2015
[27] As on April 14, 2016, 98 countries have committed to participation in automatic EOI
[28] Referred to as Common Reporting Standards
[29] Comprising of tax treaties, tax information exchange agreements, multilateral convention on Mutual Administrative Assistance in Tax Matters, SAARC Limited Multilateral Agreement exchange of information ("EOI")

regard – whether such sharing of information justifies the larger public interest as contemplated under section 138 of the Act may possibly would need to be evaluated, especially where information is shared under the automatic EOI mechanism. Further, the rights and involvement of the taxpayer in the EOI process such as notifying the person subjected to enquiry or person who supplied the information prior to prior to supply of information would be governed by the domestic laws of the contracting state[30]. The Revised Manual on EOI issued by CBDT in May 2015 lays down in-depth guidelines on applicable law and procedures with respect to EOI and information gathered under EOI.

The Right to Information Act, 2005 ("RTI Act") enacted to promote transparency and accountability in the working of public authorities, also contains exceptions providing protection to commercial confidences, trade secrets, personal information[31]. In multiple cases[32] , the Courts have held that income-tax return and information furnished to the tax authorities is in the nature of personal information and are thus specifically exempted under the RTI Act, except where its disclosure serves the larger public interest.

Evolving Citizen's charter to recognise taxpayer services

Taking cue from best practices pursued by the tax administration across the world, the CBDT issued Citizens' Charter in July 2007 (subsequently revised in 2010 and 2014). The Citizen's Charter issued by CBDT is a guidance note, which inter-alia expresses their commitment towards quality service for taxpayers. The Charter broadly revolves around setting out timelines for speedy redressal of basic grievances of taxpayers. However, the document lacks in articulating the fundamental strategy for improving quality of taxpayers' experience (such as confidentiality, proprietary of information shared by taxpayers, etc). The Citizens' Charter advocates noble promises and ambitious timelines for redressal of taxpayer grievances, which are rarely met in practice.

Taking note of concerns noted by the TARC in its report, in March 2016, CBDT ordered[33] setting up a dedicated structure for delivery and monitoring of taxpayer services in the Income-tax department. Two separate directorates have been set up in this regard and they will be responsible for delivery and monitoring of taxpayers services in the field offices and e-services deliverable through various electronic platforms of the Department.

Conclusion

Reviewing the reform initiatives over past year and half, it is apparent that the new Government has demonstrated strong intent to push tax policy reforms and revamp the tax department in line with global best practices to provide best in class taxpayer experience to investors. The World Bank Annual Publication (Doing Business 2016) report has ranked India at 130 (out of 189 countries) on the 'ease of doing business' parameter, which reflects an improvement of 12 places since last rankings. Interesting to note that whilst India's overall ranking has improved, the performance on parameter of 'paying taxes' has decreased; India ranks 157 (against 156 for last year). Clearly, a lot of ground work is required for India to be amongst most preferred investment destination and global manufacturing hub, particularly on the manner of provision of services to the taxpayer.

[30] Commentary on Article 26(3) of the OECD Model Tax Convention
[31] RTI Act allows disclosure of personal information if larger public interest justifies the disclosure of such information:
[32] Girish Ramchandra Deshpande vs Central Information Commissioner (2013) 351 ITR 472 (SC), Vinubhai Haribhai Patel (Malavia) vs ACIT (2015) 235 Taxman 467 (Gujarat HC), Naresh Trehan vs Rakesh Kumar Gupta (2015) 228 Taxman 119 (Delhi HC)
[33] Press release dated March 7, 2016 and order No. 1/Ad.VII/2016 dated February 26, 2016

EQUALISATION LEVY

CA Rashmin Sanghvi, CA Naresh Ajwani, CA Rutvik Sanghvi[34]
Senior Tax Professional

Short Forms:

BEPS	:	Base Erosion & Profit Shifting
COR	:	Country of Residence
COS	:	Country of Source/Payment
EL	:	Equalisation Levy
G20	:	Group of 20 nations formed in the aftermath of US & Europe - Economic crises that started in the year 2008.
IR	:	Indian Resident
IRP	:	Indian Resident Payer
NR	:	Non-Resident
OECD	:	Organisation for Economic Co-operation & Development
PE	:	Permanent Establishment
R	:	Resident
RBI	:	Reserve Bank of India
TDS	:	Tax Deducted at Source
TDS	:	Deduction of EL at Source
TFDE	:	Task Force on Digital Economy

Background:

Finance Minister has proposed Equalisation Levy (EL) through Finance Bill, 2016, Chapter VIII.

Non-Resident E-commerce companies like Facebook, Google, etc. are earning substantial revenues and some of them are avoiding Income-tax in the Country of Source (COS) as well as Country of Residence (COR). E-commerce business is growing at the fastest rate globally and no Government in the world can allow this business to go tax free.

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[34] All the views expressed in this paper are the views of the authors of this paper. E-commerce Committee and Government of India may or may not agree with these views.
This paper combines a few different papers and an interview by Business Standard.
This paper covers only a few aspects. More issues will be covered later and uploaded on our website - www.rashminsanghvi.com

It is now **admitted by OECD** and other concerned authorities that under the present rules of international taxation, E-commerce companies can escape taxation. The main reason is that - under the existing rules, COS can tax a non-resident providing E-commerce services only if the non-resident has a **Permanent Establishment** (PE) in the COS. And a PE is defined as a fixed place of business. E-commerce companies do not need PE in any COS. They can set up the companies in **tax havens** and avoid COR tax also. For the last few years, there was strong **public criticism** – in Britain and other European countries - of these companies escaping taxation. In the light of the American and European **financial crisis, G20** countries asked OECD to come out with recommendations for necessary modifications in the existing rules so that E-commerce companies also can be taxed.

BEPS Action Report No. 1 on Digital Commerce has discussed these issues. It has not made any specific recommendation. However, it has given three different options. One of the options is Equalisation Levy. When a company resident in COS earns revenue from E-commerce business, that company has to pay indirect taxes as well as Income-tax. However, when a non-resident company provides E-commerce services, it escapes Income-tax. Equalisation Levy tries to make a **level playing field** for both – Resident & Non-Resident.

In India, CBDT appointed **"E-commerce Committee"** to study the subject and to recommend appropriate law for taxing NR E-commerce entities. Committee has given its report & Finance Minister has made proposal for Equalisation Levy to tax E-Commerce companies.

(For more details, please see paragraph 15.)

Finance Act, 2016 Proposals:

1. **Only Non-Resident Earners:**

Equalisation Levy is proposed to be **charged only on non-residents** of India. It's very purpose is to protect Indian Residents. Hence Indian E-commerce companies like Flipkart, Snap Deal etc. are not liable to Equalisation Levy. If a company is non-resident today and it opens a subsidiary or a PE in India to provide E-commerce services in India; it will be liable to normal Indian Income-tax and it will escape Equalisation Levy.

2. **Only Services:**

Equalisation Levy is charged only for services. There is no such tax on goods sold through E-commerce. Simple reason is: Somehow, the rules of international taxation have distinguished goods and services. This weakness in the system continues at present. Finance Minister is not trying to remove a global weakness through his budget proposals. The impact is: Even after the budget is passed, if someone purchases goods on E-commerce platforms, he will not have to deduct EL at source.

3. **Home Consumer is exempt:**

Millions of home consumers and small business consumers utilise internet services like Google, Face Book, What's App etc. Most of us do not make any payment to the service provider. Hence we are not liable to deduct any tax at source.

Assuming some home consumer makes payment for any specialised services, he will still not be liable to deduct any tax. This is specifically provided in the charging section – 162 (1) (i). This means that millions of consumers are not at all affected by EL.

4. No Computation:

Tax is payable on gross amount. Hence no computation of taxable income, no deduction of expenses. Entire computation machinery Sections 14 to 91 not required.

5. No Characterisation:

EL is so designed that there is no characterisation issue. One does not have to determine whether it is a business income, royalty, or FTS or any other category of income.

6. No PE:

There is no need to determine Permanent Establishment or any other nexus to India. Simply because a non-resident earns **revenue from India** he is liable to Equalisation Levy. Revenue is the source, it is the nexus.

7. Independent Tax: No DTA:

This is not Income-tax. Chapter VIII of Finance Bill does not become part of the Income-tax law. Like STT, it will remain a separate tax. Hence Double Tax avoidance Agreements are not applicable to EL.

8. Compliance:

8.1 Ideally, the responsibility to pay **tax and file EL returns** should be on the non-resident. However, enforcing these obligations on a non-resident requires a lot of ground work. Best method of ensuring compliance by Non-Residents who have no PE in India would be – to ask all banks, credit card companies and Payment Gateways to deduct EL before making the remittance abroad. However, at present, there is no mechanism under which EL can be deducted by credit card companies from payments made through credit cards. The E-Commerce Committee had a discussion with Reserve Bank of India. And RBI confirmed that at present, it will not be possible to impose TDS through credit cards. (Note: In this article, by the term "TDS" we mean Deduction of Equalisation Levy at Source.) In the circumstances, the only mechanism available to the Government of India was to recover the tax from the **Indian resident payer**.

This will mean: the burden of tax may fall on the Indian resident payer. The non-resident service provider may refuse to bear the cost of EL. There can be different situations. Large consumer goods companies - that advertise on media & net - have strong bargaining power. They can refuse to bear the cost. And any online company hosting the advertisement may have to bear the cost of EL for advertisements received from such strong companies. Very small payers – paying less than Rs. one lakh will not be liable to deduct EL. Payers falling between the two categories, may have to suffer the burden of EL. Even these persons may have choices in some cases. If there is competition, they will go to an alternative where the payer does not have to suffer the EL. Hence the force of market competition may make the NR receiver to bear the cost of EL.

It may be noted that the present proposal is a **work-in-progress**. A lot of work needs to be done. Government in collaboration with Reserve Bank of India may work out a mechanism whereby any payment from an Indian resident to a non-resident can be separated if it is an E-commerce payment. Once this step is implemented, EL can be deducted by credit card companies, banks and all payment gateways. Until this is done, a compromise has to be accepted. This is what the Finance Bill proposes. The burden of **compliance is on Resident Payers.**

Under the Finance Bill proposal Indian resident payers will deduct EL at source and pay to the Government of India. **Whole mechanism** for charging of tax, payment of tax, filing of returns and assessments – all can be completed on **internet.** The tax deductor may not have to meet Income-tax department.

8.2 Business:

Only persons carrying on business or profession and making payment for specified services to non-resident E-commerce companies are liable for deducting EL at source and paying to Government of India. The payment mechanism is simple. From all the payments to a non-resident for specified services tax may be deducted throughout a month. It has to be **paid** to the Government of India on or before 7^{th} day of next succeeding month **-** Section 163.

8.3 Thresholds:

The TDS is applicable only if his payment for specified services to non-resident service provider exceeds Rs.1,00,000 during a financial year. Section 162 (2) (b). Thus assessees making small payments are exempted from TDS compliance. This system does leave some **scope for leakages.** For example, one Non-Resident may receive – say Rs.99,000 from ten Indian assesses. Still, he will not suffer any EL. Similarly, one resident may pay Rs.99,000 to ten non-residents. He will not be liable to deduct EL. It may be noted that the NR E-commerce MNCs earn from Rs.100 crores to Rs.5,000 crores from India. For these target companies, the thresholds of Rs.1,00,000 are so small that any manipulation by increasing the number of companies won't be worthwhile.

For clarification: there are **two way thresholds:**

(i) If the **non-resident** service provider receives less than Rs. 1 lakh, he is not liable to EL – section 162 (2) (b).

(ii) If the **resident** payer is paying less than Rs. 1 lakh, he is not liable to deduct EL at source – Section 163 (1).

8.4 The responsibility to deduct EL is cast upon – (i) Indian resident business entity; as well as (ii) a Non-resident's permanent establishment in India – if it is carrying on business in India and makes payments for specified services.

A return of EL needs to be filed after the end of the year on or before a date to be prescribed by EL rules.

If the Indian resident assessee does not pay tax to the Government of India, he will be liable to tax, interest and penalty under Chapter VIII of the Finance Act. He will also be liable to disallowance of expenditure from his business income under Section 40 (a) (ib).

8.5 Non-resident – No compliance:

At present, the **non-resident has no responsibility under the law**. He does not have to file any tax return nor pay anything. If a resident payer does not deduct EL at source and does not pay to the Government of India, it does not mean that the non-resident receiver is then liable to pay the tax. This is also work-in-progress and needs to be improved.

9. Administration:

Equalisation Levy will be administered by the **Income-tax department.**

10. Scheme of the EL: Chapter VIII:

In a very small chapter all the provisions for charging of tax, scope of revenues liable to tax, collection machinery, assessment, penalty, prosecution and appeals – everything is provided. This chapter is an **independent & complete chapter by itself.**

10.1 Its connections with Income-tax Act are as under:

(i) Words not defined in this chapter will take their meanings from Income-tax Act.

(ii) If the Indian Resident does not deduct EL, the expenditure will not be available as a deduction under ITA Section 40 (a) (ib).

(iii) Once a payment is chargeable to EL, it will be exempted from Income-tax. ITA Section 10(50).

(iv) Appeal & similar other provisions of ITA will apply to EL also. EL Section 175.

Except for these issues, the Income-tax Act concepts are not applicable to El.

10.2 Listing of Sections:

Section 160 provides for the jurisdiction comparable to Section 1 of Indian Income-tax Act (ITA).
Section 161 provides for definitions.
Section 162 provides for the charge of tax (Section 4 of ITA), Scope of tax (Section 5 of ITA), and the assessee [Section 2 (7) of ITA].
Section 163 provides for TDS.
Section 164 provides for filing of annual return.
Section 165 provides for assessment.
Other sections are for interest, penalty, prosecution & appeals.

11. No Double Taxation within India:

Once a non-resident's income is chargeable to tax under chapter VIII of Finance Bill, 2016, it is exempted from Indian Income-tax under Section 10 (50). Thus, there will be no double taxation of the same income within India. It may be better for the non-resident to be covered under EL rather than under ITA. At the same time, there is no option for the assessee. A non-resident paying 10% TDS on interest or royalty cannot say that he will pay 6% EL and then not pay 10% TDS. His services should be specified services to be covered under EL.

12. No Grossing up:

Under Indian Income-tax Act, Section 195 etc. provide for deduction of Income-tax at source from payments made to non-residents. There are cases when the non-resident insists that the tax should be borne by Indian resident. In such a situation, the Indian resident has to gross up the tax and suffer more. Section 195 A. For illustration, if the TDS rate is 10%, in this situation, Indian resident payer will have to suffer 11% tax.

Section 163 of Chapter VIII provides for deduction and payment of EL. Section 163 (3) provides that even if Indian resident payer does not deduct EL, he has to make payment of EL to Government of India. Thus, consider that the Indian resident has made a payment of Rs. 100 to the non-resident, he has not deducted any tax at source. He will simply pay Rs. 6 to the Government of India and close the chapter.

13. Tax Rate:

The rate of tax under EL is only 6%. This is much lower than the normal TDS rates of 10% to 15%. This is an attraction for the non-residents providing specified services. Instead of suffering a higher rate of tax under Income-tax, they can bear the EL and pay lower tax. Further, there will be no further controversy about characterisation of payment, determination of PE etc. The whole scheme will be simple in administration by the department and compliance by the assessee.

The lower rate compensates for the fact that most assessees may not be able to claim **credit of EL** under the Double Tax Avoidance Agreements. They can of course claim the EL as an expenditure suffered by them but not the relief of full tax adjustments.

14. Specified Service:

Section 161 (h) defines specified service as – online advertisement, provision of digital advertising space etc. and includes **any other service as may be notified by the Government.**

It may be noted that E-commerce is a constantly developing business. There are so many technologies which together make it possible to do global business without PE in COS. Some of them can be listed as: computers, internet, television, mobile phones, satellites, cables, telephones; and a convergence of all these technologies. Each technology in the field of science keeps developing. Convergence of developing technologies provides a huge constantly changing mechanism for developing new businesses. Today traditional businesses conduct their business with new technologies. And completely new businesses are developing.

In this situation, defining anything as E-commerce would be incorrect. Today's definition in the law will require an amendment within a few years. Recognising this fact, OECD had earlier published its reports under the title – "E-commerce". Present BEPS action reports are calling the same business as "Digital Commerce". Sometime back E-commerce could be conducted only through computers. At that time, no one could imagine international business transacted through telephones. Today, international business through mobile phones has become a reality. It is eminently possible that in three years' time, there will be another way of doing international business which is not considered today.

Recognising these facts of modern life, the budget proposal defines the services as "Specified Service". This definition can always be expanded by the Government. Thus the law provides for flexibility in line with the kind of business proposed to be taxed.

On the whole, Finance Minister has made an efficient and simple proposal to tax giant MNC.

15. For Equalisation Levy the future development should be – shift the Burden to the Non-Resident.

(i) Payment:

Equalisation Levy (and even other taxes) should be paid by the targeted assessee; and not by Indian Resident Consumer. Who ultimately bears the tax will depend upon the bargaining power of the parties. But Government should provide for a legal and logistical mechanism so that the Non-Resident pays the tax.

(ii) Compliance with Return filing etc.:

All responsibilities for filing tax return, assessment etc. should be cast upon the targeted assessee. The payer is a facilitator in the process of Government collecting the tax. Payer should not be the target of primary responsibility.

15.1 Tax Burden:

Main criticism of EL is that the tax burden is cast upon the Indian Resident. The foreign seller of goods and services actually does not suffer the tax.

India already taxes: import of goods – with customs duties; and import of services – with Service Tax on Reverse Charge Mechanism. In all the cases (EL, customs duty and service tax) it is the Indian consumer who has to suffer all the taxes.

The fact that - "other taxes are also suffered by the Indian consumer" - is not a goodresponse to the question – why EL should be suffered by the Indian consumer. We have to find out a way of ensuring that the tax is actually suffered by the target assessee and not others.

How can we do it?

15.2 Income-tax TDS in case of Bank Payments:

For income-tax, the mechanism is in place. When Indian Resident pays royalty, interest, FTS, etc. he is supposed to deduct income-tax at source. The bank remitting the amount abroad will not remit unless and until the payee submits forms 15CA and 15CB. (All tax consultant know that even in this matter, there has been a lot of confusion. CBDT has moved back and forth many times. If CBDT wants to develop a fool proof system, many unintended businessmen suffer. And if CBDT tries to avoid public difficulties; there are tax leakages.

If the Non-Resident supplier insists that he will not bear the tax; and the resident payer must bear the tax; then Indian resident will bear it. This is a matter of **"Bargaining Power"**. This has been discussed below.

For the time being, let me say that "The Government of India (GOI) has provided legal and logistics support for facilitating payment by the Non-Resident assessee. If the Indian payer does not have bargaining power, he suffers."

15.3 Credit Card Payments:

However, even in case of royalty, interest and FTS, assume that a party pays through the credit card. What happens? No tax is deducted. And the credit card company will process the payment. Ultimately Indian resident's bank account will be debited. Government will not get TDS.

Then the Resident Payee is expected to make payment separately. If he does not pay the due TDS, he suffers – recovery of tax, interest, penalty, disallowance of expenditure and prosecution.

Government does not get the tax at the stage of payment to vendor itself. Later, it should get.

If Resident payer / importer does not pay the TDS and if the Assessing Officer does not discover, the tax is lost.

Conclusion: In case of payments through credit cards, GOI has not enforced logistics for TDS. Why?

15.4 Credit Cards: Inability for TDS

E-Commerce Committee members met RBI – Payments & Settlements Section to find out a mechanism to facilitate TDS through credit cards. The discussion was as under:

When an Indian Resident makes payment to a non-resident through credit card, what happens? He may swipe the credit card at a vendor's place; or pay through computer or mobile phone. RBI has ensured that within two seconds he will get OTP (one time password) on his mobile phone. Within a few seconds, payer's account will be debited and Credit Card Company will get the funds.

Then another process starts.

The credit card company converts Indian Rupees into the currency of the vendor and within agreed time; credits the account of the vendor. ***Before*** **this credit, the credit card company will deduct its agreed commission.**It may be 2% or 6% or any other rate as may be agreed between the credit card company and the vendor. This rate depends upon the bargaining power of the two parties. Further, the commission is shared between the credit card company and the banks involved. The bank's share is automatically transferred to the bank before the payment is made to the vendor.

How is it possible to transfer the funds within two seconds?

When IRP swipes a credit card, there is a software at the vendor's store. When IRP pays through computer/mobile phone; the credit card company's software works. Depending upon - whether the transaction is domestic or international; respective softwares will work.

There are millions of credit cards transactions every day. There are millions of credit card holders, bank branches and vendors,several credit card companies, several international currencies and several countries' regulators.

For completing the giant processing required; massive series of softwares and hardwares work. All softwares and hardwares are connected through global internet - networks. (They are synchronised.) Some may be through landline cables, some through undersea cables and some through satellite channels.

Credit card companies give guarantee to the vendors. Once the payer has swiped his card; for no reason he can withhold or cancel the payment. He can only dispute the payment later in case of fraud, etc. Vendor will get the money within agreed period.

For all this to actually happen; entire process has to be computer driven. **No human being** will interfere the payment process. No one will exercise a judgement and decide - whether to permit the payment or not. Assume that the payment is in violation of FEMA. It will still happen.

Credit card mechanism is truly globalised. And the **process is invisible** – in the sense that no human being will interfere while the process is going on.

The Committee had been told by RBI that it is not practical to ask the credit card companies to deduct any tax at source.

Now what can the Committee or GOI do?

15.5 Important Global Developments:

(i) Consider the fact that internationally Governments are exercising their jurisdiction in different manners. **China** has prohibited **Google's search engine** in China (for reasons other than tax). They have developed their own search engine company – "Baidu" to provide similar service. It has become a big hit in China. They have no problems about WTO. Even if there is a problem, they will face the problem. Main thing is, within China, the Chinese professionals and Chinese public do not protest against Chinese Government.

(ii) In **USA**, there are several states. Each state has its own taxation regime. The E-commerce business has flourished in USA. One E-commerce company may sell its goods and services all over USA. The State Governments insist on collection of tax at the time of sale transaction itself. Thus for example, if Mr. A purchases goods from an E-commerce company on computer or mobile phone, he can make payment to the vendor by using the credit card. The Governments have insisted and the vendors have developed necessary software, so that all the taxes are paid directly to the Government. The vendor gets payment net of its taxes.

15.6 India Can:

There is no reason why Government of India cannot do the following:

GOI can pass the necessary law to provide the following:

Any person wanting to sell goods or services on the E-commerce platform and receiving payments from within India must make the following arrangements:

The vendor will develop appropriate software on its website. When a visitor to the website decides to buy any product or service; the website will clearly show separately the taxes which are applicable and the net as well as gross amounts payable. In case of indirect taxation, where prima facie the tax is to be borne by the customer; tax will be added to the price offered by the vendor. (This is already being done in USA.)In case of direct taxes like Income tax and Equalisation Levy which are to be borne by the vendor, the website will show the gross amount, the tax to be deducted and the net amount payable to the vendor.

In all these cases, the tax amount will directly be credited to the Government's account. Only the net sale proceeds will be credited to the vendor's accounts.

The credit card companies will have to make appropriate software and the Central Government of India as well as the State Governments should develop appropriate software's. Since Reserve Bank of India acts as the treasurer for all the Governments in India; RBI also will have appropriate software. All these software's will be interconnected. It can be giant task. It may take some time. It may be difficult but certainly practical.

When all the software's are made operational, the burden of tax as well as compliance can be shifted to the vendor.

Similar arrangements already exist in USA. There is no reason why it cannot be implemented in India.

15.7 Shift the Burden to NR:

Once a complete software system has been installed, all responsibilities will shift from the Indian resident consumer to the vendor. Thereafter provisions can be made so that the vendor will file its own tax returns. Vendor will provide complete information regarding taxes due from the vendor, taxes recovered through the internet sale, taxes paid by the vendor directly; and balance dues if any. For the Indian resident consumer, there should be no further responsibility except complying with the instructions on the vendor's software. Thus the complete burden of taxation as well as compliance with law will be shifted from consumer to the vendor.

15.8 Bargaining Power:

There is a repeated criticism that whenever any tax is imposed on the Non-resident, he does not accept the tax. He passes on the burden to the Indian resident. Ultimately Indian resident has to bear the tax by grossing up. Equalisation levy also, will be borne by the Indian resident payers.

This issue may be responded to in the following manners:

15.8.1 Considering the current times, most of the world is passing through **recession** or low growth periods. Indian economy has the highest growth rate. From American aeroplane manufacturer-Boeing to mobile phone manufacturers, everybody finds India to be an attractive market. In this situation, actually while the Indian buyer is having a stronger bargaining power; he does not recognise his power and does not use his power. For this inferiority complex, who is to be blamed?

There was a time when some of the white skinned people believed and claimed that they are superior to the coloured people. Now what can the coloured people do? It is for them to refuse the racist claims. Independence is not granted or donated. It has to be commanded. And if someone cannot be independent, government of India cannot help him.

15.8.2 Let us say, an Indian resident wants to buy a product or service. Will he not negotiate for the price? Will he not look out for the best offer available in the world? If the non-resident increases the price by 10% or even 2%; will not the Indian resident bargain? Today, in case of internet purchases specially, there are **comparative charts available.** Most internet savvy buyers make good comparisons & then buy. If an MNC wants to stand in the competition, it will have to offer the products at an all-inclusive competitive price.

15.8.3 I would agree that the **logistics and the mechanism** should be such that it is practical and easier for the Indian resident buyer to pass on the burden to the Non-resident seller. This part of the article is for that purpose.

15.8.4 Even the law should cast **primary burden** on the non-resident seller who is the targeted assessee. At present legally the burden is cast upon the Indian-resident payer while the non-resident has no burden of compliance. This law needs substantial change to cast the primary burden on the Non-resident. Let us say, the present law is a first step in the evolution of law. It is a work in progress. Not a finished product.

16. OECD Data Parameters:

Objection raised by some professionals: Equalisation levy should be within OECD parameters.

16.1 Please appreciate that:

OECD has accepted in writing, in its report that Existing Rules of International Taxation are inadequate to deal with E-Commerce. They are trying to find new rules. When new rules are to be brought in, the parameters have to change. OECD itself has proposed a few options for the new rules.

Compare: You have a set of traffic rules for motor cars and trucks plying on the roads. Another set of rules for waterways. But the air-traffic rules, the parameters will change significantly.

16.2 Action 1 Foreword, Report November 2015 4th para clearly says:

"……It is expected that profits will be reported where the economic activities that generate them are carried out;

And

Where value is created."

No one can deny that - Value is also created at the place of sales. And yet, existing rules on International Taxation, Domestic laws & Double Tax Avoidance Agreements do not attribute any profits to the COS. Then these parameters have to be changed. See further in paragraph 17 below

17. Logic for Equalisation Levy:

Equalisation Levy, the law is simple in understanding, compliance & administration. But the logic behind Equalisation Levy is a very involved and complex issue of international taxation. **OECD** has been discussing the same for last 20 years and still has not come to any conclusion. Government of India appointed **High Powered Committee** which gave its report in July, 2001. The committee clearly stated that "The existing rules of international taxation are inadequate to deal with E-Commerce taxation." However, India alone cannot change OECD or UN model of Double Tax Avoidance Agreement (DTA). Hence further progress could not be made.

Britain, France, Germany, Australia etc. countries are also seriously concerned that E-commerce companies collect massive revenue from their territories and pay no tax. How is it that so many country tax departments are frustrated over certain tax issues? Explaining this issue can take a lot of time. I will be brief.

Indian Income-tax Act, as well as the Income-tax laws of several countries; and the OECD plus UN Models of Double Tax Avoidance Agreements (DTA) are based on a tax structure which is almost 100 years old. There are several **systemic weaknesses** in the structure. For the present, we focus only on one weakness: The Government of a country (let us take India as the illustration) cannot tax a non-resident of India unless the non-resident has a **permanent establishment** in India. Permanent Establishment (PE) concept is also a 100 years old concept. It was developed when it was impossible for anyone to do business in another country without setting up a branch, factory or sales office – a physical, **fixed place of business**. Hence the concept of PE has been defined as a fixed place of business. (There are several clauses in the definition of PE. However, we focus only on the relevant issues.)

Now with the multiple technologies of computer, mobile phone and internet; global business without having a PE is practical. This business is called E-Commerce. And E-commerce business is growing very fast. No Government can afford not taxing E-commerce business.

If a Government wants to tax a non-resident E-commerce company, it has to amend its own domestic tax law as a first step. However, unless and until the DTA model is changed, the domestic law amendment has no impact. This is because, the Double Tax Avoidance Agreement (DTA) will override domestic law. To make it simple, let us consider an illustration:

A company named MNC is non-resident of India. It has set up its registered office in a tax haven. Its entire computer – hardware and software is installed in the tax haven. Its website operates from the tax haven. On its website, the MNC provides entertainment programmes like music, literature, art and other popular materials. Internet surfers from around the world visit the website. Hence advertisers from around the world publish their advertisements on the MNC's website. Let us say, Indian advertisers and internet surfers together pay every year Rs. 100 crores to MNC. Under the current liberalised FEMA, these remittances will go through bank or credit cards without any hindrance.

If Indian Income-tax officer wanted to tax the MNC on its revenue of Rs. 100 crore, the MNC would challenge the demand stating that India has no jurisdiction to tax it under the Indian Income-tax Act. Even if Indian Parliament amends the Income-tax Act, the MNC will take protection under DTA. In short, unless and until, the DTA is amended, India would not succeed in taxing the MNC.
(Illustration completed.)

OECD did not accept this reality as late as in the **year 2010.**

When the **American financial crisis** erupted in the **year 2008,** suddenly Governments around the world realised that this kind of tax avoidance cannot be tolerated. Britain, Germany & France were strong critics of tax avoidance. USA of course took unilateral steps to curb avoidance & evasion of US taxes. To curb all kinds of tax evasions and tax avoidance, in the year 2013; "Group of 20 Countries" **(G20)** and OECD appointed several groups of experts under the broad name: “Base Erosion & Profit Shifting **or BEPS”**. This is when OECD accepted that “The existing rules of International Taxation are inadequate to deal with E-Commerce.”

You may appreciate that G20 and OECD considered the tax avoidance by E-commerce companies to be the most important priority. The BEPS Action 1 report was named: “**Addressing the Tax Challenges of the Digital Economy”**. (The term “E-Commerce” is a mercurial term. The technology and the ‘technology based business’ are so rapidly evolving that yesterday’s definition becomes outdated today. OECD used the term E-commerce from the years 1997 till 2013. However, when the mobile business challenged the old definition of E-commerce, they have now adopted a broad term “Digital Commerce”. I am pretty sure that even this term will be outdated very soon. We continue to use the term “E-commerce” only for the reason that it has become a popular term. It broadly indicates that – “A company resident in country R is doing business with residents of other countries (COS) and the company A does not need permanent establishment in COS.”

Is it not surprising that while BEPS Group 2 to Group 15 have already published their recommendations, Group 1 – the most important group has not been able to give any recommendation.

If you consider it deeper, you will find the reason to be very simple. As on today, most of the E-commerce MNCs are residents of USA. Today these companies avoid taxes in the “Countries of Source”- from where they earn revenues. If other Governments start taxing these MNCs, USA Government’s share of tax will go down. Hence USA opposes any modification in the DTA models. And when USA opposes something, it is not surprising that nothing happens for 20 years or more.

Conclusion of the situation discussed so far is that the OECD and UN Models of DTA will not change. This means that India cannot levy Income-tax on the E-commerce MNCs. Hence we have to find a way outside the Income-tax Act. Hence Equalisation Levy is outside the Income-tax Act. Double Tax Avoidance Agreements are not applicable to Equalisation Levy.

In short, Equalisation Levy has been designed in the circumstances where existing rules of international taxation are outdated; and the global vested interest lobbies do not allow the OECD to change the rules.

18. Rate of 6-8%:

18.1 There are several permutations and combinations that were considered by the committee.

18.2 When a non-resident company earns interest, royalty or FTS etc. from India, it generally suffers TDS @ 10% or 15% depending upon the applicable DTA. For this tax paid in India, it gets a credit against the tax payable in the country of its residence. For Equalisation Levy it will not get the credit. Hence it was considered fit to levy the tax at a lower rate. Now, what should be the rate is a matter of debate. It was thought that at the beginning, the rate should be low. Hence we recommended a range of 6% to 8%. Government of India chose 6%.

18.3 If a non-resident has a permanent establishment in India and earns business profits from India, it suffers Income-tax @ 40%. Equalisation Levy (EL) is on the turnover and not on the net profit. Now what should be the rate? If we assume the profit ratio of 20%, EL should be 8%. If we assume the net profits to be 25%, EL should be @ 10%. While taxing a non-resident, worldwide system is to presume an estimated rate. Levy a flat rate of tax on the gross revenue. Some companies earning more than the estimated rate of profit will benefit. The companies earning less than the estimated rate of profit will suffer. However, all the companies will benefit in the sense that they do not have to prepare books of accounts, they don't have to get the accounts audited; and entire process of compliance with the law, assessment etc. becomes practical and simple.

In conclusion, TDS at flat rate on gross revenue is a globally accepted system for taxing non-residents. Since EL is not available as a credit in the country of residence, we recommended a lower rate.

19. Others:

The idea is not to encourage either one system or the other. Now there are two systems available to the multinational corporations supplying E-commerce services in India. Whichever is more beneficial to the MNC, may be selected by the MNC – in the sense that if the MNC opens up a PE or subsidiary in India; and supplies the services from India; it will escape Equalisation Levy. Indian assessee will then be liable to normal tax.

I personally believe the Equalisation Levy avoids considerable litigation and simplifies the matters for the assessee as well as Government of India.

20. Legal Challenges:

In a democratic set up, challenging any law is possible. In India, we are a litigious society. So, it is possible that someone may challenge. I believe, Income-tax department is competent to deal with all the challenges. And if I may tell you a secret: "Some of the Income-tax commissioners are great wizards on international taxation. They do not appear in the media. However, their knowledge is no less than several popular tax consultants."

21. Committee's view on changes in Income-Tax Act, even though levy stands outside of I-T Act:

There are several reasons:

21.1 We wanted to avoid any double taxation within India. If one MNC pays Equalisation Levy in India, the same company should not be levied Income-tax on the same revenue. To eliminate the chances of litigation in this matter, a specific exemption is given under Section 10 (50).

21.2 Present system of tax collection is inadequate. (I am not referring to the law. I am referring to only the tax collection procedures.) In India, in USA, in UK & most other countries, a non-resident's tax is collected by the TDS procedure. In other words, the Indian resident payer deducts the money from the payment to be made to the non-resident. And then pays to the tax department. Now, if the resident payer does not comply with TDS procedure, then the common preventive steps are: the tax is recovered from the resident payer; he is charged interest & penalty; and the expenditure is disallowed in his hands. This is the process adopted even under Equalisation Levy for enforcing the compliance by the resident payer. The disallowance of expenses if EL is not deducted by the Payer requires amendments in Income-tax Act. Hence insertion of Section 40 (ib).

21.3 This tax is to be administered by the Indian Income-tax department. In a democracy any tax should have the appellate mechanism also. Hence all the machinery & appellate provisions of Income-tax Act have been made applicable to Equalisation Levy.

22. Impact of the levy on Indian start-up community that are primary consumers of such e-marketing services:

(i) Probably, the biggest advertiser in India is Hindustan Unilever Ltd. Is it a start up?

(ii) Let us rephrase the query: “For startups, internet advertising is more affordable. When internet advertising is taxed, startups will be affected”.

Well, Indian internet media advertisements are not subject to Equalization Levy. Is it necessary for a startup to go to foreign media for advertisement?

It is a fashion to oppose any tax in the name of the weakest section of the society. These persons ignore the fact that MNCs earning billions in revenue from India are escaping without paying any tax in India. The tax that the MNCs don’t pay is ultimately suffered by rest of the tax payers. Which includes You& me and your & my typist & clerk. Not taxing the MNC is like subsidizing the MNC at the cost of the middle class of India.

This part of the paper completed.
For the time being.

No longer the “Apple” of Ireland’s Eye - Tracing the Apple Tax Controversy history in 10 steps

Earlier this month, Taxsutra published an article tracing Apple’s tax controversy on the much talked about ‘sweetheart deal’, between the tech giant and the Irish Government. According to the European Commission (‘EC’), the arrangement allowed Apple to avoid taxation on almost all profits generated by sales of its products in the European Union (‘EU’) single market, because Apple recorded all its sales in Ireland rather than where the products were sold. An order has been issued by the EC to the Irish Govt. to recover 13 billion Euros in taxes plus interest.

“2…..Apple incorporated subsidiaries in Ireland which were claimed as non-tax-resident in the country. Of particular note are subsidiaries Apple Sales International and Apple Operations Europe, which held the rights to use Apple's intellectual property to sell and manufacture Apple products outside North and South America under a so-called 'cost-sharing agreement' with Apple Inc. These two companies attributed almost all sales profits to a “head office” that “existed only on paper and could not have generated such profits……”

Since June 2013, the EC has been investigating the tax ruling practices of Member States, extending this information inquiry to all Member States in December 2014.

(You can read more: http://www.tp.taxsutra.com/news/11993/No-longer-the-Apple-of-Ireland-s-Eye-Tracing-the-Apple-Tax-Controversy-history-in-10-steps)