



TAXATION OF DIGITAL TRANSACTIONS

Why plugging the loopholes isn't easy

While India has been trying to bring digital entities under the tax net, the hazy nature of cross-border e-commerce transactions makes it difficult, explain **Dipesh Jain** and **Sumeet Agrawal**

6%

EQUALISATION LEVY ON FOREIGN FIRMS PROVIDING DIGITAL ADVERTISING SERVICES

2%

EQUALISATION LEVY ON FOREIGN E-COMMERCE COMPANIES SINCE APRIL 2020

APRIL 1, 2022

ONWARDS CONCEPT OF SIGNIFICANT ECONOMIC PRESENCE APPLICABLE

● OECD's views on digital transactions

THE ORGANISATION FOR Economic Cooperation and Development (OECD) has recommended certain modifications in the existing "Permanent Establishment" (PE) concept to pave the way for digital transactions to enter the PE world. Thus, where significant digital presence is observed in a third country in spite of absence of physical presence or fixed base there, such an entity's income earned in the third country would come under the tax net. This gave birth to the concept of "virtual fixed place" as in an enterprise maintaining its website on a server in a third country and conducting its business primarily through such a website.

Different forms / modes of taxation, such as withholding on certain category of payments, levying equalisation tax, profit attribution through "Significant Economic Presence" (SEP) were thereby recommended.

● Impact on conventional businesses

● The global experience

SOME COUNTRIES HAVE introduced Digital Services Tax as a temporary measure to tax digital transactions. These taxes are typically aimed at multinational digital companies that generate significant revenue from providing digital services in

the country but may not have a physical presence there. Countries such as the UK, France and Brazil are among the few examples which have implemented / proposed to introduce Digital Services Tax so as to bring them under the tax net.

● India's taxation regime for the digital economy

TAXATION OF DIGITAL transactions was introduced in India vide Finance Act, 2016 by way of an 'equalisation levy' at 6% made applicable on the gross consideration received by a non-resident for online advertisement, digital advertising and related services from specified persons. The scope of 'equalisation levy' was further expanded to cover non-resident e-commerce operators within its ambit. As a result, consideration received by a non-resident

e-commerce operator from e-commerce supply or service was made liable to equalisation levy at the rate of 2%. Subsequently, Finance Act, 2018 introduced the concept of SEP which was made effective from April 1, 2022 to bring within the tax net, non-resident entities, whether or not such entities have a residence or place of business in India or render services in India, provided certain customer base thresholds are met.

WHILE IT SEEMS the intention of the government is to bring 'digital transactions' under the tax net through the introduction of equalisation levy, SEP provisions, etc., the construct of the extant tax provisions could include, not only digital transactions, but also the transactions carried out by conventional businesses operating under the classic brick-

and-mortar model. Further, lack of clarity in respect of attribution rules on applicability of SEP invites subjectiveness, which could lead to protracted tax litigation. Given the enlarged scope of equalisation levy, even inter-group transactions without any markup could be subjected to such levy. It is pertinent to note that since the levy has not

● Challenges posed by non-resident entities

UNDER CERTAIN CASES where the non-resident entities do not have PE in India and are eligible for benefits under the Tax Treaty, they could possibly be out of the tax net provided under significant economic presence provisions contained in the Income-Tax Act, 1961.

Lack of physical presence in the source countries, transactions camouflaged as royalties or overhead charge-backs/ reimbursements without adequate basis could be difficult to assess, posing another problem.

Further, practical challenges such as ambiguity in determining the number of users of a digital service or the absence of profit attribution rules for the purpose of determining tax under SEP provisions could make the taxation framework less implementable, eventually leading to lower revenue for the state exchequer.

been introduced as part of the Income-Tax Act but as a part of the Finance Act, foreign tax credit for equalisation levy paid in India, in the home country of the non-resident could entail detailed evaluation.

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