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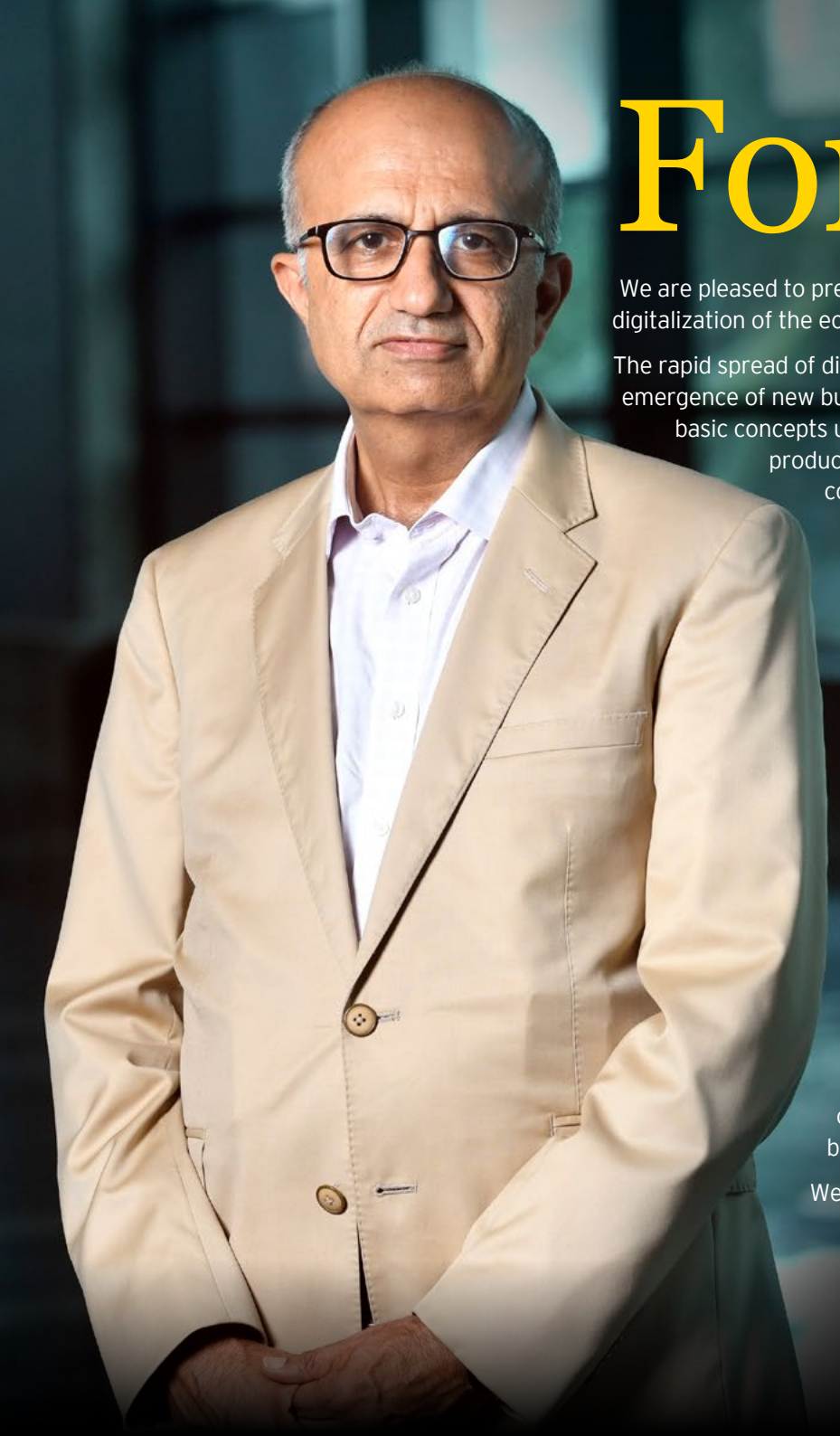
Building a better working world



Foreword

We are pleased to present a special edition of our magazine *India Tax Insights*, focusing on tax aspects relating to digitalization of the economy.

The rapid spread of digitalization has driven considerable changes in the way businesses operate. This has led to the emergence of new business models and substantial transformation of old ones. The changes have put pressure on the basic concepts underlying existing international tax rules, which were created almost a century ago. Emerging production and consumer models, as well as new technologies; all enabled by the proliferation of the connected economy, are affecting all companies in every industry. Industries are blurring and integrating elements of the technology sector into aspects of legacy business processes at an accelerating rate. Digital breaks down barriers to entry and growth, enabling companies instantly to access and monetize global consumers, reshaping markets and supply chains, and creating new business opportunities and risks. This has multiple tax implications. As most of the digital activity is "intangible", the key implication is the tax base erosion in the country where the customers/ users of the digital products and services are based. Taxation of the digital economy raises complex technical questions, and there are also differing views among countries on the extent of changes that may be required to the international tax rules. The subject raises questions regarding the relevance and effectiveness of some key concepts underlying existing international tax rules, namely nexus and profit allocation rules, which are strongly rooted in physical presence requirements.

Against this backdrop, this special edition of our magazine covers various topics relating to taxation of the digital economy such as, current state and way forward of the OECD Inclusive Framework's Unified Approach for new nexus and profit allocation rules, global developments on digital economy taxation, and a critique on India's recent expansion of equalization levy.

In this shifting tax environment, keeping abreast of changes is essential. We hope this publication helps you monitor issues and understand the drivers behind key tax developments and changes happening in India and around the globe. We also believe that its time to re-examine the existing cross border business models across sectors and plan for greater alignment of tax strategies with business models.

We look forward to your feedback and suggestions.

Sudhir Kapadia

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National Tax Leader, EY India

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How does OECD BEPS 2.0 impact your business?

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The digital economy has revolutionized the traditional ways of conducting business across the world. Emerging production and consumer models along with new technologies have created a set of fresh tax challenges and have strained existing international tax rules which have been slow to adapt to the new business environment. It is against this backdrop that governments of different countries are demanding greater transparency and introducing new rules and regulations for the digital economy.

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The prelude

In January 2019, the Organisation for Economic Co-operation and Development (OECD) released a policy note communicating that renewed international discussions will focus on two central pillars. Pillar One will address the broader challenges related to the digitalization of the economy and will focus on the allocation of taxing rights, and Pillar Two will sort out the remaining Base Erosion and Profit Shifting (BEPS) concerns (collectively, BEPS 2.0 project). In May 2019, the OECD released the 'Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy' (the workplan). The workplan's timeline summarizes a long-term solution to address the digitalization challenges, which is to be submitted to the BEPS Inclusive Framework (IF) for an agreement in January 2020, and work on elaborating the policy and technical details of the solution will continue in 2020 to deliver a consensus agreement on the new international tax rules by the end of 2020.

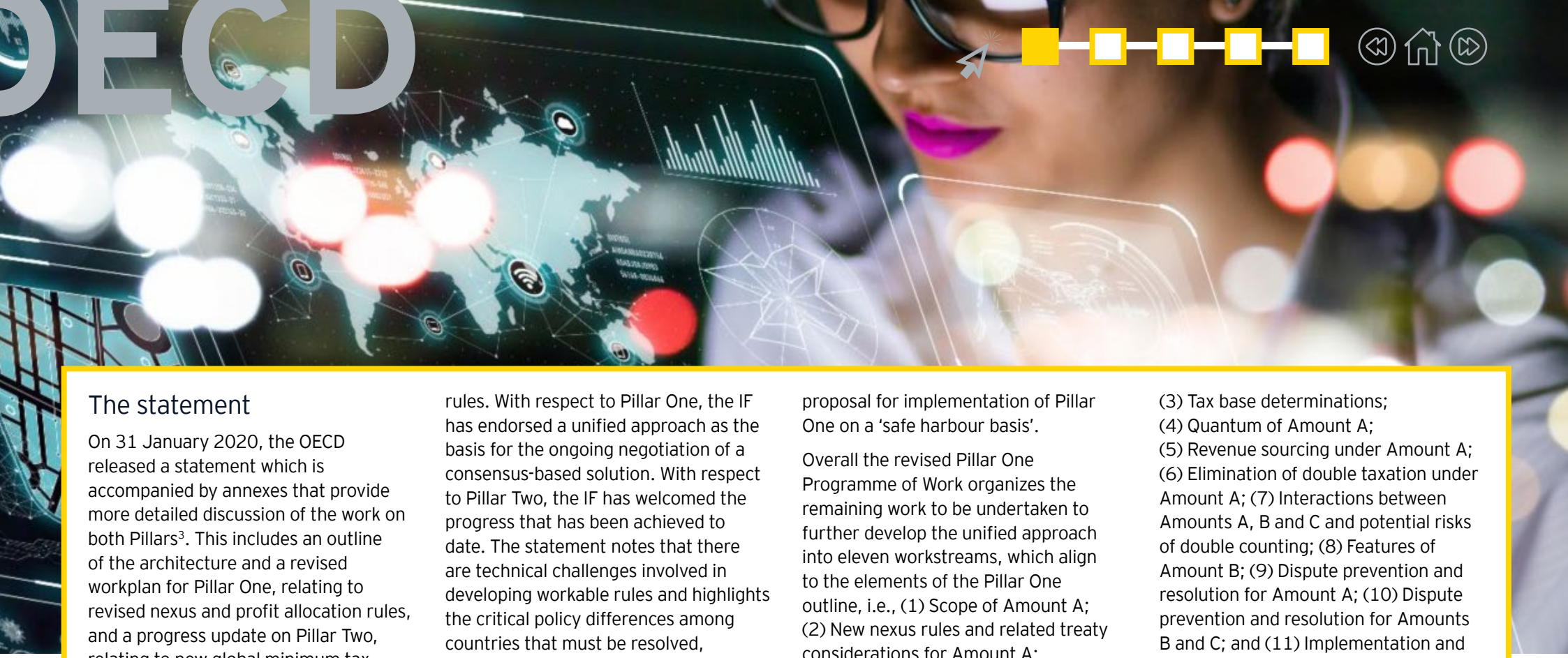
While OECD is working towards achieving a global consensus on an unified approach, the United Nations Committee of Experts on International Co-operation in Tax Matters (UN Committee) has decided to work independently on the 'tax consequences of digitalized economy' taking note of work done in other forums. Accordingly, the UN Committee has released a draft paper on introduction of a new Article 12B[1] along with commentary in the United Nations (UN) Model Convention. The new Article 12B defines the nexus and determination of profits for automated digital services (ADS), thereby providing taxing right over such income to the source jurisdiction. The proposal currently requires further consideration.

The workplan

Pillar One contains three alternative proposals: the user participation proposal, the marketing intangibles proposal and the significant economic presence proposal. These proposals differ in objective and scope of reallocation of taxing rights. However, common aspects in these proposals will allow to resolve the technical issues under Pillar One by grouping these issues into three building blocks, namely, new profit allocation rules, new nexus rules and implementation of new market jurisdiction taxing right. The workplan sets out three different methods – modified residual profit split method, fractional apportionment method and distribution-based approach – to quantify the amount of profit to be reallocated to market jurisdictions and methods to determine how profits should be allocated. The workplan stated that OECD will explore the development of remote taxable presence and a new set of standards for identifying the existence of such taxable presence.

OECD's proposal for a 'unified approach'

On 9 October 2019, the OECD released a public consultation document[2] outlining a proposal from the OECD Secretariat for a 'unified approach' under Pillar One. The scope of the Secretariat Proposal covers highly digitalized business models and consumer-facing non-digitalized businesses. The proposal also includes a new nexus concept that is not dependent on physical presence and is largely based on sales. It is proposed to be separate from the existing permanent establishment (PE) concept. The new nexus would operate regardless of whether taxpayers have an in-country marketing or distribution presence or the taxpayers sell through related or unrelated distributors. In addition, the proposal contains a three-part approach to new and revised profit allocation rules, which would provide a formulaic method to allocate deemed non-routine profits to market jurisdictions under the new nexus concept (Amount A). Besides this, the approach provides a formulaic approach for a fixed return to baseline marketing and distribution activities in situations where there is nexus under the existing principles (Amount B), and an approach for allocating additional profit to the market jurisdiction where the local activities exceed such baseline activity. Finally, the proposal contemplates binding effective dispute prevention and resolution mechanisms that would cover all three parts of the profit allocation approach (Amount C). The proposal acknowledges that further technical work is required and includes an annexure with a series of specific questions for public comment on significant policy, technical and administrability issues.



The statement

On 31 January 2020, the OECD released a statement which is accompanied by annexes that provide more detailed discussion of the work on both Pillars[3]. This includes an outline of the architecture and a revised workplan for Pillar One, relating to revised nexus and profit allocation rules, and a progress update on Pillar Two, relating to new global minimum tax rules. With respect to Pillar One, the IF has endorsed a unified approach as the basis for the ongoing negotiation of a consensus-based solution. With respect to Pillar Two, the IF has welcomed the progress that has been achieved to date. The statement notes that there are technical challenges involved in developing workable rules and highlights the critical policy differences among countries that must be resolved, including the United States (US) proposal for implementation of Pillar One on a 'safe harbour basis'.

Overall the revised Pillar One Programme of Work organizes the remaining work to be undertaken to further develop the unified approach into eleven workstreams, which align to the elements of the Pillar One outline, i.e., (1) Scope of Amount A; (2) New nexus rules and related treaty considerations for Amount A; (3) Tax base determinations; (4) Quantum of Amount A; (5) Revenue sourcing under Amount A; (6) Elimination of double taxation under Amount A; (7) Interactions between Amounts A, B and C and potential risks of double counting; (8) Features of Amount B; (9) Dispute prevention and resolution for Amount A; (10) Dispute prevention and resolution for Amounts B and C; and (11) Implementation and administration.

Proposed introduction of new Article 12B in the UN Model Convention

The proposed Article 12B grants taxing right to the source country over the income arising from ADS. It provides the option to choose either gross or net basis of taxation. The concept of introducing a new Article is largely based on a proposal presented by a senior Indian IRS officer and UN Committee member Mr. Rajat Bansal[4]. Introduction of the new Article in the UN Model Convention advocates for a simpler approach. Accordingly, in-scope activities will be confined to ADS in respect of revenue from market jurisdictions, other than income attributable to PE under the existing source rule and fee for technical services. Further, the nexus may be established in a market jurisdiction only based on local revenue derived. The profits may be determined through fractional apportionment method by applying the multinational enterprise (MNE) group profit rate derived from in-scope activities on the local sales revenue and attributing a percentage of the same to market jurisdiction. With an introduction of separate Article in the tax treaties, the double taxation relief can continue to be governed by the existing tax treaty provisions.

On the implementation front, since the bilateral tax treaty negotiation will involve substantial time, a multilateral convention similar to Multilateral Instrument is proposed. The draft outline is now before the larger member panel for further discussion.

BEPS2.0

India's perspective

India began its digital tax journey in 2012 with the amendment of the term "royalty" in the domestic tax law which now captures most technology/digital economy transactions. Further, the concept of PE as a nexus for taxing business profits has come under significant pressure, with tax authorities sometimes asserting virtual PE under the definition of traditional PE.

India was also the first country to implement an equalization levy of 6% of the amount received or receivable by a non-resident for providing specified digital services and facilities.

India also sought to introduce the concept of Significant Economic Presence (SEP) to amend the rules on profit attribution to a PE. However, Central Board of Direct Taxes (CBDT) is yet to prescribe these rules.

Recently[5], India has extended the source-based taxation rule to cover income from advertisement, sale of data collected from India, and sale of goods or services using data collected from India. Further, the scope of equalization levy is expanded to cover e-commerce transactions. Currently, the scope is wider and may potentially cover even traditional business models. However, an additional guidance in this regard is much anticipated from the Government of India.

Traditionally, India has sought to have greater source country taxation while allocating taxing rights under a tax treaty by seeking to have a broader definition of PE as compared to the OECD standard. Accordingly, India may look at bilateral negotiation of tax treaties to include new Article 12B or sign a multilateral convention to this effect.

Conclusion

The reallocation of taxing rights under Pillar One has fundamental implications on the international tax framework. Thus, it is essential for all jurisdictions to implement such changes simultaneously to avoid double taxation. The proposals could bring significant changes to the overall international tax rules under which multinational businesses operate and could have important consequences on the overall tax liability of businesses and tax revenues of the countries.

As a significant contributor to the user base, India's reaction to the proposals would be keenly watched. It is presently unclear whether a consensus may be achieved within the ambitious timeframe set by the Inclusive Framework (i.e., end of 2020) and whether a "one-size-fits-all" approach would be feasible. This uncertainty, coupled with uncoordinated and unilateral measures adopted by different countries, is likely to exacerbate the double taxation woes of companies – something which is not in the interests of taxpayers as well as the policymakers. The recent expansion of equalization levy and source rule in domestic taxation indicates India's urge to acquire the taxing rights associated with digital and market/ user factors which may put India in a better position in the global deliberations on the Pillar One proposal.

Therefore, it is important for MNEs to follow the developments closely and consider engaging with the OECD and policymakers at both national and multilateral levels on the business implications that these proposals might bring. Companies should also start evaluating the potential impact of these changes on their business models.

1. *https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX%20TREATY%20PROVISION%20ON%20PAYMENTS%20FOR%20DIGITAL%20SERVICES.pdf*
2. *https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf*
3. *https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf*
4. *Committee of Experts on International Cooperation in Tax Matters - Twentieth session (Virtual Session commencing 22 June 2020 Item 3(i) of the provisional agenda) - Tax consequences of the digitalized economy – issues of relevance for developing countries (E/C.18/2020/CRP.25)*
5. *Introduced by Finance Act, 2020*

Taxation of the digital economy: developments in ASEAN countries

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Since the mid-2010s, there has been a growing concern about international tax legislations not keeping pace with the evolution of the economy. Digitalization of the economy has only exacerbated the gap. Tax legislations generally apply to tax businesses where they have physical operations. With digitalization, businesses no longer require a physical presence to derive income. This means they can derive income from consumers outside their home country but need not pay tax in those foreign jurisdictions where they do not have a physical presence.

This has led to the Organisation for Economic Co-operation and Development (OECD) introducing the Base Erosion Profit Shifting (BEPS) Action Plans 1-15 in 2015, with its top priority, Action Plan 1, to recommend changes to international tax rules. This will help them achieve a more equitable allocation of taxing rights (Pillar 1 under the OECD's Programme of Work) as well as to arrive at a global anti-base erosion mechanism (Pillar 2) and achieve consensus by end 2020.

Given the sheer number of jurisdictions with differing interests, consensus is yet to be reached. Hence, notwithstanding the multijurisdictional discussions taking place, some jurisdictions have adopted unilateral actions to introduce new legislations aimed at taxing the digital economy (referred to collectively as digital tax hereinafter).

These legislations can generally be categorized into direct taxes (e.g., digital services tax, tax on digital permanent establishments (PE), tax on significant economic presence (SEP)), and indirect taxes (e.g., the Goods and Services Tax (GST) or value-added tax (VAT) registration requirements for non-resident providers of digital goods and services).

The following table shows a snapshot of what the Association of Southeast Asian Nations (ASEAN) countries have implemented or proposed in terms of digital tax legislation.

		Type of tax	Tax legislation introduced	Implementation date
Indonesia	Direct tax		Any foreign e-commerce trader, service provider and/or marketplace meeting a significant economic presence test can be treated as a PE and be subject to income tax (at the prevailing corporate income tax rate). Should the foreign e-commerce trader, service provider and/or marketplace not be deemed to have a PE due to the application of the tax treaty, they are subject to an electronic transaction tax (ETT).	31 March 2020
	Indirect tax		The Indonesian Government has introduced VAT on the utilization of intangible taxable goods and/or taxable services imported from outside the Indonesian Customs Area (ICA) into the ICA through electronic transactions. The effective rate is 10% and the legislation to take effect from 1 July 2020.	31 March 2020
Malaysia	Indirect tax		Foreign service providers are required to register for service tax if their total annual sales of digital services to customers in Malaysia (be it business-to-business (B2B) or business-to-consumer (B2C)) exceed RM500,000. Businesses that have been charged service tax on digital services provided by a foreign registered person (FRP) are exempted from service tax in Malaysia on these imported taxable services.	1 January 2020
Philippines	Direct and indirect tax		The Philippines House of Representatives has tabled a bill, the Digital Economy Taxation Act of 2020, which proposes to subject certain digital goods and services to 12% VAT. Non-residents providing digital services will also be required to establish representative offices or appoint resident agents to carry out business in the Philippines. Network orchestrators or platform service providers will be responsible for withholding the VAT (as well as corporate income tax if non-resident suppliers are deemed to be subject to corporate income tax). This bill is subject to discussion and approval in the Congress.	Proposed
Singapore	Indirect tax		Non-resident vendors of digital services to consumers in Singapore have to register for and collect GST.	1 January 2020

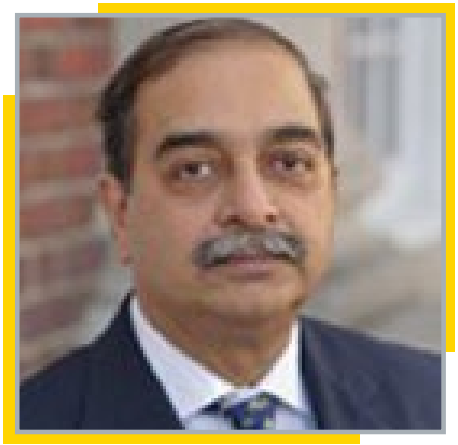
		Type of tax	Tax legislation introduced	Implementation date
Thailand		Direct tax	Financial institutions facilitating e-commerce supplies of goods and services will be responsible for withholding and remitting 5% of the transaction value to the Thai Revenue Department.	Proposed
		Indirect tax	The Thai Cabinet has approved a draft VAT bill on 9 June 2020 that would require foreign e-business operators to register and impose Thai VAT on electronic services to individual consumers in Thailand. The draft bill is pending for parliamentary approval.	Proposed
Vietnam		Direct and indirect tax	Foreign e-commerce traders and digital platform-based service providers, without a PE in Vietnam, are required to register with the Vietnamese tax authority to enable declaration and payment of tax or authorize another party to do so on their behalf. If the foreign taxpayer fails to do so, financial institutions facilitating the transactions will be responsible for withholding and remitting the applicable tax. There will be deemed corporate income tax and VAT components to the amounts withheld but the government is in the midst of drafting the detailed implementation guidance.	1 July 2020, but the effective date has been postponed given that detailed guidance is not yet available.

Businesses should also assess whether their existing business model is feasible or they should restructure it to mitigate tax costs. Further, they should also consider whether their existing processes and information technology systems are robust or do they need to upgrade them to facilitate collection of information to comply with the digital tax.

In the absence of internationally-agreed standards on this issue, different jurisdictions have adopted different definitions regarding the scope of digital tax and the thresholds triggering it. In addition, there is a lack of detailed guidance on how the legislation should be interpreted. As digital tax (excluding GST or VAT) is a relatively new concept and is often imposed on turnover rather than profits, it seems unlikely to be covered by a tax treaty.

Given the uncertainties, businesses with existing operations in the ASEAN countries or those looking to expand their operations into this region, should keep abreast of digital tax developments. This will help them assess whether they will be in scope of the digital tax legislation. They would not want to be non-compliant inadvertently and would not want to be burdened under potential penalties and reputational damage. Businesses should also calculate the financial impact of the digital tax and should take into consideration the potential tax implications (e.g., double taxation). The model adopted should be flexible to accommodate changes given that digital tax is still an evolving concept. Businesses should also assess whether their existing business model is feasible or they should restructure it to mitigate tax costs. Further, they should also consider whether their existing processes and information technology systems are robust or do they need to upgrade them to facilitate collection of information to comply with the digital tax.

With digitization becoming more prevalent in how businesses are conducted, the finance and tax function should be part of business strategy discussions as a best practice. This can help organizations to take digital tax into consideration while building their business case. Organizations can also minimize the need for subsequent changes to ensure compliance with the digital tax legislation.



In conversation with

Mr. Akhilesh Ranjan, former Member, CBDT

Q&A

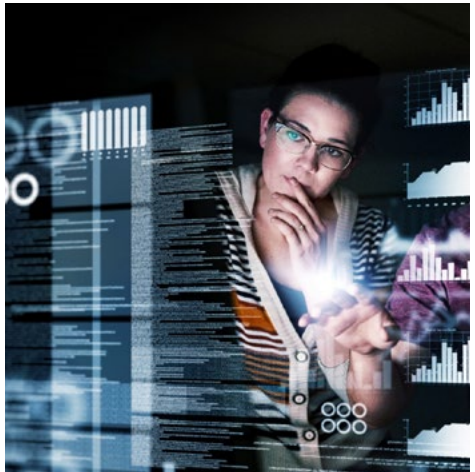
***1** The taxation of digital economy is complex and varied, both for the taxpayers as well as the tax administration. What, according to you, are the key focus areas that the OECD needs to address as part of BEPS 2.0?*

There are a number of important focus areas. On the broader level, firstly, there must be a multilateral consensus solution, not just because the G20 wants it, but because the subject is such that a solution without full consensus may lead to mayhem in the world of tax and many unnecessary compliance issues for taxpayers. Many countries, including India, have already implemented unilateral measures. Other countries are also contemplating or in the process of doing it, including the European Union. If all these developments come up simultaneously but in different forms, it will become difficult for multinational enterprises to sort things out. There is also the revenue constraint which COVID-19 has further accentuated. A lot of countries now want to raise revenues, and that has become a major reason for quickly implementing such taxation measures. So, unless a multilateral consensus is found quickly, the issues concerning taxation of digital economy might go out of control.

The second aspect is that the solution must be inclusive. You can't have a few countries just staying away. Earlier, the concept of 'inclusive' was that the developing world should be a part of it. But now, the emphasis is shifting to some of the developed economies that need to be on board and participate in this solution. If you come to a consensus minus one or consensus minus two, it may not help. What do countries like India do in such a situation? Do we withdraw the equalization levy, or do we let it be? So, it should be an inclusive solution in more ways than one.

Next, coming to the details, the Organisation for Economic Co-operation and Development (OECD) must focus on the scope of the solution, defining new concepts like nexus and revenue sourcing, which would be determined by the location of the Internet Protocol (IP) address rather than the physical/ geographical location. On scope, we must be very clear about the extent to which we are targeting consumer-facing businesses and digital services. On nexus, the reason for many countries, including India, to join the base erosion and profit shifting (BEPS) process was to have a new definition of nexus because that's what, we feel, is the most important issue. If nexus is not defined in an appropriate manner and if it is only something introduced to justify taxation of some residual profits, then there might be issues for countries in accepting that approach.

These are the key areas that the OECD must focus on. They must discuss and find solutions which are acceptable to all.



2. *BEPS 2.0 Pillar One provides for various thresholds and classification of profits into routine and non-routine, before arriving at the share of profits to market jurisdictions.*

2.1 *Do you believe that some of these proposals might be more beneficial or do you believe they create more issues than the status quo?*

Yes, the threshold dimension is going to be a major issue in negotiations, as it really decides the applicability of the new regime to different countries. If there are several countries who feel that they are not going to get anything out of the BEPS discussions, then expecting them to enter into multilateral agreements and pass legislations in their countries will be a problem. For India, yes, we do think that the solution will generate some revenue, though it is not certain how much. It is also a fact that these proposals are leading to new issues. For example, if nexus is defined only in a limited way, then the starting point of these discussions remains unanswered. Are we really finding a solution to the digital economy? Or are we finding a solution only to tackle some problems of low-risk distributors? Such issues will keep coming up. But, right now one must be ready for a gradual movement towards addressing issues arising from digital economy. Slow progress, but progress, nevertheless. That's what I would hope for.

2.2 *What are India's expectations from BEPS 2.0 and more specifically from Pillar One?*

We are not very clear as to how much revenue India can hope to get from the Pillar One decisions. The expanded equalization levy, as introduced in March 2020, is something unknown. I don't think anyone, not even in the government, has any idea of the estimated revenue collections on account of this new levy. If the scope of equalization levy remains as wide as it is now, and so ill-defined, then maybe the revenue collections might go up to a higher figure. But several factors are involved on this subject and what we must primarily hope for is to get an in-principle agreement which can take things forward.

2.3 *Do you believe the objectives sought to be achieved by the OECD are aligned with India's policy considerations?*

No, unfortunately. This whole debate started off on the reasoning that the new business models were highly-digitalized. Somewhere down the line, that focus seems to have been diluted into 'consumer-facing businesses' in general. It is true that all businesses right now are digitalized and therefore we can't really talk of a digital economy by itself. But in that process, we should not really lose focus of the new business models, which are essentially those of rendering digital services. We had always talked about modifying the definition of nexus and introducing the concept of significant economic presence, which is the most important thing for India. We maintain that the first nexus should be defined and then allocation of profit should be considered. Instead of following a reverse approach of deciding the profit allocation first, followed by the nexus rule to justify taxation of that profit is being pursued. This is not the solution that India was looking for and it's not in line with our policy objectives. Even letting go of the arm's length principle to a limited extent does not serve the purpose that we wanted. So, the current OECD work is not really aligned with India's policy interest.

2.4 *In terms of India's economic assessment, how beneficial is BEPS 2.0 Pillar One from the expected revenue target, compliance, certainty and administrative standpoint?*

Pillar Two of BEPS 2.0 is likely to achieve agreement and consensus. It may not, in the near term, give us much additional revenue but it's something that India would need in the years to come. With Indian businesses also expanding worldwide and going multinational in a big way, I think Pillar Two proposals are going to help us, even though not quantified. India is not hoping for any significant additional revenue on account of Pillar One. What we are really hoping for is some agreement on the principle of 'nexus' or departure from the arm's length standards, or some new ways of looking at business.

3. *In terms of unilateral measures adopted by India, India has introduced/proposed to introduce various measures like equalization levy (EL), Profit Attribution to Permanent Establishment (PAPE) rules, Significant Economic Presence (SEP) rules, etc.*

3.1 *What are the policy objectives sought to be achieved through these measures?*

The existing rules for allocation of taxing rights, which are enshrined in the tax treaties, are completely obsolete. They were always biased or were in favor of the technologically developed and capital-exporting countries. They still do not address the issues thrown up by new ways of doing business. Therefore, they require a change, particularly the rules of nexus and the concept of permanent establishment. The digital debate is expected to resolve the issue of taxation rights, though that doesn't seem to be happening too much now. We would require a strong and alternate definition of nexus for reallocation of taxing rights.

3.2 *Which measures will find a place in the Indian tax regime?*

These are intended to be interim measures. The equalization levy that was introduced in 2016 was very clearly an interim measure because it was an admittedly imperfect tax. Tax officials were aware before the introduction of this levy that the incidence of taxation may not always fall on the multinational companies. It might fall on the consumer in India and there is a lot of scope to confuse that levy with consumption-based taxation. Tax officials have been trying to find better ways of defining a new nexus and for taxing these new incomes.

3.3 *Given India's need for revenue and specially after the COVID-19, do you think that this interim measure is likely to continue for a while and could this become a new source of revenue?*

We always intended equalization levy to be an interim measure, but the developments of last one year have really created confusion in the minds of taxpayers and tax administrations. In December 2019, the US said that they were not comfortable with the new nexus rule and are moving away from the arm's length principle. Recently, they said that they don't think that the OECD's discussions are going anywhere and that they wanted to pause the talks without any concrete reason. So, it appears difficult to achieve a solution with the support of all countries. Even after the introduction of Multilateral Instrument (MLI), which the US has still not signed, it seems difficult to persuade countries like India to withdraw the equalization levy without a full consensus solution. It is a major reason coupled with the revenue constraints caused by COVID-19. These two things led to the hurried implementation of the new equalization levy in March 2020.

3.4 *When these negotiations are happening with the equalization levy already in place in India, does it enhance our negotiation position in the inclusive framework? Do you think it can help us in getting what we want?*

If the chances of consensus are receding, then countries who need revenue, will continue to enhance the scope of equalization levy. France and the European Union also hold the same strong views. So, to some extent, equalization levy is a bargaining tool, urging countries to come back to the negotiating table, though it also has its own problems.

4. *Recently, the scope of EL was expanded to cover e-commerce transactions. This has happened at a time when discussions are ongoing at the OECD on BEPS 2.0 Pillar One with active participation by India.*

4.1 ***What does this indicate from a policy perspective – is it an indication of the lack of consensus at the OECD level?***

4.2 ***Should India have waited until discussions on BEPS 2.0 reached some level of finality?***

Countries around the world have started to lose patience. I am aware of countries, for example, the African countries like Nigeria, Ghana and South Africa who want an early solution. To expect the whole world to just keep sitting tight, not doing anything to tax this income in the hope that that at some point of time some sort of solution will emerge, is a bit optimistic. Countries must keep this in their minds and find a solution which is quick, just and simple and which can yield results so that no interim measures are introduced.

5. *The objective of expanding the scope of EL is to tax the income earned by non-residents from Indian jurisdiction which is otherwise not taxable due to the limitations of the existing nexus and rules in the tax treaty. Does this tantamount to tax treaty override?*

5.1 ***If yes, can the Indian Parliament override a tax treaty through unilateral amendment to the domestic tax laws?***

In my view, it's not a treaty override at all. The issue is entirely different. The issue is that current international tax rules themselves do not contemplate this sort of a business model or an income stream. The fact that business can be done without having any defined physical presence is a new concept which is not envisaged in the international tax rules or in the tax treaties. In such cases, one can't really say that a new law brought in by the Parliament of a country is overriding the treaty. The treaty never said anything about it because it really never envisaged this sort of business model. I think the Parliament is fully justified in considering a new income stream which is identifiable and not addressed by the current rules of international tax, and tax it to the best of its capabilities.

5.2 ***If you believe treaty access is not permitted to deal with disputes arising from the EL, what is the proposed approach for dealing with controversies that may arise on account of interpretation of e-commerce EL?***

The levy which was introduced in March 2020 does appear to be wide in scope. The confusion is continuing because of the uncertain terms that have been used in the law, which can be stretched in their meanings. The taxpayer must be clear as to what is it that the government wants to tax and how it is going to tax. Without this clarity, there will always be frictions or tensions between the taxpayers and the tax authorities, resulting in litigation and disputes. It should be incumbent upon the government to try and clarify some aspects and convince the taxpayers as to why it is necessary and how it can work in an efficient manner.

6. *Your thoughts on the United States probe on unilateral digital taxation measures including India's EL. Will India's EL sustain the investigation?*

The government's stand is very clear. The US expects countries to find a multilateral solution and not take any unilateral measure. However, no country can expect the world to just sit tight and not tax incomes which are clearly arising in the jurisdictions only because there is absence of rules.

Whether this levy is really discriminatory in any way, or does it really harm the US companies in particular, the answer is very clear. The law, as it is drafted, prescribes very low thresholds and is applicable to several businesses. In fact, the wide scope that is being criticized, is the biggest defence against any sort of threat of discrimination. If it was only discriminating against some companies in the US then it would have been focused only on digital services. EL is very wide in scope and the thresholds are such that they do not target only a few huge multinationals. The Indian Government is not wrong in any way in maintaining the stand that EL is not discriminatory and that the Parliament is justified and competent to enact this law without contravening the World Trade Organization's (WTO's) regulations.

7. *Given the current situation where businesses are grappling with the pandemic situation, a new levy unaccompanied with guidance/ clarifications has added challenges for the non-residents. Further an eleventh-hour modification of the challan for facilitating payment of equalization levy has created an additional burden on the non-residents from the compliance's standpoint. However, this indicates that there is no intention to defer the applicability of e-commerce equalization levy. Do you expect any relaxations on the compliance front in the near future, particularly considering the interplay with the Income-tax Act, 1961?*

The equalization levy introduced in March 2020 is very different from that introduced in 2016. The March 2020 levy is very wide in scope and it is an area which is uncharted. We don't have global precedents of countries trying to tax such a range of incomes. Then, to bring it in without discussion, since the government won't have discussed it internally or with outside stakeholders, and to expect taxpayers to comply, is high expectation. Some news reports indicate that the government has also ruled out issuing any clarifications or Frequently Asked Questions (FAQs). To implement a new levy, the government must help taxpayers to comply.

There are a number of issues which FAQs can clarify, and these can help businesses to decide themselves on whether they are liable or not and to what extent. To take an example, the exemption in Section 10 of the Income Tax Act, 1961 does not match the timing of the levy. So, what does the taxpayer do with this one year? Similarly, even a single word like 'facility' gives rise to so much confusion. What does facility mean really? Everything can be a facility to an extent. The reluctance to issue clarification or to issue some FAQs is quite surprising and would destroy the trust between the taxpayer and the tax authority. If there is no transparency or communication between the two, the feeling of mistrust will be heightened. It is also worrying that the government does not want to take any decisions. Unwillingness to give definitions or clarity on the meaning of the terms used in the law would mean tax authorities are leaving it on the courts to decide. The government is bound by its duty to clarify its intent to the best possible extent.

8. *Do you expect that there is a risk of cross border disputes with the unilateral measures being adopted by countries as well as with the outcome of the BEPS 2.0?*

8.1 *Is India adequately equipped with controversy management options for dealing with future controversies that may arise on these counts?*

It's not just the disputes that will be created, there is an obvious double taxation which should not be happening. No uniform levy is being contemplated by different countries, including the European Union, and the proposed levies as well as the levies already in place, will all have some differences. From the point of view of a multinational taxpayer, it will be difficult to strategize or plan its affairs. Presently, there are not enough good dispute resolution mechanisms and we are struggling to cope with the disputes thrown up even by normal corporate taxation. The situation may worsen if the current disputes are accompanied by these new disputes, which may not get resolved under tax treaties. We may have to resolve the disputes through our internal process of courts but that will be a huge challenge for our judicial authorities because nobody really knows what's happening, and what is intended to be taxed.

The is only idealistic is that we strive for a consensus on levies like the equalization levy. There's another thought that we should have a uniform levy across the world. Without that uniformity, these interim measures are going to raise a lot of controversies. It is not just India, but even other countries are not equipped to handle emerging controversies.

9. ***With regard to the current direction of India's tax policy and the objectives which are sought to be achieved by Pillar Two, the Global Anti-Base Erosion (GLoBE) seems less relevant from the Indian perspective. Which are the specific proposals of GloBE, according to your opinion, that will have some relevance for India?***

GLoBE is essentially something on the lines of the US Global Intangible Low-taxed Income (GILTI) and it tries to include income for taxation in the hands of the parent in some circumstances. The ultimate objective of this levy is to have an environment in which all countries, including the low-tax jurisdictions and no-tax jurisdictions, raise their tax levels and a minimum tax is ensured all over the world, regardless of the location. One of the shortcomings of the BEPS Project is that enterprises are still able to reduce their taxes just by routing transactions through certain jurisdictions. The developing countries are stressing upon a different aspect. They want tax rules to deny deductions for payments that are not sufficiently taxed in the jurisdiction of receipt. That's the limited extent to which India and many other developing countries would currently be interested in this proposal. But overall, it's something which India should welcome. We already have multinationals in India which have branched out into the world with the Indian businesses trying to setup their businesses offshore. If this sort of a rule comes onto the statute in the proper way, it will really streamline business activities and make them clear to businesses that it is not fruitful to go into the current system of tax planning. In the long term, the move will certainly help in terms of revenues.

10. ***Any specific closing remarks for our readers or thoughts on tax policy in India in the next 12-18 months?***

It is difficult to answer as one can't really see a discernible trend in the way the government has been pronouncing tax policy in the last few months. There seems to be adhocism which may be, of course prompted by the COVID-19 situation and falling revenues, but there doesn't seem to be any clearly thought-out long-term strategy. In the next couple of years, we should really reorient and streamline our tax policies to ensure a regime can be introduced which can be understood and complied with by the taxpayers and move towards resolving age-old problems, like heavy litigation, in a more serious manner. The tax policy in India should move towards more stability and tax certainty. Tax certainty should not get lost in tax rates, exemptions and incentives. A stable regime promises tax certainty and that is what will really bring multinational businesses into India.

In the international tax context, Pillar One is specially something that we were looking forward to. For India, it was never a question of just taxing that particular kind of income or levying a new kind of tax on a new kind of business model. It has always been a question of changing the international tax rules, as the concepts of permanent establishment and nexus that exist in the treaties are biased towards the residence-based taxation. This needs to be corrected in the modern world. This was the hope with which India had been participating in the BEPS 1.0 as well as BEPS 2.0 discussions in the hope that countries will gradually realize that some change is really required. There is now a realization, for example, that a market can add value, that marketing intangibles do play an important role and it's not just the supply side intangibles which matter. There is a movement towards a formulary apportionment or trying to find easier ways of allocating income. The new developments can help us to get over the problems of the arm's length principle. The debate on digital tax was a prime opportunity for the countries to sit down and examine the tax rules that are not working. Though there is a realization that these tax rules are not working, no will is put in place to take the required measures to address the problem. We have to just keep moving forward with a hope that may be BEPS 3.0 will tackle such issues.

US Section 301 investigation into Equalisation Levy: what to expect

On 05 June 2020, the United States Trade Representative (USTR) initiated Section 301 investigation[1] with respect to Digital Services Taxes (DST) proposed or implemented by several countries. Last year, the USTR had investigated imposition of DST by France[2]. This time the countries identified for the investigation, in addition to India, are Austria, Brazil, the Czech Republic, the European Union, Indonesia, Italy, Spain, Turkey and the United Kingdom.

Under Section 302(b)(1)(A) of the US Trade Act, 1974 (Trade Act) the USTR can investigate and determine whether any act, policy, or practice of a foreign country is unreasonable or discriminatory, and burdens or restricts U.S. commerce. It may be noted that the foreign measure in question need not necessarily be inconsistent with the international legal rights of the United States. If the USTR determines that the measure is unfair and inequitable it can recommend it as actionable under Section 301 of the Trade Act.

Regarding the process now, following initiation, public comments regarding the DST regimes have been sought. The USTR will then consult the governments of specified countries. Based on all the information obtained during the investigation and the advice of the Section 301 Committee, the USTR will publish the final report with its findings and the actions to be taken. The consultation process will entail bilateral negotiations where accommodation of US trade interests might be critical.

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> ... the growing importance of the service component of the economy, and of digital products that often can be delivered over the Internet, has made it much easier for businesses to locate many productive activities in geographic locations that are distant from the physical location of their customers. These developments have been exacerbated by the increasing sophistication of tax planners in identifying and exploiting the legal arbitrage opportunities and the boundaries of acceptable tax planning, thus providing MNEs with more confidence in taking aggressive tax positions. These developments have opened up opportunities for MNEs to greatly minimize their tax burden. This has led to a tense situation in which citizens have become more sensitive to tax fairness issues. It has become a critical issue for all parties...[3]

What is the DST/EL issue?

DST is a tax on a company providing digital services in a country of which it is not a resident, i.e., a non-resident Digital Service Provider (nr-DSP). Why such a tax is becoming common can best be understood from the explanation provided in the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Tax Shifting (BEPS) Action Plan:

While the OECD, which is the main international body where these issues are being discussed, and of which India is not a member, is yet to arrive at a consensus on the modalities for DST. In India, DST was enacted in the form of an Equalisation Levy (EL) in 2016 (2016-EL). The 2016-EL was technically a charge on the nr-DSP but borne by the service recipients in India. Thus, the nr-DSPs were largely unaffected. Further, the 2016-EL covered only digital advertisements, limiting its impact on most nr-DSPs.

The 2016-EL was substantially expanded in India's 2020 annual budget (2020-EL). It is materially different and wider in its scope. It obliges the nr-DSPs owning or operating an e-commerce platform to pay tax on revenues earned by them from the supply of their own goods or services, including consideration earned for facilitating supply made by third parties on their platform. Thus, both the tax-incidence and the compliance burden, are upon the nr-DSP. This obliges them to register in India, file periodic returns and undergo assessment in India. The charge under the 2020-EL extends not just to their transactions with Indian service recipients, but to those with other non-residents in certain forms of specified transactions, such as the sale of data collected from Indian residents or advertisements targeted towards Indian residents. It is the 2020-EL that has raised questions about the lack of lead time for implementing the new law and absence of stakeholder consultation. Critics have claimed that the 2020-EL impacts India's free-trade commitments and violates WTO rules. It is the alleged restrictive and burdensome effect of 2020-EL on US businesses that is being targeted by the Section 301 investigation.

What can be expected?

The USTR completed its investigation of France's DST regime in December last year. The DST in France is similar to the EL in India in structure, as can be seen in the table below.

Comparison between French DST and Indian EL

Categories	French DST	Indian EL
Tax Rate	3%	2 - 6%
Scope	▸ Digital interface services ▸ Targeted advertising services	▸ E-commerce operators ▸ Targeted advertising services
Revenue threshold	▸ €750 million globally and €25 million in France (approx. USD 840 million and 28 million)	▸ Rs. 2 crores in India (approx. USD 0.3 million)
Other features	▸ Chargeable on revenue, not income ▸ Location of service receiver relevant, rather than that of the service provider ▸ Entities with permanent establishment in France are excluded	▸ Chargeable on revenue, not income ▸ Location of service receiver relevant, rather than that of the service provider ▸ Entities with permanent establishment in India are excluded

The USTR found the French DST to be actionable under Section 301 as it discriminates against US digital companies because it covers services where US companies are dominant, e.g., targeted advertising services. It excludes non-US companies as due to their small size they do not fit in the revenue threshold. It increases the implementation burden on US companies affecting their consumers and contravenes prevailing tax principles. It also imposes significant additional burdens on covered US companies.[4] On 10 July 2020, the US announced the imposition of additional

25 percent duties on certain products from France covering an estimated $1.3 billion of trade.[5] The additional tariffs are effective 06 January 2021, following a 180-day suspension period to be used for further negotiations. Examples of products subject to the additional tariff include cosmetics, beauty products, soaps and handbags.

India has, expressing regret at the initiation of the probe, recently responded to the USTR[6] asserting that the purpose of the equalisation levy is to ensure greater competitiveness, fairness, reasonableness and exercise the ability of governments to tax businesses that have a close nexus with the Indian market through their digital operations. The tax is neither discriminatory nor extra-territorial. Further, it is entirely consistent with India's commitments under the WTO and international taxation agreements and it does not target any US company or companies.

While India's case is structurally similar to the French DST investigation, given the current political closeness and the fact that there are several countries being investigated at the same time, the scope of the negotiations are different. This is because the US' expectations for greater market access can be achieved over negotiations with a wider set of countries. However, it is necessary to prepare for the oncoming negotiations, as there is more at stake here for India. It may be pointed out that India is also seeking restoration by the US of its GSP preferences that were suspended last year. The indication by the Commerce Minister of a limited trade deal being finalized may cover this as well.

1. *Initiation of Section 301 Investigations of Digital Services Taxes, Office of The United States Trade Representative, available at: https://ustr.gov/sites/default/files/enforcement/301Investigations/DST_Initiation_Notice_June_2020.pdf.*
2. *Report on France's Digital Services Tax, Office of The United States Trade Representative, available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.*
3. *Pages 7-8; https://www.oecd.org/ctp/BEPSActionPlan.pdf*
4. *Report on France's Digital Services Tax, Office of The United States Trade Representative, available at: https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf.*
5. *Notice of Action in the Section 301 Investigation of France's Digital Services Tax, Office of The United States Trade Representative, available at: https://ustr.gov/sites/default/files/enforcement/301Investigations/France_Digital_Services_Tax_Notice_July_2020.pdf.*
6. *https://www.medianama.com/wp-content/uploads/Government_of_India_Written_Submission_Section_301_DST.pdf*

Credit: Garima Prakash, Consultant, Indirect Tax (International Trade Practice), EY India

Equalisation Levy:

a critique on India's unilateral measure

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Novel coronavirus (COVID-19) and measures to control it have caused widespread disruption this year. While governments, businesses and people across the world are battling COVID-19, Government of India has introduced equalisation levy (EL) on consideration received by non-resident e-commerce operators for e-commerce supply or services at 2% (hereinafter referred to as "ESS EL") at the enactment stage of the Finance Bill 2020, around the end of March and, with effect from April 1, 2020.

The first due date for payment of ESS EL was 7 July, 2020. The move did come as a surprise since India is an active participant in OCED's Base Erosion and Profit Shifting 2.0 (BEPS 2.0) Pillar 1 project which is aiming to build a global consensus on taxation of digital/digitalized economy. Thus, a unilateral measure without any prior consultation or a detailed memorandum has created significant anxiety amongst taxpayers. The move also got international attention and the US Government announced a Section 301 investigation under the Trade Act, 1974 which will focus on issues such as discrimination against US companies.

Provisions

"E-commerce supply or service" has been defined in the provision of ESS EL to mean online sale of goods or online provision of services or facilitation of online sale of goods or provision of services. The levy is triggered on consideration received by a non-resident (NR) e-commerce operator on the above transactions from a person resident in India. ESS EL is also applicable if the consideration is received by the operator from an NR for (i) sale of advertisement targeting an Indian resident or a customer who accesses the advertisement though internet protocol address located in India and (ii) sale of data, collected from an Indian resident in India or where the NR avails the supply or service using an IP address located in India. Further, "e-commerce operator" has been defined as a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both.

ESS EL is not applicable where the consideration is related to permanent establishment of the e-commerce operator or subject to advertising EL (applicable @6% in such cases) or is less than INR 20 million per annum.

Scope

The ESS EL appears to tax digitalized products/services since the provisions refer to taxing consideration for online sale of goods and online provision of services. Thus, digital offerings of NRs such as online books/online games/online gaming services (under specified circumstances) come under the purview of ESS EL. Similarly, if an e-commerce operator, such as an online marketplace, earns a service fee from an Indian resident for selling its goods or services online, the fee earned by the marketplace would be subject to ESS EL. Where the e-commerce operator is merely a facilitator of goods or services, it may be fair to restrict the amount of consideration (subject to ESS EL) to convenience/ facilitation fees charged by the operator and not the value of services which it facilitated. Take the example of an NR platform owner (the operator) which provides guests with options of accommodation by listing hosts on its platform. Out of the payment made by the guest, only the fee retained by the operator should be subject to ESS EL and not the amount it passes on to the host. Any other view would create an anomaly leading to bringing offline services within the ambit of ESS EL.

ESS EL is not applicable where the consideration is related to permanent establishment of the e-commerce operator or subject to advertising EL (applicable @6% in such cases) or is less than INR 20 million per annum.

As is evident, the provisions pertaining to ESS EL are widely worded and one could also interpret them to cover sale of physical goods as also services enjoyed offline. Illustratively, while many businesses negotiate supply and service agreements online and use digital / electronic means for confirming contracts, the delivery of goods and/or services is largely offline. An example of this could be orders placed online for commodities such as oil on an e-portal. Further, pure traditional brick and mortar businesses (like construction) also use digital or electronic facility in some form, such as for maintaining a website, displaying online catalogues to drive traffic into their stores/ inquiries, using email for correspondence, digital forms of payment etc. The intent cannot be to bring billions of dollars of such transactions within the ambit of ESS EL.

Modifications

Given the varied interpretations, it might be imperative for the Indian tax authorities to provide following clarifications /modifications to remove the ambiguities:

It should be clarified that ESS EL is restricted to digitalized products and services and does not cover goods and services which are physical in nature/ services which are enjoyed offline and where e-commerce merely facilitates communication, placement, conclusion or delivery of order.

ESS EL is to be levied on the actual consideration that belongs to the e-commerce operator in their own right as against the full amount received. For instance, for operators acting in the capacity of intermediary/marketplace, the commission or fee they retain is the only consideration that should be considered for the purpose of this levy.

Amount of consideration received or receivable by the e-commerce operator should be restricted to only convenience fees or facilitation fees received from residents in India or non-residents using IP address in India. It should not cover convenience fees received from non-residents.

The expansive language of the provisions could potentially cover a wide gamut of transactions between non-residents such as a situation where an online advertisement is merely accessed by persons in India, who were not the target audience for such an advertisement at first place. Further, through advertisements, enterprises may intend to target markets region-wise rather than a specific country (say, India). This creates a complexity as to how much consideration for the sale of advertisement shall be allocated to persons accessing the advertisements in India and outside India. It would be useful for taxpayers to get clarity on the scope and exclusions from the provision and rule out the possibility of it extending to unintended situations.

As a result of expansion of scope of EL to ESS EL, section 10(50) of the Income-tax Act has been amended to state that income arising from any "e-commerce supply or services" on or after 1 April 2021 and chargeable under EL chapter shall be exempt from income tax. On the other hand, the ESS EL provisions apply from 1 April 2020. This seems to be an inadvertent error and suitable amendment should be made to section 10(50) to make it effective from 1 April 2020.

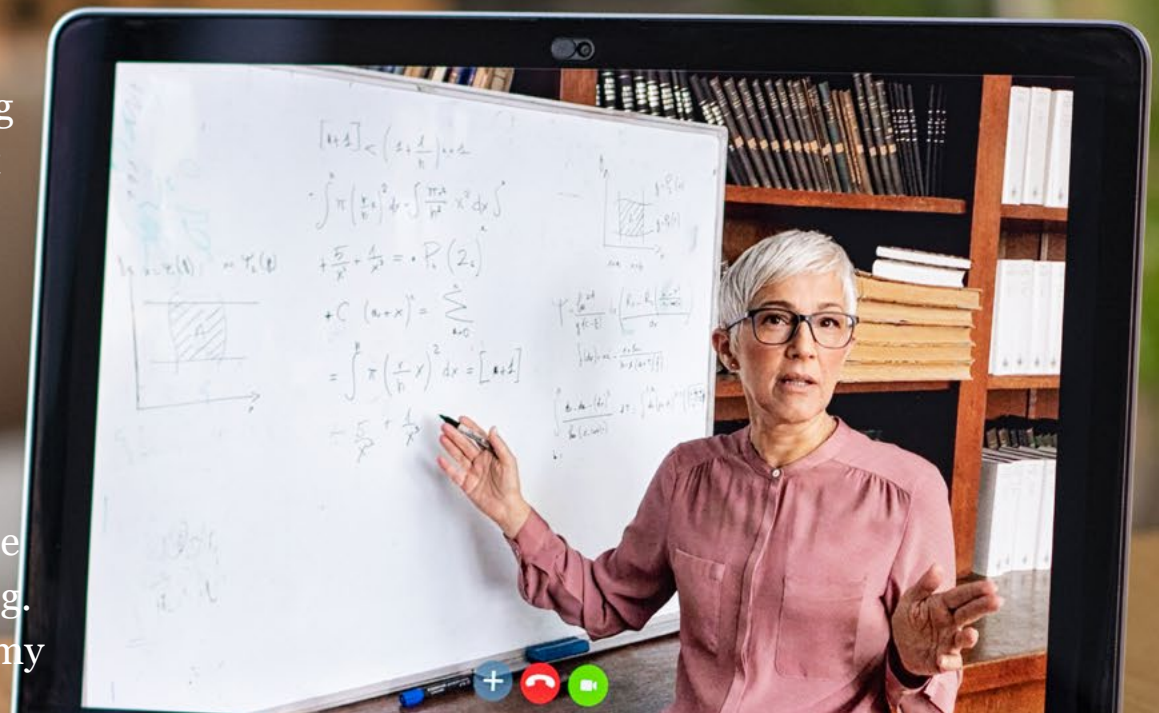
Where the non-resident e-commerce operator pays ESS EL with the understanding that it has no Permanent Establishment (PE)in India, but tax authorities subsequently dispute existence of PE amount of ESS EL should be allowed to be adjusted against tax payable on such disputes.

Various countries including India are working on the BEPS 2.0 Pillar 1 project for providing for additional taxing rights. ESS EL provisions should be amended such that a credit of ESS EL is provided to companies towards any incremental tax in future that maybe due on account of Pillar 1 project.

Specific appeal remedy/ dispute resolution provisions should be included.

Concluding thoughts

ESS EL is likely to be cost of doing business without ability of claiming tax credit in home country. Impact maybe even more significant on businesses where the margins are slender, or the businesses are operating under losses. While everyone was eagerly waiting for clarifications/ modifications and deferment of the applicability of the ESS EL, none has been forthcoming. India is a flourishing digital economy with billions of dollars of foreign investment flowing in. Even if the government provides clarifications or makes amendments to provisions pertaining to ESS EL now, it would provide some clarity and certainty to investors. In the absence of clarifications, one would need to take a position basis the interpretation of the statute and brace for litigation.



The interplay of the Equalisation Levy and transfer pricing

Transfer pricing (TP) provisions provide that arm's length return for an entity should be determined basis the functions performed, assets employed and risks assumed by the contracting entities. Characteristics of property transferred or services, contractual terms and conditions prevailing in the market are additional factors that are considered while evaluating comparability of third-party transactions with related party transactions. Thus, the arm's length principle has proven useful as a practical and balanced standard to evaluate transfer prices between associated enterprises.

However, tax authorities have argued that market or demand related factors are not considered in such arm's length analysis. Their argument has been that aspects such as value of data, user contribution and network effect are not considered in the current TP analysis and thus entities in market jurisdictions such as India should earn some additional profit beyond that earned by comparables. A contrary argument is that these market factors are not owned by any entity and thus return allocable to them should not belong to any particular entity as these factors are common for all companies. Impact of such factors is built into the margins of comparables. Thus, no additional remuneration is warranted for these factors and a proper application of the arm's length principles and the various value creation concepts would allow allocation of correct profits between two associated enterprises.

While the jury is still out there on the above issue, Equalisation Levy (EL) was introduced in 2016 to cover online advertising services and the scope has been expanded in 2020 to cover online sales of goods and provisions of online services. The rationale for the same has been that the levy takes into account the market factors discussed above and to bring to tax the income otherwise not taxed. Thereby, with the introduction of this levy, taxpayers may argue that there should be no further attribution to the Indian entities supporting non-resident operators paying the EL on account of market factors such as data, user contribution, network effect. They should only be remunerated for the functions performed, risks undertaken and assets employed by them basis the current transfer pricing provisions.

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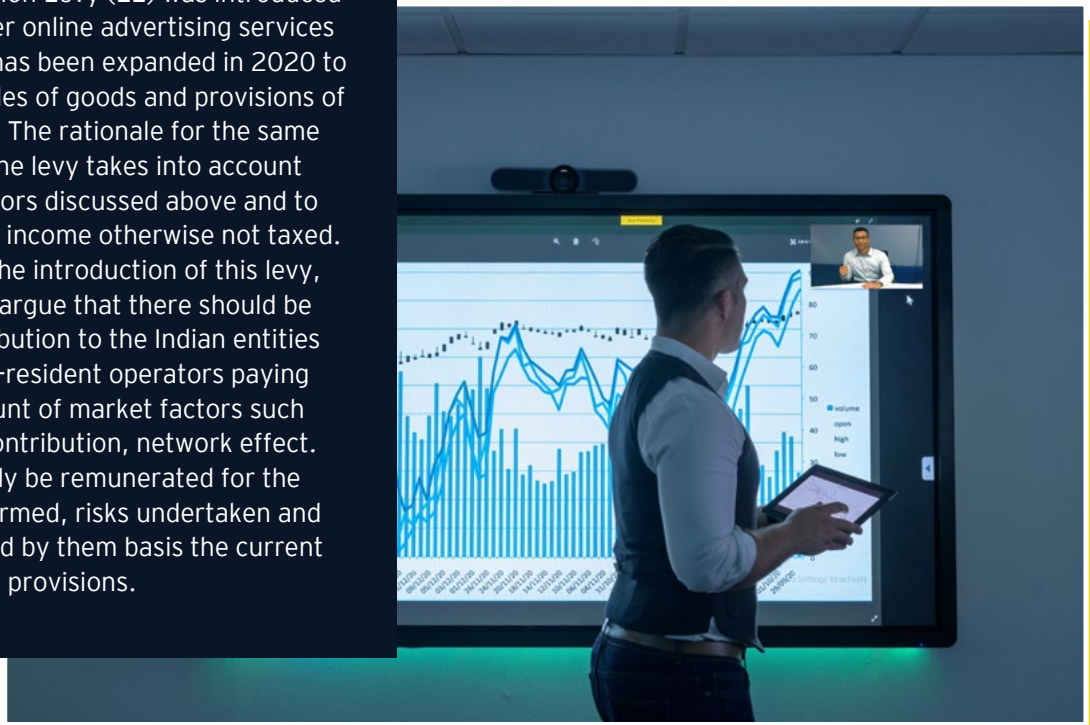

Sector-wise impact and recommendations of Equalisation Levy

Media and entertainment sector

The media and entertainment (M&E) sector, which was about to get into a hyperdrive, has been adversely impacted by the COVID-19 pandemic. The stoppage of content production, cuts in advertising spending and cancellation of sports events has stunted its growth. Implementation of equalization levy (EL) has further added an additional financial burden on the sector.

Business-to-consumer (B2C) services, such as content streaming services, online gaming services, database services, etc., which were already covered under the Goods and Services Tax (GST), are now chargeable to EL. Payments made by the Indian entities in lieu of commercial rights to distribute offshore digital services/ products may also get covered under EL.

Cases involving intermediaries who are collecting monies on behalf of sellers (such as app stores collecting on behalf of gaming companies or streaming platforms) invite ambiguities. It is not clear which entity qualifies as an e-commerce operator (app developer/publisher or their intermediary or both) and whether EL is required to be discharged on the gross monies collected or only on the collection fees charged by the intermediaries.

Lack of clarity on the meaning of 'targeted advertisements' in relation to transactions involving non-residents might lead to unintended interpretation. The revenue allocation methodology to determine revenues from advertisements targeting the Indian customers is also a challenge in case contracts cover multiple countries. The nature of data intended to be covered under the sale of data limb should be clarified along with whether the provision should be interpreted in a strict sense or other forms of data exploitation (such as licensing) are also included.

The scope of EL is very wide and the industry expects the government to provide more clarity on it. The industry also hopes to see the government waive off the interest on non-payment of first quarter instalment of EL liability by 7 July 2020.

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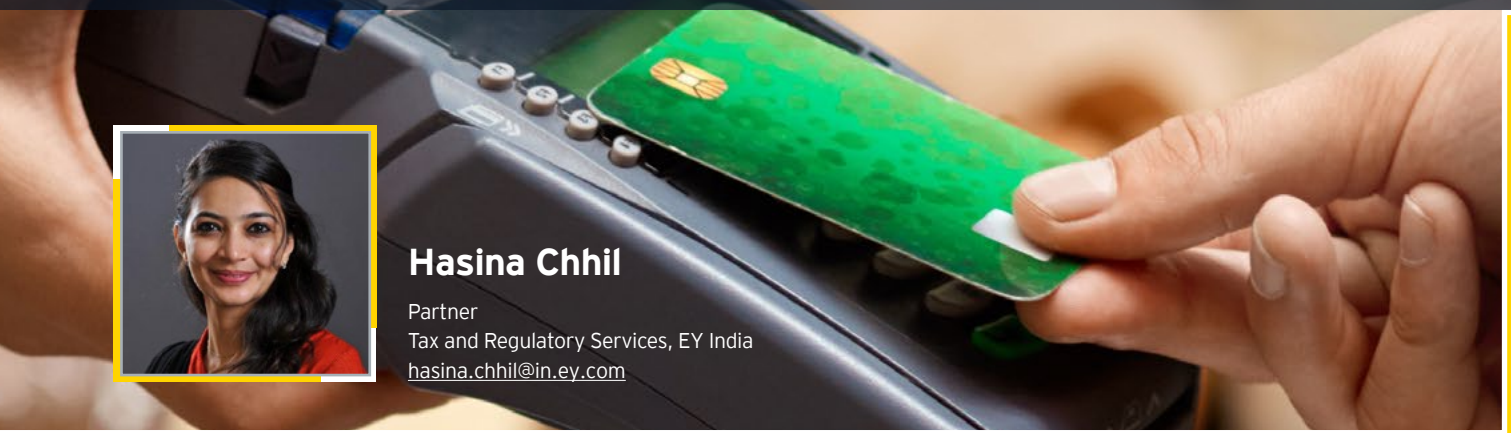
Financial services sector

The current Equalization Levy (EQL) provisions do not provide for any industry or sector specific exclusions. The widely worded provisions are likely to have undesired consequences especially for the financial services (FS) sector.

There are various factors which distinguish the functioning of the FS industry from other sectors. They necessitate the need for a specific carve out from the scope of EQL. These factors include:

- The functioning of the FS industry is highly regulated. The accounting/ reporting requirements, on-boarding of clients, sources of income, etc. are closely monitored by regulators. This creates an additional layer of regulatory supervision on their service offerings and incomes earned/ generated in/ from India.
- Given the regulatory need (in most situations) to operate through a local incorporated entity or local branches, even where the services are rendered digitally, the origination of the transaction or relationship with local customers typically is with the local entity, resulting in profits of service offerings being taxed in the local jurisdiction on an arm's length basis.
- A large portion of the digital services rendered by offshore financial services entities are rendered to their Indian Group companies. These are subject to GST (under the reverse charge mechanism) and in many cases even subject to withholding tax. A levy of EQL will further increase the cost of rendering services from India.

Several countries (such as UK, France, Italy, Spain and New Zealand)[1] have provided/ are in the process of providing exclusions to the financial services players from a levy similar to EQL. In line with the global approach, an exclusion for FS players from EQL in India will be a welcome relief especially during these stressed times.



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1. *https://www.gov.uk/hmrc-internal-manuals/digital-services-tax/dst18700*
   https://ustr.gov/sites/default/files/Report_On_France%27s_Digital_Services_Tax.pdf
   https://news.bloombergtax.com/daily-tax-report-international/insight-italy-taxes-the-digital-economy
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   https://www.ey.com/en_gl/tax-alerts/new-zealand-government-to-seriously-consider-a-digital-services-tax

Credits: Bhargav Selarka, Senior Manager, EY India

The biggest issue in the manufacturing sector pertains to import of raw materials and other goods, especially where orders are placed via an electronic platform. Should e-commerce supply or services (ESS) equalization levy (EL) be limited to only digital goods or can it extend to physical goods as well is a keenly debated topic, given the broad language of ESS EL provisions. It was hoped that the Central Board of Direct Taxes (CBDT) would provide clarifications on such aspects. However, applicability to software licensing/intra-group services' transactions involving digital medium and the corresponding exemption from income tax for FY 2020-21 are also points of deliberations.

Manufacturing sector

Given that physical imports were typically not subject to income tax earlier, any levy of ESS EL coupled with potential non-availability of credit of ESS EL in a supplier's home country could result in increased cost of imports. This could adversely impact the current pricing of the final products manufactured in India. Conversely, this could also provide a marginal competitive boost to domestic manufacturers. However, due to the pandemic, it is imperative that the government provides necessary guidance regarding the intent and scope of ESS EL at the earliest so as to provide clarity to the industry.

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