

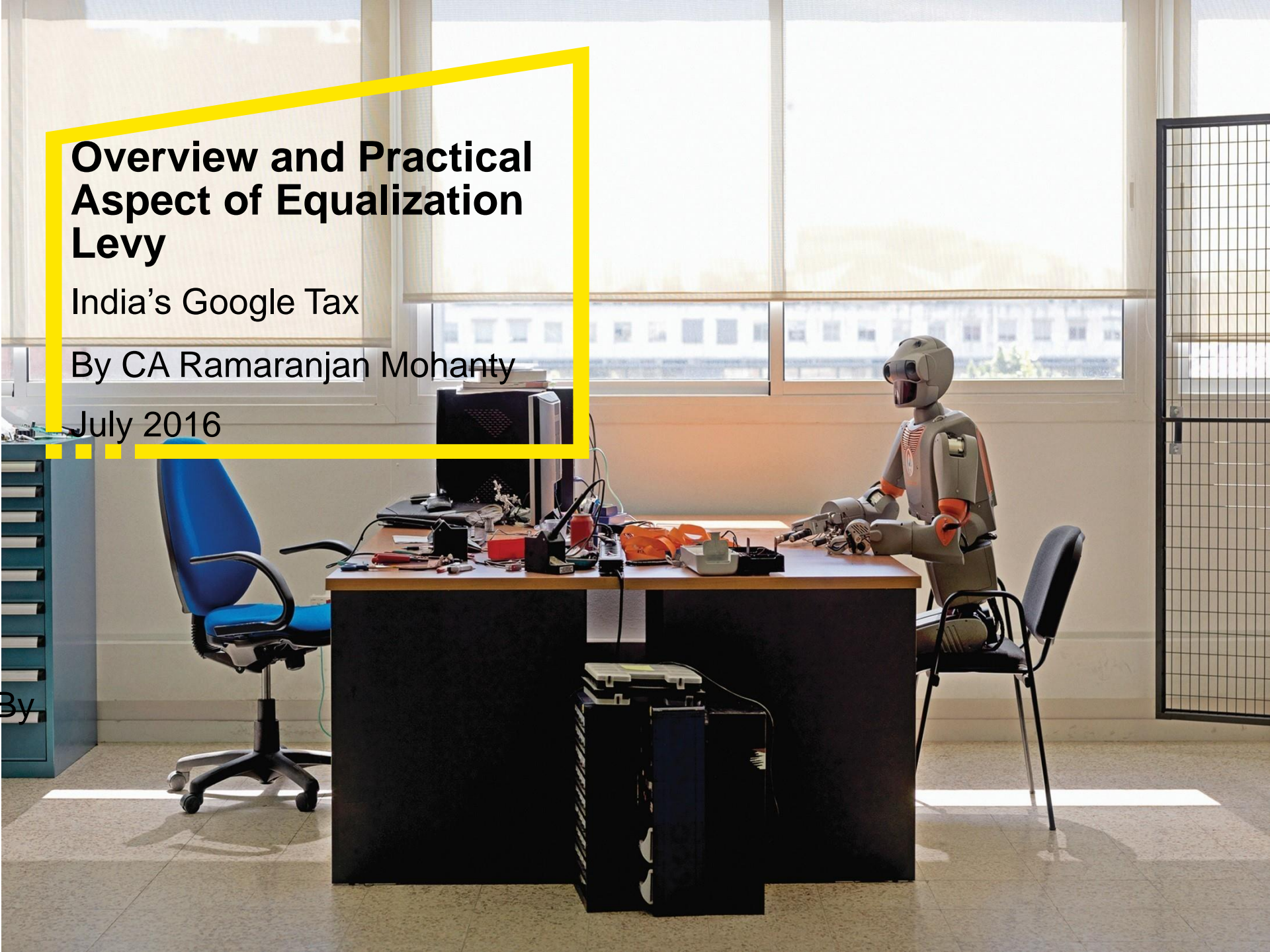
Overview and Practical Aspect of Equalization Levy

India's Google Tax

By CA Ramaranjan Mohanty

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By





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Development in the International Sphere

In 2013 the OECD along with G20 nations constituted the Task Force on the Digital Economy (TFDE) to develop a report identifying issues raised by the digital economy and detailed options to address them (Action Plan 1)

A new nexus in the form of a significant economic presence

A withholding tax on certain types of digital transactions'

An equalization levy

Direct Tax Jurisprudence

Relevant Tribunal decisions of the Tribunal on Digital Economy

1. Right Florist Pvt. Ltd.
 2. Yahoo India Pvt. Ltd.
 3. People Interactive India Pvt. Ltd.
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Tribunal's View:

1. Payment made to foreign search engine portals for online advertisement services is not in the nature of fee for technical service (FTS)
2. Such payments are not in the nature of royalty
3. Income arising from such transactions was in the nature of business income of the 'non-resident'. In the absence of a 'Permanent Establishment' in India, the same could not be taxed under the DTAA

Objects & Reasons

A new nexus, based on significant economic presence and the withholding tax on digital transactions would require changes in the tax treaties

To avoid tax litigation, it is proposed not be a tax on income and hence not to be covered by tax treaties

It is to be kept outside the Income Tax Act
Transactions which suffer Equalization levy would be exempted

Rationale & Entry for Imposition

To provide for level playing field



The concept of Equalization Levy is to bring about a level playing field for digital advertisement space and related services, offered by residents and non-residents

Introduced under residuary power



Introduced under the residuary powers of the Parliament under Article 248 of the Constitution

Reasoning



Equalization Levy is not a tax on income

Equalization Levy – Key highlights

Not covered under the Act; Equalization Levy is a **separate code itself** (for instance, service tax, STT etc.) .

Effective
June 1, 2016

Not applicable to the state of **J&K**

Chargeability

Equalization Levy to be deducted at the rate of **6%** on amounts paid or payable to a **non-resident, not having a PE in India for specified services**

Specified services



- online advertisement; or
- any provision for digital advertising space; or
- any other facility or service for the purpose of online advertisement; or
- **any other service as may be notified by the Central Government**

Payer

- Any person resident in India carrying on business or profession in India; or
- A non-resident having a PE in India

Exclusions

- Recipient i.e. the non resident has a PE in India and such income is effectively connected to the PE
- Income does not exceed Rs. 100,000
- Payment is not for carrying out business or profession i.e. Equalization Levy would apply only on B2B transaction

Equalization Levy – Key highlights

Payment due date

7th day of the immediately following month [Section 166(2)]

Requirement to furnish statement of specified service

(Section 167)

- Payer required to furnish the statement of specified services with the jurisdictional Assessing Officer or prescribed authorities
- Revised/ belated furnishing of statement permissible before the expiry of 2 years from the end of the FY in which the services were provided
- AO may also show cause the payer to furnish the statement of specified services

Processing of statements

(Section 168)

- Levy to be computed after making the adjustment for any arithmetical error in the statement
- Interest, if any, to be computed
- Any sum payable/ refundable would be determined
- Intimation prepared and sent to the assessee specifying amount payable/ refundable

Time limit – 1 year from the end of the FY in which the statement is furnished

Equalization Levy – Key highlights

Rectification of mistake apparent from record

(Section 169)

- AO may amend any intimation within **1 year** from the end of the financial year in which such intimation was issued
- Rectification may be suo-moto or mistake brought to notice by the payer
- Opportunity of being heard to be provided to the payer
- AO to pass **an order** where the sum payable is enhanced/ refund already made is reduced

Non-compliance

- Interest @ 1% for every month of part of the month for delayed payment of Equalization Levy (Section 170)
- Penalty of amount equivalent to Equalization Levy for failure to deduct (Section 171) in addition to interest
- Penalty of INR 1,000 for every day, or amount of Equalization Levy, whichever is lower, in case of failure to pay the levy after deduction (Section 171) in addition to interest
- Penalty for failure to furnish statement of INR 100 for each day during which failure continues (Section 172)

Equalization Levy – Key highlights

Appeal with CIT(A)

(Section 174)

- Appeal may be filed against the penalty order before the CIT(A)
- **Due date** - 30 days of receipt of order
- Provisions of Section 249-251 of the Act relating to filing an appeal with CIT(A) to apply

Appeal with Tribunal

(Section 175)

- Appeal may be filed against the order of the CIT(A) passed under Section 174
- **Due date** - 60 days of receipt of order
- Provisions of Section 253-255 of the Act relating to filing an appeal with Tribunal to apply

Deductibility of expenses

- New sub clause (ib) introduced to Section 40(a) of the Act [*Similar to S. 40(a)(i)/ (ia)*]
- Disallowance of expenses, if Equalization levy has not been deducted or after deduction, not paid before the due date of filing the **return of income**.
- Subsequent allowance to be claimed in the year in which Equalization Levy is deducted/ paid

Equalization Levy Rules, 2016

CBDT notified the Equalization Levy Rules, 2016;
Procedural framework for the compliances to be undertaken and appeal process

| Particulars | Section No. | Rule No. | Description |
|--|-------------|-----------------|---|
| Computation and payment of Equalization levy | Section 166 | Rule 3 & Rule 4 | <ul style="list-style-type: none"> • Rounding off to nearest multiple of ten rupees • Due date - 7th day of the immediately following month • Challan format yet to be prescribed |
| Furnishing of statement of specified services/ annual return | Section 167 | Rule 5 & Rule 6 | <ul style="list-style-type: none"> • Form No. 1 to be furnished electronically by payer • Due date – On or before 30th June of the next year • AO empowered to issue notice requiring the payer to file the statement within 30 days of receipt of notice |
| Processing of statement of specified services | Section 168 | Rule 7 | <ul style="list-style-type: none"> • Form No. 2 shall be served upon the payer post determination of any levy, interest or penalty payable • Intimation to be deemed as notice of demand |
| Filing appeal with the CIT(A) | Section 174 | Rule 8 | <ul style="list-style-type: none"> • Appeal only against the penalty order • Form No. 3 to be filed electronically within 30 days of receipt of the penalty order • Filing fee – INR 1,000 |
| Filing appeal with the ITAT | Section 175 | Rule 9 | <ul style="list-style-type: none"> • Form No. 4 to be filed electronically within 60 days of receipt of the CIT(A) order • Filing fee – INR 1,000 |

Source Rule vs. Equalization Levy

Source Rule under the Act

- **Source Rule** under the Act
 - Section 9(1)(vi) – Taxability of Royalty
 - Section 9(1)(vii) – Taxability of Fee for Technical Services (FTS)
- Following payments by non-government entities are deemed to accrue or arise in India:
 - Fee payable in respect of earning any services utilized in any business/ profession in India
 - Fee payable for the purposes of making or earning any income from any source in India

The conditions relating to income accruing or arising in India are not mentioned in the provisions relating to Equalization Levy

Issues in absence of source rule

(Illustrative)

- Payment by a head office of a foreign company (having a PE in India) for its overseas business – **May not be levied due to absence of territorial nexus with India**
- Payment by a branch of an Indian entity outside India to a non-resident – **Needs examination**

Source Rule vs. Equalization Levy – Likely treatment

| S. No. | Fee payable by | Details | Source Rule applicability | Equalization Levy applicability |
|--------|------------------------------------|---|---------------------------|--|
| 1 | Resident | Services utilized in business or profession carried on by such person in India | Yes | Yes |
| 2 | | Services utilized for making or earning income from any source in India | Yes | Yes (carrying on business in India) |
| 3 | | Services utilized in business or profession carried on by such person outside India | No | Yes |
| 4 | | Services utilized for making or earning income from any source outside India | No | Yes (carrying on business in India) |
| 5 | Non-resident, having a PE in India | Services utilized in business or profession carried on by such person outside India | No | Territorial nexus theory may be argued |
| 6 | | Services utilized for making or earning income from any source outside India | No | Territorial nexus theory may be argued |
| 7 | | Services utilized in business or profession carried on by such person in India | Yes | Yes |
| 8 | | Services utilized for making or earning income from any source in India | Yes | Yes (carrying on business in India) |

Issues in Equalization Levy

| | |
|------------------------------------|---|
| Surcharge/ education cess | Reasonable view that Equalization Levy should not be subject to surcharge and education cess |
| Appeal mechanism | <ul style="list-style-type: none">• No mechanism to prefer an appeal against the intimation under Section 168• Approaching the High Court by way of writ petition seems to be the only option |
| Grossing up - Equalization Levy | <ul style="list-style-type: none">• Contract such that Equalization Levy has to be borne by the payer• No requirement to gross up (as prescribed in Section 195A of the Act) mentioned in the provisions• Grossed up amount of Equalization Levy should not be subject to disallowance under Section 40(a)(ii) of the Act |
| Lower withholding certificate | <ul style="list-style-type: none">• With the objective of providing an inherent mechanism for identifying the non-compliances, the Committee had suggested that the provisions of Section 197 of the Act should be mandatory where the payer does not deducts the Equalization Levy• <i>However, no such amendment in the Finance Act, 2016</i> |
| Threshold limit of INR 100,000 | <ul style="list-style-type: none">• All the payments by a single payer needs to be aggregated to determine the threshold limit• Where recipient receives multiple sums but below the threshold limit, Equalization Levy not applicable; it would be governed by the provisions of the Act read with the applicable tax treaty |

Issues in Equalization Levy

| | |
|---|--|
| Various source of income | <ul style="list-style-type: none">• Where various services are provided, certain income may be subject to income tax and others may be subject to Equalization Levy (not taxable under Section 10(50) of the Act)• <i>Issue on determination and allowability of expenses incurred for earning the exempt income</i> |
| Reporting and auditing mechanism | <ul style="list-style-type: none">• Committee view – Auditor certificate that Equalization Levy has been deducted would suffice• Necessary modifications of Form 3CD can be an option for obtaining the Auditor's certification on deduction of Equalization Levy |
| Mid year PE situation | <ul style="list-style-type: none">• A Ltd., a non-resident engaged provided specified services to R Ltd., an Indian resident.• R Ltd. deducted Equalization Levy from the consideration for the first 11 months on the estimation that A Ltd. does not have a PE in India• It was realized in 11th month that the activities of A Ltd. result in PE of A Ltd. Therefore, Equalization Levy was not leviable <p>Options available:</p> <ol style="list-style-type: none">1. Claim benefit of Equalization Levy deducted under Section 10(50) while computing the taxable income2. Offer entire income to tax on net basis without claiming deduction under section 10(50) – <u>Preferred view</u> |

Other issues

1. Multiple levies
2. What is the due date of the deduction ?
3. Whether it is a Tax under Income tax Act ?
4. No appellate remedy for wrongful imposition
5. Treaty Override
6. Temporary or permanent levy
7. Possibility of future expanses of the term 'specified services'

Specified Services may eventually include

1. Designing, creating, hosting or maintenance of website
2. Facilities or services for uploading, storing or distribution of digital content
3. Digital data collection and processing services
4. Facilities or services for online sale of goods/services
5. Development or maintenance of participative online networks
6. Downloading of media content, news, online search, online maps, Apps

Services potentially covered by Equalization Levy

Category of Service Providers

| | |
|--|--|
| Social, e-commerce and other apps and websites displaying online advertisement | Advertisements displayed on social websites, such as Facebook, Twitter, You Tube, Amazon, Ali express, Ebay, Koovs, etc |
| Search Engines | Advertisements displayed on search engine/ results pages including any subscription fee paid to such search engines for priority listing of the data - Eg. Google, Yahoo, Bing |
| Server/ cloud hosting companies | Servers/cloud hosting on-line advertisements/specified services - Eg. Limelight, CloudFlare, Opera Media, Bluehost |
| Data Analytical companies | Analysis of trends/markets, etc, specifically for on-line advertisement/specified services - Eg Fractal |
| Content development platforms | Development of on-line content for advertisement/ specified services. Eg. Taboola, Outbrain, 90Seconds, Lintas, O&M |
| Celebrities engaged specifically for on-line advertisement | Persons contracted specifically for the purpose of creation of online advertisements |
| Cross charges for specified services | Indian companies making payment towards cross charges to overseas group companies for specified services |



Thank You

*“ Speaking from the heart is simple.
Listening wholeheartedly, however, is
much, much more difficult and most
rare”*

By Chris Murray