Executive summary

Under Action 1 of the Organisation for Economic Co-operation and Development’s (OECD’s) base erosion and profit shifting (BEPS) Action Plan, the OECD had considered, inter alia, an equalization levy (i.e., a tax to equalize the tax burden on remote and domestic suppliers of similar goods and services) as one option to tax digital transactions. While the final Action 1 report released in October 2015 (see EY Global Tax Alert, OECD issues final report on the tax challenges of the digital economy under Action 1, dated 23 October 2015), did not recommend introducing such a levy as an internationally agreed standard at this stage, it did state that countries could introduce one in their domestic laws as an additional safeguard against BEPS, provided they respect existing treaty obligations, or include them in their bilateral tax treaties.

In the Indian fiscal budget presented on 29 February 2016, Finance Minister Arun Jaitley proposed inserting a new chapter titled Equalization Levy in the Finance Bill 2016 to provide for an equalization levy of 6% of the amount of consideration for specified services received or receivable by a nonresident not having a permanent establishment (PE) in India, from a resident in India who carries out business or profession, or from a nonresident having a PE in India.

This Alert summarizes the key provisions relating to this levy.
Detailed discussion

Equalization levy
The equalization levy has been defined as “tax leviable on consideration received or receivable for any specified service under the provisions of this chapter.”

The levy would fall under a separate, self-contained code and would not be part of the Income Tax Act, 1961.

Services covered
The equalization levy would apply at a rate of 6% on the gross consideration payable for a “specified service.”

Specified service is defined as follows:
- Online advertisement
- Any provision for digital advertising space or any facility/service for the purpose of online advertisement
- Any other service which may be notified later by the central government

The Finance Minister in his budget speech stated that the equalization levy is aimed at taxing business-to-business (B2B) e-commerce transactions. Therefore, the scope of the levy may be expanded to cover a wider range of digital goods and services as time progresses.

Applicability
The levy will be applicable on the payments received by a nonresident service provider from an Indian resident or an Indian PE of a nonresident in respect of the specified service.

The levy would not be applicable to nonresident service providers having a PE in India, as they will be subject to regular PE-basis taxation. The levy is currently applicable only on B2B transactions, if the aggregate value of consideration in a year exceeds approximately US$1,500.

Date of applicability and treatment of income under income tax law
The Government will notify the date from which this provision shall be effective.

To avoid double taxation of income which has been subject to an equalization levy, such income will be exempt in the hands of the nonresident under the Income Tax Act, 1961.

However, one would need to evaluate the possibility of claiming a tax credit for such levy in the home country of the nonresident service provider.

Who needs to comply
Every resident person and foreign company (having a PE in India) is required to withhold the equalization levy when making payment to a nonresident service provider. The compliance procedure is similar to withholding tax provisions already prevalent in India.

While the compliance obligation is largely on Indian residents, the levy would be withheld when making payment to nonresident service providers. Service recipients are required to comply and also file an annual statement in respect of services received.

Delayed payment carries a fee of simple interest at 1% of the outstanding levy for every month or part thereof that payment is not made.

Consequences of noncompliance by service recipient
- Penalty for failure of payment:
  - Equalization levy was not deducted: The penalty is equal to the amount of the levy that the assesse failed to deduct (along with interest and the outstanding levy amount)
  - Equalization levy was deducted but not deposited: The penalty is equal to INR1,000 for each day the failure continues, but not to exceed the amount of the equalization levy that the assesse failed to pay (along with interest and the outstanding levy amount)
  - Disallowance of such expenditure in the hands of the payer (unless the defect is rectified)
- Penalty for failure to file statement of compliance: INR100 for each day the noncompliance continues
- Prosecution: If a false statement has been filed, the person may be subject to imprisonment of a term of up to three years and a fine

Other issues
As with other cases of remittance in India, it would be in the ordinary course of business for an Indian service recipient to ask the nonresident service provider for a “No PE” declaration in order to enable the recipient to decide on the applicability of the equalization levy.

Online advertising services are separately subject to service tax at a rate of 14.5% (the Finance Bill 2016 proposes increasing that rate to 15%) on a reverse charge basis which is to be collected and discharged by the Indian service recipient.
Impact

This is the first significant step taken by India to tax digital economy transactions. As the other services and rules relating to the proposed equalization levy are notified, we will have better insights into the scope and intent of the levy.

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