India’s “Equalisation Levy” Expansion

The Indian government has expanded the scope of its existing Equalisation Levy (EL), which was first imposed in 2016, to include an additional 2% levy on all “e-commerce supply or services (including facilitation) by an e-commerce operator.”

This was done through a surprise amendment to the Finance Bill, 2020 passed by Parliament on 23 March. We understand that the new provisions expanding the scope of EL were incorporated into the Finance Bill, 2020 at a late stage without any public consultation or Parliamentary debate and set to apply just one week later, starting on 1 April. The first quarterly payment to the Indian Government is due by July 7, 2020.

Background

India had in 2016 introduced an EL. The EL, at the rate of 6%, was on non-resident companies engaged in “specified services” - online advertisement and the provision of digital advertising space.

Changes to 2016 Equalisation Levy

The EL, which hitherto had only applied to digital advertising, has now been expanded by way of a sweeping amendment to cover all “e-commerce supply or services (including facilitation) by an e-commerce operator.”

The definition of the terms ‘e-commerce operator’ and ‘e-commerce supply or services’ is fairly wide in scope and covers all digital transactions and services so long as it eventually targets a customer/IP address in India.

“E-commerce supply or services” are defined as the:

i) Online sale of goods owned by an ecommerce operator;

ii) Online provision of services provided by an ecommerce operator;

iii) Online sale of goods or provision of service or both, facilitated by an e-commerce operator; or

iv) Any combination of the above.

The tax is applicable when goods or services are provided or facilitated by the e-commerce operator to:

i) A person resident in India;

ii) A non-resident who targets a customer who is a resident in India or a person who uses an IP address located in India;

iii) A person who buys goods-services using a local IP address.
Moreover, in contrast to the existing EL, the expanded EL shifts compliance onto the non-resident e-commerce operator who now has to file tax returns in India and make quarterly payments to the Indian government.

Finally, as the levy is not considered a part of income tax, companies may not get credit for it in their residence country or favourable treaty benefits.

### Compliance/Penalties

<table>
<thead>
<tr>
<th>Date of End Of Quarter</th>
<th>Due Date</th>
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<tr>
<td>30 June</td>
<td>7 July</td>
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<td>30 September</td>
<td>7 October</td>
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<td>31 December</td>
<td>7 January</td>
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<td>31 March</td>
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**Interest:** Delayed payment will carry an interest rate of 1% for every month or part of a month.

**Penalty:** Failure to pay the levy will attract a penalty equal to the amount of the equalisation levy.

### Impact on SMEs

During this period of lockdown, digital services and platforms have become a crucial link to the outside world in India - enabling people who are unable to step outside to order essentials online, maintain social engagement and allowing for business continuity through cloud-enabled video conferencing platforms. It may be imprudent to erect barriers to these services at a time when they are more important than ever. Importantly, the expanded EL will: i) seriously and negatively impact Indian SMEs and consumers; ii) dampen India’s digital exports’ potential if/when other countries retaliate with a similar levy; and iii) blindside SMEs due to its broad and discretionary nature.

Firstly, it is worth noting that foreign e-commerce platforms also serve many Indian SMEs and that domestic goods sold via these non-resident platforms will also be subject to the levy. 43% of SMEs in India participate in online sales¹. Importantly, most SMEs who sell online practice multichannel listing, i.e. they list their products on multiple channels to tap into different pockets of audiences and thereby increase their sales pipelines. It stands to reason that these would include foreign e-commerce platforms, who due to the size of their online market audience, provide SMEs with the largest possible potential market. For Indian SMEs with aspirations beyond the domestic, listing on these foreign e-commerce platforms is simply a must.

Besides, it is likely that the levy borne by e-commerce operators will be passed on to Indian consumers in the form of increased prices rather than being absorbed by e-commerce operators. Given stay-at-home mandates, most Indians will be forced to shop online for necessities. At this juncture, higher online retail prices will only hurt Indian consumers, many of whom have become jobless and are cash-strapped². In the longer term, this could also have a chilling effect on foreign investment and lead to reduced consumer choices.

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² According to the unemployment tracker survey released by the Centre for the Monitoring of Indian Economy (CMIE), the unemployment rate in India stood at 24% as of 12 April 2020, a steep rise from an unemployment rate that ranged between 7 and 8 per cent in the preceding year.
In addition to hurting Indian consumer spending and imposing costs on Indian SMEs, this will also affect the broader economy by deepening long-standing bugbears about the ease of doing business in India, scuttling the improvements made by India in 2019³.

Secondly, while the Equalisation Levy is directed at non-resident companies, it is not difficult to imagine how this may cause other countries to retaliate and implement similar digital levies to increase much-needed revenue collections during the pandemic. This would almost certainly dampen India’s digital exports’ potential which is currently valued at approximately US$35 billion and is projected to grow more than fourteen-fold to reach US$512 billion by 2030⁴.

It would be particularly hurtful if other countries were to impose similar/subjacent thresholds as India has. In India, the expanded EL is applicable to all companies with a turnover of just Rs 2 crore (approx. US$250,000), which is a very low exemption threshold. For comparison, the global revenue threshold for the Digital Services Taxes (DST) implemented thus far in Europe⁵ is US$540-815 million, while the average domestic threshold is US$19 million.⁶ The latter is 76 times higher than the Indian levy threshold, which additionally has no accompanying global revenue threshold/control.

For a reference marker closer to home, according to the amendment to the Micro, Small & Medium Enterprises Act, which is being finalized by the Indian government, a micro enterprise in India is defined as a unit with a turnover of up to Rs 5 crore - i.e. the upper limit for a micro enterprise in India, which is the smallest definable business unit, is 2.5 times bigger than the exemption threshold of the Equalisation Levy.

In this manner, should other countries choose to retaliate in kind, the levy which was supposed to target foreign operators and leave Indian firms unaffected may backfire and rebound on the very same companies the EL has carved out to protect, especially the smallest and most vulnerable.

This would also arrive at a time when Indian firms are already struggling with demand shocks and dwindling sales due to COVID-19. Indian firms, now more than ever, need to seek new markets in order to survive. According to a report by the Indian Export Organisation, more than 15 million jobs could be lost in India’s export sector due to COVID-19. Cancellations and postponement of shipments have eroded packing credits and impacted exporters’ fund-liquidity positions while cash flows have dried up. Taken together with the fact that India’s export competitiveness has been on a declining path in the last decade, an additional foreign levy would certainly undermine and sabotage the recovery efforts of smaller firms who are being strangled by COVID-19.

In the longer term, a spaghetti bowl of digital taxation rules imposed unilaterally by various countries will not only be confusing but adds undue compliance and cost burdens for Indian SMEs. India should instead look to address digital taxation issues through ongoing multilateral negotiations at the Organisation for Economic Cooperation and Development (OECD).

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³ India moved up 14 places to 63 out of 190 countries in the World Bank’s ease of doing business rankings in 2019.
⁵ Austria, France, Italy, Turkey and the UK.
Thirdly, the expanded EL represents the broadest framing of a unilateral tax on e-commerce by any country to date and is significantly broader than the scope of DSTs being considered by some European countries. The fact that it applies to all digital transactions and services insofar as it eventually targets a customer/IP address in India means that is not limited by a hard range of in-scope activities (e.g. digital advertising, intermediary activities). For the many SMEs who cannot afford in-house legal/compliance teams, this can be difficult to pin down. Most will find out too late, when they have been slapped with hefty fines, that they were subject to the levy at all.

This is in equal parts due to the discretionary nature of the levy as well as the fact that the sweeping Indian Equalisation Levy was slipped into the Finance Act 2020 at the last minute without any public consultation and set to apply just one week later, starting on 1 April. This is in contrast to the implementation of the original EL in 2016, where the provisions were proposed in February 2016, enacted after due debate and consideration by the Indian Parliament, and thereafter brought into force only in June 2016.

Moreover, given the late announcement and abrupt entering-into-force of the levy, companies will be required to change their internal systems and billing mechanisms nearly overnight, burdening businesses, SMEs in particular, at a time when they are struggling due to COVID-19.

**Call for Delay to Implementation of Expanded Equalisation Levy**

Given the likely impact on consumers and business recovery during the ongoing COVID-19 pandemic, AMTC respectfully requests a **moratorium on the expansion of the Equalisation Levy and implementation of “Section 165A” of the Finance Act 2020 until proper stakeholder consultations have been completed.**

While the presumptive aim of the expanded EL is to equalize the income tax disadvantage faced by Indian digital companies and facilitate an environment where Indian digital companies can compete with foreign players, in the current economic situation, it may well lead to the reverse.

Additionally, the timeframe within which this expansive new measure was approved and entered into force allowed for neither the dialogue nor the significant structural changes that would be necessary for impacted firms to effectively implement a levy of this scope and complexity.

A delayed implementation would permit such a dialogue to take place and would play a meaningful role in ensuring that the Government of India can most effectively and equitably achieve its policy objectives. Furthermore, a delay would underscore India’s continued support for the ongoing, multilateral negotiations at OECD on the taxation challenges arising from the digitalisation of the global economy.