Economic Effect Indian e-commerce taxation will have on industry

Korea Institute for International Economic Policy timer questioner Riggs (- | -)

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In March, the Indian government announced that it would impose a transaction tax on utilizing digital platforms in the form of Equalisaion levy of 6%. In relation to the above, the following are the excerpts of interview given by Dr. Saurabh Bandyopadhyay, Associate Fellow, NCAER, who has given his opinions on various issues.

Interview Head Topic

E-commerce Taxation in India and its economic effects

Specific Questions

1. Please explain us briefly about the current situation of E-commerce market in India.
In India, though shop-based retail is still dominant, E-commerce or electronic commerce for buying and selling products and services through electronic applications is gaining ground at a faster pace. The most well-known form of E-commerce is online shopping, known as business to consumer (B2C) where customers can order various products and receive the same by courier or postal mail. Another important category of E-commerce focuses on transactions between companies, such as manufacturers and a wholesalers or wholesalers and retailers and is called business to business (B2B). The third category involves transactions from consumer to consumer (C2C), as in the example of eBay or other similar websites. The reason for increasing E-commerce business is highly correlated to the internet usages in India. Internet user base is about 354 million as of June 2015 (Source, Report of Internet and Mobile Association of India, 2015). According to a 2015 report by the Boston Consulting Group, the number of Internet users in India is expected to increase to about 550 million in 2018. Though India is the second-largest internet user base in the world, (below China), the penetration and reach of E-commerce is low compared to markets like the US (84%), or France (81%). However, it is growing at an extraordinary rate, adding almost 6 million new entrants every month. In 2015, the retail E-commerce sales as a per cent of total retail sales in India was 0.9 per cent of all retail sales in India, which is estimated to reach 1.4 per cent in 2018. In India, COD (Cash on Delivery) is the most preferred payment method, accounting for 75% of the e-retail transactions. However, demand for international consumer products is growing much faster and in this count, the flash sales by designated companies has generated new form of retailing and enthusiasm among the Indian customers, especially for purchasing mobile phones. Largest E-commerce companies in India are Flip Kart, Amazon Snap deal, etc. Numerous small players have also entered by now and trying hard to garner a share of this promising market. There were 35 million online shoppers in India in 2014, slated to increase by over 100 million by the end of 2016 and by 2020, India would generate over $100 billion online retail revenue. Online shoppers' base is slated to grow by three times in the ongoing year and over 50 million new buyers will come from tier I and tier II cities. The confidence to shop online was on the rise as 71% non-buyers from tier I and tier II cities plan to shop online in the next 12 months, as per the survey study conducted by the Google India. Electronics and apparel are the biggest categories in terms of sales and larger proportion of women buyers are participation (40 million).

As a result of rising standard of living due to economic reforms and higher GDP growth, India's middle class population reached 267 million in 2015-16 (NCAER). In 2025-26 the number of middle class population would reach 547 million. In this backdrop, a larger percentage of population has subscribed to broadband services. This, along with increased 3G as well as 4G network with smartphone has ushered in a new era for the E-commerce business. This is further compounded by the ease of getting wider range of products at competitive prices. There is also the increased usage of online classified sites for the second-hand markets.

Gradually E-commerce business in India has started penetrating the rural markets as well. The ease and convenience of this market is also helping start-ups like, Jabong, Makemytrip, Bookmyshow, Zomato etc.

2. Please explain us the background of proposing Equalisation Levy on Digital E-commerce transaction.

The international tax system is moving at a faster pace as a result of coordinated actions to tackle concerns over base erosion and profit shifting (BEPS) and perceived international tax avoidance techniques of high-profile multinationals. The recommendations of the BEPS Project led by the Organisation for Economic Cooperation and Development (OECD) and published in 2015 are at the root of much of the coordinated activity, although the timing and methods of implementation vary. In its report, OECD recognized that the digitalisation of business has exacerbated the BEPS concerns of the developing nations, including India. The basic infrastructure of the international tax system put in place by the developed countries has worked so far to the advantage of the developed economies and many of these countries are even now wary of any change in the fundamentals of that architecture. The proposal linked to charging an equalization levy is basically derived from the suggestions made by OECD that refers to shifting of profits from the high tax-rate countries to lower tax-rate jurisdictions.

The online advertising market in India was US$ 550 million in 2015 with a year on year growth rate of 30 per cent. Search and display are the top two contributors to the total digital advertisement spends in India. Of the total digital advertisement market, search ads constitute 38 per cent of the overall ad spends followed by display ads, which contribute 29 per cent with the social media contributing 13 per cent of overall digital advertisement spends (Source: http://www.bestmediainfo.com/2015/09/online-advertising-market-pegged-to-grow-at-30-yoy-in-india/). According to some estimation, online advertising market in India could go up threefold to US $ 1516 million by 2018. The foreign players dominate the space at the moment and the revenue involved could be substantial. Google's revenue from India in the financial year 2014-15 was around US$640 million. Since these multinational companies earn huge profit margins, Equalisation levy of 6% to these companies would eventually drive up costs for the India-based advertisers. Since this is not a straight tax on digital advertising platforms, the move is supposed to create a level-playing field as it may compel the big foreign players to pay for the money they make from local advertisers.

The crux of the issue is that multi-national digital platforms did not have "permanent establishments" in the country to make them liable for paying tax in India. Moreover, double-taxation cannot be imposed means that the government has had to find a way of earning something from the profits that these platforms have been making. The issue also arises because the levy was proposed in the Budget as part of the Finance Bill and not as income tax. As such, the companies getting the brunt of the levy would not be able to take the benefit of tax treaties to avoid double taxation in their home countries. In his Budget speech, the Finance Minister of India said that payments of over Rs. 1 lakh (approximately US$ 1520) a year for online advertising to "foreign e-commerce companies" without permanent establishments would attract a levy of 6%. Therefore, depending on bargaining power, the burden would have to be shared by the foreign conglomerate, the advertiser, or partially all of them.

3. What could be the characteristics and the meanings of Equalisation Levy?
Before we converge to the nature and meaning of Equalisation levy, let us take note of the definition of the digital marketing. Broadly it is defined as a form of marketing and advertising which uses the Internet to deliver promotional marketing messages to consumers. It includes email marketing, search engine marketing, social media marketing, many types of display advertising (including web banner advertising) and mobile advertising. As already mentioned, business through digital marketing in India is moving at a faster rate. However, it is a crucial question that whether this flourishing business shares responsibility of developing infrastructure that put tax payer's hard–earned money? It is in this context, India took a lead in taxing digital economy. The report on taxation of e-commerce by the Income-Tax Department of India is fairly comprehensive and has examined various dimensions of imposing a new tax on digital economy. However, to be specific, it is not a tax on income. Since foreign companies having a permanent establishment (taxable presence) in India are exempt from this levy, it will also discourage companies from artificially avoiding permanent establishment in source countries. Equalisation levy is proposed initially for only B2B transactions and not on direct sales to customers. It has been structured to ensure that every entity making a payment to a non-resident for online advertisements will have to deduct this tax before making the payment. As the levy is not a tax on income, tax treaties will not be applicable and tax credit cannot be claimed by the foreign recipient. This is reaffirmed by the Committee on Income Tax as it has ruled out the option of levying a withholding tax, considering the fact that it would not be feasible to amend tax treaties in this regard. However, the Budget (2016-17) had brought the fact that this levy is only on "online advertisements" and "related services". However, those "related services" are not specified and therefore, we can expect some more services to be brought in the tax net in future. The other services that can be included are online collection or processing of data related to online users in India; any facility or service for the online sale of goods or services or collecting online payments, including development or maintenance of participative online networks. India is the first country to impose the levy following OECD recommendations. While OECD had proposed the tax as indirect tax such as value added tax or goods and services tax, India imposed it as direct tax. However, these new business models have created new tax challenges. The typical direct tax issues relating to E-commerce are the difficulties of characterising the nature of payment and establishing a nexus between a taxable transaction, activity and a taxing jurisdiction, the difficulty of locating the transaction, activity and identifying the taxpayer as well.
4. Please explain us about the opinions and position that E-commerce companies have?
The National Association of Software and Services Companies (NASSCOM), feels that there is no reason why there should be an Equalisation levy since there is already a tax which is being deducted at source when there is a B2B transaction. The lobbying firm has already requested the Government to ensure that that particular entity is not taxed twice on the same income. The media and entertainment houses (e.g., Earnest Young) are of the opinion that the rationale for taxing digital economy transactions will enable the Government to tax a wide range of digital economy dealings under the net of the Equalisation levy. Currently only the online advertising supply chain is in the net of the levy but in future many other services may come up through notification. It is therefore imperative for the government not only to lay down clear guidelines on the nature of transaction covered under the levy but, equally, the manner of determination as to whether Equalisation levy or income-tax will apply on such transactions. Else the transaction could lead to double taxation: equalization levy as well as income-tax. Though the Government mentioned that the proposed levy would impact only the E-commerce companies, the levy in its final form is likely to cover payments to large

advertisement exchanges as well as the companies located outside India, as these are the entities that are heavily involved in online advertising. Therefore, the levy could actually end up being a cost to small Indian businesses which advertise on these platforms. Start Ups tend to be very reliant on these online advertising platforms and a levy of this sort may have a more adverse impact on them than it would on the Facebooks and Googles of the world. This would eventually end up having undesirable impact on the Government's ambitious "Make in India" as well as the Start Up India programmes.

IAMAI termed the levy as impractical and unreasonable and it is going to hurt the small businesses in a big way. "India will stand out like a sore thumb if the government doesn't withdraw this proposal, "feels the Association.

5. Equalisation levy is expected to expand its scope to B2C industry. What do you think about this?

The recommendations of the Income Tax Committee of India mentioned specified taxable services that include designing, creating, hosting or maintenance of website, digital space for website, advertising, emails, online computing, blogs, online content, online data or any other online facility and any provision for uploading, storing or distribution of digital content. Apart from this, "use or right to use or download online music, online movies, online games, online books or online software, without a right to make and distribute any copies thereof; online news, online search, online maps or Global Positioning System (GPS) applications; online software applications accessed or downloaded through the Internet or telecommunication networks and online software computing facility of any kind and for any purpose" could also be brought under the proposed levy over the coming years.

Therefore, in future, the Government may expand the scope of the so-called levy on more transactions in the digital economy under the tax net. The ambit of the levy may further include downloading of songs, movies and books, online consumption of news, software downloads and online sale of goods and services. Based on the panel's recommendations, Equalisation levy of 6% to be deducted for payments made to non-resident entities for specified services like online advertisements. To reduce the compliance and administrative costs, the levy is now restricted to business-to business (B2B) transactions, and not to the business-to-consumer (B2C) transactions, which are more frequent, but of smaller amounts. Till the time a mechanism becomes available, by which Equalization levy can be seamlessly collected in B2C transactions (without burdening the consumer), the Government may restrict its option to only B2B transactions at the current stage. In due course, however, the ambit could be widened depending on the success of the current imposition.

6. What would be the expected effect when introducing equalization levy?

As usual there are voices of discontent which, however, still not marked as tax terrorism. The issues raised against the levy relate mainly to credit of the levy which will have to be granted by the country of residence of the taxpayer. However, if other countries also choose to impose a similar levy, the Government might have to consider an appropriate reciprocal agreement. In respect of some of the services, there is a reverse charge mechanism and hence it may not be correct to say that no tax is paid on such services. However the counter point is that the purpose of the levy is to create a level playing field between the domestic players and the foreign entities. The domestic players also pays the service tax levy and hence the field remains heavily skewed in favour of the MNCs in the area of income tax and that is the area needs to be balanced. On the other hand, the levy at 6% of gross payment might be quite high and in the absence of the authentic official statistics there is every possibility that the levy will be ultimately passed on to the payers. There may still be small issues in the actual implementation of the scheme but there is no action in respect of neutralizing the hybrid mismatch or off the track arrangements. Even the recommendations relating to transfer pricing will ultimately have to be translated into the domestic law.

As already elaborated, the levy would adversely affect the tech startup businesses. These companies are already paying 14.5% as service tax. The current levy would be a burden for them as there is no surety that the foreign firms, for whom the levy is meant to, would share them in letters and spirit. On the other hand, because of the nature of the levy, the companies will not be eligible for credits in their home countries, implying that the levy will have to be paid by users of their advertising platforms, such as startups and SMEs.

Q: Can you provide your personal biography for the Korean readers?

A : I am an orphan because of the civil war and I don't know even my birthday. I started learn how to live with my own since I was 13 years old. From 1985-1993, I took a lot of challenges and opportunities as a street boy but never forget learning. I have started working since I was young.

In between 1993-1999, I changed many working places and worked at UN's offices, local NGOs, TV broadcasting, Telecom company, Tour and Travel operator, and finally at a Cambodian airline company.

Today I have my own business as a tour company and some social works, as the Co-Chair of the Tourism Working Group of the Cambodia Government-Private Sector Forum (G-PSF), an advisor to the Cambodia Chamber of Commerce, also a real estate business man.

Q: In the beginning why do you decide to start up your own business?

A: Experience and challenge are the key factors that pushed me to start up my business. As I told you already, I got a lot experiences since I left my family when I was 13 years old. From that time I learned a lot of experiences, such as languages, management skill, financing, communication, marketing and so on; therefore, I decided to establish World Express Tours and Travel to start up my own business on July 14, 1999.

Q: How is your business now?

A: From a small local service company in the beginning now, World Express Tours and Travel is one of the top two tour operators in Cambodia among more than 500 tours and travel companies and I employ 40 Cambodian workers in 4 branch offices, including 2 in Phnom Penh capital city; one in Siem Reap, home of Angkor Wat temple; and one in Koh Kong province of Cambodia. Besides, World Express Tours and Travel, I have many cooperated counterparts in various destination in South East Asia, and Pacific including Japan and the Republic of Korea.

Q: As I have learned about you, besides the two positions that most of the people know you, you have the other right? If like this , can you tell me what are they? How do you manage your time for many position like these?

A: After World Express Tours and Travel was established and became one the successful tour operator in the country just 5 years, I was elected as the Secretary General of the Cambodia Association of Travel Agency (CATA), a national tourism organization of Cambodia in 2003, and became the president from 2005 until I resigned in 2011. At that time, in 2004 I also became the Co-Chair of the Tourism Working Group of the Cambodia Government-Private Sector Forum (G-PSF) until today. Besides my own company, I also spend more than 40% of my time and some budget for these kinds of social responsibility to promote the tour operation service in Cambodia.

Q: Korean is one of the top five market of the Cambodia inbound tour, so do you have any work, tour package, or any projects with them?

A: For the inbound services, World Express Tours and Travel has some services link with South Korean visitors, especially with the Korean International Cooperation Agency (KOICA), while outbound service, the company just cooperated with Sejong Tour and sent some group of Cambodian tourists to visit South Korea. We just organized a few tour packages to South Korean in recently.