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Equalisation levy on non-resident e-commerce facilitators – Analysing 'amount' for tax

By **Harshit Khurana**

Introduction

The recent developments in India concerning introduction of Equalisation Levy ('**2020 Levy' / 'EL'**), can be seen as an albatross around the neck for the non-resident e-commerce players[1]. With an increase in compliance burden and potential increase of costs, many of the e-commerce players consider unilateral measures taken by India as a deterrent to an effective business model.

A peculiar issue relating to 2020 Levy which has grabbed the attention of such e-commerce facilitators is regarding the amount on which the e-commerce facilitators should charge equalisation levy.

E-commerce marketplace facilitates sale of goods belonging to other vendors through their platform. The revenue earned by such ecommerce operator is only certain percentage of commission on the total sales price.

The question is on what value the ecommerce operator should pay equalization levy? Should it be on the entire sale value of goods **or** should it be only on the commission amount? Similarly, how the threshold of INR 2 crore as provided in the 2020 Levy provisions should be calculated in case of facilitators?

The way the 2020 Levy provisions have been worded, they do not provide a clear answer to the above questions. Owning to the same, the rules of legal interpretation for statutory provisions assume significant importance. The two possible views for the above questions are envisaged as below:

View I - The threshold amount of INR 2 crores as well as the base amount for 2020 Levy would be based on the gross amount collected by the e-commerce operator, including the amount which would be eventually passed on by the e-commerce operator to the vendors; or

View II - The threshold amount of INR 2 crores as well as the base amount for 2020 Levy would be based on the commission retained by the e-commerce operator.

This article discusses in detail the possible arguments in favour of both the above mentioned views.

Arguments in support of View I (gross amount collected)

1. ***Literal reading of the charging provision***

   The literal reading of Section 165A of the Finance Act, 2016 suggests that the 2020 Levy is to be charged on the entire consideration which is received by the e-commerce operator from e-commerce supply or services (whether such sale is of

[1] The new equalization levy is imposed on non-resident e-commerce operators.

goods that are owned by the e-commerce or merely facilitated by it; or such services are provided by the e-commerce operator or merely facilitated by it).

It may be argued that the emphasis in the definition of 'e-commerce supply or services' is on the activity of 'online sale or provision' and not on activity of 'facilitation'.

Considering the above, when the charging provision is read with the above definition, following is the literal reading of the charging provision:

- EL shall be charged on total consideration from online sale of goods (whether owned or facilitated by the e-commerce operator);
- EL shall be charged on total consideration from online provision of services (whether provided or facilitated by the e-commerce operator)

2. *Purpose of equalization levy*

One of the alternatives discussed in BEPS Action Plan 1 is to charge 2020 Levy on transactions involving sale (or exchange) of goods and services between two or more parties effectuated through a digital platform. It suggests the levy to be imposed on the gross value of the goods or services provided to in-country customers and users, paid by in-country customers and users, and collected by the foreign enterprise via a simplified registration regime, or collected by a local intermediary.

Keeping the above background in mind, the intent behind introducing EL by India is to tax the revenue earned from goods and services supplied online (through a digital platform) to customers or users in India. Therefore, the base value on which such EL is to be applied will be the gross revenue earned from such supply of goods and services to the users in India. It cannot be the intention to restrict the 2020 Levy to only the commission or remuneration earned by the e-commerce operator for facilitating such online sale or service.

3. *View II leads to a differential treatment in certain situations*

If 2020 Levy is charged only on the amount of facilitation income of the e-commerce operator (i.e. View II is accepted), this would lead to differential treatment in almost similar situations. For example:

- Where a non-resident manufacturer (who also qualifies to be an e-commerce operator) sells goods in India through his own platform, he would be required to pay the 2020 Levy on the entire sale consideration.
- However, where the same non-resident manufacturer sells its goods through a facilitator (i.e. another ecommerce operator), the operator would be liable to pay the 2020 Levy only on facilitation income (and not the consideration towards the goods).

Such a differential treatment to two business models cannot be the intent of the Legislature.

4. *Tax levied and collected from a person need not necessarily be linked only to his revenues/ income*

Inspite of the fact that the EL has been introduced in the background of challenges discussed in BEPS Action Plan

1, the levy per se has not been shown to be in the nature of income tax (i.e. tax on income of the e-commerce operator). It is a levy on certain transactions, viz. online sale of goods or online provision of services, either carried out by the e-commerce operator or facilitated by the e-commerce operator. Therefore, there is no anomaly if the tax is calculated by taking the overall revenue generated from such transaction as the base (irrespective of whether such gross revenue belongs to the e-commerce operator or vendor).

Arguments in support of View II (commission retained)

1. Literal reading of the provision

The literal reading of Section 165A suggests that 2020 Levy is to be charged on the consideration which is received or receivable by the e-commerce operator.

The consideration received or receivable in different situations would be as follows:

- Where such operator is acting in the capacity of the owner of goods, the 'consideration' referred under Section 165A shall be the consideration towards 'sale of goods'.
- Where such operator is acting in the capacity of a facilitator for such goods, the 'consideration' referred under Section 165A shall be the consideration towards 'facilitation'.

2. 'Received or receivable' means 'received and retained'

The terms 'received or receivable' used in Section 165A ought to be understood as receipt of such amount that will also be retained by the e-commerce operator. Mere collection of the amount on behalf of another person for onward remittance to such person would not mean that the amount has been received by the e-commerce operator.

Courts have interpreted the terms 'collected any amount' in the context of service tax. It has been held[2] that 'collected' means 'collected and kept as his'.

Accordingly, placing reliance on the said judgments, it can be argued that EL is to be charged only on the amount collected and retained by the e-commerce operator as commission.

3. Charging provisions are to be interpreted strictly and narrowly

It is now a settled law in the domain of taxation that charging provisions of the taxing statutes are ought to be interpreted strictly. Liberal construction which expand or enlarge the scope of the levy has been held to be impermissible.

In the present context, Section 165A when read literally or interpreted strictly leads to the conclusion that only the commission amount retained by the e-commerce operator for providing the facilitation services is subject to the levy.

If at all the charging provision is capable of being interpreted strictly/ narrowly as well as broadly, the narrower view which restricts the scope of the levy should be adopted.

[2] *R.S. Joshi and Ors*. v. *Ajit Mills Limited and Ors.* - AIR 1977 SC 2279.

In the present context, since View II is a possible view and narrows down the scope of the levy, the same should be adopted.

4. ***No occasion to refer to external material like BEPS Action Plan 1 when literal interpretation is possible***

It is the cardinal principle of statutory interpretation that the words of any statute must be literally interpreted and unless such interpretation results in any absurdity or ambiguity, reference cannot be made to any other external material for aiding interpretation. As already mentioned, literal interpretation of the provisions is very much possible and the same cannot be said to be leading to absurdity.

There is no basis to say that India had accepted the recommendations or suggestions of the BEPS Action Plan 1 in its entirety or that the present EL is exactly in line with the suggestions given in the Action Plan. On the contrary, the provisions of EL introduced by India are quite unique and different in its scope (including the definition of e-commerce operator and supply).

5. ***View I leads to an absurd construction with regard to an Indian vendor***

The 2020 Levy is triggered if the e-commerce operator is a non-resident and the end customer is a resident of India. The levy will be attracted even if the vendor is an Indian resident. In such cases if EL is levied on the gross booking amount in the hands of the e-commerce operator and thereafter, the net booking amount is also subjected to tax in the hands of resident vendor as his income tax, the net booking amount would suffer tax twice. When compared to a non-resident vendor whose net booking amount would not be subjected to income tax in India, the resident vendor will stand to lose. This may not have been the intent of the legislature.

Conclusion

Considering the strength of arguments available in support of both views, the tussle between the taxpayer and the taxman on this issue would definitely be an interesting one to watch out for in the near future.

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Notifications and Circulars

Guidelines for implementation of Sections 194-O and 206C(1-I)

The Central Board of Direct Taxes ('**CBDT**') has issued a Circular providing guidelines for TDS on payments made by e-commerce operator to e-commerce participants under Section 194-O, and TCS obligations under Section 206C(1H) and 206C(1G) of the Income Tax Act, 1961. As per Circular No. 17/2020, dated 29-09-2020:

1. Sections 194-O and 206C(1H) would not apply to transactions in securities and commodities traded through recognized stock exchanges or cleared and settled by the recognized clearing corporation, including those located in International Financial Service Centre, transaction in electricity, renewable energy certificates and energy saving certificates traded through specified power exchanges.
2. In case of e-commerce transactions, payment gateway will not be required to deduct tax under Section 194-O on a transaction, if the tax has been deducted by the ecommerce operator under Section 194-O on the same transaction. Payment gateways may demand an undertaking from the e-commerce operator confirming the TDS compliance.
3. The insurance agents would not be required to deduct any tax under Section 194-O if there is no involvement on their part for years subsequent to the first year. However, insurance company shall be required to deduct tax on commission payment, if any, made to the insurance agent or insurance aggregator in those subsequent years.
4. No adjustment on account of sale return or discount or indirect taxes including GST is required to be made for collection of tax under Section 206C(1H).
5. Section 206C(1H) shall not apply on the sale consideration received for fuel supplied to non-resident airlines at airports in India.
6. Further, clear-cut monetary thresholds have been clarified in cases of sale or service to an individual and HUF and the calculation of time-period of applicability of said sections.
7. The Circular also clarifies the scope and extent of Section 206C(1F) which deal with TCS collection for motor vehicle sale above INR 10 lakh and Section 206C(1H) which deals with aggregate sale of goods. The clarification emphasizes on mutual exclusivity of Sections 206C(1F) and 206C(1H).

Faceless Appeal Scheme 2020 notified

The Faceless Appeal Scheme 2020 has been notified by the CBDT *vide* Notification No. 76/2020 dated 25-09-2020. The broad contours of the scheme are as under:

1. For e-appeal, National Faceless Appeal Centre and Regional Faceless Appeal Centres would be created. Under each Regional Faceless Appeal Centre, Appeal Units would be created to facilitate the conduct of e-appeal proceedings.
2. All communications between the National Faceless Appeal Centre and the appellant/Assessing Officer/ National e-Assessment Centre shall be through electronic mode only.

3. Appellant may file the additional grounds of appeal to the National Faceless Appeal Centre, which in turn will forward them to the National e-Assessment Centre/ the Assessing Officer.
4. National e-Assessment Centre/Assessing Officer may request the National Faceless Appeal Centre to direct the production of any document or evidence by the appellant, or the examination of any witness.
5. Appeal unit may enhance an assessment or a penalty or reduce the amount of refund, after giving an opportunity of being heard to the appellant.
6. Review of the draft order passed by one appeal unit wherein the liability is above the prescribed threshold, by another appeal unit. In any other case, examination of the draft order by National Faceless Appeal Centre in accordance with the specified risk management strategy.
7. Appeal unit may, in the course of appeal proceedings, send recommendation for initiation of any penalty proceedings against the appellant/any other person to the National Faceless Appeal Centre, for non-compliance of any notice, direction or order issued under this Scheme.
8. National Faceless Appeal Centre may amend any order passed by it to rectify any mistake apparent from the record. Application for rectification of mistake may be filed by the — (a) appellant/any other person; or (b) appeal unit preparing or reviewing or revising the draft order; or (c) the National e-Assessment Centre/Assessing Officer.
9. An appeal against an order passed by the National Faceless Appeal Centre under this Scheme shall lie before the Income Tax Appellate Tribunal having jurisdiction over the jurisdictional Assessing Officer.

Ratio Decidendi

‘Royalty’ under India-Singapore DTAA narrower than under Income Tax Act and does not include ‘transmission by satellite, cable, optic fiber or similar technology’

The assessee-company, a Singapore tax resident, was engaged in the business of providing digital transmission of data through international private line or multi-protocol label switching, etc. to facilitate high speed data connectivity outside India (collectively known as ‘bandwidth services’). For the assessment years under consideration, the assessee filed a Nil return of income. However, the AO held that the payments received by the assessee for providing the bandwidth services were in the nature of equipment or process royalty under Section 9(1)(vi) of the Income Tax Act read with Article 12(3) of the India-Singapore DTAA.

On an appeal, the ITAT New Delhi placed reliance on the decisions of *Asia Satellite Telecommunications Co. Ltd.* and *New Skies Satellite-BV* to hold that the payment received by the assessee did not constitute royalty since the customers of the assessee did not use or get a right to use any equipment or process. The Tribunal observed that the assessee was merely providing services to its customers by using the equipment and processes at its disposal. It further held that unlike the expanded definition of 'royalty' under the Act, the definition of 'royalty' under the India-Singapore DTAA does not include 'transmission by satellite, cable, optic fiber or similar technology'. It concluded that since the provisions of DTAA were more beneficial to the assessee, it was not liable to be taxed on the amount received from Indian customers for the provision of bandwidth services outside India. [*Telstra Singapore Pte. Ltd.* v. *DCIT* - Order dated 30-09-2020 in ITA Nos. 1548 & 286/2016, ITAT Delhi]

Depreciation to be allowed at 10% on payment for additional FSI, increasing overall value of property

The assessee-company was engaged in the hotel business. During the financial year relevant to the assessment year under consideration, the assessee had acquired additional Floor Space Index ('**FSI**') from the Government of Maharashtra. Of the amount payable, the assessee made a certain payment to the Government, while the balance amount was to be paid in instalments. In its return of income, the assessee made a claim of depreciation on the additional FSI at the rate of 25% by contending that it was an intangible asset within the meaning of Section 32(1)(ii) of the Act. Such claim of the assessee was rejected by the AO who held that the FSI will get converted into asset as and when additional floors or additional building are constructed and that the payment for the FSI could be included in the value of the building block as and when the same is utilized.

The CIT(A) upheld the action of the AO of disallowing the claim of depreciation under Section 32(1)(ii). However, the CIT(A) held that since the amount spent by the assessee would add to existing value of the building, the overall cost of the building block would increase by the said amount and depreciation would be allowable on it at the rate of 10%. However, the claim of depreciation was to be restricted to the amount which had been actually spent by the assessee till date.

On appeal, the ITAT upheld the finding of the CIT(A) that depreciation would be allowable at the rate of 10% since the amount spent on additional FSI would enhance the value of the building. However, the ITAT differed from the CIT(A) by holding that irrespective of the fact that some instalments of payment were pending, once the entire amount has been debited to the block of assets of the building in the balance sheet and the corresponding entry of liability has also been made, then depreciation would have to be considered on the full amount of premium debited. The decision of the ITAT was affirmed by the High Court of Bombay. [*PCIT* v. *V. Hotels Limited* - Order dated 21-09-2020 in ITA (IT) No. 1734/2017, Bombay High Court]

Redesigning of moulds to satisfaction of customer is revenue expenditure

The assessee-company was in the business of manufacturing various parts of automobile components required by its customers. In AY 2007-08, the assessee claimed deduction under the head 'scientific expenditure' of the expense incurred on manufacturing the products on trial basis to align with customer's specifications. During the assessment, the AO observed that the amount claimed was not allowable under Section 35 of the Act, since neither the assessee had

obtained any approval from the scientific authority nor paid any sum to the university or research organization.

During the first appellate proceedings, the CIT(A) observed that it was actually regular revenue expenditure incurred by the assessee in respect of product perfection process and therefore, allowed the said expenditure under Section 37. The Tribunal upheld the Order of the CIT(A).

On appeal, the Madras High Court held that in absence of any material on record which would indicate any capital expenditure, the redesigning of the moulds to create new designs of the components manufactured by the assessee to the satisfaction of the customer is nothing but revenue expenditure incurred in the ordinary course of business of the assessee. [*PCIT* v. *HSI Automative Ltd.* - Order dated 16-09-2020 in Tax Case (Appeal) No. 11/2017, Madras High Court]

Word 'rupee' does not restrict the scope of Section 40A(3) to Indian currency, but includes equivalent foreign currency as well

During the year under consideration, the assessee claimed foreign travel expenses including an amount towards exhibition charges. The AO observed that the expenditure was incurred in cash in foreign currency abroad. Referring to the provisions of Section 40A(3) of the Act, the AO disallowed the expenses incurred in cash exceeding the amount of INR 20,000 in a day.

On appeal, the assessee contended that the since the provision under Section 40A(3) of the Act provides disallowance for incurring of cash expenditure exceeding INR 20,000, in a day, the provision would apply only in a case where the expenditure in cash has been incurred in Indian currency. The Tribunal however held that the word 'Rupee' in Section 40A(3) cannot be interpreted in a limited or narrow sense to mean cash expenditure incurred in Rupee only. It was of the view that the expression in fact means an expenditure incurred exceeding the particular amount in Rupee terms. Therefore, even if the expenditure is incurred in cash and in foreign currency, the provision of Section 40A(3) would be applicable if it exceeds the specified quantum in Rupee term. [*Ramlord Apparels* v. *ACIT* - Order dated 03-09-2020 in ITA No. 7349/2018, ITAT Mumbai]

Benefits under Section 54 available for investments made in wife's name

For the year under consideration, the assessee filed his return of income in response to the reassessment notice, wherein he claimed deduction under Section 54 against the capital gains arising from the deemed sale consideration received under Section 50C. The AO however disallowed the deduction under Section 54 on the grounds that (a) new investment was made in the name of the wife, and (b) the cost of construction was not substantiated.

On appeal, the Tribunal considered the conditions required to be fulfilled in order to claim the deduction under Section 54 and also noted that the cost of construction is supported by the valuation report. It accordingly held that the mere fact that the investment was made in the name of the wife cannot be a reason for disallowance of deduction under Section 54 of the Act, when other conditions have been satisfied. [*Shankar Lal Kumawat* v. *ITO* - Order dated 21-07-2020 in ITA No. 1390, 1391 & 1392/2018, ITAT Jaipur]

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