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'Google Tax': Implications for India

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Summary

India, along with several other countries, has imposed digital service taxes on online advertisement revenues and other digital sales by non-resident e-commerce firms. Popularly christened the 'Google Tax', these taxes have provoked United States (US) authorities to launch investigations on many imposing countries for determining whether or not these are particularly discriminatory to US technology firms, which are the largest online service providers in India and much of the rest of the world.

This paper reviews the global trends in digital service taxes, including efforts to arrive at solutions for fixing multilateral principles for administering these taxes, which are extra-territorial, and unlinked from the traditional principle of physical presence for taxing foreign firms. For India, which has expanded the scope of the tax from 1 April 2020, the issue has emerged as a problem in proceeding on a limited trade deal with the US.

The paper argues, from a revenue perspective, that the Indian authorities find the 'Google Tax' appealing at a time when its public finances are strained. Also, India is a major contributor to online revenues earned by big US technology firms. Whether the tax will impact US technology investments in India will depend upon outcomes of US investigations and ongoing global talks on digital taxes. More importantly, they would also depend on outcomes of bilateral consultations between the US and Indian tax authorities as the 'Google Tax' is outside the purview of existing tax treaties.

Digital Service Tax: The Global Trend

Rapid digitalisation of economic functions and generation of extensive revenue by technology businesses through digital means has drawn significant attention to the issue of global governance of digital taxes. The matter has assumed greater significance with countries beginning to tax revenues from advertisements hosted by digital platforms as well as cross-border digital sale of goods and services. The taxes are affecting revenues of multinational businesses engaging in large volumes of digital sales in various national territories, where they were not paying taxes due to absence of physical presence in these territories. United States (US) technology firms have been particularly upset by the taxes that have led to the latter being popularly referred to as the 'Google Tax'.

The taxes on revenues from cross-border digital services are extra-territorial in nature, raising questions about whether domestic tax laws give countries the right to tax cross-border services. At the same time, recognition of the exponential growth in cross-border digital trade, principally e-commerce, and the large revenues and economic wealth being generated by the trade for its actors – major digital service supplying technology firms like Google and Amazon – are drawing attention to the principles that can enable countries to tax these revenues even without physical presence and the broader allocation of global taxing rights among countries. For several countries, particularly emerging markets and developing countries, domestic tax laws are insufficient to tax businesses that are without noticeable physical presence, and using intangible means, primarily digital means and capacities, to earn profits.[1]

One hundred and thirty-five countries of the world are working with an initiative spearheaded by the Organisation for Economic Cooperation and Development (OECD), as part of an inclusive OECD/G20 framework,[2] to hammer out a common solution to the complex issues of digital tax governance. The initiative is progressing under the Base Erosion and Profit Shifting Action Plan (BEPS) of the OECD.[3] The outbreak of COVID-19 has affected progress on the work and the results from this project are expected by the end of 2020. In the meantime, however, several countries have unilaterally imposed digital service taxes (DST).

A study by KPMG shows that 22 countries have legislated such taxes, with several more well on the way to do so.[4] These include countries from Europe (Austria, France, Greece, Hungary, Italy, Poland, Turkey and the United Kingdom [UK]), Asia (India, Indonesia, Malaysia, Pakistan, Taiwan and Vietnam), Africa (Kenya, Nigeria, Tunisia and Zimbabwe), and South and Central America (Mexico, Paraguay, Uruguay and Costa Rica). More European countries – the Czech Republic, Denmark, Latvia, Norway, Romania, Spain and Russia – are working on implementing online service taxes, along with Brazil, Canada, Egypt, New Zealand and South Africa. Many of these countries are part of the ongoing OECD consultations, including India, which, ostensibly, has not prevented them from imposing the DSTs.

The US Response

The US has been unhappy over several countries unilaterally imposing the DSTs. The latter have been deemed unfair and acting against business interests of major American technology firms such as Google, Facebook, Netflix and Amazon.[5] The DSTs, imposed on revenues earned from markets with large digital sales like India, comprise additional taxation for US firms. They would now be paying taxes in other jurisdictions, in addition to those that they pay in the US on their global profits.

The US Trade Representative (USTR) has initiated enquiries against several countries in this regard, such as Austria, Brazil, the Czech Republic, the European Union, India, Indonesia,

[1] 'Corporate Tax, Digitalization and Globalization', World Economic Forum. http://www3.weforum.org/docs/WEF_Corporate_Tax_Digitalization_and_Globalization.pdf.

[2] Members of the OECD/G20 Inclusive Framework on BEPS (updated in December 2019). https://www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf.

[3] 'Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy', OECD, 29-30 January 2020. https://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf.

[4] Taxation of the digitalized economy, KPMG (updated 19 July 2020). https://home.kpmg/xx/en/home/insights/2019/06/tnf-digital-economy0.html.

[5] 'USTR launches investigations into countries' digital taxes', *The Hill*, 6 June 2020. https://thehill.com/policy/finance/500711-ustr-launches-investigations-into-countries-digital-taxes.

Italy, Spain, Turkey and the UK. The investigation has been launched under Section 301 of the US Trade Act of 1974.[6] The specific concerns that the investigation is focusing on is whether including such taxes are discriminating specifically against US businesses; pursuing unreasonable tax policies; and comprising deviations from prevalent practices and principles of US domestic and international tax systems, in terms of their extra-territorial jurisdiction, taxing of revenues (as against incomes, which is the prevalent practice) and penalising successful technology companies.

The current investigations follow earlier US investigation of the announcement of a three-per cent DST by France from 1 January 2020, and the retaliatory tariffs announced by the US on several French imports. Both countries have called a temporary halt to their respective taxes as they await the OECD/G20 initiative to lay out the broad framework for global digital taxes.[7]

While being trenchantly critical of the multilateral trade system, the DSTs ironically are an area where the US is looking forward to multilateral solutions. This is largely due to the great advantage that big US technology firms have in providing online services across the world. Unlike the Donald Trump Administration's recent action on restricting H1B visas, which attracted strong criticism from domestic technology firms, Section 301 investigations have the strong backing of the American technology industry.[8]

India's 'Google Tax'

India, along with Israel, was among the earliest to begin taxing digital service revenues earned by non-resident enterprises from 2016. It introduced the tax as an 'equalisation levy' from 1 June 2016. The Indian Union Budget for FY2016 proposed the levy as a withholding tax. Introduced at a rate of six per cent, the tax was levied on online advertisement revenues of foreign e-commerce companies, obtained from Indian sources, if such revenues exceeded ₹100,000 (S$1,841) in a year.[9]

The intention to specifically tax revenues of foreign e-commerce companies was evident from the equalisation levy being imposed on 'non-residents' without 'permanent establishment' in India. The burden of paying the tax was on the resident businesses, or non-resident companies with permanent establishment in India, which would retain (or withhold) six per cent from the payments they were making to non-resident firms for advertisement and pass on the same to the Central government. Several start-ups and local firms, advertising on Google and other digital platforms, have been unhappy about the burden that has come on them as a result.

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6 Federal Register/Vol. 85, No. 109/Friday, 5 June 2020/Notices, pages 34709-34711. https://www.govinfo.gov/content/pkg/FR-2020-06-05/pdf/2020-12216.pdf.

7 "France and US move toward temporary truce in trade war", *The New York Times*, 21 January 2020. https://www.nytimes.com/2020/01/21/business/france-US-digital-tax.html

8 Taxation of the digitalized economy, KPMG (updated 19 July 2020), op. cit.

9 Budget 2016-17, Speech of Mr Arun Jaitley, Minister of Finance, 29 February 2016, p. 28, para 151. https://www.indiabudget.gov.in/budget2016-2017/ub2016-17/bs/bs.pdf.

The scope of the equalisation levy has been expanded in the Finance Act of 2020 with the greater scope taking effect from 1 April 2020. Since 1 April 2020, an additional equalisation levy of two per cent is being charged on all online sales of goods and services provided by foreign e-commerce operators as well as those facilitated by them through online platforms. The expansion of the scope is substantial with the tax not just applying to sales by foreign e-commerce firms to Indian residents, but also to non-residents, under 'specified circumstances'. The latter include:

i) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and

ii) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India.[10]

By extending the tax to digital sales by foreign e-commerce firms to non-residents, the equalisation levy acquires an extraterritorial dimension, an aspect open to legal contestations. Extraterritoriality is an aspect being examined by the USTR in the Section 301 investigations mentioned earlier. The issue involves identification of principles for taxing digital services rendered by global tech businesses, whose digital presence in several countries is substantial, while physical presence – the key basis for taxing foreign enterprises by various jurisdictions now – is minimal, often negligible. The BEPS project of the OECD is currently occupied with the task.

The 'Google Tax' is not being charged on digital sales by e-commerce operators with permanent establishments in India, that is, domestic e-commerce entities. They are also not being levied on e-commerce businesses with annual turnovers of less than ₹20 million (around S$368,000). In this respect, the expanded scope of the tax is not just on revenues earned by foreign ecommerce operators, but specifically those are earning large revenues from digital sales in the Indian market, either directly or peripherally. American technology companies providing digital ecommerce services, as well as related services like digital payments, are among those that would be most affected by the widening of the scope of the equalisation levy.

Emerging Issues and Impact on US-India Trade Deal

India's 'Google Tax' is in line with similar taxes imposed by many other countries – both the OECD (for example, Austria, France, Italy and the UK) as well as emerging market and developing countries (for example, Mexico, Turkey, Indonesia, Malaysia, Kenya and Uruguay). The fact that more and more countries, including India, are beginning to tax online services provided by non-resident technology firms, notwithstanding unresolved issues around the principle and structure of such taxes, and their ongoing examination by OECD/G20, points to their eagerness to capture digital revenues. The DST imposing countries consider a part of these revenues rightfully theirs, as earnings are either arising

[10] Section 165(A), Para 3: The Finance Act, 2020, Ministry of Law and Justice, *The Gazette of India*. http://egazette.nic.in/WriteReadData/2020/218938.pdf.

from sales to their residents or through data pertaining to the latter. However, the view has run into conflict with the Trump Administration and set off a new trade war between the US and several other countries, including India.

The US' decision to initiate Section 301 investigations does not appear to have impacted India's position on the equalisation levy. This is notwithstanding the fact that the investigations are likely to result in retaliatory tariffs on Indian exports – similar to the outcome for France – which would create more access difficulties for Indian exports to the US, following the withdrawal of the Generalised System of Preferences last year. India's response has been to emphasise the non-discriminatory nature of the equalisation levy, while underscoring efforts to ensure a 'level playing field' between domestic ecommerce firms and their non-resident counterparts with a large digital presence in the country.[11]

At a time when India's central public finances are stressed due to large budgetary support to tackle domestic economic contraction and public health exigencies from COVID-19, the urge to collect more revenues is strong. This would encourage it to sustain the equalisation levy. Business and consumer habit adjustments following the COVID-19 pandemic would significantly enhance the role of online services in India, particularly the sale of goods. The adjustments are taking place at a time when US technology giants – Amazon, Facebook, Google, Walmart, Microsoft and Netflix – are significantly expanding their presence in India's telecommunication and e-commerce space. Such presence augurs well for revenue collections when other opportunities are almost non-existent. Furthermore, the large size of India's digital economy makes it an important contributor of global online revenues of US technology firms, giving Indian authorities, what some would argue, 'moral rights' to claim parts of the revenues.

The 'Google Tax', however, is a fresh challenge that has come up in the efforts by the US and India to reach a limited bilateral trade deal before the US elections.[12] The DSTs do not come under the purview of existing tax treaties and need to be addressed separately. Till now, the tax has not deterred major US technology firms like Facebook from acquiring large stakes in strategic Indian businesses like Reliance Jio, ostensibly with the objective of digging deeper footholds in India's burgeoning e-commerce space. However, if India's 'Google Tax', which is already at eight per cent of online advertisement revenues after expansion, becomes higher than those imposed by other locations, revenue implications for US technology firms would be significant, if US tax authorities do not allow deduction benefits on the tax. Whether that might result in some fresh thinking on US technology investments in India is not clear. Much depends on the outcome of the OECD project, Section 301 investigations and, most importantly, bilateral discussions between the US and India.

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11 "2% equalisation levy non-discriminatory, India tells US", *Deccan Herald*, 17 July 2020. https://www.deccanherald.com/business/business-news/2-equalisation-levy-non-discriminatory-india-tells-us-862515.html.

12 https://www.livemint.com.

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