Representation for exclusion of financial services industry from the ambit of Equalisation Levy applicable on E-commerce Supply or Services w.e.f. 1 April 2020

Background

1. In the course of the enactment of the Finance Act 2020 (FA 20202), the scope of Equalisation Levy (EL) has been expanded to introduce a 2% levy on consideration received/ receivable by Non-Resident (NR) E-commerce Operators (EOP) for providing or facilitating Ecommerce Supply or Services (ESS) to certain specified persons. The ESS EL is applicable w.e.f. 1 April 2020. In this regard, an amendment to Chapter VIII of the Finance Act 2016 (FA 2016) has been enacted.

2. As per the amended provisions of the FA 2016, some of the key definitions in connect with the ESS EL have been provided below:

   - E-commerce operator means a non-resident who owns, operates or manages digital or electronic facility or platform for online sale of goods or online provision of services or both

   - E-commerce supply or services means:

     - Online sale of goods owned by the e-commerce operator; or
     - Online provision of services provided by the e-commerce operator; or
     - Online sale of goods or provision of services or both facilitated by the e-commerce operator;
     - Any combination of above activities

   - Online means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network

3. Additionally, following specific exclusions have been provided from the levy of ESS EL:

   a. where the EOP has a Permanent Establishment (PE) in India and ESS is effectively connected with such PE;
   b. where the transaction is already subject to EQL under erstwhile provision (applicable to transactions for online advertising and related services);
   c. where sales, turnover or gross receipts of EOP from ESS is less than INR 2 crore in a previous year.

4. However, the current provision of ESS EL do not provide for any industry or sector specific exclusion from EQL at the current stage. The way the provisions are worded, these are extremely wide and could have undesired consequences especially for certain sectors. One such sector is financial services. Given the way the financial services entities operate in India and given that they in almost all cases are required to be both regulated and have a presence in India to operate in India, ESS EL should not apply to the financial services industry.

5. The purpose of this representation is mainly to highlight the need to carve out financial services industry such as banks, non-banking financial companies, primary dealers, asset management companies, insurance and re-insurance companies, broker dealers and their back-office entities from the applicability of ESS EL. This exclusion is especially relevant for financial organisations that have access to customers in different jurisdictions i.e. multinational financial institutions across the banking, asset management, insurance, etc.

6. As part of Action Plan 1 of Base Erosion and Profit Shifting (BEPS) and in furtherance of global efforts, it is expected that concerns arising from new form of digital businesses - particularly in the area of nexus, data and characterisation will be addressed. As part of BEPS 2.0 Pillar 1, a

framework has been agreed and work is in progress to allocate taxing rights to market jurisdictions.

7. The above work is expected to achieve global consensus by the end of 2020. In the recent report released by the Organisation for Economic Co-operation and Development (OECD) post coronavirus outbreak[1], it is acknowledged that the increased use of digital services and the need to expand revenue raising in such pandemic and lockdown situation could provide new impetus to efforts to reach agreement on BEPS Pillar 1 issues internationally. The OECD further states that policy makers could work to avoid the risks of unilateral action in the digital taxation area and the disruption of the international tax and trade agenda that could result from failing to reach a consensus-based outcome on digital taxation. Thus, the OECD is mindful of the approaching deadline and is likely to push consensus by end of 2020 as committed.

8. The efficacy of such global measure is highly dependent on uniform approach to be adopted by each member country. Any unilateral measure is not only inconsistent with global agenda but is also likely to result in undesirable multiple taxation of same income without any tax credit or an effective opportunity of eliminating such multi taxation.

9. There are various factors which distinguish the functioning of the financial services industry from the other sectors and thereby necessitates the need for a specific carve out from the scope of ESS EL. We have summarized below, few of key factors:

    a. Financial sector players are highly regulated by various financial sector regulators. The regulators oversee the functioning of the financial services industry, clientele, sources of earning income, movement of funds within/ outside India, accounting and reporting requirements, etc. Thus, there is already an added layer of regulatory supervision on their service offerings and income generated in India.

    b. Given the nature of services rendered by the financial sector players, they are typically structured as subsidiaries or locally recognised branches of foreign players. Where a customer of a particular jurisdiction is onboarded, the regulations require the initial relationship to be through a local entity i.e. either a subsidiary or a local branch. Thus, even where the services are rendered digitally, the relationship continues to be with the local entity resulting in profits of these service offerings being taxed in the local jurisdiction.

    c. Even for providing digital services, customers can be onboarded only after carrying out necessary due diligence, Know Your Customer (KYC) checks, Anti-Money Laundering, etc. Thus, due to already existing extensive tax reporting obligations, the income from such services is appropriately recognised and taxes are discharged timely in the jurisdiction of the customers.

    d. In respect of institutional businesses, inter-branch activities and inter-company transaction agreements are extremely common in the industry. They are extensively undertaken to ensure that the financial risks are centralised, the operations are conducted basis the global brand and quality requirements by the branches/ subsidiaries across jurisdiction. These services are duly compensated within the group due to regulatory and taxation requirements of each jurisdiction.

    e. A large portion of the digital services rendered by offshore financial services entities are rendered to their Indian Group companies. These are subject to GST (under the reverse charge mechanism) and in many cases even withholding tax. A levy of EQL will further increase the cost of rendering services from India. Further for banking entities given that only fifty percent credit is available for GST this is a significant cost increase.

[1] OECD report titled "Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience" released on 15 April 2020

10. As you would appreciate, tax on digital services is a matter of global debate at various forums. Various consultations were made by the financial service industry across jurisdictions and were duly considered by the Governments, thereby providing exclusions to financial services industry from Digital Service Tax (DST). An exclusion has been provided by United Kingdom to financial services industry from the levy of DST. The rationale provided by UK HM Treasury for exclusion of financial services industry from the levy of DST has been provided below:

    a. The highly regulated nature of financial services means financial services marketplaces will often be closed environments, which are only open to other highly regulated market participants. As a result, the marketplace does not generate significant value by seeking to maximize the number of other users on the platform.

    b. There are also strict rules and limitations about how financial services businesses/marketplaces interact with users, including restrictions on the products and services they can offer.

    c. Similarly, financial services businesses often bear significant risk. This is sometimes the case even when they are not contractually a party to a transaction. The wider macroeconomic risks financial institutions inherently present to the economy mean financial services businesses are typically required to hold capital against these risks and their direct or indirect exposure to other market participants. This means there can be significant additional costs involved in increasing the number of users on the platform, which distinguishes them from other marketplaces.

    d. Finally, the regulated nature of the financial services sector means that much of their activity is localized to the markets they operate, something already reflected in the unique treatment of a banking group under existing transfer pricing rules. This means a concern about unrecognized value creation due to the nature of current international tax rules applies less strongly in these cases.

11. Similar exclusions for financial services industry have been provided by other countries too which include the likes of France, Italy, Spain and New Zealand. We have provided a synopsis of the same at Appendix.

12. As ESS EL was enacted under unprecedented circumstances with no memorandum and object statements supporting the intend of the levy, the same has been susceptible to various conclusions which has led to ambiguity around the interpretation, scope and magnitude of levy.

13. In lights of the above, it is imperative to have a specific exclusion from the provisions of ESS EL for financial services industry without which there will be a significant impact on the financial services sector.

<u>Recommendation</u>

14. It is recommended that banks, non-banking financial companies, primary dealers, insurance and reinsurance companies, broker dealers, asset management companies and their back-offices in India be exempt from the levy of EQL given the reasons enumerated above.

Appendix

Instances of exclusions for financial services industry in other jurisdictions

Country	Synopsis of the exclusion for financial services industry
France	In March 2020, the French Tax Authorities (FTA) issued new draft guidance with respect to the DST. As per the guidelines, there are two categories of taxable services, namely, digital intermediation and targeted advertising (which includes the sale of data for the purpose of targeted advertising). The guidelines also provided for certain exclusions from the scope of digital intermediation which inter-alia included the following financial services: • Interbank settlement systems or systems for the settlement and delivery of financial instruments • Trading platforms and trading systems of "systematic internalisers" • Participating investment advisory activities and intermediation services in participatory finance • Other networking systems that are listed by decree (note that no decree was issued on 31 December 2019 for 2020). The draft guidance is subject to public consultation and thus, there may be revisions before the guidance is issued in final form. However, the guidance is already binding on the FTA, so that a taxpayer that follows this draft guidance will not be subject to reassessment by the FTA.
Italy	With the 2020 Budget Law, the Italian government reshaped Italy's DST to mirror it to the EU Commission proposal of March 2018. The revised version of the Italian DST is in force effective 1 January 2020. As per the revised version of the Italian DST, the making available of a digital interface utilized to manage certain banking and financial services as well as the transmission of data from the providers of such services do not qualify as digital services and are accordingly, excluded from the scope of DST
Spain	In February 2020, the Spanish Government resumed its initiative to enact a unilateral DST after its failure to pass the bill drafted in 2019. Apart from the other exclusions, the Spanish DST pursuant to the Bill proposes to inter alia exclude Regulated financial services rendered by regulated financial entities and Income derived from the transfer of data by regulated financial entities. The Bill has been sent to the Parliament for a vote and awaits its approval
New Zealand	In July 2019, the Government came up with a Discussion Document putting forth a proposal for New Zealand DST. Basis the public comments, it was likely to be introduced in the Parliament in 2020. Based on the discussion paper, DST is proposed to be narrowly targeted to certain highly digitalised supplies and thus, does not apply to 'Standard financial services' and 'Electronic funds transfer at point of sale (EFTPOS)'.