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DIGITAL SERVICE TAX

The government had moved an amendment in the Finance Bill 2020-21 imposing a 2% Digital Service Tax (DST) on trade and services by non-resident e-commerce operators with a turnover of over Rs. 2 crore.

United States Trade Representative (USTR) reported that the India's 2% digital services tax (DST) is discriminatory & inconsistent with international tax principles.

What is digital service tax (DST)?

- Digital companies are not adequately taxed because they don't have a physical location in the markets where they operate.
- DST aims to ensure that non-resident, digital service providers pay their fair share of tax on revenues generated in the Indian digital market.

DST in India

- In 2016, **Akhilesh Ranjan Committee** suggested to create a level-playing field between online businesses and brick-and-mortar businesses.
- Since digital businesses don't have physical presence but enjoy a sustainable economic presence they need to be taxed.
- India was the one of the first countries to introduce a 6 per cent equalisation levy in 2016, but the levy was restricted to online advertisement services.
 - The equalization levy was imposed "to give level playing field between Indian businesses who pay tax in India and foreign e-commerce companies who do business in India but do not pay any income tax here.

- However, India introduced the digital tax in April 2020 for foreign companies selling goods and services online to customers in India and showing annual revenues more than INR 20 million.

Issues Raised by USTR

Section 301 of the US Trade Act, 1974, authorizes it to appropriately respond to a foreign country's action that is discriminatory and negatively affects US commerce.

- The USTR report states that the DST discriminates against US digital businesses because it specifically **excludes from its ambit domestic (Indian) digital businesses**.
- The report also concerns that the DST does not extend to identical services provided by non-digital service providers.

India's clarification

The reason behind taxing US companies because the market for digital services is dominated by US-based firms.

Also the Business models employed by non-resident digital service providers obviate the need for a physical presence in India and profits earned here could easily escape the Indian income tax net. Hence, this kind of taxation is necessary.

For domestic companies India said that any company that has a permanent residence in India is excluded since it is already subject to tax in India.

Is India's DST discriminatory?

- The threshold that India has laid down for the equalisation levy is actually much below what the EU envisages.
- Moreover the levy aims to create a level-playing field with ordinary businesses have a physical presence & pay regular taxes.
- Now international communities are moving towards a scenario where such transactions need to be taxed.
- Hence to say that levy violates international tax principles is not valid.

Associated Concerns with DST

- Eventually the tax may become a burden for Digital Consumers. While the Indian customer may not pay this as a tax, this could mean higher prices, contrary to the claim that it taxes the company.

- The USTR investigations could invite a threat of retaliatory tariffs, as similar tariffs were imposed by the US on France. Which could also turn into a digital trade war-like scenario
- It would also result in double taxation.

Way forward

- EU and India advocated the new model of digital taxation which says that digital corporations can operate in a market without a physical presence.
- Therefore, taxing in a particular jurisdiction may not augur well with the growth of the digital economy.



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