

Taxation of E-commerce Transactions

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E-Commerce

- ▶ E-commerce is basically buying / selling of products/ provision of services by businesses through an electronic medium not requiring any human interface.



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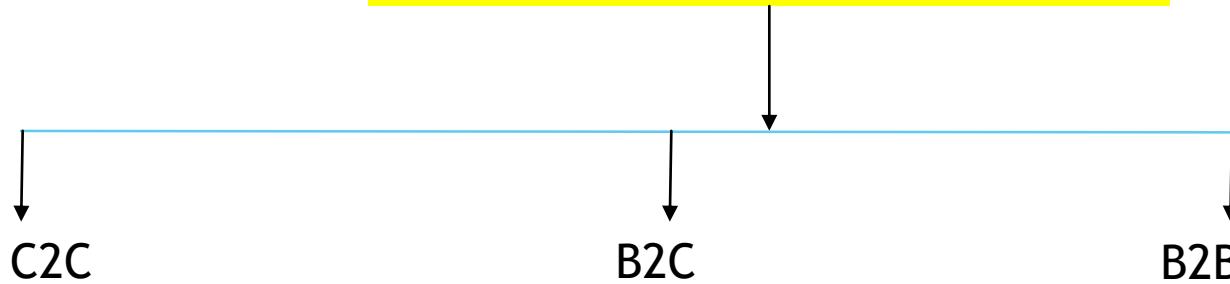
OLA

What is E-commerce

- No standard definition of the term E-commerce specified under any law
- Denotes a method of conducting business through electronic means
- Includes act of purchasing goods and / or availing services through online platform along with associated activities such as:
 - Delivery
 - Payment facilitation
 - Supply chain & service management

Business Models under E-commerce

Modes of e-commerce transactions



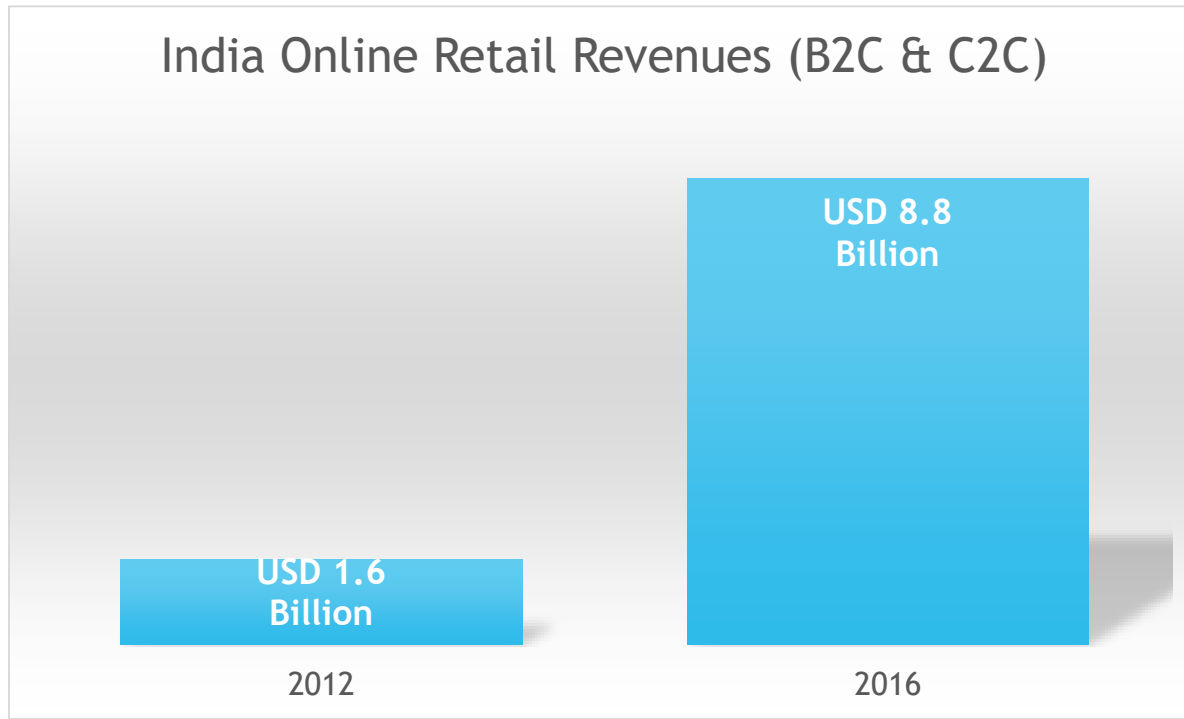
- Online classifieds
- Online retail

- Online travel
- Online retail/e-tailing
- Online classifieds
- Digital downloads
- Financial services

- Online classifieds

E-commerce Industry in India

- More than 3 billion internet users in the world
- Out of this, India has more than 260 million internet & broadband subscriber.
- E-commerce revenue in India will increase by more than 5times by 2016



Legal Validity of E-commerce transactions in India

- Online/e-contracts are governed by the Indian Contract Act, 1872
- Important requirements of a valid contract under the Indian Contract Act:
 - Free consent
 - Lawful consideration
 - Competence to contract
 - Object should be lawful
- Consideration or object of a contract is unlawful when (Sec 23):
 - Forbidden by law
 - Contract defeats provision of any law
 - It is fraudulent
 - Involves or implies injury to the person or property
 - Court regards it as immoral or opposed to public policy
- LIC v. Consumer Education & Research Centre: 1995 AIR 1811 & Lily White v R Munuswami: AIR 1966 Mad 13

Taxable Jurisdiction

- ▶ **Physical jurisdiction** not possible to derive in most of the e-commerce transactions as transactions carried out through satellite and networks.
- ▶ Even **Physical Presence (182 days rule)** is challenged as a person visits a country many times through virtual presence ??
- ▶ In E-commerce situations, with transactions being completed in cyberspace, it is often not clear as to the place where the transaction is effected, giving rise thereby to difficulties in implementing source rule taxation.

Main Issues

- ▶ **Characterization of Income**
- ▶ **Existence of PE in India**

Characterization of income

Business
Income

Royalties

FTS

Note: In case, characterization of Income is not in consonance with international principles, the income may be subject to double taxation (in absence of availability of credit of taxes paid in India).

Permanent Establishment (PE)

➤ PE where Server is Located

- Generally outside India in a Low Tax Jurisdiction

➤ Server rented from a 3rd Party

- Website hosted on server of 3rd Party shall not result in PE

➤ Observations of Indian Tax Authorities on OECD

- Website hosting may create a PE and may be considered as having a 'place of business
- Online bookings and reservation taxable in the country where booking fee is received from the customer

BEPS & E-commerce

- OECD has, under Action Plan I in Base Erosion and Profit Shifting (BEPS) recommended various measures to tackle taxation challenges in digital space including:
 - Modification of definition of PE to includes the digital services provided by an enterprise in another country if it maintain significant digital presence in the economy of the recipient.
 - Creation of PE when the enterprise maintains a website on a server of another enterprise located in a jurisdiction.
 - Introduction of an Equalization Levy under the domestic laws to equalize tax burden on remote and domestic supplier of similar goods and services.
- The Finance bill 2016 has introduced a new chapter titled Equalization Levy which is discussed in the subsequent slide.

Equalization Levy

- Every resident person and foreign company [having a PE in India] to withhold equalization levy on payments made to non-resident service provider for specified services.
- Equalization levy to be withheld at the rate of 6% on gross consideration payable to the non-resident
- Specified services include:
 - Online advertisement
 - Any provision for digital advertising space or nay facility/service for the purpose of online advertisement
 - Any other service which may be notified later by the central government

Equalization Levy

- Applicable on B2B transactions if aggregate value of consideration exceed value of Rs. 1 lacs.
- Service recipient to file an annual statement in respect of services received.
- Income from above services exempt in hands of non resident u/s 10(50)
- It is applicable from 1 June' 2016
- Disallowance of entire expenditure in case of failure to withhold tax
- No Foreign Tax Credit will be available to Non-Resident

CASE STUDIES

The background features abstract, overlapping geometric shapes in various shades of blue, ranging from light sky blue to deep navy blue. These shapes are primarily located on the right side of the frame, creating a modern, dynamic feel. The text 'CASE STUDIES' is centered horizontally and underlined with a thin blue line.

Yahoo India (P.) Ltd. Vs. DCIT. [2011] 11 taxmann.com431(Mum.)

▶ Facts:

- a) Yahoo, HK provides internet services and marketing solutions on its HK portal such as banner, advertisement and microsite hosting services.
- b) Indian advertiser entered into contract with Yahoo India to approach Yahoo, HK for providing uploading and display of banner advertisement on Yahoo, HK portal.
- c) Yahoo India hired the services of Yahoo, HK for hosting banner advertisements and made payments without withholding any tax
- d) **Revenue Contention:** Payment for use of industrial commercial and scientific equipment taxable as royalty- tax should have been withheld.
- e) **Assessee's Contention:**
- f) No possession or control over equipments (portal of Yahoo HK)
- g) Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

Contd.....

- ▶ It was held by the Hon'ble ITAT that:
 - ▶ **Banner advertising hosting services did not involve use or right to use any industrial, commercial or scientific equipment.**
 - ▶ Yahoo, India had no right to access the portal of Yahoo, HK and nothing to show any positive act of utilisation or employment of the portal
 - ▶ Availing benefit/ taking advantage of an equipment cannot be construed as 'use' or 'right to use' of an equipment.
 - ▶ **Payment in the nature of business profit – not taxable in the absence of any PE of Yahoo, HK in India**
 - ▶ Relied on Delhi HC ruling of Asia Satellite telecomm. And AAR ruling in Dell International services & ISRO satellite centre

People Interactive (India)

[I.T. Appeal Nos. 2179 to 2182 (Mum.) of 2009, dated 29-2-2012]

▶ Facts of the case:

- People Interactive, owner of matrimonial website
- Rackspare Inc., US provide following services:
 - Dedicated server and support team
 - Security of data stored on server
 - Bandwidth provision
- **No tax was withheld** on payments made by People Interactive for above services in the absence of Rackspare Inc.'s PE in India
- **Revenue's contention-** Payment for use of industrial commercial and scientific equipment taxable as royalty- tax should have been withheld
- **Assessee's contention-** Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

Contd

ITAT Decision

- People Interactive does not operate or have physical access to, or control of, the equipments
- All equipments and machines relating to the services provided under the control of Rackspare Inc. and situated outside India
- Not 'using' equipments but merely availing services by Rackspare- payment for such services ***not 'royalty'*** as per the India- USA DTAA and the Act (***judgment prior to the amendment***)
- Such payments not taxable as business profits as Rackspare Inc. ***does not have a PE in India***
- Relied on Delhi HC ruling in Asia Satellite Telecommunication Co. Ltd.

Payment for website hosting not taxable as 'Royalty'

Pinstorm Technologies Pvt Ltd.

[2012] 24 taxmann.com 345 (Mumbai)

Facts of the case:

- ❖ Pinstorm is engaged in business of digital advertising and internet, marketing; **buy space on internet search engine-** Google, Yahoo, etc.
- ❖ Pinstorm **books certain 'key words'** on search engine; advertisements of Pinstorm or its clients are displayed when specific key word is searched on Google
- ❖ Google, Ireland renders online advertising services from Ireland; invoice and payment for such services made online
- ❖ **No taxes withheld** on payment to Google, Ireland for availing advertising services
- ❖ **Revenue's contention-** services rendered by Google are in nature of 'technical service'/ royalty- tax should have been withheld
- ❖ **Assessee's contention-** payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

ITAT Decision

- ❖ Decision of Yahoo India followed
- ❖ Payment to Google, Ireland in the nature of business profits and not 'royalty'
- ❖ In the absence of PE of Google, Ireland in India, business profits not taxable in India

Payment for uploading and display banner advertisement services not 'royalty'

E Bay International AG

[2012] 25 taxmann.com 500 (ITAT-Mum.)

Facts of the case

- E-Bay International AG, a Switzerland based company, provides platform for *facilitating purchase & sale of goods and services to Indian Users*
- E- Bay AG received *user free from sellers* on successful completion of sale through its website- not offered to tax as Business profits, claiming no PE constituted in India
- Entered into marketing support agreement with E-Bay India and E- Bay Motors (group companies) for availing *support services* in connection with its India specific websites
- E- Bay India provided only marketing support services and was responsible for collection of user fees from sellers on behalf of the E- Bay AG
- **Revenue's Contention-** Income taxable in India as- services rendered in nature of *managerial/ technical/ consultancy* and taxable as per Indian DTA; group companies are in form of *dependent agent PE*

Contd

ITAT Decision

- Providing a platform for conducting business not managerial or consultancy services- ***no consultancy provided by E- Bay India at any stage***, either to the buyer or the seller.
- Such services not technical in nature- only involves ***provision of standard facility***
- E- Bay India ***not involved in finalization*** of transactions between buyers and sellers, does not maintain any stock of goods; or carry any processing of goods for E- Bay AG, hence not a DAPE under the Indian Switzerland DTAA- Business Profits not taxable in India
- Group Companies have ***no role*** in maintenance or operation of the websites and entering into online business agreements; hence do not form Place of management of E- Bay AG;'s India business

User fee not taxable as FTS; Group companies do not constitute PE in India

Right Florists P. Ltd.

[2013] 32 taxmann.com 99 (Kolkata - Trib.)

Facts of the case

- ❑ Assessee is a florist- uses advertising on search engines Google & Yahoo to generate business
- ❑ Makes **payment in respect of online advertising** to Google, Ireland and Yahoo, US
- ❑ **Does not include withhold taxes** from these payments and claimed deduction
- ❑ Server of Google is in Ireland **located outside India**- they have no presence in India
- ❑ Advertisements services provided in a purely automated manner using algorithms and codes without human intervention
- ❑ **Revenue's contention**- Whether or not income was taxable in India, assessee should have approached the AO u/s 195 of the TDS
- ❑ **Assessee's contention**- Payment made was in the nature of business income of the recipient; not taxable in absence of PE in India

ITAT Decision

- ❑ Payment made to Google and Yahoo for uploading and display of banner advertisement is business profit and not in the nature of 'royalty' – followed **Pinstorm**
- ❑ Search engine- present only through a website cannot be treated as PE under basic rule, **unless web servers are also located in India**- Business profits not taxable in India
- ❑ Online advertising services rendered by search engines completely **automated and without human intervention**- payments cannot be taxed as FTS under the Act
- ❑ Payments received by Yahoo, US not taxable as FTS under India- US DTAA since, advertising services **do not make available any technology**
- ❑ India' reservations on "website PE" in OECD Commentary were not relevant in judicial analysis
- ❑ A search engine having its presence only in the form of website cannot create PE, unless its web servers are also located in the relevant jurisdiction

Payment for uploading and display banner advertisements services is not regarded as 'royalty' and/ or 'FTS'.

Verizon Communications, Singapore

[2013] 39 taxmann.com 70 (Madras)

Brief facts of the case:

- ❖ Assessee company is engaged in the business of providing international connectivity services (bandwidth services or telecom services) to customers in India for transmission of data and voice;
- ❖ The assessee provided a dedicated private link to transport voice data and video traffic between the office in different Countries. Assessee provided international registration and VSNL provided local leg;
- ❖ Assessee used its equipment situated outside India for International leg
- ❖ The AO held that payment received by the assessee was taxable as 'royalty' for use of or right to use of commercial and scientific equipment under the Act and treaty
- ❖ ITAT confirmed AO's action and observed that as the agreement, the customer acquired significant, economic or possessory interest in the equipment of the assessee to the extent of the bandwidth hire by the customer. This was made available to the assessee on a dedicated basis. Thus, payments were for use of equipment as well as for the purpose.

❖ **Contention of the Assessee:**

- ❖ Service agreement- not royalty
- ❖ Customer does not get right to use equipment or attain any knowledge
- ❖ Relies on Sky cell, Asia Set and Dell International, Cable & Wireless, BSNL etc.

❖ **Hon'ble High Court Held that:-**

- ❖ Rejected that transactions only involve rendition of services
- ❖ Explanation 5 gives a very expansive meaning to Royalty. Thus, rendition of services through equipment (irrespective of use, control etc.) were for royalties
- ❖ ***Payment is also for the use of "process" per Explanation 6, and is royalty as per treaty***

Observations made by Hon'ble High Court

“ In any event, in a virtual world, the physical presence of an entity has today become an significant one; the presence of the equipment of the assessee, its rights and the responsibilities of the assessee, vis-à-vis the customer and the customers' responsibilities clearly show the extent of the virtual presence of the assessee which operates through its equipment placed in the customer's premises through which the customer has access to data on the speed and delivery of the data and voice sent from one end to the other. The Explanations inserted thus clearly point out that the traditional concepts relating to the control, possession, location on economic activities and geographic rules of source of income recede to the background and are not of nay relevance in considering the question of dealing with issues arising on account of more complex situations brought in by technological developments by the use of and role of digital information, goods etc., the foreign enterprise does not need physical presence at all in a country for carrying on business. Hence, we don't think that we need to go in depth in this regard for the reason that we have already given herein before.”

Key observation in Verizon...

- ▶ Services do not involve use or right to use of any industrial, commercial or scientific equipment
- ▶ No managerial, technical or consultancy services provided
- ▶ No right to access portal/ physical equipment of foreign company
- ▶ No PE of foreign company in India
- ▶ A search engine having its presence only in the form of website cannot create PE, unless its web servers are also located in the relevant jurisdiction
- ▶ Changes in 'royalty' clause in IT Act vis-à-vis tax treaty provisions?
- ▶ Virtual presence vis-à-vis physical presence.

Reuters Transaction Services Ltd. V. DDIT(IT)

[2014] 47 taxmann.com 10 (Mumbai - Trib.)

- ▶ Where assessee, a non-resident company, allowed clients to use its software and computer system to have access to its portal for finding relevant information and matching their request for purchase and sale of foreign exchange, it amounted to imparting of information concerning technical, industrial, commercial or scientific equipment work and payment made in respect of same would constitute 'royalty' taxable in terms of article 13(3) of India-UK DTAA

Viacom 18 Media (P.) Ltd. V. ADIT (International Taxation)

[2014] 44 taxmann.com 1 (Mum-Trib.)

- ▶ Payment of fees for use of satellite transponder service by assessee to US company taxable as 'royalty', under article 12 of India-US DTAA

ADIT v. Antwerp Diamond Bank NV Engineering Centre

[2014] 44 taxmann.com 175 (Mumbai-Trib.)

- ▶ Belgium based bank, having obtained a licence to use software, allowed its Indian branch to use same software by making it accessible through server located at Belgium, amount reimbursed by branch on pro rata basis for use of said resources was not liable to tax in India as royalty under section 9(1)(vi) or article 12(3) of India-Belgium DTAA

Standard Chartered Bank v. Dy. DIT (IT)

[2011] 11 taxmann.com 105 (ITAT-Mum.)

- ▶ There is no control or physical access to equipment used for data processing and it cannot be said that payment is made for use or right to use equipment. Assessee was a non-resident company carrying on business of banking in India through its various branches. It entered into an agreement with Singapore based company (S) for providing data processing support from outside India to be used for its business in India. Under agreement, S required to make available disc space capacity in its Singapore data centre for exclusive use by assessee.
- ▶ Amount payable by assessee to S is not 'Royalties' or 'Fees for technical services' within meaning of article 12 of Treaty
- ▶ Amount payable in nature of Business income and since S did not have any PE in India, same were not taxable in India as per article 7 of the DTAA
- ▶ **Therefore, amount payable by assessee as data processing charges to S was not liable to tax in India.**

Cargo community Network Pte Ltd

289 ITR 355[2007] / 159 TAXMAN 243 (AAR - New Delhi)

- ▶ Applicant, a NR Co., has its registered office at Singapore- it is engaged in business of providing access to an internet based Air cargo Portal- An agent who books cargo through various airlines can subscribe for said portal, which, enables him to access data bank of airlines like flight schedules, availability of cargo etc.- For this service applicant charges subscription fee, system connects fee and help desk support fee, etc.- It is found that payments are made by cargo agent ('resident') in India for use of portal developed by applicant and hosted on his server in Singapore; portal is displayed on computer screen of cargo, and acceptance of connected airline is conveyed in India and, therefore, use of commercial equipment is made by Indian agent / subscriber to applicant for providing a password to access and use portal hosted from Singapore are in nature of royalties and fees for technical services and taxable under article 12 of DTAA as also u/s 9 and subject to deduction of tax at source- **Held Yes**

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