Government imposes equalisation levy of 6% on online ads

Finds a way to tax companies like Google, Facebook

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The government has found a way to indirectly tax companies such as Google and Facebook, a development which could set the stage for taxation of cross-border digital transactions and potentially drive up costs for advertisers.

Instead of a straight tax on digital advertising platforms, the government has come up with what it calls an "equalisation levy" of 6% on the fees that advertisers pay.

The 'equalisation' happens because the government is supposedly levelling the playing field and making companies such as Google and Facebook pay for the money they make from local advertisers.

The nub of the issue is that multi-national digital platforms don't have "permanent establishments" in the country, which would make them liable to pay tax in India. And they cannot also be double-taxed, which means that the government has had to find a way of earning something from the profits that these platforms have been making.

In his Budget speech on Monday, Finance Minister Arun Jaitley said that payments of over Rs 1 lakh a year for online advertising to "foreign ecommerce companies" without permanent establishments would attract a levy of 6%. What this means is that depending on bargaining power, the burden would have to be borne by Google et al, the advertiser, or both.

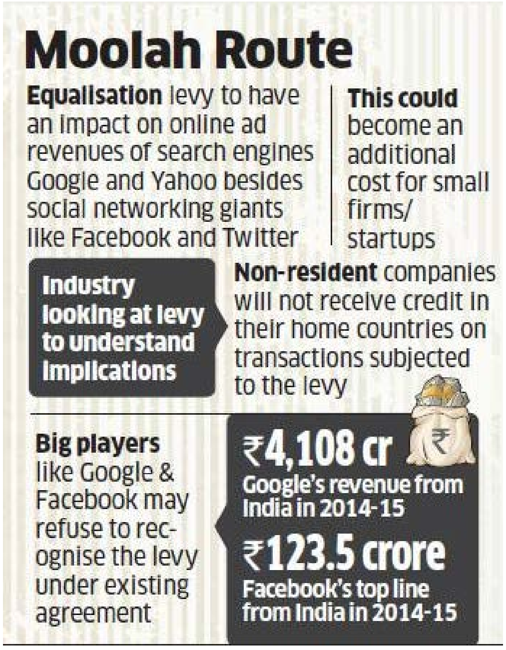
Google's revenue from India was Rs 4,108 crore in 2014-15, according to disclosures by the company. Facebook's top line was Rs 123.5 crore in the same period.

Google said it is reviewing the proposed levy. Facebook, Microsoft, Yahoo and Twitter did not respond to email requests for comment. The Internet and Mobile Association of India, the industry body representing internet companies, said it is "looking into" the impact of the levy with member companies.

The issue of taxing companies such as Google has been vexing tax authorities in several countries, and recently erupted into a controversy in the United Kingdom.

By completing its transaction in the Irish capital Dublin instead of in the UK, Google was paying negligible amount as tax in a country where its revenue topped $6.5 billion. Recently, the US-based search giant agreed to pay $185 million in back taxes to the UK.

Tax experts said that the levy is a result of co-ordination between the rich OECD countries and the G20 grouping which includes India. The move by the government comes at a time when the online advertising market is set to explode, with both old-economy companies and startups looking to increase spends in the space.



Goldman Sachs has forecast that the digital ad spending will grow to $15 billion by fiscal 2030 from $500 million now, driven by mobile advertising.

Though the minister mentioned ecommerce companies in his speech, the levy is likely to cover "payments to large ad exchanges as well as ecommerce companies that are located outside India, as these are the entities that are heavily involved in online advertising", said Chetan Nagendra of law firm AZB & Partners.

While the intention of the government may be to tax online companies, the levy could actually end up being a cost to small Indian businesses which advertise on these platforms.

"Startups tend to be very reliant on these online advertising platforms, and a levy of this sort may have a more adverse impact on them than it would on the Facebooks and Googles of the world," said Shreya Rao, founder of the Law Offices of Shreya Rao.

Tax authorities have been on the lookout for revenue from digital platforms, and one of the cases where this issue has been spotlighted is between the tax department and Right Florists Limited at a Kolkata Tax Tribunal.

In that case, tax officials asked the Kolkata-based merchant why it didn't withhold tax on payments made for online advertisement on search engines of Google Ireland Ltd and Overture Services Inc USA (a Yahoo entity) in 2006.

According to a note by law firm Nishith Desai Associates on this development, the tribunal ruled in favour of Right Florists in 2013 stating that "such payments were not taxable in India because such payments would not be considered to be fee for technical services in the absence of human intervention in the course of provision of services."

With legal backing for its position, the concern is that the government could go one step ahead and expand the scope of the levy.

"The government has the power to expand the list of services on which the equalisation levy will be charged and it will not be surprising if tax is levied on more services, including software services, in future," said Rajesh H Gandhi, partner, tax, Deloitte Haskins & Sells.

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