

Tax Hotline

November 22, 2016

CROSS – BORDER ONLINE SERVICES NOW SUBJECTED TO SERVICE TAX: FOREIGN SERVICE PROVIDERS TO BE AFFECTED

- Cross-border B2C online information and database access or retrieval services (OIDAR) made taxable; B2B OIDAR services taxable on reverse charge.
- OIDAR services expanded to include internet advertisements, cloud services, e-books, movies, music etc.

On November 9, 2016, the Central Board of Excise and Customs (“**CBEC**”) released four service tax notifications¹ (“**Notifications**”) which will come into effect on December 1, 2016. The Notifications have amended the Place of Provision of Services Rules, 2012 (“**PPS Rules**”) whereby online information and database access or retrieval (“**OIDAR**”) provided by a person located outside India to a person located in India which were earlier not chargeable to service tax in India, will now be taxable services. Further, the definition of OIDAR services under Rule 2(l) of the PPS Rules has been amended and made more illustrative to include services such as “advertising on the internet”, which were earlier not considered as OIDAR services. These Notifications have been elaborated and explained in Circular No. 202/12/2016-Service Tax, dated November 9, 2016 (“**Circular**”).²

POSITION UNTIL DECEMBER 1, 2016

Currently, applicability of service tax on a service depends primarily on two factors –

1. Whether the service falls under the ‘negative list’ provided under Section 66D of the Finance Act, 1994 (“**FA 1994**”).³ All services except those under the negative list are taxable.
2. Whether the service is provided in the ‘taxable territory’, i.e., India except the State of Jammu and Kashmir. The place of provision of a service is determined as per rules set out in the PPS Rules. A service is taxable in India if its place of provision is in India as per the PPS Rules. Generally, the place of provision of a service is the location of the service recipient (“**General Rule**”), subject to specific exceptions under Rules 4 to 12 of PPS Rules.⁴

At present, all cross-border B2C (business to consumer) services are exempt from service tax. These are services provided in India to the Government, local authority, governmental authority or an individual, in relation to any purpose other than commerce, industry or any business or profession. On the other hand, as per Notification No. 30/2012-Service Tax (“**Reverse Charge Notification**”), cross border B2B (business to business) services are taxable under a reverse charge, i.e., the service recipient is liable to pay service tax. In view of Rule 9 of the PPS Rules, OIDAR services (among others) have been specified as an exception to the General Rule and are deemed to be provided at the location of the service provider. Hence, all cross-border OIDAR services provided to Indian residents, whether they are B2B or B2C services, were exempt from service tax.

Further, OIDAR services are defined in Rule 2(l) of the PPS Rules as “*providing data or information, retrievable or otherwise, to any person, in electronic form through a computer network*”.

POSITION AFTER DECEMBER 1, 2016

(a) Place of Provision of OIDAR services

The place of provision of OIDAR services will be as per the General Rule, i.e., at the location of the service recipient (and not the service provider). Hence, cross-border OIDAR services provided in India shall no longer fall under Rule 9 of PPS Rules and accordingly, be taxable.

(b) Exemption for B2C services

The exemption which is currently available to all cross-border B2C services provided in India has been removed for cross-border B2C OIDAR services.

(c) Reverse / Forward charge

By amendments in the Service Tax Rules, 1994 (“**ST Rules**”) and the Reverse Tax Notification, cross-border OIDAR services provided in India are made taxable under a reverse charge in case of a B2B service, and a forward charge in case of a B2C service.

Further, for any cross-border OIDAR service, the service recipient shall be deemed to be located in India if any of the two specified non-contradictory conditions are satisfied. These conditions relate to presence of certain factors in India including recipient’s address as presented by him via internet, issuance of his credit card debit card etc., his billing address, internet protocol address of device used by him, etc.

(d) Intermediary service

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If an intermediary such as an electronic platform, broker, agent etc. located outside India facilitates the provision of a cross-border B2C OIDAR service without providing the main service on his account, such intermediary shall be deemed to be receiving such services from the service provider outside India and providing such service to the customer in India, therefore being liable to pay service tax on a reverse charge basis. However, this deeming fiction won't apply if the intermediary successfully establishes that he is merely an intermediary by satisfying some specific conditions which are - (i) the intermediary's invoice to the customer clearly identifies the service in question, the main service provider and his service tax registration in India; (ii) intermediary neither collects or processes the payment in any manner nor is responsible for payment between the service provider and recipient; (iii) the intermediary does not authorize delivery; and (iv) the general terms and conditions are set by the service provider and not by the intermediary. On satisfaction of all the above conditions, the liability to pay service tax will fall on the main service provider.

(e) Definition of OIDAR service

OIDAR services have been assigned the same meaning as under clause (ccd) of sub-rule 1 of Rule 2 of the ST Rules, which defines OIDAR services as services which are delivered through the medium of information technology over internet or an electronic network, and by nature they are completely automated services involving minimal human element, to the extent that their delivery cannot be ensured in the absence of information technology. This is a departure from the current understanding of OIDAR services. The definition further provides that OIDAR services include -

1. advertising on the internet;
2. providing cloud services;
3. provision of e-books, movie, music, software and other intangibles via telecommunication networks or internet;
4. providing data or information, retrievable or otherwise, to any person, in electronic form through a computer network;
5. online supplies of digital content (movies, television shows, music, etc.);
6. digital data storage; and
7. online gaming.

The Circular further elaborates the new meaning of OIDAR services and provides an indicative list of OIDAR services which includes website and web-page hosting, distance maintenance of programmes and equipment; remote systems administration; supply of software and updating thereof; supply of music, films and games, images, text and information etc.

However, the Circular also states that using the internet or some other electronic means of communication just to communicate or facilitate the service does not always qualify as an OIDAR service. An indicative list of non-OIDAR services includes supply of goods, where the order and processing is done electronically, supply of physical books, newsletters etc., services of lawyers and financial consultants advising over email, booking services for entertainment events, hotel accommodation etc., advertising services in newspapers, posters and television.

ANALYSIS

This notification is a significant expansion in the service tax base to include online services. All cross-border OIDAR services, whether B2B or B2C, have now been made taxable by deeming their place of provision to be the location of the service recipient. Below is a tabular summary of the changes made by the Notifications –

Type of Service	Service [Cross-border]	After Notifications			
		Before Notifications		w.e.f. December 1, 2016	
		Taxable / Exempt	Taxing Mechanism	Taxable / Exempt	Taxing Mechanism
B2C	OIDAR services	Exempt	Exempt	Taxable	Forward charge
B2C	Other than OIDAR services	Exempt	Exempt	Exempt	Exempt
B2B	OIDAR services	Exempt	Exempt	Taxable	Reverse Charge
B2B	Other than OIDAR services ⁵	Taxable	Reverse Charge	Taxable	Reverse Charge

There has been a significant change in the definition of OIDAR services. The earlier definition has been explained in an Education Guide published by CBEC⁶ as services in relation to online information and database access or retrieval or both, in electronic form through a computer network. As per the Education Guide, the earlier definition covers services such as web-based services providing access or download of digital content, social networking sites, digitized content of books, subscription to online newspapers and journals, online news, flight information and weather reports, etc.

However, after the Notification, potentially all automated services involving minimal human element provided over internet would come under the blanket of OIDAR services, which as per the new definition also specifically includes “advertising on the internet”.⁷ Further, the old definition of OIDAR only forms one of the 7 items of the inclusive list [item (iv)] provided in the new definition, which includes additional services such as online gaming, cloud services, digital data storage, online supplies of digital content, etc. Moreover, as per the Circular, while purchase and automated delivery of digital content would be an OIDAR service, supply of tangible goods where the order and processing is done electronically will not be covered under OIDAR services.

The expansion of service tax net is in line with the recommendations for addressing indirect tax challenges in a digital economy suggested by the OECD in the Action Plan of its flagship project on Base Erosion and Profit Shifting (“BEPS”). The

Action Plan 1 suggests that cross-border digital services should be taxed in accordance with the destination principle in the country in which the consumer is located. Hence, this confirms to global consensus at taxing online services in the destination jurisdiction.

The expansion of service tax base has surprisingly been done by the Indian Government only a few months before its aspired date for rolling out the Goods and Services Tax ("GST") Regime which will entirely subsume service tax. The Draft Model GST Law released by the Government in any event has a sufficiently wide tax base to potentially cover all cross-border online services.

It is also relevant to mention the impact of the new Equalisation Levy ("Levy") on the expanded scope of service tax. The Levy which is introduced as a 6% tax on gross payments made by Indian businesses to non-resident enterprises on online advertisements overlaps with service tax. This overlap may be significantly wider in the future because the Levy may potentially be expanded to cover many more online services such as cloud services, provision of e-books, movies, online gaming etc.⁸ Hence, there is a case to be made for repealing the Levy in light of the fact that the services it seeks to cover have already been covered under service tax.

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You can direct your queries or comments to the authors

¹ No. 46/2016-ST, 47/2016-ST, 48/2016-ST and 49/2016-ST, all dated November 9, 2016.

² Available at <http://www.cbec.gov.in/htdocs-servicetax/st-circulars/st-circulars-2016/st-circ-202-2016>

³ There is no separate legislation for service tax. The law relating to service tax is governed by the FA 1994 and rules and notifications issued thereunder.

⁴ Rule 3, PPS Rules

⁵ These don't include services which along with OIDAR are specific exceptions to the General Rule under PPS Rules.

⁶ *Taxation of Services: An Education Guide*, June 20, 2012, CBEC, Department of Revenue, Ministry of Finance, Government of India. Available on <http://www.cbec.gov.in/resources/htdocs-servicetax/EducationGuide.pdf>

⁷ While cross-border online advertising was taxable before the Notifications as well, it has been brought under the blanket of OIDAR.

⁸ According to the "Report of the Committee on Taxation of E-Commerce" which recommended the introduction of the Levy.

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