The Challenges of Taxing E-Commerce

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ABSTRACT

E-Commerce all over the world succeeded in capturing the mind and attention of the consumers like never before and with an extraordinary pace of growth, is expected to take up the shape of a gigantic industry in years to come. However, International tax arrangements find it difficult to keep pace with globalization and market liberalization especially with issues like taxing E-Commerce. A new business style was emerged to use integrated cyber networks with no boundaries. E-Commerce developed a unique code of conduct in business strategies underlying real time management and techniques with an exceptional reach. Therefore, developing a comprehensive and rational tax policy would require a clear and better understanding of the industry, challenges faced by the taxing authorities and peculiarities of Internet. The paper pronounces the phenomenal growth of E-Commerce across the world including India and evaluate the challenges faced by legal and tax system with regard to E-Commerce. The paper also takes in account various tax reforms initiated by India to keep track of outstanding growth of E-Commerce industry in India.

Keywords: E-Commerce, Technological advancements, International taxation arrangements, Challenges, Rational tax policy.

INTRODUCTION:

E-Commerce with all its new code of conduct and business practices has revolutionized the mode of conducting business worldwide. The concept of product creation, marketing, business processes, organizational structure including functional areas of business has been taken over by technological advancement using intranet, internet, electronic money transfer systems and electronic data interchange. With EC, companies now a days trade with “just in time production” and “just in time delivery”, to enhance their customer base and competitiveness globally. There is no universal definition of EC. According to European Commission “E-Commerce encompasses more than the purchase of goods online. It includes a disparate set of loosely defined behaviors such as shopping, browsing in Internet for goods, gathering information about items to purchase and completing the transaction like any other sustained business activity. It also means conducting consumer satisfaction surveys, capturing information about consumers and maintaining consumer databases for marketing promotion and other related activities”. With ever increasing pace of E-Commerce, the government all over the world including India struggled to frame a rational tax policy which not only takes into account the peculiarities of internet having no territorial jurisdiction but also the challenges pose by intangible nature of business transaction. However with the passage of time taxing authorities realized the need of understanding the basics of E-Commerce and designing tax policies to curb the most of tax evasion and bringing E-Commerce industry within the ambit of tax system.

LITERATURE REVIEW:

Indian Brand Equity (2018)¹, with the awareness of using internet, more and more people are being drawn to E-
E-Commerce. Whether it is sellers, buyers, users or investors, people have started getting used to online mode of commerce. Government initiatives like Digital India are constantly introducing people to online modes of commerce. The number of mobile internet users is expected to reach 478 million by June 2018 which will further boost the mobile commerce sector in India.

Indian council for research on international economic relations (2018)⁴ The WTO is the exclusive forum for negotiating and enforcing global rules governing cross border trade in goods and services. Studies have shown that the rule-based system covering goods, services, and IPRs can help ensure a predictable and transparent trade regime for E-Commerce (Wunsch-Vincent and McIntosh, 2005), and that it is not easy for member countries to roll back from commitments undertaken in the WTO. Global E-Commerce trade has seen fast growth, which is predicted to continue in the future. The sector is now discussed in various international forums, and a group of countries are exploring the possibility of open, transparent and non-discriminatory E-Commerce trade rules in the WTO.

Pandey P.K. (2017)⁵ As per GST law, E-Commerce means supply of goods or services or both including digital products over digital or electronic network and E-Commerce operator has been defined to mean any person who owns, operates or manages such digital or electronic platform for E-Commerce. Under GST regime every E-Commerce operator and every supplier providing their goods or services through E-Commerce compulsorily requires registration irrespective of threshold limit. Further where consideration is collected by E-Commerce operator on behalf of supplier, it is also required to collect tax at source (TCS) not exceeding 1% on net value of taxable supplies after adjusting the value of taxable supplies returned during the month.

Khosa.M and Kumar.H (2017)⁶ Another emerging trend in the E-Commerce market is acquisition of smaller firms by the market leaders, which helps to curb competition and ensures the survival of the fittest. The past years have been marked by significant acquisitions, which have enabled firms like Flipkart, Snapdeal, Olaf and others to grow inorganically. WeRead, Letsbuy.com, Myntra are some of the firms acquired by Flipkart. Snapdeal has made around 12 acquisitions since its inception.

Chanana N. and Goele S.(2016)⁷ E-commerce in India is still in growing stage, but even the most-pessimistic projections indicate a boom. It is believed that low cost of personal computers, a growing installed base for Internet use, and an increasingly competitive Internet Service Provider (ISP) market will help fuel e-commerce growth in Asia’s second most populous nation. The online retail segment is expected to report strong growth in the coming years owing to growing Internet consumer base thanks to increasing use of smartphones, laptops/PCs and availability of Internet in the remotest part of the country.

Panigrahi D. and Sarangi S.K.(2016)⁸ The Challenges of E-Commerce are manifold. Some of the conceptual challenges thrown by E-Commerce are how to characterize income and the approach towards residence-based and source-based taxation approaches. The worldwide nature of ecommerce transaction muddles the issue of ‘jurisdiction’ which is a principle tenet of taxation. E-commerce also challenges traditional company tax rules because businesses can sometimes exist almost totally in cyberspace, with communication tools/ technology being used to carry out interactions with directors or shareholders. Basically ecommerce challenges when, where and how taxation can be applied in an era where local markets are being transformed into global markets. Committee on Taxation of E-Commerce (2016)⁹ Technological advancements and cheaper innovations have ensured widening spread of these techniques to hitherto unexposed populations. Entrepreneurs across the world have been quick to evolve their businesses to take advantage of these changes. The digital means of doing business have perpetrated so fast that the Task Force on Digital Economy (TFDE) of the Committee on Fiscal Affairs of the OECD has commented in its report that the digital economy is fast becoming the economy itself.

Saxena.G (2015)⁶ The common perception of E-Commerce is that it is in an online shop similar to the shops we are familiar with in real space. In the past, companies typically engaged in producing and selling products or services. But with the advent of the Internet and cloud computing, more and more companies are implementing application ideas that allow communities of participants to interact and transact business. Well-known examples are Facebook, Skype, Google Maps and PayPal, Uber etc. are mushrooming every day.

Kirti and Agrawal N.(2014)⁹ The first and foremost approach towards dealing with such situations can be attributed to the Ottawa Conference on E-Commerce (1998) organized upon the behest of OECD. This conference was study the new emerging way of conducting business and to analyze, discuss and generalize some ways of dealing with the issues. In 2001 the O.E.C.D came out with a Discussion Paper on the aspect of applying the existing principles of double-tax treaties for taxation of business profits arising on account of e-commerce and based upon this discussion paper, the Committee of Fiscal Affairs in 2002 adopted a ‘Report on Treaty Characterization issues arising from ecommerce’.
The challenge that e-commerce launches is that it cannot determine a fixed location, because transactions are being carried out through websites hosted on servers in various locations (other than the business owners). The contract by electronic means does not require the simultaneous presence of the two parts involved - the trader and the consumer - electronic contract is regarded as a distance contract. It is therefore necessary to harmonize the global taxation system, as the rapid development of electronic commerce defies national tax system.

**RESEARCH METHODOLOGY & DESIGN:**

The paper broadly used an exploratory research technique based on past literature from respective journals, reports, newspapers and magazines covering extensive academic literature on taxation including GST. According to the objectives of the study, the research design is of descriptive nature. Available secondary data was extensively used for the study. The present study has been undertaken to comprehend extraordinary growth of E-Commerce along with the challenges faced by the taxing authorities with special reference to Indian perspective.

**Growth of E-Commerce in India:**

E-Commerce has changed the nature of conventional business practices in India. Since 2014, with the announcement of several initiatives by the Government like Digital India, Make in India, Start-up India, Skill India and Innovation Fund, E-Commerce industry has taken a big leap in the country. The E-Commerce has a direct impact on the micro, small & medium enterprises (MSME) in India. The Government of India launched an E-Commerce portal called TRIFED and M-commerce portal called ‘Tribes India’ so as to enable thousands of tribal artisans get access to international markets. Reserve Bank of India has also allowed “inter-operability” among Prepaid Payment Instruments (PPIs) such as digital wallets, prepaid cash coupons and prepaid telephone top-up card.

Three category of E-Commerce business model are prevalent in India viz. (i) Inventory base model (ii) Marketplace base model (iii) Hybrid model of inventory based and market place model. In India 100% FDI is permitted in B2B E-Commerce. As per new guidelines on FDI in E-Commerce, 100% FDI under automatic route is permitted in marketplace model of E-Commerce, which is not the case with inventory based model of E-Commerce. Marketplace operators are not allowed to hold inventory, influence prices of products and sell products on their platform rather they can only facilitate the process for other vendors.

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<tr>
<th>E-Commerce models</th>
<th>Leading companies</th>
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<tr>
<td>B2C E-Commerce marketplace</td>
<td>Snapdeal.com, Amazon.com, Flipkart.com</td>
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<tr>
<td>B2C E-Commerce inventory led</td>
<td>BigBasket.com, FirstCry.com, Zovi.com</td>
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<td>Omni-channel Retailers</td>
<td>Shoppers Stop Ltd., Infiniti Retail Limited Croma, Raymond Ltd.</td>
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Driven by growing smartphone penetration, the launch of 4G networks and increasing consumer wealth, the Indian E-Commerce market is expected to grow to US$ 200 billion by 2026 from US$ 38.5 billion in 2017.¹⁴

In Q1 2018, overall internet penetration in India was 38.02 per cent with urban areas mounted at 84.74 per cent and 16.41 per cent in the rural areas. Urban India with an estimated population of 444 million as per 2011 census, already had 348.13 million using the internet as of March 2018 as against Rural India having estimated population of 906 million as per 2011 census, has 145.83 million internet users.¹⁵

An interesting fact about E-Commerce in India is that it fascinates customers from Tier II and III cities having limited access to brands but have high aspirations. Nearly 60 per cent of Snapdeal’s purchases came from cities classified as tier II and III and same is the case with Flipkart having sales of branded products across categories as more of tier 2 and tier 3 Indian towns choose to shop online.¹⁵

**E-Commerce Industry in India (US$ billion)**

Source: Economic Times, PWC, Financial Express

![E-Commerce Industry in India](chart)

In just a decade of outstanding growth, the Internet has shown its far reaching capacity, appealing millions of consumers in a gigantic virtual shopping mall.

**E-Commerce and Taxation – An Overview:**

Electronic commerce is opening new ways of innovative business practices with broad economic and social implication. EC can broadly be classified into four of the major market segments viz. business to business, business to consumer, consumer to consumer and consumer to business. B2B (Business to business) E-Commerce comprises the online sale of products and services between companies as opposed to B2C (Business to Consumer), which deals in the online business transacted between a business and individual.
customers. Prices are generally fixed in B2C in contrast to B2B transactions where prices are highly variable. In C2B model, instead of business, customers now demanded a service for a price that they’re happy to pay and waited for a business (or freelancer) to fill the gap. C2C (Consumer to consumer), is the business model that enables commerce between private individuals. The most noticeable examples of C2C include eBay, an online auction site, and Amazon, which acts as both a B2C and a C2C marketplace. The Internet has challenged many of the fundamental concepts of direct and indirect taxation. Governments all over the World are struggling in coping with issues of taxing E-Commerce. This is because of lack of comprehensive understanding, communication technologies, complex nature and modus operandi of the business.

To formulate a rational tax policy one should understand the nature of E-Commerce industry. Some of the peculiarities of Internet are:

- It is a network of networks which cannot be controlled by one person.
- Data Transmission at an unmatched speed.
- User friendly graphical interface.
- Massive information on a single click.
- No territorial and geographical limitations
- Automated payments mechanism.
- The Internet can re-route itself if one computer is connected to the net.

Keeping these unique features of Internet in mind one can visualize the issues surrounding taxes on E-Commerce. Less than a year after Turku, OCED ministerial conference at the Ottawa entitled “A Borderless World – Realizing the potential of Electronic Commerce”, a global action plan for electronic commerce was prepared by business with recommendations for governments.

**Challenges of Taxing E-Commerce:**

In absence of boundaries and physical nature of transactions in goods and services, taxation of E-Commerce raises several issues.

**Tax Jurisdiction:**

As per traditional rules of determination of jurisdiction, the courts in a country have jurisdiction over individuals and/or to the transactions which occurs within the territorial boundaries of that country. One of the key administrative issues is the identification of the country or countries that have tax jurisdiction. Electronic commerce enables a distant person to initiate multiple transactions with customers in different countries without getting in touch with them. Since the supplier has no existence at all in the jurisdiction of the customer, establishing place of supply would not be an easy task. In addition to this, the development of WAP (Wireless Application Protocol) integrates mobile telephony with the Internet, making the place of origin of business invisible and post a real challenge to domestic jurisprudence.

**Permanent Establishment:**

Due to the intangible nature of transactions in E-Commerce, it is difficult to determine permanent establishment. Based on the existing tests of determining permanent establishment, the geographic location and ownership of web servers further complicate the matter. To tax E-Commerce transacted on the websites hosted on its webservers, hosting companies is required to have a “permanent establishment” status (a rule for determining the right of a state to tax the profits on an enterprise of another state). Websites comprises of databases and software do not constitute “real property” and therefore not considered to have permanent establishments of their own. For an Internet-based business to be accountable for taxes, possession of ownership or lease of the webserver is an essential criterion. However, the possibility of a quick transfer of website and its database to a webserver in another country poses a challenge for governments to easily track and collect taxes from Internet businesses having operations all over the world.

**Tax Collection:**

Web-based businesses which has an outstanding reach to the universe of customers at low cost, provides an opportunity for small companies to flourish with minimal start-up capital. According to Ernst and Young, a prominent accounting firm based in the U.S., the estimated cost of compliance of small businesses will be close to 87% of the sales tax they collect, in contrast to 14% of the tax collected by large businesses.
Tax competition:
It has been acknowledged that mobility of electronic commerce with its geographical advantage may aggravate harmful tax competition. While number of websites providing aggressive tax planning were identified, many of them appeared to be associated with a promoting organizations and often based in tax havens. Most of the sites were physically located on servers in other countries, may be because of bandwidth considerations or reliable telecommunication facilities. Growing technological advancement underlines the importance to all countries to curb harmful tax competition.

Confidentiality:
In general, the revenue legislation of most nations covers confidentiality provisions preventing their tax administration from revealing information regarding a taxpayer's tax affairs to another revenue authority. Therefore, secrecy laws act as a further barrier to cooperation and integration within tax authorities across the world. Even where secrecy provisions do not apply, fear of unwanted economic consequences such as capital outflows prevent authorities from making such disclosures.¹⁸

Intellectual Property Rights:
With E-Commerce platforms, the enterprise can make use of either proprietary or licensed technology. Often E-Commerce companies outsourced the designing of websites, platforms or content to third party which raises the issue as to who own the Intellectual property right(such as copyrights and trademark) in the design and functionality of the website and its content which could range from information to logos of third parties. Similarly providing links to other websites is also a concern that needs to be addressed. However, to beat the above challenges, corrective measures need to be initiated toward simplification of the international tax regime in close co-operation with government and business community across the world. A number of such options are as follows:
- Cross-border electronic invoicing.
- Verification of the declared jurisdiction of residence in B2C transactions.
- Practical and effective means of verifying the status of the recipient (business/consumer).
- Registration thresholds in minimal compliance of non-resident suppliers.
- Verification of technology-based collection mechanisms.
- Uniformity in International administrative co-operation.

Tax Incidence on E-Commerce - Indian Perspective:
The E-Commerce industry in India which was in infant stage until couple of years ago is in a flying mode today with an unprecedented growth is predicted to be the next big Industry. As reported by Forrester Research¹⁹, E-Commerce revenues in India is increased by more than five times by 2016, i.e. from USD 1.6 billion in 2012 to USD 8.8 billion in 2016. Currently 100% FDI (Foreign Direct Investment) is allowed under the automatic route (i.e., no Foreign Investment Promotion Board approval is required) in companies engaged in B2B E-Commerce.²⁰ Unfortunately, for the E-Commerce sector, the tax laws in India have been more of hindrance than a driver for growth until the inception of revolutionized Good and service tax in 2017. Therefore, it becomes important to judiciously structure E-Commerce business models so as to mitigate tax risks especially risk of taxation in more than one country.
Goods and Services Tax (GST) replacing the earlier indirect tax regime in India hold the key to unlock the issues faced by the E-Commerce sector. Under GST ‘E-Commerce operators’, or ‘marketplaces’ are required to collect tax at source from sellers at a notified rate. Marketplaces are intermediaries that provide a platform for sellers to showcase their products to potential customers. The term ‘electronic commerce operator’ includes any person who owns, operates or manages digital or electronic facility or platform for electronic commerce. Further, the definition of electronic commerce is inclusive with regard to digital products over digital or electronic network. Place of supply in B2C transactions would be the location of the service provider as against service recipient in case of B2B transactions. However no threshold exemption has been provided to the electronic commerce operator. E-Commerce companies are required to get themselves registration in each state where they have their place of business, leading to increased compliances. Both E-Commerce player and seller are required to mention invoice wise details of supplies in their respective returns and the GST system will match them accordingly and in case of any supply reported by platform not matched with the marketplace, unless reconciled, will be added to the liability of the seller. Under GST there will be restrictions on cross utilization of credit for the marketplace players, resulting in reduction of cascading effect of taxes, therefore
reducing the overall cost of supplies. Each Order or Invoice will now need to carry HSN (Harmonized System of Nomenclature) or SAC (Services Accounting Code) code. Place of Supply has to be determined, based on GSTIN for B2B and delivery address for B2C model.

However, with GST most of the issues regarding E-Commerce has been addressed, still lot more need to be done in terms of transparency, reporting and management of E-Commerce industry in India so as to match with the dynamic nature of the industry.

CONCLUSION:

E-Commerce has eliminated territorial boundaries and transformed the world into a global community during last two decades or so. The growth of E-Commerce has not only revolutionized the conventional business procedures and practices and makes the world into a gigantic global shopping mall but also tested the adequacy and traditional validity of international taxation principles which is in line with the basic canons of taxation. Cross-border E-Commerce poses new international challenges for tax authorities to check tax evasions and underlines the need for substantial administrative co-operation and guidelines to be evolved by the policy makers. To block undesirable facts like tax loss and tax evasion, countries are struggling to find certain and uniform solution as yet which is a matter of enquiry and research. However, E-Commerce leads to some of the major tax reforms which may curb the unethical and unlawful tax practices all over the world but still lot more need to be done with rapidly changing pace of innovative technological and business practices in the form of E-Commerce and M-commerce which is need of the hour for the most sensitive sector. After all for revenue generation, taxation is the only source, technique or mechanism in any economy.

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MEITY, http://meity.gov.in/E-Commerce (Ministry of Electronics & Information Technology)


Para 6.2.16.2.1 of the Consolidated FDI Policy 2014.


The existing tests for determination of PE are – Service PE, Fixed place of business PE, Agency PE, Warehouse PE, Construction, Installation and Supervisory PE.

Trends In India’s E-Commerce Market*: Report provided by Forrester Research for ASSOCAM’s 2nd National Conference on E – Commerce.


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