Taxation of E-Commerce Transactions in India: An Exploratory Study

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Abstract:
E-commerce means consumer and business transactions conducted over internet and which is one of the most expanding and profit making market in India. Now a day's every start up begins working on platform of e-commerce model. It includes online – trading, on line buying, on line payments, electronic fund transfer and electronic data exchange, exchange of all financial transactions. This paper is an attempt to understand the concept behind taxation rules governing online transactions and how government promote or licensed these ventures in India.

Keywords: *e-commerce, taxation, India, taxation laws*

1. Introduction

In truancy of national confines and physical nature of transacting in goods and services as in the scenario of traditional commerce transaction, taxation of activities of e-commerce raises several issues. With the receptiveness of internet across borders, e-commerce transactions may include consumers who are resident of more than one country. Therefore, income from such transactions may be taxed in more than one country. The policies framed by the Committee on Fiscal Affairs of the Organization for Economic Cooperation and Development ("OECD") highlighted neutrality; efficiency; certainty and simplicity; effectiveness and fairness; and flexibility as guiding principles for the taxation of e-commerce transactions.

In India, the High Powered Committee ("HPC") constituted by the Central Board of Direct Taxes, submitted a report in September 2001. The report studied and contemplated upon the requirement pertaining for introduction of a separate tax regime for e-commerce transactions. The report prepared by the HPC took into account the principles laid down by the OECD albeit with some exemptions. However, based on the principle of 'neutrality', the HPC maintained that the existing laws are sufficient to tax e-commerce transactions and no separate regime for the taxation of e-commerce transactions is required.
E-commerce sector is buzzing with deals and sales. But when it comes to taxation policy, the sector does not sizzle, especially on the Budget day.

2. Definition of e- Commerce

According to Greenstein and Ferman" electronic commerce (e-commerce) is defined as the use of electronic transmission medium (telecommunication) to engage in the exchange, including buying and selling of products and services requiring transportation either physically or digitally from location to location."

E-commerce is any negotiation completed over a computer-mediated network involving the transfer of ownership or rights to use goods or services. According to European Commission, e-commerce circumscribe more than making purchases of online products.It includes a discordant set of loosely defined behaviors such as shopping, browsing in Internet for goods and defined behaviors, accumulating data about items to purchase and completing the transaction like any other sustained business activity. It includes conducting consumer satisfaction surveys, capturing information about consumers and maintaining consumer databases for marketing promotion and other related activities.

The first phase of e-commerce threw up a new business nomenclature using various combination of business and consumers. It has its own pros and cons as with traditional business methods. Thus, e-commerce has necessarily changed the world economy in a dynamic and interactive pattern.

3. Taxation for Internet Transaction

The Internet overtime has bought changes in many of the fundamental and long established traditional concepts of direct and indirect **taxation**. Governments all over the World are grappling with the various issues of **taxation** raised by e-commerce. This is because of lack of comprehensive understanding of:

- The communication technologies
- The complex nature of business offered through Internet business, etc.
- The modus operandi of Internet business, etc. has made the operation of tax legislations more difficult.

The Information Technology Act, 2000, which is the first legislation to deal with e-commerce is quite silent about tax system. Substantial amount of state revenue which is generated through direct and indirect taxes is lost when Internet transaction remain untaxed. A way is to be found to tackle this relevant problem.

4. Basic Principles of Taxation

Taxation policies and structure varies from countries to countries and that what catters towards the complexities in measurement of these transactions. Several basic principles form the foundation of **taxation** policy in any country. The most important of these principles are efficiency, equality, certainty and positive economic effect. For the development of rational tax policy one should understand the nature of industry. Some of the peculiarities of Internet are".

- It is a network of networks and it cannot be controlled or owned by one person.
- This network of networks is capable of rapidly transmitting packets from one computer to another.
- No human involvement is necessary to transmit data from one computer to another.
- The Internet can re-route itself if one computer is connected to the net. Content wise the Internet is very rich.
- The world-wide web environment provides a user friendly graphical interface.
- A simple click is sufficient to obtain vast information anywhere in the World.
- It encompasses all territorial and geographical limitations

Internet activities are divided into two parts. One is "access service" and other is "content service". In the former, access to the Internet will be provided to the individuals whereas, in latter, content consisting of information are delivered electronically. To distinguish further Internet service provider is one who provides the service of accessing Internet whereas, online service provider (OSP) is one who provides service through Internet. The service is rendered by them in return for the payment of subscription and usage fees. These are subjected to tax. The Internet as discussed earlier encompasses content/material service, traditional retail transaction to an electronic medium, electronic commerce involving digital products. This would eventually create so many intellectual property problems.

4.1 Offline Transactions

The offline transactions describe any transaction where goods and service are ordered and possibly paid for electronically, but delivered by other means. The bulk of e- commerce is currently found in offline transactions. In contrast to the normal transactions, these offline transactions came by disintermediation. The practicalities of enforcing sales tax, customs duty differ between online and offline transactions. The tax authorities will need to re-think their current methods of tax collection, simplifying or streamlining procedure without threatening any revenue and other cross-frontier controls.

4.2 Online Transactions

The term online is used to describe any transaction that is delivered online. For tax authorities, these transactions are very difficult to handle. The problems with online transactions, as perceived by tax collecting authorities include:

- Inability to identify a transaction
- Encryption of transaction
- Collecting the tax from millions of end-users rather than a small number of intermediaries.
- Difficulties in determining where a product is produced or consumed.
- Definition of goods and services and
- Distinctions between types of services

Tax collecting authorities will be virtually powerless in identifying transaction between Indian consumers and overseas suppliers, where all of the transaction has been performed electronically including paying the money through electronic cash.

4.3 Encryption of Transaction

Powerful encryption technologies are now available to everyday Internet user and are expected to become commonly used in the next two to three years. These technologies allow users to encrypt all of the transaction so that only the parties involved can decrypt the information. This means that if the income tax officer or other tax authority is able to interrupt a transaction, he will not be able to read it or understand its content in order to identify whether the transaction involves accessible goods or not. The use of encryption technologies will not only be conducted by tax evaders but also by the most honest citizen who just wishes for his transaction to be secure collecting the tax from end users.

5. E-Commerce Taxation

The well -planned tax system in India with the authority to levy taxes is divided between the Central and State Governments.

- Central Government collects direct taxes like personal income tax, corporate tax
- State Governments collect local and state sales tax.

In India the tax policies should be carefully formulated based on a policy that is clear and transparent and is consistent with the international norm of characterisation of revenues. The Government should honor the principle of neutrality as laid down by the OECD in characterisation of income from e-commerce transactions.

6. OECD Report

The recent report of OECD paved way for a statement of broad **taxation** principles that should apply to e-commerce as reported in "The Economic Times" dated, 3rd June, 2000.

"All double **taxation** avoidance treaties to be reviewed". In sum and substance, same principles of conventional **taxation** should apply to e-commerce.

- **Neutrality - Taxation** should be neutral and equitable between different forms of e-commerce and thus, avoiding double **taxation** or international non-**taxation**.
- **Efficiency -** Compliance costs for business and administration costs for the Governments should be minimised as far as possible.
- **Certainty and Simplicity-**Tax rules should be clear and simple to understand so that tax payers know where they stand.
- **Effectiveness and fairness - Taxation** should produce the right amount of tax at the right time, and the potential for evasion and avoidance should be minimised.
- **Flexibility - Taxation** system should be flexible and dynamic to ensure that they keep pace with technological and commercial developments. These principles can be applied through existing tax rules and there should be no discriminatory tax treatment of e-commerce. The OECD ministerial conference held in Ottawa in October 1998 endorsed the principles summarized above.

7. Transfer Pricing

The OECD recognises that transfer pricing issues will be increasingly important in the e-commerce age. E-commerce is more collaborative and dispersed than traditional forms of commerce and its supply chain is intrinsically connected. It facilitates connectivity both intra-group and inter-group. Examining the totality of existing arena, it will be difficult in terms of determining appropriate transfer pricing to decide which business functions should carry greater weight particularly given that e-commerce has changed the way of intermediation and distribution of business flows to a significant extent. It is of no wonder therefore, that tax payers and tax collectors alike are struggling to determine which business functions are significant and then agree upon a suitable allocation of profits thereto.

8. Administration of Tax - Technological Challenges

It is a fine balancing act to legislate on the basis of an intellectual and equitable framework on the one hand and to take proper consideration of enforcement barriers and administrative particularities on the other. In action on the part of **taxation** authorities in today's e-business environment is simply not an option. **Taxation** authorities worldwide appreciate that obtaining information from taxpayers and related parties and ensuring tax compliance in an e-commerce world will be a mushrooming problem. Numerous questions arise in this regard:

a. How should transaction be kept and where?
b. What is the appropriate record keeping standard and how detailed should this be?
c. How should the constraints under various privacy and personal data laws be balanced with the need to ensure tax compliance?
d. It is feasible or appropriate to require an e-merchant to obtain a business registration in every place in which sales are made or services provided.
e. How parity treatment should be ensured between new e-merchants and old style catalogue houses that export goods from a remote location?

9. Challenges before Tax authorities

The general perceived wisdom, to which tax authorities universally appear to subscribe, is that their major challenges regarding e-commerce are:

a. Identifying the tax payer, especially when an Internet user is involved.
b. Identifying audit risks and developing audit trials to ensure compliance.
c. Obtaining access to verifiable information and documents.

d. Obtaining access to encrypted data
e. Developing a response to the advent of electronic money (e-cash) and ensuring efficient mechanism for collecting tax especially from non-resident tax payers.

There is a need for initial inter-government and multi-jurisdictional co-operation and agreement to synchronize the **taxation** treatment. **Taxation** authorities need to modernise their operation radically. There is a need to monitor cross-border business activities on the Internet. Authorities need to upgrade their technological knowledge.

10. Judicial Approach to Taxation Issues

The judiciary is caught in the middle of the tray, burdened with responsibility of interpreting the different types of software and bringing Order to their inherently conflicting treatment. They lack guidance from precedent or legislature. Rather in US, the state and federal taxing entities have not relied on consent policies of relations in their approach to software **taxation**, each entity has construed and classified software in the manner most advantages to its own safe. This results in the incompatible standards of tax treatment. Even in India, almost all states have their own taxing policies therefore, to reconcile them into a comprehensive legislation is a very difficult task.
Courts generally relied upon two principles in classifying software as intangible. They are :

a. Software as knowledge and
b. Software encompasses an array of services.

11. Tax Evasion and the Internet

Some of the Conventional tax evasion measures undertaken by companies are

- Shifting of profits to low tax Countries by transfer pricing.
- Allocation of costs operation artificially either against domestic profits or foreign profits depending on where the rates of tax are less favourable.
- Setting up conduit or intermediary companies outside the home country to process and channelise income from different foreign source.
- Establishing base companies in tax havens or legal domicle.

12. Conclusion

E-Commerce, still is in its growing arena, is not currently a major economic force but in all likelihood, will become the future of international commerce. The concrete tax rules applying specifically to the direct taxation of E-Commerce is few. There is little in the way of new rules or new laws to address the proper taxation of E-Commerce. On a larger perspective, the base of tax system should be widened. It should also be simple within the administrative capacity of the Government. The Government tries to enhance its revenue while tax payers oppose any increase in tax rates. Therefore, there has to be a line of demarcation which the Government will have to follow because exclusive taxes do not reflect positive indications for the growth of any economy and may act as hindrance for the people entering the Indian market.

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