

Research Report:

India Introduces 2% Equalisation Levy on Non-Resident E-commerce Operators

21 July 2020



Research Report

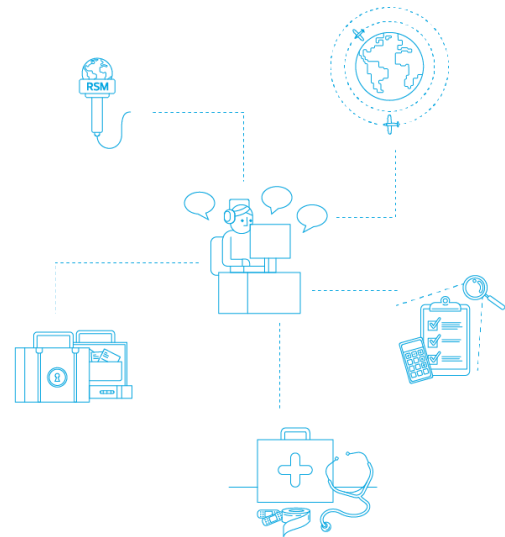
India Introduces 2% Equalisation Levy on Non-Resident E-commerce Operators

For Client Circulation

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1.0 Background

The Digital economy and e-commerce businesses are growing exponentially and impact all of us. The digital economy would cover within its ambit, various things such as online subscription-based services, online sale of goods/ services/ software, online gaming, hotel/ flight booking etc. Taxation of cross border e-commerce transactions has been a challenge for the entire world, including India, as there are several issues with taxing such transactions due to location of the supplier being outside taxable jurisdiction, absence of physical presence, characterizing the nature of transaction (goods or service), administrative challenges in tracking and collecting taxes and various others. In order to bring such cross-border e-commerce transactions into the tax net, India has recently vastly expanded the coverage of “Equalisation Levy” with effect from 1 April 2020. The Finance Act, 2020 which received assent from the President of India on 27 March 2020 has amended the provisions of Equalisation Levy and widened its scope to introduce levy on e-commerce supply or services @ 2% facilitated by a non-resident e-commerce operator.



2.0 Scope of Research Report

India has introduced a 2% “equalisation levy” on non-resident e-commerce operators with effect from 1 April 2020. This levy is applicable to those e-commerce operators who do not have any entity or office or permanent establishment in India.

In this Research Report, we have endeavoured to cover the following:

- Legal provisions relating to Equalization Levy – Persons covered, taxable event, rate, payment timelines, compliances, and related aspects
- The legal validity of the levy due to extra-territorial applicability, the OECD guidelines, and the GATT¹
- Whether Equalization Levy is in the nature of income-tax or direct tax? If so, whether the levy is subject to the terms of the Double Tax Avoidance Agreements and Multi-Lateral Instruments with various countries? Whether credit for Equalization Levy can be claimed by the E-commerce operator against his corporate or direct tax liability?
- Whether Equalization Levy is in the nature of GST or indirect tax? Whether credit for Equalization Levy can be claimed by the recipient of goods or services against his GST liability?

¹ GATT – General Agreement on Tariffs and Trade

It must be pointed out that the analysis in this report contains our view of the subject matter and needs to be revalidated by the users based on their facts and country of operation. The equalisation levy is a newly introduced global tax with limited guidance from judicial and administrative authorities and diverse views and litigation are possible.

3.0 Equalisation Levy on online advertisement introduced by Finance Act, 2016

Following the roadmap laid by BEPS Action Plan 1, India had introduced “Equalisation Levy” in the Finance Act, 2016 which provided for a levy at 6% on the amount of consideration for any specified service received or receivable by a non-resident (not having Permanent Establishment – PE in India) from a person resident in India and carrying on business or profession or a non-resident having a PE in India, if such consideration exceeds Rs 1 lakh during the financial year. The said levy is applicable to specified services which cover online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement under business-to business (B2B) transactions and hence had a very limited coverage. The responsibility of deducting and depositing the levy is on the Indian payer who is receiving the services.

4.0 Equalisation Levy on E-commerce Operators

4.1 Legal Provisions:

4.1.1 The first-time equalisation levy, in India, was brought into force through Chapter VIII of Finance Act, 2016 but was restricted to online advertisement service only, as we have discussed above. However, the Government has extended the scope of equalisation levy to e-commerce operator through amendment vide Finance Act, 2020 which came into force from 1st April 2020.

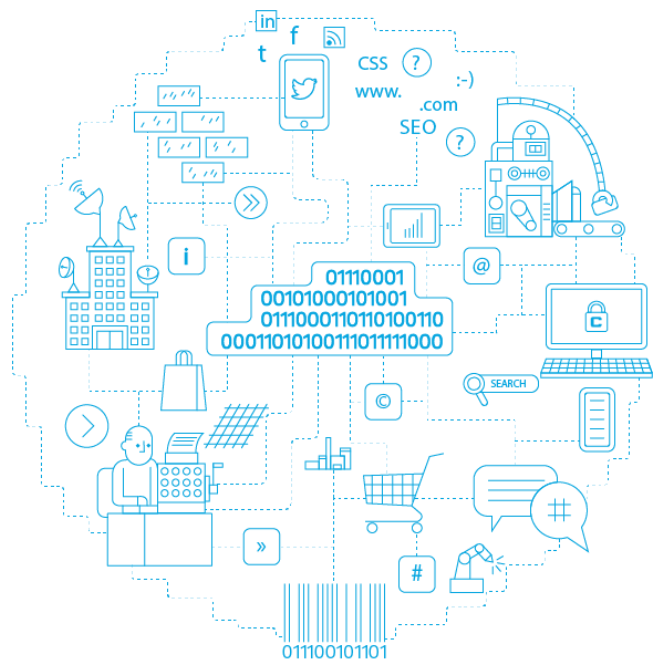
4.1.2 The newly inserted clause (ca) and (cb) to section 164 provides the definition of ‘e-commerce operator’ and ‘e-commerce supply or services’ respectively and the same is reproduced below-

“(ca) ‘e-commerce operator’ means a non-resident who owns, operates, manages digital or electronic facility or platform for online sale of goods or online provision of services or both.

(cb) 'e-commerce supply or services' means-

- Online sale of goods owned by the e-commerce operator; or
- Online provision of services provided by the e-commerce operator; or
- Online sale of goods or provision of services or both, facilitated by the e-commerce operator; or
- Any combination of activities listed in above clauses."

4.1.3 Further, newly inserted section 165A, being charging section, reads as under-



“There shall be charged an equalisation levy at 2% of the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it-

- a. *To a person resident in India; or*
- b. *To non-resident in following circumstances-*
 - *Sale of advertisement which targets a customer who is resident in India or a customer who access the advertisement through internet protocol (IP) address located in India.*
 - *Sale of data collected from a person who is resident in India or from a person who uses IP address located in India.*
- c. *To a person who buys such goods or services or both using IP address located in India.”*

Upon careful examination of the above legal provisions, we may infer that the equalisation levy shall be charged on amount of consideration from e-commerce supply or services made or facilitated by it. Thus, equalization levy would become applicable on the entire value of the e-commerce supply or services carried out by the e-commerce operator.

- 4.1.4 Further, from a plain reading of the provisions, it is the ‘electronic commerce operator’, wherever applicable, who is required to comply with the provisions for collection and payment of the Equalization Levy. Section 166A, dealing with collection and recovery of equalisation levy, states, inter alia, that equalisation levy shall be paid by e-commerce operator on quarterly basis. The section does not expressly provide for its recovery from customer. This point is important to analyse as unlike Equalization Levy on advertisement services, where compliance obligations were cast on the payer, here the obligation to pay tax is on the e-commerce operator.
- 4.1.5 Another important aspect that needs to be understood is the value on which equalization levy is to be charged. From the above provisions, equalization levy is an independent levy, charged by e-commerce operator **on consideration received or receivable for e-commerce supply or service**. As the scope of "e-commerce supply or services" is wide which include both inventory model of e-commerce and marketplace model of e-commerce. Thus, in the absence of appropriate valuation model, it would be difficult to value transaction especially where the e-commerce operator is operating on commission basis and not selling inventory on its own account. Clarification is awaited on whether the complete gross value of goods sold would subject to equalization levy or whether equalization levy need to be charged only on the commission amount and not the entire value of the goods.
- 4.1.6 Therefore, in our understanding, equalisation levy is an independent levy, charged by e-commerce operator on consideration received or receivable for e-commerce supply or service and the law does not expressly provide for shifting of burden to customer. This levy is a separate from the existing Income Tax Act, 1961 and GST. Therefore, the clarification from Government, which is awaited, may provide better clarity on its application. There is a view that Equalization levy is at variance with the international tax treaties, especially Double Tax Avoidance Agreements and therefore may lack jurisdiction. We will analyse nature and validity of equalization levy later on in the report.
- 4.1.7 Further, the equalisation levy shall not be charged:
 - Where the e-commerce operator has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;
 - Where equalisation levy is leviable u/s 165 (i.e. online advertisement);

- Sales, turnover or gross receipts of e-commerce operator from the e-commerce supply or service is less than Rs. 2 crores during the financial year.

4.1.8 Other vital points with respect to compliance of provision of equalisation levy:

- This levy is required to be paid by the non-resident e-commerce operator quarterly within the following due dates:

Date of ending of the quarter	Due date
30 June	7 July
30 September	7 October
31 December	7 January
31 March	31 March

The Income Tax department has recently modified challan ITNS 285 (challan for payment of equalization levy”) so as to allow the non-resident e-commerce operators to do the payment of equalization levy. The amended challan now adds ‘e-commerce operator for e-commerce supply or services’ under the type of deductor. Furthermore, in addition to the above-mentioned timelines, non-resident e-commerce operator is also required to file an annual return in Form- 1.

- Further, Section 178 of the Finance Act, 2016 restricts the applicability of Income Tax Act, 1961 to certain predefined provisions only, which does not include the provision of international treaties.

However, keeping in view of double taxation or excess taxation an exemption is provided in Income tax Act by amending section 10(50) of Income Tax Act, 1961.

- There is one-year delay in relief provision under Income Tax as this levy is applicable from 1st of April 2020 and its corresponding relief under Income Tax is provided from 1st of April 2021. This appears to be unintended error and a clarification from the government is necessary.

5.0 Nature of Equalization Levy – Whether it is a direct tax or indirect tax?

As Equalization Levy brought into force with effect from 1st April 2020 has a wide tax base i.e. it covers all “electronic commerce supply or services”, it is important to analyse the nature of this tax. There is a lot of debate on whether the same is a direct tax or an indirect tax and this is important to analyse. It must also be mentioned that the Equalization Levy on e-commerce supply or services is different from the Equalization Levy introduced in April 2016 which sought to tax e-advertisement services. Below are the salient features of the expanded equalization levy.

5.1 Legal Framework:

Equalization Levy on “E-commerce supply or services” (hereinafter abbreviated as “E-commerce Equalization Levy”) has been introduced as a separate levy and not under the GST law or under the Income Tax law. Further, the equalization levy introduced on e-commerce services is different than equalization levy on specified services i.e. advertisement introduced in 2016.

Before commenting on the nature of levy as direct or indirect tax, it would be important to analyse the definition of ‘direct tax’.

“As per section 2(c) of the Central Boards of Revenue Act, 1963, “direct tax” means

(1) any duty leviable or tax chargeable under—

(i) the Estate Duty Act, 1953 (34 of 1953);

- (ii) *the Wealth-tax Act, 1957 (27 of 1957);*
- (iii) *the Expenditure-tax Act, 1957 (29 of 1957);*
- (iv) *the Gift-tax Act, 1958 (18 of 1958);*
- (v) *the Income-tax Act, 1961 (43 of 1961);*
- (vi) *the Super Profits Tax Act, 1963 (14 of 1963);*
- (vii) *the Interest-tax Act, 1974 (45 of 1974);*
- (viii) *the Hotel-Receipts Tax Act, 1980 (54 of 1980); 8*
- (ix) *the Expenditure-tax Act, 1987 (35 of 1987);*
- (x) *the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (22 of 2015); and*

(2) *any other duty or tax which, having regard to its nature or incidence, may be declared by the Central Government, by notification in the Official Gazette, to be a direct tax."*

The expansion of the equalization levy has not been expressly introduced as a change in Income Tax Act but has been introduced in the Finance Act. The Finance Act is not covered by those statutes mentioned above and thus, it appears that Equalization Levy is not introduced as "direct tax" if we take recourse to the definition stated above. As such even though a few provisions of Income Tax Act are made applicable, by and large, equalization levy is a distinct levy and is governed by the amendment to Finance Act.

5.2 Recovery or Tax burden

In the case of equalization levy, the burden to pay tax is on non-resident e-commerce operator. The law is not express on recovery or burden of tax being shifted to the customer. Since the same is not expressly clarified, the exact nature of equalization levy is indeterminate.

5.3 Administration

If we refer to section 164 which contains the definitions relevant for the analysis of Equalization Levy, we find that a lot of the administration is left to the Central Board of Direct Taxes (CBDT) which is the apex body for administering direct taxes.

The following are relevant definitions:

"Appellate Tribunal" means the Appellate Tribunal constituted under section 252 of the Income-tax Act;

"Assessing Officer" means the Income-tax Officer or Assistant Commissioner of Income-tax or Deputy Commissioner of Income-tax or Joint Commissioner of Income-tax who is authorised by the Board to exercise or perform all or any of the powers and functions conferred on, or assigned to, an Assessing Officer under this Chapter;

"Board" means the Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963 (54 of 1963);

The Assessing Officer and Appellate mechanism that is brought in for purpose of administering Equalization Levy is the same administration as direct tax i.e. Income Tax as per Income Tax Act, 1962. As per section 174, any person aggrieved by order of the Assessing Officer (defined above) can make an appeal to the Commissioner of Income Tax (Appeals).



Further, certain sections of Income Tax Act are also mutatis mutandis made applicable to Equalization Levy which are as follows:

Sec 119 : Instructions to subordinate authorities

Sec 120 : Jurisdiction of Income Tax Authorities

Sec 131: Power regarding discovery, production of evidence, etc

Sec 133A: Survey

Sec 138: Disclosure of information respecting assesseees

Sec 156: Notice of demand

Chapter XV: Liability in special cases

Sec 220 to 227 : Related to recovery of dues

Sec 232: Recovery by suit or under other law not affected.

And other provisions

Thus, from the plain reading it is clear that Equalization Levy is administered in the same manner as a direct tax i.e. Income Tax. According to our understanding, mere administration alone, however, cannot determine the nature of tax as direct and indirect. We have analysed definition of “direct tax” as per section 2(c) of the Central Boards of Revenue Act and found that equalization levy is not a direct tax as it is not introduced under any of the statutes mentioned in the aforesaid provision of law. Thus, merely because the tax has administrative and appellate mechanism that is akin to direct tax, would not make the said equalization levy a direct tax.

5.4 Taxable Event

The taxable event in case of Equalization Levy is e-commerce supply. Taxable event is therefore the ‘supply’ made by a non-resident e-commerce operator. Thus, it is a transaction-based tax which is governed by its own set of laws and rules. It is akin to Securities Transaction Tax. According to the Glossary of Tax Terms – OECD, indirect tax is defined as “Tax imposed on certain transactions, goods or events. Examples include VAT, sales tax, excise duties, stamp duty, services tax, registration duty and transaction tax.” Transaction taxes are further defined under the Glossary as “Tax that uses a specific type of transaction as its object, e.g. sales tax, immovable property transfer tax, etc.” Since equalization levy on e-commerce is a transaction tax as it seeks to tax e-commerce supply, it appears that the same would be an indirect tax as per the definitions as per OECD Glossary of Tax Terms mentioned above.

5.5 Computation of Tax

Equalization Levy is an ad valorem tax. It is levied on the amount of consideration received or receivable. Further, as the taxable event as stated earlier is ‘supply’, tax is computed on the value of the consideration received towards the supply.

5.6 Concluding Remarks:

From the above, there is ambiguity on nature of Equalization Levy i.e. whether it is a direct tax or an indirect tax. Since e-commerce equalization levy is not governed covered by definition of ‘direct tax’ under section 2(c) of Central Boards of Revenue Act, it can be said that the same is not a direct tax. Though a few administrative provisions of Income Tax Act, 1961 are made applicable to procedural and appellate aspects of E-commerce Equalization Levy, that does not render the nature of tax as direct.

6.0 DTAA vs Equalization Levy

Another pertinent question that arises in context of discussions on Equalization Levy would be whether benefit of Double Taxation Avoidance Agreements (DTAAs) would be available in respect of Equalization Levy. In this context, we need to analyse coverage of the DTAAs. This is generally contained in Article 2 of the DTAAs. We have reproduced below the coverage for a few of the countries:

- USA: As per Article 2, the existing taxes to which this Convention shall apply are :

“(b) in India :

*(i) the income-tax including any surcharge thereon, but excluding income-tax on undistributed income of companies, **imposed under the Income-tax Act** ; and*

(ii) the surtax”

2. The Convention shall apply also to any identical or substantially similar taxes which are imposed....

- UK: As per Article 2, the taxes to which this Convention shall apply are

“(b) in India :

(i) the income-tax including any surcharge thereon”

2. This Convention shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State.....

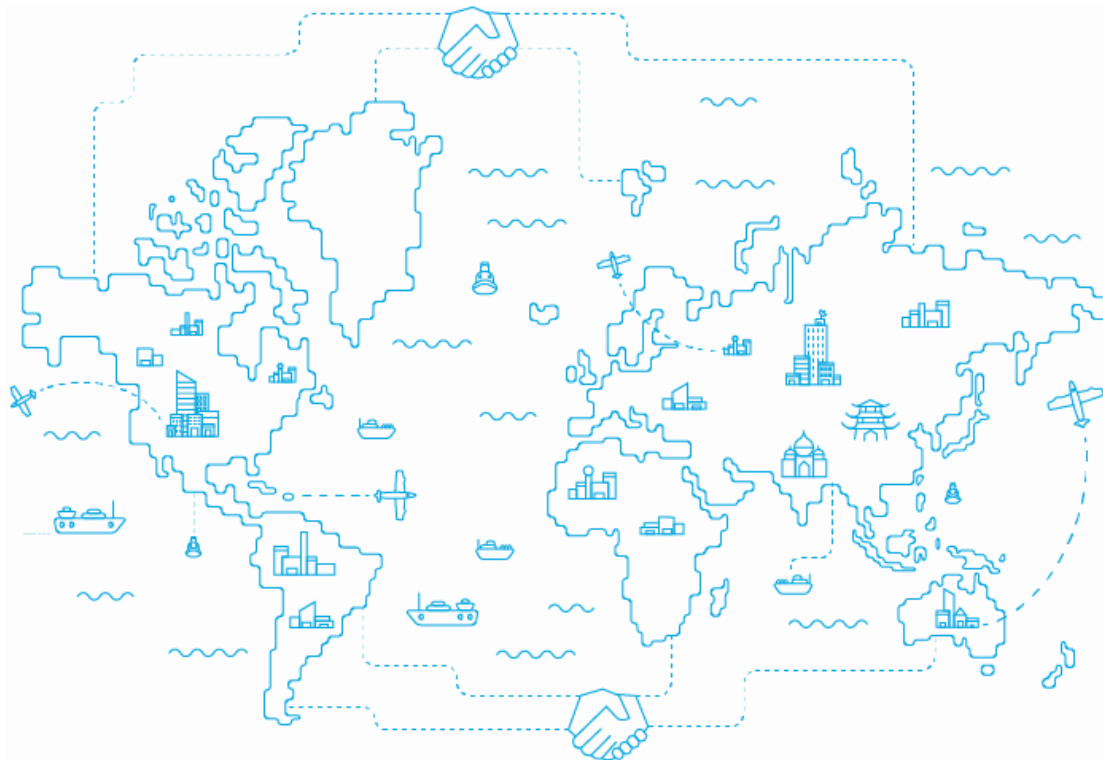


A bare perusal of the coverage under the above DTAAs suggests that the treaty covers only income tax as per Income Tax Act. Since equalization is not enacted under Income Tax Act, it seems that from the coverage alone, the benefit of international tax treaties would not be available for taxpayers to claim relief from Equalization Levy. Since benefit of DTAA is not available, non-resident e-commerce operators would be liable to pay this tax even if they do not have a permanent establishment in India.

For further determining whether benefit of international tax treaties would be applicable to equalization levy, it would also be useful to understand the intent of the Government of India in introducing Equalization Levy in 2016. When the proposal for introduction of equalization levy on specified transactions was made, reliance was placed on the **(Report of the Committee on Taxation of E-Commerce) February, 2016** prepared by the Committee on Taxation of E-Commerce formed by the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India. In that, the Committee observed that the BEPS Report conceptualizes Equalization Levy as a **tax that is different from the Corporate Income Tax, and thus may not necessarily be subjected to the limitations of tax treaties**. The Report does not prescribe any particular design that must be adhered to but suggests that it could be a tax on the gross payment arising from digital economy. Such a tax on the gross amount of payment, would thus be very similar to the second option of withholding tax, except that it, **not being a tax on income, would not be covered by the obligations of the tax treaties, and hence can be levied under domestic laws, even without changes in the tax treaties**.

As the Equalization Levy is imposed on the gross amount of transaction, and not on the income arising from such transaction, it is applicable irrespective of whether any income arising from the transaction is taxable in India or not. As the Equalization Levy is not imposed on income, it does not fall within the scope of “income-tax” or “tax on income” or “any identical or substantially similar taxes”, which typically define the scope of taxes covered within the tax treaties. Thus, the inherent concept of ‘Equalization Levy’ as suggested in the BEPS Report on Action 1 keeps it outside the purview of the limitations imposed by tax treaties, a feature, which makes it the only option that can be adopted without violating or in any other way affecting the treaty obligations of the Contracting States in a tax treaty.

7.0 WTO GUIDELINES



Based on the analysis in the previous section, it would appear that the benefit of double tax avoidance agreements would not be available in respect of equalization levy. As such, it is now pertinent to analyse whether Equalization Levy has validity in terms of jurisdiction and keeping in mind certain WTO and OECD guidelines and overarching principles of taxation

7.1 RELEVANT WTO PROVISIONS

World Trade Organization, the apex body for international trade co-operation has enacted two agreements – General Agreement on Trade and Tariffs (GATT) (in respect of goods) and General Agreement on Trade in Services (GATS). One needs to pay attention to the National Treatment Clause of the GATS and GATT.

The key tenets of this clause under GATT (for goods) is that:

- Contracting parties recognise that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions,

- should not be applied to imported or domestic products so as to afford protection to domestic production.
- The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1.

Similar clauses in place in GATS are as follows:

- This article states that each member shall accord to services and services suppliers of any other member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.
- A member may meet the above requirement by according to services and service suppliers of any other member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.
- Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the member compared to like services or service suppliers of any other member

8.0 Analysis of International Regulations vis-à-vis Equalization Levy

Equalisation levy is charged exclusively on non-resident e-commerce operator carrying out e-commerce business in India without having PE in India and resident e-commerce operator are not subject to this levy. As this levy is unilateral measure by India, the credit of such levy, paid in India, at present, would not be available for any concession in home country of such e-commerce operators and thereby adding cost to the business. This additional cost may be determining factor for carrying out cross border transactions in India by non-resident e-commerce operators and even may looked as barrier to trade in service. Therefore, there is a possibility that introduction of equalisation levy may be treated as attempt to restrict the trade and thereby may be considered as violation of Article XVII- National Treatment for not treating supplier of member country at par with domestic supplier.

Based on above, we may infer that India's Equalisation levy, in its current state, may be challenged in international forum WTO on the ground of violation of "National Treatment" provision of GATS and GATT, as Equalization Levy does not treat a non-resident i.e. foreign e-commerce operator at par with domestic e-commerce operator. However, it is also undisputed that due to digitalisation of business, the host country is facing revenue loss and at times such e-commerce operator is adversely impacting domestic industry as it is avoiding tax in both the host and consumption country. Therefore, it can be argued that equalization levy shall become necessary to protect the interest of the nation, especially a developing country like India, and accordingly, till the time all member countries are coming to consensus for tackling the tax challenges arising in digital business, equalization levy may be held to not be violative of the GATS and GATT. These agreements at present do not consider challenges of taxing digital economy and approaches outlined by OECD for taxing digital transactions.

Notably, the National Treatment obligation is not a general obligation but sector-specific commitments which every WTO Member undertakes by inscribing them in its Schedule which is annexed to the GATS.

Considering the wide scope of Equalisation Levy and varied transaction types that are expected to fall under the levy, it would be essential to carry out a fact-based analysis and it could be considered whether the Levy breaches India's GATS commitment.

As such, taxation of digital transactions and equalization levy is thus at its nascent stages in terms of analysing for compliance with international legislations. It is expected that with advent of time, international cooperation in respect of digital transactions would improve. At present, it is a unilateral measure imposed by India to tax digital transactions.

9.0 Industry Representations on Equalization Levy

Since the equalization levy has a wide tax net and ramifications on the digital landscape, there have been a number of industry representations that have been undertaken. A lot of the provisions of the newly enacted equalization levy require clarification. There are also various administrative hurdles in terms of requirement for non-resident e-commerce operators to obtain a Permanent Account Number and requests for extension of deadlines by industry bodies.

NASSCOM has, based on inputs received from a number of IT industry participants, submitted a detailed representation to the authorities to Ministry of Finance, India. As part of the representation, they have sought out a lot of clarifications on grey areas related to E-commerce Equalization Levy such as clarity on timelines of exemption under Income Tax Act, meaning of 'consideration received or receivable', characterization of this as a unilateral measure etc. and have also emphasised on the impact of Equalization Levy on the entire industry as a whole.

It is important to track these representations and await suitable clarifications on equalization levy by the tax authorities. At 2% of the consideration received, equalization levy has significant impact on the business decisions of e-commerce operators and also for consumers of e-commerce supply or services.

It is important, therefore, to understand the legal provisions and take necessary steps to ensure compliance with the provisions of equalization levy.

10.0 Scope and Limitations

The purpose of the above report is to provide our views on the concerned issues. The report contains our views on the subject matter based on facts and information stated herein before us. Our views are based on current provisions of the Act and the rules and regulations made thereunder. Our views may differ depending upon changes in facts, circumstances, or legal provisions. Government or Judicial authorities may or may not subscribe to the views expressed herein; as the interpretation of law may differ. Under no circumstances, our liability in respect of matters discussed in this report shall exceed the fees received in this matter. This report is meant for the sole use of the Client and not for any other person. No part of this report may be reproduced without our prior written consent.

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21 July 2020