India to impose Custom Duty on Electronic Transmissions: An Analysis

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At present, no custom duty on import of Electronic Transmission (ET) into the country is levied in India. ET can be defined as online trading of 'digitizable products' which are traded both in physical form as well as online i.e., downloaded from the internet, e.g. music, books, software, video games, films etc. It is worthwhile to mention here that the ET differs from cross border e-commerce as it excludes those products which are ordered online but delivered physically.

The reason for not imposing custom duty on import of ET was the unanimous decision taken by the member countries (including India) at the 2nd Ministerial Declaration (MC) of the World Trade Organization (WTO) made on 20th May 1998.

Though the decision was not to impose custom duty on ET till the next MC (known as the 'moratorium on imposing custom duties on electronic transmission') but the subsequent MCs continued extending this moratorium from one to the next MC. However, at the recently concluded 13th MC of the WTO at Abu Dhabi, UAE on 2nd March 2024, the Declaration included the following text on the issue:

1. *"We instruct the General Council to hold periodic reviews on the Work Programme, including based on reports that may be submitted by the relevant WTO bodies, with a view to presenting recommendations for action to the next Session of the Ministerial Conference.*
2. *We agree to maintain the current practice of not imposing customs duties on electronic transmissions until the 14th Session of the Ministerial Conference or 31 March 2026, whichever is earlier. The moratorium and the Work Programme will expire on that date."* [i]

So, it is clear from the above that the moratorium on custom duty on electronic transmission shall finally expire, and member countries shall be free to impose custom duty on electronic transmissions in their respective countries after 31st March 2026.

What is at stake?

The prospect of digitization of a greater number of items and the surge in trade in such digitizable items vis-à-vis the trade in their physical form is happening very rapidly. 3D printing is being used for manufacturing products in the sectors including automobile, auto components, health and medicine, medical devises, aviation, aerospace components, electronics, construction equipment, and for a host of consumer items such as toys, shoes, textile products, jewelry, furniture and household goods.

The shift from the importation of physical goods to digital form has become a phenomenon that has occurred in recent years. In 2017, the estimated imports of digitizable goods using 8% of the Average Annual Growth Rate (AAGR) was USD 255 billion. However, the physical import of those digitizable goods was USD 116 billion. The difference between the estimated import value and the physical import value reached USD 139 billion; this number can be estimated as the

import value of digitizable goods imported using Electronic Transmission. In addition, using the same conservative growth rate of online imports of 49 HS code of digitizable goods, it is projected that the online worldwide imports of digitizable goods imported by Electronic Transmission will rise to USD 365 billion in 2025.

In UNCTAD's Research Paper (2019), it was found that based on the identification of a small number of digitizable goods in five areas, namely printed material, music and video downloads, software, and video games, there was an estimated loss of tariff revenue of more than $10 billion globally, 95% of which is borne by developing countries. As more and more goods are getting digitized with the advent of Industry 4.0 and 3D printing technologies, the estimate of fiscal revenue forgone will snowball.

The paper further argued that most of the developing countries are experiencing profound challenges due to infrastructure/technological divide, the skills divide, and the rising concentration in digital markets, particularly the market power of global digital platform. Moreover, in the period 2017-2020, it was estimated that developing countries and Least Developed Countries(LD) lost USD 56 billion in tariff revenue, of which USD 48 billion were lost by the developing countries and USD 8 billion by the LDCs. It is interesting to note that this loss of tariff revenue is from the imports of just 49 products.[ii]

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How is India affected?

It is unfortunate that the developed countries have kept tariffs on the import of electronic products suspended on several pretexts. Today, the situation is such that, more than USD 30 billion of electronic products are being imported by India alone. That is, even if 10 percent tariff is imposed, the Government of India would have received a revenue of more than USD 3 billion. India is a net importer with software product imports at nearly USD 10 billion, and most of the ITeS and software exports from India are not likely to fall in the category of goods. Along with this, we also have to understand that production processes in the world are also changing fast.

Today, to import any item from abroad, it is not necessary to physically import it. By 3D printing, that object can be physically produced using software and other materials in the importing country itself. Consequently, if this happens, the country may also incur a loss of import duties imposed on the import of physical goods. Thus, the issue is not only about the loss of revenue on electronic products, but also of possible loss of import duties on physical goods in future.

Moreover, the issue here is not only about loss of revenue; it's a much larger issue for a country like India. Our start-ups make a variety of electronic products, as well as movies and other entertainment products in our country. However, when all these products are imported without tariff, there is hardly any incentive to produce them domestically. This tariff moratorium on e-products is benefitting the US, European countries, and China.

India missed out the first three industrial revolutions, which hampered and stalled our industrial development. Today, we are in the midst of the fourth industrial revolution, characterized by digital industrialization.

We should not miss this opportunity. The imposition of tariff on electronic transmission is the first condition for success in the fourth industrial revolution, specifically for digital industrialization. It was in India's best interest to lift the moratorium on custom duty on e-transmission, not to only regulate imports but also to provide policy space for formulating a prudent policy, generating revenue directly by imposing tariffs and achieving the objective of digital industrialization.

Background- why was the moratorium imposed?

Recognizing that global electronic commerce is growing and creating new opportunities for trade, the WTO in its 2nd MC on 20th May 1998, adopted the 'Declaration on Global Electronic Commerce' and decided to establish a comprehensive Work Programme to examine all trade related issues relating to global electronic commerce. The General Council (GC) was mandated to produce a report on the progress of the work programme and recommendation for action in the next MC. It was also declared that members shall continue their current practice of not imposing custom duties on electronic transmission.[iii]

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In September 1998, the GC adopted the Work Programme on Electronic Commerce to be taken up by four Councils, namely the Committee on Trade and Development (CTD), Council for Trade in Goods (CTG), Council for Trade in Services (CTS) and Council for Trade Related aspects of IPRs (CTRIPR). Each Council was given specific tasks to do in their respective areas. Exclusively for the purposes of the Work Programme, the term 'electronic commerce' was defined to mean the production, distribution, marketing, sale, or delivery of goods and service by electronic means.

Before the 4th MC in November 2001, the GC prepared a list of cross cutting issues relevant to electronic commerce. The list, inter alia, included:

i. classification of the content of certain electronic transmission,

ii. development-related issues,

iii. fiscal implication of e-commerce,

iv. relationship between e-commerce and traditional form of commerce,

v. imposition of custom duty on electronic transmissions,

vi. competition, and

vii. jurisdiction and other legal issues.[iv]

At the 4th MC at Doha on 14th November 2001, it was noted that the examination of issues under the Work Programme is not yet complete and therefore, it was declared that members shall maintain their current practice of not imposing custom duties on electronic transmission until the next session.

Why was moratorium extended multiple times?

Over the period, the member countries continued to amend/ enhance the scope of Work Programme quite regularly. At the 7th MC in December 2009, it was decided that the WP would also include, inter alia, (i) development related issues, (ii) basic WTO principles including non-discrimination, predictability and transparency and (iii) trade treatment of electronically delivered software.[v]

At the 8th MC on 17th December 2011, it was decided that the Work Programme would also examine enhancing internet connectivity and access to all information and telecommunications technologies, and public internet sites for the growth of electronic commerce with special consideration in developing countries and particularly in the least-developed country members as well as access to electronic commerce by micro, small and medium sized enterprises including small producers and suppliers.[vi]

Not much progress was reported by the GC and the four Committees tasked with examining various aspects of electronic transmission allocated to them. Furthermore, no consensus could emerge on the definition of 'electronic transmission'. In this background, the Declaration extending the moratorium on imposing custom duties on electronic transmission was continually adopted in all the subsequent ministerial conferences, up to the 13th MC held in February 2024 at Abu Dhabi, UAE.

What were the other developments at WTO relating to E-Commerce?

Frustrated with the very slow progress at WTO on the issue, a Group of 71 WTO members agreed at the 11th MC, in December 2017, to initiate exploratory work towards future negotiation on trade related aspects of e-commerce. They decided that participation would be open to all WTO members and would be without prejudice to participants' position on future negotiations. In January 2019, 76 WTO members (co-convened by Australia, Japan, and Singapore) confirmed in a Joint Statement their intentions to commence these negotiations, known as the Joint Statement Initiative (JSI).[vii]

However, on 18th February 2021, through a joint communication, the delegates of India and South Africa clarified that negotiated JSI outcomes, even if offered

on MFN basis, cannot result into multilateral consensus to bring it under the umbrella of the WTO and therefore opposed the move.[viii]

What was being discussed outside WTO on Electronic Commerce?

In 2016, the Asia Pacific Economic Cooperation (APEC) economies namely Australia, Brunei, Canada, Chile, Japan, Korea, Mexico, New Zealand, Peru, Singapore, Chinese Taipei, and the United States agreed to seek to enhance participation in the Pathfinder through continuous dialogue in relevant APEC fora and to identify capacity building opportunities for a permanent custom duty moratorium on ET including content transmitted electronically in the WTO. It was advocated that old style trade barriers such as custom duties should not be placed on digital products as it would only impede trade in these products and run contrary to the idea of expanding economic activities over internet.[ix]

Japan, during his presidency at the World Economic Forum summit at Davos on 25th January 2019, launched the "Osaka Declaration on Digital Economy" also termed as the "Osaka Track'. The signatories countries to the declaration renewed their commitment to work together building on the JSI. However, India, South Africa, Egypt, and Indonesia boycotted the "Osaka Track" and argued that it overtly undermined "multilateral" principles of consensus-based decisions in global trade negotiations, and denied "policy space" for digital-industrialization in developing countries.[x]

The Digital Economy Partnership Agreement (DEPA), signed electronically in June 2020, between Chile, New Zealand, and Singapore is the first digital-only trade agreement open to all WTO Members. Unlike traditional trade agreements, digital economy agreements encourage domestic regulatory reforms and "soft" cross-border collaboration on issues as wide-ranging as data innovation, digital identities, cybersecurity, consumer protection and digital inclusion. Article 3.1 of the DEPA definitions 'digital product' as a computer programme, text, video, image, sound recording or other product that is digitally encoded, produced for commercial sale or distribution, and that can be transmitted electronically including by photonic means. Article 3.2 of DEPA provides that no Party shall impose customs duties on electronic transmissions, including content transmitted electronically. [xi] More such agreements are being entered into by various countries.

In October 2021, G-7 trade ministers, including Canada, France, Germany, Italy, Japan, UK, and the US, in a Joint Statement demanded that electronic transmissions, including transmitted content, should be free of customs duties in accordance with the WTO Moratorium on Customs Duties on Electronic Transmissions and supported a permanent prohibition of such duties.

What are the major arguments given against continuing with the moratorium?

It is argued that the moratorium could be a continuous provision of duty-free access to developed countries to enter the markets of developing countries, including LDCs. This will have a negative impact on economic growth, employment, and sustainable development. Other arguments against continuing with the moratorium can be summarized as under:

1. As online trade increases, physical trade will decrease, resulting in a decline in custom revenue.
2. Tariffs are a tried and tested policy tool for supporting nascent and even mature industries. All successful economies have arrived at higher levels of development because they started off by providing protection to domestic industries through tariffs to grow and gain competitiveness.
3. The majority of developing countries are net importers of digital products. With zero tariffs, the moratorium is likely to make developing countries even more dependent on imports of digital products from developed countries.
4. Three countries namely the US, China, and the EU, account for 80% of the cross-border e-commerce in the world which clearly shows that the benefits of digital economy are highly uneven and prejudicial to the interest of developing countries.
5. Tariff revenue loss from the moratorium on custom duties on physical imports of digitizable products for developing countries is 30 times greater than that for the developed countries. Estimates show

that 95% of the world's total tariff revenue loss due to the moratorium will be borne by developing countries.

6. Another argument for the removal of moratorium was that by no means will the members necessarily impose custom duties across the board. The key is policy space and to use such policy space appropriately for domestic digital industrialization and the generation of local jobs.
7. The success in levying consumption tax or GST on foreign based entities for digital products/ services shows that it might also be possible to levy customs tariffs on electronic transmission without any difficulties.

What has Indonesia done on custom duties on electronic transmission?

In a communication at WTO on 09 December 2022, Indonesia has confirmed that the Indonesian Customs Law has stipulated the imposition of Customs Duties on digital goods (software, electronic data, multimedia, etc.) which are delivered via electronic transmission i.e., through the internet. It has issued specific tariff headings for intangible goods in Chapter 99 of the Indonesia Customs Tariff Book which consists of five tariff lines, namely: Operating System Software (9901.10.00), Application Software (9901.20.00), Multimedia (9901.30.00), Supporting or Driver Data (9901.40.00), and Other Software and Digital Product (9901.90.00).

It was further informed that, thus far, Indonesia imposes a zero percent (0%) most favoured nation (MFN) tariff on software and other digital goods transmitted electronically under Heading 99.01. The importer of digital goods will utilize a simplified customs declaration with the minimum requirement of filled-in element data compared with the general imports, and exclusion of several customs measures.

The communication also mentioned that the termination of the moratorium does not mean that Indonesia will abruptly increase the MFN tariff on electronically transmitted digital goods.

Indonesia explained that the rationale for imposing customs duties on digital goods is not solely about the state revenue, but more importantly about creating a level playing field for domestic and foreign firms, promoting the growth of local SMEs, providing business certainty, and assessing digital goods risks. It considers that customs duties are the most accurate and effective policy tool of the government to administer the importation of digital goods transmitted electronically, referring to the above-mentioned rationales. The imposition of Customs Duties on electronically transmitted content will not create a distortion for global trade, and it is not meant to put an administrative burden on the importation procedure of digital goods using electronic transmission. Indonesia considers that these rationales are essential in establishing state sovereignty.[xii]

Indonesia took this decision of imposing custom duty on digital transmission after carefully going through the data collected. It found that the shifting of physical goods importation to digital form has been a phenomenon in Indonesia in the period of 2010 to 2020. The estimated import value of Digitizable Goods (49 HS Code) by using the 8% Average Annual Growth Rate (AAGR) is USD 4.5 billion in total. On the other hand, the total amount of physical import of digitizable goods is only USD 3.16 billion. As a result, there is a USD 1.39 billion gap between the total amount of estimated import value and the physical import value of digitizable goods, which indicates that Digitizable Goods importation has been altered from physical into digital form.

Indonesia's data on import value and tax revenue (Value Added Tax/VAT and Income Tax) of Digital Goods Importation (HS Code 99) during 2018-2022 depicted a very significant increase in the import value of digital goods, from USD 1.1 million in 2020 to USD 56.2 million in 2021. In addition, an increase in the value of imports also occurred until September 2022, with the import value reaching USD 66.5 million.

Suggestions for India to impose custom duty on electronic transmissions

India is one of the member countries that were opposing the continuation of this moratorium at WTO on the grounds that it is losing revenue as well as it does not have a policy space to encourage/protect its domestic industry to grow in this field.

To be in a position to levy custom duty on electronic transmissions with effect from the financial year 2026-27,

it is time now for India to start the exercise of collecting and analyzing data to validate its stand and for that purpose, it should take appropriate steps through amending custom duty structure in the forthcoming budget, as done by Indonesia.

It is suggested that India may impose custom duty on digitizable goods with a most favoured nation tariff of zero percent, through the forthcoming budget on electronic transmissions on the similar lines as done by Indonesia by creating specific tariff heads in the Indian Custom Tariff Manual for software and other digital goods transmitted electronically including operating system software, application software, multimedia, support or driver data and other digital products

It is worthwhile to mention here that the Goods and Service Tax (GST) is already being charged on the import of some of these 'digitizable assets' under the following SAC Codes:

998431 – Online text-based information such as online books, newspapers, periodicals, directories etc.

998432 – Online audio contents.

998433 – Online video content.

998434. – Software downloads.

998439. – Other on-line contents n.e.c.

998316. – IT Infrastructure and network management services.

998874. – Computer, electronic, and optical product manufacturing services.

This will help custom authorities to monitor the flow of contents into the country and collect statistical data on content for the purpose of assessing the amount of custom duty involved for making public policy decisions at appropriate times.

It would also help custom authorities to impose custom duties on content to support the domestic creative industries including small and medium players, otherwise struggling in the domestic market, which can facilitate domestic digital industrialization and generate local employment.

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