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<u>Course Material</u>

M.A. (INTERNATIONAL TAXATION)

2.3.11. TAXATION OF DIGITAL ECONOMY

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Taxation of Digital Economy

Module I – Challenges of Digital Economy

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1. Introduction

Digital economy means an economy that is based on digital computing technologies, although it is increasingly perceived as conducting business through markets based on the internet and the World Wide Web. The digital economy is also known as the Internet Economy, New Economy, or Web Economy. In a nutshell, it refers to an economy based on digital technologies.

Brick-and-mortar business model has become outdated because business models have been severely revamped. In the last decade, there has been a rapid shift in the way of conducting business. Today, the biggest cab aggregator Uber does not own any cab, the largest accommodation provider Airbnb does not own any apartments and many other frontiers like makemytrip, Amazon, Flipkart, Paytm, etc. do not function the way conventional businesses functioned but they thrive on the digital technology.

The current tax rules including both international as well as domestic were devised decades ago based on the functionality of the brick and mortar economy. However, with the emergence of the digital economy, the present tax regime stands redundant. The profits of the digital businesses have been increasing alarmingly, but they don't commensurate tax laws to tax such profits. Accordingly, it is need of the hour for all the countries to devise and revamp their tax laws, as the digital economy is ripe for taxation.

2. BEPS Action Plan 1

Action 1 of BEPS addresses the tax challenges of the digitalization of the economy, and specifically aims to identify and address the main challenges that the digitalization of the economy poses for the existing international tax rules.

A final report on Action 1 was issued in October 2015 alongside the final reports on other BEPS actions. The Action 1 final report includes few specific recommendations, as the potential solutions identified could involve changes to the tax framework that go beyond those required by BEPS. Therefore, it was agreed that this area should continue to be monitored.

Work on this area was reinvestigated in 2017 when the OECD released a request for input regarding the tax challenges raised by digitalization and for potential options to address these challenges, as part of the ongoing work of the Task Force on the Digital Economy (TFDE). This has led to further reports from the OECD and to a renewed commitment by the OECD and G20 to try to reach a consensus solution.

There are two pillars included in the current work program:

Pillar 1: Reallocation of profit and revised nexus rules: This pillar involves work on potential solutions for determining where tax should be paid and on what basis, as well as the proportion of profits that should be taxed in the jurisdiction of the customer or user.

Pillar 2: Global anti-base erosion mechanism: This pillar involves work on a system that would ensure that multinational enterprises pay a minimum level of tax, regardless of whether they have highly digitalised businesses. This work is intended to address remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to prevent their tax base from being shifted to jurisdictions that tax profits at less than the minimum rate.

In the absence of an international agreement on the taxation of the digitalized economy, some countries have either proposed or introduced an interim unilateral tax on certain digital services. These digital services taxes (DSTs) generally apply to gross revenue that is derived from "users" in those countries. The revenues in scope generally include those from online advertising, the sale of customer data, and subscriptions or other fees from online marketplaces and other intermediation platforms.

On 5 June 2021, the G7 finance ministers discussed the Pillar 1 and Pillar 2 proposals and reached an agreement on key elements of the global tax reform. Pillar 1 would still entail the reallocation of a share of the global residual profit of certain businesses to market countries, but this would only apply to very large global businesses. Pillar 2 would apply where income is not subject to a minimum effective tax rate in each country in which a business operates of at least 15%. The G7 also agreed on the need for coordination between DSTs and the new Pillar 1 rules and the expectation is that in due course unilateral DSTs will be withdrawn.

3. Tax Avoidance in Digital Economy

In recent times, there has been a rapid and expansive digital transformation that has deep economic and societal impacts which has resulted in significant changes. This has also resulted in global debates in many legal and regulatory realms and international tax forums. The tax implications are wide-ranging affecting both direct and indirect taxation, tax administration and broader tax policy issues. The center of the debate is whether international income tax rules which were developed in a "brick-and-mortar" economic environment more than a century ago still remain fit for purpose in the modern global economy.

The fundamental elements of the global tax system which determines where taxes should be paid are:

(i) **Nexus** which means rules to determine the physical presence of the taxable person.
(ii) **Profit allocation** which means the rules to determine at what portion of profits should be taxed based on the arm's length principle.

The emergence of the digital economy has raised new fundamental policy questions linked to its effects on competition and the need to adapt existing tax systems to the new way of doing business. The existing international taxation framework are effective since the early 20th century and is no longer relevant because of being tailored to a less globalised economy and relying on the physical presence of businesses in a territory that allows for making a nexus between them and the tax jurisdictions.

The European Commission estimates that digital businesses usually pay a lower effective tax rate than traditional ones. The problem of under-taxation in digital economy is challenged by some studies, there is an international consensus that the current rules need to be adapted. They leave too many gaps to be effective – for example, a joint IMF and University of Copenhagen study found that 40% of the global FDI is structured to reduce tax obligations as much as possible, rather than operating with a genuine business activities in mind. The academic literature and international bodies, such as the OECD, the IMF and the UN, have worked on identifying the main tax challenges facing the digital economy. One of such challenges includes, online business can be carried out without any physical presence, while the current tax rules were designed for 'bricks and mortar' businesses having a permanent establishment which means most tax treaties are based either on the UN Model Tax Convention or the OECD Model Tax Convention, both of which use the 'permanent establishment' concept when determining whether a business is liable to taxation. Foreign businesses are taxable only if they have such an establishment, itself broadly defined as the place where the business of a given company is wholly or partly conducted. Jurisdictions can tax companies only if there is an established tax 'nexus' (connection) between the two.

However, digitalisation allows businesses to engage in significant business activities without meeting the requirement for a permanent establishment in any given jurisdiction. This is what the OECD calls 'scale without mass'. Such commercial presence need not be accompanied by a physical presence, which can lead to a situation in which taxes do not reflect the value and profits created by a business.

The assets and activities of digital businesses can easily be moved across jurisdictions to help them avoid a taxable presence where taxes are higher. Furthermore, there is a risk that vendor on online platforms skip registration in third countries where they conduct most of their transactions. Businesses may create value, or parts of it, in a different jurisdiction to that in which they are physically present. These practices render the task of determining the jurisdiction competent to tax a multinational or digital company complex, and current rules may lead to substantial activity without a right of taxation.

Another difficulty may arise due to the increasing reliance of digital or transnational businesses on intangible assets, such as software and algorithms, which are crucial for many new business models. These assets are easy to move around the world, which facilitates the process of structuring businesses in such a way as to minimise their tax liabilities. Consequently, tax authorities find it increasingly difficult to determine how to identify income generated by intangibles and how such income is allocated amongst different entities forming the multinational groups. The 'arm's length principle' determines how to value transactions between these related entities by setting the amount that they charge each other, known as the 'transfer price'.

This price should be the same as if the entities were independent, in other words, what they would have to pay on an open market. The arm's length principle helps in prevention of price manipulation and tax avoidance. However, in the digital economy, a large part of profits are generated from unique intangibles such as databases, software and algorithms, and marketing activities making use of brands and trademarks that are specific and valuable only to a given business entity. In such scenario, free-market price is often difficult to determine, which impairs the application of the arm's length principle. As a result, digital businesses (due to the nature of their activities) and multinationals (due to their activities on global level) can actively use transfer pricing rules to maximise costs, which are attributed to their subsidiaries in higher-tax jurisdictions, thereby reducing the taxable income. In other words, they can increase the taxable income realised by the entity located in the lower-tax jurisdiction. In addition, legal uncertainty may arise due to other broader phenomena, such as the incorporation of services, which increasingly rely on intangibles, into manufacturing.

Also, highly digitalised businesses rely heavily on the use of data and user-generated content. This leads to a situation where it is very difficult to determine to what extent the users, who allow platforms to use their data in exchange for free access, contribute to value creation. Some of the tax forums including EU support the notion that taxes should be levied in the country where users are located, since they contribute to value creation and network effects. Indeed, businesses benefit greatly from data analysis, and user data are often sold to online advertisers. However, the value of data collected is an intangible asset of the business and it would not generally show the same on its balance sheet and therefore it cannot be taken into account when determining income liable to taxation. Some countries, such as the US, refuse to take user-generated data into account for taxation purposes. The current lack of updated rules makes it very challenging to establish exactly how and where value is created, and there is no uniformity in the way of assessing the tax bases and the tax nexus for digitalised businesses. In addition, the digital economy has increased the complexity of characterising income for tax purposes. The main issue is whether certain rather novel payments and transactions (as, for example, in the case of the infrastructure as a service business models), should be treated as business profits or classified as royalties or technical services. Under the current treaties, business profits would be subject to corporate tax on net income in a country if they could be attributed to a permanent establishment located therein. On the other hand, royalties and technical services may be subject to withholding tax in the country of the payer. Since the characterisation of income has become very difficult in the digital economy, it may, in effect, lead to taxation mismatches and other loopholes.

It is worth mentioning that the constantly evolving digital economy poses a lot of other tax challenges, which are beyond the scope of this briefing. For example, some online transactions made through platforms, particularly peer-to-peer transactions, may not reveal the identity of the users and the payment amount, thereby creating a pathway to tax fraud. Entirely different challenges are connected with shifts in working patterns and the taxable status of workers, due to the rise of 'gig' and collaborative economies.

Furthermore, a 2019 study for the European Parliament Special Committee on Financial Crimes, Tax Evasion and Tax Avoidance (TAX3) mentions that delivery channels and business models, such as service-oriented models using software or hardware, cloud computing, 3D printing, collaborative platforms and block chain, pose legal uncertainty for both taxpayers and administrations, as they are hardly matched by existing rules. The vast diversity of the digital businesses and digital businesses using multiple businesses lines are further tax challenges, which shall be addressed by robust measures that would last in face of rapid digital evolution.

Further issues arise with regard to indirect taxation, mainly VAT. These issues concern the import of low-value parcels that are VAT-exempt and the difficulties in enforcing VAT payments on services and intangibles, particularly those sold to private consumers. The EU adopted new rules on VAT for cross-border goods trade in November 2019, which partially addresses these issues. Applicable since 1 July 2021, they simplify the VAT rules, notably for online transactions, and remove the VAT exemption for low-value consignments.

Digitalization is facilitated by three important characteristics which are:
(i) scale without mass
(ii) reliance on intangible assets
(iii)the centrality of data

These three major characteristics of digitalization pose serious challenges to elements of the foundations of the global tax system. On one hand, the emergence of new and often intangible value drivers have changed entire sectors creating new business models while continuously decreasing the need for physical proximity to target markets. This continuously effects the application of existing profit allocation and nexus rules to distribute taxing rights on income generated from cross-border activities in a way that is acceptable to all countries, small and large, developed and developing. This is also known as allocation of taxing right issue.

On the other hand emergence of new technologies has facilitated tax avoidance through the shifting of profits by multinational enterprises (MNEs) to low or no tax jurisdictions. This is the essence of the base erosion and profit shifting (BEPS) project and remains a top priority of the work of the 141 members of the OECD/G20 Inclusive Framework.

The centrality of a predictable, efficient and sustainable international tax system within the ecosystem of economic growth and global welfare cannot be overstated. Growing discontent among countries has highlighted these issues to paramount importance and has left governments in search of effective responses. The result of nearly a century of multilateral efforts to create a clear, consistent, and co-ordinated tax system lies in the balance. Considering the nature of these challenges and the difficulty to put borders around the digitalised economy, the approach at this critical juncture is clear- a comprehensive consensus-based solution that deals with both the allocation of taxing rights and the remaining BEPS issues. This would secure and sustain the international income tax system and increase tax equity amongst traditional and digital businesses.

Failure to deliver, however, will ultimately lead to a patchwork of unilateral actions, which in a fragile global economy, would harm investment and economic growth hampering the ability of governments to collect revenues and invest in programmes. The recent success of the elimination of double non-taxation through the BEPS Project illustrates the strength of a co-ordinated multilateral approach.

3.1. EU Proposals on How to Tax Digital Economy

The digital taxation issue has been discussed in the EU over the past few years, as well as globally, with efforts carried out under the Group of Twenty (G20)/OECD base erosion and profit sharing action plan (known as BEPS). The EU's initial position was that digital taxation needs to be addressed with an interim, temporary solution accompanied by a long-term, permanent fix. This position reflected a twofold ambition:

(i) to mitigate the risk of fragmentation of the single market elevated by the emergence of unilateral national measures, and
(ii) to plan for measures on addressing this issue that would help shape global discussion under the BEPS.

The European Commission proposed a package on fair taxation of the digital economy on 21 March 2018. The interim proposal was for a Council directive that would tax revenues created by certain digital services that are currently untaxed, such as those generated by the online sale of advertising space, by digital intermediary activities between users (that facilitate the sale of goods and services), and by the sale of data generated by users. It would only apply to enterprises operating above two thresholds: total annual worldwide revenues above €750 million, and total annual EU revenues exceeding €50 million. The Commission proposed a single rate of 3%, to be levied on gross revenues obtained from the provision of those digital services for which user value creation is crucial. It would apply to both non-resident and domestic businesses and to domestic and cross border transactions. Tax revenues would be allocated to each Member State proportionately to the number of users of the taxable service. The Commission intended for this tax to be temporary until the implementation of the comprehensive reform envisaged in the second proposal.

The long-term solution proposed was to be a Council directive determining 'where' and 'what' to tax in the digital economy. It defined a 'significant digital presence' that could be established even when there is no physical presence in a Member State's territory. Businesses would be liable to tax if they met at least one of the following criteria in a taxable year- annual revenue exceeding €7 million; over 1,00,000 users in a Member State; and more than 3,000 business-to-business contracts for digital services concluded by the business. A proportionate share of profits would then be taxable in the Member State in which the business had a taxable digital presence. The rate would be equivalent to 'bricks and mortar' establishments.

The tax would cover not only corporate taxpayers incorporated or established in the Union, but also those incorporated or established in a non-EU jurisdiction which has no double taxation treaty with the Member State in which a significant digital presence of the taxpayer is identified. Taxation is subject to unanimous agreement in the Council, with Parliament involvement limited to giving a non-binding opinion under the consultation procedure. Parliament has generally supported fair taxation of the digital economy. It supported the Commission proposal on the common consolidated corporate tax base (CCCTB), which was designed to distribute the tax base among the Member States.

As early as March 2018, Parliament voted to introduce the concept of digital permanent establishment. Parliament thereby supported the proposal that companies generating revenues in a Member State without having a physical presence but having a digital permanent establishment get the same tax treatment as those with a physical permanent establishment. The CCCTB proposal has, however, been blocked in the Council. Similarly, Parliament has supported both short- and long-term solutions tabled by the Commission, widening their scope and coverage and backing integration of the concept of significant digital presence in the proposed Council directives on corporate taxation. The Council however has given preference to working towards reaching a global solution at OECD level, and has postponed work on these proposals.

3.2. Unilateral Measures to Tax Digital Economy by Member Countries of EU

In the absence of immediate measures on digital taxation at EU or global level, some countries have decided to continue with national initiatives. Others have announced plans to implement digital taxes or to wait for international solutions. Some of the tax norms framed by such countries are highlighted below:

Italy

The Italian web tax, effective as of 1 January 2019, applies to digital business-to-business transactions and is due both by resident and non-resident businesses, whenever they provide more than 3,000 transactions annually, at a rate of 3% levied on the service fees charged. Italy also introduced its own Digital Services Tax (DST) as of 1 January 2020, at a rate of 3%. This tax covers companies with total worldwide revenues of €750 million and revenues of at least €5.5 million obtained from digital services provided in Italy. Digital services that generate taxable revenues include targeted advertising on a digital interface, linking users of multi-sided digital interfaces, and transmitting user data generated from the use of platforms. It will be repealed once an international solution is agreed.

Austria

The Austrian Digital Services Tax (DST), adopted in 2019, applies to companies with a global turnover of €750 million or more, and a national turnover of at least €25 million. Revenues from domestic online advertising services are liable to tax when they are targeted at Austrian users. The tax rate has been set at 5%.

Hungary

In 2014, an advertisement tax was introduced on the turnover from broadcasting or publishing advertisements, with several progressive tax rates ranging from 0% to 50%. After a 2015 Commission investigation found that this tax constituted State aid and was therefore incompatible with competition law.

Hungary replaced these progressive rates with two flat rates: a 0% rate for the part of the taxable revenues below HUF 100 million (approximately €3,12,000) and a 5.3% rate for the part of the taxable amount that is higher than the aforementioned threshold. Hungary then raised the latter to 7.5% for taxpayers with sales revenues from advertising exceeding HUF 100 million. In 2017, the European Court of Justice (ECJ) annulled the Commission's decision; however, Hungary suspended the tax temporarily by setting its rate at 0% between 1 July 2019 and 31 December 2022.

France

On 24 July 2019, the French DST became law, applying retroactively from January 2019. The tax applies to companies with a global digital turnover of more than €750 million and a digital turnover of more than €25 million in France. It covers targeted online advertising, the management and sale of user data for advertising and the connection of users through digital platforms. It is applied at a 3% rate on the gross revenues generated by those digital activities where French users play a major role in value creation. If an agreement is implemented at OECD level, it will replace the DST.

Poland

As of 1 July 2020, all video-on-demand (VOD) platforms operating in the country have had to pay an additional levy on their revenues obtained from subscription fees or advertising. The tax is set at 1.5% of these revenues.

Spain

The Spanish tax on certain digital services entered into force on 16 January 2021. It is levied on three types of services: online advertising services (when they appear on a device used in Spain), online intermediation services (when at least one user is located in the country), and the data transfer services for sale of user data (when it has been generated in Spain). The tax is set at 3% of the taxable base, which is the gross income generated from the provision of these services. The tax covers the companies whose global net turnover exceeds €750 million, and which generate at least €3 million.

Slovakia

The Slovakian tax, which covers income obtained by digital platforms and websites for intermediating services in transport and accommodation, was introduced in 2017. Effective from 1 January 2018, these businesses were considered as having their permanent establishment in Slovakia and were therefore eligible to pay corporate tax at a rate of 21%.

The situation in the rest of the Member States varies. Belgium discussed a formal proposal but decided to hold out until a global solution is found. The October 2021 parliamentary elections in Czech mean that the proposal will have to be considered by the newly elected members. In September 2021, the Latvian Parliament decided to consider a bill to introduce the digital services tax. In Slovenia, the bill to introduce the digital tax was defeated in the Parliament in October 2020.

3.2.1. Shortcomings in Implementation of Unilateral Measures

(i) Ideally, the intent behind expanding the scope of business connection was to cover new business models operating through digital medium. However, on plain reading of the phrase ‘transaction in respect of any goods, services or property’, the goods could be physical goods and property could include intangible property, which probably was not the intent of the legislature.

(ii) It is unclear whether a transaction which is partly carried outside India and partly in India is covered by the condition or not; in other words, if the non-resident is not in India but the customer is in India, the goods imported by customer in India may not be regarded as transaction ‘in India’.

(iii) It appears that the specified services covered under the ambit of equalization levy could also be covered as SEP under Explanation 2A. Now section 10(50) of the Act provides that any income arising from such specified service and chargeable to equalization levy is exempt from tax. This exemption would also be applicable to income deemed to accrue or arise under Explanation 2A and hence to the extent there is equalization levy there cannot be any further tax under Explanation 2A.

(iv) While defining SEP, few words like ‘systematic’, ‘continous’ and ‘soliciting’ have not been defined expressly and thus are subject to more than one interpretation.

(v) The term ‘user’ is ambiguous, as it has not made out explicitly, whether user includes only active users or passive users too like click-based user, viewer, subscriber, etc. For example, there are numerous apps which allow access for free or a trial basis and thus, the users would be more of passive users.

(vi) The clauses (a) & (b) to the explanation are separated by ‘Or’, thus, these are not to be read in conjunction with each other. However, this does not seem to be the intent of the legislature. The revenue-based threshold and the user-based threshold cannot be mutually exclusive.

(vii) A transaction covered within the ambit of equalization levy may also be subject to SEP provisions. Thus, there could be an overlap between the SEP provisions and the equalisation levy provisions. Therefore, an explicit clarification should be issued, stating that the provisions of SEP would not apply to a transaction which is subject to equalisation levy.

4. Task Force on Digital Economy (TFDE)

The Task Force on the Digital Economy (TFDE), a subsidiary body of the Committee on Fiscal Affairs (CFA) was established in September 2013 to carry out the work, with the aim of developing a report identifying issues raised by the digital economy and possible actions to address them by September 2014.

The TFDE held its first Meeting on 29-31 October 2013 during which delegates discussed the scope of the work and heard presentations from experts on the digital economy. The Task Force also discussed the relevance of the work done in the past on this topic. In particular, the Task Force discussed the outcomes of the 1998 Ottawa Ministerial Conference on Electronic Commerce where Ministers welcomed the 1998 CFA Report “Electronic Commerce: Taxation Framework Conditions” setting out the following taxation principles that should apply to electronic commerce.

The Task Force considers that these principles are still relevant today and, supplemented as necessary, can constitute the basis to evaluate options to address the tax challenges of the digital economy. In addition, the Task Force discussed the post-Ottawa body of work and in particular the work of the Technical Advisory Group on Business Profits (TAG BP) relating to the attribution of profits to permanent establishments (PEs), the place of effective management concept and treaty rules in the context of e-commerce.

Considering the importance of stakeholders’ input, the OECD issued a public request for input on 22 November 2013. Input received was discussed at the second meeting of the TFDE on 2-3 February 2014. The Task Force discussed the evolution and pervasiveness of the digital economy as well as the key features of the digital economy and tax challenges raised by them. The Task Force heard presentations from delegates outlining possible options to address the BEPS and tax challenges of the digital economy and agreed on the importance of publishing a discussion draft for public comments and input. The input received was discussed by the Task Force and contributed to the finalisation of its report.

4.1. Functions of Task Force on Digital Economy (TFDE)

i. The Task Force on the Digital Economy shall to assist the Inclusive Framework on BEPS (hereafter the "IF") with respect to its responsibilities in relation to the tax challenges of the digital economy by providing policy, legal, administrative and technical support to advance the work identified in the BEPS Action 1 Final Report, Addressing the Tax Challenges of the Digital Economy.

ii. It shall monitor developments in the digitalisation of the economy over time that may affect tax policy and its implementation, which shall include but not be limited to the consideration of:

a) the developments and emerging trends in technology, innovation and business models related to the digitalisation of the economy;
b) the impact of the developments and trends identified in (a) above on the determinants of value creation;
c) the impact of (a) and (b) above on tax policy and its implementation

iii. TFDE shall monitor developments in the regulation of the digital economy, which shall include but not be limited to the monitoring of the implementation by governments of tax policy options to address the broader tax challenges of the digitalisation of the economy, such as:

a) Options relating to a new nexus in the form of “significant economic presence”;
b) Options to implement withholding taxes on certain types of digital transactions;
c) Options to introduce an “equalisation levy”.

iv. It shall also monitor and evaluate the effectiveness of measures implemented as part of the BEPS package - including the International VAT/GST Guidelines - in addressing the BEPS issues and the broader tax challenges associated with the digitalisation of the economy;

v. Review and analyse data that becomes available over time and are relevant for assessing the tax challenges of the digitalisation of the economy;

vi. Monitor the continuing effectiveness of existing international tax standards to deal with the tax challenges raised by developments in the digitalisation of the economy. Issues to be examined in this context include, but are not limited to:

a) Assess the extent of the broader tax challenges identified in the digital economy, taking into consideration the outcomes of the work described in (ii), (iii), (iv) and (v) above;
b) Develop policy options to address the challenges related to the digitalisation of the economy.

vii. Act as a centre of expertise for the IF on issues related to the digital economy and work in close cooperation and coordination with the other subsidiary bodies to avoid duplication and ensure a consistent and efficient approach across all activities relevant for addressing the tax challenges of the digital economy.

viii. Engage with a broad range of stakeholders on relevant subjects to ensure that the work of the Task Force is informed by the most up to date and relevant information.

ix. Undertake other tasks as requested by the IF.

4.2. Interim Report by TFDE

On 16 March 2018, the Interim Report on the Tax Challenges Arising from Digitalisation (Interim Report), prepared by the Task Force on the Digital Economy (TFDE), was released on to the OECD website. The Interim Report reviews the progress made in tackling the issues of double non-taxation, and aggressive tax planning, which motivated the 2013-2015 Base Erosion and Profit Shifting (BEPS) project to reform global tax rules. It surveys the increasing adoption, across countries, of unilateral measures to tax digitalised businesses. It sets out a new theoretical framework for analysing the value creation processes in digitalised business models, to underpin the revision of international tax rules. Most importantly, the report makes clear that while there is no current consensus among countries on how to revamp the international tax framework for the digital era, and no consensus on the use of interim measure turnover taxes, the Inclusive Framework on BEPS will seek to arrive at a new global consensus.

Highlights of the report include the following:

• **Unilateral measures:** The report segments unilaterally adopted digital economy tax rules into four categories.

These include
(i) alternative applications of the PE threshold (e.g. India, Israel);
(ii) withholding taxes;
(iii) turnover taxes (e.g. India, Italy, France); and
(iv) specific regimes to deal with large MNEs (e.g. UK, Australia, US). The report observes that the adoption of such measures reflects a growing discontent among countries with the tax outcomes of the current international tax rules, and has increased the sense of urgency to revamp the existing framework.

• **Value creation in digitalised businesses:** It sets out a new theoretical framework for analysing the value creation processes in digitalised business models. Moving beyond the classic 'value chain', the report describes two further 'value creation categories', the 'value shop' and the 'value network'. The latter encompasses, inter alia, internet advertising and intermediation services models, which rely on active user contributions/participation, and on direct and indirect network effects in their target markets. The report indicates that, out of the three value creation categories, the strongest case for value creation 'in the market' (in the absence of physical presence) can be made for value networks.

• **BEPS outcomes:** The report concludes that the BEPS measures, adopted by countries since 2015, have had some success in tackling the multinational enterprise (MNE) tax planning behaviours that motivated the launch of the BEPS project. There is some evidence that MNEs are changing their corporate structures (e.g. moving to local distributor models, 'on-shoring' of IP), though more evidence is needed. While the adoption of the BEPS PE rule changes by countries is below expectations, progress has been made with the rollout of the BEPS recommendations and standards for VAT, CFC rules, treaty abuse measures, transfer pricing, and IP regimes. The report considers the BEPS measures to be inadequate to tackle the more fundamental long-term problems, caused by digitalisation and business model change, for traditional international tax rules.

• **Long-term solutions:** Looking to the long-term revamp of international tax rules, the report identifies three groups of countries with disparate views. One group consider that targeted measures are called for, which are directed solely at certain highly digitalised businesses, in light of the manner in which their business models rely on user participation/ contributions. A second group consider that a broader reconsideration of the international tax framework, as it applies to both digitalised and traditional businesses is called for, in light of the progressive digitalisation of the entire economy. However, this second group is highly diverse in its views, some considering that no special emphasis should be put on user participation/contributions in the redesign of tax rules, and others considering this calls for major changes to nexus and profit allocation rules. A third group consider that the existing framework does not need alteration.

• **Interim measures:** The report is clear that many countries strongly oppose interim turnover taxes on digitalised businesses, and sets out the risks and adverse consequences for economic welfare, productivity and competition. As some countries are, however, determined to proceed, considerations for minimizing their negative impact are outlined (e.g. high revenue thresholds, targeting at internet advertising and intermediation services).

5. <u>Virtual Permanent Establishment</u>

For more than two decades, information technology has become an integral part of modern society. Moreover, technology has rapidly interrupted everyday life and has brought with it a whole new industry, technological and telecommunication developments, and, most importantly, new ways in which business operates, encouraging globalization and integration of the markets (OECD, Action plan on BEPS, 2013). In fact, due to the global integration of economies and markets it is possible for corporations that operate all around the world to shift manufacturing bases from high-cost to low-cost locations. Also, such enterprises manage risks and of developing by means of global models based on matrix management organizations and integrated supply chains that centralize several functions at a regional or global level. Additionally, globalization has allowed multinational corporations exploit intellectual property at different levels within such organizations (OECD, Action plan on BEPS, 2013).

These developments has provided such enterprises an opportunities to significantly minimize their tax burden, taking advantage of the "loopholes" that may arise from the incoherence of the tax rules of jurisdictions whose infrastructure is used in the performance of the business activities. For example, in a given state where the residence status for entities is solely determined by the place of incorporation, a foreign company would not be subject to the tax burden provided for a resident entity, even though it has substantial presence; on the other hand, the country of residence might provide with an exemption for the foreign income earned by its residents, which may derive in no taxation of the income derived neither in the source country nor in the residence country. Thus, countries have long worked to eliminate such non-taxation in order to minimize trade distortions and obstacles to sustainable economic growth by means of the elaboration of concepts that allow them to tax the revenue produced using their infrastructure and resources, and that cannot be levied under the standards provided in the traditional tax system.

Currently, the PE is understood as the fixed place of business through which the business of an enterprise is wholly or partly carried on (OECD Model tax Convention on Income and Capital, 2010). However, this concept has experienced a noteworthy dilution during the recent years to meet emerging commercial practices, where physical presence is not required. So far, although several theories has been formulated to adapt the current definition of permanent establishment to the challenges provided by the electronic commerce, the international organs, such as OECD, UN and other Governmental Authorities have not reached to a conclusion in the most effective framework to warrant the taxation of such transactions in the Country where economic activities occur

5.1. Virtual Permanent Establishment (VPE) Approach in the World of Digital Economy

As it is well known, MNC's have exploited their digital presence to obtain significant income from different countries with low taxes, and in most of the cases without paying taxes. Thus, it has led to proposals to redefine the PE concept.

According to this "Virtual PE" (VPE) theory, it is proposed that the taxing nexus for electronic commerce should be "the continuous commercially significant conduit of business activity", rather than the fixed place of business. The virtual PE approach applies to the jurisdictional criterion for source-based taxation of profits.

Furthermore, the modern PE definition should be "reinvented" in order to apply to electronic commerce the original idea of taxation on basis of economic commitment and equivalence and establish common thresholds for differentiating commercial mainstream from auxiliary business activity.

Additionally, in order to determine if the taxing nexus is met, it can be done by measuring the development of a qualitative and quantitative facts and circumstances test, taking into account issues like the turnover or number of transactions.

The "Virtual PE" approach

i. is relatively and competitively neutral to the buyer or user in the market, since source taxation of its profit is probably more neutral than taxation exclusively based on residence,
ii. it recognizes extensive source taxability according to economic allegiance and subject to thresholds,
iii. it is effective because it establishes a link between the electronic business and its customer established in the source country.

However, although VPE theory requires some kind of physical presence by the vendor, before a person is taxed, because a person can neither have operations, nor systematic activities, within a state, without him/her or his/her employees or agents being present in that state.

5.2. Virtual Permanent Establishment Concept under OECD

The OECD has worked for more than 20 years analyzing the impact of the electronic commerce to the current international tax legislation. As mentioned before, in 1998 the principles that should guide the development of rules in international tax matters for the electronic commerce were established.

In 2005, the OECD released the report titled "Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?", based on the work of the business profit Technical Advisory Group. In such report, the OECD, studied the "VPE" theory as an alternative nexus that would apply to electronic commerce operations.

According to such report, the PE definition requires to be extended in three ways in order to extend the PE definition, as follows (OECD, 2005, 67):

i. **"Virtual fixed place of business"** through which the enterprise carries on business (i.e. an electronic equivalent of the Traditional PE). In other words, when the enterprise maintains a web site on a server of another enterprise located in a jurisdiction and carries on business through that website, a PE is configured and the place of business is the web site, which is virtual.

ii. **"Virtual agency"** (i.e. an electronic equivalent of the Dependent Agent PE i.e. DAPE). This concept would be an electronic equivalent of a dependent agent and, therefore, will cover situations where contracts are habitually concluded on behalf of the enterprise with persons located in the jurisdiction through technological means rather than through a person.

iii. **“On-site business presence”**, which would be defined to include “virtual” presence. An enterprise providing on-site services or other business interface (which could be a computer or phone interaction or internet connection) to users located in certain Country may be deemed as “on-site business presence”. Under this alternative, it would be necessary to specify a minimum threshold to ensure that source country taxation would only be applied where there is a significant level of economic activity. Possible thresholds might include a minimum time during which the enterprise regularly operates within the jurisdiction, or monetary thresholds or limitations on the types of activities covered (e.g. exclusions for preparatory or auxiliary activities, or intermittent and occasional activities).

5.3. Basic Framework of Indian Tax Laws & View of Indian Courts on VPE

The domestic law of India contains basic framework for attribution of profits to a ‘business connection’ or ‘Permanent Establishment’. Section 9(1)(i) of the Act read with the relevant Explanation provides that income from a ‘business connection’ in India shall be taxable in India but only to the extent as is reasonably attributable to operations carried out in India.

Further, Rule 10 of the Income Tax Rules, 1962 provides that if the Tax Officer is of the opinion that income arising to a non-resident cannot be properly ascertained, the amount of such income may be calculated at (i) percentage of turnover, as may be considered appropriate; or (ii) an amount which bears the same proportion to the total profits of business of such person as the receipts accruing or arising bear to the total receipts of business.

Moreover, the Finance Act, 2016 introduced the concept of Equalisation Levy (Levy) which targeted specific transactions between residents and non-residents. At the time of its introduction, the Levy was charged at 6% of the consideration earned by non-resident entities from India for provision of online advertisements and digital advertising space. This was done with a view of reducing revenue loss to the Government by advertising income earned by non-resident falling outside the ambit of the tax net, in the absence of any business presence in India.

It is apparent that digitalisation has affected various aspects of business beyond mere marketing and advertising services and changed the way of doing of business. Moreover, by expanding the scope of the Levy in Finance Act 2020 w.e.f. 1st April 2020, the Levy shall be charged at 2% of the consideration earned by an e-commerce operator from:
(i) Online sale of goods/provision of services; or
(ii) Facilitation of the sale of goods/provision of services; or
(iii)Combination of the above activities.

The recipient being:
(i) A person resident in India or using an IP address located in India; (Indian resident) or
(ii) A non-resident under specified circumstances

An e-commerce operator means a non-resident who owns, operates or manages digital or electronic facility or platform. Contrary to the prior application of the Levy, the compliance requirements are to be fulfilled directly by the operator on a quarterly basis. The receipts of the operator covered by the Levy as above, would not be subject to further taxation in India.

However, the Levy would **not** be applicable to:
(i) a non-resident earning receipts attributable to the above activities from its business presence effectively connected with permanent establishment in India; or
(ii) where sales, turnover or gross receipts from the above activities are less than INR 2 crores; or non-residents already covered by the Levy at its introduction in 2016.

Further, the inclusion of "services" increases the scope of the tax net by recognising the growing utilisation of digital platforms for provision of various services like media streaming services, etc.

In other words, looking to scope of section 9, Significant Economic Presence (SEP) and Equalisation Levy, the domestic law framework provides for sufficient determination of a profit rate to the India-specific turnover of the foreign company for ascertaining the profits attributable to the operations or digital transactions carried out in India.

Applying a global profit rate on India specific turnover would result in estimation of total profits from Indian turnover, though the entire activities giving rise to such profits, e.g. research and development, manufacturing, marketing and selling may not have been carried out in India.

5.4. Effect of Adoption of MLI on VPE

India ratified MLI and deposited ratified copy of MLI with OECD Depositary on 25 June 2019 –MLI Effective for 29 Indian Tax Treaties w.e.f. 1 April 2020. Therefore, one needs to check the MLI provisions also for Tax compliance.

Recommendations under BEPS adopted under MLI by way of:

MLI Article 12: Expanding scope of Agency PE
MLI Article 13: Restricting Preparatory and Auxiliary exemptions and introduction of Antifragmentation rules
MLI Article 14: Avoiding artificial splitting up of contracts
Therefore, looking to expanded scope in MLI, PE concept will also change accordingly.

Consequences of PE:
(i) Even a part of business carried on through a PE is sufficient for taxation
(ii) Books of accounts and audit requirements
(iii) TDS compliance and tax @ 40% on net profits

(iv) Transfer pricing implications for transactions with Associated Enterprises

Information technology has brought new ways in which business operates, encouraging globalization and integration of the markets, which has made it possible for multinational entities to shift manufacturing bases from high-cost to low-cost locations and managing risks and of developing, provided with opportunities to impressively minimize their tax burden.

This is due to two important factors:

(i) the existing ambiguities of the tax rules of the countries that may be involved in electronic commerce transaction (source and residence states) and,

(ii) the dilution of important notions that were constructed in the inter- national field to harmonize the different domestic rules under the digital environment, where physical presence is not required.

6. BEPS Pillar 1

Pillar One seeks to adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits. It expands the taxing rights of market jurisdictions where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.

Pillar One applies to about 100 of the biggest and most profitable MNEs and distributes part of their profit to countries where they sell their products and provide their services. The key elements of Pillar One can be grouped into three components:

(i) **Amount A (new taxing right):** A share of residual profit allocated to market countries using a formulaic approach to all in-scope businesses.

(ii) **Amount B (fixed “baseline” return):** For marketing and distribution functions based on arms’ length principle, applicable to all businesses.

(iii) **Tax certainty:** Through effective dispute prevention and resolution mechanisms, applicable to all businesses.

6.1. Amount A

The diagram below represents profit **Amount A**

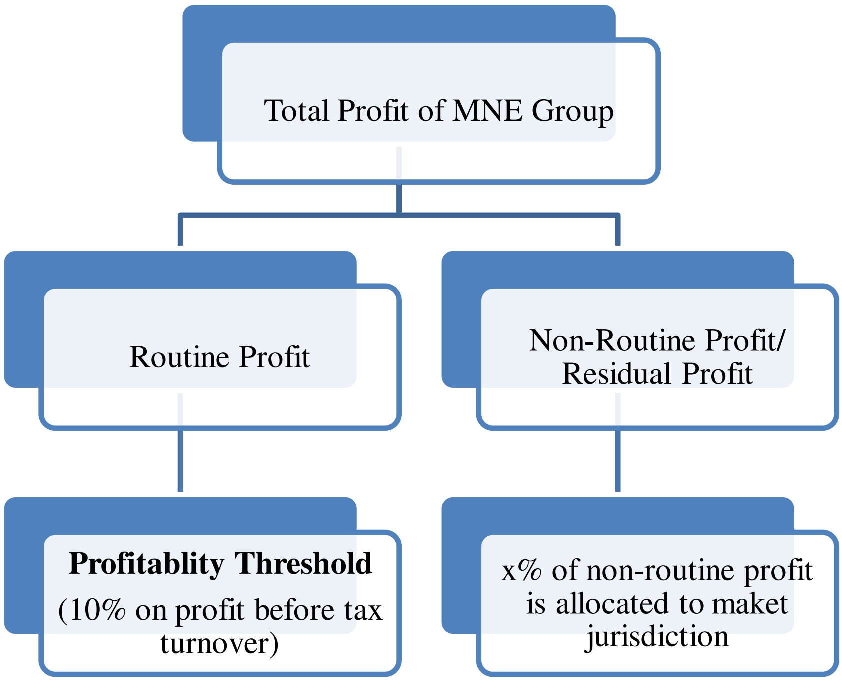


Fig. Profit Amount A

The profits within the profitability threshold of 10 per cent are routine profits, while those beyond the profitability threshold are residual or non-routine profits. Between 20 and 30 per cent of residual profits is treated as Amount A and distributed amongst market jurisdictions. This is the new taxing right under Pillar One. All MNE groups with gross revenue exceeding €20 billion and profitability above 10 per cent (Profit before tax/ revenue) are considered in-scope for Amount A. Extractives and regulated financial services are out of scope.

Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Amount A is allocated to the market jurisdiction only if the nexus exists. To establish nexus, the market revenue thresholds (€1 million/ €250,000 for jurisdictions with GDP lower than €40 billion) will apply to the in-scope revenue of a group, generated in a market jurisdiction. Market revenue will be identified and measured per the revenue sourcing rules

Tax base will be quantified using an adjusted Profit Before Tax (PBT) measure, derived from the consolidated financial accounts of in-scope MNE groups, rather than on a separate entity basis. To these, a limited number of book-to-tax adjustments will apply for certain items such as dividends, gains/losses under equity method of accounting, and bribes. Losses will be carried forward.

For in-scope MNEs, between 20 and 30 per cent of residual profit defined as profit in excess of 10 per cent of revenue will be allocated to market jurisdictions with nexus, using a revenue-based allocation key.

The proposed mechanism to eliminate double taxation will have two components:

(i) Identification of paying entities; and

(ii) Methods to eliminate double taxation. Approaches being considered include a marketing and distribution profits safe harbour, mechanism to eliminate double taxation and domestic business exemption.

6.2. Amount B

It aims to standardise the remuneration of related party distributors that perform "baseline marketing and distribution activities" to align with the Arm's Length Price. Further work is being done on this and is expected to be completed by the end of 2022.

6.3. Tax Certainty

Pillar One aims to significantly improve tax certainty by introducing innovative dispute prevention and resolution mechanisms. The Blueprint embeds a mechanism to ensure that the application of the new taxing right to a particular MNE group is agreed upon by all interested jurisdictions.

A panel mechanism would be implemented for tax administrations working with relevant MNEs to agree on:

(i) the tax base,

(ii) the result of the implementation of the formula, and

(iii) any other feature of the new taxing right, including paying entities and elimination of double taxation. A mandatory binding timely dispute resolution mechanism, for disputes not related to the application of the new taxing right is also being developed.

Appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies will be provided. The multilateral instrument through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023.

7. Case Studies Relating to Digital Economy

In certain cases, certain marketing activities as well as negotiation and conclusion of sale contracts may have been carried out in India, but all other activities, e.g. research and development, manufacturing, technical services etc. may have been carried out outside India. In such cases, the Indian courts have, in the past, used an ad hoc basis for estimating the profits attributable to India specific activities, based on facts of each case.

In the case of ***Anglo-French textile Co. Ltd. v. CIT [1954] 25 ITR 27 (SC)***, for instance, the Supreme Court of India returned a finding that in the facts of the case, 10% of profits were to be attributed to operations carried out in India.

In ***Hukum Chand Mills Ltd. v. CIT [1976]103 ITR 548(SC)***, the Supreme Court found that attribution of 15% of profits was reasonable in the facts of that case.

In case of ***Motorola Inc. v. Dy. CIT [2005] 95 ITD 269 (Delhi)(SB)***, a Special Bench of the Income Tax Appellate Tribunal held that attribution of 20% of profits was sufficient for role played by the PE in negotiation and conclusion of contracts and supply of equipment in India by the PE of the taxpayer.

In case of ***Morgan Stanley ruling [2007] (SC)***, the Supreme Court made a reference to a "software pe", but did not define such notion. Moreover it held that in Morgan Stanley, the case related to an associated enterprise, which was also held to constitute a service PE and since remuneration paid to the associated enterprise was already at arm's length and justified by a transfer pricing analysis, the Court did not consider any further need for attribution of profits to it.

Similarly, in ***Galileo International Inc. Dy. CIT [2009] 116 ITD 1/[2018 19 SOT 257 (Delhi)***, 15% of total revenues were considered to be attributable to the Indian PE on the basis that the PE played a role in negotiating contracts. More importantly ITAT held that a PE was configured in India because

(i) existed a business connection of Galileo in India due to the fact that the Company provided equipment, connectivity and configuration through a continuous, process available to travel agents in India;

(ii) there was a fixed place of business, since part of the reservation services performed with Galileo's system took place in the premises of the clients where the computers were placed; and

(iii) Inter globe constituted a dependent agent PE for Galileo in India, as it was functionally and financially dependent on the company.

In ***DIT v. Nipro Asia Pte Ltd. [2017] (Delhi – Trib.)***, the Delhi Bench of the ITAT held that Rule 10 of the Income tax Rules, 1962 can be invoked if the Assessing Officer is of the opinion that amount of income accruing to non-resident companies on account of business connection in India is not ascertainable.

Recently in case of ***LG Electronics Inc. Korea vs. Deputy Commissioner of Income-tax (International Taxation), Circle-2(2)1, Noida [2019] 109 (Delhi – Trib.)*** it was held that

Assessee-company was engaged in business of manufacture and sale of refrigerators, washing machines, air conditioners and other household appliances – It had a wholly-owned subsidiary in India (LG India) which had entered into several transactions relating to sale of raw materials and finished goods but no tax was deducted by LG India, on off shore supplies on ground that no portion of income from such supplies arose in India. AO held that assessee had a fixed place PE in India in terms of article 5(1) and 5(2) as LG India was legally and economically dependent on assessee and that assessee exercised total control over Indian subsidiary. AO attributed an income in addition to returned income as income allocable to assessee's PE in India – DRP without considering profit attribution by Assessing Officer directed him to take profit attribution at 20 per cent of profit margin of 50 per cent of salary cost of expatriates in India.

The Madras High Court in the case of ***Verizon Communications Singapore Pte Ltd. [2013]*** while deciding whether payments made to Verizon Singapore from India resulted in royalty income, stated that In any event, in a virtual world, the physical presence of an entity has today become an insignificant one; the presence of the equipment of the assessee, its rights and the responsibilities of the assessee, vis-a-vis the customer and the customers' responsibilities clearly show the extent of the virtual presence of the assessee which operates through its equipment placed in the customer's premises through which the customer has access to data on the speed and delivery of the data and voice sent from one end to the other.

New Delhi AAR in case of ***MasterCard Asia Pacific Pte. Ltd., In re [2018] (AAR – New Delhi)*** held that Applicant MasterCard Asia Pacific is a Singapore based company engaged in processing of electronic payment transactions – Customers are provided with a MasterCard Interface Processor (MIP) that connects to MasterCard's Network and processing centers. Indian subsidiary owns and maintains MIPs placed at customers locations in India. Whether applicant has a PE in India under provisions of article 5 of India-Singapore DTAA in respect of services rendered/to be rendered with regard to use of a global network and infrastructure to process card payments for customers in India; there is fixed place PE, service PE and dependent agent PE. Arm's length remuneration to PE on account of Indian subsidiary for activities performed/to be performed in India, would not absolve applicant from any further attribution of its global profits in India since FAR of Indian subsidiary does not reflect functions/risks of applicant performed/undertaken by it. Whether a part of fees received/to be received by applicant from Indian customers (being processing fees, assessment fees and transaction related miscellaneous fees) would be classified as royalty within meaning of this term in article 12 of India-Singapore DTAA, and not as FTS; however, since it is effectively connected to PE, it would be taxed under article 7 and not under article 12.

On other hand, regarding the configuration of a PE because of the virtual presence through a web page in India the Indian Income Tax Appellate Tribunal held in the ***Right Florists Pvt Ltd. [2013] 99 (Kolkata – Trib.)*** case held that the presence of search engines of Google and Yahoo through websites, when servers are located outside India did not constitute a business connection or PE in India.

Similarly, recently in ***Union of India v. U.A.E. Exchange Centre [2020] (SC)***, the Supreme Court held that an Indian liaison office of a United Arab Emirates ('UAE') company engaged in fund remittance services did not constitute a permanent establishment ('PE') in India. The Supreme Court rules that the activities performed by the Indian liaison offices of the UAE entity were 'preparatory and auxiliary' in nature and hence outside the purview of PE and further relies on the scope of RBI permission for setting up the liaison offices for its conclusion.

Test Your Knowledge

	QUESTIONS
1.	What are the two pillars of BEPS Action Plan 1?
2.	What are unilateral measures taken by the member countries of EU to mitigate the tax loss due to the emergence of digital economy?
3.	What are functions of Task Force on Digital Economy (TFDE)?
4.	Discuss whether physical presence of a company overrides the virtual presence in digital economy era?

SOLUTIONS	
1.	There are two pillars included in BEPS: **Pillar 1: Reallocation of profit and revised nexus rules:** This pillar involves work on potential solutions for determining where tax should be paid and on what basis, as well as the proportion of profits that should be taxed in the jurisdiction of the customer or user. **Pillar 2: Global anti-base erosion mechanism:** This pillar involves work on a system that would ensure that multinational enterprises pay a minimum level of tax, regardless of whether they have highly digitalized businesses. This work is intended to address remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to prevent their tax base from being shifted to jurisdictions that tax profits at less than the minimum rate.
2.	Some of the tax norms framed by member countries of EU in order to mitigate the tax loss due to the emergence of digital economy are: **Italy** The Italian web tax, effective as of 1 January 2019, applies to digital business-to-business transactions and is due both by resident and non-resident businesses, whenever they provide more than 3,000 transactions annually, at a rate of 3% levied on the service fees charged. Italy also introduced its own DST as of 1 January 2020, at a rate of 3%. This tax covers companies with total worldwide revenues of €750 million and revenues of at least €5.5 million obtained from digital services provided in Italy. Digital services that generate taxable revenues include targeted advertising on a digital interface, linking users of multi-sided digital interfaces, and transmitting user data generated from the use of platforms. It will be repealed once an international solution is agreed. **Austria** The Austrian Digital Services Tax (DST), adopted in 2019, applies to companies with a global turnover of €750 million or more, and a national turnover of at least €25 million. Revenues from domestic online advertising services are liable to tax when they are targeted at Austrian users. The tax rate has been set at 5%. **Hungary** In 2014, an advertisement tax was introduced on the turnover from broadcasting or publishing advertisements, with several progressive tax rates ranging from 0% to 50%.

After a 2015 Commission investigation found that this tax constituted State aid and was therefore incompatible with competition law.

Hungary replaced these progressive rates with two flat rates: a 0% rate for the part of the taxable revenues below HUF 100 million (approximately €3,12,000) and a 5.3% rate for the part of the taxable amount that is higher than the aforementioned threshold. Hungary then raised the latter to 7.5% for taxpayers with sales revenues from advertising exceeding HUF 100 million. In 2017, the European Court of Justice (ECJ) annulled the Commission's decision; however, Hungary suspended the tax temporarily by setting its rate at 0% between 1 July 2019 and 31 December 2022.

France

On 24 July 2019, the French DST became law, applying retroactively from January 2019. The tax applies to companies with a global digital turnover of more than €750 million and a digital turnover of more than €25 million in France. It covers targeted online advertising, the management and sale of user data for advertising and the connection of users through digital platforms. It is applied at a 3% rate on the gross revenues generated by those digital activities where French users play a major role in value creation. If an agreement is implemented at OECD level, it will replace the DST.

Poland

As of 1 July 2020, all video-on-demand (VOD) platforms operating in the country have had to pay an additional levy on their revenues obtained from subscription fees or advertising. The tax is set at 1.5% of these revenues.

Spain

The Spanish tax on certain digital services entered into force on 16 January 2021. It is levied on three types of services: online advertising services (when they appear on a device used in Spain), online intermediation services (when at least one user is located in the country), and the data transfer services for sale of user data (when it has been generated in Spain). The taxis set at 3% of the taxable base, which is the gross income generated from the provision of these services. The tax covers the companies whose global net turnover exceeds €750 million, and which generate at least €3 million.

Slovakia

The Slovakian tax, which covers income obtained by digital platforms and websites for intermediating services in transport and accommodation, was introduced in 2017. Effective from 1 January 2018, these businesses were considered as having their

	permanent establishment in Slovakia and were therefore eligible to pay corporate tax at a rate of 21%.
3.	i. The Task Force on the Digital Economy shall to assist the Inclusive Framework on BEPS (hereafter the "IF") with respect to its responsibilities in relation to the tax challenges of the digital economy by providing policy, legal, administrative and technical support to advance the work identified in the BEPS Action 1 Final Report, Addressing the Tax Challenges of the Digital Economy. ii. It shall monitor developments in the digitalisation of the economy over time that may affect tax policy and its implementation, which shall include but not be limited to the consideration of: a) the developments and emerging trends in technology, innovation and business models related to the digitalisation of the economy; b) the impact of the developments and trends identified in (a) above on the determinants of value creation; c) the impact of (a) and (b) above on tax policy and its implementation iii. TFDE shall monitor developments in the regulation of the digital economy, which shall include but not be limited to the monitoring of the implementation by governments of tax policy options to address the broader tax challenges of the digitalisation of the economy, such as: a) Options relating to a new nexus in the form of "significant economic presence"; b) Options to implement withholding taxes on certain types of digital transactions; c) Options to introduce an "equalisation levy". iv. It shall also monitor and evaluate the effectiveness of measures implemented as part of the BEPS package - including the International VAT/GST Guidelines - in addressing the BEPS issues and the broader tax challenges associated with the digitalisation of the economy; v. Review and analyse data that becomes available over time and are relevant for assessing the tax challenges of the digitalisation of the economy; vi. Monitor the continuing effectiveness of existing international tax standards to deal with the tax challenges raised by developments in the digitalisation of the economy. Issues to be examined in this context include, but are not limited to: a) Assess the extent of the broader tax challenges identified in the digital economy, taking into consideration the outcomes of the work described in (ii), (iii), (iv) and (v) above;

	b) Develop policy options to address the challenges related to the digitalisation of the economy. vii. Act as a centre of expertise for the IF on issues related to the digital economy and work in close cooperation and coordination with the other subsidiary bodies to avoid duplication and ensure a consistent and efficient approach across all activities relevant for addressing the tax challenges of the digital economy. viii. Engage with a broad range of stakeholders on relevant subjects to ensure that the work of the Task Force is informed by the most up to date and relevant information. ix. Undertake other tasks as requested by the IF.
4.	The emergence of the concept of Digital Economy has given more importance to the concept of the Virtual Permanent Establishment. The “Virtual PE” approach - i. is relatively and competitively neutral to the buyer or user in the market, since source taxation of its profit is probably more neutral than taxation exclusively based on residence, ii. it recognizes extensive source taxability according to economic allegiance and subject to thresholds, iii. it is effective because it establishes a link between the electronic business and its customer established in the source country. However, although VPE theory requires some kind of physical presence by the vendor, before a person is taxed, because a person can neither have operations, nor systematic activities, within a state, without him/her or his/her employees or agents being present in that state. The Madras High Court in the case of ***Verizon Communications Singapore Pte Ltd. [2013]*** while deciding whether payments made to Verizon Singapore from India resulted in royalty income, stated that In any event, in a virtual world, the physical presence of an entity has today become an insignificant one; the presence of the equipment of the assessee, its rights and the responsibilities of the assessee, vis-a-vis the customer and the customers’ responsibilities clearly show the extent of the virtual presence of the assessee which operates through its equipment placed in the customer’s premises through which the customer has access to data on the speed and delivery of the data and voice sent from one end to the other. Therefore, physical presence of an entity has today become an insignificant one and the concept of Virtual Permanent Establishment has become more relevant in order to determine the actual presence of the entity to determine the taxing rights of a country.

Taxation of Digital Economy

Module II – Domestic Law Responses

1. Introduction

Rapid advancement in technology and digitization has enabled given businesses an opportunity to generate more revenues from other countries/market jurisdictions without the need of any physical presence in such countries. This has been a matter of concern for market jurisdictions where the consumers/users are located. These jurisdictions are deprived of their share of the tax due to previous tax rules which were designed to cater to brick-and-mortar business models and focus on physical presence to allocate taxation rights. This has been a major area of debate in international tax for past several years. Globally, there have been several attempts to frame new rules of international taxation to keep pace with these new business models.

One such remedy was offered by Organization for Economic Co-operation and Development (OECD) under Base Erosion and Profit Shifting (BEPS) Action Plan 1. This Action Plan recommended three interim options to address the tax challenges arising from digital economy till a global consensus is reached to address this issue. These options were:
(i) Significant economic presence (SEP);
(ii) Withholding tax on digital transactions; and
(iii) Equalization levy.

After these developments, several countries have taken unilateral steps and made necessary changes in their domestic laws to tax new-age businesses.

India was one of the first countries to take early steps in the direction of taxing the Digital Economy. The Central Board of Direct taxes (CBDT), the apex tax administrative body in India set up a committee on taxation of e-commerce to evaluate the options available. The committee recommended equalization levy as a suitable option for India, as it did not require alternation in the existing tax treaties, which would have been a tedious and time-consuming process. Thus, India became one of the first countries to levy equalization levy of 6% on online advertising and related services in 2016. The equalization levy provisions were substantially widened in 2020 by bringing in its ambit the online sale of goods and services.

2. Significant Equalization Presence

The committee on Income Tax was also of the view that concept of SEP could be introduced within the concept of "business connection". Under domestic tax laws of India, a non-resident is taxed in India if it has a "business connection" in India. BEPS Action Plan 1 had recommended that a non-resident enterprise would create a taxable presence in a country if it has a SEP in that country on the basis of factors that have a purposeful and sustained interaction with the economy by the aid of technology and other automated tools.

The SEP provisions were initially introduced in 2018. It was felt that this change in the domestic law will enable India to negotiate for inclusion of this new nexus rule in the tax treaties. These provisions, however, remained inoperative as the thresholds were not prescribed. The current

SEP provisions are applicable from 2021-22. As per the current provisions, a non-resident having SEP in India shall be deemed to have a business connection in India. Accordingly, income attributable to the transactions or activities referred to in these provisions shall be deemed to accrue or arise in India and hence such income shall be taxable in India.

Significant Economic Presence is defined to mean transaction in respect of any goods, services or property carried out by a non-resident in India, including the provision of download of data or software in India, subject to payment threshold to be prescribed; or systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

SEP of a non-resident would be established if:

(i) the aggregate of payments arising from transactions in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, during the financial year exceeds 20 million (during a financial year); or
(ii) Non-resident undertakes systematic and continuous soliciting of business activities or engages in interaction with 300,000 or more number of users in India.

SEP provisions would be applicable, irrespective of whether:

(i) Agreement for such transactions or activities is entered in India; or
(ii) Non-resident has a residence or place of business in India; or
(iii) Non-resident renders services in India.

Further it has also been clarified that income attributable to the operations carried out in India, shall include income from:

(i) advertisement which targets a customer who resides in India or a customer who accesses the advertisement through internet protocol address located in India;
(ii) sale of data collected from a person who resides in India or from a person who uses internet protocol address located in India; and
(iii) sale of goods or services using data collected from a person who resides in India or from a person who uses internet protocol address located in India.

It is important to note that the concept of SEP has been introduced in the Indian domestic tax law. As far as the tax treaties are concerned, they provide that business profits of a non-resident would be taxable in India only if the non-resident has a permanent establishment (PE) in India. Under the tax treaties, the PE provisions, in general, would get triggered basis some physical presence of an entity. For example, entities have an office or physical presence of employees exceeding specified number of days, etc. Therefore, non-residents who are entitled to claim treaty benefit are not impacted by the SEP provisions, considering that the scope of PE in tax treaties continues to be much narrower.

3. Equalization Levy

Equalization Levy was introduced in India in 2016, with the motive of taxing the digital transactions i.e. the income accruing to foreign e-commerce companies from India. It is aimed at taxing business to business transactions.

Over the last decade, Information Technology has gone through an exponential expansion phase in India and globally. This has led to an increase in the supply and procurement of digital services. Consequently, this has given rise to various new business models, where there is a heavy reliance on digital and telecommunication networks. As a result, the new business models have come with a set of new tax challenges in terms of nexus, characterization, and valuation of data and user contribution.

The combination of inadequacy of physical presence based nexus rules in the existing tax treaties and the possibility of taxing such payments as royalty or fee for technical services creates a fertile ground for tax disputes. To bring clarity in this regard, the government introduced vide Budget 2016, the equalization levy to give effect to one of the recommendations of the BEPS (Base Erosion and Profit Shifting) Action Plan.

Equalization Levy is a direct tax, which is withheld at the time of payment by the service recipient. The two conditions to be met to be liable to equalization levy:
(i) The payment should be made to a non-resident service provider;
(ii) The annual payment made to one service provider exceeds Rs. 1,00,000 in one financial year.

3.1 Evolution of Equalization Levy

The following chart represents the evolution of Equalization Levy since 2016:

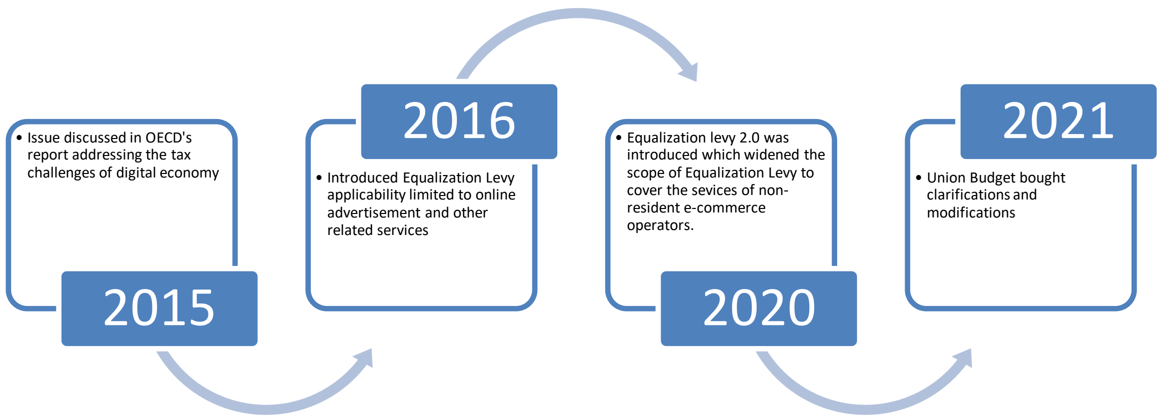


Fig. Evolution of Equalization Levy

3.2. Coverage of Equalization Levy

Currently, not all services are covered under the ambit of Equalization Levy. The following services covered:

(i) Online advertisement
(ii) Any provision for digital advertising space or facilities/ service for the purpose of online advertisement

3.3 Rate of Tax under Equalization Levy

Currently, the applicable rate of tax is 6% of the gross consideration to be paid.

Example:
Mohan has advertised on Facebook to expand his business. He has to pay Rs. 2,00,000 in FY 2020-21 to Facebook for the advertising services availed.

Facebook will bill Mohan for an amount of Rs. 2,12,765.9
Mohan will deduct TDS at the rate of 6% of Rs. 2,12,765.9 = Rs. 12,765.9 and pay the balance of Rs. 2,00,000 (Rs. 2,12,765.9 – Rs. 12,765.9) to Facebook.

3.4 Due Dates of Equalization Levy

Due date of furnishing Equalization Levy Statement (Form-1) is on or before 30th June of Financial Year ended (unless the date is extended). For FY 2020-21, CBDT has extended the last date for furnishing the Equalization Levy Statement (Form-1) to 31st December 2021.

Example:
In the above example, it is assumed that Mohan made the payment on 15th February 2021. Accordingly, he will have to deposit the tax with the authorities by 7th March 2021 and file the statement (i.e. Form -1) on or before 31st December 2021(extended due date).

3.5 Delayed Payments Consequences under Equalization Levy

In case there is a delay in payment, interest is charged at 1% of the outstanding levy for every month or part thereof is delayed.

In case there is non-compliance on behalf of the service recipient, the compliance procedure for the Equalization Levy is the responsibility of the service recipient.

3.6 Penalties and Prosecution under Equalization Levy

(i) Penalty for failure of payment

a) Equalization Levy not deducted:

   Penalty equal to the amount of levy failed to be deducted (along with interest and depositing of the principal levy outstanding).

b) Equalization Levy deducted but not deposited:

   Penalty equal to INR 1,000/day subject to the maximum of the levy failed to be deducted (along with interest and depositing of the principal levy outstanding).
   Disallowance of such expenditure in the hands of the payer (unless the defect is rectified).

(ii) Penalty for failure of filing statement of compliance

A penalty of Rs. 100/day for each day till the non-compliance continues.

(iii) Prosecution

If a false statement has been filed then the person may be subjected to imprisonment of a term of up to 3 years and a fine.

3.7 Equalization Levy vs. SEP

Currently, the equalization levy provisions and SEP provisions co-exist in the Indian domestic laws. Hence, it is possible that there could be an overlap between the two. It has, however, been provided that if a transaction is subject to equalization levy, then there would be no further Indian income tax liability. Accordingly, non-residents would need to check if equalization levy provisions are applicable in the first instance. If these provisions are applicable, then the transaction should be outside the purview of SEP provisions. Broadly speaking, equalization levy provisions reign supreme.

4. Withholding Tax Under Section 194-O of the Income-tax Act, 1961

Section 194O has been introduced in the Union Budget 2020. According to Section 194O, an e-Commerce operator is required to deduct TDS for facilitating any sale of goods or providing services through an e-Commerce participant. TDS on e-commerce operators under section 194-O is applicable from 1 October 2020.

Equalization Levy is levied on online sale of goods or online provision of services or a combination of both, by non-resident (NR) e-commerce operators (ECO), when online sale is made by a non-resident to specified persons. Equalization Levy being charged at the rate of 2% on amount of consideration received or receivable by a non-resident ‘e-commerce operator’ from e-commerce supply or services as against 6% which was introduced earlier in 2016. Also, Equalization Levy must be deposited by the non-resident ‘e-commerce operator’ and all related compliances viz. filing of Equalization Levy return, etc. to be made by non-resident 'e-commerce operator'.

4.1 Law before 194-O

Earlier, there was no TDS on payments made to e-Commerce participants. They were required to independently file their income tax returns. Therefore, many small e-Commerce participants did not file their ITR's and escaped the tax liability. Section 194O has been introduced in the Union Budget 2020 and is applicable from 1 October 2020.

4.2 Applicability of Section 194O

Section 194O of Income Tax Act, 1961 is applicable to:

(i) both resident and non-resident e-commerce operator;
(ii) resident e-commerce participant.

Points to be noted:

(i) Even if purchaser of goods/recipient of services is a non-resident, e-commerce operators should deduct TDS @ 1% at the time of credit or making payment to an e-Commerce participant, whichever is earlier.
(ii) If e-commerce participant is a corporate, then TDS u/s 194O is deductible irrespective of the threshold limits.
(iii) In case of Individuals/HUF, there is no requirement to deduct TDS if the gross amount of sale of goods, services, or both during the previous year does not exceed Rs. 5 lakh and if the e-Commerce participant has furnished his PAN or Aadhaar.
(iv) The threshold limit of INR 500,000 under section 194-O is calculated from 1 April 2020.
(v) The liability to deduct TDS or collect TCS applies to payments or credits on or after 1 October 2020.
(vi) TDS must be deducted at the rate of 5%, as per provisions of Section 206AA if the participant does not furnish his PAN or Aadhaar.

Exceptions to above applicability are as follows:

No TDS will be deducted if the participant is a non-resident (in such cases, the provisions of "Equalization levy" are applicable); and if the amount, paid or credited to individuals/HUF during a financial year, does not exceed Rs. 5 lakh.

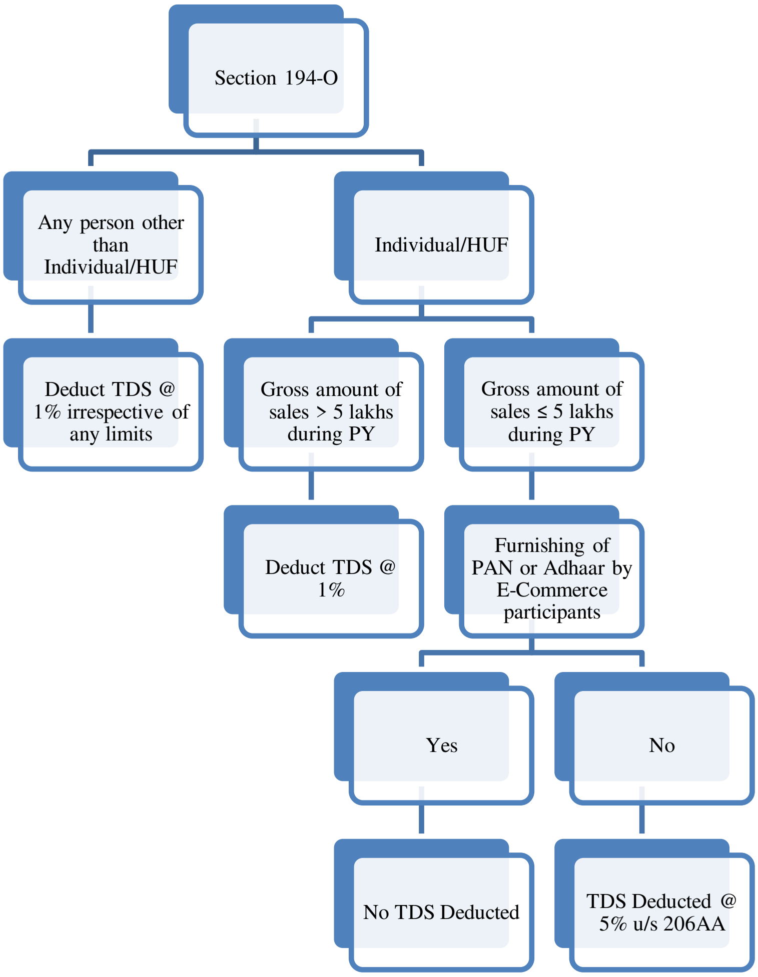


Fig. Section 194-O

4.3 Instances where both Equalization Levy and 194-O are Applicable

A buyer who is resident in India purchases goods on an E-Commerce platform run by a non-resident from a seller who is a resident in India. In such a scenario, non-resident E-Commerce Operator would be liable to pay an equalization levy @ 2% in India (subject to other conditions of the section being satisfied) and deduct tax @ 1% u/s 194-O of the Income-tax Act from the payment to be made to the seller.

Points to be noted:

(i) Equalization Levy would be applicable to inter-company transactions and reseller arrangements. No exemption is provided in this regard.
(ii) Advice rendered through email or telephone would also constitute digital or electronic facility or platform which is used for online provision of services and therefore can fall within the ambit of e-commerce supply or services, hence liable for equalization levy.

4.4 Transition of Tax Laws Taxing Digital Economy from 2016 to 2021

<table>
<tr><th>Particulars</th><th>Advertisement Equalization Levy (EL) as introduced by Finance Act 2016</th><th>E-commerce Equalization Levy (EL) as introduced by Finance Act 2020</th><th>Union Budget 2021</th></tr>
<tr><td>Applicability for EL in India</td><td>Non-resident service provider engaged in providing specified services as below.</td><td colspan="2">Non-resident e-commerce operator who owns, operates, or manages digital or electronic facility or platform in connection with India operations.

Non-resident who sells advertisement to another non-resident which targets an Indian resident customer or a customer who accesses the advertisement through internet protocol (IP) address located in India.

Non-resident who sells data, collected from an India resident person or from a person who uses IP address located in India.</td></tr>
<tr><td>Specified services/ transactions on which EL is applicable</td><td>• Online advertisement.
• Any provision for digital advertising space.
• Any provision of facility or service for online advertisement.
• Any other service which may be notified later by the central government.
• Online sale of goods owned by the non-resident e-commerce operator.
• Online provision of services provided by the nonresident e-commerce operator.</td><td colspan="2">Online sale of goods or provision of services or both, facilitated by the non-resident ecommerce operator.
Any combination of activities listed above.</td></tr>
<tr><td>Rate</td><td>6%</td><td colspan="2">2%</td></tr>
<tr><td>Person responsible for compliance or</td><td>Payer</td><td colspan="2">Non-resident e-commerce operator</td></tr>
</table>

<table>
<tr><td colspan="1">person liable to pay EL in India</td><td></td><td colspan="2"></td></tr>
<tr><td>Non–applicability of EL</td><td>EL is not applicable if:
Non-resident has a PE in India and specified services (as above) are effectively connected to PE in India; or
Aggregate value of consideration for specified transactions do not exceed INR 0.1 million (approx. US$ 1,300) in a FY; or
Where payment is not for the purpose of carrying out business or profession.</td><td>E-commerce EL is not applicable if:
Non-resident e-commerce operator has a PE in India and e-commerce transaction is effectively connected to PE in India; or
Aggregate value of consideration for specified transactions do not exceed Rs. 2 crores; or
Where Advertisement EL is levied on services.</td><td>Consideration in the nature of royalty and fees for technical services (FTS), which is taxable under the Income Tax Act read with Double Tax Avoidance Agreements, will not be subject to EL.
Thus, royalty and FTS income will continue to be charged at 10% (plus applicable surcharge and cess) on a gross basis and will not be chargeable to EL.</td></tr>
<tr><td>Collection and Recovery</td><td>The amount of equalisation levy so deducted by the payer has to be deposited by 7th day of the month following the month in which the equalisation levy is deducted.</td><td colspan="2">The equalisation levy shall be paid by every e-commerce operator to the credit of government quarterly within the following due dates:<table><tr><th>Date of ending of Quarter</th><th>Due Date</th></tr><tr><td>30 June</td><td>7 July</td></tr><tr><td>30 September</td><td>7 October</td></tr><tr><td>31 December</td><td>7 January</td></tr><tr><td>31 March</td><td>31 March</td></tr></table></td></tr>
<tr><td>Due Date of Furnishing the Annual Statement</td><td>On or before 30th June of FY ended.</td><td colspan="2">On or before 30th June of each FY.</td></tr>
<tr><td>Interest on Failure to pay Equalisation Levy</td><td>1% of the outstanding levy for every month or part thereof is delayed.</td><td colspan="2">1% of the outstanding levy for every month or part thereof is delayed.</td></tr>
</table>

<table>
<tr>
<td>Penalty</td>
<td>
<table>
<tr><th>Situation</th><th>Penalty (in addition to paying equalisation levy and interest)</th></tr>
<tr><td>Failure to deduct equalisation levy (wholly or partly)</td><td>A penalty equal to amount of equalisation levy</td></tr>
<tr><td>Failure to deposit with government</td><td>Rs. 1,000 for each day of default (not to exceed amount of equalisation levy)</td></tr>
<tr><td>Failure to furnish statement</td><td>Rs. 100 for each day of default</td></tr>
</table>
</td>
<td colspan="2">
<table>
<tr><th>Situation</th><th>Penalty (in addition to paying equalisation levy and interest)</th></tr>
<tr><td>Failure to deduct equalisation levy (wholly or partly)</td><td>A penalty equal to amount of equalisation levy</td></tr>
<tr><td>Failure to furnish statement</td><td>Rs. 100 for each day of default</td></tr>
</table>
</td>
</tr>
<tr>
<td>Income Tax Exemption</td>
<td>When equalisation levy is deducted under the above provisions, income of the recipient non-resident is exempt under section 10(50).</td>
<td>Income from the above activities in the hands of e-commerce operator is exempt under section 10(50).</td>
<td></td>
</tr>
<tr>
<td>Clarifications</td>
<td></td>
<td></td>
<td>Clarification on Mismatch of Effective Dates of EL:
Exemption from the income tax was with effect from 1 April 2021. Thus, for FY 2020-21, there was a mismatch in the effective dates of EL and the corresponding</td>
</tr>
</table>

			income tax exemption. It has been proposed to remove this anomaly in order to grant the income tax exemption with retrospective effect to 1 April 2020. The scope of the terms "online sale of goods" and "online provision of services" will cover any of the following activities if undertaken online: • Acceptance of an offer for sale • Placing a purchase order • Acceptance of a purchase order • Payment of the consideration • The supply of goods or provision of services, partly or wholly As per the amendment, EL provisions are also made applicable if any one of the above activities has taken place online and such goods/services are supplied offline.

			E-commerce operators are currently subject to EL at 2% on the amount of consideration "received or receivable." A clarification has now been provided through an amendment that such consideration will include: • Consideration for sales of goods irrespective of whether the e-commerce operator owns the goods • Consideration for the provision of services irrespective of whether the service is provided or facilitated by the e-commerce operator.

5. Digital Service Tax in UK and Australia

With the rapid globalization and digitalization of the global economy, the question of how countries should approach the taxation of digital multinational enterprises (MNEs) has come to the forefront of international tax policy discussions. This digitalization has made it more difficult for countries to tax economic activity which takes place within their own territory and has facilitated corporations' ability to shift profits. In 2015, the OECD implemented an Action Plan on Base Erosion and Profit Shifting (BEPS) that included 15 measures dedicated to improve the coherence of international tax rules and ensure a more transparent tax environment in order to prevent an estimated USD 100-240 billion annually lost in tax avoidance practices globally.

A Digital Services Tax (DST) is a tax on selected revenue streams of multinational digital companies. Revenue streams that may be taxed by a country include advertising, intermediation, and digital marketplaces and data transmission. The rationale for the DST is to attempt to capture profits that are generated in a country but then shifted offshore by digital MNEs. The DSTs implemented to date generally have a very high tax-free threshold which ensures that the tax only applies to large MNEs which are thought to make a significant amount of profit in the domestic country. It is usually targeted at Google, Apple, Facebook and Amazon and is thus known as the "GAFA tax". DSTs have gained political traction and media attention over the past few years, particularly in light of the high profile of these companies.

In today's economy, most businesses have adopted some digital elements into their business practice. Early efforts to implement digital taxes attempted to define a digital business model. Such models were not envisaged when the existing tax codes were designed. In its 2018 Interim Report, the OECD defined the digital economy as having the ability to have
(1) "cross jurisdictional scale without mass,"
(2) "reliance on intangible assets, including IP," and
(3) a reliance on "data, user participation and their synergies with IP."

While profit shifting takes place in many industries and elements of these three factors are present in other industries (such as television and newspapers), the combination of these three features, and in particular IP (where television and newspaper have lagged), has changed the way in which value is created and has allowed for companies to minimize tax by allocating intangible assets in low-tax countries. Digital MNEs, born into an international tax environment with many BEPS opportunities, set up structures to take advantage of these opportunities from their inception.

Digital MNEs can produce substantial value in countries like Australia with minimal physical presence and consequently pay little tax. The European Commission found that within the EU, digital companies were subject to an average effective tax rate of 9.5% while traditional business models, with more of a physical presence, were subject to a 23% average effective tax rate. This has given momentum to efforts by countries to tax these foreign digital companies.

5.1 Digital Service Tax in UK

From 1 April 2020, the government of UK will introduce a new 2% tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users.

The application of the current corporate tax rules to businesses operating in the digital economy has led to a mis-alignment between the place where profits are taxed and the place where value is created. Many of these digital businesses derive value from their interaction and engagement with a user base.

Under the current international tax framework, the value businesses derive from user participation is not taken into account when allocating the profits of business between different countries. This measure will ensure the large multinational businesses in-scope make a fair contribution to supporting vital public services.

The government still believes the most sustainable long-term solution to the tax challenges arising from digitalization is reform of the international corporate tax rules and strongly supports G7, G20 and OECD discussions on long-term reform. The government is committed to dis-applying the Digital Services Tax once an appropriate international solution is in place.

The Digital Services Tax will apply to a group's businesses that provide a social media service, search engine or an online marketplace to UK users. These businesses will be liable to Digital Services Tax when the group's worldwide revenues from these digital activities are more than £500 million and more than £25 million of these revenues are derived from UK users.

If the group's revenues exceed these thresholds, its revenues derived from UK users will be taxed at a rate of 2%.

There is an allowance of £25 million, which means a group's first £25 million of revenues derived from UK users will not be subject to Digital Services Tax.

The provision of a social media service, internet search engine or online marketplace by a group includes the carrying on of any associated online advertising service. An associated online advertising service is an online service that facilitates online advertising and derives significant benefit from its association with the social media service, search engine or online marketplace.

There is an exemption from the online marketplace definition for financial services providers.

The taxable revenues will include any revenue earned by the group which is connected to the social media service, search engine or online marketplace, irrespective of how the business monetises the service. If revenues are attributable to the business activity and another activity, the group will need to apportion the revenue to each activity on a just and reasonable basis.

Revenues are usually derived from UK users if the revenue arises by virtue of a UK user using the service. However, there are some exceptions to this general rule.

Where one of the parties to a transaction on an online marketplace is a UK user, all of the revenues from that particular transaction will be treated as derived from UK users.

When the transaction involves accommodation, land or buildings in the UK, revenue from that transaction will be treated as derived from UK users. When the transaction involves accommodation, land or buildings not in the UK, revenue from that transaction will only be treated as derived from UK users if the consumer of the relevant service is a UK user.

The revenue charged will be reduced to 50% of the revenues from the transaction when a user in respect of a marketplace transaction is normally located in a country that operates a similar tax to the Digital Services Tax. Advertising revenues are derived from UK users when the advertisement is viewed or otherwise consumed by a UK user. A UK user is an individual that is normally located in the UK, or other type of user established in the UK.

Groups will be able to elect to calculate their Digital Services Tax under an alternative calculation. This is intended to ensure that the Digital Services Tax does not have a disproportionate effect on business sustainability in cases where a business has a low operating margin from providing in-scope activities to UK users.

The total Digital Services Tax liability will be calculated at the group level, but the Digital Services Tax will be charged on the individual entities in the group that realize the revenues that contribute to the total. The group consists of all entities which are included in the group consolidated accounts, provided these are prepared under an acceptable accounting standard. Revenues will consequently be counted towards the Digital Services Tax thresholds even if they are recognized in entities which do not have a UK taxable presence for corporation tax purposes.

A single entity in the group will be responsible for reporting the Digital Services Tax to Her Majesty's Revenue and Customs (HMRC). Groups can nominate an entity to fulfill these responsibilities. Otherwise, the ultimate parent of the group will be responsible. The Digital Services Tax will be payable and reportable on an annual basis.

The measure is expected to have an impact on a small number of large multinational groups by bringing into scope of Digital Services Tax the proportion of their revenue that is derived from UK users of social media, search engines or online marketplaces. The policy will be delivered through a Digital Services Tax charge reported and collected under new provisions.

As with any new tax, there will inevitably be an increased administration burden on the affected groups. The customer experience for the businesses in scope of the Digital Services Tax will change due to the additional requirements placed on them from complying with a new tax. HMRC will provide clear and targeted guidance to support businesses further.

One-off costs will include familiarization with the new rules. Ongoing costs may include keeping records of revenue referable to UK users and making payment to HMRC. Businesses in scope will also use a new service to make their annual return of the tax due.

5.2 Digital Service Tax in Australia

From 1st July 2017, Australia imposed 10% GST on the sale of electronic/digital services by non-resident providers to its consumers. The enacting legislation is the Tax and Superannuation Laws Amendment (2016 Measures No1) Bill 2016. These measures contributed to an additional AUD 348 million in tax revenue, representing only about 0.5% of total GST revenues. In response to these measures however, many companies altered their business models. For example, in 2018 Amazon redirected Australians' access from its main website to a domestic webpage to avoid the 10% import VAT.

The following activities are included within the Australian definition of electronic services:

(i) Streaming or downloads of music, films, apps and games
(ii) E-books
(iii) Online professional services
(iv) Online web, cloud and storage services

Non-resident providers of electronic services will only be required to register if their annual sales exceed AUS$ 75,000. Market platforms (Google Play; Apple App Store and Amazon Kindle) acting as the provider of the services to the consumer on behalf of content creators will be liable to declaring any GST due.

There are three types of Australian GST registrations:

(i) Simplified GST registration
(ii) Standard GST registration
(iii) Standard claim only GST registration

For digital services, most non-resident providers should opt for option (i), Simplified GST registration. Businesses may opt to voluntarily register for GST if they are below the threshold.

Australian returns are filed quarterly, along with a remittance of any GST due. If a provider's annual turnover is below AUS$ 10m, it may be able to remit quarterly, but only file a GST return quarterly.

By contrast, foreign owned (FODB) pay little to no corporate income tax in Australia because, while they generate significant profit from Australians who consume the digital services they provide, they lack a physical presence in Australia. This is possible since FODBs rely on intangible and highly mobile assets, which can be located anywhere in the world. DSTs aim to tax FODBs, which lack a physical presence in Australia, on the sizable and growing profits generated by their users in Australia. While the OECD is formulating an internationally coordinated approach to taxing multinational digital corporations, some countries have moved forward with their own unilateral DSTs. As of October 2021, legislation had been enacted in 26 countries.

DSTs would tax FODBs by taxing particular revenue streams, including advertising, intermediation, and digital marketplaces and data transmission. In practice, implemented DSTs have a high tax-free threshold, thereby only applying to the largest FODBs, such as the GAFA companies. However, DSTs achieve this not through corporate income taxation, but rather a consumption tax. The demand for digital services, such as the use of the Apple Store or the Google search engine, is relatively inelastic since the services provided by the largest FODBs have few substitutes. By contrast, the supply of these services, such as the provision of an additional advertisement, is relatively elastic, since most investment incurred by companies for their provision is in the form of large, fixed cost investments in hardware and software development. Combined, this elasticity suggests that the burden should be shifted largely to consumers. Thus far, FODBs have responded as expected—by passing the burden down to consumers in the form of higher fees in the countries that impose them.

6. USTR Section 301 Digital Investigation

Section 301 of the Trade Act of 1974 grants the Office of the United States Trade Representative (USTR) a range of responsibilities and authorities to investigate and take action to enforce U.S. rights under trade agreements and respond to certain foreign trade practices. Prior to the Trump Administration and since the establishment of the World Trade Organization (WTO) in 1995, the United States used Section 301 authorities primarily to build cases and pursue dispute settlement at the WTO. Former President Trump was more willing to act unilaterally under these authorities. The Trump Administration attributed this shift in policy to its determination to close a persistent gap between U.S. and foreign government practices that it said disadvantaged U.S. firms. In addition, it justified many of its tariff actions—particularly those against China—by pointing to alleged weaknesses in WTO dispute settlement procedures and the inadequacy or nonexistence of WTO rules to address certain Chinese trade practices. It also cited the failure of past trade negotiations and agreements to enhance reciprocal market access for U.S. firms and workers. The recent use of Section 301 has been the subject of congressional and broader international debate. In 2021, the Biden Administration took a number of steps to eliminate certain foreign practices and policies that were the subject of Section 301 investigations. The Administration continues to review its strategy for China, and so far, it has extended and reinstated certain tariff exclusions and announced a review of all Section 301 actions against China.

Title III of the Trade Act of 1974 titled "Relief from Unfair Trade Practices," is often collectively referred to as "Section 301." Section 301 provides a statutory means by which the United States imposes trade sanctions on foreign countries that violate U.S. trade agreements or engage in acts that are "unjustifiable" or "unreasonable" and burden U.S. commerce. Prior to 1995, the United States used Section 301 extensively to pressure other countries to eliminate trade barriers and open their markets to U.S. exports. The creation of an enforceable dispute settlement mechanism in the WTO, strongly supported by the United States, significantly reduced the use of Section 301. While the United States retains the flexibility to seek recourse for foreign unfair trade practices in the WTO or under Section 301, a determination to bypass WTO dispute settlement and impose retaliatory measures in response to a Section 301 investigation may be challenged at the WTO.

While the law does not limit the scope of investigations, it cites several types of foreign government conduct subject to Section 301 action, including

(i) a violation that denies U.S. rights under a trade agreement,
(ii) an "unjustifiable" action that "burdens or restricts" U.S. commerce, and
(iii) an "unreasonable" or "discriminatory" action that "burdens or restricts" U.S. commerce.

6.1 Administration of Section 301

Section 301 investigations are conducted by a “Section 301 Committee” which is a subordinate, staff-level body of the USTR-led, interagency Trade Policy Staff Committee (TPSC). The Section 301 Committee reviews Section 301 petitions, conducts public hearings, and makes recommendations to the TPSC regarding potential actions under Section 301. The USTR then bases its final decision on the recommendations provided by the TPSC.

6.2 Procedures for Section 301

Sections 302 through 309 describe the procedural requirements and limitations for Section 301 actions.

(i) **Initiation-** the USTR may initiate a Section 301 case as a result of a petition or can “self-initiate” a case. Any interested person may file a petition with the USTR requesting that the agency take action under Section 301. Within 45 days of the receipt, the agency must review the allegations and determine whether to initiate an investigation. In the absence of a petition, the USTR can also investigate any matter, but only after consulting with appropriate stakeholders. In addition, the USTR is generally required to initiate an investigation of any country within 30 day after identifying it as a “Special 301” “Priority Foreign Country.” (Rules for intellectual property rights [IPR] cases initiated through “Special 301” differ somewhat from those that govern standard Section 301 investigations.)

(ii) **Consultations-** Upon initiating an investigation, the USTR must request consultations with the targeted foreign government regarding the issues raised. If the investigation involves a trade agreement and a mutually acceptable resolution is not reached, the USTR must request formal dispute settlement proceedings under the governing trade agreement (WTO or potential U.S. free trade agreement). In the past, with regard to investigations that do not involve an agreement, the USTR has initiated investigations while simultaneously requesting consultations with the foreign government and seeking information and advice from appropriate trade advisory committees. If an investigation includes “mixed” issues, some of which are covered by an agreement and some of which are not, the USTR generally pursues consultations within the agreement framework and through bilateral negotiations.

(iii) **Determinations and Implementation-** Following consultations, the USTR begin its investigation to determine if the alleged conduct is unfair or violates U.S. rights under trade agreements. If the USTR’s determination is affirmative, it then decides what action, if any, to take (subject to the direction of the President, if any). Section 301 divides such actions into mandatory and discretionary categories. Mandatory action is required if the USTR concludes that there is a trade agreement violation or that an act, policy, or practice of a foreign government is “unjustifiable” and “burdens or restricts” U.S. commerce. If Section 301 of the Trade Act of 1974 an investigation involves an alleged violation of a trade agreement, the USTR must make its final determinations 30 days after the date on which the dispute settlement procedure concludes. Generally, in cases not involving trade agreements, the USTR must make its determinations within 12 months after an investigation begins. Upon making an affirmative determination to take retaliatory action, the USTR must implement that action within 30 days. Waivers are allowed for mandatory actions and implementing timelines.

6.3 Retaliatory Action

To remedy a foreign trade practice, Section 301 authorizes the USTR to
(i) impose duties or other import restrictions,
(ii) withdraw or suspend trade agreement concessions, or
(iii) enter into a binding agreement with the foreign government to either eliminate the conduct in question (or the burden to U.S. commerce) or compensate the United States with satisfactory trade benefits.

6.4 Subsequent Actions

The USTR must give preference to duties (i.e., tariffs) if action is taken in the form of import restrictions. The level of mandatory action under Section 301 should "affect goods or services of the foreign country in an amount equivalent in value to the burden or restriction being imposed by that country on" U.S. commerce.

Sections 306 and 307 specify the requirements for monitoring, modifying, and terminating any action taken under Section 301. Notably, foreign noncompliance with a measure or agreement undertaken as a result of a Section 301 investigation is considered a violation of an agreement under Section 301 and subject to mandatory retaliatory action. Section 301 actions terminate automatically after four years, unless the USTR receives a request for continuation and conducts a review of the case. In addition, in some cases, the USTR may reinstate a previously terminated Section 301 action.

6.5 Section 301 Cases

There have been 130 cases under Section 301 since the law's enactment in 1974, of which 35 have been initiated since the WTO's establishment in 1995. These cases have primarily targeted the European Union (EU), Canada, Japan, and South Korea. Prior to 2017, the last Section 301 investigation took place in 2013 and involved Ukraine's practices regarding IPR. Given the political situation in Ukraine, the USTR determined that no action was appropriate at the time. The last investigation prior to the Trump Administration resulting in retaliation (i.e., tariffs) took place in 2009 and involved Canada's compliance with the 2006 U.S.-Canada Softwood Lumber Agreement. During the Trump Administration, the USTR initiated six new investigations. Two investigations resulted in the imposition of tariffs: on U.S. imports from China and the EU. The U.S. action against the EU—unlike that against China—was based on a WTO dispute in which the USTR anticipated being allowed to retaliate.

6.6 Issues for Congress

Since 1995, the United States has addressed most trade disputes bilaterally and multilaterally, including through the WTO. While some Members support recent Section 301 actions, others have decried such unilateral actions as an undesirable shift in U.S. trade policy. Congress could consider amending Section 301 to require greater consultation or approval before a President takes new trade actions, or to establish a formal product exclusion process. Congress could also request an economic study of how such actions may affect the U.S. economy, supply chains, and the multilateral trade system.

7. <u>Some Relevant Case Laws</u>

I. Google Asia Pacific Private Limited, Singapore
Overview: Over the years, India has made significant changes to its domestic tax law to ensure that it receives its fair share of tax from the digital economy. Some of the changes include: (i) the amendment of the definition of "royalty" in 2012; (ii) the introduction of the equalisation levy in 2016 (restricted only to online advertisement services and providing digital advertising space), which was expanded in 2020 to include non-resident e-commerce operators within its ambit; (iii) the amendment of the definition of "business connection" to include a "significant economic presence" in 2018; and (iv) the introduction of withholding tax on domestic e-commerce transactions in 2020. As per the expanded provisions, with effect from April 1, 2020, consideration received by a non-resident e-commerce operator from an e-commerce supply or service (except for online advertisement services already covered under the equalisation levy introduced in 2016) will be liable to equalisation levy at the rate of 2%. An exemption from equalisation levy is currently provided in the following cases: (i) non-resident e-commerce operators having a Permanent Establishment (PE) in India and where the e-commerce transaction is effectively connected to such PE in India; and (ii) cases where the aggregate value of the consideration for the specified transactions does not exceed INR 20 million (~ US$ 266,000) in a year. Additionally, transactions entered into on or after April 1, 2021, which are chargeable to equalisation levy, are exempt from income-tax. **High Court's Rulings:** In the case of Google Asia Pacific Private Limited, Singapore (the taxpayer), the Delhi High Court (DHC) has dealt with the issue of withholding tax at source on Google's cloud

service-related payments which were already subject to a 2% equalisation levy.

As an interim measure, without ruling on the merits of the case, the DHC has allowed the Singapore based taxpayer to receive the payment from an Indian entity post deduction of tax at the rate of 8% (without additional surcharge and health and education cess based on the decision in the Epcos Electronic case and the Frequently Asked Questions explanatory circular issued by the Central Board of Direct Taxes) instead of 10% as provided under the “Royalty and fees for technical services” article in the India-Singapore double taxation avoidance agreement because 2% equalisation levy was already paid on the transaction.

Conclusion:
Equalisation levy has been introduced as a separate Chapter in the Finance Act and, hence, does not form part of the Income-tax Act, 1961 (IT Act). Therefore, given that equalisation levy does not partake the character of income tax, credit of equalisation levy in the home country of the non-resident is, generally, not possible. Whilst much will depend on the provisions of the domestic tax law of the country of the non-resident recipient, but assuming that equalisation levy is not creditable, it is likely to result as a sunk cost in the hands of the non-resident.

While the equalisation levy applies with effect from April 1, 2020, the corresponding exemption from income tax in the hands of non-resident recipient applies only from April 1, 2021. Given this, there can be potential double taxation in the financial Year 2020-21, where the same transaction is subjected to equalisation levy as well as royalty or fees for technical services. So, the interplay of taxability of services under the head of royalty or fees for technical services vis-à-vis the equalisation levy provisions needs to be assessed.

The Finance Act, 2021, clarifies that equalisation levy shall not apply if the consideration is taxable as royalty or fees for technical services under the IT Act read with the tax treaty provisions. In the instant case, although the taxpayer had already paid equalisation levy, the tax department wanted to tax the same transaction under the royalty or fees for technical services provision. The DHC, as an interim measure, directed that the taxpayer would be entitled to receive the cloud service-related payment after deduction of tax at the rate of 8%. It is not currently known if the income-tax department will prefer an appeal against this ruling or will refuse the 2% equalisation levy adjustment at the time of assessment proceedings a year down the line.

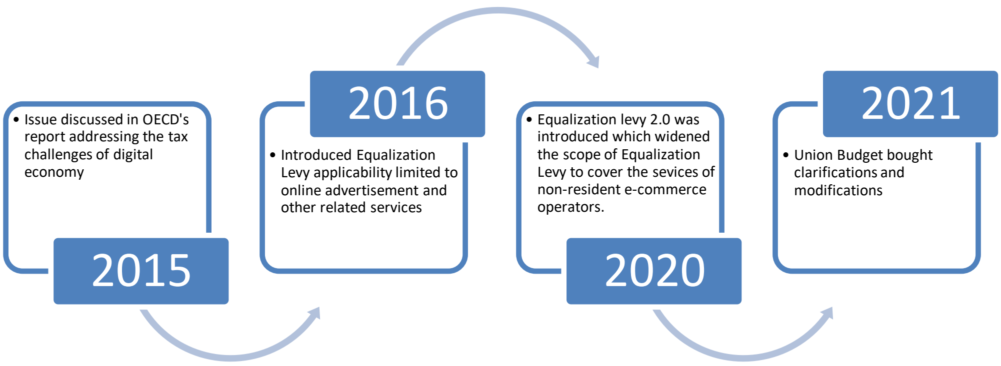
Interestingly, India is a party to the two-pillar solution introduced by the OECD and the G20 Inclusive Framework on Base Erosion and Profit Shifting. Pillar One requires all member countries to withdraw their existing digital services taxes. However, on November 24, 2021, the Indian government announced that a transitional approach of 2% equalisation levy on e-commerce supply or services has been agreed with the US and the applicable interim period will be from April 1, 2022 until the implementation of Pillar One or March 31, 2024, whichever is earlier. As we see it, unless the interplay between

the equalisation levy and the applicability of the royalty or fees for technical services provisions is sorted out soon, tax litigation on this issue cannot be ruled out.

II. Coursera vs. Income Tax Officers
Coursera is a US tax-resident and an e-platform operator, acting as an aggregator of educational institutions and providing easier access to various courses. The organisation filed a writ petition challenging Revenue's order against rejection of its application for NIL Tax Withheld Certificate in respect of its receipts for financial year 2021/22 (equivalent to Assessment Year 2020/21), whereby Revenue directed the customers of Coursera to withhold tax of 10% without giving reasons for arriving at such a rate. **High Court's Ruling:** Delhi HC observes that the impugned order noted, "the receipts from Indian customers are not chargeable to tax as royalty/FTS under the provisions of the Act read with India US tax treaty and since the assessee has been suo moto paying equalization levy at 2% on receipts from Indian customer … such receipts may be subjected to tax withheld … keeping in the interest of Revenue", thus, remarks that "There is no reasoning as to how the rate finally granted has been arrived at". Delhi HC opines that the impugned order does not take into account the impact of the amendment carried out in section 10(50) by Finance Act, 2021 with effect from 1 April 2021, whereby the amounts taxable as royalty/fees for technical services under the Act and the relevant DTAA would not be considered for the charge of the Equalization Levy. It further notes that although Revenue held that the Assessee is not eligible for benefit under article 12(5)(c) of the India-US DTAA, the order does not contain any reasoning or discussion on the applicability or otherwise of various sub-articles of the DTAA to the facts of the case. Therefore, it sets aside the order and directs the Revenue to pass a fresh reasoned order taking into account the amendments to section 10(50) within a period of 4 weeks and accordingly, disposes of the writ petition. **Conclusion:** Therefore, the amounts earned by coursera taxable as royalty/fees for technical services under the Act and the relevant DTAA would not be considered for the charge of the Equalization Levy.

Test Your Knowledge

QUESTIONS	
1.	What is Equalization Levy? Also state how the concept of Equalization Levy has evolved with time?
2.	Discuss the applicability of Section 194-O.
3.	What are provisions related to Digital Service Tax in UK?
4.	What rulings were given by high court in the case of Google Asia Pacific Private Limited, Singapore?

SOLUTIONS	
1.	Equalization Levy was introduced in India in 2016, with the motive of taxing the digital transactions i.e. the income accruing to foreign e-commerce companies from India. It is aimed at taxing business to business transactions. Over the last decade, Information Technology has gone through an exponential expansion phase in India and globally. This has led to an increase in the supply and procurement of digital services. Consequently, this has given rise to various new business models, where there is a heavy reliance on digital and telecommunication networks. As a result, the new business models have come with a set of new tax challenges in terms of nexus, characterization, and valuation of data and user contribution. The combination of inadequacy of physical presence based nexus rules in the existing tax treaties and the possibility of taxing such payments as royalty or fee for technical services creates a fertile ground for tax disputes. To bring clarity in this regard, the government introduced vide Budget 2016, the equalization levy to give effect to one of the recommendations of the BEPS (Base Erosion and Profit Shifting) Action Plan. Equalization Levy is a direct tax, which is withheld at the time of payment by the service recipient. The two conditions to be met to be liable to equalization levy: (i) The payment should be made to a non-resident service provider; (ii) The annual payment made to one service provider exceeds Rs. 1,00,000 in one financial year. **Evolution of Equalization Levy** The following chart represents the evolution of Equalization Levy since 2016: 

2.	Section 194O of Income Tax Act, 1961 is applicable to: (i) both resident and non-resident e-commerce operator (ii) resident e-commerce participant. Points to be noted: (i) Even if purchaser of goods/recipient of services is a non-resident, e-commerce operators should deduct TDS @ 1% at the time of credit or making payment to an e-Commerce participant, whichever is earlier. (ii) If e-commerce participant is a corporate, then TDS u/s 194O is deductible irrespective of the threshold limits. (iii) In case of Individuals/HUF, there is no requirement to deduct TDS if the gross amount of sale of goods, services, or both during the previous year does not exceed Rs. 5 lakh and if the e-Commerce participant has furnished his PAN or Aadhaar. (iv) The threshold limit of INR 500,000 under section 194-O is calculated from 1 April 2020. (v) The liability to deduct TDS or collect TCS applies to payments or credits on or after 1 October 2020. (vi) TDS must be deducted at the rate of 5%, as per provisions of Section 206AA if the participant does not furnish his PAN or Aadhaar. Exceptions to above applicability are as follows: No TDS will be deducted if the participant is a non-resident (in such cases, the provisions of "Equalization levy" are applicable); and if the amount, paid or credited to individuals/HUF during a financial year, does not exceed Rs. 5 lakh.
3.	From 1 April 2020, the government of UK will introduce a new 2% tax on the revenues of search engines, social media services and online marketplaces which derive value from UK users. The application of the current corporate tax rules to businesses operating in the digital economy has led to a misalignment between the place where profits are taxed and the place where value is created. Many of these digital businesses derive value from their interaction and engagement with a user base. Under the current international tax framework, the value businesses derive from user participation is not taken into account when allocating the profits of business between different countries. This measure will ensure the large multinational businesses in-scope make a fair contribution to supporting vital public services.

	The government still believes the most sustainable long-term solution to the tax challenges arising from digitalization is reform of the international corporate tax rules and strongly supports G7, G20 and OECD discussions on long-term reform. The government is committed to dis-applying the Digital Services Tax once an appropriate international solution is in place. The Digital Services Tax will apply to a group's businesses that provide a social media service, search engine or an online marketplace to UK users. These businesses will be liable to Digital Services Tax when the group's worldwide revenues from these digital activities are more than £500 million and more than £25 million of these revenues are derived from UK users. If the group's revenues exceed these thresholds, its revenues derived from UK users will be taxed at a rate of 2%. There is an allowance of £25 million, which means a group's first £25 million of revenues derived from UK users will not be subject to Digital Services Tax. The provision of a social media service, internet search engine or online marketplace by a group includes the carrying on of any associated online advertising service. An associated online advertising service is an online service that facilitates online advertising and derives significant benefit from its association with the social media service, search engine or online marketplace. There is an exemption from the online marketplace definition for financial services providers. The taxable revenues will include any revenue earned by the group which is connected to the social media service, search engine or online marketplace, irrespective of how the business monetises the service. If revenues are attributable to the business activity and another activity, the group will need to apportion the revenue to each activity on a just and reasonable basis. Revenues are usually derived from UK users if the revenue arises by virtue of a UK user using the service. However, there are some exceptions to this general rule. Where one of the parties to a transaction on an online marketplace is a UK user, all of the revenues from that particular transaction will be treated as derived from UK users. When the transaction involves accommodation, land or buildings in the UK, revenue from that transaction will be treated as derived from UK users. When the transaction involves accommodation, land or buildings not in the UK,

	revenue from that transaction will only be treated as derived from UK users if the consumer of the relevant service is a UK user. The revenue charged will be reduced to 50% of the revenues from the transaction when a user in respect of a marketplace transaction is normally located in a country that operates a similar tax to the Digital Services Tax. Advertising revenues are derived from UK users when the advertisement is viewed or otherwise consumed by a UK user. A UK user is an individual that is normally located in the UK, or other type of user established in the UK. Groups will be able to elect to calculate their Digital Services Tax under an alternative calculation. This is intended to ensure that the Digital Services Tax does not have a disproportionate effect on business sustainability in cases where a business has a low operating margin from providing in-scope activities to UK users. The total Digital Services Tax liability will be calculated at the group level, but the Digital Services Tax will be charged on the individual entities in the group that realize the revenues that contribute to the total. The group consists of all entities which are included in the group consolidated accounts, provided these are prepared under an acceptable accounting standard. Revenues will consequently be counted towards the Digital Services Tax thresholds even if they are recognized in entities which do not have a UK taxable presence for corporation tax purposes. A single entity in the group will be responsible for reporting the Digital Services Tax to Her Majesty's Revenue and Customs (HMRC). Groups can nominate an entity to fulfill these responsibilities. Otherwise, the ultimate parent of the group will be responsible. The Digital Services Tax will be payable and reportable on an annual basis. The measure is expected to have an impact on a small number of large multinational groups by bringing into scope of Digital Services Tax the proportion of their revenue that is derived from UK users of social media, search engines or online marketplaces. The policy will be delivered through a Digital Services Tax charge reported and collected under new provisions. As with any new tax, there will inevitably be an increased administration burden on the affected groups. The customer experience for the businesses in scope of the Digital Services Tax will change due to the additional requirements placed on them from complying with a new tax. HMRC will provide clear and targeted guidance to support businesses further.

	One-off costs will include familiarization with the new rules. Ongoing costs may include keeping records of revenue referable to UK users and making payment to HMRC. Businesses in scope will also use a new service to make their annual return of the tax due.
4.	**Overview:** Over the years, India has made significant changes to its domestic tax law to ensure that it receives its fair share of tax from the digital economy. Some of the changes include: (i) the amendment of the definition of "royalty" in 2012; (ii) the introduction of the equalisation levy in 2016 (restricted only to online advertisement services and providing digital advertising space), which was expanded in 2020 to include non-resident e-commerce operators within its ambit; (iii) the amendment of the definition of "business connection" to include a "significant economic presence" in 2018; and (iv) the introduction of withholding tax on domestic e-commerce transactions in 2020. As per the expanded provisions, with effect from April 1, 2020, consideration received by a non-resident e-commerce operator from an e-commerce supply or service (except for online advertisement services already covered under the equalisation levy introduced in 2016) will be liable to equalisation levy at the rate of 2%. An exemption from equalisation levy is currently provided in the following cases: (i) non-resident e-commerce operators having a Permanent Establishment (PE) in India and where the e-commerce transaction is effectively connected to such PE in India; and (ii) cases where the aggregate value of the consideration for the specified transactions does not exceed INR 20 million (~ US$ 266,000) in a year. Additionally, transactions entered into on or after April 1, 2021, which are chargeable to equalisation levy, are exempt from income-tax. **High Court's Rulings:** In the case of Google Asia Pacific Private Limited, Singapore (the taxpayer), the Delhi High Court (DHC) has dealt with the issue of withholding tax at source on Google's cloud service-related payments which were already subject to a 2% equalisation levy.

	As an interim measure, without ruling on the merits of the case, the DHC has allowed the Singapore based taxpayer to receive the payment from an Indian entity post deduction of tax at the rate of 8% (without additional surcharge and health and education cess based on the decision in the Epcos Electronic case and the Frequently Asked Questions explanatory circular issued by the Central Board of Direct Taxes) instead of 10% as provided under the "Royalty and fees for technical services" article in the India-Singapore double taxation avoidance agreement because 2% equalisation levy was already paid on the transaction. **Conclusion:** Equalisation levy has been introduced as a separate Chapter in the Finance Act and, hence, does not form part of the Income-tax Act, 1961 (IT Act). Therefore, given that equalisation levy does not partake the character of income tax, credit of equalisation levy in the home country of the non-resident is, generally, not possible. Whilst much will depend on the provisions of the domestic tax law of the country of the non-resident recipient, but assuming that equalisation levy is not creditable, it is likely to result as a sunk cost in the hands of the non-resident. While the equalisation levy applies with effect from April 1, 2020, the corresponding exemption from income tax in the hands of non-resident recipient applies only from April 1, 2021. Given this, there can be potential double taxation in the financial Year 2020-21, where the same transaction is subjected to equalisation levy as well as royalty or fees for technical services. So, the interplay of taxability of services under the head of royalty or fees for technical services vis-à-vis the equalisation levy provisions needs to be assessed. The Finance Act, 2021, clarifies that equalisation levy shall not apply if the consideration is taxable as royalty or fees for technical services under the IT Act read with the tax treaty provisions. In the instant case, although the taxpayer had already paid equalisation levy, the tax department wanted to tax the same transaction under the royalty or fees for technical services provision. The DHC, as an interim measure, directed that the taxpayer would be entitled to receive the cloud service-related payment after deduction of tax at the rate of 8%. It is not currently known if the income-tax department will prefer an appeal against this ruling or will refuse the 2% equalisation levy adjustment at the time of assessment proceedings a year down the line. Interestingly, India is a party to the two-pillar solution introduced by the OECD and the G20 Inclusive Framework on Base Erosion and Profit Shifting. Pillar One requires all member countries to withdraw their existing digital services taxes. However, on November 24, 2021, the Indian government announced that a transitional approach of 2% equalisation levy on e-commerce supply or services has been agreed with the US and the applicable interim period will be

	from April 1, 2022 until the implementation of Pillar One or March 31, 2024, whichever is earlier. As we see it, unless the interplay between the equalisation levy and the applicability of the royalty or fees for technical services provisions is sorted out soon, tax litigation on this issue cannot be ruled out.