Digital Taxation

- *BEPS (Tracing the origin and developments)*

- CA K Prasanna

Global Developments

Need for Digital Taxation

Commentary: Apple Avoided $40 Billion in Taxes. Now It Wants a Gold Star?

Google shifted $23bn to tax haven Bermuda in 2017, filing shows

Firm used Dutch shell company in move known as 'double Irish, Dutch sandwich' that cuts its foreign tax bill

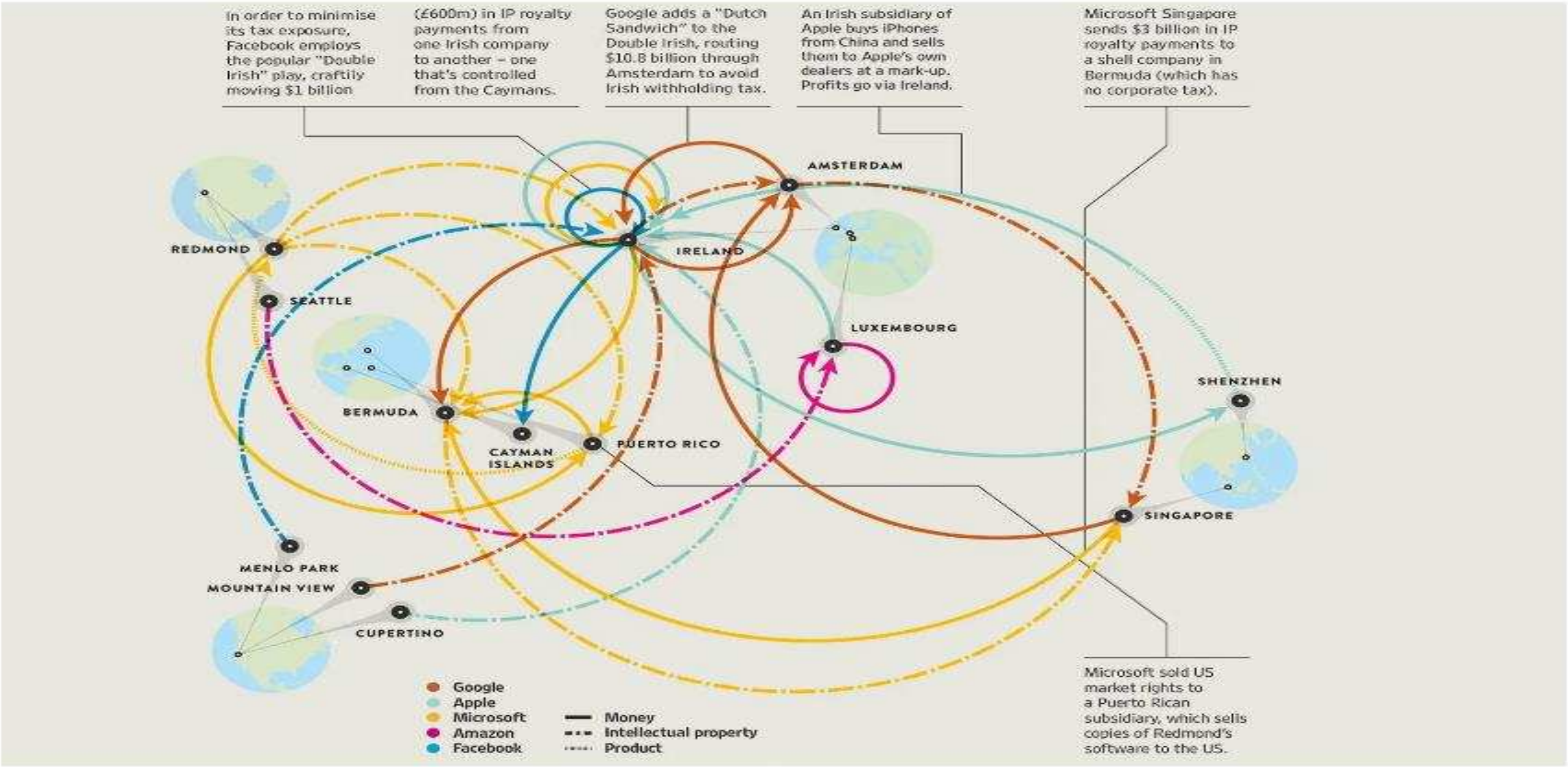
US IRS sues Facebook for $9 billion in unpaid taxes

The IRS lawsuit, filed in a San Francisco court, claimed that Facebook "undervalued the royalty amount between 2010 and 2016, which cut the company's domestic tax bill as th royalties are ultimately reported as income".

Amazon's expected tax avoidance comes despite it nearly doubling its U.S. profits to $11.16 billion in 2018, according to the Institute on Taxation and Economic Policy (ITEP), a nonpartisan tax policy-focused think tank. In fact, instead of paying any federal income taxes, the company received a $129 million tax rebate from the government.

UK: Google called back to parliament to answer tax questions after investigation challenges some of its previous evidence; company denies claims

Need for Digital Taxation



Yeesh, only slightly more confusing than an Indiana Jones flightplan VALERIO PELLEGRINI

Source – https://www.wired.co.uk/article/us-tax-patent-shuffle

Digital Tax – Journey so far and timeline upto interim report

1998
Ottawa Ministerial conference on EC

February 2001
TAG Report on Characterisation Issues on E-commerce Payment

February 2013
Report on Addressing BEPS

July 2013
OECD CFA submits BEPS Action Plan to G20

September 2013
Task force on digital economy

March 2014
Discussion draft on Tax challenges in Digital Economy

March 2015
Rolling out 15 AP

March 2018
Interim report on digital economy

Common features of digital business

01 Cross jurisdictional scale without mass

Digitization has allowed businesses in many sectors to locate various stages of their production processes across different countries, and at the same time access a greater number of customers around the globe.

02 Reliance on intangible assets

The intense use of IP assets such as software and algorithms supporting their platforms, websites and many other crucial functions are central to business models of many digitized enterprises.

03 Data user participation

Data, user participation, network effects and the provision of user-generated content are commonly observed in the business models of highly digitalised businesses. The benefits from data analysis are likely to increase with the amount of collected information linked to a specific user or customer. E.g.Social Media

Policy challenges raised by Digital Economy

Nexus:

Enhanced flexibility to choose where substantial business activities take place and reduced need for physical presence to carry on business raise questions as to whether existing rules to determine nexus with a jurisdiction for tax purposes are appropriate

Data:

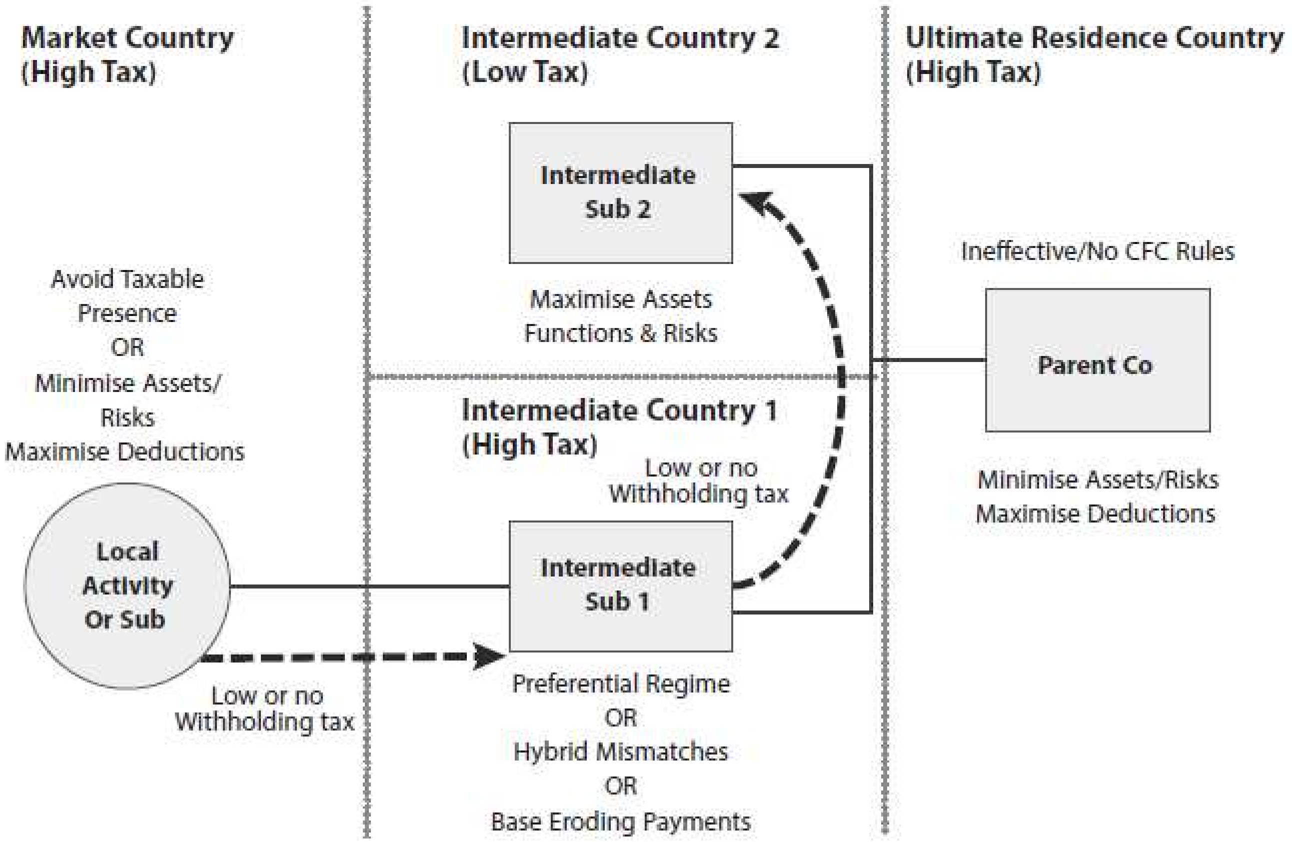
Use of sophisticated technology to gather and use data raise questions as to how to attribute value created from generation of data. Further, how to characterise income from supply of data for tax purposes

Characterisation:

Development of new digital products or means of delivering services create uncertainties for proper characterisation of payments, particularly in relation to cloud computing

BEPS in the context of direct taxation

Figure 5.1. **BEPS planning in the context of income tax**



Source – BEPS AP 1 – Page 79

Feb 2013 Report addressing BEPS identifies no of coordinated strategies associated with BEPS under direct taxation

1) Minimization of taxation in the market country by avoiding taxable presence or other means

2) Low or no withholding tax at source

3) Low or no taxation at the level of the recipient

4) No current taxation of low tax profits at the level of ultimate parent

Overarching Principles of Tax Policy

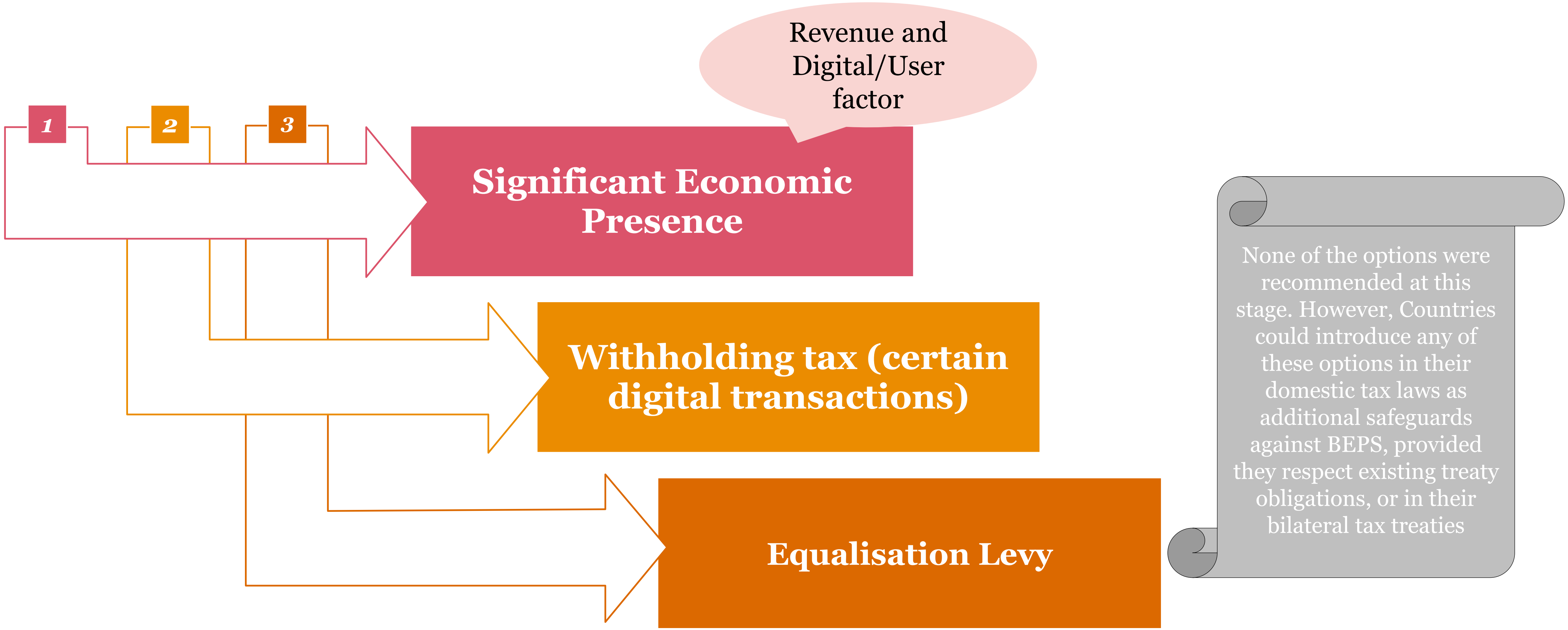
Neutrality - Taxation should seek to be neutral and equitable between forms of business activities. A neutral tax will contribute to efficiency by ensuring that optimal allocation of the means of production is achieved

Fairness and Effective – Taxation should produce the right amount of tax at the right time, while avoiding both double taxation and unintentional non-taxation. In addition, the potential for evasion and avoidance should be minimised

Efficiency – Compliance cost and administrative for business and government should be minimal

Certainty – Tax rules should be clear and simple to understand, so that taxpayers know where they stand. Complexity also favours aggressive tax planning, which may trigger deadweight losses for the economy

Options analysed by TFDE in AP 1



Digital Tax – Journey so far after interim report

January 2019
Delivery of Policy Note

March 2019
Public Consultation document on profit allocation and nexus rules

May 2019
Programme to develop consensus based solution – 3 approaches

November 2019
Secretariat Proposal – Unified Approach under Pillar 1

December 2019
Public Consultation - GLOBE Pillar two

Jan 2020
Statement by IF to develop 2 Pillar approach

October 2020
Blue Print on two pillar solution document

Oct 2020 – Jan 2021
Public Consultation

July& October 2021
Statement on a two pillar solution – 137 Members agreed

December 2021
GLOBE Rules

March 2022
Commentary on GLOBE Rules and Nexus Rules

July 2022
Progress Report on Amount A – Pillar 1

October 2022
PR on Admin and Tax Certainty – Pillar 1

Initial Proposals for Pillar one and Secretariat Proposal

Initial Proposals

1

User Participation Model (UK/EU)

The activities and participation of these users contribute to the creation of the brand, the generation of valuable data, and the development of a critical mass of users which helps to establish market power.

2

Marketing Intangible (USA)

Unlike the user participation proposal, it would not be intended to apply only to a subset of highly digitalised businesses. Instead, it would have a wider scope in an effort to respond to the broader impact of the digitalisation on the economy

3

Significant Economic Presence (India)

The digitalisation of the economy and other technological advances have enabled business enterprises to be heavily involved in the economic life of a jurisdiction without a significant physical presence.

Secretariat Proposal

Amount A

Share of deemed residual profit allocated to market jurisdiction

Amount B

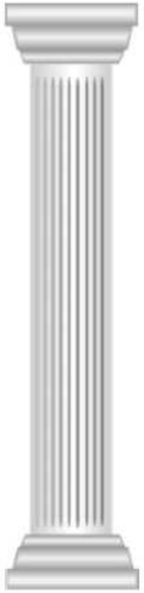
Fixed remuneration for baseline marketing and distribution

Amount C

Binding and effective dispute resolution

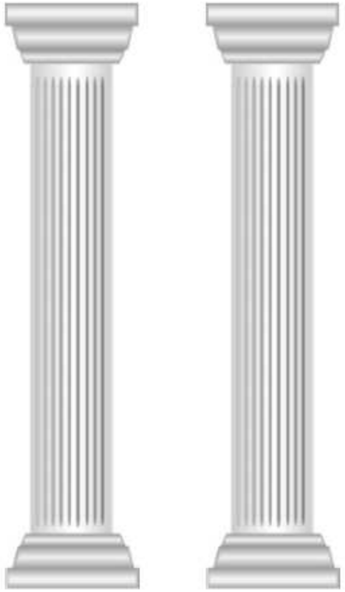
Two Pillar Solutions - Overview

Pillar one



- Focus on allocation of taxing rights to jurisdiction, new profit allocation and nexus rules – Group approach
- Seeks to accommodate new business model and expand the right of market jurisdiction
- Exclusion of certain industries/services are scoped out (extractive, financial services etc)

Pillar Two



- GLOBE Rules to address remaining BEPS issues
- Coordinated set of rules to address profit shifting and tax competition
- Proposed a global minimum tax of 15% to provide level playing field across jurisdiction

Pillar One – Key Highlights

In Scope

- EURO 20 Billion consolidated turnover (reduced to Euro 10 Billion after 8 year)
- 10% profitability (calculated using average mechanism)
- Excluded extractive and regulated financial activities

Nexus

- EURO 1 Million revenue in market jurisdiction
- EURO 250,000 in case of lower GDP countries (<40 Billion EURO)

Profit Allocation

- 25% of excess profits before tax over 10%

Elimination of double tax

- Double taxation relief through exemption or credit method

Marketing & Distribution

- Fixed remuneration of distributors located in market jurisdiction
- Result will be based on Transfer Pricing

Certainty

- Mandatory and binding dispute resolution relating to Amount A
- 'Effective Binding' dispute resolution for developing economy

Comparison of UN v. OECD Model

	UN Art. 12B	OECD Pillar 1 Amount A
Conceptual base	Supply and demand (OECD Members view not reflected)	Compromise (including supply and demand)
Scope	Narrow scope: ADS	Broader scope: ADS & CFB
Thresholds	No thresholds (high compliance costs)	Global and local revenue threshold (compliance costs for big MNEs as a start)
Profit Allocation	Gross basis withholding tax: Ineffective in B2C relations Net taxation: No loss mechanism	Net taxation with loss mechanism. Gauranteed collection of taxes by market / users countries
Revenue Sourcing	Payer's jurisdiction Many instances, developing countries cannot tax ADS businesses	Developing countries can tax ADS and CFBs in many cases
Dispute Prevention	No tax certainty	Tax certainty mechanism
Implementation	Bilateral: Low chances to implement with OECD states	Multilateral: Advances international tax debate

Source – Pillar 1 – Digital Economy Debate by Prof. Vikram Chand at IFA India

Pillar two – Key Highlights

- New Rules (GLOBE Rules) to target that large MNCs pay minimum tax of 15% on profits in all countries
- MNEs with Consolidated Turnover of Euro 750 Crores (2 out lf 4 FY) is part of in-scope and certain entities are excluded.
- Controlled entities that are owned and controlled by same Ultimate Parent Entity are considered for revenue threshold
- Common Approach – No mandatory and if countries adopts, then implementation must be consistent with outcome discussed.
- It contain series of inter-locking rules which has order of priority over another.

GLOBE Rules

- Domestic Law Based
  1) Domestic Minimum Tax ('DMT') – *Right to LTJ*
  2) Income Inclusion Rules ('IIR') – Right to *UPE jurisdiction*
  3) Undertaxed Payment Rule ('UTPR') – *Right to payer country*
- Treaty Based
  1) Subject to Tax Rules ('STTR') – *Right to Payer jurisdiction (min - 9% rate)*

India Developments

Digital Tax – India's Journey

Public consultation document on attribution of profits

- Address concern on drawback of Arm's length principle
- Fractional apportioned methodology for attribution of profits
- Separate methodology for traditional BC and SEP

Proposal for Fractional Apportionment

- India's been front runner in BEPS discussions and addresses concern from developing countries;
- Submitted fractional apportioned proposal for revised allocations rules

1999 & 2001

- Formation of High Powered Committee to address tax characterisation of income
- The Committee submitted its report in 2001 on 28 transactions

February 2016

- Formation of taxation committee on e-commerce
- Committee submitted its recommendation on equalisation levy

February 2016

- Introduction of EL in Finance Act, 2016 (Chapter VIII)
- 6% EL is levied on online advertisement services

February 2018

- Introduction of concept of Significant Economic Presence (SEP) under domestic act. But the provision is deferred

March 2020

- Introduction of EL on Non Resident E-commerce Operation
- Widening the scope of SEP
- Introduction of income attributable to operations in India

Significant Economic Presence (SEP)

Finance Act 2018

"Explanation 2A.—For the removal of doubts, ***it is hereby clarified*** that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction in respect of any goods, services or property ***carried out by a non-resident in India*** including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; **or**

(b) 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***:"

Finance Act 2020

Explanation 2A - For removal of doubts ***it is hereby declared*** that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction 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, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; **or**

(b) systematic and continuous soliciting of business activities or engaging in interaction with **such number of users in India**, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not—
(*i*) the agreement for such transactions or activities is entered in India; or
(*ii*) the non-resident has a residence or place of business in India; or
(*iii*) the non-resident renders services in India:
Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (*a*) or clause (*b*) shall be deemed to accrue or arise in India.';

Equalisation Levy – Committee's recommendation

Objectives of EL

- To address the base erosion faced in digital economy from limitations of existing international taxation rules. Payments made for purpose of business is allowed as deduction and the income is not taxable due to existing tax rules;
- To reduce unfair advantage enjoyed by a multinational digital enterprise over its Indian competitors;
- To provide greater certainty and predictability with regard to taxation of payments for digital services by way of a stable tax regime;

Other aspects

- The EL should be limited to the payments made for intangible services, including for use or right to use intangible, access a digital, telecommunication or similar network (para 131)
- Committee had listed 13 categories of payments may be subjected to EL (para 135)

It will not be levied on goods imported	Not necessary to chargeable on all e-commerce transactions	Payments subject to EL shall be exempt from income-tax	Outside Income-tax – Not a tax on income
No FTC – India may have reciprocal agreement	Currently, some payment may be taxes Royalties and FTS	Broad categories would lead to greater uncertainty	EL will satisfy the test of constitutional validity

To the extent possible, the categories of payments that would be subjected to EL should be listed clearly. The Committee also took into account this possible overlap with taxation as royalty or fee for technical services it is the considered view of the Committee that bringing such payments under the purview of EL, as included in the list above, and the consequent exemption of income under the Act, will bring about more certainty, predictability and stability to the tax regime, reduce costs of compliance as well as administration, and could significantly contribute to reducing tax litigation

Equalisation Levy – Version 2.0

Taxable event for EL

EL shall be levied @ **2%** on consideration received or receivable by **e-Commerce operator** from **e-Commerce supply or services** made or provided or facilitated to:

a person resident in India

or

a person who is non-resident in India and undertakes:

- Sale of advertisement which targets a customer who is a resident in India or a customer who accesses the advertisement through Internet Protocol address located in India
- Sale of data collected from a person who is resident in India or from a person who uses Internet Protocol address located in India

or

A person who buys such goods/services/both using IP address in India

e-Commerce Operator

1. A non-resident who owns, operates or manages
2. a digital or electronic facility or platform
3. for online sale of goods or online provision of services or both

e-Commerce supply or services

Online sale of goods owned by the e-commerce operator (expanded further by FA 2021)

or

Online sale of provisions provided by the e-commerce operator

or

Online sale of goods or provision of services or both facilitated by the e-commerce operator or any other combination of the above

Exclusions to EL

a) Where e-Commerce operator making/providing/or facilitating e-Commerce supply or services has a Fixed place **PE in India & such e-Commerce supply or services is effectively connected with such fixed place PE in India.**

b) Where Equalisation levy is chargeable under Specified services – online advertisement or provision of digital advertising space

c) Sales or turnover or gross receipts from e-Commerce supply or services is less than INR 20 Million during the previous year.

'Online'

A facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network

Exemption from Income-tax

Income arising from any e-commerce supply or services provided / facilitated is exempt from income-tax

Equalisation Levy 1.0 v. 2.0

Coverage	Introduced vide Finance Act 2016	Expanded vide Finance Act 2020
Scope of EL	NR providing online advertisement services/ digital space/facility or service for online advertisement	NR ECO providing E-com online supply of goods or provision of services or facilitation
Rate of EL	6%	2%
Obligation of EL	Resident/ NR (having PE in India) deduct while making payment to NR	NR ECO
Threshold for EL	Aggregate transaction value > INR 1 Lac in a FY (tested in the hands of the payer)	Aggregate transaction value >= INR 2 Crore, in a FY (tested in the hands of the NR ECO)
Exclusion	NR having PE in India and the specified services are effectively connected; Services not used for business or profession	NR Eco having PE in India and the specified services are effectively connected EL on online advertisement chargeable under EL (2016)

Around the world

Other Countries approach – A snapshot

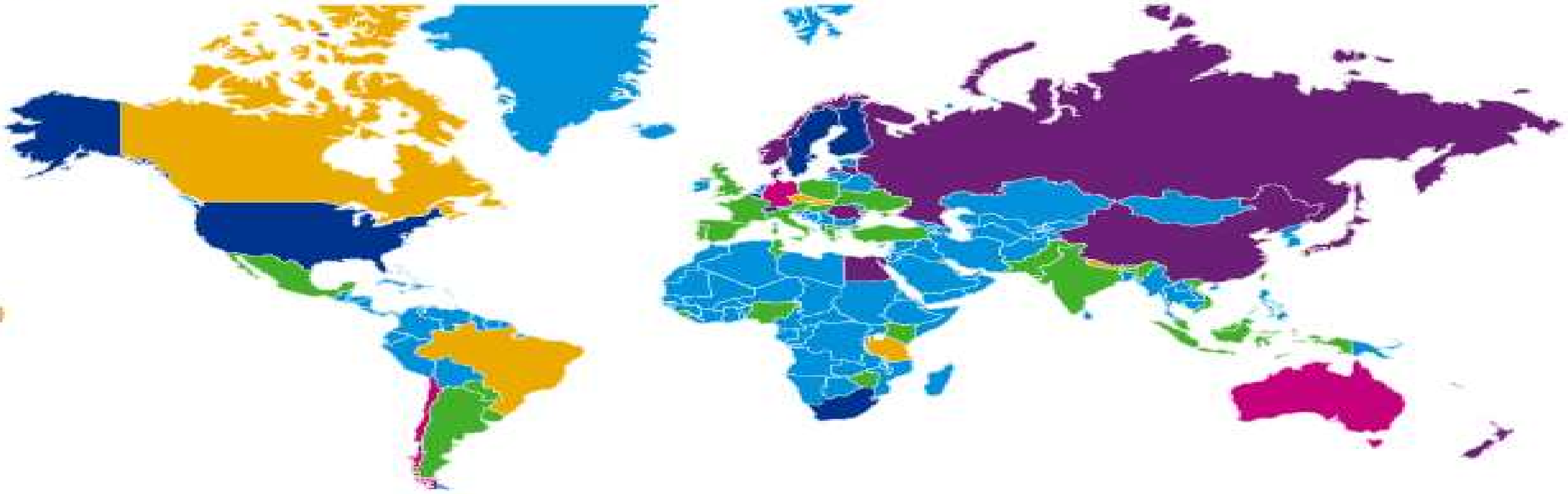
Country	Effective date	Type	Rate	Tax Base
Belgium	Expected 2023, if global consensus not achieved	DST/ Digital PE	3%	1) Revenues from advertising space on digital platform 2) selling user data generated from user 3) digital intermediation services to users
France	01 Jan 2019 – Collection deferred till end of 2020	DST	3%	GAFA Tax - 1. Intermediary services 2. advertising services based on users' data
Hungary	July 1, 2017	DAT	7.5% rate reduced to 0% effectively from 01 July 2019 through Dec 31, 2022	Net turnover for the financial year generated by the broadcasting or publication of advertisements in Hungary
Israel	April 12, 2016	Digital PE & DST	3% or 5%	Revenue related to the digital PE. DST to be based on French Model
Italy	Jan 1, 2020	DST	3%	(i) Advertising on digital interface (ii) Multilateral digital interface that allow user to buy/sell goods and services and (iii) Transmission of user data generated from using digital interface
UK	April 1, 2020	DST	2%	Revenue in excess of 25 Mn pounds derived from UK in respect of (i) Social media platform, (ii) internet search engine and (iii) online market place

Where other Countries stand

Direct taxes

Direct Taxes (e.g., DST/WHT/Digital PE)

1. Argentina
2. Australia
3. Austria
4. Belgium (DST/PE)
5. Brazil
6. Canada
7. Chile
8. China
9. Costa Rica
10. Czech Republic
11. Denmark
12. Egypt
13. Finland
14. France
15. Germany (WHT)
16. Greece
17. Hungary
18. India (Eq.Tax/WHT/PE)
19. Indonesia
20. Israel (DST/PE)
21. Italy
22. Japan
23. Kenya
24. Laos
25. Latvia
26. Malaysia
27. Mexico
28. Nepal
29. New Zealand
30. Nigeria
31. Norway
32. Pakistan
33. Paraguay
34. Poland
35. Portugal
36. Romania
37. Russia
38. Sierra Leone
39. Singapore
40. Slovakia (DST/PE)
41. South Africa
42. Spain
43. Sweden
44. Switzerland
45. Taiwan
46. Tanzania
47. Thailand
48. Tunisia
49. Turkey (WHT/DST)
50. Ukraine (WHT)
51. United Kingdom
52. United States
53. Uruguay



27 Legislation Enacted
57Draft Legislation/Public Consultation
10 Announced/Intention to Implement
3 Rejection of a Public Announcement/Proposal
7 Waiting for Global Solution
No Development

Source – KPMG Digital Tax – as of July 20222

Select Jurisprudence in India

Judicial precedents till date – selective business model (1/2)

Business model	Case law name	Citation	Ruling summary
Social media monitoring services	Thoughtbuzz (P) Ltd	21 taxmann.com 129 (2012) (AAR)	Provision of social media monitoring services on a subscription basis taxable as royalty
Subscription for research products	Gartner Ireland	[2013] 37 taxmann.com 16 (Mum)	Subscription received for its research product would not tantamount to royalty
Dissemination of info though hired equipment	TIS Two Administration (Singapore) Pte. Ltd.	[2010] 40 SOT 16 (MUM.) (URO)	Taxed as business profits due to PE. Hence not treated as royalty/FTS
Business reports using information available in public	Dun & Bradstreet Espana S.A	[2005] 142 Taxman 284	It is akin to sale of goods for price and not royalty
Internet Advertising	Right Florists	2013] 32 taxmann.com 99	Income is not taxable as royalty. India's reservation on OECD MC - website constitute PE is negated Contrary in Google India P ltd [2018] 93 taxmann.com 183 – Payment towards 'adwords program' constitute royalty
Software as Service (SaaS)	Microsoft Regional Sales Corpn.	[2009] 32 SOT 116 (Delhi)	Software without grant of exploitation of copyright would not give rise to royalty
Platform as Service (PaaS)	Bombardier Transportation India	[2017] 77 taxmann.com 166	Whether the payer is in exclusive ownership and custody of the equipment and rights related to it – Not taxable as digital royalty

Judicial precedents till date – selective business model (2/2)

Business model	Case law name	Citation	Ruling summary
Domain Registration	GoDaddy.com LLC	[2018] 92 taxmann.com 241 (Delhi – Trib)	Domain name being valuable commercial rights, having characteristics similar to trademark property. Taxable as royalty
Web hosting services	Savvis Communication Corporation	2016] 69 taxmann.com 106 (Mum Trib)	Recipient does not user equipment and the same is used by service provider. Hence not taxable as royalty
Live Coverage	IMG Media Ltd.	[2015] 60 taxmann.com 432 (Mum-Triib)	There is no transfer of broadcasting rights to UK. Hence not royalty. Further not taxable as FTS
Data Link Charges	iGATE Computer Systems Ltd	[2015] 53 taxmann.com 431	No human intervention, hence not FTS.
Service PE – physical presence not required	ABB FZ LLC	[2017] 83 taxmann.com 86	Physical presence is not required to constitute service PE.
Fixed place PE through presence of equipment	Galileo International Inc	19 SOT 257 (Del Trib)	F Co engaged in operating and maintenance of computer reservation system could constitute PE in India
	Mastercard Asia Pacific Pte Ltd	[2018] 94 taxmann.com 195 (AAR-Delhi)	Presence of MIP and other extensive network constitute fixed place PE

Q & A