Issues with taxes outside the scope of treaties

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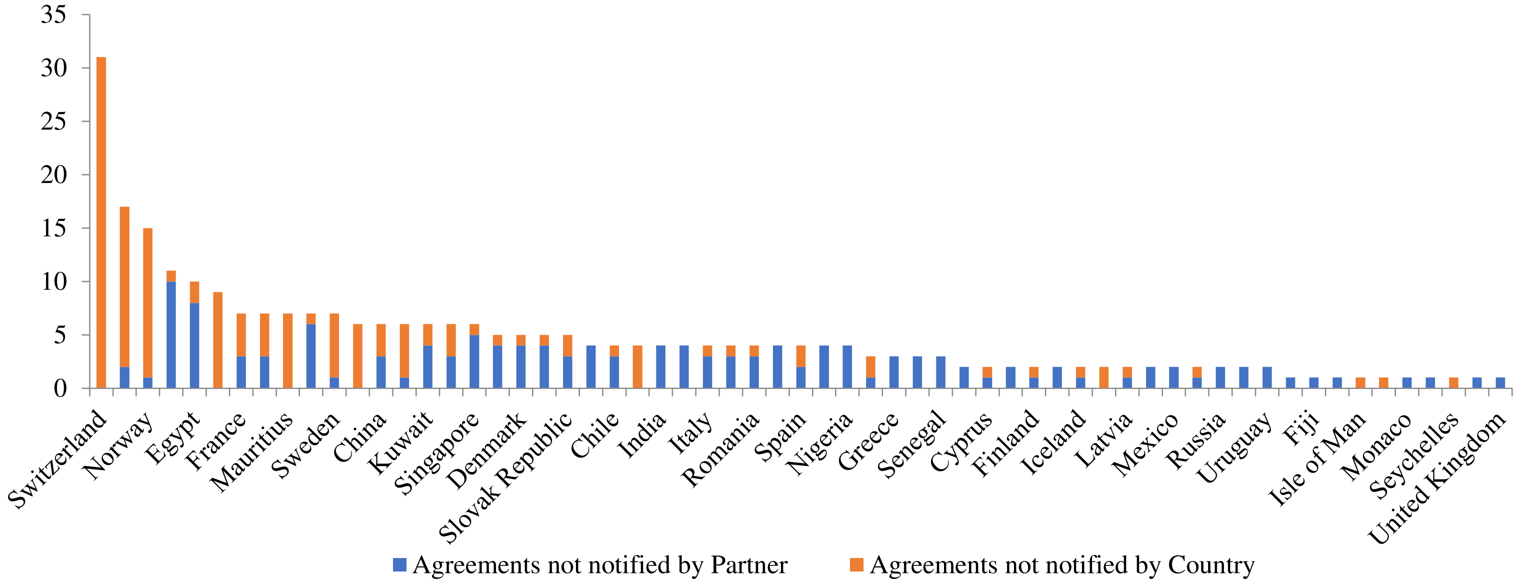
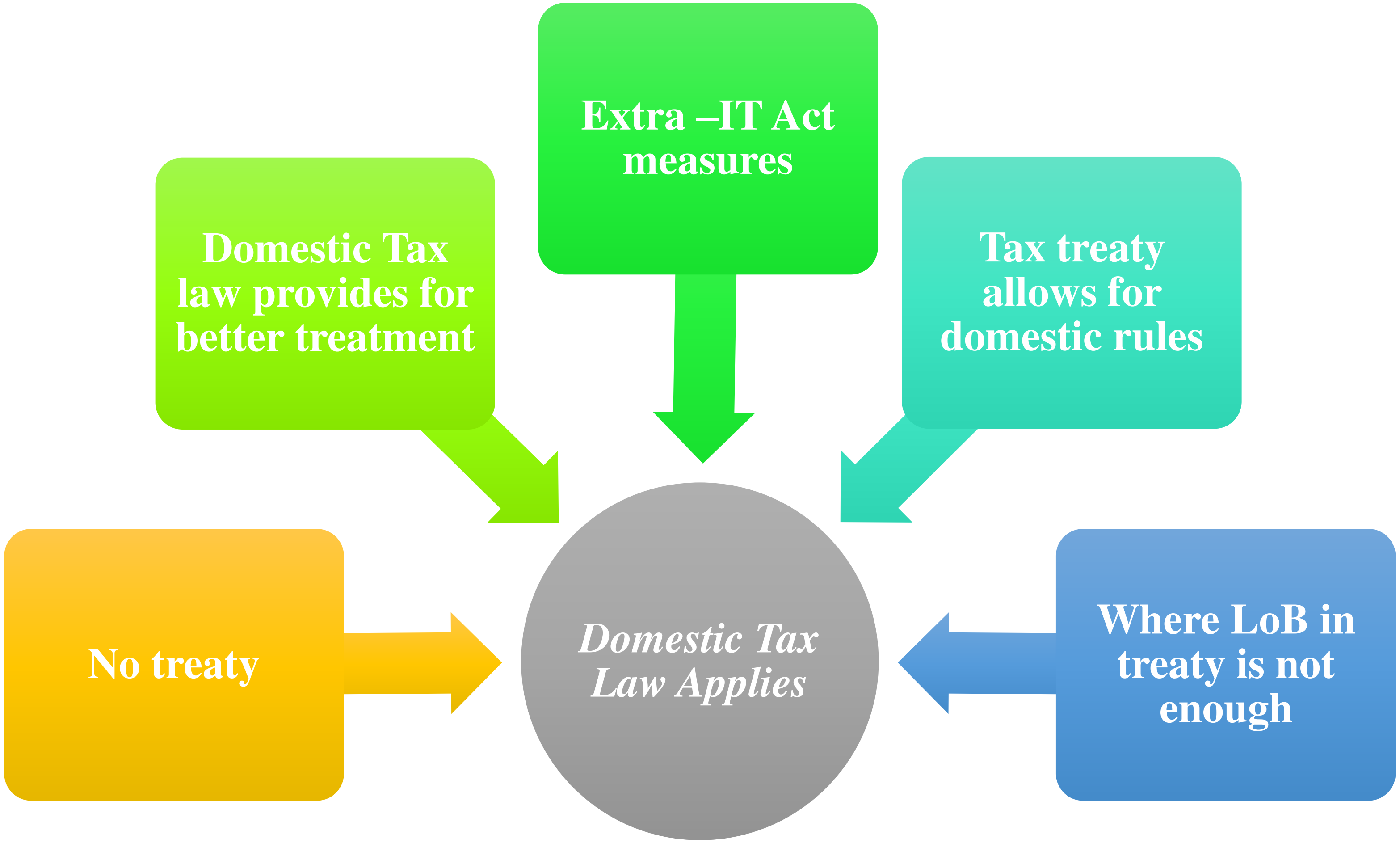
The importance of tax treaties

- Allocation of taxing rights is based on tax treaties but a lot depends on domestic tax law
- Treaty design is a function of economic policy and power relations



Source: The Multilateral Instrument: A developing country perspective, [WP_2018_220.pdf (nipfp.org.in)](WP_2018_220.pdf)

When does domestic tax apply



When does domestic tax apply

- Section 90(2) of the Income Tax Act

"Where the Central Government has entered into an agreement with the Government of any country outside India under sub- section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.]"

Digitalisation and extra-treaty measures

2015:No measures in sight, no solutions to recommend

Withholding

Equalisation levy

New nexus

Fixing the problem unilaterally: EL 1.0

Section 165 of Finance Act, 2016

(1) On and from the date of commencement of this Chapter, there shall be charged an equalisation levy at the rate of six per cent of the amount of consideration for any specified service received or receivable by a person, being a non-resident from—

(i) a person resident in India and carrying on business or profession; or
(ii) a non-resident having a permanent establishment in India.
(2) The equalization levy under sub-section (1) shall not be charged, where—

(a) the non-resident providing the specified service has a permanent establishment in India and the specified service is effectively connected with such permanent establishment;
(b) the aggregate amount of consideration for specified service received or receivable in a previous year by the non-resident from a person resident in India and carrying on business or profession, or from a non-resident having a permanent establishment in India, does not exceed one lakh rupees; or
(c) where the payment for the specified service by the person resident in India, or the permanent establishment in India is not for the purposes of carrying out business or profession.

Equalisation levy 2.0

Section 165A of Finance Act, 2021

(1) On and from the 1st day of April, 2020, there shall be charged an equalisation levy at the rate of two per cent. of the amount of consideration received or receivable by an e-commerce operator from e-commerce supply or services made or provided or facilitated by it—

(i) to a person resident in India; or
(ii) to a non-resident in the specified circumstances as referred to in sub-section (3); or
(iii) to a person who buys such goods or services or both using internet protocol address located in India.

…..contd.

Equalisation levy 2.0

Section 165A of Finance Act, 2021

(2) The equalisation levy under sub-section (1) shall not be charged—

(i) where the e-commerce operator making or providing or facilitating e-commerce supply or services has a permanent establishment in India and such e-commerce supply or services is effectively connected with such permanent establishment;

(ii) where the equalisation levy is leviable under section 165; or

(iii) sales, turnover or gross receipts, as the case may be, of the e-commerce operator from the e-commerce supply or services made or provided or facilitated as referred to in sub-section (1) is less than two crore rupees during the previous year.

….contd.

Equalisation levy 2.0

Section 165A of Finance Act, 2021

(3) For the purposes of this [section,—

(a) "specified circumstances" mean—]

(i) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and

(ii) sale of data, collected from a person who is resident in India or from a person who uses internet protocol address located in India]

[(b) consideration received or receivable from e-commerce supply or services shall include—

(i) consideration for sale of goods irrespective of whether the e-commerce operator owns the goods, so, however, that it shall not include consideration for sale of such goods which are owned by a person resident in India or by a permanent establishment in India of a person non-resident in India, if sale of such goods is effectively connected with such permanent establishment.

(ii) consideration for provision of services irrespective of whether service is provided or facilitated by the e-commerce operator, so, however, that it shall not include consideration for provision of services which are provided by a person resident in India or by permanent establishment in India of a person non-resident in India, if provision of such services is effectively connected with such permanent establishment.]

Revenues from EL: The intended outcome?

- 2016-17 INR 3.386 billion
- 2017-18 INR 5.894 billion
- 2018-19 INR 9.389 billion
- 2019-20 INR 11.36 billion
- 2020-21 INR 14.921 billion

Are collections enough? Total revenue collections are ~INR 12,000 billion

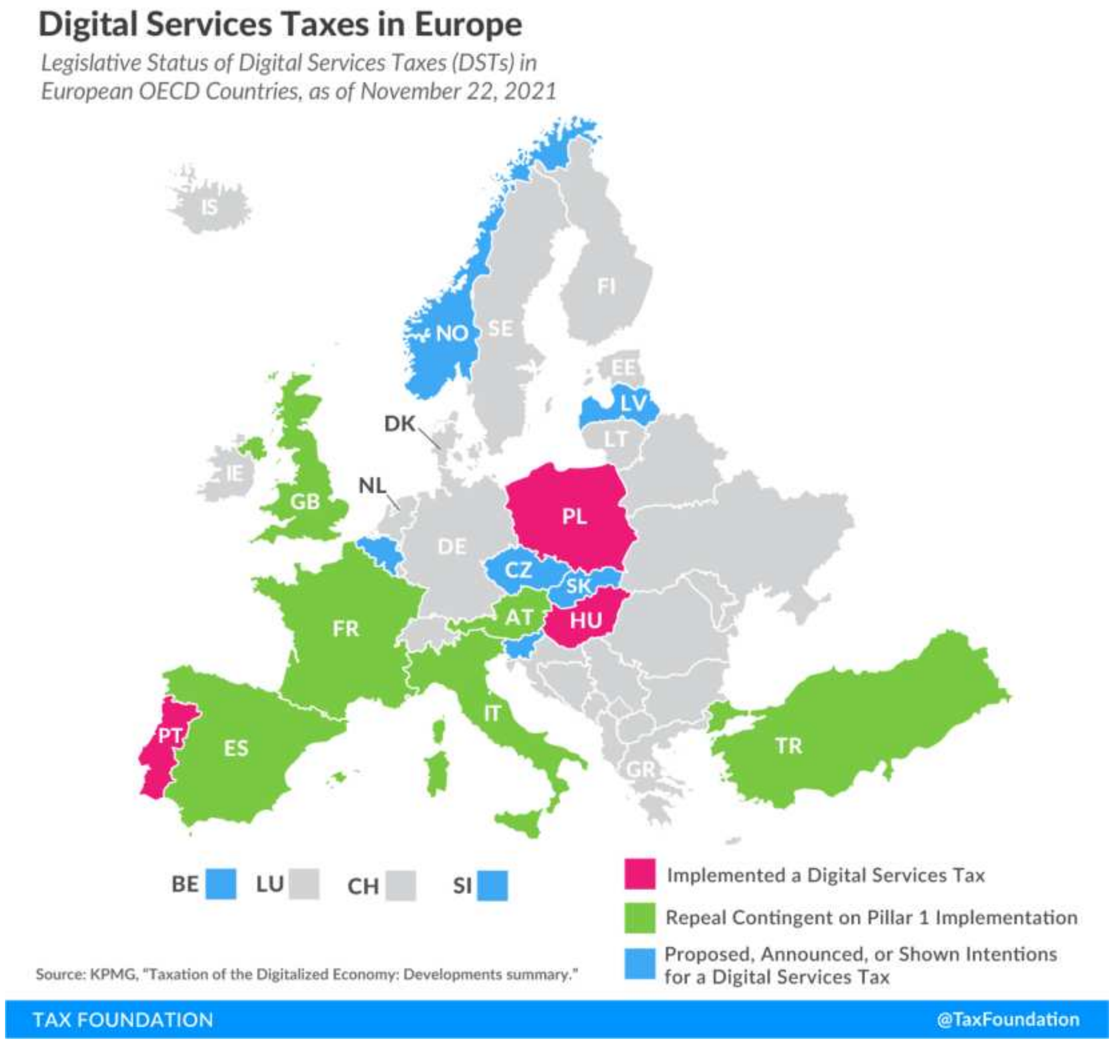
Why won’t treaties apply?

- Amendment outside the Income Tax Act 1961, even though the processes are applied by IT department
- The tax is not covered by treaties-as suggested by the OECD and the US, Article 2 of the treaty
- Constitutional challenge-nexus and object test

Has it been used before?

"In the area of insurance, some countries have adopted equalisation levies in the form of excise taxes based on the amount of gross premiums paid to offshore suppliers. Such taxes are intended to address a disparity in tax treatment between domestic corporations engaged in insurance activities and wholly taxable on the related profits, and foreign corporations that are able to sell insurance without being subject to income tax on those profits, neither in the state from where the premiums are collected nor in state of residence. As discussed below, an equalisation levy could be structured in a variety of ways depending on its ultimate policy objective. In general, an equalisation levy would be intended to serve as a way to tax a non-resident enterprise's significant economic presence in a country. In order to provide clarity, certainty and equity to all stakeholders, and to avoid undue burden on small and medium-sized businesses, therefore, the equalisation levy would be applied only in cases where it is determined that a non-resident enterprise has a significant economic presence" (OECD, 2015)

DSTs in EU


Digital Services Taxes in Europe
Legislative Status of Digital Services Taxes (DSTs) in European OECD Countries, as of November 22, 2021
IS
NO
SE
FI
EE
LV
LT
DK
IE
GB
NL
PL
DE
CZ
SK
HU
AT
FR
IT
PT
ES
GR
TR
BE
LU
CH
SI
Implemented a Digital Services Tax
Repeal Contingent on Pillar 1 Implementation
Proposed, Announced, or Shown Intentions for a Digital Services Tax
Source: KPMG, "Taxation of the Digitalized Economy: Developments summary."
TAX FOUNDATION
@TaxFoundation

Test for Significant Economic Presence

i. Any 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 the amount as may be prescribed; or

ii. Systematic and continuous soliciting of its business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—

- the agreement for such transactions or activities is entered in India; or
- the non-resident has a residence or place of business in India; or
- the non-resident renders services in India:

In order to prescribe the thresholds as mentioned above, suggestions/comments of stakeholders and the general public have been invited in order to prescribe the thresholds to establish significant economic presence of a non-resident in India. The comments and suggestions so received are under consideration.

Pillar one proposal

New Nexus

New allocation

New dispute resolution

Multilateral convention

Dividend Distribution Tax: No tax credits

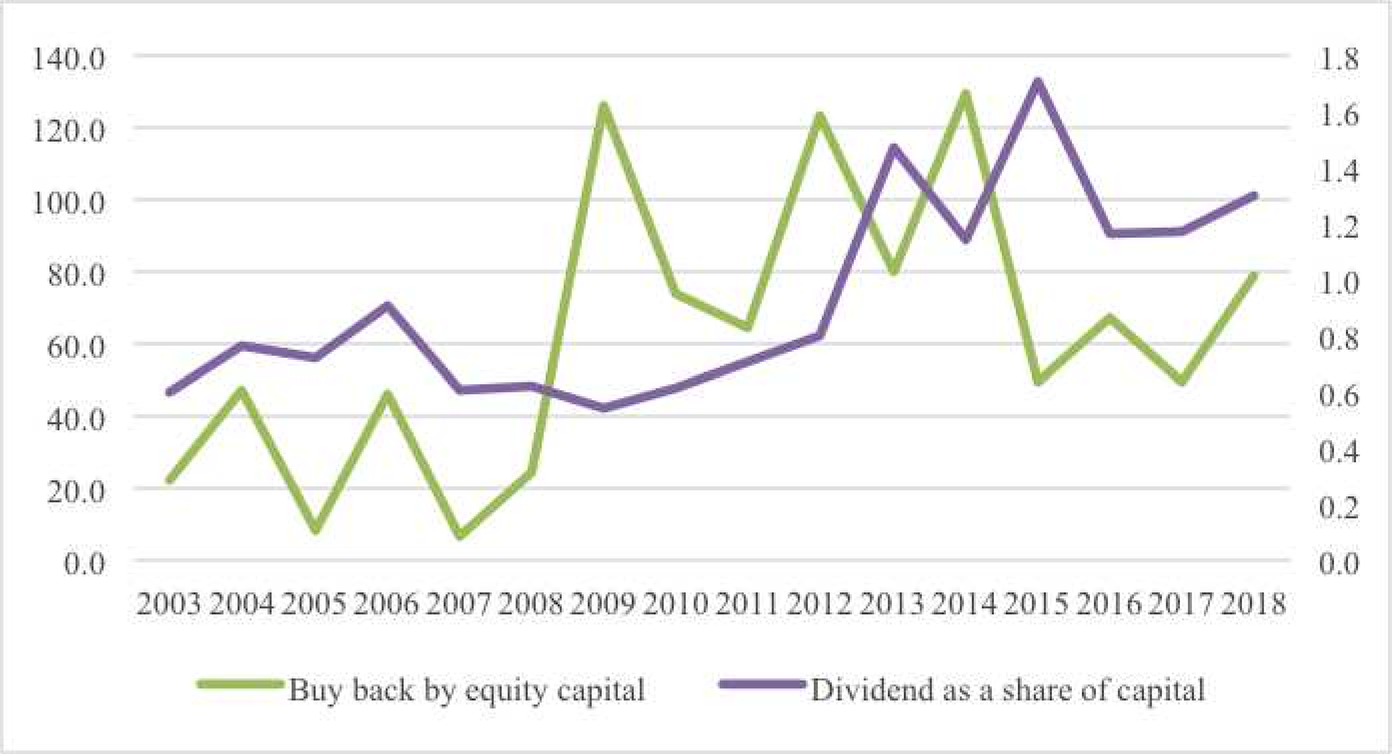
Methods of taxing dividends

- *Exempt dividends*
- *Tax at concessional rate*
- *Tax rebate against dividend income*
- *India's DDT-paid by company but no credit for it*

Methods of taxing dividends

Australia	China	UK
Individuals (resident) - Refundable credit is available (franking credit) Dividends received by individuals are included in their assessable income. If the dividend is franked (i.e. the payer distributes imputation credits together with the dividend), franking credits are also included in the assessable income. The imputation credit may be used to reduce the tax liability. Excess credits of individuals are refunded. Expenses incurred in deriving dividend income are deductible. (Individuals –NR) Return on equity instruments paid to a non-resident is subject to a final withholding tax of 30%. Franked distributions are not subject to withholding tax	China has not adopted imputation system. *Individuals* Dividends are taxed @20% on gross basis. Dividends may be exempt if some listed shares are held for more than 1 year. For non-residents favorable treaty rate may apply. *Domestic companies* Dividends are taxed @ 25%.But intercorporate dividends between Chinese companies are tax exempt if holdings are for more than 12 months. .*Non-resident companies* Dividends derived by a non-resident company are subject to withholding tax at a rate of 10% (or a lower rate agreed under an applicable tax treaty).	*Resident individuals-* In taxation of individual incomes, UK differentiates between savings income and non-savings income. Incomes are arranged in the following order – income from non-savings, income from savings and income from dividends. There is a basic personal allowance. Beyond this level, for non-savings income and savings income, there are three tax slabs associated with a basic rate, a higher rate and an additional rate. The rates of tax are 20 percent, 40 percent and 45 percent. For dividend income, the tax rates are lower at 7.5 percent, 32.5 percent and 38.1 percent. *Domestic companies-* Inter-corporate dividends from resident companies are tax-free. *Non-resident companies-* Taxed under corporate tax only if attributable to a PE, else subject to income tax not corporate tax. Under domestic law, there is no withholding tax on dividends and there is also no imputation credit. Imputation may be available under tax treaties. (Source-IBFD)

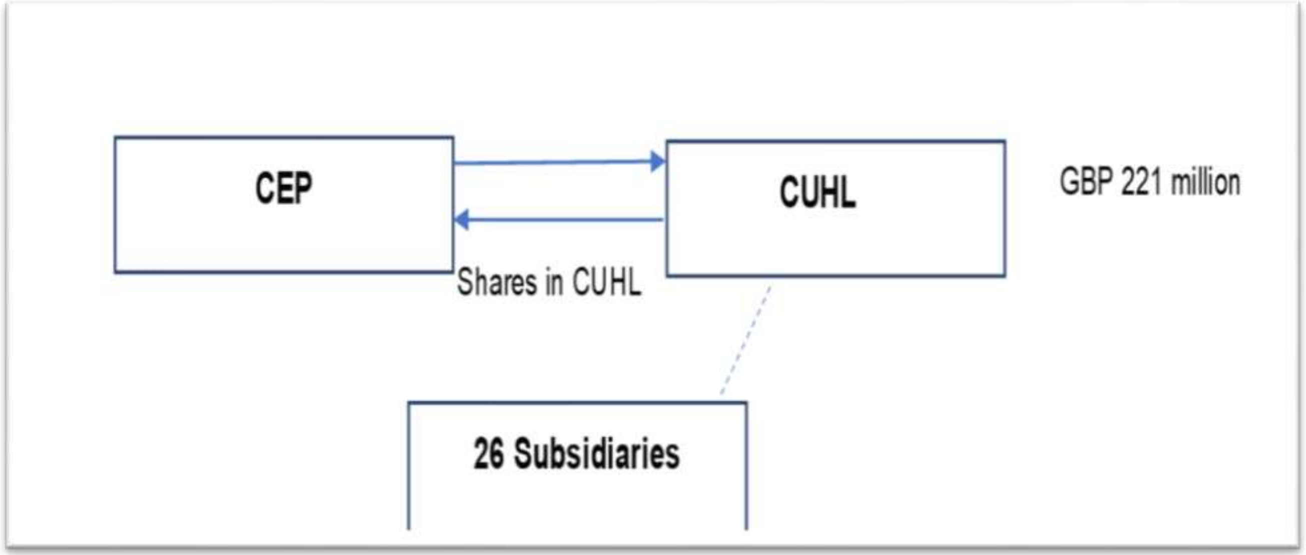
Impact the dividend tax can have

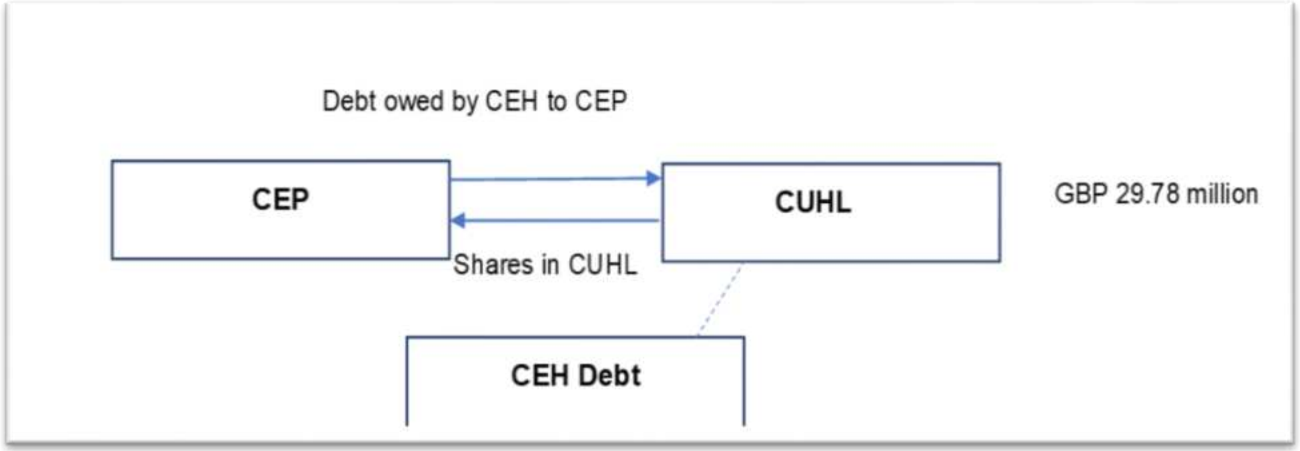


- Firm behaviour
- Investment behaviour

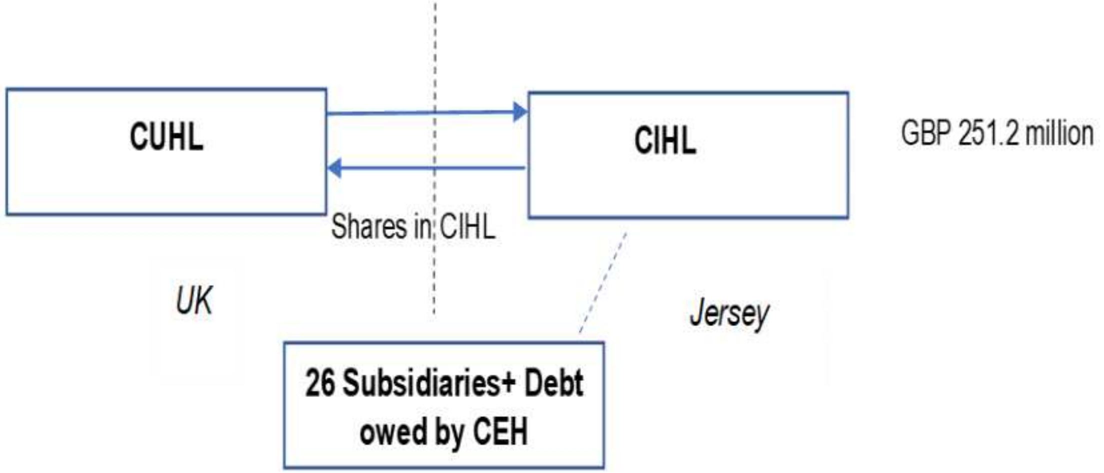
Investment treaties

Transaction 1:Sale of shares in CUHL to CEP

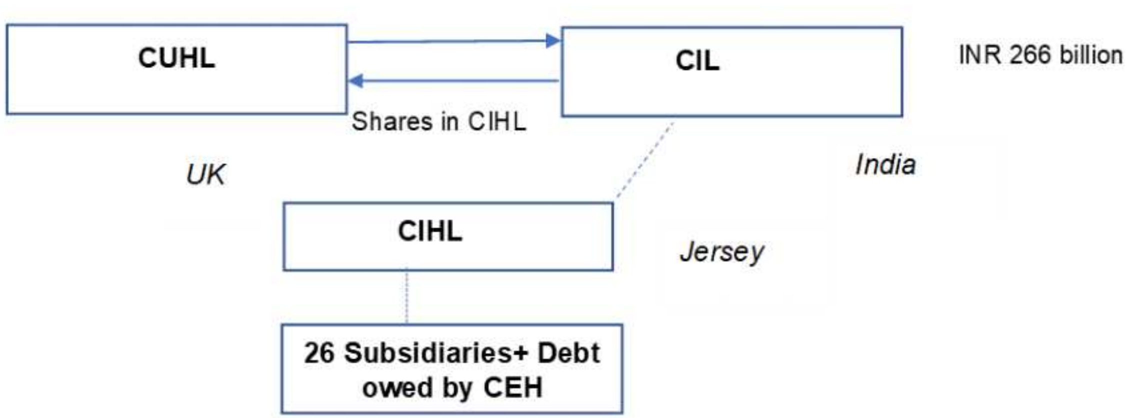




Transaction 2: Sale of shares to CIHL



Transaction 3: Sale of shares to CIL



- AO found that CUHL made exceptional gains of USD 1.36 billion from sale of CIHL
- No tax was paid in UK

Questions for tax policy

- Where is the source
- What is impermissible tax avoidance
- Are offshore indirect transfers widely accepted as taxable – MLI introduce 336 treaties contain Article 13(4), these are 35 per cent of the treaties but is less likely to be found between low income and resource rich countries.
- No comparable treaty provision like UN Article 13(5)

BIT challenge

- Fair and equitable treatment i.e. investments made by investors of other contracting jurisdictions be treated the same as domestic investors or of any other jurisdiction (Article 4)
- limits actions of the states that may amount to nationalisation or expropriation except for public purpose related to internal requirements for regulating economic activity on a non-discriminatory basis and against fair and equitable compensation
- Arbitration is available as an option

GAAR over-ride

SAARs and GAAR

"Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR."

Other issues

- Surcharge- covered in gross withholding
- Taxing top incomes at a higher rate