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DIPLOMA IN INTERNATIONAL TAX ISSUES IN INTERNATIONAL TAXATION

CA PRERNA PESHORI

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Treatment of exchange gains and losses

PC Tax

Exchange rate fluctuation benefit allowed on loan borrowed in forex - Sec 43A

- Treatment of gain or loss on account of foreign exchange fluctuation of foreign currency loans obtained for import of fixed asset:
- "Notwithstanding anything contained in any other provision of this Act, where an assessee has **acquired any asset** in any previous year **from a country outside India** for the purposes of his business or profession **and,** in consequence of a change in the rate of exchange during any previous year after the acquisition of such asset, there is an **increase or reduction in the liability of the assessee** as expressed in Indian currency (as compared to the liability existing at the time of acquisition of the asset) at the time of making payment—

  (a) towards the whole or a part of the cost of the asset; or

  (b) towards repayment of the whole or a part of the **moneys borrowed** by him from any person, directly or indirectly, **in any foreign currency** specifically for the purpose of **acquiring the asset** along with interest, if any,

Exchange rate fluctuation benefit allowed on loan borrowed in forex - Sec 43A

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- the amount by which the liability as aforesaid is so increased or reduced during such previous year and which is taken into account at the time of making the payment, **irrespective of the method of accounting adopted by the assessee**, shall be added to, or, as the case may be, deducted from—

  (i) the actual cost of the asset as defined in clause (1) of section 43; or

  (ii) the amount of expenditure of a capital nature referred to in section 35(1)(iv); or

  (iii) the amount of expenditure of a capital nature referred to in section 35A; or

  (iv) the amount of expenditure of a capital nature referred to in section 36(1)(ix); or

  (v) the cost of acquisition of a capital asset for the purposes of section 48,

  and the amount arrived at after such addition or deduction shall be taken to be the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset as aforesaid.

Case Study

- I Co purchased machinery from F Co for 10,000 USD on 1st April 2022. as per the terms, I Co will make payment of 2,000 USD every quarter. On 1st April the ER was Rs. 75/USD.

Month	Repayment	INR/USD	Total	Cost	Difference
June	2000	77	1,54,000	1,50,000	4,000
Sept	2000	80	1,60,000	1,50,000	10,000
Dec	2000	82	1,64,000	1,50,000	14,000
March	2000	84	1,68,000	1,50,000	18,000

Issues

- What would be the treatment of balance payable on 31st March 2023?
  - Reference to AS – 11
  - ICDS 6
- What would be the treatment of opening balance if the assets was acquired in preceding year.
- What if the assets is acquired from F Co against loan from SBI, India
- Whether your answer would be different if the assets is acquired from F Co against loan from SBI, Washington DC Branch.
- What if the assessee has entered into hedging contract with bank to meet the future liability.
- What would be the treatment of interest paid to foreign bank.
- What would be the treatment of principal paid to foreign bank.
- What if the asset is acquired in India?

ICDS VI - Effects of changes in foreign exchange rates

- Initial recognition - rate prevailing on the date of the transaction
- Monetary item – recognition at closing rate
- Non-monetary item - The exchange gain or loss should not be treated as taxable gain or loss for the year.
- Forward exchange contracts – Amortise premium over life of contract

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Diverted Profits Tax

Applicability

- Large multinational enterprises with business activities in the UK who enter into contrived arrangements to divert profits from the UK by avoiding a UK taxable presence and/or by other contrived arrangements between connected entities.
- For a non-UK tax resident company, DPT broadly applies where arrangements have been put in place to avoid a UK taxable presence being created.
- For a UK tax resident company, DPT generally applies in certain circumstances where profits are regarded as diverted to foreign companies that are not subject to an effective tax rate of at least 80% of the UK tax rate.
- DPT is applicable on both UK tax resident companies and non-UK tax resident companies.
- The rate of tax charged on diverted profits is 25%

- **Insufficient economic substance test** - Where a company, subject to UK corporation tax (whether UK company or non-UK company) has entered into an arrangement with another entity outside UK and such arrangement lacks economic substance
    - **Transaction-based approach** - wherein the related/ un-related entities enter into a transaction specifically designed to secure a tax reduction and the non-tax benefits of such transaction do not exceed the financial benefits of the tax reduction.
    - **Entity-based test** - wherein separate entity is formed in order to secure the tax reduction and where the non-tax benefit of the contributions made by such entity (in terms of the functional profile or activities of staff employed) does not exceed the financial benefits of the tax reduction.
- **Avoidance of permanent establishment test** – Where a non-UK foreign company carries on activities in UK but those activities are specifically designed to avoid creating a permanent establishment of that foreign company in the UK

Exceptions:

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- However, the applicability of DPT may not arise if the following conditions are met:
  1. Companies have substance in the business carried out by their offshore asset owning subsidiaries;
  2. Companies enter into arm's length transfer pricing through their international value chain;
  3. A taxable presence in UK through either a PE or an onshore distributor/reseller
  4. Small and medium sized enterprises ('SMEs') are not subject to the DPT - The total sales revenue arising from sale of goods and services in UK should not exceed 10 million pounds for a twelve month accounting period
  5. Certain loan relationships are not subject to the DPT
  6. Where a tax mismatch arises solely due to the persons being tax exempt solely by reason of being a charity, pension scheme or having sovereign immunity
  7. Where a non-UK person does not have a PE in UK due to fact that the entity undertaking operations in UK being of independent status that is not connected with such non-UK person.

Tax credit under DPT

- DPT is a separate tax from corporation tax and any payment of DPT should be ignored to its entirety while computing UK's corporation tax.
- Where the profits on which the DPT is charged are also subject to UK corporation tax or a non-UK equivalent of corporation tax, such tax will be credited against the DPT liability to avoid double taxation.
- As per HMRC's guidance, the design of the DPT is such that it is not covered by existing double taxation treaties and therefore liability to DPT cannot be avoided pursuant to a double tax treaty.

Assessment and Collection of DPT

- Where a UK company has entered into arrangements lacking economic substance that result in a 'substantial' effective tax mismatch;
- Where a non-UK company has an 'avoided PE', resulting in an effective tax mismatch which must be 'substantial'; and
- Where there is no mismatch, instead of the tax avoidance purpose condition, a notification obligation can arise where the arrangements have resulted in an overall reduction in tax, regardless of the motive for the arrangements.

Cases which could be subject to DPT

- Commissionaire and sales agent structures.
- Principal structures or operating models lacking adequate substance.
- IP migrations from the UK where key personnel do not move.
- Companies operating in the UK without a taxable presence.
- Royalties paid to lower tax jurisdictions
- High value services provided on a cost plus basis.

Examples

- An Irish Principal company provides services to third party European customers and its activities are supported by the UK Marketing Company. While the UK Marketing Company assists in negotiating contracts, the Irish Principal agrees and signs the final contract with customers. As a consequence, the Irish Principal does not have a presence in the UK for corporation tax purposes under current tax rules. In this example, subject to a detailed analysis of the facts, the Irish Principal may be regarded as diverting profits from the UK by avoiding a UK taxable presence, and so may be liable to DPT.

- A Bahamas IP Holding Company has co-funded the development of IP with its US Parent and holds worldwide rights for exploiting that IP outside the US. It licenses this IP to a UK company and charges a royalty in respect of this arrangement. The Bahamas IP Holding Company pays no tax in the Bahamas. The individuals responsible for the development, maintenance, exploitation and protection of the IP are employed by the US parent and not by the Bahamas IP Holding Company. Given the tax profile of the overseas company and the fact that the employees responsible for the IP are not employed by the Bahamas IP Holding Company, there is a risk that some (or conceivably even all) of the royalty may be regarded as diverted and subject to DPT

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Taxation of E-commerce/Digital transactions/Digitalised Transactions?

PC Tax

Challenges in taxation of digitalized economy

CBDT High Powered Committee for e-commerce: The traditional concept of PE, which was conceived at a point of time when internet and e-commerce was not even on the radar, does not really fit into the modern day world in which virtual presence through internet , in certain respects, is as effective as physical presence for carrying on businesses.

BEPS Action Plan 1 : Digitalisation of Economy

- Challenge to the nexus rules
- Characterisation of income
- Value attribution issues due to data

Taxation of digitalized transactions – Development in India

India

Earlier

- Royalties
- FTS

Now

- Royalties
- FTS
- EQL 1.0 and 2.0
- SEP
- TDS u/s 194-O
- TCS under GST
- OIDAR under GST

Globally

- Pillar 1 – Amount A
- Article 12B on automated digital services

Copyright v. Copyrighted article

- **Definition under the Act**
- Royalty includes consideration paid for the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films
- Explanation 4 clarifies that the transfer of all or any rights in respect of any right, property or information includes transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

SC ruling:

1. Software purchased by end user from NR supplier/manufacturer
2. Software purchased by Indian reseller from NR supplier/manufacturer and sold to end user
3. Software purchased by NR distributor from NR and resold to Indian distributor
4. Software embedded in hardware sold to Indian distributor or end user

Copyright v. Copyrighted article

- **SC Ruling in Engineering Analysis Centre of Excellence**
- In absence of meaning of 'copyright' under the Act or DTAA, the SC (SC has placed reliance on the specific provisions under the Indian Copyright Act, 1957 for the purpose of finding out the true meaning and context for usage of expression 'copyright'. (Engineering Analysis Centre of Excellence Private Limited vs The CIT & ANR. (125 taxmann.com 42)

Key Observations

01 Distribution/ EULA

Grants non-exclusive and non-transferable license to 'resell' software to distributors. No rights given to reverse engineer, modify, reproduce software in any manner

02 Royalty

Transfer of all or any right in copyrighted article (software) is mandatory for classification as 'Royalty'

03 Treaty supremacy

Reaffirms past rulings - withholding obligations arise only when income is chargeable to tax under provisions of the Act read with tax treaty

04 Copyrights

Ownership of copyright in a work is different from ownership of physical material in which copyrighted work may be embodied. 'Right to reproduce' distinct from 'Right to use' computer software

05 OECD Commentary

Highlighted relevance of OECD commentary in interpreting tax treaties and its persuasive value in interpreting 'Royalty'

06 Income Tax Act

2012 amendment expanding scope of Royalty cannot be clarificatory in nature having retrospective effect and does not impact tax treaties

Copyright v. Copyrighted article

- Where 'No Royalty' position taken, NR sellers/ service providers to revisit applicability of 2 percent Equalisation levy for period post April 1, 2020
- All 4 categories of transactions treated as sale of goods. If same principles are ascribed for domestic sales and no TDS is done under Section 194J, evaluate TCS under Section 206C(1H) and TDS under Section 194Q
- Where no TDS position under Section 194J/ Section 195 is taken, evaluate impact on domestic software resellers based on CBDT Notification No 21/ 2012
- Apex Court ruling based on premise of no PE in India. NRs to build strong arguments and fortify facts/ documents to establish 'no PE' before income tax authorities, if examined
- Evaluate impact of Apex Court ruling on concluded/ to be renewed APAs and MAPs

Impact of the verdict on other categories of transactions

Database Subscription	Wipro Limited (Karnataka HC) Gartner Ireland Limited (Mumbai ITAT)
Network Connectivity/ Transponder	Verizon Communications Singapore Pte Ltd (Madras HC) Cognizant Technology Solutions India Pvt Ltd (Chennai ITAT)
Interface Processor	MasterCard Asia Pacific Pte Ltd (AAR)
Intranet	CGI Information Systems & Management Consultants (P) Ltd (Karnataka HC)
Advertisement Space	Google India Private Limited (Bangalore ITAT)
Submarine Cable System	Dishnet Wireless Limited (AAR)

Online advertisement

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- **ITO v. Right Florists [2013] 32 taxmann.com 99 (Kolkata - Trib.)**
  - Website cannot constitute PE
  - The service which is rendered by Google is generation of certain text on the search engine result page. This is a wholly automated process. This cannot be classified as FTS
- The banner advertisement hosting services did not involve use or right to use by the assessee any industrial, commercial or scientific equipment and no such use was actually granted – **Yahoo India v. DCIT [2011] 11 taxmann.com 431 (Mumbai)**
- **Google India (Bang ITAT)** - The computerised advertising program i.e., "Google AdWords Program" is essentially a computer program i.e., a computer software.
- None of the rights as per section 14(a)/(b) and section 30 of the Copyright Act, 1957 have been transferred by Google Ireland to the assesse
- The assessee cannot be said to have gained right to use any scientific equipment, since, Google Ireland has not parted with the copyright it holds in the Adwords program and hence it cannot be said that any kind of technical knowhow has been transferred to the assessee company.
- **Other rulings:**
  - Pinstorm
  - Inception Business
  - Urban Ladder
  - Myntra Designs
  - Play Games -The Hon'ble Tribunal observed that Play Games did not get any right to modify/deal with the servers, which belonged to Facebook Ireland Ltd., in any manner. It was also observed inter alia that the said servers, which hosted online advertisements, were located outside India and that Facebook Ireland Ltd. did not have a PE in India.
  - Matrimony.com
  - ESPN Digital Media - The consideration paid by ESPN India is not for 'use' of equipment (server) or for any process nor imparting of any information concerning technical, industrial, commercial, or scientific knowledge, experience or skill. Further, no right has been conferred on ESPN India over the server or website belonging to ESPN UK and ESPN India is merely a reseller of advertisement space it purchases on ESPN UK's website.
  - Interactive Avenues

Online provision of the content

- Section 9(1)(vi) includes the consideration for imparting of any imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill
- Whether the content for which payments are made is in the nature of know-how and therefore in the nature of royalty?
- Copyright vs Copyrighted article?
- Uptodate Inc. V. DCIT [2023] 150 taxmann.com 231 (Delhi - Trib.) - The assessee collates data relating to healthcare as available in public domain and has put them in one place by creating a database. Thus, the content which is put in the database is not created by the assessee but created by third parties, which the assessee has picked up from public domain and created a database. The only improvement the assessee has made in the database is like analysis, indexing, description, appending notes for facilitating easy access to the customers. For allowing access to the database to customers the assessee charges subscription fee. The assessee has not transferred right to use of any industrial, commercial, or scientific equipment as the subscriber are only granted access to online database. Further, the assessee has transferred right to use of any copyright of literary, artistic or scientific work or any other secret formula or process or information concerning industrial, commercial, scientific experience.
    - RELX Inc. v. ACIT [2023] 149 taxmann.com 78 (Delhi - Trib.)
    - American Chemical Society v. DCIT [2023] 146 taxmann.com 133 (Mumbai - Trib.)
    - Salesforce.com Singapore Pte. V. DDIT [2022] 137 taxmann.com 3 (Delhi - Trib.)
    - Everest Global Inc (P.) Ltd. [2022] 143 taxmann.com 176 (Delhi - Trib.)
    - Fact set Research Systems Inc [2009] (317 ITR 169)(AAR)
    - DowJones & Company Inc. [2022] 135 taxmann.com 270 (Delhi - Trib.)
    - Factiva Ltd. [2022] 141 taxmann.com 246 (Mumbai - Trib.)
- The Indian customers do not make payments for availing the knowledge of assessee's experience of creating/maintaining database; what they pay for is access to information that such database encompasses. By granting access to the information forming part of the database, the assessee neither shares its own experience, technique or methodology employed in evolving databases with the users, nor imparts any information relating to them
- Elsevier Information Systems GmbH v. DCIT [2019] 106 taxmann.com 401 (Mumbai - Trib.) - here is no material on record to demonstrate that while providing access to the database there is any human intervention. When a subscriber accesses the online database maintained by Taxman/CTR online etc. he only gets access to a copyrighted article or judgment and not the copyright. The subscription fees would neither be royalties or FTS

Cloud Computing

- Whether Server is PE? The OECD commentary has mentioned that where the server on which the website is stored and through which it is accessible is a piece of equipment having a physical location, it would be considered as a fixed place of business. Hence, the company shall be taxed in the country where the server is located if the server is at the disposal of the enterprise.
- Delhi Tribunal in MOL Corporation [2022] 137 taxmann.com 286 (Delhi - Trib.) has held that where assessee, a U.S based company, provided cloud computing infrastructure and software services to Indian customers through a subscription agreement, since the grant of right to install and use software underlying cloud computing service did not include providing a copy of said software and even though cloud-based services were based on patents/copyright but subscribers did not get any right of reproduction. The Cloud services merely facilitate the flow of user data from the front-end users through the internet to the provider's system and back. The subscription fee was merely a consideration and would not be taxable as a royalty under section 9(1)(vi) and article 12 of India-USA DTAA.
- Racksapce US, Inc. v. DCIT [2021] 124 taxmann.com 92 (Mumbai – Trib.) has held that the agreement between the taxpayer and its customer was for providing hosting and other ancillary services to the customer and not for the use of or leasing of any equipment. The customers do not have physical control or possession over the servers, and right to operate and manage this infrastructure or servers is vested solely with the taxpayer. The agreement was to provide simpliciter hosting services and not give the underlying equipment on hire or lease. The customer did not know any server location in the data centre, webmail, websites, etc.
- Amazon Web Services, Inc. v. ACIT [2023] 153 taxmann.com 45 (Delhi – Trib.) – AWS services provided by the assessee are merely standard and automated services which are all publically available online to anyone. These services are all standardized, and there is no customization done for any particular customer. AWS services provided by the assessee are merely standard and automated services that are publicly available online to anyone. These services are all standardized, and there is no customization done for any particular customer.

Access to website and servers

- Section 9(1)(vi) includes the consideration with respect to use or right to use any industrial, commercial or scientific equipment (excluding where section 44BB of the Act is applicable).
- Explanation 5 has clarified that the term royalty includes consideration in respect of any right, property or information, whether or not
- (i) The possession or control of such right, property or information is with the payer;
- (ii) Such right, property or information is used directly by the payer;
- (iii) The location of such right, property or information is in India.
- If an advantage was taken from sophisticated equipment installed and provided by another, it could not be said that the recipient/customer 'used' the equipment as such. The customer merely made use of the facility, though he did not himself use the equipment. If an advantage was taken from sophisticated equipment installed and provided by another, it could not be said that the recipient/customer 'used' the equipment as such. The customer merely made use of the facility, though he did not himself use the equipment. Dell International Services (India) (P.) Ltd., In re [2009] 308 ITR 37/[2008] 172 Taxman 418 (AAR - New Delhi)
- Right Florist – Website cannot constitute PE
- While website per se, does not constitute a tangible property as it cannot have a location which constitutes place of business, a web server, on which the web site is stored and through which it is accessible, is a piece of equipment having a physical location and such location may, thus, constitute a "fixed place of business" of the enterprise that operates that server. A search engine, which has only its presence through its website, cannot, therefore, be a permanent establishment unless its web servers are also located in the same jurisdiction.
- India's reservation – Website can constitute PE

Web-hosting

- EPRSS Prepaid Recharge Services India (P.) Ltd. [2018] 100 taxmann.com 52 (Pune - Trib.) - The assessee in the present case did not use or acquire any right to use any industrial, commercial or scientific equipment while using the technology services provided by Amazon and hence, the payment made by assessee cannot be said to be covered under clause (iva) to Explanation 2 of section 9(1)(vi) of the Act. The fees paid by assessee was for use of technology and cannot be said to be for use of royalty, which stands proved by the factum of charges being not fixed but variable i.e. it varies with the use of technology driven services and also use of such services does not give rise to any right in property of Amazon and consequently, Explanation under section 9(1)(vi) of the Act is not attracted.
- Similarly, Hyderabad Tribunal in Reasoning Global E-Application Ltd. [2022] 145 taxmann.com 464 (Hyderabad - Trib.) observed that the web hosting charges paid to Amazon towards AWS Data Transfer, Amazon Simple Storage Services, AWS Premium Support, Amazon Simple Notification Services, Amazon Elastic Compute Could etc, do not involve any transfer of rights to the assessee in any process. It was held that services, merely facilitate the flow of user data from the front run user through internet to the providers system and back. Therefore, the subscription fee is merely a consideration for the online access of the cloud computing services for process and storage of data or run the applications but cannot be considered as Royalty within the meaning of section 9(1)(vi) of the Act.

Whether the server can be considered as PE?

- The OECD commentary has mentioned that where the server on which the website is stored and through which it is accessible is a piece of equipment having a physical location it would be considered as a fixed place of business. Hence, the company shall be taxed in the country where the server is located, if the server is at the disposal of the enterprise.

Automatic Equipment Constituting PE

- An automatic equipment can constitute PE
  - MIPs also pass the test of permanency.
  - MIPs may not be owned by the applicant is not relevant
- The role played by MIPs is a significant in facilitating authorization process, and without this initial verification/validation by MIPs, the authorization would not happen. this is a significant activity for authorization part of the transaction processing and cannot be said to be preparatory or auxiliary.
- The functions performed by the facility at Singapore, such as securing of the transaction, prevention of fraud and add on functions performed by server outside India are also significant functions, but these would be important for attribution and apportionment purposes, which is not the issue under discussion
- Thus, the initial verification/validation of PIN, card codes, names and address, and encryption and communication of data are important and crucial function in the context of overall functions performed by the applicant to facilitate authorization. These functions cannot be called preparatory or auxiliary.
- MISPL does not exercise any of the rights of an owner, such as deciding whether and when to repair the instrument or buy a new one; agreeing to the terms and conditions of repair; whom to engage for repair and at what cost, and so on. In the present case, all these risk mitigation decisions are taken by the applicant or its overseas AEs on its behalf. They enter into the agreement with third party service providers on their own behalf and not on behalf of the MISPL. The applicant enters into agreement with banks. Thus, all decisions with respect to MIPs are taken by the applicant
- The details of 'MasterCard one-time license fee' referred to in the billing manual. This fee is charged to an affiliate member as a one-time on boarding fee for availing transaction processing services. One-time on boarding fee is paid for the cost of MIP installation, for establishing connectivity and set-up of processors. This is an additional evidence to prove that MIPs are at disposal of the applicant as the Applicant is charging fee for cost of its installation.
- The facts clearly establish that MIPs, though shown to be owned by MISPL, are not under the control or disposal of MISPL. The term 'at the disposal of' would mean right to use and having control over that place/equipment. Thus, it is clear that the applicant has right to use MIP and has control over it.
- As regards the clearing and settlement functions, transaction processing has three stages: authorization, clearing and settlement. It is not necessary that PE will be created only if the fixed place/equipment is involved in all three stages. Involvement in even one stage (without it being preparatory or auxiliary) can create PE, provided they are significant. The distinction of these three stages (authorization, clearance and settlement) would be important for profit attribution and not for creating a PE.

Equalisation Levy 1.0 – Online Advertisement

Payers are required to deduct equalisation levy @ 6 percent from the amount paid or payable to a NR in respect of the specified services

Applicability

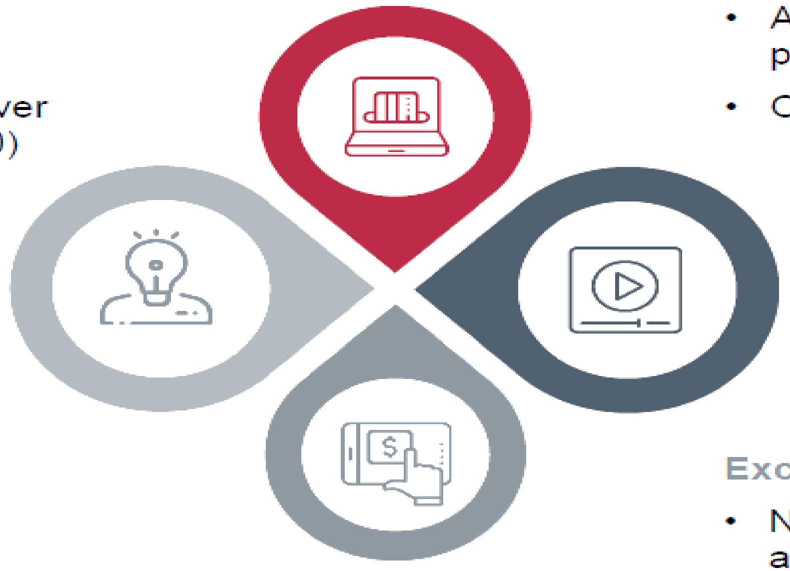
Specified services provided to

- Indian resident carrying on business or profession (B2B)
- NR having PE in India

If aggregate consideration in a FY is over **INR 100,000** (payer wise) (~USD 1350)

Specified Services

- Online advertisement,
- Any provision for digital advertising space
- Any other facility or service for the purpose of online advertisement
- Other notified services



Key Consideration

- Credit of taxes deducted in home country may not be available
- Compliance burden on resident payer. No compliance requirement by the NR service provider

Exclusions

- NR service provider having PE in India and specified services is effectively connected with that PE
- For purpose other than business or profession (B2C)

Equalization Levy 2.0 on E-Commerce Supply or Services

NR e-commerce operator (NR ECO) required to pay 2 percent on consideration from e-commerce supply of goods or provision of services to specified recipients

Types of transactions

e-commerce supply of goods or services

i. Online sale of goods owned by NR ECO or services provided by NR ECO

ii. Online sale of goods or provision of services 'facilitated' by the operator

iii. Any combination of the above

Includes online activities like acceptance of offer for sale, placing or acceptance of purchase orders, payment of consideration and supply of goods or provision of services (partly or wholly)

Specified recipients

i. Person resident in India

ii. NR in 'specified circumstances'

iii. Person who buys goods or services or both using IP address located in India

Non-applicability

i. NR ECO having PE in India

ii. Where EQ Levy 1.0 is leviable

iii. Sales, Turnover or Gross Receipts of NR ECO is less than INR 20 million (~USD 270,000 in FY)

iv. Any consideration taxable as Royalty/ FTS under IT Act or DTAA

v. e-commerce transactions, where seller/ service provider is a tax resident of India or NR seller having PE in India

Important definitions

E-commerce operators - NR who **owns, operates or manages** digital or electronic facility or platform for online sale of goods/ provision of services/ both

Online - facility/ service/ right/ benefit/ access that is **obtained through internet** or any other form of digital or telecommunication network

Specified circumstances - Sale of advertisement targeting Indian customers or sale of data, collected from Indian users

Equalization Levy 2.0 on E-Commerce Supply or Services

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Digital Businesses

- Online Marketplace
- Online food delivery platforms
- Online travel
- Online payments/ wallets/ gateways
- Vehicle Aggregators
- Online Advertisers
- Cloud Computing Services
- Online content
- Search Engines & Research Platforms
- Matrimony & Dating Services
- Online entertainment
- Online auction

Regardless of industry/ business segment, certain transactions if carried 'online' could attract EQ Levy sheerly for NR

Intra-group transactions

ERP

Cost allocation

Import of goods and services

Targeting Technology 'driven' or Technology 'enabled' business?

Deviation from fundamental intent of law (extracts from e-commerce expert committee report#):

– *Para 1*: to tax supply and procurement of 'digital goods and services'

– *Para 109*: to bring to tax, foreign enterprises that earn significant income from a jurisdiction that erodes its tax base

– Specified services as per report, *Para 193*: (vii) any 'facility or service' for online sale of goods or services or collecting online payments

– India's EL position differs from EU countries (UK, Spain, France etc) providing specific exemption to intra-group transactions

A definite need for clarification from Indian Revenue

Significant economic presence

- The meaning of term SEP as amended by Finance Act 2020, is provided as-

(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.

(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.

- The Significant Economic Presence in case of a non-resident shall be triggered if:

(a) aggregate amount of payment for a specified transaction with a person in India exceeds INR 20 million (during a year) or

(b) non-resident undertakes systematic and continuous soliciting of business activities or engages in interaction with 300,000 or more users in India.

The above provisions will apply-

- Whether or not the agreement for such transactions or activities is entered in India or
- Whether or not, the non-resident has a residence or place of business of business in India or
- Whether or not, the services are rendered in India.

Section 194O – TDS on Payment made to E – Commerce Participant:

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Effective from October 1, 2020, ECO is required to withhold tax @ 1 percent on e-commerce transactions

Applicability

- ECO (resident or non-resident of India) liable to deduct TDS @ 1 percent on gross amount of sales or services or both paid or payable to a resident e-commerce participant
- Tax to be deducted at the time of credit or payment (whichever is earlier)
- TDS rate – 5 percent for non-PAN/ non-Aadhaar cases

Non-Applicability

- E-commerce participant is a non-resident
- Individual/ HUF e-commerce participants, where gross amount of sales through e-commerce operator during the year does not exceed INR 5 lakhs (PAN/ Aadhaar needed)
- On amounts received or receivable by an e-commerce operator for hosting advertisements

ECO **deemed to be person responsible for paying e-commerce participants**

Services includes FTS and fees for professional services

Electronic commerce

Supply of goods or services or both, including digital products, over digital or electronic network

E-commerce participant

A person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce

E-commerce operators

Any person who owns, operates or manages digital or electronic facility or platform for electronic commerce

AP 1- Addressing the challenges of the Digital Economy:

- Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.
- Challenges posed by the digital economy
  - Establishing nexus
  - Value creation through Data
  - Characterisation
- Interim solutions
  - SEP as a new nexus
  - WHT on transactions
  - Equalisation levy

International Chaos

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United Kingdom

DST @ 2 percent
Revenue in excess of 25 million pounds derived from UK users from:
- social media platforms
- internet search engine
- online market place

France

DST @ 3 percent
Apply "French digital presence" ratios on
- Digital Interface
- Digital advertising services based on users' data

Spain

DST @ 3 percent
Gross revenue from:
- online advertising services
- sale of online advertising and
- sale of user-data

Argentina

DST @ 5 percent
Bets made through a digital platform in or from Argentina

Austria

DST @ 5 percent
- Online advertisements
- Threshold limits:
  Global turnover- Euro 750M+ &
  Domestic turnover- Euro 25M+

Turkey

DST @ 7.5 percent
- Digital advertising services
- Digital content
- Digital interface services

Kenya

DST @ 1.5 percent
- Digital content services
- Transmission of data
- Digital marketplace
- Subscription based media services
- Search Engine
- Online learning/e-learning

Italy

DST @ 3 percent
- Digital advertisements
- Digital intermediary services
- Transmission of user data

International Chaos

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Indonesia

Foreign digital entities without physical presence in Indonesia with prescribed consolidated gross revenue, sales amounts and/or the size of active members in Indonesia

Israel

Foreign entity deriving income from online transactions with Israeli residents will create a PE, even if activity is of a preparatory or auxiliary character only

Nigeria

NR company will have an SEP in Nigeria in any FY if it has gross turnover or income of more than NGN 25 million ($64,601) from specified digital activities

Italy

A significant and continuous economic presence in the territory of the state built in such a way as not to result in any physical presence in the same territory

Turkey

A significant and continuous economic presence in the territory of the state built in such a way as not to result in any physical presence in the same territory

Slovak Republic

NR operators without physical presence that regularly facilitate the conclusion of contracts for providing transportation and accommodation services via a digital platform

Progress Achieved

- October 2015: BEPS Action 1 - Addressing the Tax Challenges of the Digital Economy
- March 2018: Delivery of the Interim Report
- January 2019: Delivery of Policy Note
- May 2019: Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy
- January 2020: Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy
- October 2020: Statement by the OECD/G20 Inclusive Framework on BEPS and delivery of the reports on the Blueprints of Pillar One and Pillar Two, and the Economic Impact Assessment.
- July 2021: Statement on a Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy
- October 2021: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy
- December 2021: Global Anti-Base Erosion Model (GloBE) Rules - Pillar Two
- March 2022: Commentary to the Global Anti-Base Erosion Model (GloBE) Rules - Pillar Two
- December 2022: Implementation package for Pillar Two
- February 2023: Agreed Administrative Guidance for the Pillar Two GloBE Rules
- July 2023: Outcome Statement on the Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy
- July 2023: Agreed Administrative Guidance for the Pillar Two GloBE Rules
- July 2023: GloBE Information Return (Pillar Two)
- July 2023: Subject to Tax Rule (Pillar Two)
- October 2023: Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule (STTR MLI)
- October 2023: Minimum Tax Implementation Handbook (Pillar Two)
- October 2023: Multilateral Convention to Implement Amount A of Pillar One

OECD v. UN Approach

- OECD Approach
- 2 tier approach – Amount A and B
- Covers all the transactions
- Regulated FS and extractives industries excluded
- Complex calculations

- UN Article 12B
- Taxation on gross basis
- Net basis tax on 30% of the qualified profits
- Limited coverage – Automated digital services
- Simple to administer and calculate

Pillar One

- Applicability: Pillar 1 applies to a covered group having
  - Adjusted Revenues greater than EUR 20 billion
  - a pre-tax profit margin > 10%
- Regulated financial institutions and extractive industries are excluded
- Nexus: There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250 000 euros.
- Revenue sourcing:
  - Sale of finished goods – where finished goods are delivered to the final custome
  - Sale of raw materials - in the Jurisdiction in which the finished goods containing the component are
  - delivered to the final customer
  - Services connected to tangible property – where property is located
  - Location specific purpose – where the service is performed
  - Online advertisement – where the viewer of advertisement is located or where the Ads are displayed
  - Online intermediation services that facilitate the sale or purchase of tangible goods, digital content or services – 1:1 in the jurisdiction of buyer and seller

Pillar One

- Revenue sourcing:
  - Customer reward program - in each Jurisdiction in proportion to the number of members located in each Jurisdiction who have redeemed or earned one or more units during the Period
  - licensing, sale, or other alienation of user data are treated as arising in the Jurisdiction in which the user associated with the data is located
  - licensing, sale or other alienation of intangible property
    - Related to Finished goods – where finished goods are delivered
    - Related to service or digital content – where service or digital content is used
    - Others – where intangible property is used
- Quantum - For in-scope MNEs, 25% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.
- Amount B – Marketing and distribution safe harbour under public consultation

Pillar Two

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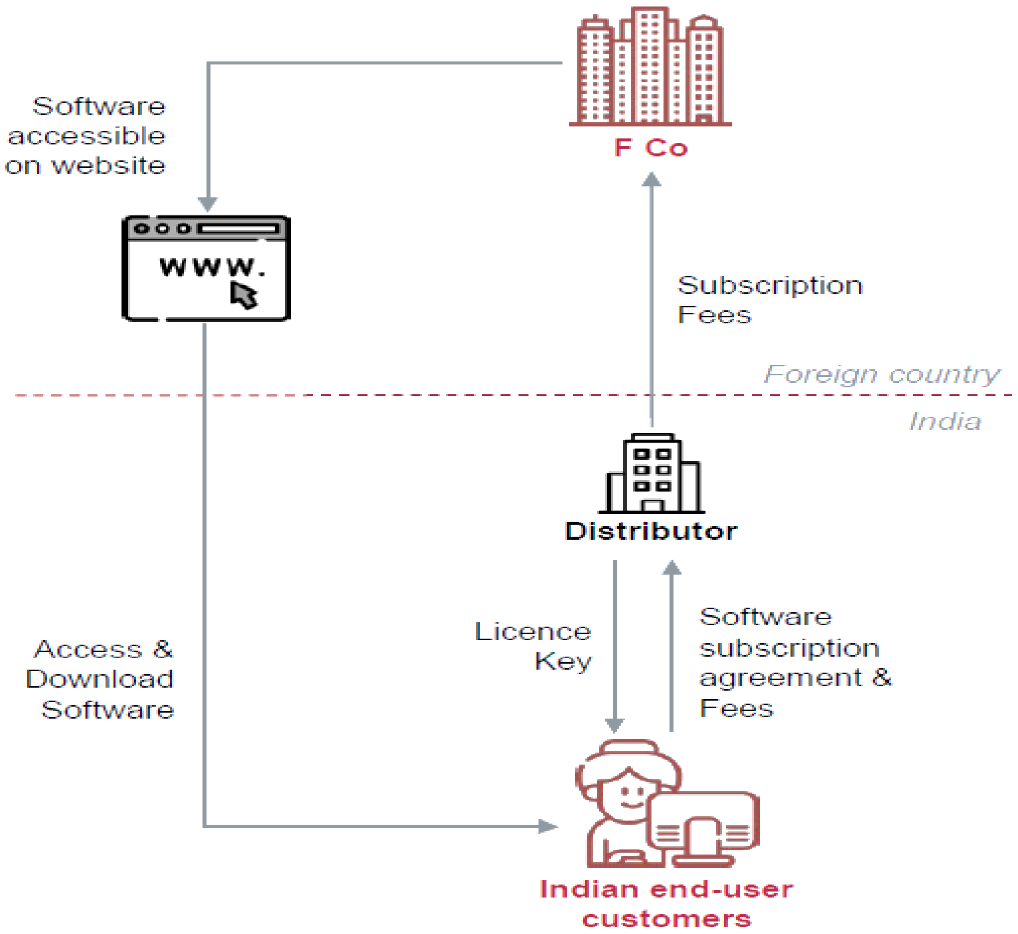
- Pillar Two would introduce a global minimum corporate tax rate of 15% to put a floor on competition over corporate income tax for companies with revenue above €750 million. It would include the following two interlocking domestic rules (together, the Global anti-Base Erosion Rules (GloBE) rules):

1. An Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low-taxed income of a constituent entity

2. An Undertaxed Payment Rule, which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR

3. STTR of 9% on 0 interest, royalties and a defined set of other payments

Electronic delivery of software



Facts

- F Co owns copyright in a software which is accessible online
- End users obtain licence either directly or through an intermediary to download software on their server and use the same

Points to Ponder

- Apex Court ruling is on 'conventional mode' of software transactions and there is need to analyse whether ruling could apply to new-age software transactions as well (non-shrink-wrapped software cases)
- As per OECD Commentary on Article 12 - Method of transferring computer program to transferee is not relevant. For example, it does not matter whether transferee acquires computer disk containing a copy of program or directly receives copy on hard disk of computer via modem connection
- Most relevant factor is whether end-user or distributor has any exclusive right to exploit/ use 'copyright' in software and if any copyright has been parted with
- Principles emanating from Apex Court ruling may be relied upon irrespective of mode of delivery for characterisation of software transactions
- 2% EQ Levy could still apply

Grant of database

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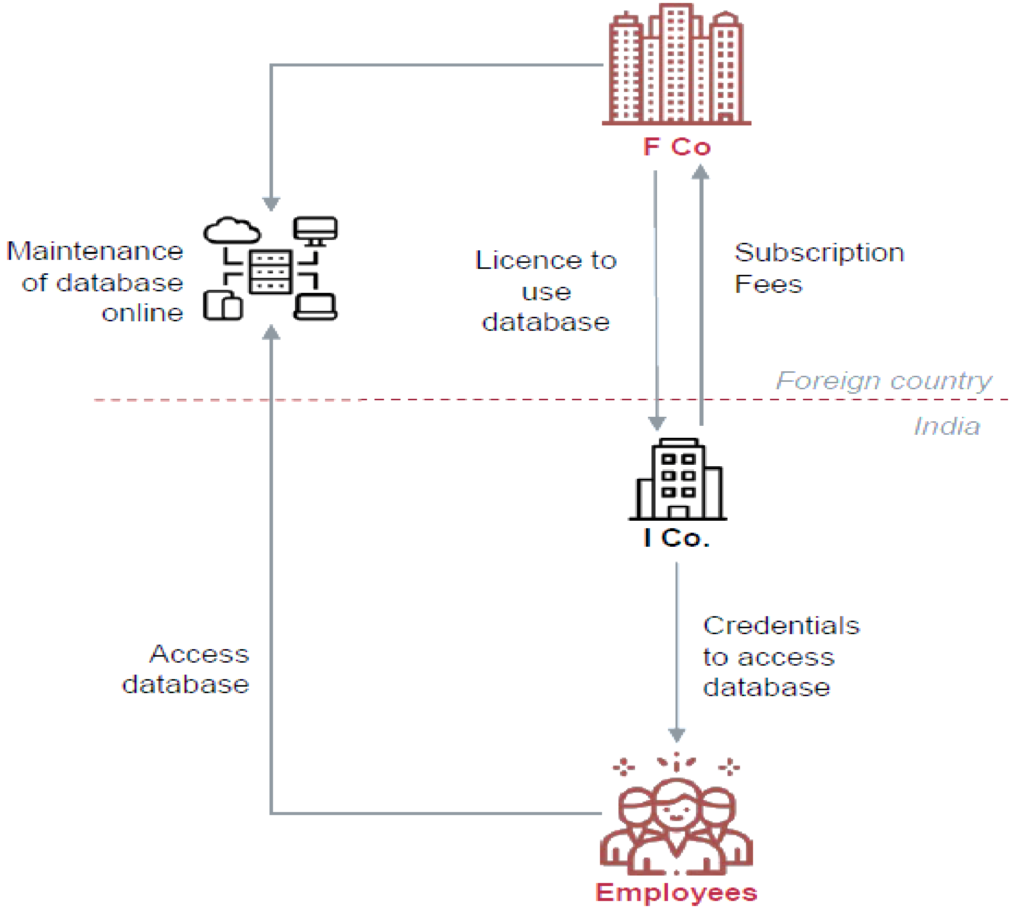

[1] CIT vs Wipro Ltd. (2013) 355 ITR 284
[2] CIT vs Samsung Electronics Co Ltd (2012) 345 ITR 494

Facts

- F Co engaged in research/ advisory and maintains tools, database and advisory reports online
- I Co engages F Co to avail access services with respect to database maintained by F Co, for purpose of its business
- I Co pays subscription fees as a consideration and can only access database. I Co does not have any right to transfer or reproduce the database.

Points to Ponder

- Karnataka HC in the case of Wipro[1] held that payment towards license to access database is to be treated as 'Royalty' by relying on its own decision in Samsung's case[2]
- Apex Court ruling does not directly deal with payment for database access. However, SC has overruled Samsung's case[2] relied by Karnataka HC and has laid down a principle that parting of copyright is mandatory for characterisation as 'Royalty'
- Taxability as FTS (whether devoid of human intervention or not & make available exemption) and applicability of 2% EQ Levy to be analysed

Cloud Computing

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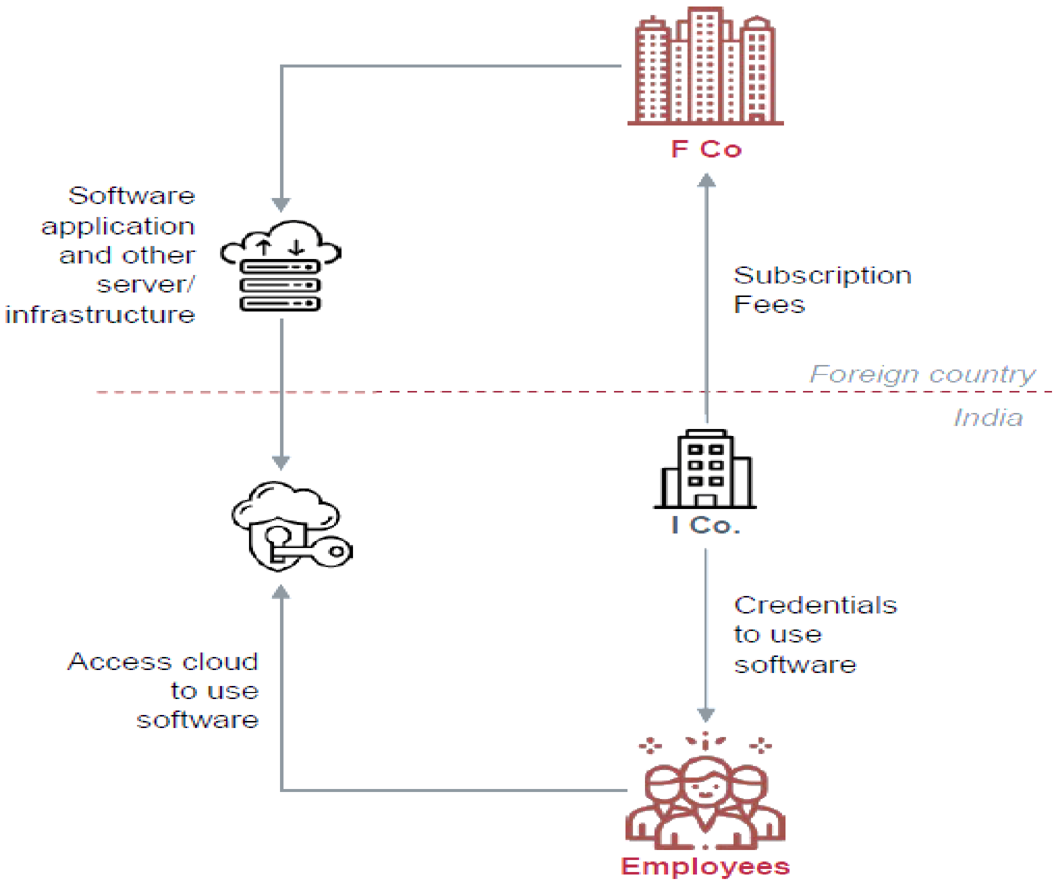


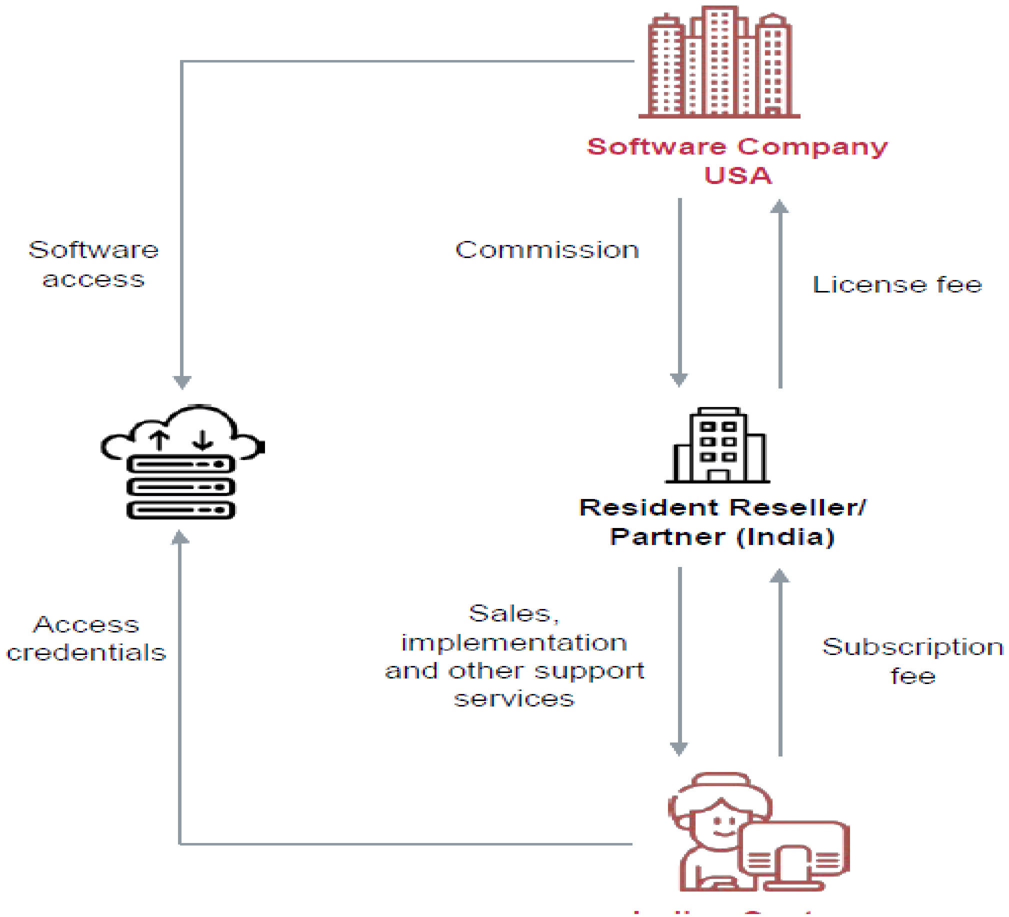
Facts

- F Co provides cloud computing services (IaaS, PaaS or SaaS)
- I Co contracts with F Co to obtain on-demand access to software application and other server/ infrastructure services for its employees
- Employee access software through internet and I Co pays subscription fees for same

Points to Ponder

- Whether it is merely service transaction or involves provision of services along with software is to be determined
- Where there is parting with any copyright in software, payment may be characterised as 'Royalty'
- Where it is mere use of copyrighted article with non-exclusive and non-transferable licence, transaction may not constitute 'Royalty'. Arguments may be drawn from the principles laid out in the Apex Court ruling
- Taxability as FTS (whether devoid of human intervention or not & make available exemption) and applicability of 2% EQ Levy to be analysed

Software resale



Facts

- Software company in USA sells its software through a reseller in India
- Reseller pays a license fee to the software company
- Reseller receives commission for each sale made

Points to Ponder

- EQ Levy is applicable on the license fee paid by the reseller (subject to turnover limit of INR 20 million of the US software company)
- EQ Levy will also be applicable on any online after-sales services provided by the Software Company in USA, either directly or through a service provider in India
- Principles emanating from Apex Court in software-royalty ruling may be relied upon irrespective of mode of delivery for characterisation of software transactions and can take no royalty position
- TDS on domestic transaction to be evaluates based on on CBDT Notification No 21/ 2012

Purchase of goods through resident e-commerce seller

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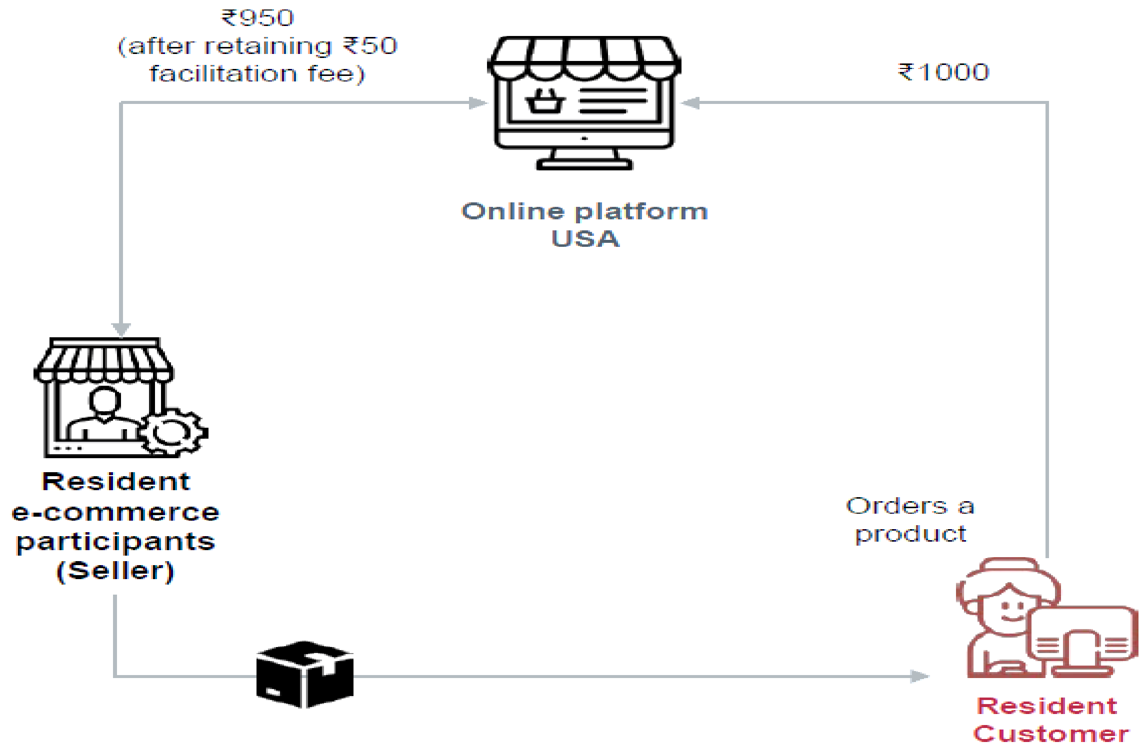

Facts

- Indian resident customer orders a product online on a NR e-commerce platform
- Payment made by the customer via online platform
- Seller is a Indian resident

Points to Ponder

- ECO is required deduct tax at source under Section 194-O of IT Act @ 1% on gross amount
- TCS under GST @ 1% shall also be collected by ECO
- EQ Levy would not apply if the services is provided by a person resident in India

Purchase of goods through non-resident e-commerce seller

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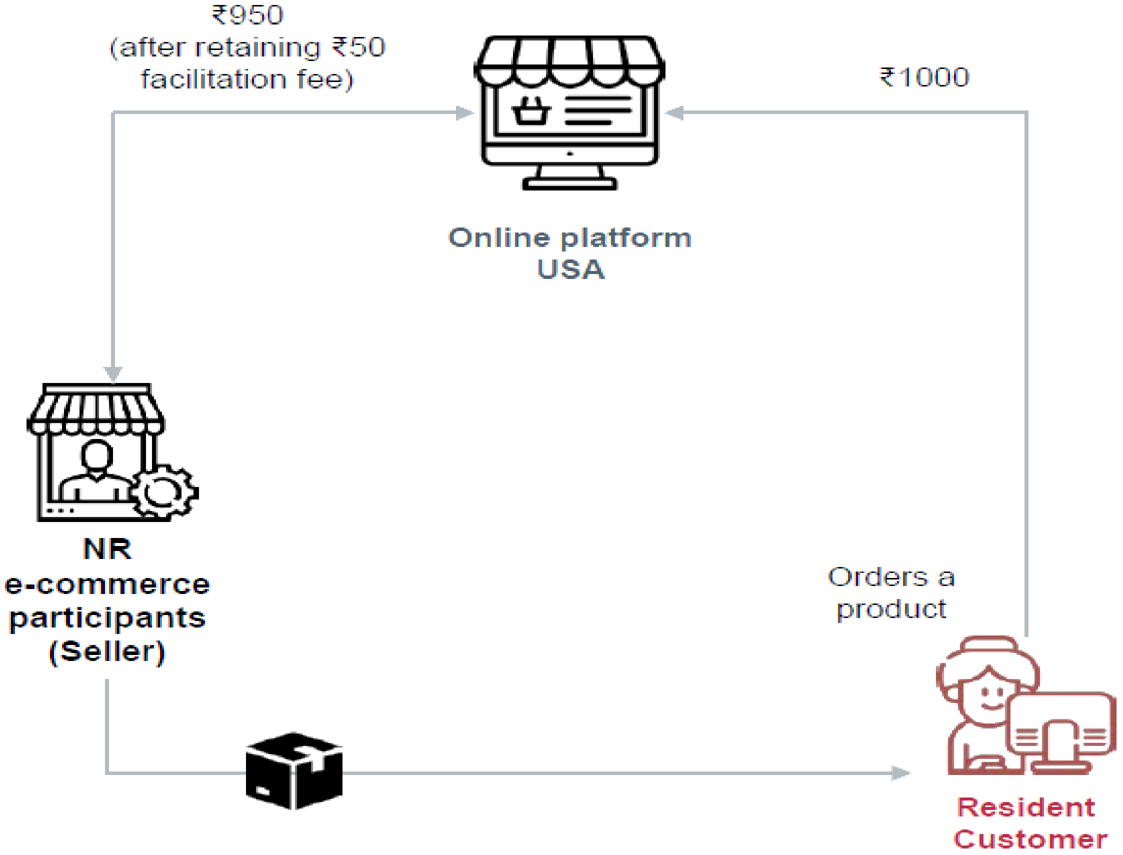


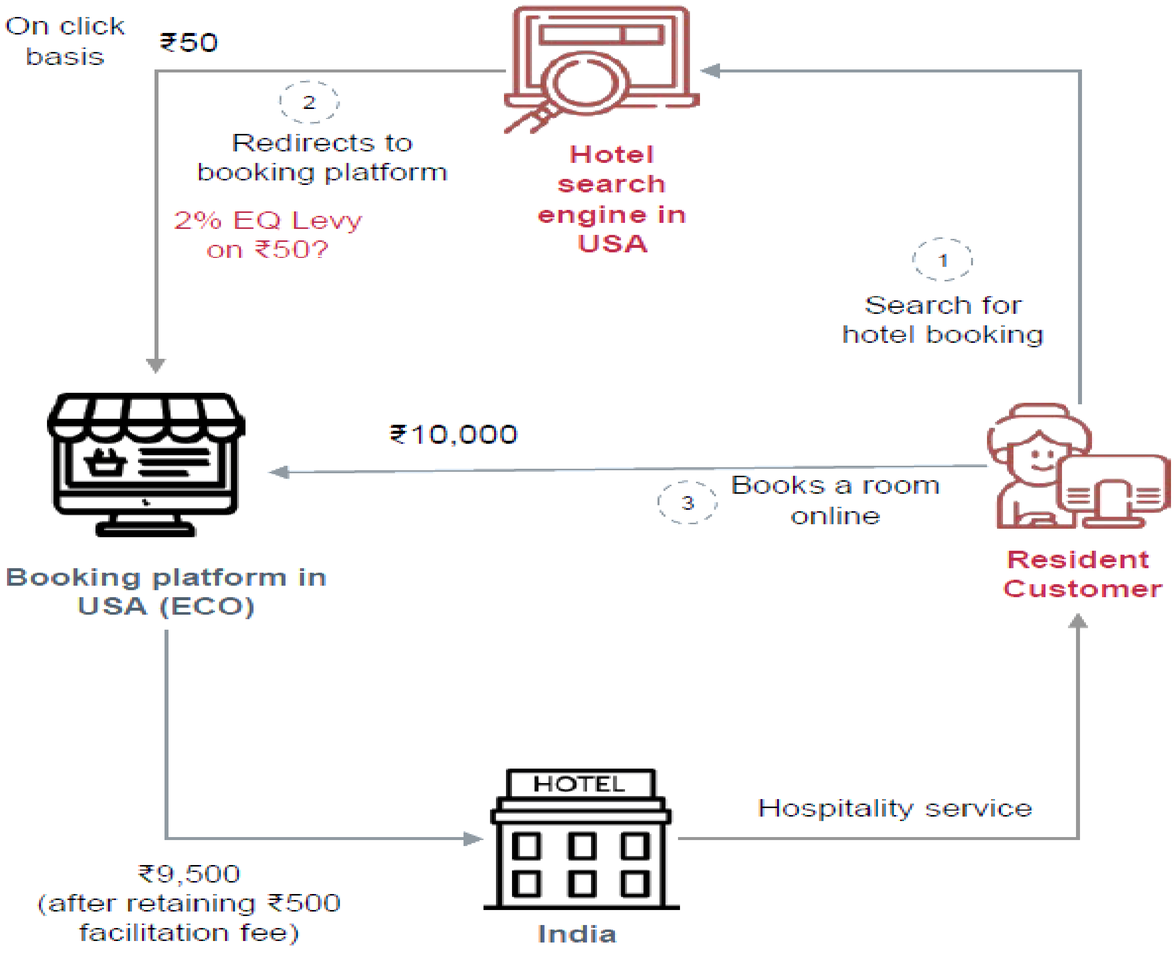
Facts

- Indian resident customer orders a product online on a NR e-commerce platform
- Payment made by the customer via online platform
- Seller is a Indian resident

Points to Ponder

- EQ Levy would apply @ 2% on gross consideration received by e-commerce platform
- TDS under Section 194-O of IT Act and TCS under GST will not apply as NR seller

Online provision of booking services (Reseller)



Facts

- Indian resident customer searches for a hotel on a travel search engine
- Travel search engine redirects the customer to an online booking platform (e-commerce operator)
- Customer books a room in a hotel situated in India (resident e-commerce participant), on such platform and payment is also done via such platform

Points to Ponder

Leg 1 - Transaction between booking platform & search engine

- EQ Levy should apply @ 2% - Covered under "specified circumstances" as sale of advertisements targeting Indian customers

Leg 2 - Transaction between customer & booking platform

- ECO is required deduct tax at source under Section 194-O of IT Act @ 1% on gross amount & TCS under GST @ 1%
- EQ Levy would not apply if the services is provided by a person resident in India

If e-commerce participant is a resident in India, then TDS under Section 194-O of IT Act to apply & EQ Levy to not apply

Online provision of booking services (Reseller)

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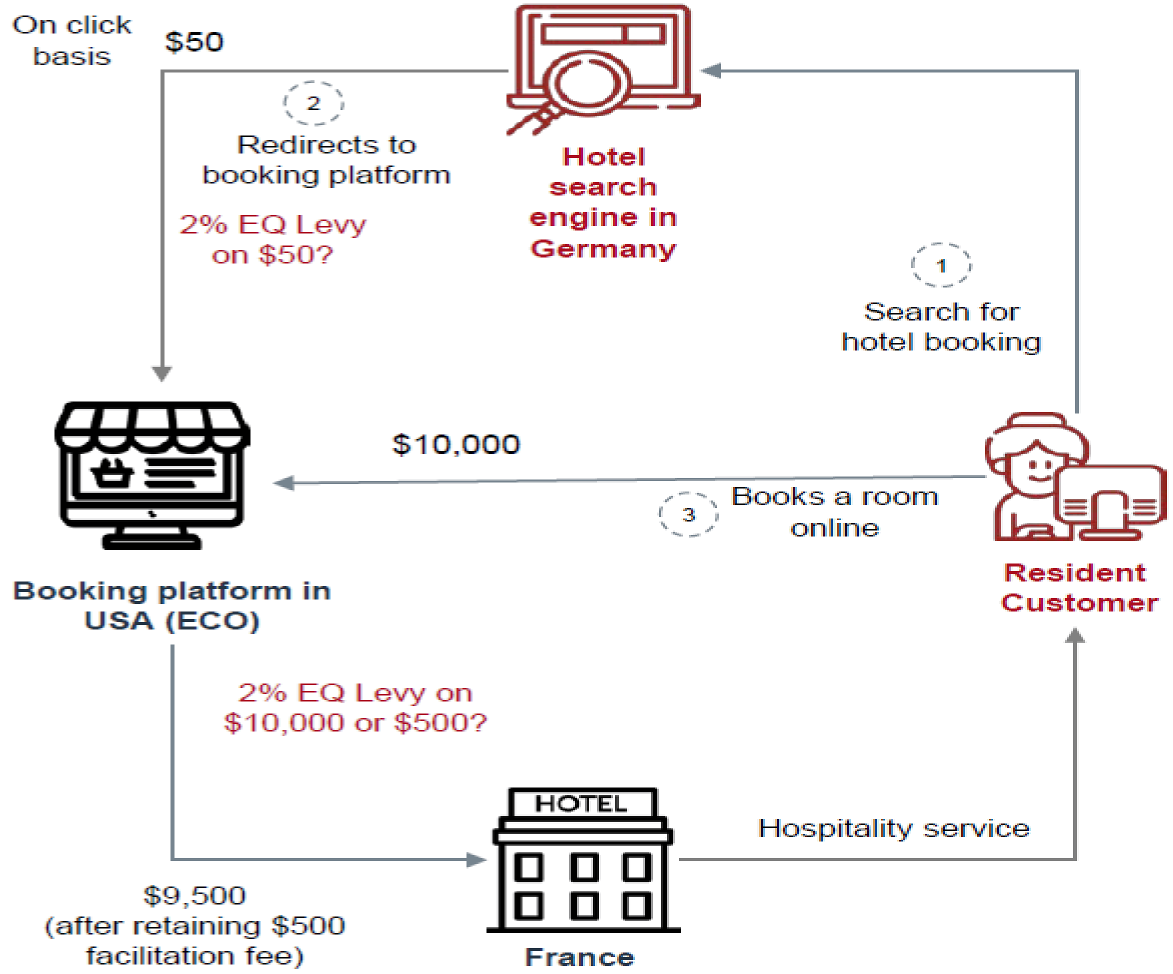

Facts

- Indian Resident customer searches for a hotel on a travel search engine
- Travel search engine redirects the customer to an online booking platform
- Customer books a room online on such platform and payment is also done via such platform

Points to Ponder

Leg 1 - Transaction between booking platform & search engine

- EQ Levy should apply @ 2% - Covered under "specified circumstances" as sale of advertisements targeting Indian customers

Leg 2 - Transaction between customer & booking platform

- EQ Levy @ 2% to be charged on gross consideration including hotel charges and not only on listing fee

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Thank you!

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