

# TAXATION AND DIGITALIZATION

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# BACKGROUND

- Taxation of business profits on the basis of economic allegiance has been the underlying basis of existing international taxation rules.
- *“The oranges upon the trees in California are not acquired wealth until they are picked, not even at that stage until they are packed, and not even at that stage until they are transported to the place where demand exists and until they are put where the consumer can use them. These stages, up to the point where wealth reached fruition, may be shared in by different territorial authorities.”* (excerpts from a report on double taxation submitted to League of Nations in early 1920s)

# BACKGROUND

- In respect of taxation of business profit - both the residence and source countries claim the right to taxation.
- As per the existing allocation of taxing rules, business profit of an enterprise is taxable in the country in which the taxpayer is a resident and also in a country where business is carried through a PE which is generally a fixed place of business.
- For a long time, nexus based on physical presence was used as a proxy for economic allegiance of a non-resident.

# BACKGROUND

- The technological advances in Information & Communication Technology has brought into existence new business models.
- The non-resident enterprises interact with customers in another country without having any physical presence in that country.
- Nexus rule based on physical presence do not hold good anymore for taxation of business profits in source country.
- The rights of the source country to tax business profits derived from its economy is unfairly and unreasonably eroded.

# BACKGROUND

- In BEPS project under Action Plan 1, the following options have been discussed to address broader tax challenges arising from digital economy leading to non-applicability of physical presence based rule-
  - ✓ Modifying the existing Permanent Establishment rule by including “Significant Economic Presence”.
  - ✓ Final withholding tax on certain payments for digital goods or services.
  - ✓ Imposition of Equalisation Levy on consideration for specified digital services received by a non-resident.

# EQUALISATION LEVY (EQL)

# EQL- Background

- In India, a Committee was set up to examine the tax matters relating to e-commerce, committee included experts from within and outside the Government.
- Equalisation Levy was recommended by the Committee, which relied extensively on the observations made in BEPS Action 1 Report as well as work of renowned international experts.
- The Committee noted that in Action 1 Report -
  - ✓ None of the options discussed were agreed as international standard.
  - ✓ It was acknowledged that countries could introduce any of these options.
  - ✓ Equalisation Levy was recognized as a potential option.

# EQL- OBJECTIVES

- India has introduced Equalisation Levy in 2016
  - ✓ To address tax challenges arising from digital economy.
  - ✓ To ensure tax neutrality between services provided from within India and outside India.
  - ✓ To achieve minimal disruption for enterprises, without creating multiple or excessive taxation, and with minimal costs of compliance and administration.
  - ✓ To ensure that options are available either to pay tax on income from specified services on net basis (by adjusting their business model) or to pay tax on specified services on gross payment.



# EQI – TAX DESIGN

1/2

- **Tax on Specified services**
  - ✓ Introduced as Chapter VIII of Finance Act, 2016 : A self contained code unrelated to any other tax.
  - ✓ Rate of tax: 6% of the gross payment.
  - ✓ Charged on consideration for specified services received or receivable by a Non-resident.
  - ✓ Specified services- Online Advertising- power of notification.
  - ✓ from a person resident in India carrying on business and profession in India or a Non-resident having PE in India.
- **No EQI if**
  - ✓ Recipient has PE in India & payment is connected with PE.
  - ✓ Aggregate yearly payment from a person is below INR 100000
  - ✓ B2C transactions.

# EQI – TAX DESIGN

2/2

- **Exemption from tax for income from Specified Services**
  - ✓ To avoid multiple taxation, income from specified services chargeable to EQI have been exempted under the Income-tax Act.
- **Collection of Equalisation Levy**
  - ✓ EQI deduction if yearly payment exceeds INR 100000
  - ✓ Interest of 1% every month for delay in payment of EQI
  - ✓ Penalty for failure to deduct EQI – 100% of EQI payable
  - ✓ Payment of EQI - a condition for claiming deduction of expenses in the Income-tax Act

# EQL – RESPONSE & OPTIONS IN FUTURE

- **Statistics**
  - ✓ For FY 2016-17, collection was Rs. 3.39 billion (in 9 months)
  - ✓ For FY 2017-18, collection is Rs. 5.89 billion (provisional)
- **Option for getting taxed on Net income is inherent in tax design of EQL**
  - ✓ The tax design enables an enterprise to avail of the option of getting taxed on net income instead of being subjected to EQL on gross receipt, by establishing PE in India.
- **Possible Options in Future**
  - ✓ Expansion of scope of specified service

SIGNIFICANT ECONOMIC PRESENCE (SEP)

# SIGNIFICANT ECONOMIC PRESENCE

- In Action 1 Report- a new nexus rule in the form of a “significant economic presence” test was discussed as one of the option to tackle the broader direct tax challenges of digital economy.
- The scope of existing Indian income-tax law was restrictive as it essentially required physical presence based nexus or dependent agent for taxation of business income of the non-resident in India.
- Emerging business models based on digitalisation which do not require physical presence were not covered.
- Finance Act, 2018 amended Indian income-tax laws to provide that ‘significant economic presence’ shall constitute business connection.

# SIGNIFICANT ECONOMIC PRESENCE

- Significant economic presence shall mean–
  - ✓ any transaction in respect of any goods, services or property (including download of data or software) carried out by a non-resident in India– if the payments exceeds prescribed threshold limit.
  - ✓ systematic and continuous soliciting of business activities or engaging in interaction through digital means with prescribed number of users in India.

# SIGNIFICANT ECONOMIC PRESENCE

- Significant economic presence shall be deemed irrespective of whether
  - ✓ the non-resident has a residence or place of business in India or
  - ✓ the non-resident renders services in India
  - ✓ the agreement for such transactions/activities is entered into in India
- Only income attributable to transactions or activities carried out in India shall be deemed to accrue/arise in India.

## SIGNIFICANT ECONOMIC PRESENCE

- This will enable India to negotiate for inclusion of the this new nexus rule in the form of 'significant economic presence' in the Double Taxation Avoidance Agreements.
- Threshold limits for 'revenue' and 'users' to be prescribed after stakeholder consultations.
- Cross-border profits to be taxed as per existing DTAA provisions – until corresponding modifications to Permanent Establishment (PE) rules are made in India's DTAAs.



# The Way Forward...

- ✓ Need for continuing the work initiated in Action 1 of BEPS for addressing tax challenges arising from digital economy.
- ✓ Nexus and profit allocation rules of existing tax framework should consider the impacts of digitalization.
- ✓ Arrive at international consensus at the earliest to prevent the need for unilateral actions, which can lead to multiple taxation and raise costs of compliance.

THANK YOU