

BANGALORE CHAPTER OF ICAI

Taxation of Digital Economy -
International Taxation,
equalization levy and TDS

BDO India

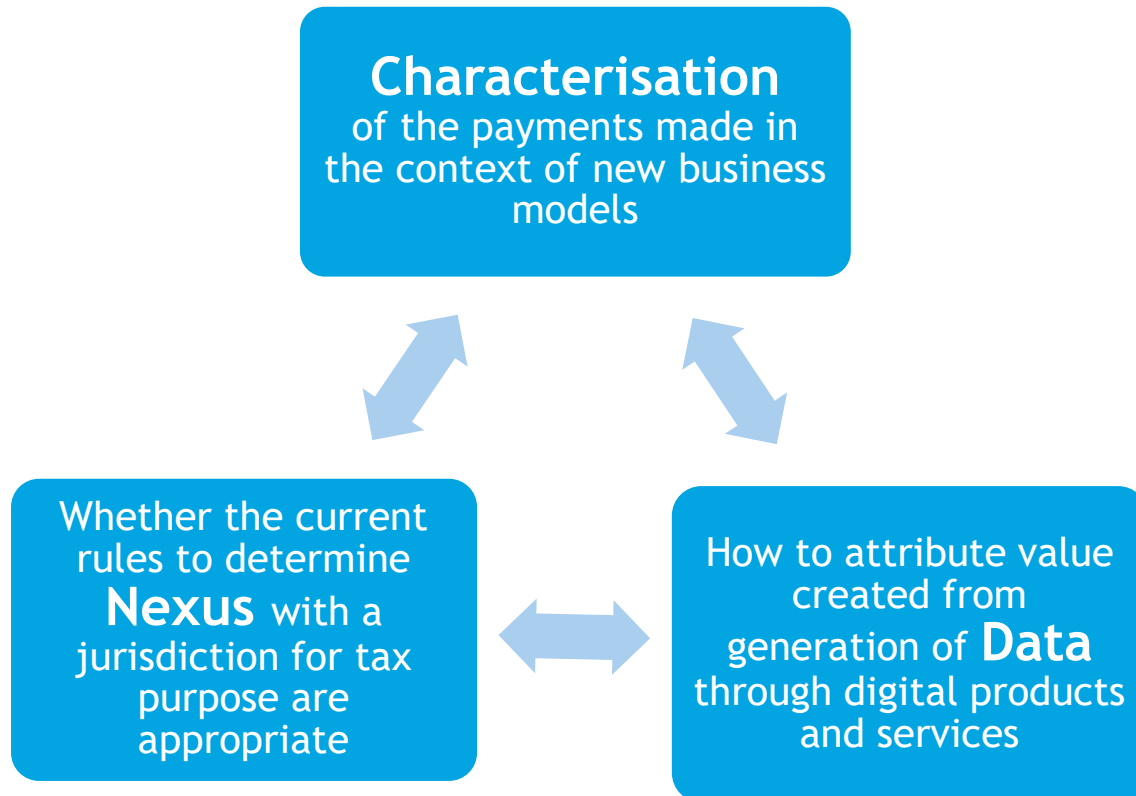




CHALLENGES IN TAXATION OF DIGITAL ECONOMY

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Main Policy Challenges Raised by the Digital Economy Fall into Three Broad Categories:



[Click here to go to Annexure 1 - Article 5 and 7 of India - USA DTAA](#)



CHALLENGES IN TAXATION OF DIGITAL ECONOMY

Administrative Challenges:

- ▶ **Identification:** Identifying remote sellers and to ensure compliance with domestic rules. Difficulty in identifying remote sellers may also make ultimate collection of tax difficult.
- ▶ **Determining the extent of activities:** Even if the identity and role of the parties involved can be determined, it may be impossible to ascertain the extent of sales or other activities without information from the offshore seller, as there maybe no sales or accounting records held in the local jurisdiction or otherwise accessible by the local revenue authority.
- ▶ **Information collection and verification:** To verify local activity, the market jurisdiction's tax administration may need to seek information from parties that have no operations in the jurisdiction and are not subject to regulation therein.
- ▶ **Identification of customers:** There are number of ways by which the seller may identify the country of residence of its clients or the country in which consumption occurs, but it could be burdensome for the business and would not work where customers are able to disguise their location.



INDIAN JURISPRUDENCE

INDIAN JURISPRUDENCE

Precedents in Digital Economy Space

▶ CIT vs Visakhapatnam Port Trust 144 ITR 146 (Andhra Pradesh High Court)

- The concept of virtual PE was first discussed by the Court in this case. The Court observed that the words “permanent establishment” postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country, which can be attributed to a fixed place of business in that country; it should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.”

▶ ITO vs Right Florists (Pvt) Ltd 143 ITD 445 (Kolkata Tax Tribunal)

- In this case Tribunal held that a third party website hosted on a computer server of an internet service provider should not result in the server being at the disposal of the enterprise owning the website and therefore, such hosting should not create a service PE.

▶ Pinstorm Technologies Pvt Ltd vs ITO 154 TTJ 173 (Mumbai Tax Tribunal)

- The Tribunal held that the amount paid by the appellant to Google Ireland for the services rendered for uploading and display of banner advertisement on its portal was in the nature of business profit, which was not chargeable to tax in India in the absence of any PE of Google Ireland in India.

▶ Millennium Infocom Technologies Ltd vs ACIT 117 ITD 114 (Delhi Tax Tribunal)

- The Tribunal held that payments made to non-residents by way of rentals for hosting of websites on servers are not in the nature of interest, or royalty or fees for technical services. The providing of space on the servers for the purpose of hosting of the website, it was held will not result in the provision of technical service to the assessee Indian payer for a fee.



INDIAN JURISPRUDENCE

Precedents in Digital Economy Space

▶ Areva T&D India Ltd 346 ITR 456 (AAR)

- AAR further ruled that existence of a computer server amounts to existence of a PE within a jurisdiction since a PE may exist even if the business of the enterprise is carried on mainly through automatic equipment and the activities of the personnel are restricted to setting up, operating, controlling, and maintaining such equipment.

▶ Cargo Community Network Pte Ltd 289 ITR 355 (AAR)

- AAR held that use of the portal is not possible without the use of the server that provides internet access to the cargo agents/subscribers, on the one hand, and to different airlines, on the other hand, for to and fro communication; the portal and server together constitute integrated, commercial cum scientific equipment and for obtaining internet access to airlines, the use of the portal without the server is unthinkable.

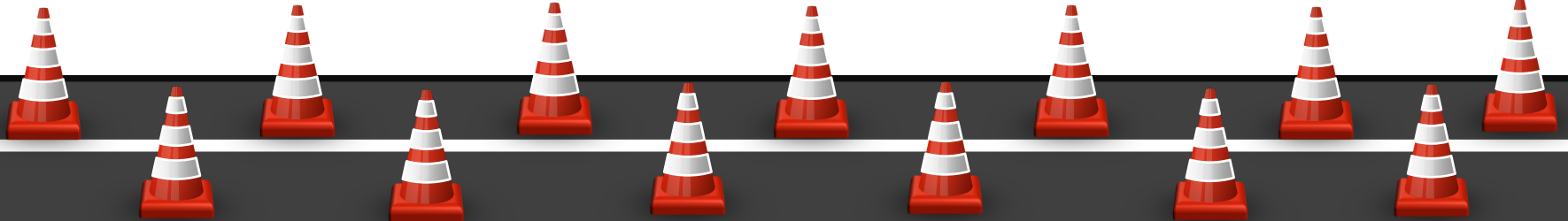


THE ACTION SO FAR

THE ACTION SO FAR

Key milestones accomplished so far by OECD

October 1998 CFA report- Electronic Commerce Taxation Framework Conditions	July 2013 OECD releases Action Plan on BEPS identifying 15 actions points for reform	September 2017 OECD invites public input on the tax challenges of digitalization	March 2018 Tax challenges arising from digitalization -interim report	February 2019 Public Consultation document - addressing the tax challenges of digitalization	May 2019 Programme of work to develop a consensus solution to tax challenges	October 2020 Reports on the Blueprints of Pillar One and Pillar Two
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February 2013 OECD publishes report on 'Addressing Base Erosion and Profit Shifting'	October 2015 BEPS Action 1 Report: Tax Challenges of the Digital Economy	November 2017 BEPS public consultations on the tax challenges of digitalization	January 2019 Addressing the tax challenges of the digitalization of the Economy-Policy note	February 2019 OECD invites public input on the PCD	October 2019 "Unified Approach" under Pillar One and GloBE proposal under Pillar Two
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OECD is working towards a global solution i.e. a Global Consensus

UN has proposed draft Article 12B for automated digital services for its model convention





OECD BEPS ACTION PLAN 1

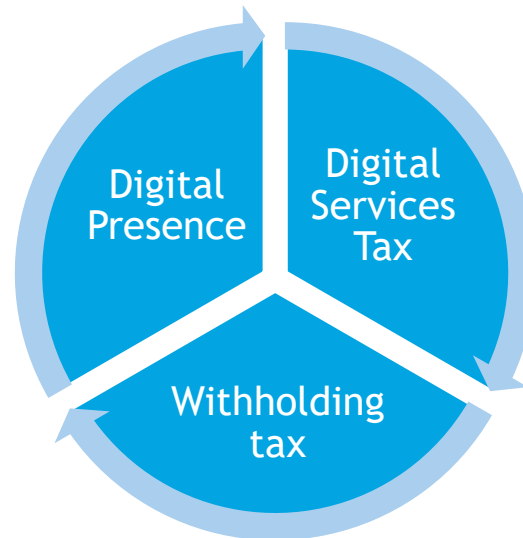
OECD BEPS ACTION PLAN 1

Tax Challenges Arising from Digitalisation

- ▶ Base Erosion and Profit Shifting (BEPS) refers to corporate tax planning strategies used by MNE's to shift profits from higher-tax jurisdictions to lower-tax jurisdictions, thus eroding the tax-base of higher tax jurisdictions.
- ▶ BEPS Action Plan 1 recommended following 3 interim measures or additional safeguard against BEPS, provided they respect the tax-treaty obligations:

Create a taxable presence in a country when a non-resident enterprise has a SEP in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools.

- Revenue-based factors
- Digital factors
- User based factors



An equalisation levy could be structured in a variety of ways depending on the ultimate policy objective. In general, an equalisation levy would be intended to serve as a way to tax a non-resident enterprise's SEP in a country.

A withholding tax can be imposed as a standalone gross basis final withholding tax on certain payments made to nonresident providers of goods and services ordered online or, alternatively, as a primary collection mechanism and enforcement tool to support the application of the nexus



UNILATERAL ACTIONS ACROSS GLOBE

UNILATERAL ACTIONS ACROSS GLOBE

AUSTRIA

Nature of Tax

- Digital Services Tax

Effective Date

- 31 December 2019

Tax Rate

- 5%

Threshold or De Minimis

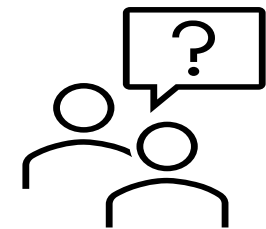
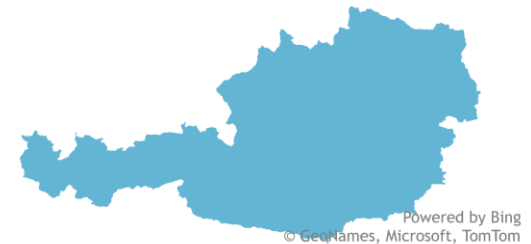
- Local Revenue € 25mn; Worldwide Revenue € 750mn

Revenue streams in scope

- Online advertising

Affected business models

Digital services, file sharing, online content, search engines, social networks, online retailers, intermediaries.



DID YOU KNOW ?

For non-compliance or non-payment., the general sanctions of the Law on financial crime apply and could lead to severe penalties and late payment fines..

UNILATERAL ACTIONS ACROSS GLOBE

AUSTRALIA

Nature of Tax

- GST on Digital Services

Effective Date

- 1 July 2017

Tax Rate

- 10% (Indirect Tax-GST)

Threshold or De Minimis

- AUD\$ 75,000 (or AUD\$ 1,50,000, if you are a non-profit body)

Revenue stream in scope

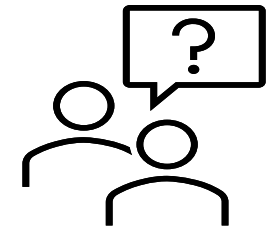
- Online sales of third party goods, provision of digital services, provision of third party content, provision of own content.

Affected business models

Digital services, file sharing, search engines, social networks, intermediaries.



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DID YOU KNOW ?

Australia could recoup as much as AU\$ 3.2 billion in a decade from a new 10% digital services GST revealed in the 2015 budget.

UNILATERAL ACTIONS ACROSS GLOBE

CANADA-QUEBEC

Nature of Tax

- Quebec Sales Tax

Effective Date

- 1 January 2019

Tax Rate

- 9.975%

Threshold or De Minimis

- CAD\$ 30,000

Revenue stream in scope

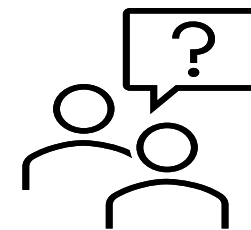
- Online sale of own goods, online sales of third party goods, provision of digital services, other.

Affected business models

Digital services, online retailers, intermediaries.



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DID YOU KNOW ?

It is proposed effective 1 July 2021 federal level tax i.e., GST to be levied.

UNILATERAL ACTIONS ACROSS GLOBE

FRANCE

Nature of Tax

- Digital Services Tax

Effective Date

- 1 January 2019

Tax Rate

- 3%

Threshold or De Minimis

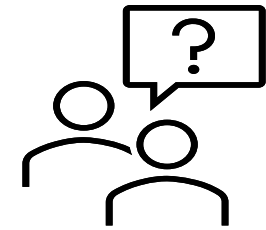
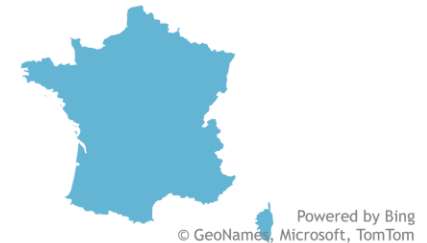
- Local Revenue € 25mn; Worldwide Revenue € 750mn

Revenue stream in scope

- Revenue from sales/service

Affected business models

Social networks, search engines, intermediaries, digital services, file sharing, online retailers, online content



DID YOU KNOW ?

France is the first EU member state to have implemented the DST.

UNILATERAL ACTIONS ACROSS GLOBE

ITALY

Nature of Tax

- Digital Services Tax

Effective Date

- 1 January 2020

Tax Rate

- 3%

Threshold or De Minimis

- Local Revenue € 5.5mn; Worldwide Revenue € 750mn

Revenue stream in scope

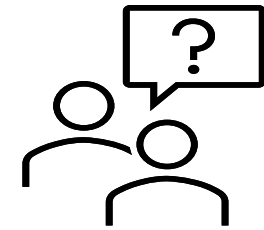
- Online advertising, online sale of own goods, online sales of third party goods, provision of digital services, provision of third party content, sale of user data, other.

Affected business models

- Digital services, file sharing, online content, search engines, social networks, online retailers, intermediaries.



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DID YOU KNOW ?

Inter-company transactions of digital services are excluded from the scope of the tax.

UNILATERAL ACTIONS ACROSS GLOBE

SINGAPORE

Nature of Tax

- Indirect Tax-GST

Effective Date

- 1 January 2020

Tax Rate

- 7% (Indirect Tax)

Threshold or De Minimis

- Local Revenue SGD\$ 100,000; Worldwide Revenue SGD\$ 1mn

Revenue stream in scope

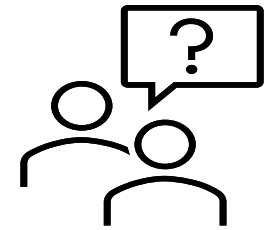
- Provision of digital services

Affected business models

- Digital services



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DID YOU KNOW ?

Government is planning to increase the GST rate to nine percent between 2021 and 2025.

UNILATERAL ACTIONS ACROSS GLOBE

SOUTH AFRICA

Nature of Tax

- Indirect Tax-VAT

Effective Date

- 1 April 2019

Tax Rate

- 15% (Indirect Tax)

Threshold or De Minimis

- ZAR 1mn

Revenue stream in scope

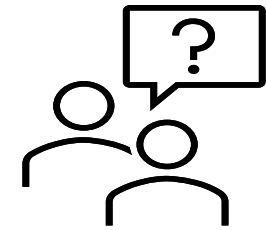
- Online advertising, online sale of own goods, online sale of third party goods, provision of digital services, provision of telecom service, radio/television broadcasting service, sale of user data, provision of third party content, provision of own content.

Affected business models

- Digital services, file sharing, online content, search engines, social networks, online retailers, intermediaries.



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DID YOU KNOW ?

South Africa was one of first African countries to bring digital services within its indirect tax (VAT) net.

UNILATERAL ACTIONS ACROSS GLOBE

SPAIN

Nature of Tax

- Digital Services Tax

Effective Date

- 1 January 2021

Tax Rate

- 3%

Threshold or De Minimis

- Local Revenue € 3mn; Worldwide Revenue € 750mn

Revenue stream in scope

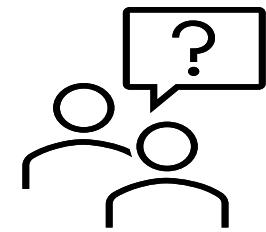
- Online advertising, provision of digital services, sale of user data.

Affected business models

- Digital services, search engines, social networks, intermediaries.



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DID YOU KNOW ?

The Spanish government has forecast collecting 968 million euros per year through the DST.

UNILATERAL ACTIONS ACROSS GLOBE

TURKEY

Nature of Tax

- Digital Services Tax

Effective Date

- 1 March 2020

Tax Rate

- 7.5%

Threshold or De Minimis

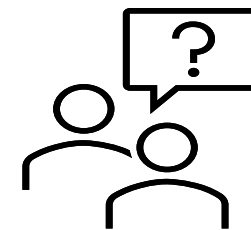
- Local Revenue TRY 20mn; Worldwide Revenue €750mn

Revenue stream in scope

- Online advertising, online sale of own goods, provision of digital services, provision of telecom service, radio/television broadcasting service, sale of user data, provision of third party content, provision of own content, online sales of third party goods.

Affected business models

- Digital services, file sharing, online content, search engines, social networks, online retailers, intermediaries.



DID YOU KNOW ?

Turkey has the highest DST rate in Europe.

UNILATERAL ACTIONS ACROSS GLOBE

UNITED KINGDOM

Nature of Tax

- Digital Services Tax

Effective Date

- 1 April 2020

Tax Rate

- 2%

Threshold or De Minimis

- Local Revenue £ 25mn; Worldwide Revenue £ 500mn

Revenue stream in scope

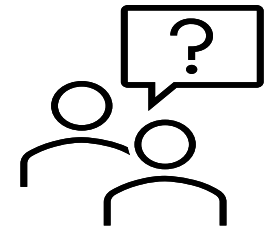
- Online advertising, online sale of own goods, provision of digital services, provision of third party content, sale of user data, provision of own content, online sales of third party goods.

Affected business model

- Digital services, file sharing, online content, search engines, social networks, online retailers, intermediaries, other.



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DID YOU KNOW ?

DST is deductible as an expense of business, provided it is for the purposes of a trade. However, it is not creditable against any U.K. corporation tax liability. This may result in double taxation.



CHALLENGES WITH UNILATERAL ACTIONS

CHALLENGES WITH UNILATERAL MEASURES

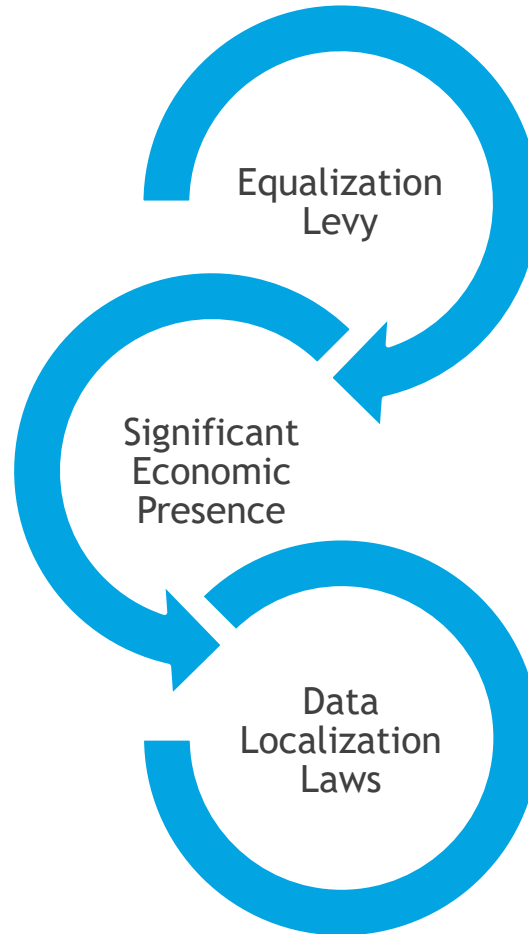
- ▶ Unilateral measures may lead to extra-territorial taxation.
- ▶ There is a shift in internally accepted principle of taxing the income, unilateral measures seek to tax the revenue/turnover instead of profit/surplus.
- ▶ Non-availability of credit in home jurisdiction for taxes paid in order to comply with unilateral measures.
- ▶ Additional compliance obligations are expected on the impacted digital service providers like re-engineering their processes and systems to collect the required information on buyers and jurisdiction wise compliance.
 - ▶ Bangalore app maker case study on app sold through Play store / apple store
- ▶ Over-riding international tax-treaty framework.
- ▶ May result into economic double taxation.
- ▶ Most countries have not provided for a sunset clause or transition rules once the global consensus is reached on taxation under Pillar 1



INDIAN MEASURES

INDIAN MEASURES

Unilateral Measures Taken by India





EQUALISATION LEVY

EQUALISATION LEVY

2016 Committee Report on Equalisation Levy

- ▶ CBDT constituted a Committee in 2015 headed by Shri Akhilesh Ranjan, which submitted its report in February 2016. The Committee heavily relied on BEPS Action 1 Report.
- ▶ Amongst the 3 options suggested in BEPS Action Plan 1, Equalisation Levy (EL) was considered to be the best alternative due to following reasons:
 - Significant Economic Presence-Not Sufficient, unless treaty amended by inserting new nexus rules
 - Withholding Tax-Ineffective, unless same option included in tax treaty
 - Equalisation Levy-As EL is imposed on gross amount of transaction and not on income, it is not income-tax. The inherent concept of EL keeps it outside the purview of limitations imposed by tax treaties.
- ▶ Key recommendations of the Committee:
 - Impose EL on digital transactions, by introducing a separate chapter in Finance Act, 2016. This will not be a part of income tax;
 - EL to be charged on any sum received by a non-resident from a resident in India or a PE in India as a consideration for the specified digital services;
 - The rate of EL maybe between 6-8% of the gross sum;
 - Listed 13 digital transactions to be covered under definition of ‘specified services’;
 - Threshold of INR 1 lakh from a person for specified services in a year;
 - Payments subjected to EL exempted from income tax;
 - Disallowance of expense if EL has not been deducted.

EQUALISATION LEVY 1.0

Finance Act, 2016

- ▶ India was the first country to unilaterally introduce equalisation levy in 2016.
- ▶ Specified services for EL 1.0 under Section 164 of Finance Act, 2016:
 - Online advertising, provision of other facility or service for the purpose of online advertising or such other services as may be notified.
- ▶ Recipient of consideration must be a non-resident (Section 165 of Finance Act 2016).
- ▶ Rate of levy: 6% of the consideration received or receivable for specifies services (Section 165 of Finance Act 2016)
- ▶ Not applicable if:
 - Non-resident service provider has an Indian PE to which the services are connected or
 - Services availed are not for the recipient's business purpose or
 - Aggregate consideration for services is less than INR 1 lakh in a fiscal year.
- ▶ Key features of EL 1.0:
 - Payer is responsible to withhold tax;
 - No compliance requirement on non-resident payee;
 - EL is levied on gross amount.
 - If EL is levied then consideration shall not be subject to income-tax.

EQUALISATION LEVY 2.0

Finance Act, 2016 as Amended by Finance Act, 2020

- ▶ EL 2.0 is levied on consideration received or receivable by non-resident e-commerce operator for e-commerce supply or services made or provided or facilitated.

- ▶ E-commerce supply or services to (Section 165A of Finance Act 2016):
 - A person resident in India;
 - A non-resident in following specified circumstances:
 - Sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement through internet protocol address located in India or
 - Sale of data collected from a person who is resident in India or from a person who uses internet protocol address located in India;
 - A person who buys goods or services using an IP address located in India.

- ▶ Rate of levy: 2% of the consideration received or receivable by e-commerce operators from e-commerce supply or services.

- ▶ Not applicable if (Section 163 of Finance Act 2016):
 - Non-resident e-commerce operator has a PE in India and e-commerce supply, or services are effectively connected to those establishments;
 - Scenarios where EL 1.0 is applicable or
 - Sales, turnover or gross receipts of the non-resident e-commerce operator from online sale or services are less than INR 20 million during the fiscal year.

EQUALISATION LEVY 2.0

Finance Act, 2016 as Amended by Finance Act, 2020

- ▶ EL 2.0 is required to be collected and paid by the non-resident e-commerce operator. Shift from EL 1.0 where payer had to withhold tax.

- ▶ In case of failure to comply with EL 2.0 provisions, the resident person in India who is the recipient of ecommerce supply or can be regarded as a representative assessee on behalf of e-commerce operator.

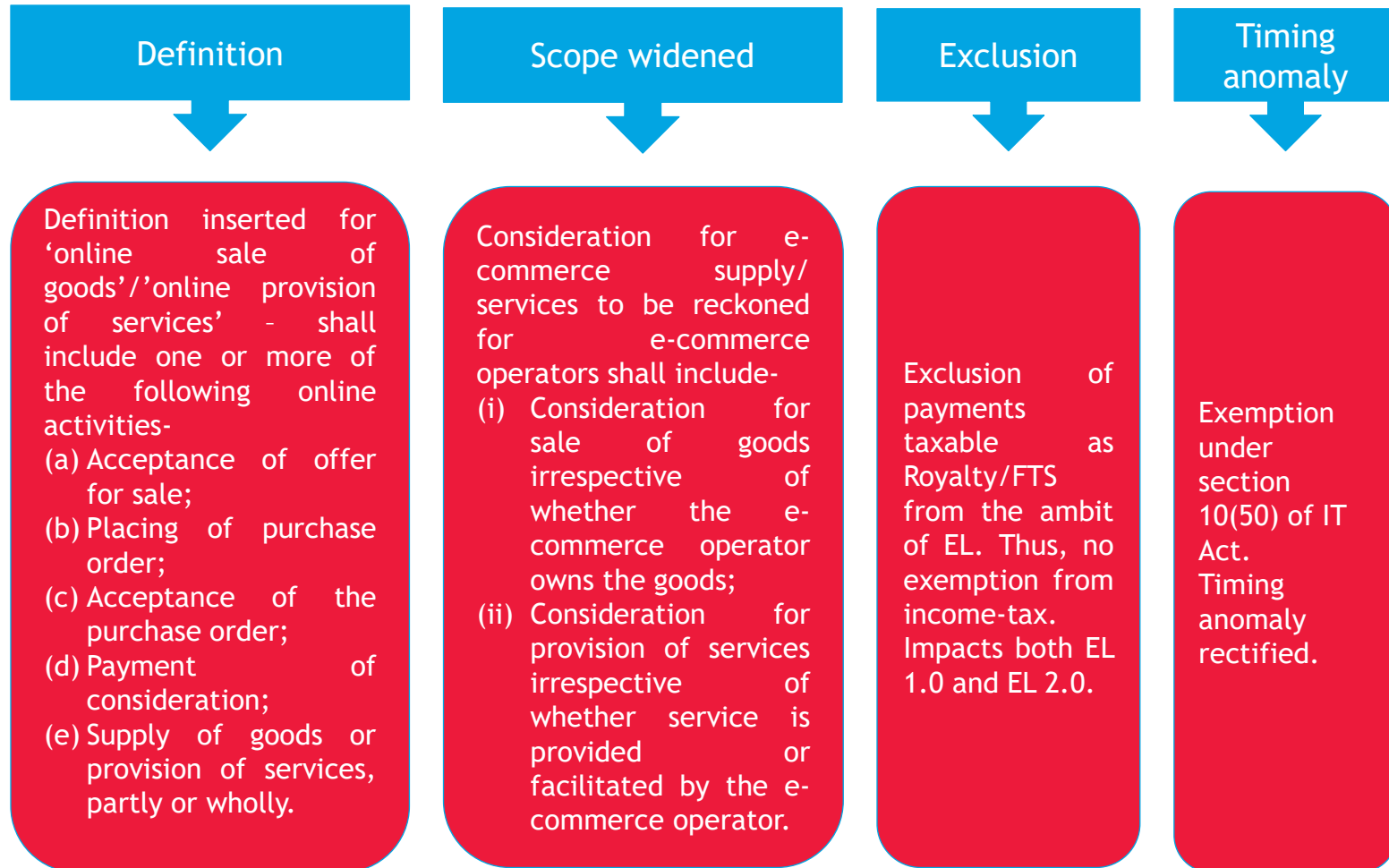
- ▶ Key terms:
 - E-commerce operator is a non-resident who owns, operates or manages a digital or electronic facility or platform for online sale of goods or the online provision of services or both.

 - E-commerce supply or services means:
 - Online sale of goods owned by the e-commerce operator; or
 - Online provision of services 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 combination of the above.

 - Online means a facility or service or right or benefit or access that is obtained through the internet or any other digital or telecommunication network.

EQUALISATION LEVY

Proposals of Finance Bill, 2021 (effective from 1 April 2020)





EQUALISATION LEVY

Issues Emanating from EL

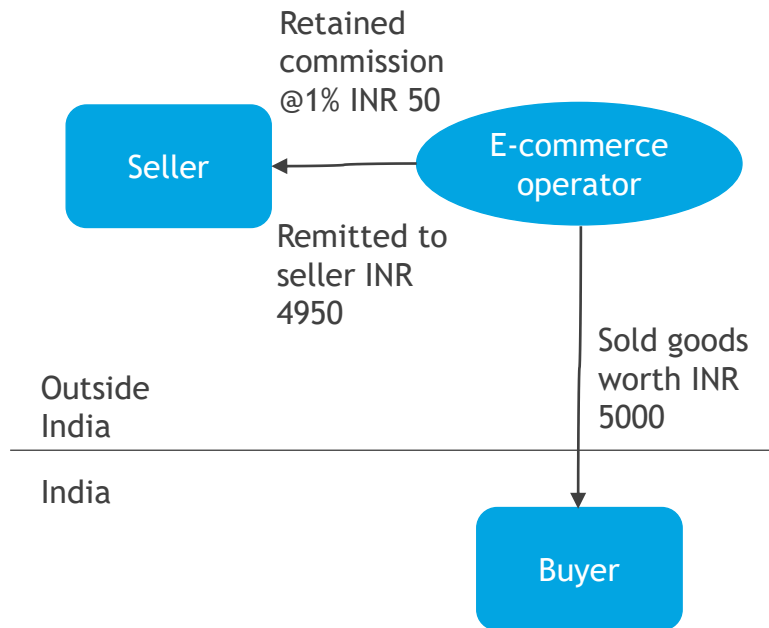
- ▶ Definitions of some of the terms are either very wide or not defined and therefore the scope of EL 2.0 is ambiguous.
- ▶ Whether the threshold of INR 20 million is qua the e-commerce operator or qua each user, buyer or service recipient?
- ▶ Should EL be computed on amounts including indirect taxes like GST?
- ▶ Whether EL paid in India can be claimed as credit by e-commerce operator/taxpayer in their home jurisdiction?
- ▶ EL paid with the understanding that there is no PE in India, but tax authorities subsequently dispute existence of PE. Can EL paid be adjusted against tax payable on such disputes?
- ▶ Applicability of EL on intra-group transactions?
- ▶ E-commerce supply or service provided to a resident person outside India using IP address located outside India, should EL be charged on such transaction?



CASE STUDIES ON EQUALISATION LEVY

EQUALISATION LEVY

Case Study 1



► Facts:

- ECO owns, operates and manages a digital platform to facilitate sale of goods.
- Buyer is a person resident in India.
- Seller lists his goods on ECO platform.
- Buyer pays to ECO INR 5000 for goods ordered online.
- ECO retains his commission and remits the balance to the seller.

► Question

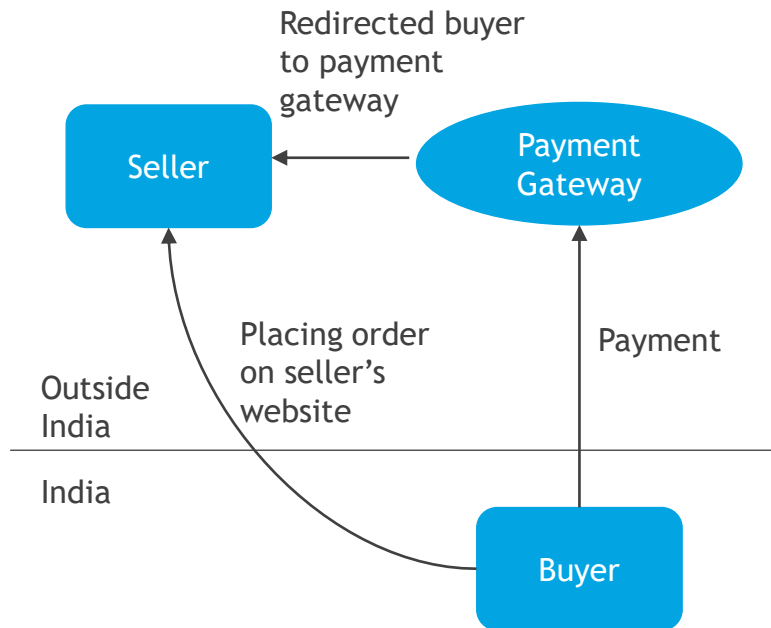
- What is the consideration for charge of EL?

► Answer

- A) INR 50
- B) INR 5000
- C) INR 4950

EQUALISATION LEVY

Case Study 2



► Facts:

- Buyer places order for goods on seller's website.
- Seller redirects the buyer to a payment gateway page where payments will be accepted on seller's behalf.
- Buyer makes the payment-on-payment gateway page.
- Payment gateway withholds his commission and remits the balance amount to seller.

► Question

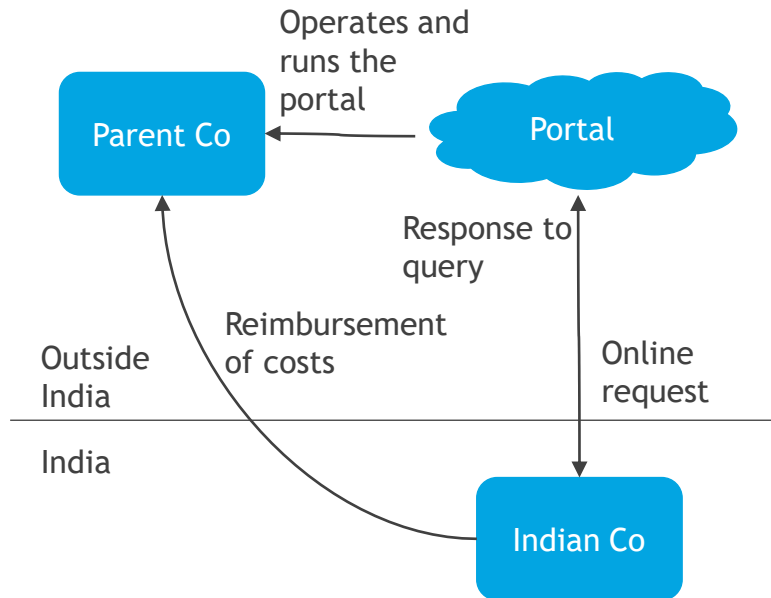
- Who is the e-commerce operator in this scenario?

► Answer

- A) Seller
- B) Payment gateway provider

EQUALISATION LEVY

Case Study 3



► Facts:

- Parent Co is outside India and runs an online portal.
- Portal resolves queries raised by employees of the group companies.
- Indian Co is the subsidiary in India. Its employees raise query requests on the portal.
- Portal responds to employee queries.
- Parent Co raises invoice on the group companies to reimburse the cost of running the portal without any mark-up.

► Question

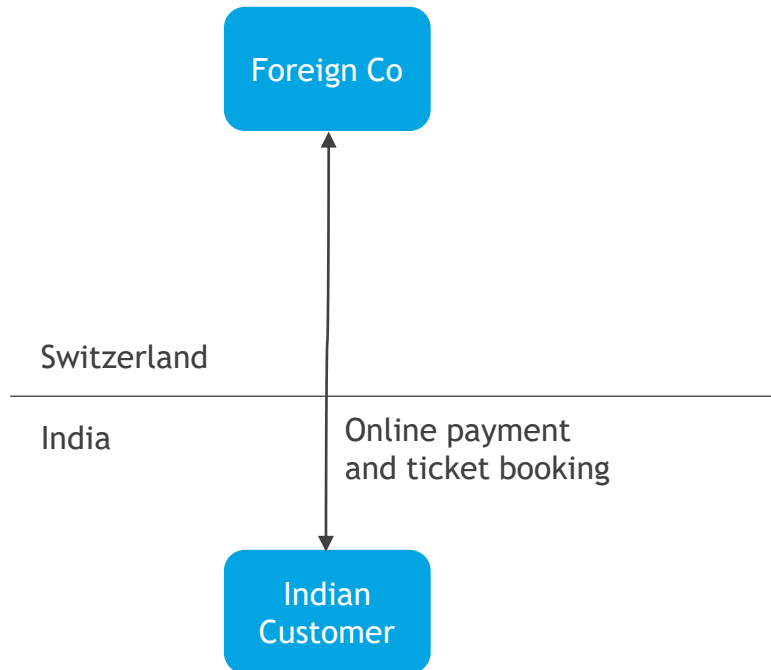
- Whether Parent Co is non-resident e-commerce operator?

► Answer

- A) Yes
- B) No

EQUALISATION LEVY

Case Study 4



▶ Facts:

- Foreign Co provides services outside India say in Switzerland for example, services are in relation to booking Swiss Rail Pass.
- Indian customer is going to visit Switzerland for a personal tour and for travel it has booked tickets using online booking facility.

▶ Question

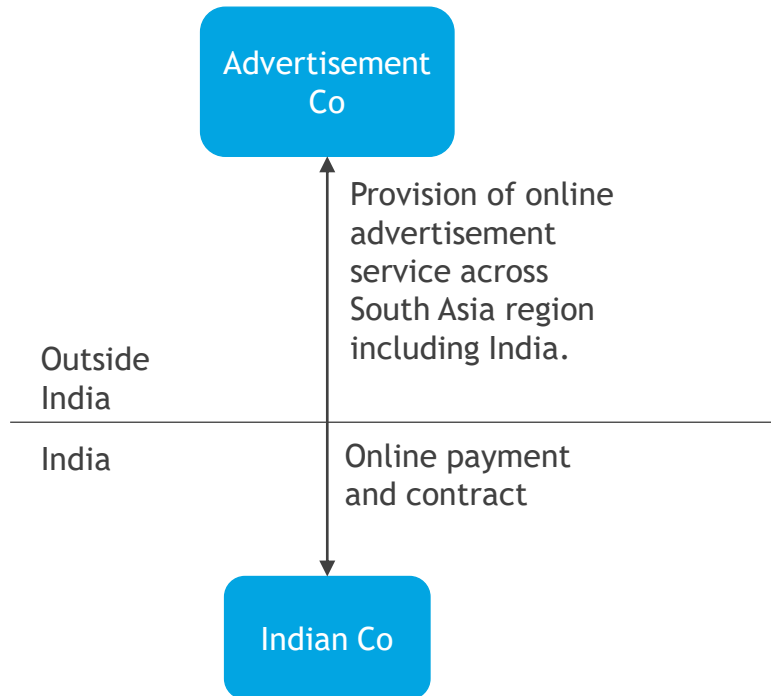
- Whether Foreign Co is liable to pay EL even though the services are provided outside India and only the tickets are booked online i.e. contract is concluded online and payment is made online?

▶ Answer

- A) Yes
- B) No

EQUALISATION LEVY

Case Study 5



▶ Facts:

- Indian Co visits the website of Advertisement Co and makes payment online for availing online advertisement services.
- Advertising Co will showcase the ads of Indian Co in the South Asia region including India.

▶ Question

- Should Indian Co withhold EL 1.0 on entire amount?

▶ Answer

- A) Yes
- B) No



WITHHOLDING TAX UNDER SECTION 194-0

WITHHOLDING TAX UNDER SECTION 194-O

- ▶ Where the sale of goods/services of e-commerce participants are facilitated by an e-commerce operator through its digital or electronic facility or platform, such e-commerce operator is required to deduct tax at source under section 194-O @1%.
 - “e-commerce operator” means a person who owns, operates or manages a digital or electronic facility or platform for electronic commerce.
 - “e-Commerce participant” means a person resident in India selling goods/services (including digital products) through digital or electronic facility or platform for electronic commerce.
 - “Services”, for this purpose, include fees for technical services/professional services.
 - For the purpose of this section, e-commerce operator shall be deemed to be the person responsible for paying to e-commerce participant.

- ▶ Tax is not deductible under section 194-O if the following conditions are satisfied -
 - e-commerce participant is an individual or HUF;
 - gross amount of such sale of goods/services through e-commerce operator during the previous year does not exceed Rs. 5 lakh, and
 - such e-commerce participant has furnished his PAN or Aadhaar number to the e-commerce operator.

- ▶ Lower/nil TDS certificate can be obtained by e-commerce participants by submitting Form No. 13 within the parameters of section 197



USTR INVESTIGATION ON INDIAN EL

USTR INVESTIGATION ON INDIAN EL

Snapshot on USTR Section 301 Investigation Report

- ▶ United States Trade Representative (USTR) initiated an investigation of Digital Services Tax under section 301 of the Trade Act, 1974 on the jurisdictions including Austria, Brazil, Czech Republic, European Union, India, Indonesia, Italy, Spain, Turkey and the United Kingdom.
- ▶ USTR has concluded with the following:
 - India's DST discriminates against US digital services companies;
 - India's DST is unreasonable, because it is inconsistent with international tax principles;
 - India's DST burdens or restricts US Commerce.
- ▶ Basis of the above conclusion is as follows:
 - EL 2.0 explicitly exempts Indian companies, while targeting non-Indian firms;
 - Non-resident providers of digital services are taxed, while Indian providers of the same digital services to the same customers are not;
 - EL 2.0 targets digital services, but not similar services provided non-digitally;
 - Out of the 119 companies USTR has identified as likely liable under EL 2.0, 86 (72%) are US companies;
 - Levy of EL is on revenue rather than income is inconsistent with prevailing principles of international taxation
 - USTR estimates that the aggregate tax bill for US companies could exceed US\$ 30 million per year;
 - The unusually expansive scope of taxable digital services under EL 2.0 makes the tax particularly burdensome for US companies;
 - EL 2.0 forces US companies to undertake costly measures to comply, this includes the reengineering of existing systems to collect and organize new and different types of information, costs of which could run into millions of dollars for each affected company.

USTR INVESTIGATION ON INDIAN EL

India's response to USTR Section 301 Investigation Report

▶ The Equalisation Levy is a Non-discriminatory Levy

- The GOI notes that the BEPS Report on Action 1 provides an internationally accepted recognition of the broader tax challenges arising from digital enterprises, their unprecedented business models including multi-dimensional businesses, mobility of these enterprises, their ability to relatively easily avoid taxes in jurisdictions that significantly contribute to their profitability, and the challenges and difficulties that arise in the application of currently practiced international taxation rules in their case.
- India's EL does not discriminate against non-resident e-commerce operators as the underlying policy objective and application of India's EL is to ensure that neutral and equitable taxation is applicable to e-commerce operators that are resident in India or have a PE in India and those that are non-resident in India.
- EL does not discriminate against companies based in the United States as it applies equally to all non-resident e-commerce operators not having permanent establishment in India.
- The concept of EL in India emerged as a result of the Report on Action 1 of BEPS Project. The BEPS Report on Action 1 was accepted by India and other members of the OECD. This report formed the basis of detailed consultations by a Committee on Taxation of E-Commerce constituted by the GOI. The India Committee Report analyzed in detail the BEPS Report on Action 1, which had highlighted the need for modifying existing international taxation rules and laid out three options (a) a new nexus based on significant economic presence, (b) a withholding tax on digital transactions, and (c) Equalisation Levy. The BEPS Report on Action 1 did not recommend any specific option, recognizing that more work may be required in the area of attribution of profits. It however noted that: "Countries could, however, introduce any of these three options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties".

USTR INVESTIGATION ON INDIAN EL

India's response to USTR Section 301 Investigation Report

▶ The Equalisation Levy is a Non-discriminatory Levy

- The ongoing multilateral consultations under the aegis of the G-20-OECD due in this regard, to which India has been one of the key members, have not arrived at any consensus even after many years of discussion. Further, as discussed above, the Equalisation Levy is seen as an additional safeguard against BEPS and loss of revenue in India due to activities of the e-commerce operators operating in India. This has necessitated introduction of 2% EL on e-commerce supply or services. This levy is non-discriminatory as it has uniform applicability.

▶ The Equalisation Levy only has prospective application

- There is no retroactive element in the Equalisation Levy. The levy was enacted before 1 April 2020 which is the date when it was made effective.

▶ The Equalisation Levy cannot be said to have “extra-territorial” application

- The OECD's BEPS Report on Action 1 has clearly brought out tax challenges arising from the digitalization of the economy, and that the physical presence nexus in existing international taxation rules, which were developed in the last century keeping in view the business models of that time, is no longer the only justifiable indication of nexus.
- India further notes that the Supreme Court of the US in a recent ruling-South Dakota vs Way fair Inc, in a case relating to taxation, has held that physical presence is not required for the levy of sales tax by a state where the online seller has no physical presence but makes online sales to buyers of the state. The principle under the US legal framework is clearly along the same lines as that of India, which is that, in a digitalized world, a seller can engage in business transactions without any physical presence.



SIGNIFICANT ECONOMIC PRESENCE

SIGNIFICANT ECONOMIC PRESENCE

- ▶ The Finance Act, 2018, widened the scope of business connection in India by inserting Explanation 2A to Section 9(1)(i) of the IT Act, that provides that a non-resident having SEP in India will also constitute business connection. It will become enforceable from 1 April 2019. However, the government has conceded that business profits will be taxed in accordance with existing treaty rules until new rules are introduced in the treaty and hence, SEP provision remains ineffective.

- ▶ SEP is defined under the IT Act as:
 - A transaction in respect of goods, services or property carried out by non-resident in India. The aggregate of payments arising from such transaction during previous year shall exceed a prescribed threshold amount i.e., INR 20 million (notified on 3 May 2021).
 - A transaction involving provision of download of data or software in India. The aggregate of payments arising from such transaction during previous year shall exceed a prescribed amount i.e., INR 20 million (notified on 3 May 2021).
 - A systematic and continuous soliciting of business activities or engaging in interaction with number of users. The activity must exceed the prescribed number of users i.e., 300,000 users (notified on 3 May 2021).

- ▶ Further as per the first proviso to Explanation 2A to section 9(1)(i) of the IT Act, transactions shall constitute SEP irrespective of:
 - Whether the agreement of such activities is entered in India or not; or
 - Whether the non-resident has a residence or place of business in India or not; or
 - Whether non-resident renders services in India or not.

SIGNIFICANT ECONOMIC PRESENCE

- ▶ The Finance Act, 2020 expanded the scope of SEP rules as follows:
 - The rule applied to non-residents carrying out transactions in India in respect of any goods, services or property, including provision of download of data or software. FA 2020 widened the scope to now cover within its ambit any transaction in goods, services, or property carried out by a non-resident with any person in India.
 - The rules further applied to systematic and continuous soliciting of business activities or engagement with specified number of users through digital means. FA 2020 has done away with the requirement of interacting through digital means and thus, any medium of interaction would now trigger the SEP tax rules.

- ▶ Taking into cognizance that the BEPS report covering this issue is likely to be released by the end of December 2020, the Finance Bill proposes to defer the applicability of the SEP tax rules, such that GOI would be able to specify the limits once the BEPS report on the issue is released.

- ▶ These amendments shall be made effective from fiscal year 2021-22.

- ▶ In the current form, the provisions of SEP which shall be implemented with effect from fiscal year 2021-22 and shall only apply to non-resident business from countries with whom, India does not have a tax treaty.



BEPS 2.0

BEPS 2.0

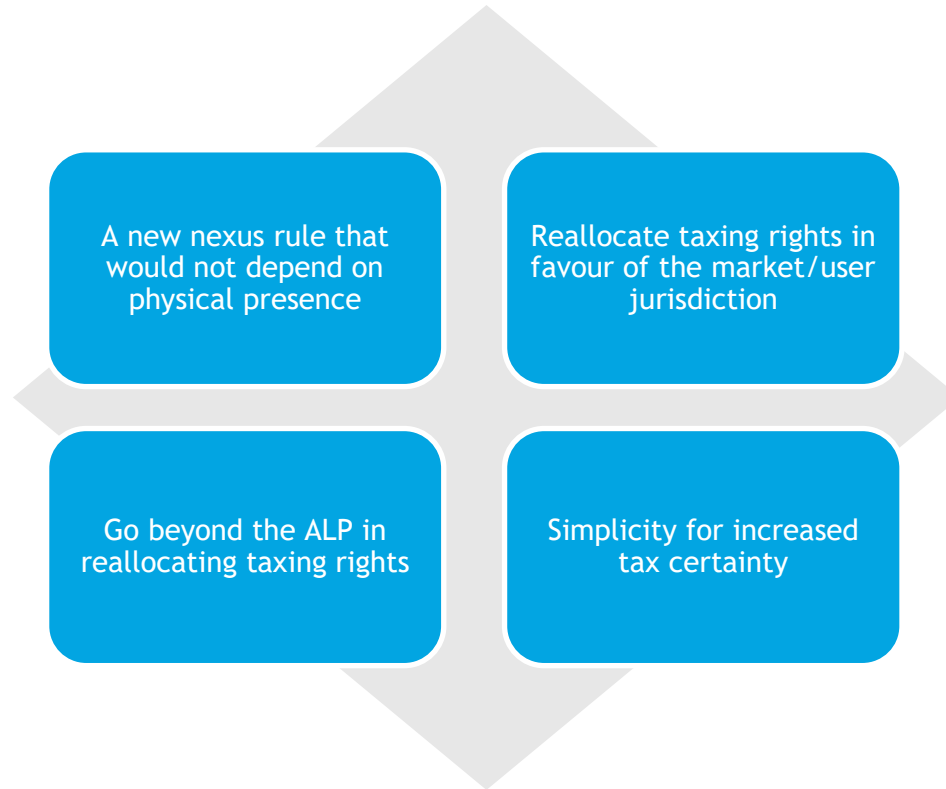
- ▶ On 12 October 2020, the Organisation for Economic Co-operation and Development (OECD) released its reports on the blueprints of the two-pillar approach to address the tax challenges arising from digitalization of the economy (Blueprints). The Blueprints are a continuation of the work by the OECD since the OECD's taskforce on digital economy released an interim report in May 2018.
- ▶ Pillar One focuses on defining a new nexus rule and allocating a share of residual profits to the market jurisdictions, while Pillar Two focuses on a global minimum tax intended to address remaining base erosion and profit shifting (BEPS) issues.
- ▶ Pillar 1:
 - New taxing rights for market jurisdictions over a share of the (deemed) residual profits of a multinational enterprise (MNE) or segment of such a group (Amount A)
 - A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction (Amount B)
 - Process to improve tax certainty through effective dispute prevention and resolution mechanisms
- ▶ Pillar 2:
 - Rules under Pillar Two are designed to ensure that large MNEs pay at least a minimum level of tax, regardless of the jurisdiction where the profits may be earned or booked.



PILLAR ONE

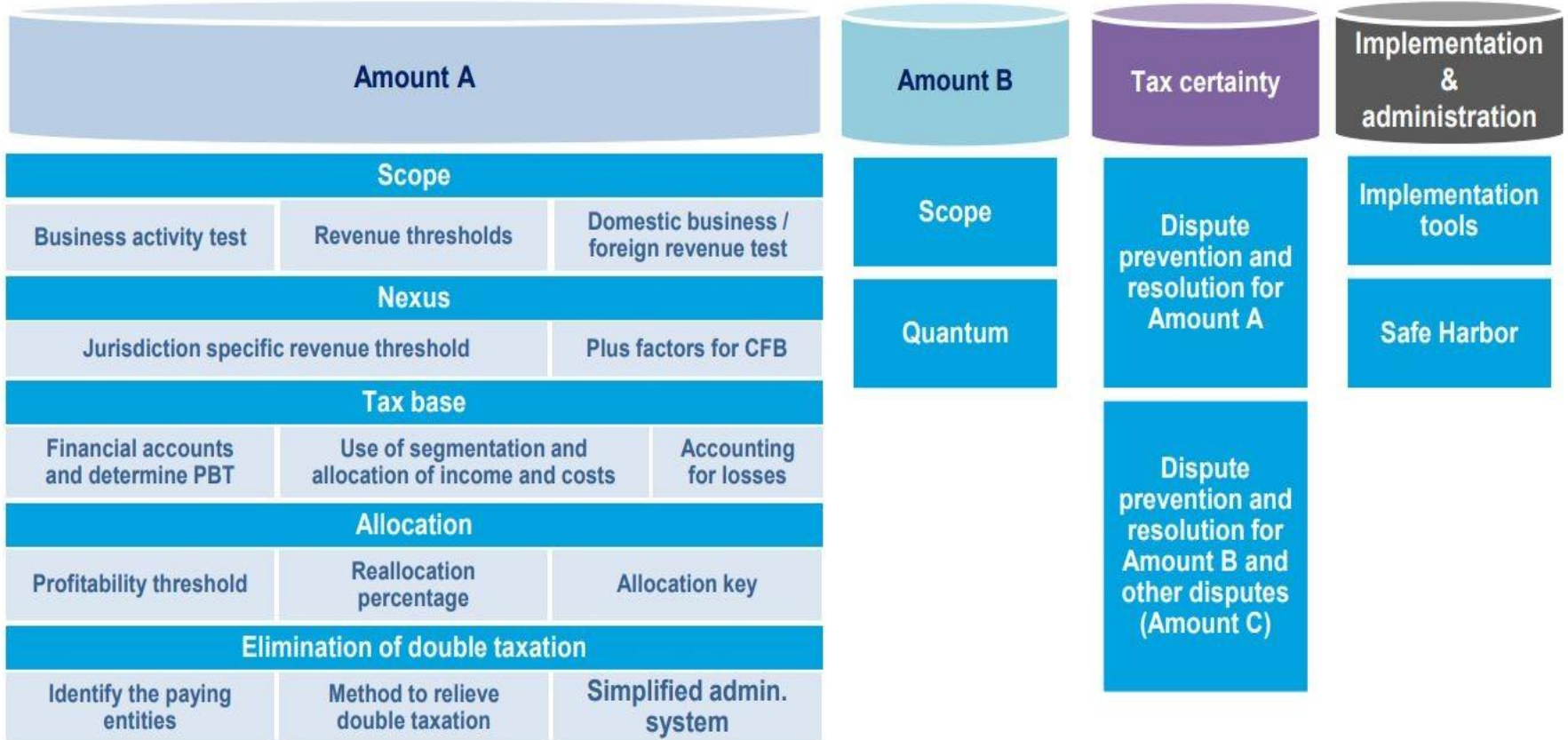
PILLAR ONE

Objectives



PILLAR ONE

Building Blocks



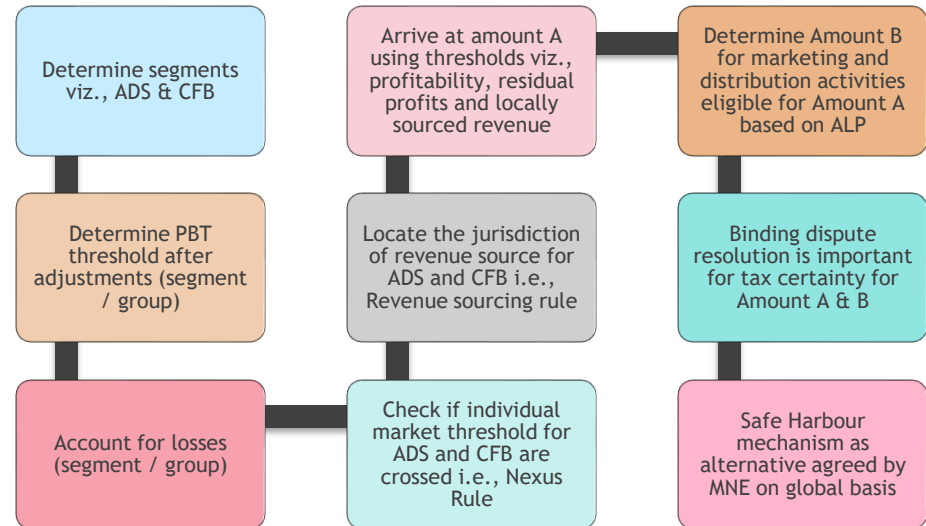
PILLAR ONE

Illustrative understanding

FACTS

- ▶ An MNE is head quartered in the US and prepares its consolidated financial statements under IFRS ('Parent')
- ▶ The Parent entity has a centralised operating model, in which it owns the group's trade and marketing intangibles and realises the entire residual profit of the group
- ▶ It has consolidated revenue over Euros 750 million and has revenue from Automated Digital Services ('ADS') and Consumer Facing Businesses ('CFB') ['Segments']
- ▶ It has its subsidiaries across multiple geographies engaged as low risk distributors
- ▶ Its subsidiaries maintain an arm's length margin as per respective jurisdictions and there is no further attribution
- ▶ Besides, Parent entity has sales directly to its customers across the geographies

Indicative steps for application of Pillar One



Based on application of Pillar One rules for the above illustration, there shall be allocation of profit to its subsidiaries in respective geographies



GLOBAL MINIMUM TAX

GLOBAL MINIMUM TAX

- ▶ Global Minimum Tax has been proposed by the US as a measure to counter efforts by major global multinational firms to escape taxes in their country of operations.
- ▶ It is an attempt to reverse a “30-year race to the bottom” in which countries have resorted to slashing corporate tax rates to attract multinational corporations (MNCs).
- ▶ This proposal requires all countries to impose at least a minimum tax of 15 per cent on global companies. Unilateral measures may lead to political and trade barriers between the countries.
- ▶ It aims for developing a taxation structure that is relevant for a digital and globalised world. It is part of the inclusive framework on BEPS agreed upon by G20 countries and OECD.
- ▶ It rests on two pillars – re-allocation of additional share of profit to the market jurisdictions, and minimum tax.
- ▶ This tax has been introduced specifically to ensure that big technology firms are brought under the tax net. Since these firms do not have a significant physical presence in any country like a factory or place of business, they can route their earnings from their digital operations to low tax jurisdictions thus saving taxes on the profits they earn.
- ▶ While a broad agreement has been reached, many of the aspects are still to be agreed upon and finalised. The aim is to settle the framework by October this year and implement the same from 2023.
- ▶ India has been a staunch proponent of taxing large digital companies that earn a substantial share of their revenues on account of their large user base in India.



THE ROAD AHEAD



THE ROAD AHEAD

- ▶ Will the countries go ahead with Unilateral measures in absence of global consensus?
- ▶ Would the global consensus be as effective and revenue enriching as the present unilateral measures are benefiting the countries?
- ▶ Unilateral measures may lead to political and trade barriers between the countries.
- ▶ Should all the countries adopt a similar framework for applying unilateral measures rather than current individual country wise frameworks being adopted?
- ▶ Would the MNE's be required to restructure their operations?
- ▶ Increase in compliance burden and costs of MNE's operations.



ANNEXURES

ANNEXURE - 1: INDIA - USA DTAA

Article 5 - Permanent Establishment

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially :

(a) a place of management; (b) a branch; (c) an office; (d) a factory; (e) a workshop; (f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources;

(g) a warehouse, in relation to a person providing storage facilities for others ;

(h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on ;

(i) a store or premises used as a sales outlet;

(j) an installation or structure used for the exploration or exploitation of natural resources, but only if so used for a period of more than 120 days in any twelve-month period;

(k) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve-month period ;

(l) the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period ; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)]

3. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include any one or more of the following :

(a) the use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the enterprise ;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or occasional delivery ;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise ;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise ;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise.

ANNEXURE - 1: INDIA - USA DTAA

4. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 5 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if :

(a) he has and habitually exercises in the first-mentioned State an authority to conclude on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph ;

(b) he has no such authority but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in the State on behalf of the enterprise have contributed to the sale of the goods or merchandise ; or

(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

ANNEXURE - 1: INDIA - USA DTAA

Article 7 - Business Profit

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment ; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment ; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.



ANNEXURE - 1: INDIA - USA DTAA

Article 7 - Business Profit

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of this Convention, the profits to be attributed to the permanent establishment as provided in paragraph 1(a) of this Article shall include only the profits derived from the assets and activities of the permanent establishment and shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other Articles of the Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

7. For the purposes of the Convention, the term "business profits" means income derived from any trade or business including income from the furnishing of services other than included services as defined in Article 12 (Royalties and Fees for Included Services) and including income from the rental of tangible personal property other than property described in paragraph 3(b) of Article 12 (Royalties and Fees for Included Services).

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