

*Taxation of digital economy and other key updates

Agenda

TAXATION OF DIGITAL ECONOMY

OTHER CHANGES BY BUDGET 2020

Taxation of digital economy in India – an introduction

Domestic law changes

- Introduction of an 'Equalisation Levy' on online advertising / provision of digital advertising space (2016)
- New nexus rule - 'Significant Economic Presence' ('SEP')(2018)
- Introduction of withholding tax on e-commerce transactions (2020)
- Deferral of SEP and expansion of Equalisation levy (2020)

01

Expansive interpretation of existing source-based taxing rights by Indian tax authorities

- Payments for several digital goods / services sought to be treated as royalty / FTS
- PE asserted based on websites / other digital activities

02

Active participation in global initiatives

- Key player in the OECD BEPS initiatives on taxing the digitalised economy (Pillars One and Two)
- Proponent of expanded source based taxation

03

Unilateral measures being introduced by India to tax digital businesses, in absence of any global consensus till date

Expanding scope of business connection to include Significant Economic Presence

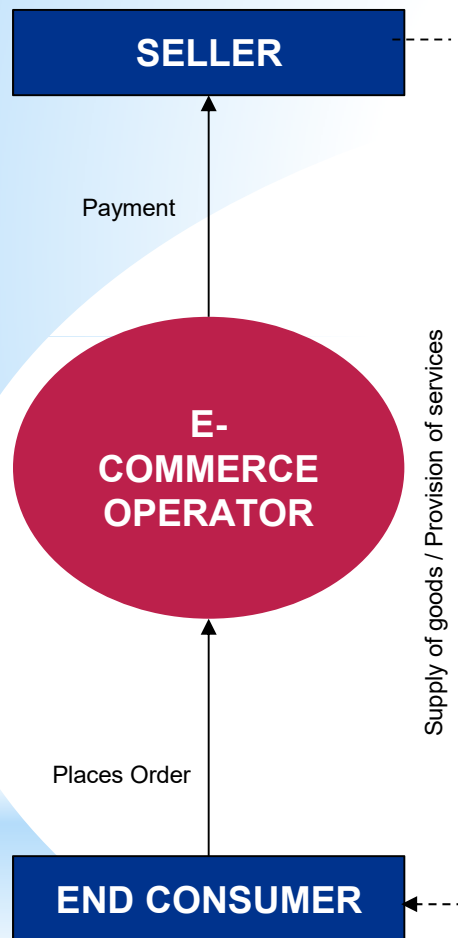
- Business connection to include significant economic presence ('SEP') in India
- SEP to cover the following:
 - Transaction in respect of goods, services, property by NR in India including provision of download of data or software in India, if aggregate of payments during the year exceed the prescribed amount
 - Systematic and continuous soliciting of business in India through digital means
 - Engaging in interaction with prescribed number of users in India
- Taxation to be restricted to income attributable to activities leading to SEP in India

Changes to the SEP regime

- Existing SEP provisions omitted from AY 2021-22 and modified provisions to be inserted from AY 2022-23
- Source Rule expanded and modified w.e.f. AY 2021-22 to include income from:
 - Advertisement that targets India customers
 - Sale of data collected from India
 - Sale of goods and services using such data collected from India
- Ongoing work at the OECD / G20 cited in the Budget Memorandum while deferring the SEP provisions

SEP provisions modified and deferred to AY 2022-23. Meanwhile, EL provisions expanded by Finance Act to tax non-resident e-commerce operators

TDS on E-Commerce transactions



BACKGROUND

- **Huge growth potential in e-commerce sector** - expected growth of \$200 BN in 2026 from \$50 BN
- **Untapped tax potential in e-businesses** - *food delivery platforms, cab aggregators, online ticketing platforms etc.*
- **TDS non-compliance on transactions falling within TDS ambit** (*commission earned by Uber, Amazon, etc.*)
- **Increasing no. of surveys** conducted by tax department on **various e-commerce operators**
- **Huge tax demands** raised on account of **TDS non-compliance**
- **Separate committee set up by CBDT** to devise TDS collection mechanism for e-commerce sector

TDS on E-Commerce transactions



PROPOSED CHANGE

- **TDS @ 1%** on sale of goods / services through e-commerce operator (**5% if PAN not available**)
- TDS obligation on e-commerce operator as 'deemed payer'
- **TDS not to apply** where:
 - Gross proceeds < Rs. 5 lakhs (individual/HUF)
 - Payment made for **hosting advertisements**
- No other **TDS implications on the transaction**

Applicability of Equalization Levy

As originally introduced w.e.f. 1 June 2016

- 'Specified services' i.e.
 - (i) Online advertisement;
 - (ii) Any provision for digital advertising space;
 - (iii) or
Any other facility or service for the purpose of online advertisement

Rate – 6 per cent

Additional Scope w.e.f. 1 April 2020

- 'E-commerce supply or services' i.e.
 - (i) Online sale of goods owned by an e-commerce operator
 - (ii) Online provision of services provided by an e-commerce operator
 - (iii) Online sale of goods or provision of services or both, facilitated by an e-commerce operator; or
 - (iv) Any combination of the above
- E-commerce operator defined to mean a non-resident who owns, operates or manages a digital or electronic facility / platform for online sale of goods or online provision of services

Rate – 2 per cent

Scope of the expended Equalization Levy

Applies to online supply of goods or online provision of services to:

- Persons **resident** in India
- **Non-residents** in the following circumstances:
 - (i) For sale of advertisements targeting a customer resident in India or a person who accesses the advertisement from an IP address located in India
 - (ii) Sale of data collected from a person who is resident in India or a person who uses an IP address located in India
- Persons who buy goods or services or both using an **IP address located in India**

Scope of the expended Equalization Levy (contd.)

Exclusions

- Where the 'E-commerce operator' has a PE in India, and the supply or services is effectively connected with such PE
(PE defined to include a fixed place of business through which the business of the enterprise is wholly or partly carried on)
- If Equalisation levy @ 6% applies (subject to a threshold of INR 1 lakhs), then Equalization levy @ 2% shall not apply
- Sales, turnover or gross receipts of the E-commerce operator from supply or services made to residents, non- residents in specified circumstances or persons using an IP address in India does not exceed INR 2 crores (approx. USD 250,000) in the year

Mechanics of the expended Equalization Levy

- Liability to pay Equalisation Levy cast on the non-resident 'e-commerce operator'
 - No obligation on a resident payer to deduct and pay Equalisation levy (unlike in the case of online advertisements etc.)
 - Payment to be made on a quarterly basis:

Quarter ending on:	Due date of Payment
30 th June	7 th July
30 th September	7 th October
31 st December	7 th January
31 st March	31 st March

- Interest at 1 per cent per month payable for delay in payment
- Penalty equal to amount of levy payable for default in payment
- Existing filing, assessment, appellate remedies to apply

Interplay with the Income-tax Act, 1961

- Equalisation levy outside the ambit of Income-tax Act, 1961 – impacts treaty applicability
- Exemption provided to ‘e-commerce operators’ liable to Equalisation levy from income-tax (section 10(50))
 - Exemption applies to e-commerce supply or services made or provided or facilitated on or after the **1 April 2021** (though expanded Equalisation Levy applies from 1 April 2020)
 - **Urgent correction / clarification needed**
- TDS under section 195 not applicable on payments covered by Equalisation Levy (on account of the exemption under section 10(50))
- Normal provisions of the Income-tax Act, 1961 (i.e. section 9) and Tax Treaties to apply where the e-commerce operators have a PE in India and payments are effectively connected to the PE

OECD 2 Pillars approach

* OECD 2 pillar approach

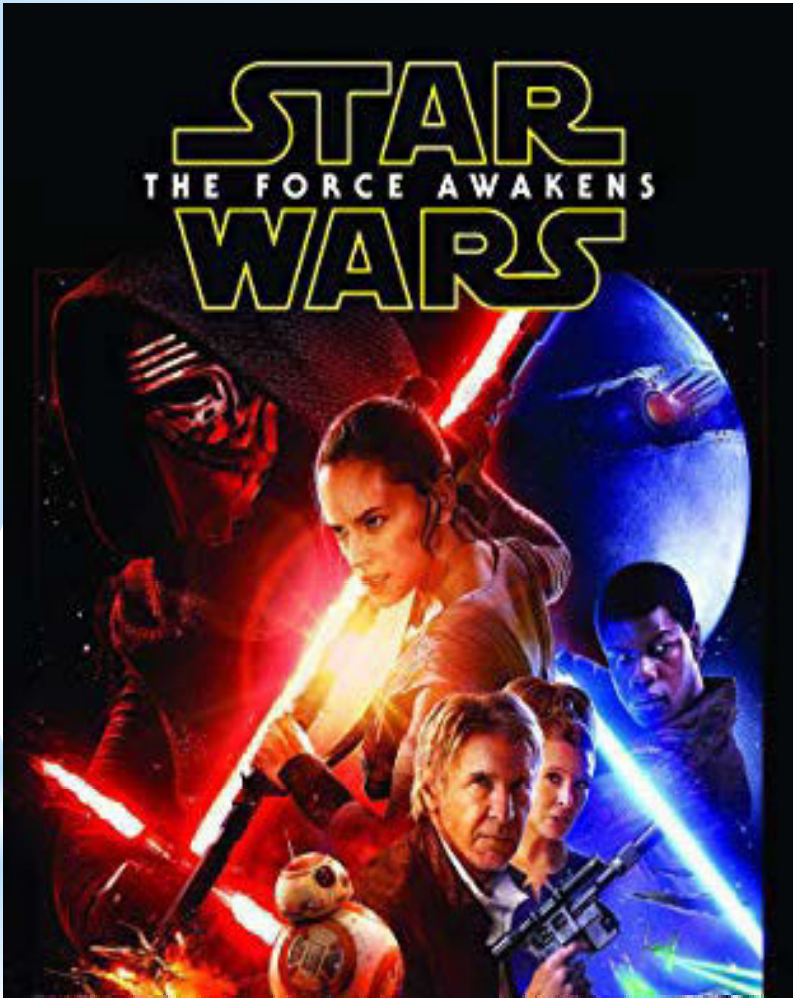
PILLAR ONE (Unified approach)

- Pillar one focuses on allocation of taxing rights
- Seeks to undertake review of profit allocation and nexus rules
- Discussion on user participation, marketing intangibles and SEP proposals

PILLAR TWO (Global Anti-Base Erosion (GLoBE) Proposal)

- Pillar two envisages GLoBE proposal comprising of:
- Income inclusion rule
- Tax on base eroding payments

Star Wars – The Force Awakens



- Movie produced by Walt Disney Studios
- British and US actors involved
- Movie shot in UAE, UK, Iceland and Ireland
- Special effects carried out in US, Singapore, UK and Canada
- IP of movie resides in US
- Movie screened throughout the world



In which jurisdiction should the income be taxed?

* **Unified approach under Pillar One - proposal for profit allocation & nexus rules**

- **Key proposals** – user participation, marketing intangibles and Significant economic presence
 - Mechanics proposed for allocating profits and establishing nexus under each of the above proposals
 - **Applicability** – social media platforms, search engines, online marketplaces, etc. in addition to other businesses
 - **Proposed method** – non-routine / residual profit split method, fractional apportionment method
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* Key Features of Unified Approach under Pillar One

1	SCOPE	Covers digital business models as also consumer facing businesses
2	NEW NEXUS	Not dependent on physical presence but largely based on sales
3	NEW PROFIT ALLOCATION RULE	Complements ALP with formula-based solutions
4	THREE TIER PROFIT ALLOCATION MECHANISM	<ul style="list-style-type: none">• Amount A – portion of deemed residual profit allocated to market jurisdiction based on a formula• Amount B – fixed remuneration for baseline marketing / distribution functions• Amount C – allocation of additional profits where functions exceed baseline activity

Proposals prepared by OECD Secretariat, not attained finality yet

* Deep dive into unified approach



SCOPE

- Focus on large consumer facing businesses
 - ✓ What would it encompass?
 - ✓ Will it cover B-to-B businesses?
- Carve out of certain sectors
- Consideration of size limitations



NEXUS

- Covers cases of sustained and significant involvement in market jurisdiction
 - ✓ Revenue threshold being the primary indicator thereof
- New nexus through a standalone rule – on top of PE rule
- Ensure neutrality between different business models

Pillar Two

Global Anti-Base Erosion
(GloBE) proposal under
Pillar Two

* What does the GloBe Proposal do?

It explores an approach that:

- a) Recognizes and respects the right of countries to determine their own tax system i.e.
 - Whether they should have a corporate income tax; and
 - If yes, the rates of tax they will adopt

BUT

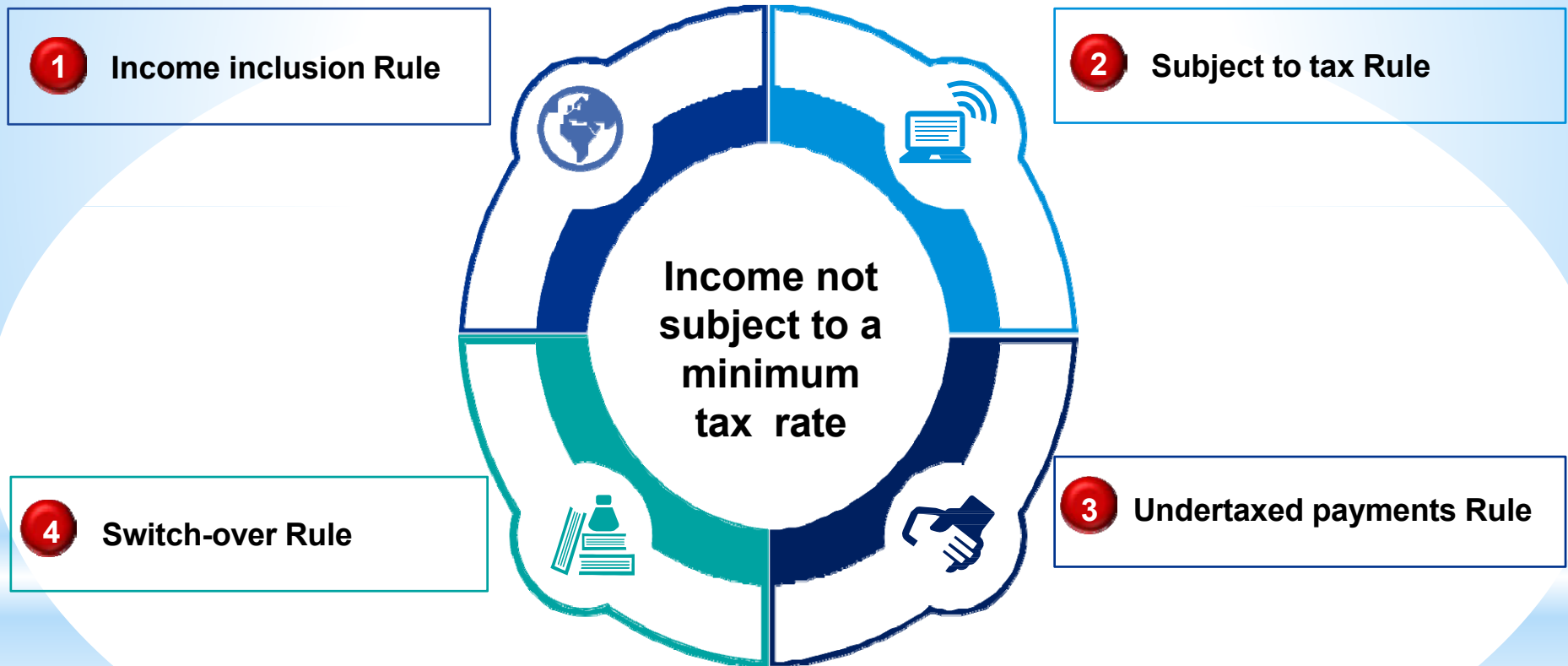
- b) **Considers the right of other jurisdictions to apply certain rules if the income is taxed by a country at an effective rate below a minimum rate**

Designed to ensure that all internationally operating businesses pay a minimum level of tax

* Why is the GloBe Proposal considered necessary?

- Existing BEPS measures do not fully address the risk of profit shifting
- Profit shifting is particularly acute in connection with profits arising from intangibles (prevalent in the digital economy- but proposals not limited to digitalised businesses)
- A minimum rate of tax on all income reduces the incentive for taxpayers to engage in profit shifting and establishes a floor for tax competition among countries
- In the absence of multilateral action, there is a risk of uncoordinated action to attract and protect tax bases (i.e. a race to the bottom)
- There is a need for proposals which will effectively shield developing countries from the pressure to offer inefficient

* Components of the GloBE Proposal



* Components of the GloBE Proposal

- An **income inclusion rule** that would tax income of a foreign controlled entity if that income was subject to tax at an effective rate below a minimum rate
- An **undertaxed payments rule** that would deny a deduction or impose source-based tax for payment to a related party if that payment was not subject to tax at or above a minimum rate
- A **subject to tax rule** that would complement the undertaxed payment rule by subjecting a payment to withholding tax at source and adjusting eligibility of treaty benefits on payments that are not subject to tax at a minimum rate
- A **switch-over rule** that would permit a residence jurisdiction to switch over from an exemption method to a credit method where profits attributable to a PE or immovable property are subject to an effective rate below the minimum rate

Rules intended to not result in double taxation or the levy of tax where there are no economic profits

* Way Forward

- Public consultation on Pillar One in November 2019
 - Outline of unified approach to be agreed in 2020
 - Political agreement on Pillar One (Unified Approach) to be reached by mid-2020
 - Global consensus-based solution to the tax challenges of digitalization by end of 2020
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* Other changes by Budget 2020

TAX COLLECTION AT SOURCE PROVISIONS

- TCS currently applicable to seller of liquor, timber, scrap, etc. (*ranges b/w 1%- 5%*)
 - Scope extended to **included following under TCS provisions:**
 - **Banks LRS remittances \geq Rs. 7 lac in a FY- @5% (10%*) on earlier of receipt/ accrual;**
 - **Seller of overseas tour packages –@5% (10%*) on earlier of receipt or accrual;**
 - **Seller of goods $>$ Rs. 50 lac per buyer - @ 0.1% (1%*) on receipt basis**
 - TCS to apply on seller of goods if, turnover of PY $>$ Rs. 10 crores
 - Provisions deferred until 1 October 2020
 - Exports and Imports excluded from ambit of TCS on sale of goods
 - Relaxation of TCS on remittances under the Liberalised Remittance Scheme:
 - TCS (at 5 per cent) to apply only on amounts remitted in excess of INR 700,000 (except in case of remittance for tourpackages)
 - Reduced rate of 0.5 per cent to apply to funds borrowed from approved financial institutions for pursuing education
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Thank You