

Digital Economy: Navigating through the critical issues including global perspectives

CA Radhakishan Rawal

ICAI Webinar – August 28, 2021

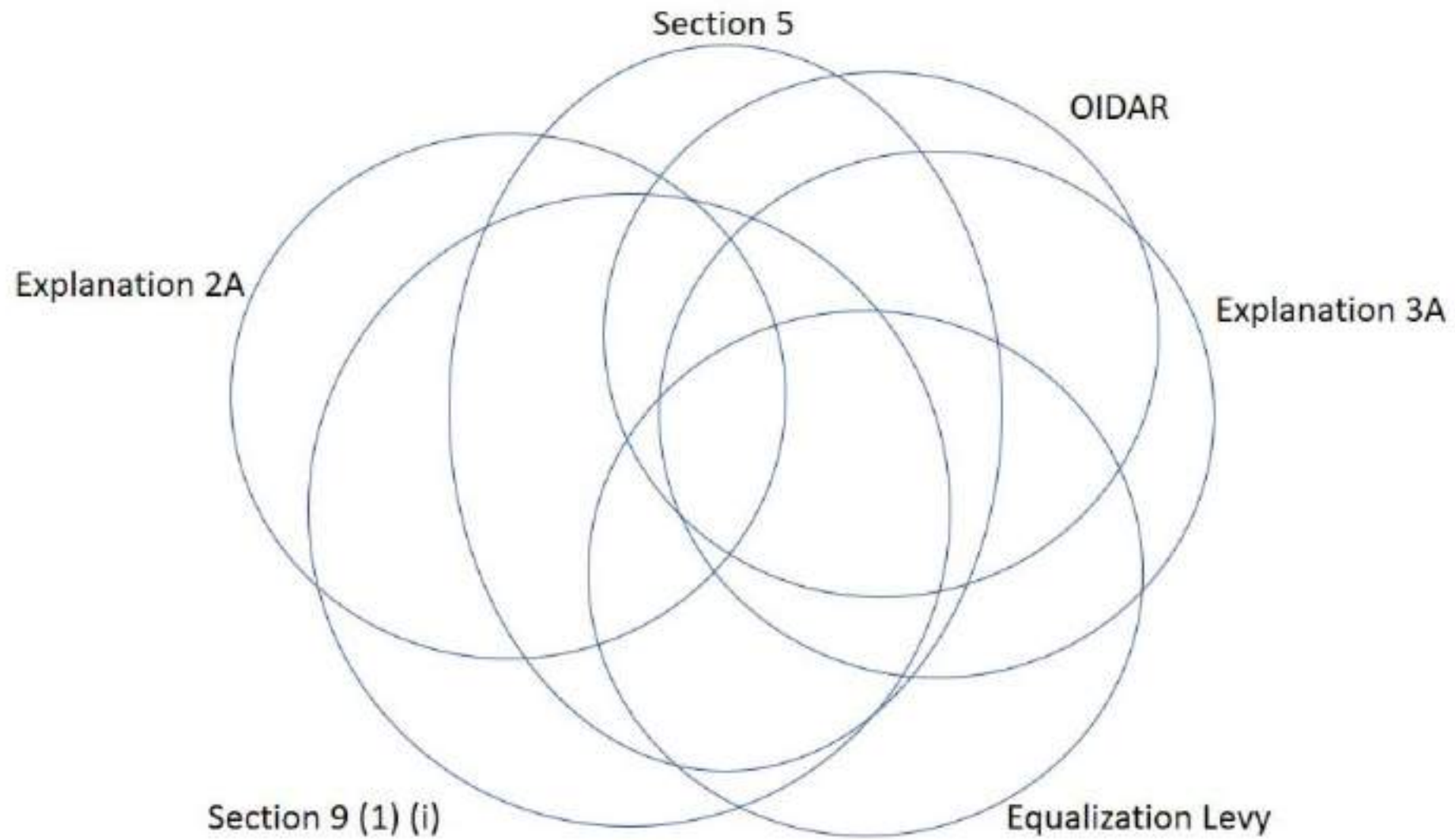
Taxation of digital economy – Global developments

OECD Inclusive Framework work so far



Indian approach to digital economy

Measures		Key features
A	Equalisation Levy (EL) on online advertisement and related services provided to residents	EL is charged @6%. This is effective June 2016.
B	Equalisation Levy (EL) on online sale of goods or provision of service.	EL is charged @2%. This is effective April 1, 2020.
C	Significant Economic Presence (SEP) [Explanation 2A] Net income is subject to tax @40%. This is effective April 1, 2021.	SEP is created on account of: - download of data, software and other transactions, if the aggregate value crosses the threshold. - continuous solicitation of business, interaction with certain users in India.
D	Income from advertisement, sale of data and products [Explanation 3A] Net income is subject to tax @40%. This is effective April 1, 2020.	Subjected to tax in India: - Income from advertisements targeted at Indian resident. - sale of data collected from Indian residents. - sale of goods and services using such data.
E	Section 194-O	TDS
F	Section 52 CGST Act	TCS
G	OIDAR	Online information and database access and retrieval services



Amendment to section 9

Explanation 2A

Explanation 2A

Following *Explanation 2A* shall be inserted in clause (i) of sub-section (1) of section 9 by the Finance Act, 2020, w.e.f. 1-4-2022 :

Explanation 2A.—For the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person 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; or

(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users in India, as may be prescribed:

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

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or

(iii) the non-resident renders services in India:

Provided further *that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.*

Rule 11UD

1. Short title and commencement. —(1) These rules may be called the Income-tax (13th Amendment) Rules, 2021.

(2) They shall come into force with effect from the 1st day of April, 2022.

2. In the Income-tax Rules, 1962, after rule 11UC, the following rule shall be inserted, namely:-

- "11UD. **Thresholds for the purposes of significant economic presence.** — (1) For the purposes of clause (a) of *Explanation 2A* to clause (i) of sub-section (1) of section 9, the amount of aggregate of payments arising from transaction or transactions in respect of any goods, services or property carried out by a nonresident with any person in India, including provision of download of data or software in India during the previous year, shall be **two crore rupees**;
- (2) For the purposes of clause (b) of *Explanation 2A* to clause (i) of sub-section (1) of section 9, the number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction shall be **three lakhs.** ”.

Significant Economic Presence

- Explanation 2A to section 9(1)(i) of the Act was inserted to declare that significant economic presence (SEP) of a non-resident in India shall constitute a "business connection" in India w.e.f 1 April 22 i.e., AY 22-23. Rule 11UD has been notified to prescribe threshold for Significant economic presence applicable from 1 April 22.
- "Significant economic presence" is defined to mean -

Transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India provided the revenue therefrom exceeds monetary threshold, i.e, **two crores rupees**

OR

Systematic and continuous soliciting of business activities or engaging in interaction with users (the number prescribed is **three lakhs**) in India.

- Non-resident to constitute SEP whether or not -
 - The agreement is entered in India;
 - The non-resident has a residence or place of business in India; (or)
 - The non-resident renders services in India

Attribution - Only so much of income as is attributable to the specified transactions or activities is to be deemed to accrue or arise in India**No reference to operations in India.**

Explanation 1 to section 9(1)(a)

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—For the purposes of this clause—

(a) in the case of a business ⁸[, *other than the business having business connection in India on account of significant economic presence,*] of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

Key considerations – Issues for sub-clause (a)

Transactions in respect of any goods, services or property

- Applicability to physical goods?
- Applicability to non-digital services?
- Applicability to non-digital property?



- Guidance from Explanatory Memorandum to Finance Bill, 2018
- Other observations of the authorities

Attribution of profit to the “transactions and activities” referred in Explanation 2A



- Method to be prescribed u/s 295 (2)(b)(iib)
- Rule 10?

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person 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; or

.....

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

Key considerations –Issues for sub-clause (b)

Interpretation issues

- Meaning of systematic and continuous soliciting of business activities?
- Meaning of engaging in interactions?
- Meaning of users?
- Solicitation from persons other than users?

Quantification for determining SEP

- How to find number of users?
- Guidance from Pillar One revenue sourcing rules?

Attribution of profit to the “transactions and activities” referred in Explanation 2A

(b) **systematic and continuous soliciting of business activities** or engaging in interaction with such number of users in India, as may be prescribed:

(2) For the purposes of clause (b) of *Explanation 2A* to clause (i) of sub-section (1) of section 9, the number of users with whom systematic and continuous business activities are solicited or who are engaged in interaction shall be three lakhs.

Overlap between Section 9(1)(i) Explanation 2A and section 9(1)(vi) / (vii)

Taxability on account of business connection – Significant Economic Presence

- (a) transaction in respect of any **goods, services or property** carried out by a non-resident with any person 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; or

Taxability as “royalties” or “fees for technical services”

- Taxation of software u/s 9(1)(vi) Explanation 4
- Taxation of fees for technical services u/s 9(1)(vii)

- *generalia specialibus non derogant – Which is a special provision?*
- *Later in time?*
- *Can the intention be to apply section 9(1)(i) as against section 9(1)(vi)/(vii)?*

Impact of Explanation 2A on taxability


Explanation 2A does result in taxable income in terms of the domestic law



Cross border business profits to continue to be taxed as per existing treaty rules till the DTAAs are modified. Tax authorities may want to challenge availability of treaty benefit



Royalties and FTS will be taxed as per the tax treaty [overlap between section 0(1)(i) Explanation 2A and section 9(1)(vi) / (vii) would have no impact]



Non-treaty jurisdictions to be impacted by the proposed amendment



Interplay between Significant Economic Presence and Equalisation levy – Benefit of section 10(50) will be available if Equalisation Levy is applicable.

Compliance issues

Where treaty benefit is not available	Where treaty benefit is available
Obligation to file tax return	
<ul style="list-style-type: none">Income is subject to tax under the domestic law.Non-resident has an obligation to file tax return in India pay tax on income.	<ul style="list-style-type: none">Income is subject to tax under the domestic law.Non-resident has an obligation to file tax return in India under the domestic law.The tax authorities should get fair chance to determine treaty availability.It will be good compliance to file ROI and claim treaty benefit.Non-filing of tax return is strictly not in accordance with the provisions of the law.
Obligation to withholding tax	
<ul style="list-style-type: none">Persons responsible for paying non-resident need to comply with section 195	<ul style="list-style-type: none">Treaty benefit can be given at withholding stage

Other issues

- **Domestic law and Pillar One**
- **Significant Economic Presence in India and obligation of Non-resident to deduct tax**
- **Obligations under the Companies Act, 2013**
 - Meaning of “foreign company” – Defined under section 2(42) of the Companies Act:
“foreign company” means any company or body corporate incorporated outside India which –
*(a) has a place of business in India whether by itself or through an agent, **physically or through electronic mode**, and*
(b) conducts any business activity in India in any other manner.”
- **Section 163**

Agent in relation to a non-resident includes any person in India
- who has any business connection with the non-resident

Pillar One

Pillar One

Key elements

Amount
A

New taxing right

- A share of residual profit allocated to market countries using a formulaic approach

Largest and
most
profitable
businesses

Amount
B

Fixed "baseline" return

- For marketing and distribution functions based on the arm's length principle

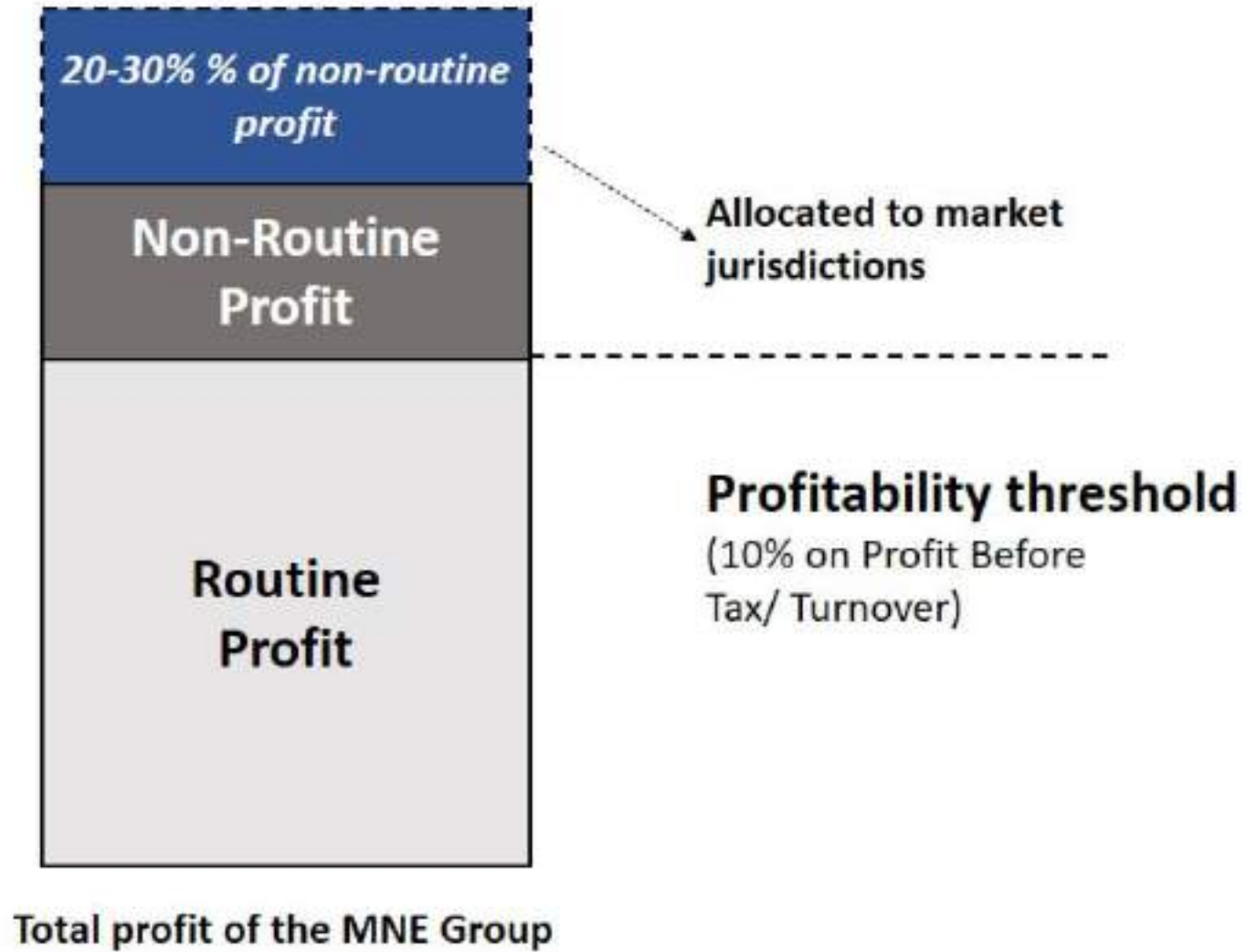
All
businesses

Tax
certainty

Tax certainty

- Through effective dispute prevention and resolution mechanisms

All
businesses

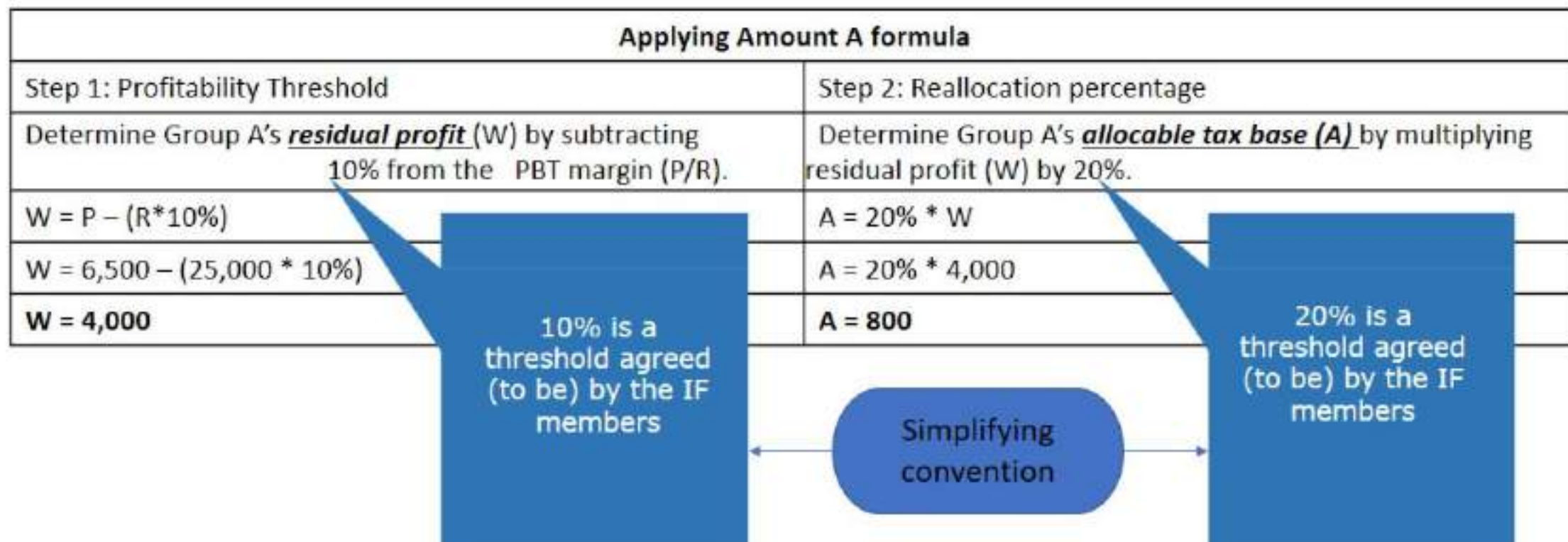


Facts

Group A is a large MNE group providing exclusively in-scope ADS via an online platform. It is assumed that Group A is treated as one segment for Amount A purposes and that it has the following simplified income statement:

	in million EUR
Revenue (R)	25,000
Profit before tax (P)	6,500
PBT margin (P/R)	26%

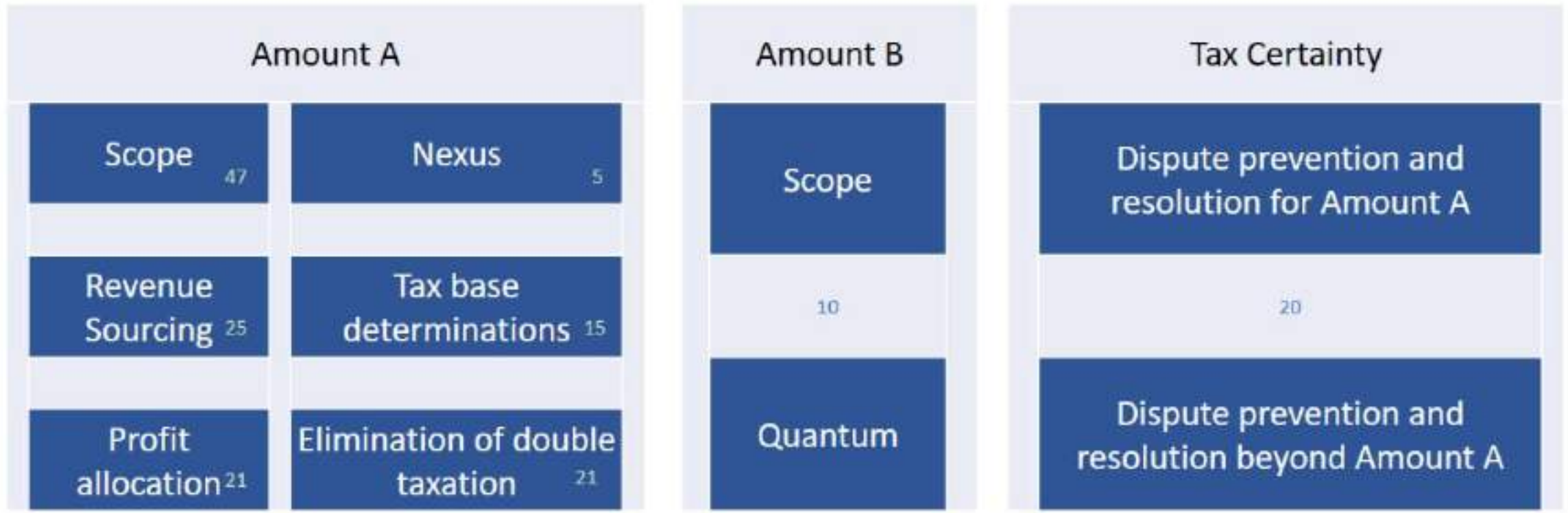
in million EUR	Local revenue (S)	
Market 1	2,000	local subsidiary
Market 2	18,000	remote activity
Market 3	5,000	remote activity
Total	25,000	



Step 3: Allocation key

Allocation key based on the ratio of locally sourced revenue (S) to total revenue (R). This last step provides for the quantum of Amount A taxable in each eligible market jurisdiction (M), as described in the below table.

in million EUR	Local revenue (S)	Allocation Key (S/R)	Amount A (M)
Market 1	2,000	8%	$A * S/R = 64$
Market 2	18,000	72%	$A * S/R = 576$
Market 3	5,000	20%	$A * S/R = 160$
Total	25,000	100%	800



Implementation & Administration

7

Amount A – new taxing right

Scope

Superseded OECD Blueprint proposal:



Inclusive Framework proposal:

Groups with **global turnover above €20 billion**
and **profitability above 10% (PBT/revenue)**

Reduced turnover threshold of €10 billion potentially in 2031

Extractives and regulated financial services excluded

Nexus - Amount A – new taxing right

A market country will only be entitled to an allocation of Amount A if there is a nexus

	Countries with GDP over €40 billion	Countries with GDP less than €40 billion
Local sales threshold to create nexus	€1,000,000	€250,000

Target those MNE groups that are able to participate in an **active and sustained manner** in the economic life of a market jurisdiction, without having commensurate level of taxable presence.

Amount A – Revenue Sourcing Rules...from tax treaties

- 5. Interest shall be deemed to arise in a Contracting State when the payer is that State itself or a political sub-division or local authority of that State or a person who is a resident of that State for the purposes of its tax. Where, however, the person paying the interest, whether the person is a resident of one of the Contracting States or not, has in one of the Contracting States or outside both Contracting States a permanent establishment or fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.
- Royalties shall be deemed to arise in a Contracting State when the payer is that State itself or a political sub-division or local authority of that State or a person who is a resident of that State for the purposes of its tax. Where, however, the person paying the royalties, whether the person is a resident of one of the Contracting States or not, has in one of the Contracting States or outside both Contracting States a permanent establishment or fixed base in connection with which the liability to pay the royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

Amount A – Revenue Sourcing Rules

1 July Statement

- Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Blueprint

- The revenue sourcing rules determine the revenue that would be treated as deriving from a particular market jurisdiction. The rules would be relevant in applying the scope rules, the nexus rules and the Amount A formula;
- A **sourcing principle** is identified for each type of in-scope revenue, accompanied by a list of the acceptable specific **indicators** an MNE will use to apply the principle and identify the jurisdiction of source.
- The acceptable indicators would be organised in a hierarchy. The MNE should use the first indicator hierarchy, as this will be the most accurate.
- Exceptions: when information is “unavailable” or “unreliable”

ADS business	Type of revenue sourcing rules applied
Online Advertising Services	<ul style="list-style-type: none"> • Revenue from online advertising services
Sale or Other Alienation of User Data	<ul style="list-style-type: none"> • Revenue from sale or other alienation of user data
Online Search Engines	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data
Social Media Platforms	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data • Revenue from digital content services
Online Intermediation Platform Services	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data • Revenue from online intermediation platform services • Revenue from digital content services
Digital Content Services	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data • Revenue from digital content services
Online Gaming	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data • Revenue from digital content services
Standardised Online Teaching Services	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from sale or other alienation of user data • Revenue from digital content services
Cloud Computing Services	<ul style="list-style-type: none"> • Revenue from online advertising services • Revenue from cloud computing services

Amount A – Revenue Sourcing Rules – Revenue from Online Advertising Services

Online advertising services based on the real-time location of the viewer

- **Sourcing rule** - Jurisdiction of the real-time location of the viewer of the advertisement.
- Relevant **indicators**:
 - a. The jurisdiction of the geolocation of the device of the viewer at the time of display; or if unavailable or unreliable
 - b. The jurisdiction of the IP address of the device of the viewer at the time of display; or if unavailable or unreliable
 - c. Other available information that can be used to determine the jurisdiction of the real-time location of the viewer

Other Online advertising services not based on the real-time location of the viewer

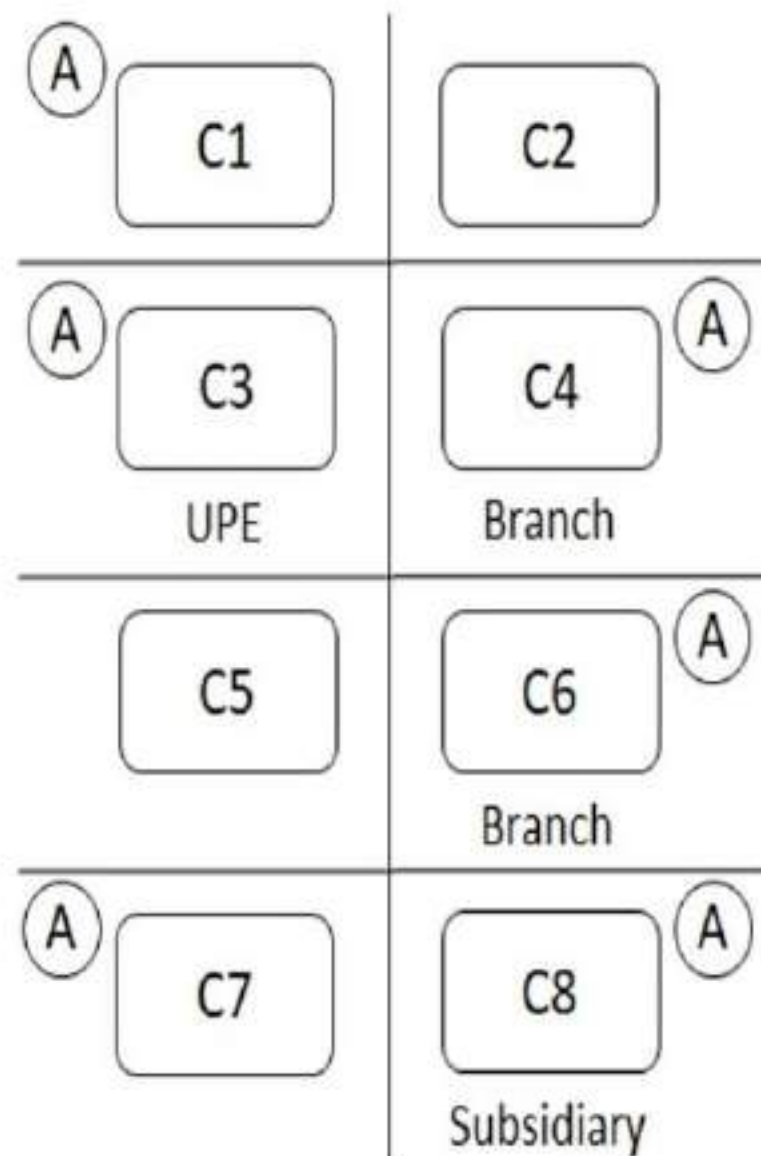
- **Sourcing rule** - Jurisdiction of the ordinary residence of the viewer of the advertisement.
- **Relevant indicators**:
 - a. The jurisdiction of the ordinary residence of the viewer, based on user profile information:
 - i. Information on residence obtained from recurring data on geolocation or IP address of the viewer's device; (ii) Billing address of the viewer (iii) Mobile country code of the phone number of the viewer (iv) information on residence inputted by the viewer (v) the jurisdiction of the ordinary residence of the viewer;
 - b. The jurisdiction of the geolocation of the device of the viewer at the time of display; or if unavailable or unreliable
 - c. The jurisdiction of the IP address of the device of the viewer at the time of display

Amount A – Tax base determination

- The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments (1 July, 2021 Statement).
- The Amount A tax base will be quantified using an **adjusted PBT measure that will be derived from the consolidated financial accounts (or in some cases segmented accounts) of in-scope MNE groups.**
- Consolidated financial accounts prepared by the ultimate parent entity under GAAP, that produce equivalent or comparable outcomes, to consolidated financial accounts prepared under IFRS will mainly be used.
- Eligible GAAPs : GAAPs of US, Japan, China, Hong Kong (China), Canada, India, Korea, New Zealand, Australia and Singapore
- PBT as a selected measure of profit
- Only a limited number of **book-to-tax adjustments** will apply to seek **alignment of the tax base with the corporate tax base of Inclusive Framework members.**
- Book-to-tax adjustments permitted on PBT (bottom-line figure of the P & L a/c i.e. total for profit or loss):
 - Adjustment of income tax expenses,
 - exclusion of dividend income and gains or losses in connection with shares, (participation exemption)
 - Exclusion of income derived as per equity method of accounting
 - Adjustment for expenses not deductible for public policy reasons (bribes, illegal payments excluding minor costs)

Amount A – Profit allocation – The issue of double counting

- The interactions between Amount A and existing taxing rights of market jurisdictions could, in some circumstances, result in a market jurisdiction being able to tax twice the residual profit of an MNE group:
 - once under its existing taxing rights, and
 - again through Amount A
- Two options identified for the above:
 - Marketing and distribution profits safe harbor;
 - Other options:



Amount B

Baseline marketing and distribution activities

Simplify transfer pricing of **in-country baseline marketing and distribution** activities

Focus on needs of **low-capacity countries**

Technical work to be completed **by end of 2022**

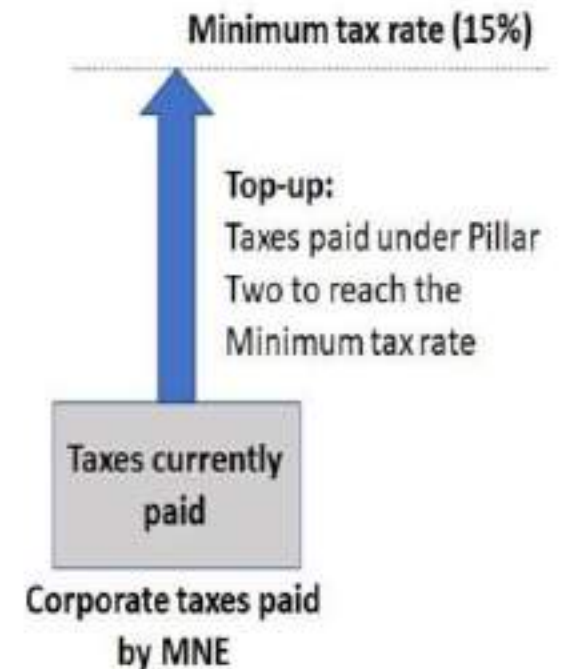
Tax Certainty and Implementation

- Group approach
- Review Panel and Determination Panel

Pillar Two

Pillar Two - Scope of GloBE Rules

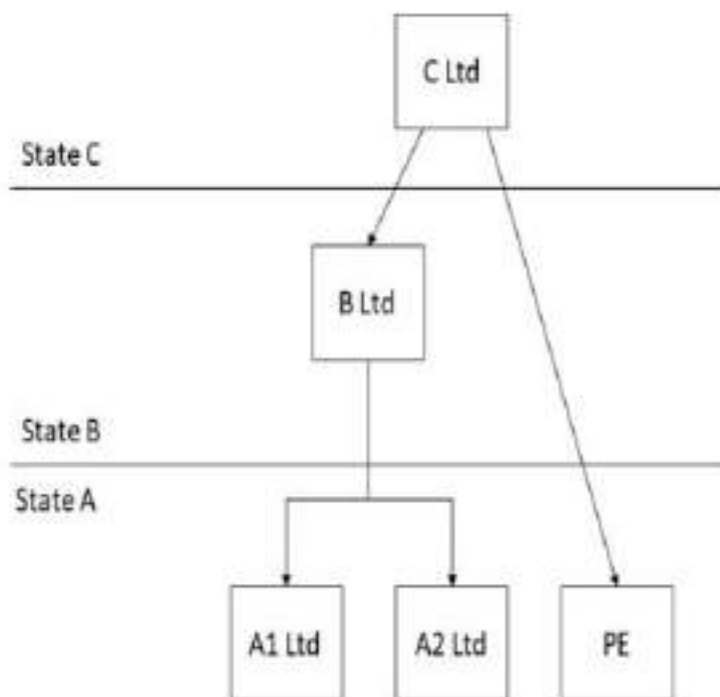
- *MNE Groups* having total consolidated group revenue €750 million or above, in the immediately preceding fiscal year, are subject to application of the GloBE rules.
- The consolidated group revenue threshold is applied to all those CEs that are owned and controlled by the same UPE
- Excluded entities / income
 - Investment Fund
 - Pension Fund
 - Governmental Entity
 - International Organisation
 - Non-profit Organisation
 - International shipping
- Specific Rules
 - Income Inclusion Rule (IIR) – At least 15%
 - Undertaxed Payment Rule (UTPR) – At least 15%
 - Subject to Tax Rule (STTR) – 7.5% to 9%



Concepts and threshold adopted from CbCR mechanism

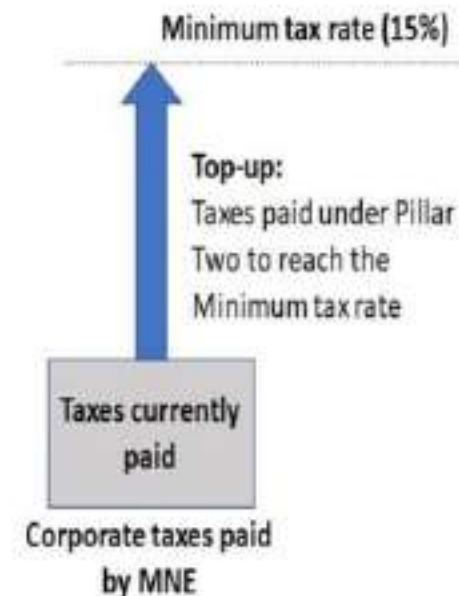
Computation of ETR - Jurisdictional Blending

- Determination of IIR top-up tax payable by shareholder



Scenario 1	Total	A1 Ltd	A2 Ltd	PE
Covered Taxes	351	100	120	131
GloBE Income	3900	1200	1400	1300
ETR %	9.00	8.33	8.57	10.08

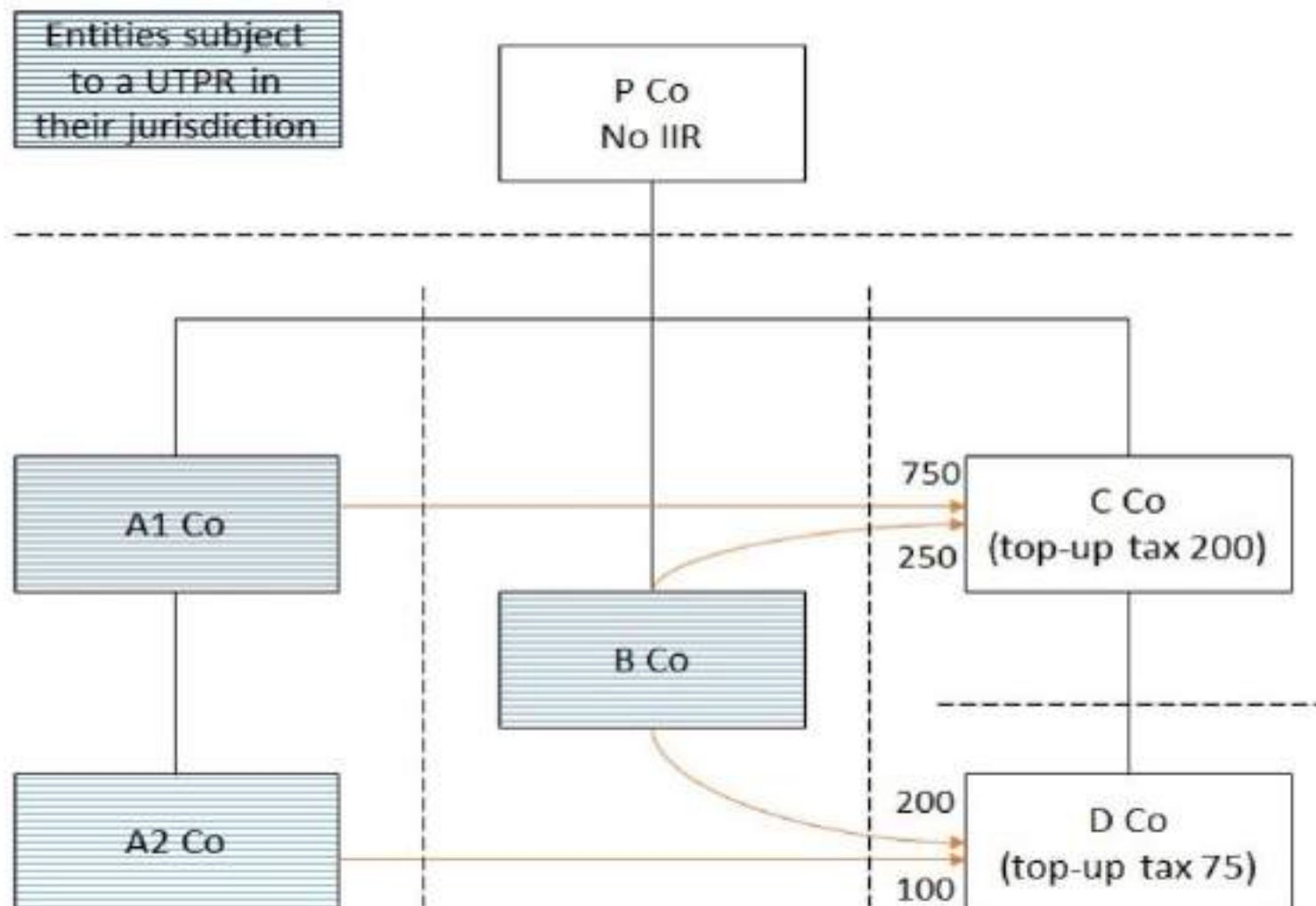
Scenario 3	Total	A1 Ltd	A2 Ltd	PE
Covered Taxes	250	50	150	50
GloBE Income	2500	1200	1400	-100
ETR %	10.00	4.17	10.71	



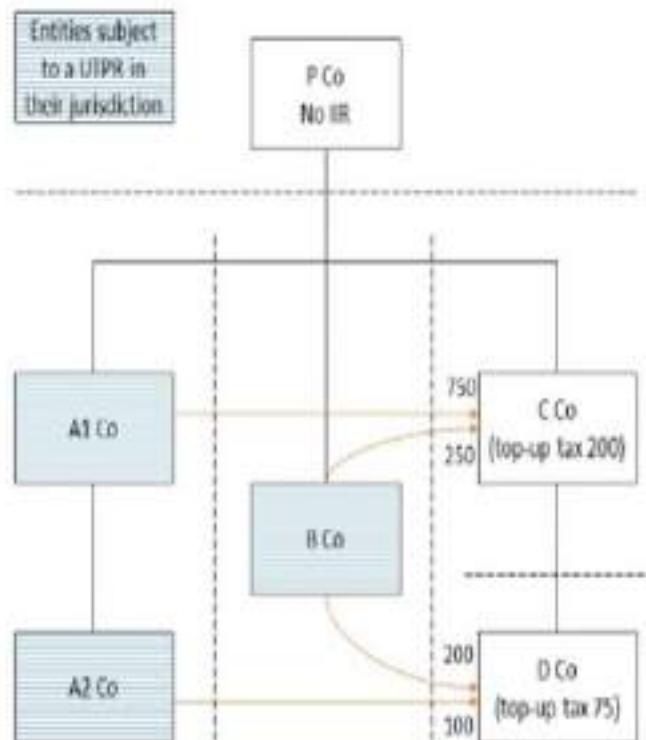
- Determination of “covered taxes”
- Determination of “tax base”
- Allocation of income and taxes

Undertaxed Payment Rule

- No IIR in State P
- The ETR in Country C and Country D are below the minimum rate
- Top up tax payable in respect of C Co. and D Co. is 200 and 75 respectively



Undertaxed Payment Rule



Influence of domestic tax rate on UTPR top up tax

Allocation of top up tax in relation to C co's profits

UTPR Taxpayers	Amount of direct payments made to C Co	Proportion of direct payments
A1 Co	750	$750/1000 = 75\%$
B Co	250	$250/1000 = 25\%$
Total	1000	100%

UTPR Taxpayers	Proportion of direct payments	Allocated top-up tax
A1 Co	75%	$75\% \times 200 = 150$
B Co	25%	$25\% \times 200 = 50$
Total	100%	200

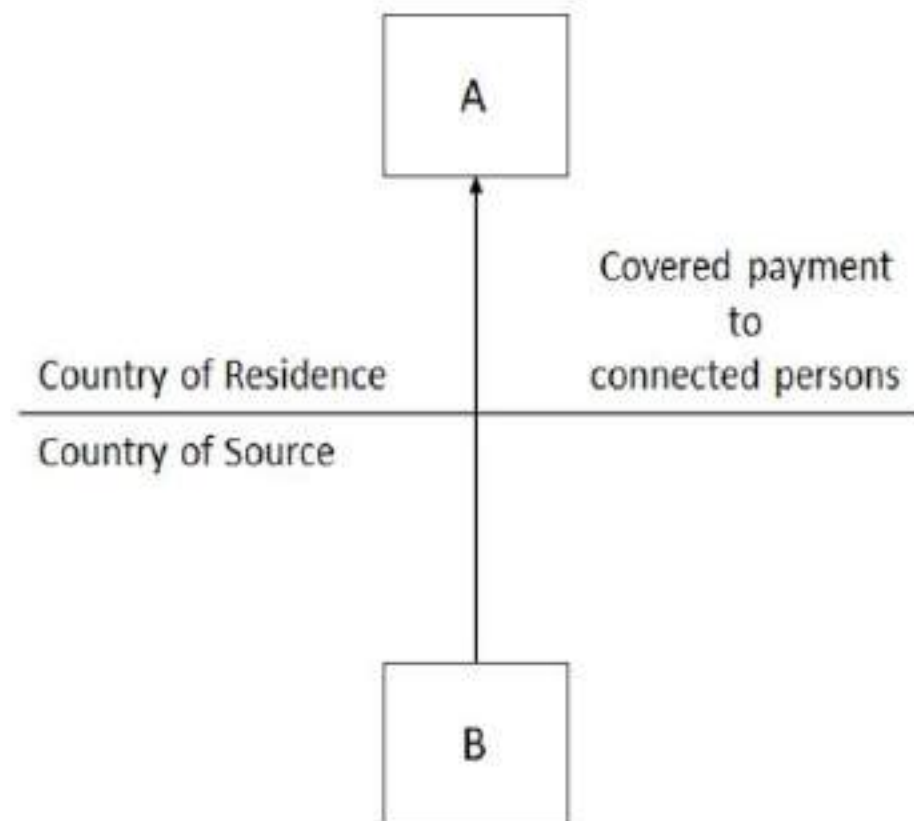
Allocation of top up tax in relation to D co's profits

UTPR Taxpayers	Amount of direct payments made to D Co	Proportion of direct payments
A2 Co	100	$100/300 = 33.33\%$
B Co	200	$200/300 = 66.66\%$
Total	300	100%

UTPR Taxpayers	Proportion of direct payments	Allocated top-up tax
A2 Co	33.33%	$33.33\% \times 75 = 25$
B Co	66.66%	$66.66\% \times 75 = 50$
Total	100%	75

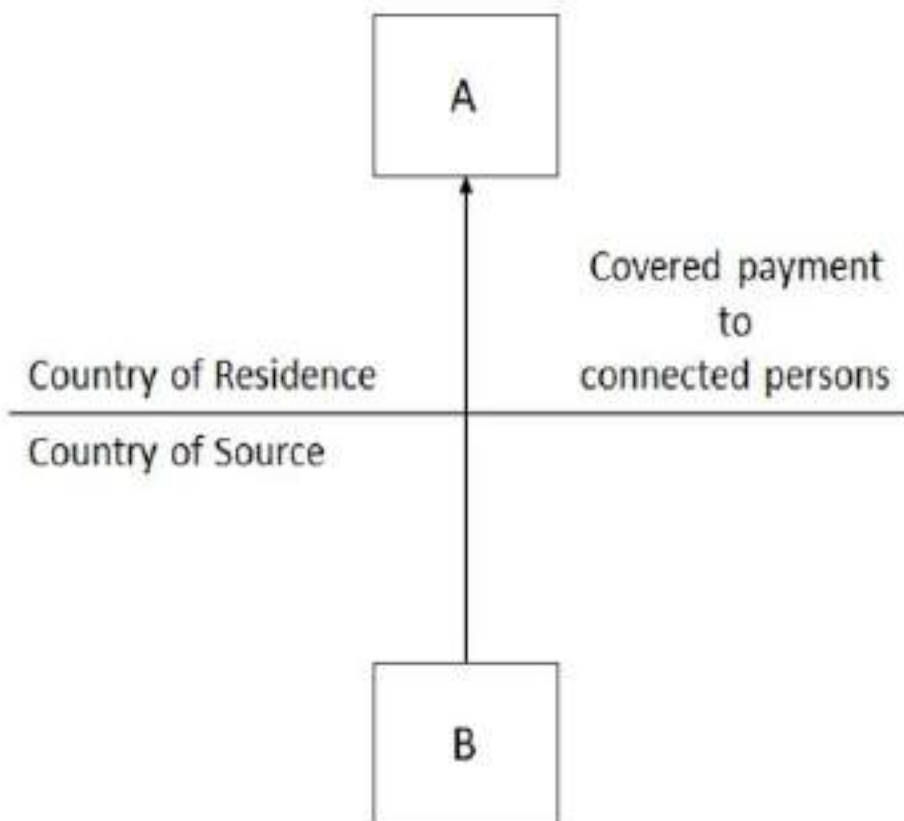
Subject to Tax Rule [STTR] - scope

- Targets cross-border intragroup payments (*connected persons*) that exploit certain treaty provisions
- Enables source jurisdiction to protect itself against base eroding payments to no or low tax jurisdictions and bring back taxing rights
- Scope of STTR :
 - *Applied to cross-border payments between connected persons (excludes payments made to or by individuals)*
 - **Covered payments** - These include interest, royalties and the following other payments (*related to mobile risk, asset or capital*):
 - a. A franchise fee or other payment for the use of or right to use intangibles in combination with services;
 - b. Insurance or reinsurance premium;
 - c. A guarantee, brokerage or financing fee;
 - d. Rent or any other payment for the use of or the right to use moveable property;
 - e. Consideration for the supply of marketing, procurement, agency or other intermediary services



Subject to Tax Rule [STTR] - scope

- **Excluded entities** - investment funds; pension funds; governmental entities (including sovereign wealth funds); international organisations, and non-profit organisations
- **Materiality threshold** - based on one or a combination of the size of the MNE group, a tiered EUR-value of covered payments, and the ratio of covered payments to total expenditures. (Further technical work)



Implementation Plan - New law / instruments to be expected

International – Pillar One	International – Pillar Two	Domestic Law
October 2021 – Final implementation plan		Feb 2022 – Finance Bill, 2022?
2022 – MLI for implementing Amount A to be made available for signature (<i>Amount A MLI</i>)	2022 – Global Model Rules for implementation of GloBE rules 2022 – MLI to implement to GloBE rules (<i>GloBE MLI</i>) 2022 – STTR model provision and MLI for facilitation of STTR adoption in the tax treaty (<i>STTR MLI</i>) 2022 – Transition rules – Possibility of deferred implementation of UPTR	2022 – Income Tax (Amendment Act), 2022? Feb 2023 - Finance Bill, 2023?
2023 – Pillar One to be implemented	2023 – Pillar Two to be implemented	

Relevant provisions

Rule 10

Determination of income in the case of non-residents. - In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax may be calculated :-

- (i) at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or
- (ii) on any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or
- (iii) in such other manner as the Assessing Officer may deem suitable.

Relevant provisions of the Companies Act, 2013

- Meaning of “electronic mode” – Defined under Rule 2(c) of the Companies (Registration of Foreign Companies) Rules 2014:

“(c) for the purposes of clause (42) of section 2 of the Act, ‘electronic mode’ means carrying out electronically based, whether main server is installed in India or not, including, but not limited to –

(i) business to business and business to consumer transactions, data interchange and other digital supply transactions;

(ii) offering to accept deposits or inviting deposits or accepting deposits or subscriptions in securities, in India or from citizens of India; (iii) financial settlements, web based marketing, advisory and transactional services, database services and products, supply chain management;

(iv) online services such as telemarketing, telecommuting, telemedicine, education and information research; and

(v) all related data communication services,

whether conducted by e-mail, mobile devices, social media, cloud computing, document management, voice or data transmission or otherwise;”

Explanatory Memorandum – Finance Bill, 2018

*The scope of existing provisions of clause (i) of sub-section (1) of section 9 is restrictive as it essentially provides for physical presence based nexus rule for taxation of business income of the non-resident in India. Explanation 2 to the said section which defines 'business connection' is also narrow in its scope since it limits the taxability of certain activities or transactions of non-resident to those carried out through a dependent agent. **Therefore, emerging business models such as digitized businesses, which do not require physical presence of itself or any agent in India, is not covered within the scope of clause (i) of sub-section (i) of section 9 of the Act.***

In view of the above, it is proposed to amend clause (i) of sub-section (1) of section 9 of the Act to provide that 'significant economic presence' in India shall also constitute 'business connection'. Further, "significant economic presence" for this purpose, shall mean-

- (i) any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed; or*
- (ii) systematic and continuous soliciting of its business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means.*