



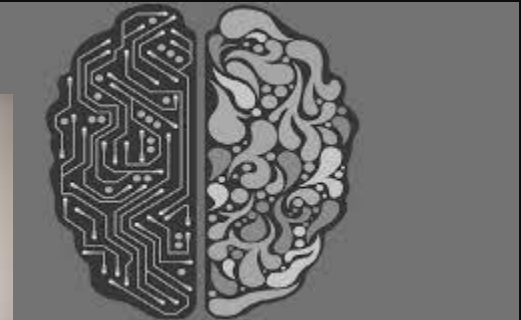
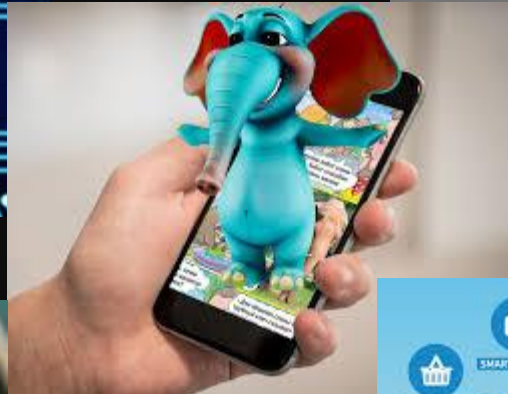
# **Digital economy taxation – Emerging frontiers**

**CA Sandeep Dasgupta**  
**18 May 2019**



# **Riding the digital wave – emerging trends**

# Riding the digital wave – emerging trends



The emergence and evolution spree continues.....  
Imperative to understand the technology and  
business models for evaluating tax implications



# What's also trending in this digital era....

Emergence of OTT platforms and online advertising

E-tail and online marketplaces slowly getting into physical marketplaces business share

Upsurge in the cloud services and digital payment services

Greater thrust by Governments to expand internet infrastructure and to digitize operations and routine interactions with citizens

Increasing growth and promotion of E-Sports due to increasing online streaming media platforms

Recognition of digital economy as an inseparable part of the larger economy - OECD's TFDE actively evaluating the new technology and emerging business models to suggest measures against BEPS through virtual business models – consensus based solutions towards taxation of digital economy expected by 2020 from the TFDE under OECD's inclusive framework

# **Digital economy – features**

Digital economy primarily includes-

- (i) Supporting infrastructure (Tangibles such as personal computing devices, routers, cables etc.) and intangibles
- (ii) Electronic Business Processes / Internet based business models
- (iii) E-commerce transactions –

***US Bureau of the Census report – Measuring the Digital economy***

**It's difficult to ring fence the digital economy from the rest of the economy for tax purposes –**

***OECD's BEPS Action Plan 1 report of 2015***

**What we see around us --**

**Range of digital and tangible goods & services including smart phones, tablets, digital content and communication, app computers, cloud based services, robotics and of course extensive internet based applications**

**From a tax perspective, the increasing and unparalleled reliance on intangible assets, the extensive use of data and enhanced adoption of multi-sided business models within the digital ecosystem, makes it difficult for determining the jurisdiction where value creation occurs**

# Digital economy – features

[2/2]

## **MOBILITY OF USERS**

Customers may use services remotely while travelling across borders. For example, an individual can reside in one country, purchase an application while staying in a second country, and use the application from a third country.

## **MOBILITY OF INTANGIBLES**

Easy to shift legal ownership between associated enterprises – not necessarily to entity which developed the intangible.

## **MOBILITY OF BUSINESS FUNCTION**

No need for location in place of operations or place of customers – global operations can be managed on an integrated basis.

## **RELIANCE ON DATA**

Collection of massive amount of data is now possible – leads to improvement in product and services. For example, by recording internet browsing preferences, location data etc.

## **NETWORK EFFECTS**

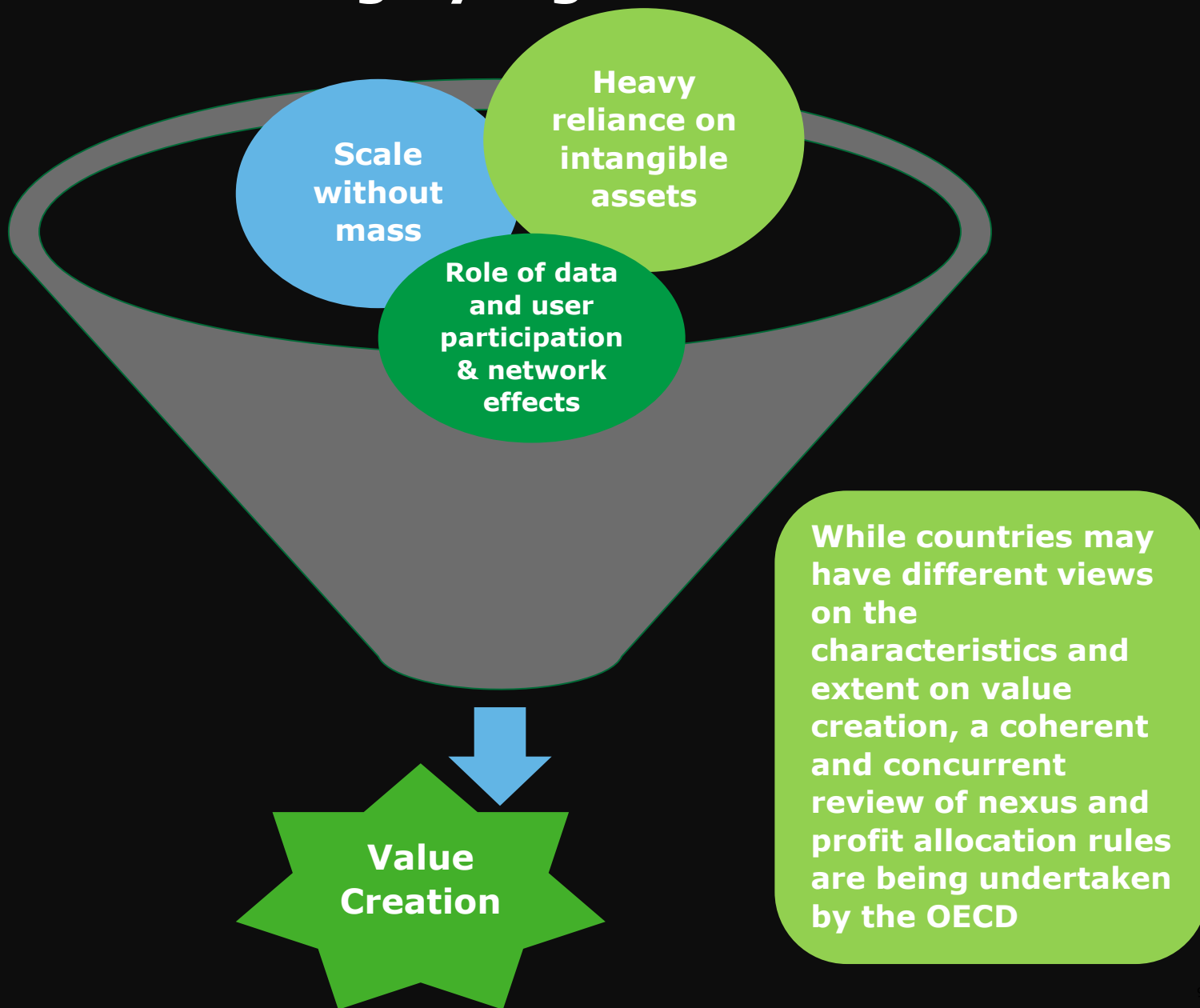
Decisions of users may have a direct impact on the benefit received by other users. For example, when additional people join a social network, the welfare of the existing users is increased, even though there is no explicit agreement for compensation between users.

## **MULTI SIDED BUSINESS MODELS**

Where various persons interact through an intermediary and the decision of each person affects the outcome for the other. For example, a card payment system will be more valuable to customers if more merchants accept the card.



# Characteristics of highly digitalized businesses



# Digital economy – certain tax concerns [1/2]



- ❑ An Indian resident, while on a visit to Singapore orders certain goods online from Online.com in the USA.
- ❑ Orders are received and processed by servers located in Philippines
- ❑ Delivery takes place from a warehouse located in China

Which country has a right to tax income from sale of goods? Where is the PE, if any, of Online.com located?

# Digital economy – certain tax concerns

## [2/2]

**Characterization of e-goods (such as e-books / e-videos) – whether “goods” or “services”?**

Application of related source rules and how to ensure effective collection of VAT / GST for cross-border supply of goods and services.

Ability to have significant digital presence in another country without liable to tax due to lack of nexus under current international tax rules.

**Eg, store is replaced by website, remote interactions with customers are now possible, people are replaced by software / hardware. Current nexus rules do not address this.**

**Why the tax concerns?**

Attribution of value created from the generation of marketable location - relevant data through the use of digital products and services

Characterisation of income derived from new business models – whether royalty / FTS / FIS

With the growth in global internet traffic influenced by digital technologies, enormous data is constantly generated – businesses capture this data and through data analytics and gather insights towards constant transformation of business models and in turn consumers behavior towards this transformation

# **Certain direct tax aspects pertinent to india**

# Key direct tax provisions / policy aspects relevant to taxation of digital economy



Indian income tax provisions other than Transfer pricing

Indian Transfer pricing regulations

Tax reforms suggested by the OECD / UN through BEPS Action Plan / Changes to the model commentary

Additionally, it may be pertinent to track the measures being adopted by other countries to address digital economy tax issues, although such unilateral measures may create more inconsistencies for tax administrations and taxpayers – consensus based solutions a need of the hour

**Current key relevant  
elements of international tax  
architecture – India  
perspective**

# Certain key relevant elements of international tax architecture – India perspective

**1**

Basic charging provisions

**2**

Business connection as an evolving concept, Royalty and Fees for technical services and the source / nexus rules

**3**

Tax treaty network and nuances

**4**

Transfer pricing regulations as evolving

**5**

BEPS recommendations slowly being incorporated

**The entire development track should be monitored well to understand the implications of evolution of law and alignment levels with business dynamics**

**Tax reforms suggested so far  
by the OECD / UN through  
BEPS Action Plan / Changes  
to the model commentary**



# Action plan 1 – Addressing the challenges of the digital economy

## Identify main difficulties that digital economy poses for application of existing international tax rules

- Develop detailed options to address difficulties
- Taking holistic approach and considering direct and indirect taxation

## Issues examined included

- Significant digital presence in economy of another country
- Attribution of value
- Characterization of income
- Application of “source” rule
- VAT/ GST on cross border supply of goods/ services

# Action plan 1 – Addressing the challenges of the digital economy

- **Key observations and conclusions by the OECD**

- Transformation of business conduct due to relentless advancement in information and communication technology and resultant new business models
- The effects of the above advancement are so pervasive throughout the sectors of the Indian economy, it is impossible to apply special rules to identified digital economy business
- Many BEPS issues shall be addressed and dealt with at least partially under other action plans

“The broader tax challenges raised by the digital economy go beyond the question of how to put an end to double non-taxation and chiefly relate to the question of how the taxing rights on income generated from cross border activities in the digital age should be allocated among countries – BEPS Action Plan 1 Final Report at Page 132

# Action plan 1 – Addressing the challenges of the digital economy

- **Key recommendations under further evaluation by the OECD**
  - Modification of the list of the exceptions to the definition of PE regarding preparatory / auxiliary activities as they relate to a digital environment and introduction of new anti-fragmentation rules
  - Modifications to the definition of PE to prevent artificial arrangements through certain conclusion of contracts and correlative update to the transfer pricing guidelines
  - Countries ought to apply principles of OECD's international value added tax / goods and services tax (VAT/GST) and introduce tax collection mechanisms
  - Future work in the area of AP 1 to be conducted in consultation with a broad range of stakeholders

A supplementary report reflecting the outcome of continued work on the overall taxation of the digital economy should be released by 2020 – as per the OECD's interim Report on 16 March 2018 and Action Plan 1 policy note on 23<sup>rd</sup> January 2019

# Action plan 1 – India experience – Equalisation levy

In order to address the challenges in taxation of such digital transactions, India introduced a new levy called 'Equalization Levy' at the rate of 6% on gross consideration payable for a specified service.

## Applicability

- The levy will be applicable on the payments received by a non-resident service provider from an Indian resident or an Indian Permanent Establishment ('PE') of a nonresident, in respect of the specified service. The levy is currently applicable only on B2B transactions, if the aggregate value of consideration in a year exceeds INR 100,000.
- Specified Service includes:
  - 1) Online advertisement;
  - 2) Any provision for digital advertising space or facilities/ service for the purpose of online advertisement
  - 3) Any other service which may be notified later.

## Other considerations

- Commercial aspect such as who will bear the cost of this levy
- Practical challenges in deducting equalization levy while making payments online even if parties agree to deduction of equalization levy
- Recipient of income may not be able to claim credit of such levy in the home country

# Action plan 1 – India experience – Significant Economic presence

In order to address the challenges in taxation of such digital transactions, India also recently introduced the concept of Significant Economic Presence within the already broadened business connection definition under the Act.

## Applicability

Presently, the Act provides for **physical presence** based taxation of business income of NRs. To tackle AP1 concerns, 'Business Connection' to include 'Significant Economic Presence', which is defined as:

- Any transaction in respect of any goods, services or property carried out by a NR in India, including provision of download of data or software in India, if aggregate of payments arising from such transaction(s) during the year exceeds a prescribed amount
- Systematic and continuous soliciting of business activities or engaging in interaction with prescribed number of users in India through digital means

## Other considerations

Only income as **attributable** to such transactions/ activities shall be deemed to accrue or arise in India

Unless treaty provisions are amended, existing treaty protection should prevail

# SEP – certain food for thought

**1**

Connotation / ambit of the phrase “carried out in India” in the context of non-resident’s business

**2**

Doing business “in” India vs. Doing business “with” India & source taxation for non-technical services

**3**

Can payments for download of data or software be treated as “royalty”?

**4**

Connotation of the term “solicitation” and “interaction”

**5**

How will data on SEP be collected and how will value creation be determined from the data gathered through user interactions, network effects and user generated content

Since global consensus on issues above and beyond shall take time, what’s the fate of Indian litigation landscape – shall India be able to adopt a pragmatic approach?

# Action plan 7 - Preventing the artificial avoidance of PE status

Review of definition of PE

## Artificial avoidance of PE through specific activity exemptions

- (i) Exclusions in Article 5(4)
- (ii) Anti-fragmentation rule

## Artificial avoidance of PE through Commissionaire arrangements and similar strategies

## Modified agency PE rule

## Splitting up of contracts to meet PE time thresholds

# Action plan 7 - Preventing the artificial avoidance of PE status – specific activity exemption

## Key amendments

### Existing Article 5(4)

Activities mentioned at sub-paras (a) to (d) are not subject to the condition that activities should be preparatory or auxiliary

All activities listed under Article 5(4) would need to be 'preparatory and auxiliary' in nature to qualify for exemption under Article 5(4)

**Preparatory activity – An activity carried out in contemplation of carrying on an essential and significant part of activity of enterprise as a whole**

**Auxiliary activity – Activity carried on to support without being part of the essential and significant part of activity of enterprise as a whole**



# Action plan 7 - Preventing the artificial avoidance of PE status – anti-fragmentation rule

- No remedy was available in existing Article 5 read with OECD Commentary to deal with cases where complementary functions were segregated among various related enterprises such that each place of business in isolation appeared to perform 'preparatory and auxiliary activities'.
- Where an enterprise maintains separate fixed places of business carrying out 'preparatory and auxiliary activities' which are separate 'organisationally and locationally' each place of business is to be viewed separately to decide if PE exists.
- Places of business are not "separated organisationally" where they each perform in a contracting state complementary functions (viz. receiving and storing goods in one place, distributing those goods through another etc.)

## **New Para 4.1 proposed to be inserted in Article 5 through BEPS**

**To prevent an enterprise or a group of closely related enterprises from fragmenting a cohesive business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.**

**Under paragraph 4.1, the exceptions provided in paragraph 4 do not apply.**

# Action plan 7 - Preventing the artificial avoidance of PE status – Modified agency PE rule

## Article 5(5)

Agency PE is created under Article 5(5) if a person acting in a Contracting state on behalf of an enterprise either:

-habitually concludes contracts, **or**

**-Habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise (*emphasis supplied*)**

-Contract for provision of services and for the transfer of the ownership of, or for the granting of the right to use, property owned by an enterprise or that the enterprise has the right to use have been included under Article 5(5) **in addition to** contracts entered into by the agent in the name of the enterprise. (*emphasis supplied*)

**Agent with contract concluding authority has been expanded to cover an agent who concludes contracts or habitually plays the principal role in concluding contracts.**

**India modified the definition of “dependent agent” for the purpose of “business connection” for non-residents under Explanation 2 to section 9(1) of the Income Tax Act 1961**

# Action plan 13 – Three tier transfer pricing documentation – enhancing transparency & disclosure

## Master File

MNEs are required to provide the tax administration with high level information regarding their global business operations and transfer pricing policies

## Country-by-Country Report

The CbC report sets out for each jurisdiction, specified data pertaining to revenue, income, taxes, number of employees, capital and tangible assets

## Local File

MNEs are required to maintain a detailed transactional transfer pricing documentation specific to each country and company's transfer pricing determination

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These three together will warrant taxpayers to articulate consistent policies and positions and will provide tax administrations with useful information to assess BEPS risks

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# **BEPS Action Plans and recent updates to the Model conventions**

## **The 2017 OECD MC update mainly reflects a consolidation of the treaty-related measures resulting from the work on:**

- BEPS Action 2 (Neutralising the effects of hybrid mismatch arrangements)
- BEPS Action 6 (Preventing the granting of treaty benefits in inappropriate circumstances)
- BEPS Action 7 (Preventing the Artificial avoidance of permanent establishment status)
- BEPS Action 14 (Making dispute resolution more effective)

## **The 2017 UN MC update reflects the following:**

- A modified title of the Convention and a new preamble of the Convention emphasizing that treaties should not create opportunities for tax avoidance or evasion, including through treaty shopping;
- A modified version of Article 5 to prevent the avoidance of permanent establishment status;
- A new Article 29 that contains provisions relating to entitlement to treaty benefits. These include a limitation on benefits rule, a third state permanent establishment rule and a general anti-abuse rule.

# **Other country developments to tackle digital economy taxation**

# Country developments (1/2)

## INDIA

In lines with the recommendation of BEPS Action Plan 1, Finance Act, 2016 has introduced the concept "equalisation levy" effective from June 1, 2016.

## NEW ZEALAND

GST at 15 percent on supply of digital services.

## ARGENTINA

Introduced a turnover tax withholding system for revenues derived by non-residents from rendition of online services, wherein 3 percent of the net price is to be withheld at the time of remitting funds abroad.

## UNITED KINGDOM

- Diverted profit tax on multinationals who conduct business in UK but pay miniscule tax thereby seeks to counter artificial avoidance of PE and lack of economic substance
- Proposes to introduce withhold tax on digital business- at public consultation stage.

## CHINA

Proposed consumption tax on import of retail goods through e-commerce. Presently postponed.

## RUSSIA

Introduced new VAT law to tax digital transactions at 18 percent from January 1, 2017. Applies to all foreign businesses selling digital products to Russia-based consumers, without any registration threshold.

# Country developments (2/2)

## AUSTRALIA

- GST at 10 percent applicable on supply of digital services.
- Introduced “Multinational Anti-Avoidance Law” in lines with UK’s DPT- (a) to tax transactions that make sales in Australia but book that revenue offshore and (b) CbCR reporting.

## JAPAN

- Japan’s ‘consumption tax’ levied at 8 percent on digital services provided by foreign enterprises.
- Japan Court considers E-commerce activities to constitute PE and endorsing BEPS Action Plan 7.

## ITALY

Proposed ‘digital or web tax’ applying withholding tax of 25 percent for payments by financial institutions to foreign e-commerce provider, or in case foreign e-commerce provider identified to have a hidden ‘virtual PE’. Concept of ‘virtual PE’ introduced.

## EUROPEAN UNION

France, Germany, Italy and Spain introduced a statement urging European UN to implement ‘equalization tax’ on turnover generated by digital companies in Europe.

**Countries are opting for methods such as levies, consumption taxes or deemed attribution for taxing digital economy rather than formulating new nexus rules.**

# **Taxation of certain digital transactions in India**



# Characterization of e-commerce transactions

Three aspects of digitization are important when considering the problem of characterization

<b>Rights could vary</b>	<ul style="list-style-type: none"><li>▪ Right to use single copy</li><li>▪ Right to reproduce several copies for internal use or for mass circulation</li></ul>
<b>Perfect duplication</b>	<ul style="list-style-type: none"><li>▪ Purchase of 10 books could be replaced by buying 1 and making 9 copies – royalty or substitute of buying 10 books?</li><li>▪ Should physical books and ebooks be treated in the same manner assuming they are considered functional equivalents? If not, different characterizations are possible</li></ul>
<b>Delivery in intangible manner</b>	<ul style="list-style-type: none"><li>▪ For example, two television companies A &amp; B are interested in airing a live performance of artist X. If A pays X for live broadcasting and B pays A to buy the recorded performance and broadcast it in a month, are the economic nature of two transactions different?</li></ul>

# Characterization of specific transactions (1/2)

## Online Advertising

- Payment not in the nature of royalty or FTS
- Appeal of Revenue admitted in High Courts

*Negative finding in Google India (Bangalore Tribunal)*

*Right Florist Pvt Ltd (Kolkata Tribunal); Yahoo India Pvt Ltd and Pinstorm Technologies Pvt Ltd (Mumbai Tribunal)*

## Website Hosting

- Payment by Indian website operator to a non-resident for hosting and running its matrimonial site (shaadi.com) on the latter's server
- Indian payer only had remote access to the server
- Payments held not to be in the nature of royalty

*People Interactive India Pvt Ltd (Mumbai Tribunal)*

## Domain registration

- Domain name is valuable commercial right – similar to trademark
- Services in connection with registration of domain name ~ services in relation to intangible property and hence payments therefor is royalty

*Go Daddy LLC (Delhi Tribunal)*

# Characterization of specific transactions (2/2)

## Online Database Subscription

- Non-resident taxpayer provided access to its database stored on servers outside India
- Distinction between standard data and tailor made data provided
- Mixed view by courts

*Negative findings in ONGC Videsh Ltd (Delhi Tribunal); ThoughtBuzz Pvt Ltd (AAR); Gartner Ireland (Mumbai Tribunal); Wipro Ltd (Karnataka High Court); Cross Tab Marketing (Bangalore Tribunal)*

*Positive finding in Dun & Bradstreet (AAR); Factset Research Systems Inc (AAR)*

## E-learning

- Non-resident taxpayer providing on demand e-learning courses, online information resources, flexible learning technologies and performance support solutions – taxpayer had developed copyrighted products stored on servers outside India
- Distinction between copyright vs copyrighted article considered “illusory” - Held to be royalty

*SkillSoft Ireland Limited (AAR)*

## Data link charges

- Payment of data link charges by software company to various telecom service providers for use of it's network element does not involve any human intervention
- The limited human intervention as required is in relation to maintenance purposes
- Hence the above payments are not in the nature of FTS

*igate Computer Systems (Pune Tribunal)*

# Typical cloud based delivery models

## SaaS



Web access to commercial software

Users are provided licenses to applications

## PaaS



Platform for creation of software

Deployment of customer applications

## IaaS



Storage

Computing resources

### Aspects for consideration:

- Whether there is a taxable presence / PE ?
- Classification of payments

**Parting thoughts**

# Parting thoughts

**1**

Scientific innovation will continue to push the digital frontier

**2**

Cross jurisdictional scale without mass, reliance on intangible assets including IP and data user participation and their synergies with IP will continue to be common characteristics of digital businesses

**3**

Emergence of new business models led to transformation of old ones and have placed pressure on the basic concepts underlying existing international tax laws which were framed century ago

**4**

OECDs BEPS project provided substantial renovation of international tax rules underpinned by the principle that the location of taxable profits should be aligned with the location of economic activities / value creation

**5**

Lack of consensus on whether and to what extent to which data and user participation represent contribution to value creation by the enterprise might lead to more unilateral steps by sovereign states

**In depth understanding of the emerging technologies and nuances of digitalized businesses key to determine economic value creation and the place and identity of value creator for better alignment of the international tax rules**

# Questions



# Thank You





**Annexure**

**Certain key relevant  
elements of corporate tax  
and transfer pricing  
provisions impacting digital  
economy including relevant  
BEPS reforms**

# Non-resident taxation – basic charging provisions

## Sec. 5

Income received or deemed to be received in India

Income accrued or deemed to be accrued in India

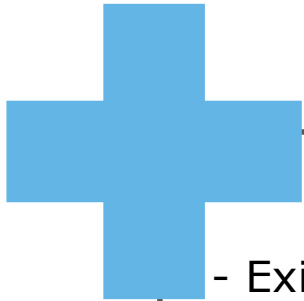
## Sec.9

Business connection in India

Income by way Interest, royalty and technical fees

Source Rule of Taxation

# Business connection in India



- Existence of business operations in India on a regular basis

- Business operations so carried out are related to the business carried on by the NR outside India

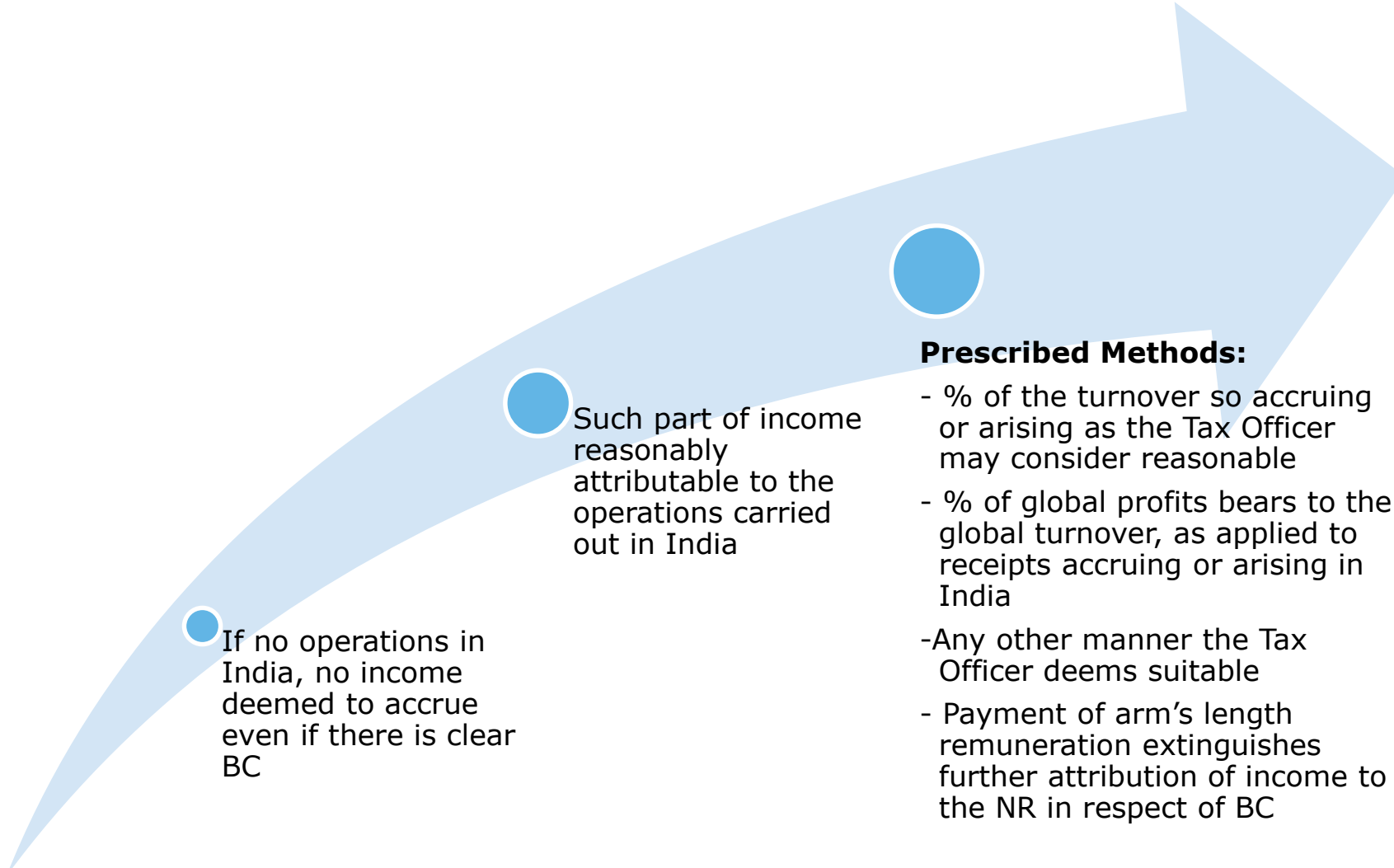
- Business operations so carried contributed to the earning of profits or gains of such business

- Major part of NR's goods are sold in India either directly or through agents

- Raw Material required by NR is sourced from India

- Rendition of services outside to a person carrying on business in India

# Attribution based on business connection in India



• If no operations in India, no income deemed to accrue even if there is clear BC

• Such part of income reasonably attributable to the operations carried out in India

## **Prescribed Methods:**

- % of the turnover so accruing or arising as the Tax Officer may consider reasonable
- % of global profits bears to the global turnover, as applied to receipts accruing or arising in India
- Any other manner the Tax Officer deems suitable
- Payment of arm's length remuneration extinguishes further attribution of income to the NR in respect of BC

# Section 9(1)(vi) – “Royalty”

- Consideration paid for –
- (a) includes lump sum payments
  - (b) excludes income chargeable as capital gains
  - (c) includes services in relation to any of the following

Transfer of all or any rights (including the granting of a license)

Imparting of any information concerning the working of, or the use

Use

Imparting of any information concerning

Use or right to use

The transfer of all or any rights (including the granting of a license)

Patent, invention, model, design, secret formula or process or trademark or similar property

Technical, industrial, commercial or scientific knowledge, experience or skill

Any industrial, commercial or scientific equipment

Copyright, literary, artistic or scientific work

# Section 9(1)(vi) – “Royalty” re-defined

Finance Act 2012 inserted following explanations with retrospective effect from April 1, 1976:

- Transfer of all or any rights in respect of any right, property or information, ***includes and has always included*** transfer of ***all or any*** right to use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred. ***[Explanation 4]***
- Royalty shall include consideration in respect of any right, property or information whether or not such right, property or information (a) is under the control of the payer, (b) is used by the payer, (c) is located in India. ***[Explanation 5]***
- The expression “**process**” **includes and shall be deemed to have always included transmission by satellite** (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret. ***[Explanation 6]***

**For the purpose of disallowance u/s 40a(ia),  
the above explanations seeking to expand the  
definition of royalty not applicable – Sonata  
Information Technology Ltd. [25 Taxman.com**

**125]**

# Section 9(1)(vii) - Fees for Technical Services (FTS) – territorial nexus saga continues

- Explanation 2 to section 9(1)(vii) of the Act defines “fees for technical services” to mean any consideration (including any lump sum consideration) for the:
  - **Rendering of any managerial, technical or consultancy services** (including the provision of services of technical or other personnel)
  - **but does not include consideration for -**
    - any construction, assembly, mining or like project undertaken by the recipient or
    - consideration which would be income of the recipient chargeable under the head “ Salaries”
- With the new explanation to section 9, the requirement of residence or place of business for rendering services in India has become irrelevant
- Even if no service is rendered in India the amount received by a non-resident could still be taxable attracting the deeming fiction of section 9



# Sections 9(1)(vii) – FTS source rule

## FTS income payable by Government of India

- Income deemed to accrue or arise and thereby taxable in India

## FTS income payable by a resident person

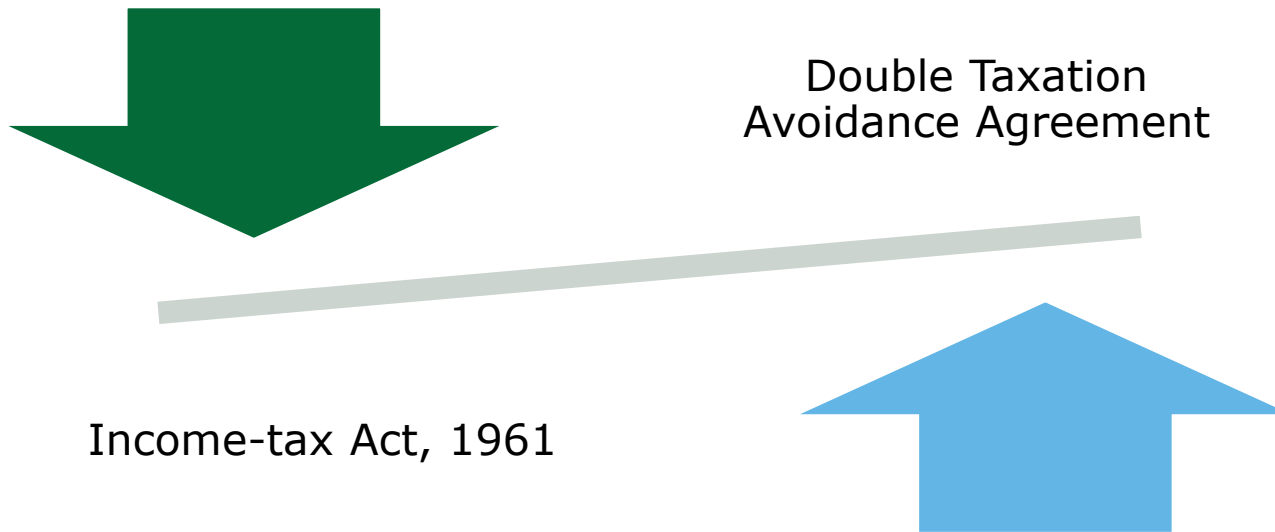
- Income deemed to accrue or arise and thereby taxable in India except Fees towards services utilized in respect of business or profession carried on / earning any income from any source outside India by such resident

## FTS income payable by a non resident person

- Income deemed to accrue or arise and thereby taxable in India in respect of Fees towards services utilized in respect of business or profession carried on / earning any income from any source in India by such non-resident

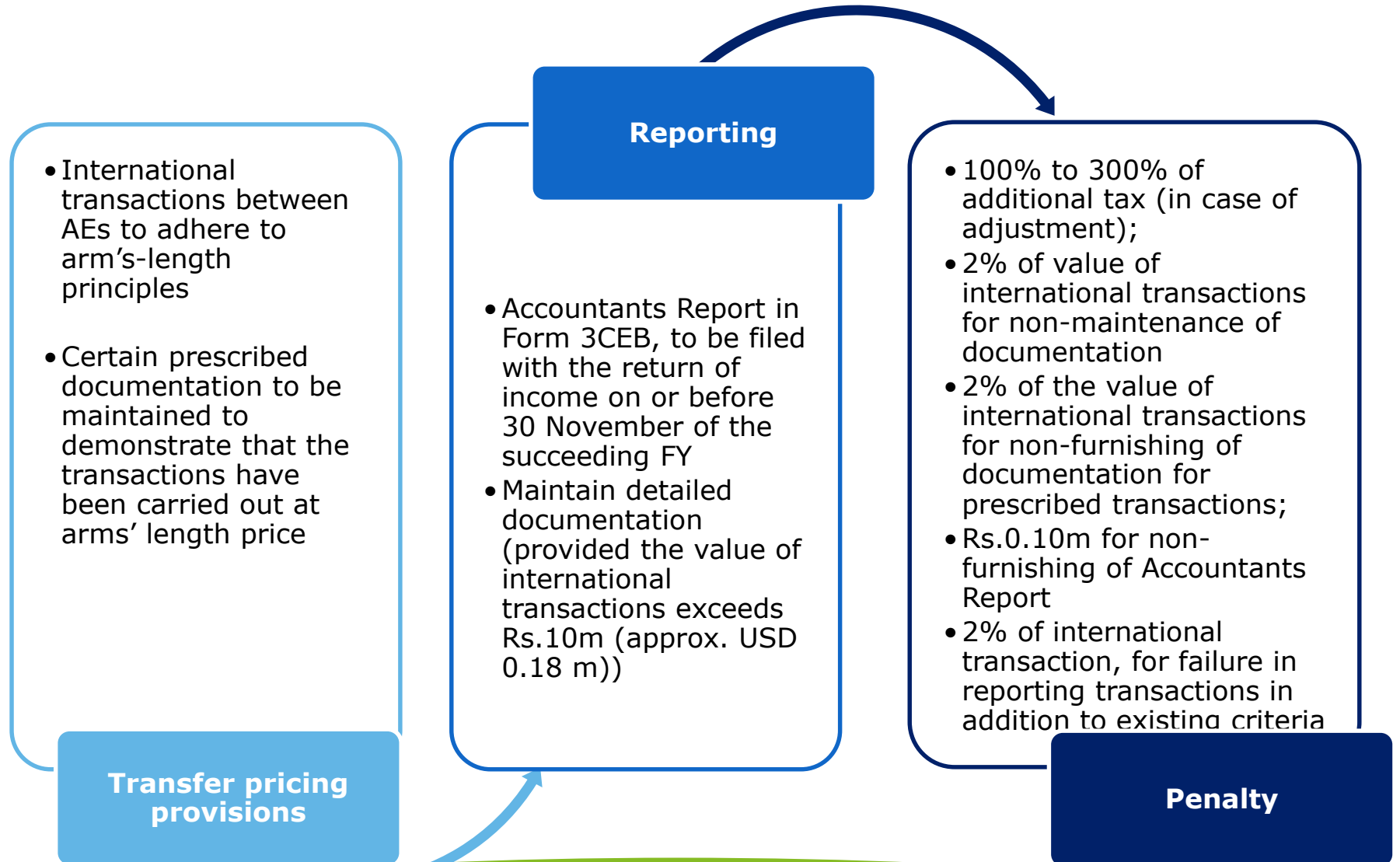
# Double tax avoidance agreements (DTAAs)

- As per the provisions of the ITA, where India has entered into a DTAA with any other country, the provisions of the DTAA or ITA, whichever are more beneficial to the tax payer shall apply
- A tax payer can avail the beneficial provisions of the DTAA only if it possesses the following documents:
  - Tax Residency Certificate (TRC)
  - Form 10F (self-declaration in the specified format)



# **Transfer pricing provisions**

# Transfer Pricing provisions



Advance Pricing Agreement have evolved to be an effective alternative towards certainty and substantial reduction in transfer pricing induced litigation cost

# Action plan 13 – Three tier transfer pricing documentation – Country by Country (CbC) Report

**Table 1: Information included in CbC**

Revenues (related, unrelated, total)	Profit/loss before income tax
Income tax paid (cash)	Income tax accrued
Stated capital	Accumulated earnings
Number of employees	Tangible assets other than cash and cash equivalents

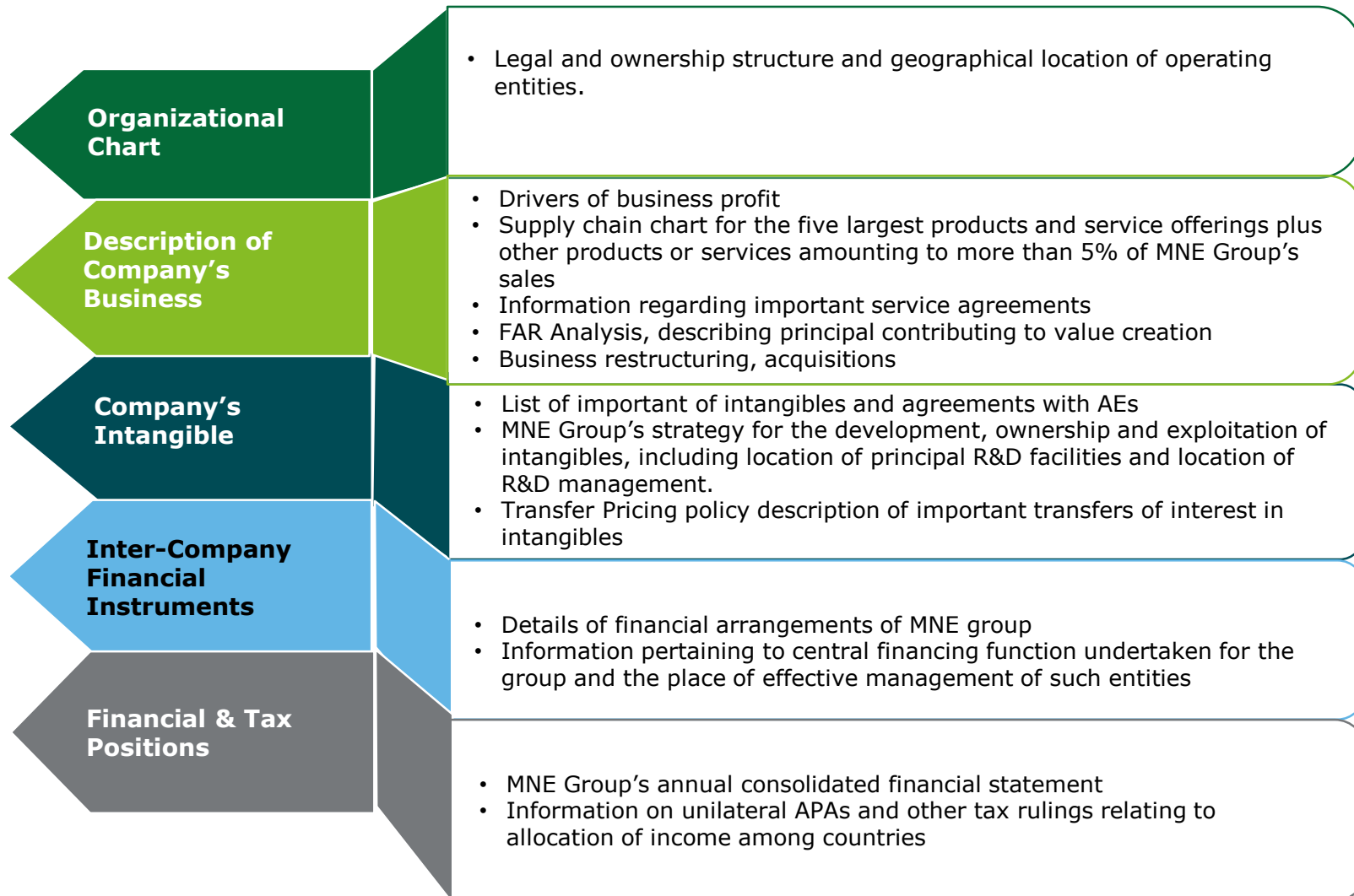
**Table 2: Information included in CbC – for each tax jurisdiction**

Tax Jurisdiction of organization or incorporation if different
Main business activity of each of the entity
<p><b>Main business activity(ies)</b></p> <ul style="list-style-type: none"> <li>• Research and development</li> <li>• Holding or managing intellectual property</li> <li>• Purchasing or procurement, Manufacturing or production</li> <li>• Sales, marketing or distribution</li> <li>• Provision of services to unrelated parties</li> <li>• Internal financial services</li> <li>• Holding shares or equity instruments, Dormant, Others</li> </ul>

**Table 3:**

To include any further brief information or explanation that taxpayer may consider necessary or that would facilitate the understanding of the compulsory information provided in the CbC Report.

# Action plan 13 – Three tier transfer pricing documentation – Master file contents



# Action plan 13 – Three tier transfer pricing documentation – Documentation requirements in India



## Master file

- Finance Act 2017 has introduced the concept to maintain Master File
- Penalty for non-furnishing of prescribed information and document is ₹ 500,000
- No threshold prescribed as yet, Master File requirements in India may be independent of CbC reporting requirement



## CbC Reporting

Requirements	Threshold	Timeline	Penalty
<ul style="list-style-type: none"> <li>• Filing CbC report in India or notification of parent entity</li> <li>• Effective from Financial Year 2016-17</li> </ul>	<ul style="list-style-type: none"> <li>• MNE group having consolidated revenue exceeding € 750 million (in line with BEPS)</li> <li>• Threshold in Indian currency – to be computed based on exchange rate as on the last day of previous year. E.g. threshold for FY 2016-17 - ₹5,562 crores</li> </ul>	<ul style="list-style-type: none"> <li>• CbC report to be filed in prescribed format on or before due date of filing return of income i.e. 30 November following the end of the Financial Year</li> </ul>	<p>Graded penalty structure from ₹ 5,000 to ₹ 50,000 per day for:</p> <ul style="list-style-type: none"> <li>• Non-furnishing of CbC report</li> <li>• Non- submission of required information</li> </ul> <p>Penalty of ₹ 500,000 for:</p> <ul style="list-style-type: none"> <li>• Furnishing of inaccurate particulars</li> <li>• Non-furnishing of master file data</li> </ul>



## Local file

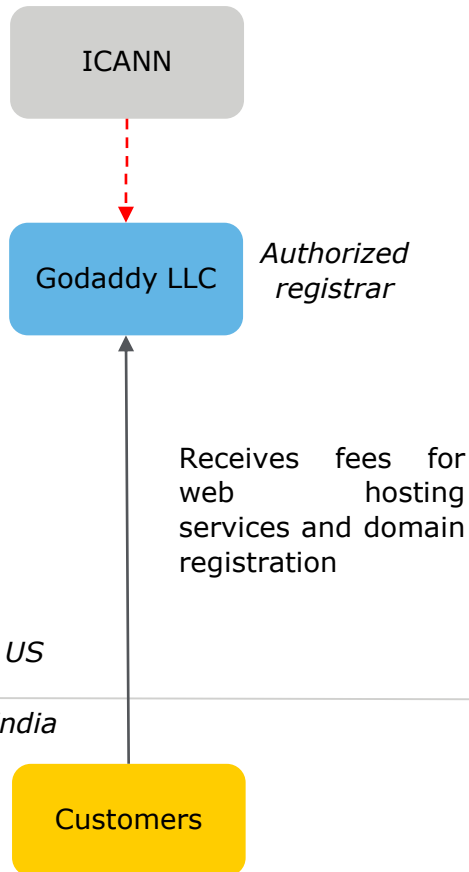
- Existing local transfer pricing documentation requirements retained
- Possibility of further alignment with BEPS Action 13 resulting in additional disclosures

# **Certain Indian key judicial precedents**



# Godaddy.com LLC [2018] 92 taxmann.com 241 (Delhi - Trib.)

## - Facts



- Godaddy.com LLC ('Godaddy') is a limited liability company located in USA
- Internet Corporation for Assigned Names and Numbers ('ICANN') has authorized Godaddy as accredited domain name registrar
- Godaddy receives two streams of income from Indian customers – Web hosting charges & Domain registration fees
- Domain name registration involves the following factual pattern:
  - Checking the availability of desired domain name with ICANN
  - ICANN assigns unique IP address for the domain name
  - Maintaining a record of all the domain names and their IP address
  - No human intervention for registration
  - No employees visit India / no presence in India
- Godaddy filed its return in India offering the web hosting service fee as royalty. However, the Assessing Officer assessed the same as fees for technical services which is affirmed by learned DRP
- Income from domain registration fees was claimed to be not taxable in India. However, the Assessing Officer assessed the same as income from royalty.

## Issues:

**Whether rendering of services for domain registration can be termed as Royalty?**

# Godaddy.com LLC [2018] 92 taxmann.com 241 (Delhi - Trib.)

- The Tribunal relied on the following judicial precedence:
  - **Satyam Infoway Ltd. (SC)**

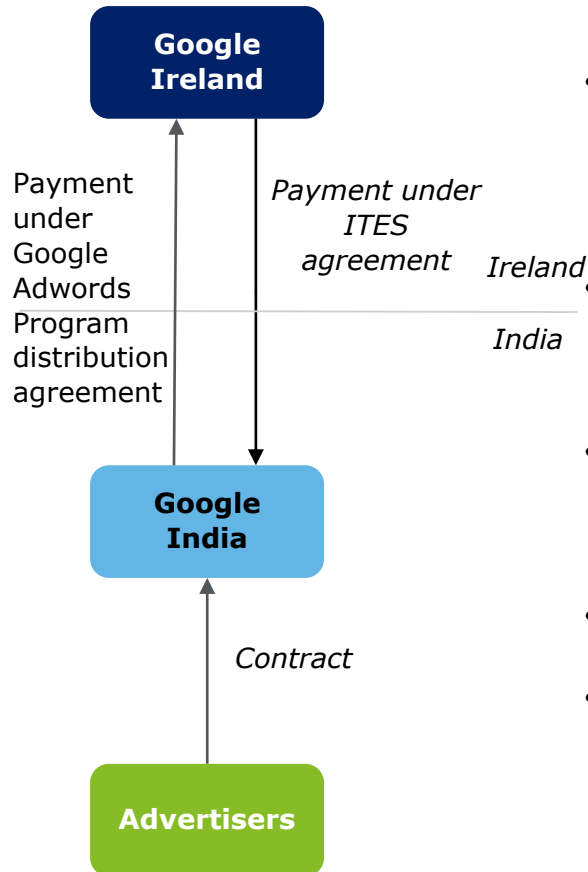
Domain name is a valuable commercial right and it has all the characteristics of a trademark. Domain names are subject to legal norms applicable to trademark.
  - **Rediff Communications Ltd. (Bom. HC)**

Domain names are of importance and can be a valuable corporate asset and such domain name is more than an internet address and is entitled to protection equal to a trademark.
  - **Tata Sons Limited (Del HC)**

Domain names are entitled to protection as a trademark because they are more than an address
- The Tribunal followed the above decisions and held that the rendering of services for domain registration is rendering of services in connection with the use of an intangible property which is similar to trademark
- Hence, the Tribunal held that the charges received by Godaddy for services rendered in respect of domain name is royalty within the meaning of Clause (vi) read with Clause (iii) of Explanation 2 to Section 9(1) of Income-tax Act, 1961

# Google India Pvt Ltd [2018] 93 taxmann.com 183 (Beng – Trib)

## - Facts



- Google India was engaged in IT and IT enabled service (ITES) to its overseas companies
- Google India had been appointed by Google Ireland Ltd. ["GIL"] as a non-exclusive authorized distributor of "Adwords Program" pursuant to a Distribution Agreement entered into in Dec 2005 for sale of advertisement space in India
- Google India was granted the marketing and distribution rights of Adword program to the advertisers in India. It had also signed a service agreement with Google Ireland
- During FY 2007-08, Google India credited distribution fee as per the aforesaid agreement of Rs. 119 crores to GIL, without deducting tax at source
- Proceedings were initiated against Google India under section 201
- Separately, Google India had also entered into an ITES agreement with GIL in 2004 for ad review and other services for which fees are paid to Google India.

## Issues:

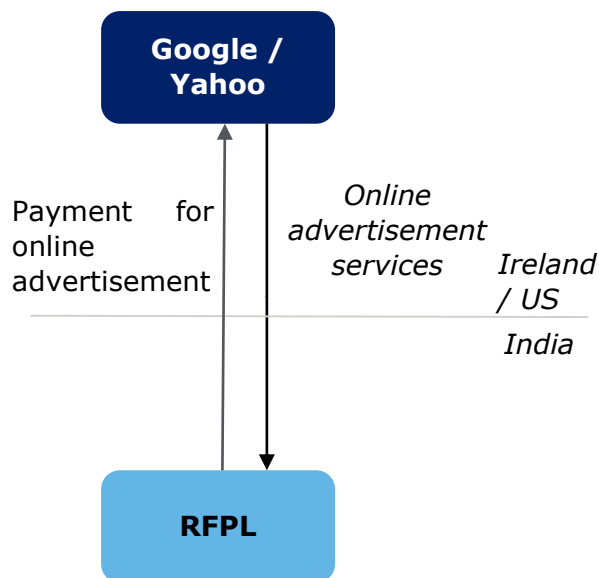
**Characterisation of amount payable by Google India to Google Ireland under the distributorship agreement**

# Google India Pvt Ltd [2018] 93 taxmann.com 183 (Beng – Trib)

- The distributorship agreement is not merely an agreement to provide advertisement space but is an agreement that uses Google's user database as well the content of more than 2 million websites to provide a targeted marketing facility
- The IP of Google vests in the search engine, technology, associated software and other features ~ Use of these tools for performing various activities, including accepting advertisements, providing before / after sales services, falls within the ambit of royalty.
- The entire Adwords program works around customer data. Therefore assessee's argument that it was using customer data only for ITES agreement is not correct
- Use of trademarks and brand features of GIL by Google India as a marketing tool for promoting and advertising the advertisement space, which is the main activity of Google India
- The process employed by the Google Adwords program is not in public domain and is therefore a secret process
- The Tribunal did not give any finding on the assessee's contention that the definition of 'royalty' under the tax treaty is narrower than the domestic tax law
- Both the agreements – Adword program and service agreement were interconnected and was observed that Google India was appointed as a distributor with certain obligations that could not be fulfilled without having access to technical know-how, trademark, derivative works, brand features, etc., of the GIL. Thus, the nature of payments were royalty and tax was ought to be withheld
- Further, it was pointed out that equalization levy is only charged on consideration for specified services and not for the services provided w.r.t use of IPR, copyright, etc.

# Right Florist (P.) Ltd [2013] 32 taxmann.com 99 (Kolkata - Trib.)

## - Facts



- Right Florists (P.) Ltd. ('RFPL') is a florist having franchises across India. It also advertises on search engines like Google and Yahoo to generate business
- RFPL made payments to Overture Services Inc. USA ('Yahoo') and Google Ireland Limited ('Google') in respect of online advertisement
- Advertising is done in the result generated by the search results against agreed key words or by placing the advertising banners on websites
- No taxes were withheld at source from the payments made to Yahoo and Google
- Assessing Officer, relying on the Supreme Court decision of Transmission Corporation of India (239 ITR 587), held that RFPL ought to have approached the assessing officer under section 195 prior to making the foreign remittance and thus, disallowed the amount under section 40(a)(i)
- CIT(A) deleted the disallowance on the basis that as Yahoo and Google did not have any PE in India, no portion of payments made to these non-resident companies was taxable in India and therefore, RFPL was not under an obligation to deduct TDS under section 195

## Issues:

**Whether payments made to the non-resident entities would attract withholding tax and therefore non-deduction of TDS would result into disallowance u/s 40a(ia)?**

# Right Florist (P.) Ltd [2013] 32 taxmann.com 99 (Kolkata - Trib.)

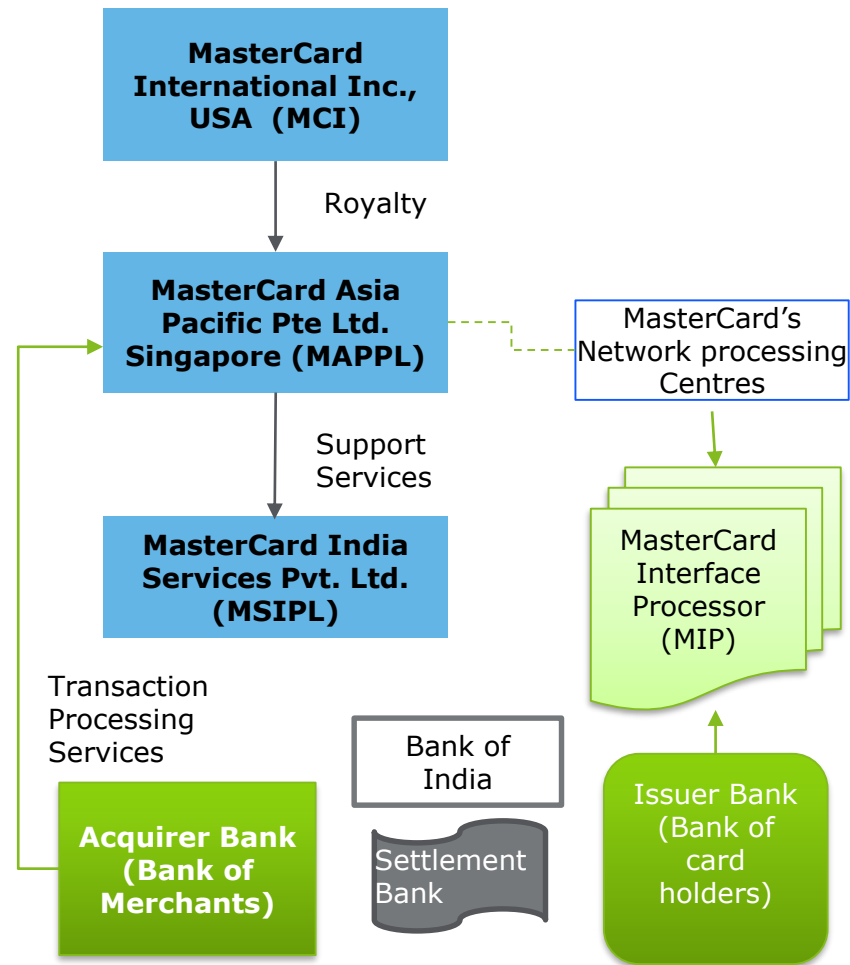
- Online Advertisement Services rendered by Google is generation of certain text on the search engine result page which is a wholly automated process
- The Tribunal held that for the reason that there is no human touch involved in the whole process of actual advertising service in the light of the legal position that any services rendered without human touch, even if it be a technical service, it cannot be covered by the limited scope of section 9(1)(vii). Thus, the receipts for online advertisement by the search engines cannot be treated as fees for technical services taxable as income, under the provisions of the Act
- For the services provided by Yahoo, US, it was held that since the services were not making available any technical know-how, knowledge, etc. as there is no transfer of any technology of any kind, it was held that the payments made were not in the nature of fees for technical services
- Further, the Tribunal held that Conventional PE tests fail as search engine has got presence only on the internet or by way of website, which is not a form of physical presence. Consequently, presence of Google and Yahoo in India through website could not be said to constitute fixed place PE in India
- Tribunal relied on the Mumbai Tribunal decisions of Pinstorm Technologies Pvt. Ltd. (24 taxmann.com 345) and Yahoo India (P.) Ltd. (11 taxmann.com 431) and held that payments for advertising services cannot be treated as 'Royalty' as it does not involve use or right to use by the client of any industrial, commercial or scientific equipments and uploading the advertisement was entirely the responsibility of the advertiser and client had no right to access the portal of the advertiser
- Accordingly, the Tribunal held that RFPL did not have any obligation to withhold tax from the payments made to Google and Yahoo

# MasterCard Asia Pacific Pte. Ltd., In re. [2018]

## 94 taxmann.com 195 (AAR - New Delhi)

### - Facts

- Mastercard Asia Pacific Pte. Ltd. ('MAPPL') belongs to the Mastercard group
- MAPPL enters into a Master License Agreement (MLA) with various customers in the Asia-Pacific region, including India. These customers are mainly banks and other financial institutions
- Customer is provided with a MasterCard Interface Processor ('MIP') that connects to Mastercard's Network and processing center.
- MIPs are owned by Mastercard India Services Private Limited ('MISPL')
- Main business of MAPPL includes authorization, clearance and settlement of transactions between its customers for which it charges fees
- It also receives fees in the form of assessment fees for building & maintaining a processing network, fees for setting up of clearing and settlement process, warning bulletin fees for listing invalid or fraudulent account, account and transaction enhancement services, fees for holograms and publications



# **MasterCard Asia Pacific Pte. Ltd., In re. [2018] 94 taxmann.com 195 (AAR - New Delhi)**

## **- Issues**

- Whether MAPL had a PE in India under the provisions of India Singapore tax treaty in respect of services to be rendered with regard to use of global network and infrastructure to process card payment transaction to customers in India?
- Without prejudice to the above, where a PE of MAPL was found to exist in India, whether the provision of arm's length price to such PE for activities performed in India would absolve any further attribution of global profits of MAPL in India?
- Whether fees to be received by MAPL from customers would be chargeable to tax in India as royalty or fees for technical services within the meaning of Article 12 of India Singapore tax treaty?
- Whether any tax withholding would be required on the amounts to be received by MAPL?



# MasterCard Asia Pacific Pte. Ltd., In re. [2018] 94 taxmann.com 195 (AAR - New Delhi)

## - AAR Ruling

- **Fixed place PE on account of MIP**
- MIPs constitute a fixed place since there is no condition of attachment on ground
- Permanency test is also satisfied since MIPs were on the premises of customer banks throughout the year
- Nature of activities performed by MIPs is significant and cannot be categorized as preparatory and auxiliary
- MIPs are controlled by MAPPL and is thus, at the disposal of MAPPL.
- The software inside MIPs is also owned by MAPPL and is upgraded by the third parties on behalf of MAPPL
- Thus, MIPs create a fixed place PE for MAPPL in India
- **Fixed place PE on account of Mastercard Network**
- Mastercard network in India consist of MIPs owned by MISPL, transmission tower, leased lines, fiber optic cable, nodes and internet – owned by third party service provider and application software owned by MAPPL
- Network passes the permanence and fixed place test as also the disposal test
- Hence the Mastercard Network also creates a fixed place PE for MAPPL in India

# MasterCard Asia Pacific Pte. Ltd., In re. [2018] 94 taxmann.com 195 (AAR - New Delhi)

- AAR Ruling

## Fixed Place PE

- MAPPL has a fixed place PE in India because of the presence of MIPs
- The MasterCard network constitutes a fixed place PE for MAPPL in India
- The premises of Bank of India constitute a fixed place PE for MAPPL in India
- MISPL (i.e. the Indian subsidiary) constitutes a PE for MAPPL in India

## Service PE

- Employees of MAPPL visiting India to provide services constitute a services to Indian clients would constitute a PE in India, once their stay in India exceeds the threshold of 90 days
- Activities performed by Bank of India's employees do not result in the formation of a Service PE

## Dependent Agent PE (DAPE)

- MISPL constitutes a DAPE of MAPPL in India on account of habitually securing orders wholly for MAPPL

## Income classification

- A portion of the fees received by MAPPL would be classified as 'royalty' under the Treaty. Since such incomes effectively connected with PE the same would be taxed in terms of provisions of Article 7 and not Article 12