

# E-Commerce – structures & tax issues

A person wearing a light blue shirt is sitting at a table, using a tablet computer. They are holding a credit card in their left hand. On the table, there is a white cup of coffee on a saucer with a spoon and a sugar packet. The background is blurred, showing a white chair.

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WIRC, Mumbai

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Traditional commerce

E- commerce and related tax considerations

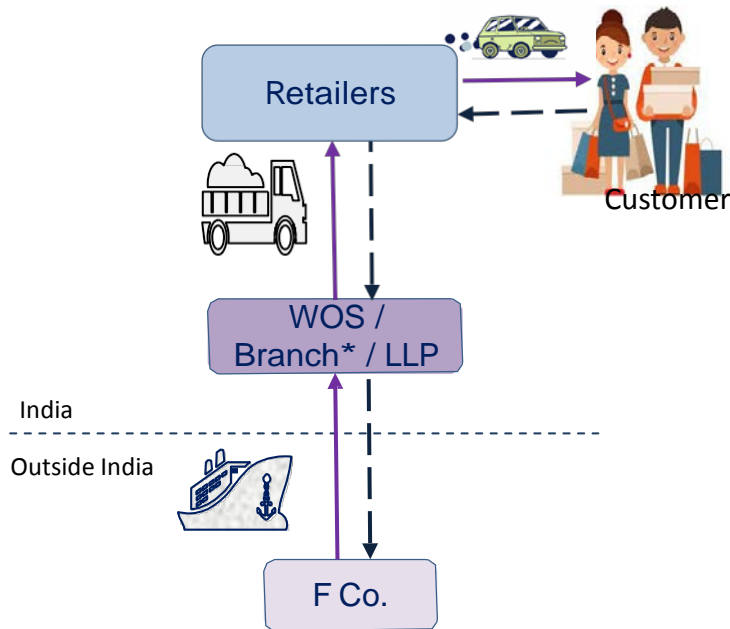
Recent amendments under the Income-tax Act, 1961

Case studies

Next steps

Traditional commerce

# Traditional concept of commerce



- Physical movement of products
- -→ Payment for the product

## Mechanics

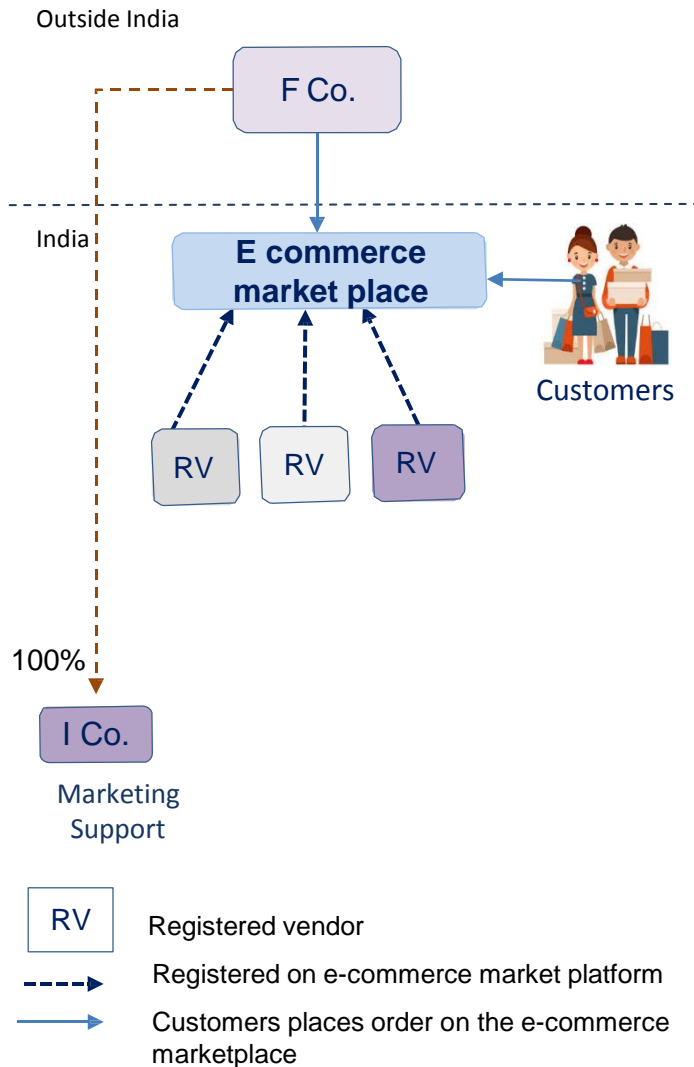
- F co. intends to sell smartphones (i.e. goods) in India
- For this purpose, F Co. incorporates WOS/LLP/Branch
- WOS/LLP/ Branch in turns sells goods to retailers at an x price
- Customer buy goods from retailers at x+y price

Retailers and WOS / branch / LLP by virtue of its **physical presence** in India pays tax on the net profit

\* Permitted activity for a branch office in India of a person resident outside India

# E-commerce and related tax considerations

# Concept of e-commerce



## Mechanics

- F Co. has E-commerce market place in India;
- Vendors get registered on the market place for selling their products to customers;
- Customers browse through products and place order online and have the option of either paying cash on delivery or online
- I Co. is a wholly owned subsidiary of F Co. which carries out the marketing support functions for F Co.
- While I Co is remunerated at cost plus appropriate markup, F Co. earns commission income from vendors registered on its platform

What are the tax issues associated with e-commerce?



# Tax considerations in e-commerce

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## Corporate tax

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- Characterization of income
- Business connection
- Deductibility of discounts
- Situs of intangibles
- Carry forward of losses
- Withholding tax
- Permanent Establishment exposure under BEPS r.w. MLI

## Transfer pricing

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- Global transparency and alignment of FAR with value-chain in light of CbCR and Master File
- Recognition of value-drivers and distributing returns as per contributions
- Payments for technology and management cross charges under radar
- Difficulties in attribution of profits to Permanent Establishment, in line with FAR



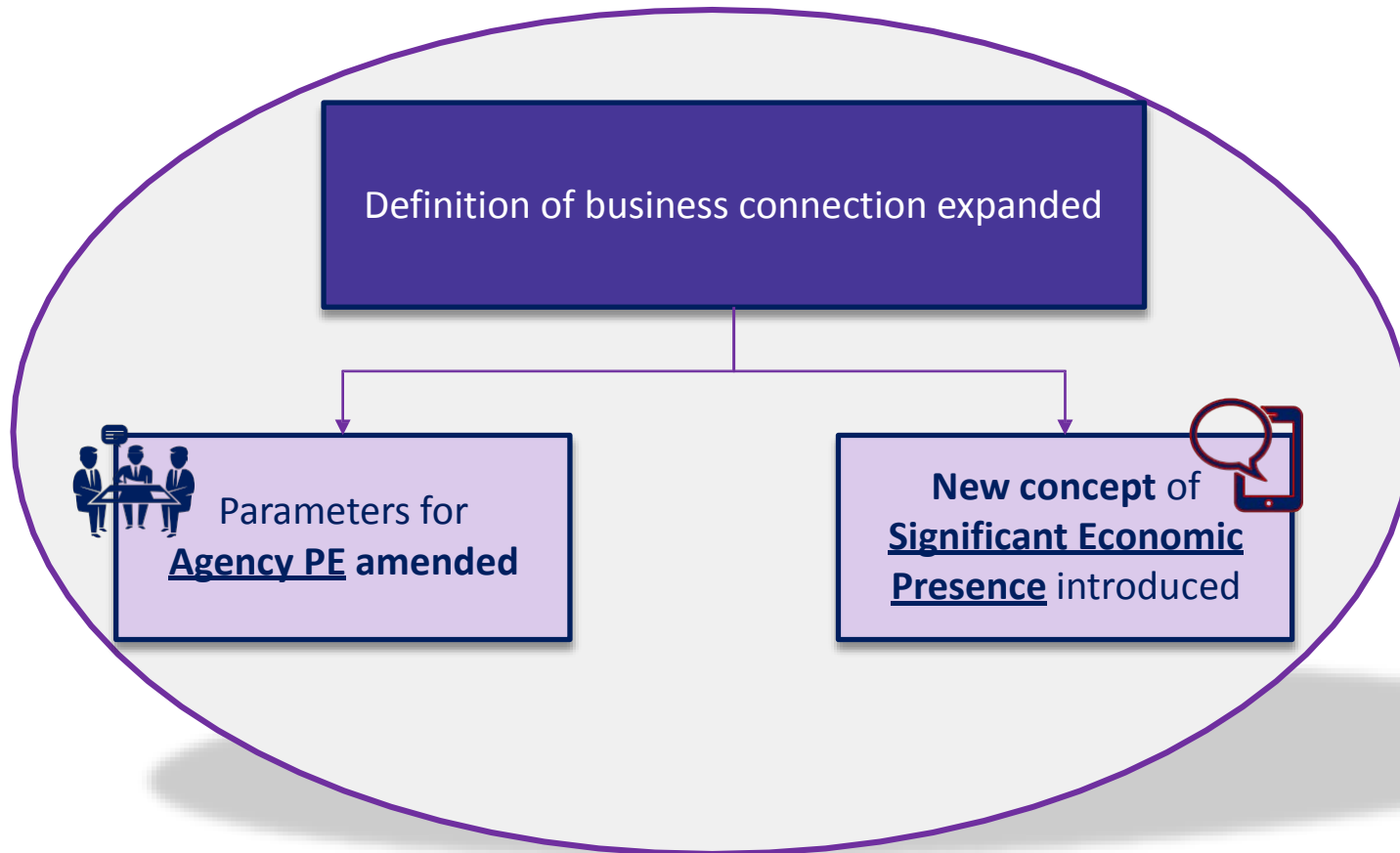
## Goods and services tax

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- Cross Border Transactions
- GST pre discount and post discount
- Compulsory registration;
- No Composition Scheme
- Increase in Compliance
- Credit loss to aggregators
- Goods return in a state different from purchase

# Recent amendments under the Income-tax Act, 1961

# Recent amendment u/s 9(1) of the Income-tax Act, 1961



# Agency PE – parameters amended

Business connection

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## No PE case Pre-amendment

- **Agency scope** – No authority to **conclude contracts** for F Co
- **Non-exclusivity of agency:**
  - agent not **rendering service solely** to F Co. in source state; and
  - agent not deriving **entire / almost entire revenue** from F Co.

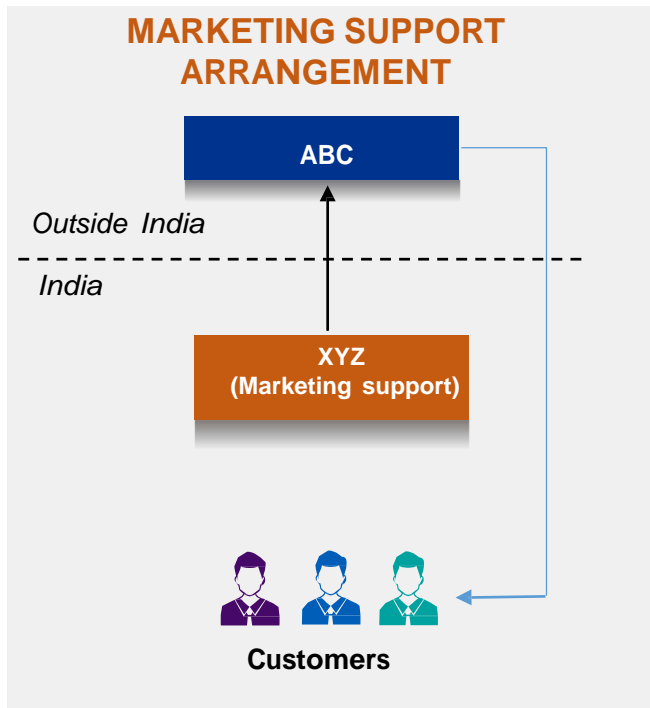
## Amendment

- **Scope** of PE expanded to include agent **playing principal role** leading to routine conclusion of contracts by Foreign Company **without material modification**
- Participation in **negotiation** may be **relevant** but not **sufficient** factor
- **Principal role not defined**

Are marketing support entities ('MSEs') impacted?

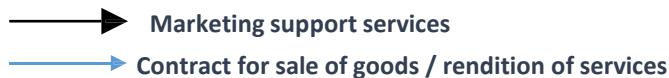
# Agency PE – parameters amended

Business connection



## MECHANICS

- ABC a foreign company provides online travel booking services
- XYZ enters into a contract with ABC to provide the **marketing and support services** and is remunerated at cost plus mark up;
- XYZ interacts with prospective customers (in India) being airlines and hotels and convince them for contracting with Company ABC ;
- XYZ explain the standard terms of contract to prospective customers;
- XYZ is not authorized to modify the contracts (to be executed online) and the price is also fixed by ABC;
- Routine on-line contracts executed without material modifications between the customers and ABC;

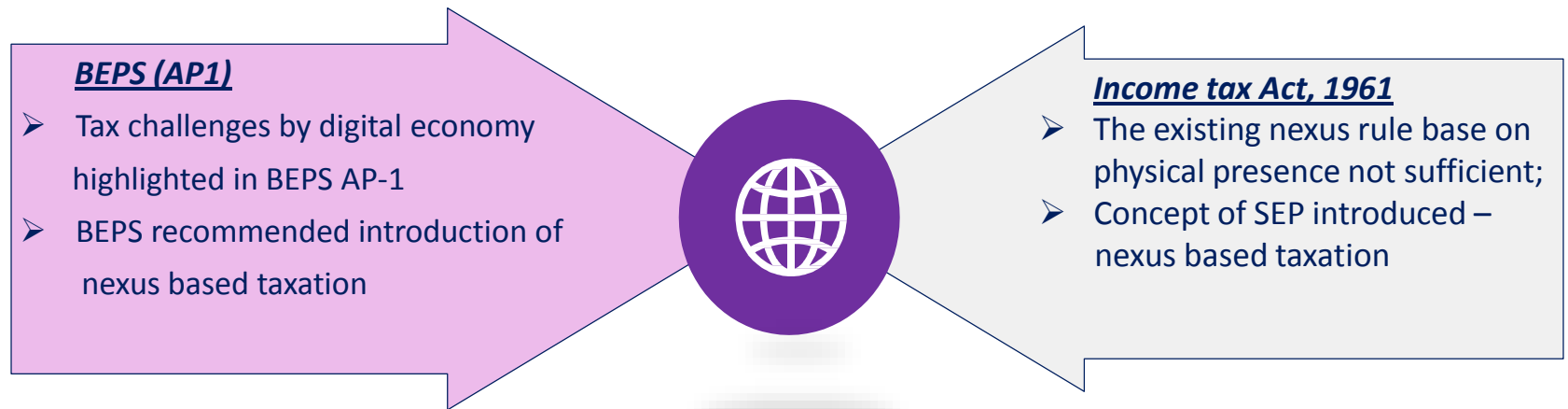


Whether interaction and negotiation with customers constitutes executing a principal role?

# SEP- new concept

Business connection

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# SEP- new concept

Business connection



## The Amendment Section 9(1)(i) Explanation 2A

- Business Connection to include ‘Significant Economic Presence’ (SEP)
- Significant Economic Presence means:
  - 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 (threshold amount of transaction to be prescribed) **[clause a]**
  - or
  - 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 **[clause b]**
- The transaction or activities shall constitute SEP in India, whether or not the non-resident has a residence or place of business in India or renders services in India

First proviso – Provided that the transactions or activities shall constitute SEP 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**

# SEP- new concept

Business connection



## Issues

- Whether clause (a) covers brick and mortar transactions or it is limited to digital transaction?
- Clause (a) and (b) refers to transactions or activities carried out in India, however, proviso states otherwise
- CBDT recently requested for suggestions from stakeholders with respect to:
  - (i) Revenue threshold of transaction in respect of **‘physical goods or services’** carried out by a non-resident in India
  - (ii) Revenue threshold of transaction in respect of **‘digital goods or services’ or property** including provision of download of data or software carried out by a non-resident in India
  - (iii) Threshold for number of **‘users’** with whom a non-resident engages in interaction or carries out systematic and continuous soliciting of business activities in India through digital means

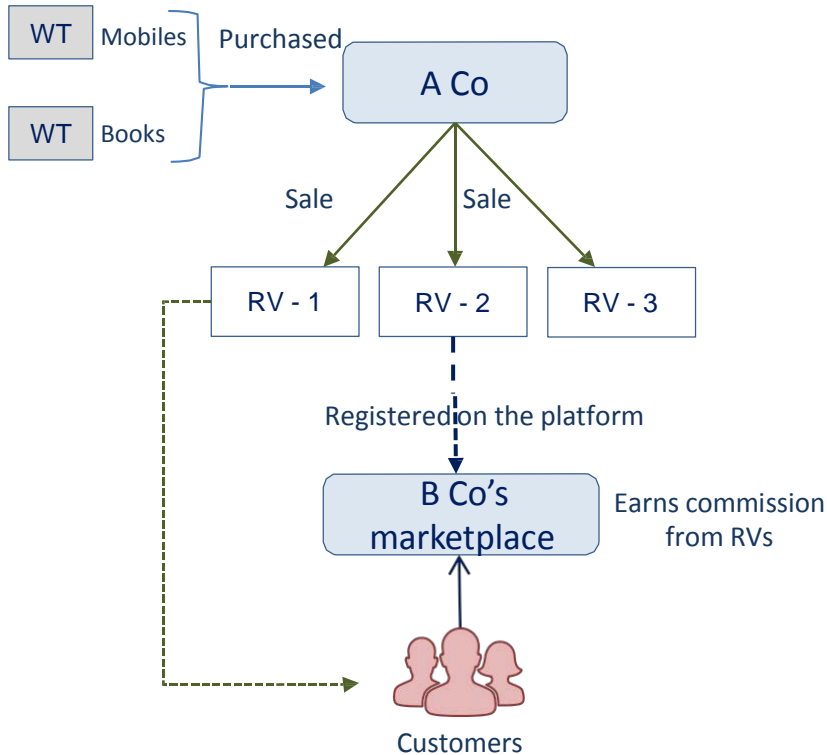
Point that may require further clarity...

- What is meant by digital property?
- Whether user threshold would also include one time user base?
- Can SEP and EL apply to a non-resident not having physical presence and providing advertising services?



# Case studies

# Case study 1 – E-tail model



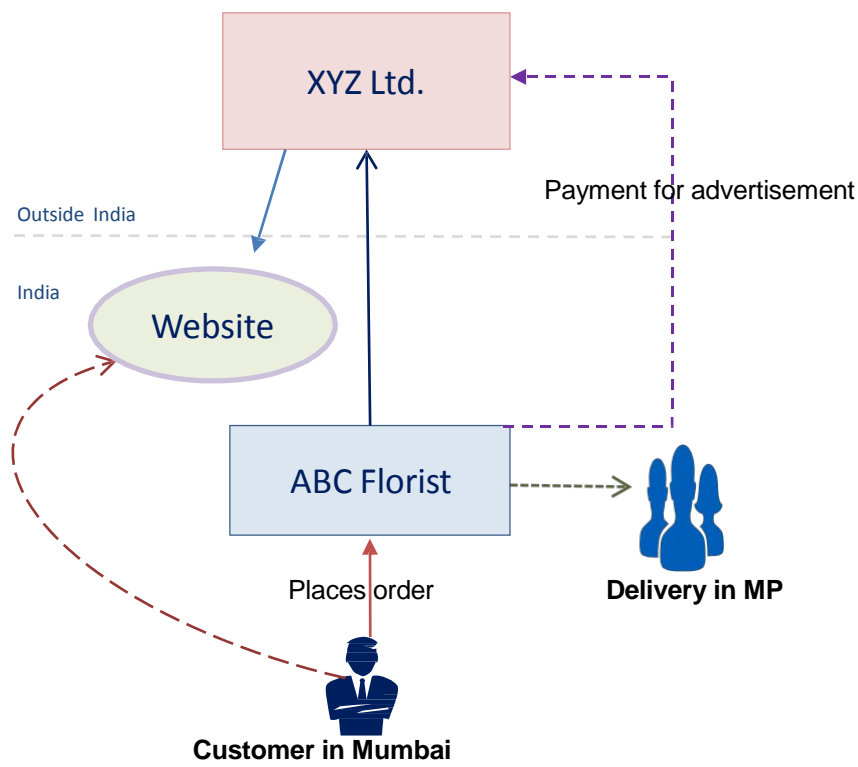
- WT Wholesale trader
- RV Registered vendor
- .-> Registered on ABC's platform
- > Customers places order on the ABC marketplace
- > Sale at discounted price
- .-> Sale below market value

## Facts of the case

1. A Co is a wholesale trader of mobiles and books ('products')
2. A Co acquires products from various vendors and sold to retailers at a discount
  - purchase price per unit on an average amounts to INR 100
  - sold to retailers at discounted price of INR 85
3. B Co., an affiliate of A Co, owns and operates marketplace platform
4. Retailers registered on B Co.'s marketplace sell products to customers at say INR 90 per unit
5. A Co filed its ROI declaring losses to be c/f for adjustment in the subsequent AYs

Characterization of discount – whether capital or revenue?

# Case study 2 – Online advertisement



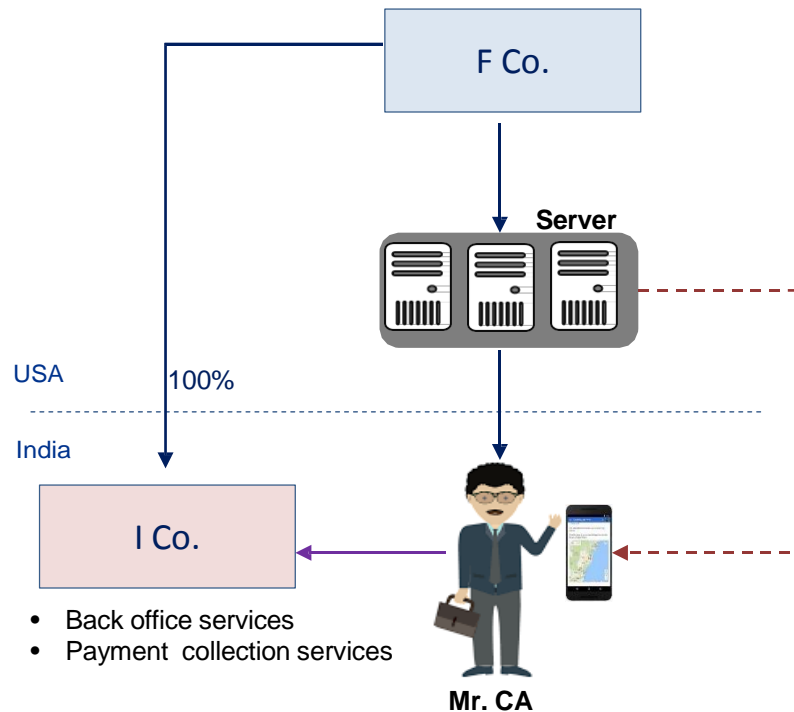
- Contractual arrangement for advertisement
- - - - - Payment for advertisement
- - - - - Undertakes a search on XYZ Ltd.'s search engine
- - - - - Delivery of flowers

## Facts of the case

1. XYZ Ltd., a foreign company, owns and operates a search engine
2. XYZ Ltd., for Indian advertisement business, has a website in India which is hosted on a server situated outside India
3. ABC enters into a contract for advertisement on XYZ Ltd.'s search engine
4. Payment to XYZ Ltd. is not subject to withholding tax in India

Whether payment by ABC Florist to XYZ Ltd. is liable to withholding tax?

# Case study 3 – Application download



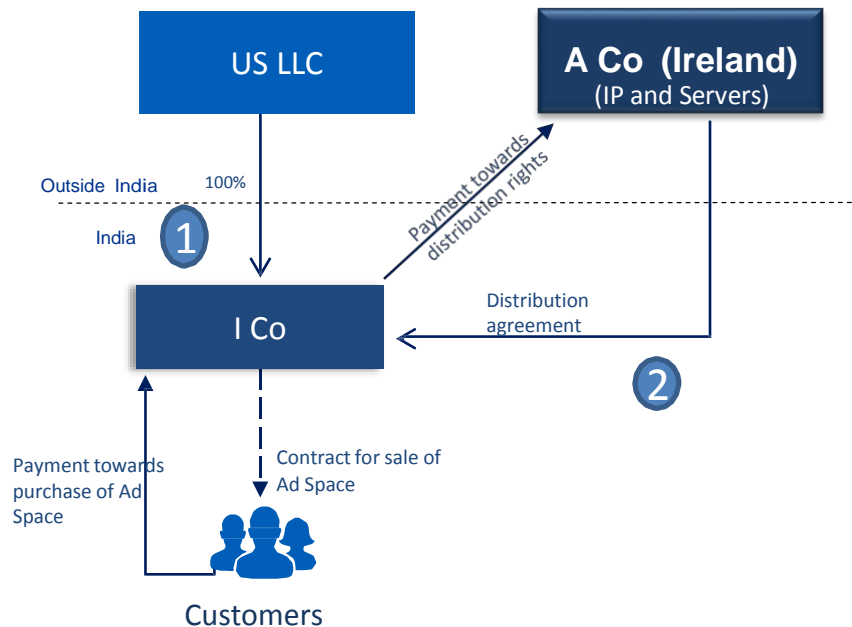
- Download of map
- Payment for advertisement

## Facts of the case

1. F Co. is a tax resident of USA and owns maps which are available could be downloaded after payment of specified amount, i.e. USD 1 (approx. INR 70)
2. Maps are stored on a server located outside India
3. I Co. is a subsidiary of F Co. which provides back office support and payment collection services and is remunerated at cost plus appropriate mark up
4. Mr. CA download maps and pays INR 70 to I Co.
5. As per the terms and conditions, F Co. is the owner of IP or copyright in maps

Whether payment of INR 70 is taxable in India?

# Case study 4 – Distributor of advertisement space



## Facts of the case

1. I Co. is a wholly owned subsidiary of US LLC.
2. I Co entered into agreement for providing the following services to its affiliate entity, A Co, Ireland:
  - Information technology services and information technology enabled services under a services agreement;
  - I Co. functions as a non-exclusive authorized distributor of A Co's AdWords program in India under the Distribution Agreement. In addition to this, I Co. was also required to provide pre-sale and post-sale / customer support services to the advertisers.
3. I Co. invoices the customer and the payments are received in I Co's bank account
4. Re-distribution rights fee is paid to A Co. pursuant to a distribution agreement entered with the latter on P2P basis
5. Contractual arrangement between I Co and A Co discussed in the subsequent slide

# Contractual arrangement between I Co and A Co

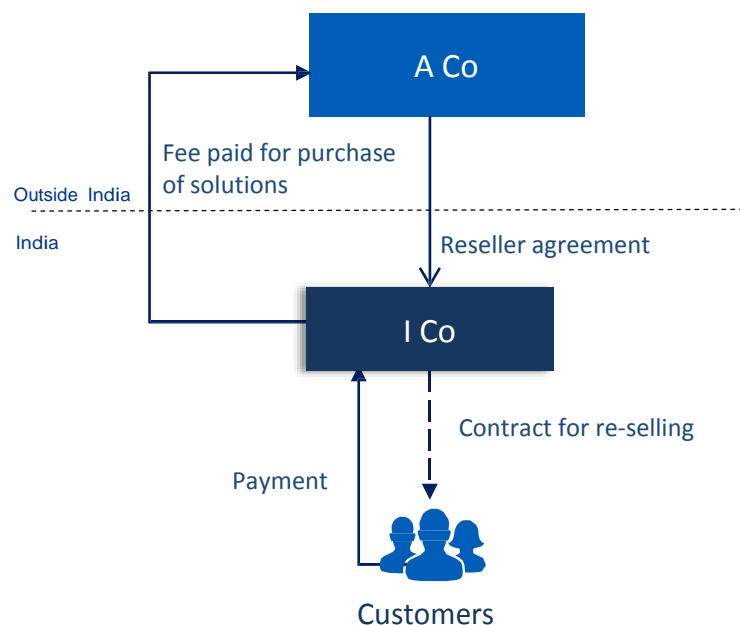
## Case study 4 - Distributor of advertisement space

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- Entered into two agreements with Ireland (i) for IT / ITES services and (ii) distribution of advertisement space
- Arrangement between I Co and A Co on principal to principal basis
- Ownership of any IP or derivate works to remain the property of A Co
- I Co responsible for uploading advertiser's information that is required for participation in the advertising program
- A Co owns all right, title and interest in and to all information and data relating to advertisers in connection with the advertising program
- Advertisers shall communicate with I Co

Whether distribution charges payable to A Co are subject to withholding tax in India?

# Case study 5 – Re-seller of solutions

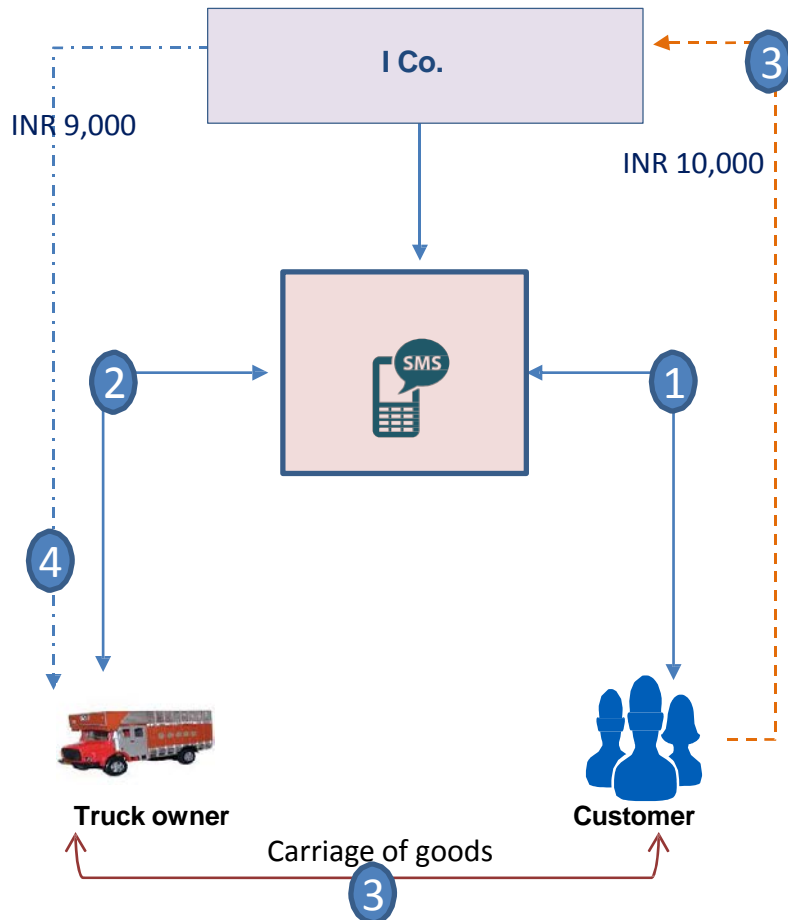


## Facts of the case

1. A Co, a technology company, is a leading global service provider of content solutions for accelerating content and business processes online
2. A Co owns a platform which pulls content from the customer's web server and monitors the internet traffic
3. I Co is appointed as a non-exclusive re-seller of content delivery solutions of A Co
4. I Co directly contracts with customers in India and re-sells the content solutions to them
5. I Co has appointed staff and has adequate resources for the purpose of re-selling solutions to customers
6. I Co does not have any right, title and interest in the platform owned by A Co.

Whether fee paid to A Co for purchase of solutions is liable to withholding tax in India?

# Case study 6 – Transport aggregator



## Facts of the case

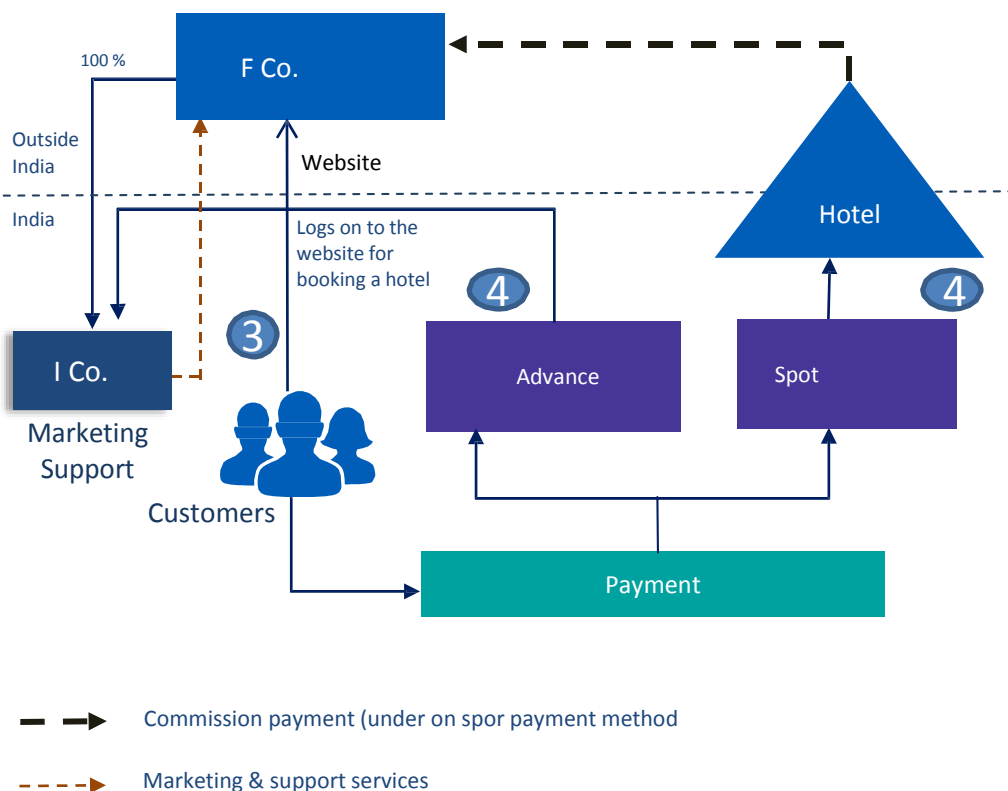
1. Customer downloads I Co.'s App on its smartphone, accepts digital terms and conditions thereafter raises a request for transportation of goods
2. Lead generation
  - On entering the destination and pick up location, lead is generated and approximate charges are shared with the customer
  - Lead generated is shared with the truck owner who has a right to either accepts / rejects the lead
3. On acceptance of lead, customer pays the charges to I Co. (acting as a collection agent of the truck owner) and goods are transported
4. On completion of transportation, charges are remitted to the truck owner after retaining service charge

Whether withholding tax is applicable on INR 10,000 paid to I Co.?

—→ Payment made by customer to I Co.  
- - -→ Payment made by I Co. to driver



# Case study 7 – Hotel aggregator



Does I Co. constitute F Co.'s PE in India?

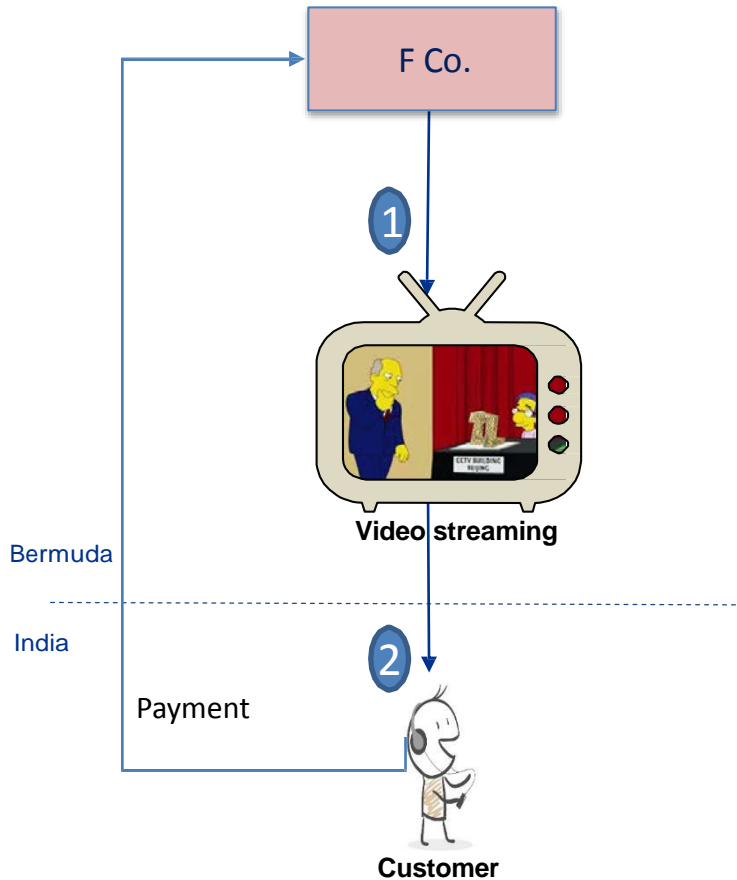
## Facts of the case

1. F Co. is hotel aggregator and has a website located on a server operating outside India
2. I Co. provides marketing support services to F Co. and is remunerated at cost plus appropriate mark up
3. Customers log on to F Co.'s website for booking a hotel
4. Customers has two options to make payment, i.e.
  - Advance – which is collected by I Co. on behalf of F Co.
  - Spot – which is directly collected by the hotel on check out
5. Depending on the type of payment
  - Commission is retained and balance remitted to the hotel on behalf of F Co.
  - Hotel pays commission to F Co. after customer checks out from the hotel

## Functions of I Co.

- I Co. a wholly owned subsidiary of F Co. in India and provides marketing support and collection services to the latter
- I Co. sends e-mails, make telephone calls and carries out hotels surveys in order to list the hotel on the portal

# Case study 8 – Digital streaming



## Facts of the case

1. F co. is incorporated in Bermuda, provides online services (through its servers) for streaming movies, videos on its website;
2. The customer in India accesses the digital streaming application of F Co. for a fee
3. Services provided by Company B is said to have been provided electronically without having any physical presence in India.

Whether F Co. constitutes a business connection in India?

Next steps

# Next steps

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- Re-visit the business model and contractual arrangements
- Evaluate possibility of obtaining a lower withholding order or AAR
- Representation for specific provision to be introduced dealing with withholding tax on payments to e-commerce companies

Questions?

# Thank You

Jasdeep Sahni

# Annexure 1 – OECD’s view on website and server

## *Para 124 of the revised OECD commentary*

The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, **it is common for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise,** even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, **if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.**



# Annexure 1 – OECD’s position on mirror server

## *Para 128 of the revised OECD commentary*

Another issue relates to the fact that **no permanent establishment may be considered to exist where the electronic commerce operations carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4.** The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. **Examples of activities which would generally be regarded as preparatory or auxiliary include:**

- providing a communications link — much like a telephone line — between suppliers and customers;
- advertising of goods or services;
- **relaying information through a mirror server for security and efficiency purposes;**
- gathering market data for the enterprise;
- supplying information.

Where functions carried are essential and significant part of the business activity of the enterprise as a whole  
OR

Where other core functions of the enterprise are carried on through the computer equipment these would go beyond the activities covered above AND if the equipment constituted a fixed place of business of the enterprise, there would be a PE

