Tax challenges of Digitalisation

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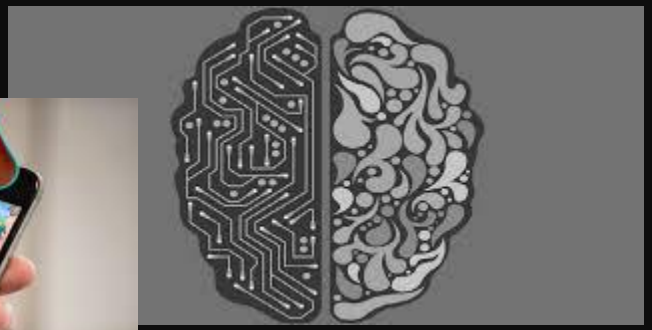
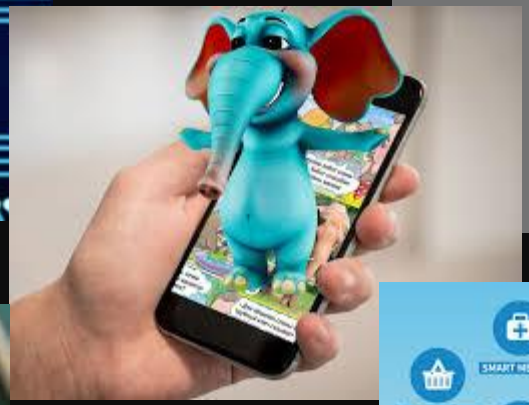
Discussion points

- Riding the digital wave – emerging trends
- Digital economy – features & broad tax challenges
- Refreshing fundamental direct tax aspects pertinent to digital economy taxation in India
- Digital economy taxation - unilateral measures by India and certain other countries
- OECD's "work in progress" approaches to tax digital economy
- Indian revenue authorities' views on the OECD approaches
- The road ahead….

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 frame-work

Digital economy – features & broad tax challenges

Digital economy – features [1/2]

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.

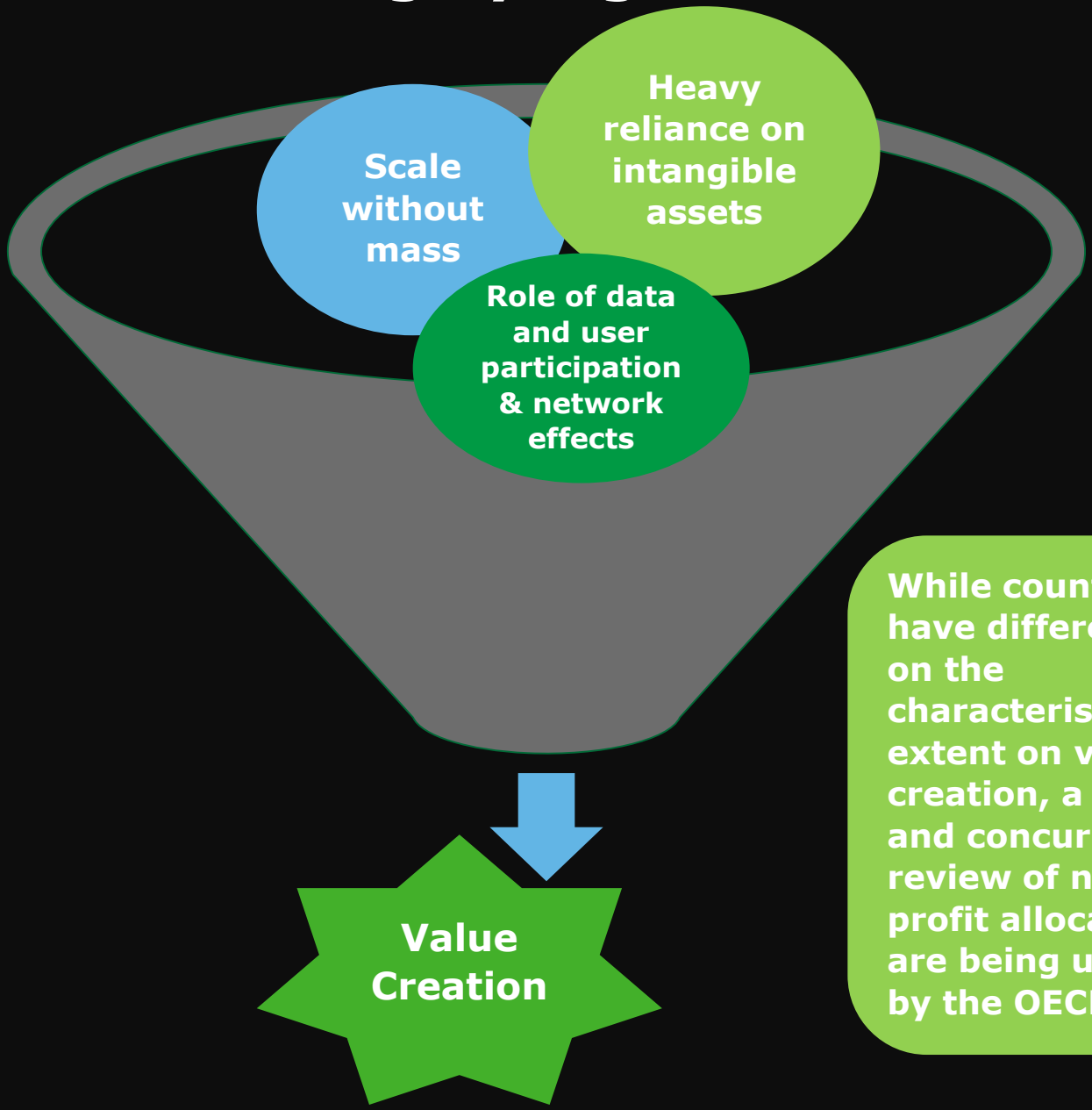
NETWORK EFFECTS

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

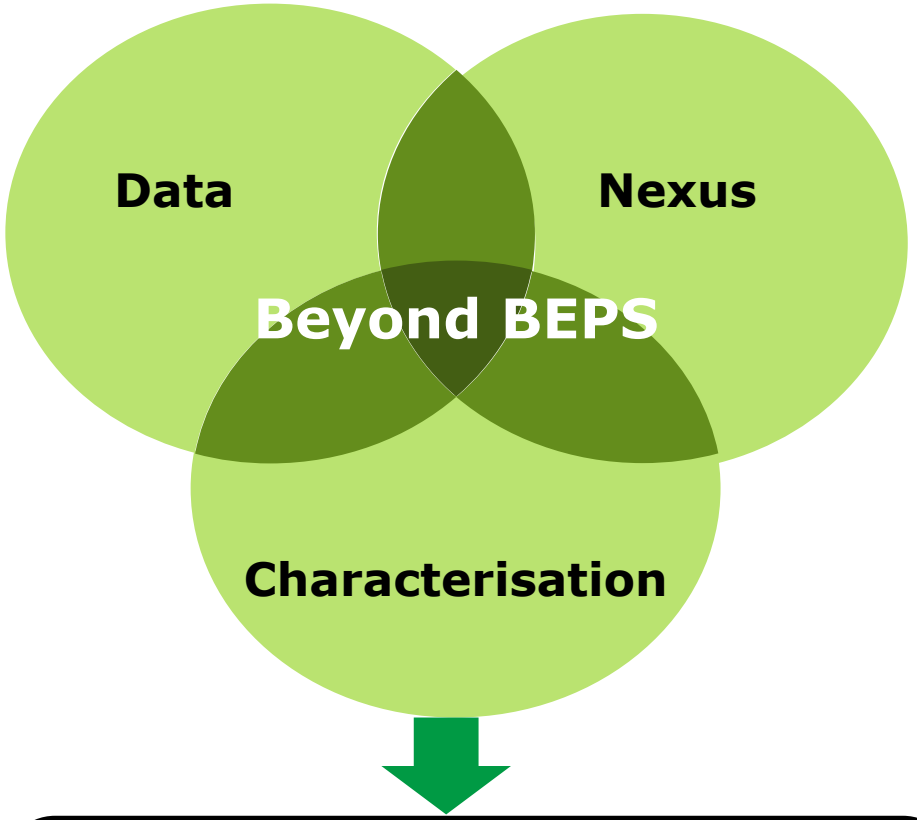
Where various persons interact through an intermediary and the decision of each person affects the outcome for the other. For example, a card payment system will be more valuable to customers if more merchants accept the card.

Characteristics of highly digitalized businesses



While countries may have different views on the characteristics and extent on value creation, a coherent and concurrent review of nexus and profit allocation rules are being undertaken by the OECD

Broader tax challenges posed by digitalisation of the economy



Key challenges –

1. How will the taxing rights be allocated among countries with respect to income generated from cross border activities
2. Divergent positions and unilateral & uncoordinated taxation measures by countries
3. Syncing with International VAT/GST Guidelines

The Journey so far by the TFDE, OECD –

2015- BEPS Action Plan 1 Report

2018-Interim Report – Tax Challenges arising from Digitalisation

2019 – Programme of Work to develop a consensus based solution to the tax challenges by the end of 2020 (Preceded by a policy note containing 2 Pillars for consensus)

Digital economy – why the tax challenges?

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 challenges?

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

Characterisation, nexus determination beyond traditional PE principles, profit allocation and basis thereof, difference in views among nations on these aspects constitute the core challenges in reaching a global consensus on the digital economy taxing principles.

BEPS 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

Refreshing fundamental direct tax aspects pertinent to Digital economy taxation in india

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 being gradually incorporated

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 has been a need of the hour

Business connection definition as further expanded

Business connection – Scope of income attributable to operations in India

- In case of a "business connection", it is proposed to clarify that income attributable to operations carried out in India shall include income from:
  - advertisement which targets a customer who **resides** in India or a customer who accesses the advertisement **through IP address located in India**
  - **sale of data** collected from a person who resides in India or who uses IP address located in India; and
  - **sale of goods and services using data collected from a person who resides in India or who uses IP address located in India**.

As per Finance Act 2020 the above provisions are applicable from AY 2021-22

Digital economy taxation – Unilateral measures by India & certain other countries

Equalisation Levy ambit broadened to cover e-commerce operators

Overview

- Taking a cue from the G20 / OECD Base Erosion and Profit Shifting (BEPS) Action 1 dealing with digital economy, India introduced an Equalisation Levy ('EL') in 2016 at the rate of 6 percent on nonresident companies engaged in online advertisement and related activities.
- The scope of the said provision has now been expanded to include EL of 2 percent on consideration received or receivable by an 'ecommerce operator' from 'e-commerce supply or services', and is effective from 1 April 2020.

Key features of the new EL

Applicability – Non-resident e-commerce operators who own, operate, or manage digital or electronic facility or platform for online sale of goods or online provision of services or both and derive revenues from e-commerce supply or services made or provided or facilitated by it.

Scope of e-commerce supply or services:

- Online sale of goods owned by the e-commerce operator
- Online provision of services by e-commerce operators
- Facilitation of online sale of goods or provision of services or both by e-commerce operator • Any combination of the above

E-commerce supply or services rendered to the following:

- A person resident in India
- A non-resident in specified circumstances
- A person who buys goods or services using an IP address located in India

Levy of 2 percent imposed on consideration received or receivable by e-commerce operators from e-commerce supply or services

Effective date: 1 April 2020

Exclusions – Cases outside the scope of EL

- Non-resident e-commerce operators who have permanent establishments in India and e-commerce supply or services are effectively connected to those establishments
- Cases where EL is leviable on online advertisement and related activities (as these are covered by different provisions)
- Sales, turnover, or gross receipts are less than INR 20 million during the financial year

Payment and compliance timelines

Quarter closing date	Due Date
30 June	7 July
30 September	7 October
31 December	7 January
31 March	31 March

An annual statement needs to be furnished to the tax authorities on or before 30 June of the subsequent financial year.

Exemption from applicability of normal income tax provisions on the revenues subjected to EL

Equalisation Levy on e-commerce companies – what such companies should do

A suggested way forward

Assess the applicability of EL provisions and their impact on the following key areas:

- Existing business models
- Technology platforms, and mode of contracting and delivery
- Customer contracts and the remuneration arrangements

Assess the preparedness and support needed to implement EL provisions in the following areas:

- Stakeholder communication
- Technological changes to meet the compliance requirements
- Filings and payments with tax authorities

The EL imposed on e-commerce transactions will have a significant impact on non-residents supplying goods or services through digital means, given the wide definition of the term 'e-commerce supply or service.

Multinational enterprises earning income from India or focusing on customers in India will need to evaluate EL's impact on their businesses. As the provision of EL is not part of the income tax law, the tax treaty benefits will not be available in relation to such a levy.

Significant Economic presence

In order to address the challenges in taxation of such digital transactions, India had introduced the concept of Significant Economic Presence (SEP) within the already broadened **business connection** definition – Explanation 2A to section 9(1)(i) of the Act

SEP has been 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 as may be prescribed

OR

Systematic and continuous **soliciting** of business activities or engaging in interaction with users (exceeding the number as may be prescribed) in India.

Attribution - Only so much of income as is attributable to the specified transactions or activities

Non-resident to be said 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

Finance Act 2020 deferred the application of SEP to AY 2022-23, pending global consensus on taxation of digital economy

Significant Economic Presence – 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?

Certain other country developments (1/2)

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.

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.

NEW ZEALAND

GST at 15 percent on supply of digital services.

CHINA

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

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.

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)

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.

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.

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.

Countries are opting for methods such as levies, consumption taxes or deemed attribution for taxing digital economy rather than formulating new nexus rules. These unilateral measures by countries to tax digital transactions permeated inconsistency in taxing principles globally

OECD’s “work in progress” approaches to tax digital economy

Groups of Proposals by Inclusive Framework – OECD's Policy Note

Pillars representing groups of proposals forming basis of Consensus

Pillar 1 – Allocation of taxing rights through
(a) Review of Nexus Rules
(b) Review of Profit allocation rules

Pillar 2 – Globe Proposal pertaining to rules that would allow jurisdictions to tax back where other jurisdictions have either not exercised their taxing rights OR the income is subject to low levels of effective taxation

Why the urgency to complete the Final Report on Taxation of Digital Economy by 2020?

1. More probability of unilateral uncoordinated measures by countries
2. International tax framework would collapse in terms of divergent practices of taxation and taxpayer attributes across nations
3. Increased dispute levels domestically and globally

Whether the objective of quicker uniform measures will be achieved soon?

OECD's Unified approach – Pillar 1 – a brief snapshot

The Unified Approach - towards allocation of taxing rights

3 fundamental proposals under Pillar 1 on allocation of taxing rights **– User Participation, Marketing Intangibles & Significant Economic Presence**

Commonalities between these proposals culminating into Unified Approach

The Unified Approach – features of this solution

Scope – Highly digital business models and even wider to cover consumer facing businesses and not including extractive industries– to be fine tuned with carveouts

New Nexus – not dependent on physical presence but largely on sales. Through self standing treaty provisions and based on thresholds including country specific thresholds for benefitting even smaller economies – likely

New Profit allocation rules beyond ALP – Retains current transfer pricing rules but complement them with formula based solutions in specific cases where current Transfer Pricing rules are inadequate to allocate profits

Increased tax certainty for tax payers and tax administrators in a market jurisdiction through 3 tier mechanisms – 1. a share of deemed residual profit using formulaic approach, 2. a fixed remuneration for baseline marketing & distribution functions & 3. additional profit allocation where in-country functions exceed baseline activity

The Proposed Nexus Rule – Taxing Right

Why needed?

Digitalisation of business – more consumer facing &/user facing activities from remote location with zero / minimal physical presence in consumer market – Lack of physical presence - no PE & therefore inadequate nexus to tax sustained & significant economic nexus

Need for neutrality between different business models & capture all forms of remote involvement in an economy

New Nexus Rule (Physical nexus agnostic rule)

- Standalone / on the top of PE rule – not to have spillover effect on other existing rules
- Based on definition of a revenue threshold in the market (based on the adaptation to the market size) as primary indicator of sustained & significant involvement in an economy
- The revenue threshold to factor in certain activities and their situs
- Rule relevant not only to business models involving remote selling but also ones with distributor involvement (whether related / unrelated local entity)

Definitions of revenue thresholds, determination of criteria for various business models and associated permutations – combinations of scenarios – key for tax certainty

The Proposed Revised Profit allocation rule – Supplementary to existing TP Regulations under Articles 7 and 9 of the convention

Imperative need of revised profit allocation (RPA) rule based on new nexus rule:

- Existing Articles 7 and 9 compatible only with traditional physical nexus / PE rule.
- Interpretation of these articles, especially in context of marketing / distribution functions – not free from disputes
- In the absence of physical nexus (no FAR), new / revised profit allocation rule required

Amount A – Deemed Residual Profit

Reallocated portion of residual profits remaining after allocation of routine profits to the group / business line activities

To be implemented through simplified conventions for better administration alongside existing TP rules & less disputes

4 step calculation process

Amount B – Fixed Returns for baseline / routine marketing & distribution activities

Simplification of existing TP regulations for greater tax certainty + dispute reduction

Fixed returns could vary by industry / region

Determination of fixed return quantum – variety of ways viz.

1. Single Fixed Percentage
2. Fixed Percentage varied by Industry / region
3. Some other agreed method

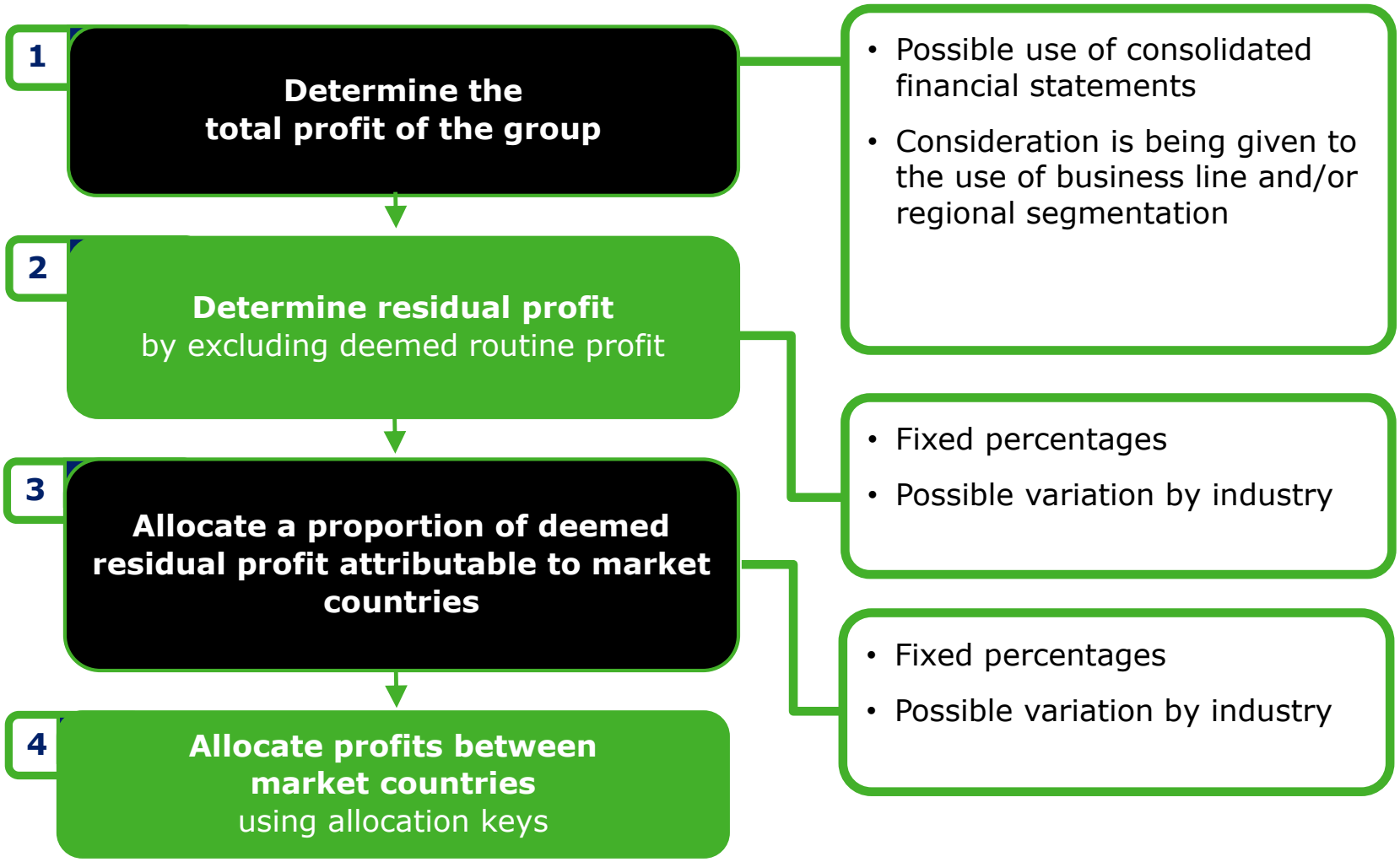
Amount C – Additional Returns through binding dispute prevention & resolution process

If marketing / distribution / other business functions taking place in a market jurisdiction differ from / exceed baseline activity levels

Based on the ALP

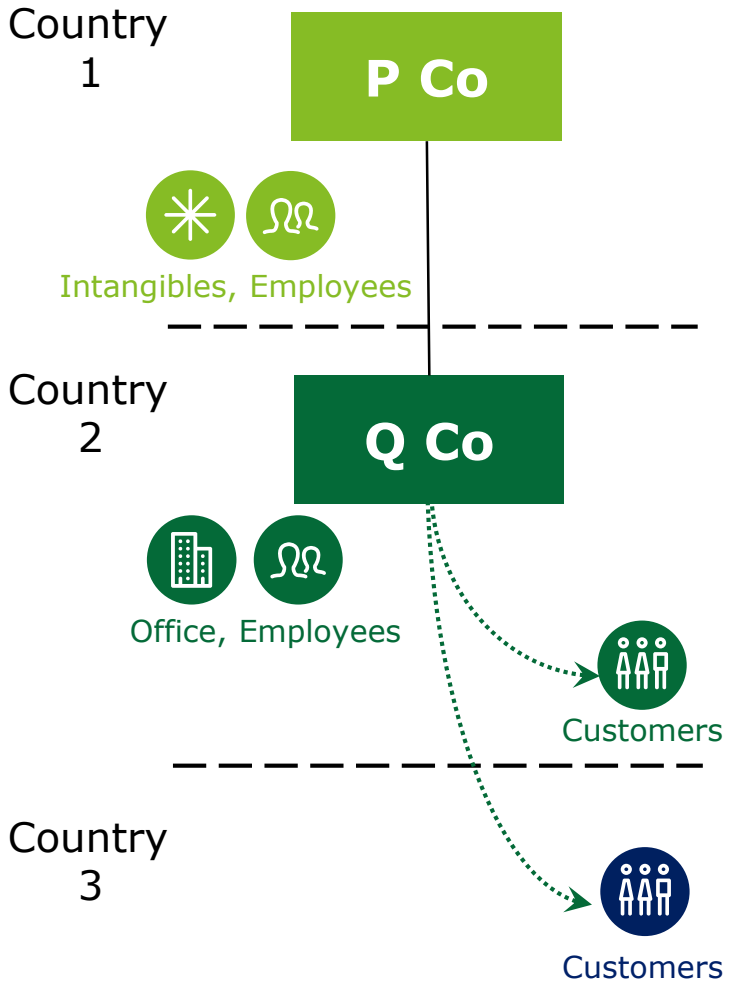
Robust & mandatory dispute prevention and resolution mechanisms in market jurisdiction mandatory

4 Step process to determine Amount A



OECD's illustration on how Unified Approach works

Group X provides a streaming service



- **P Co**
  - Owns all intangibles
  - Currently entitled to all non-routine profit

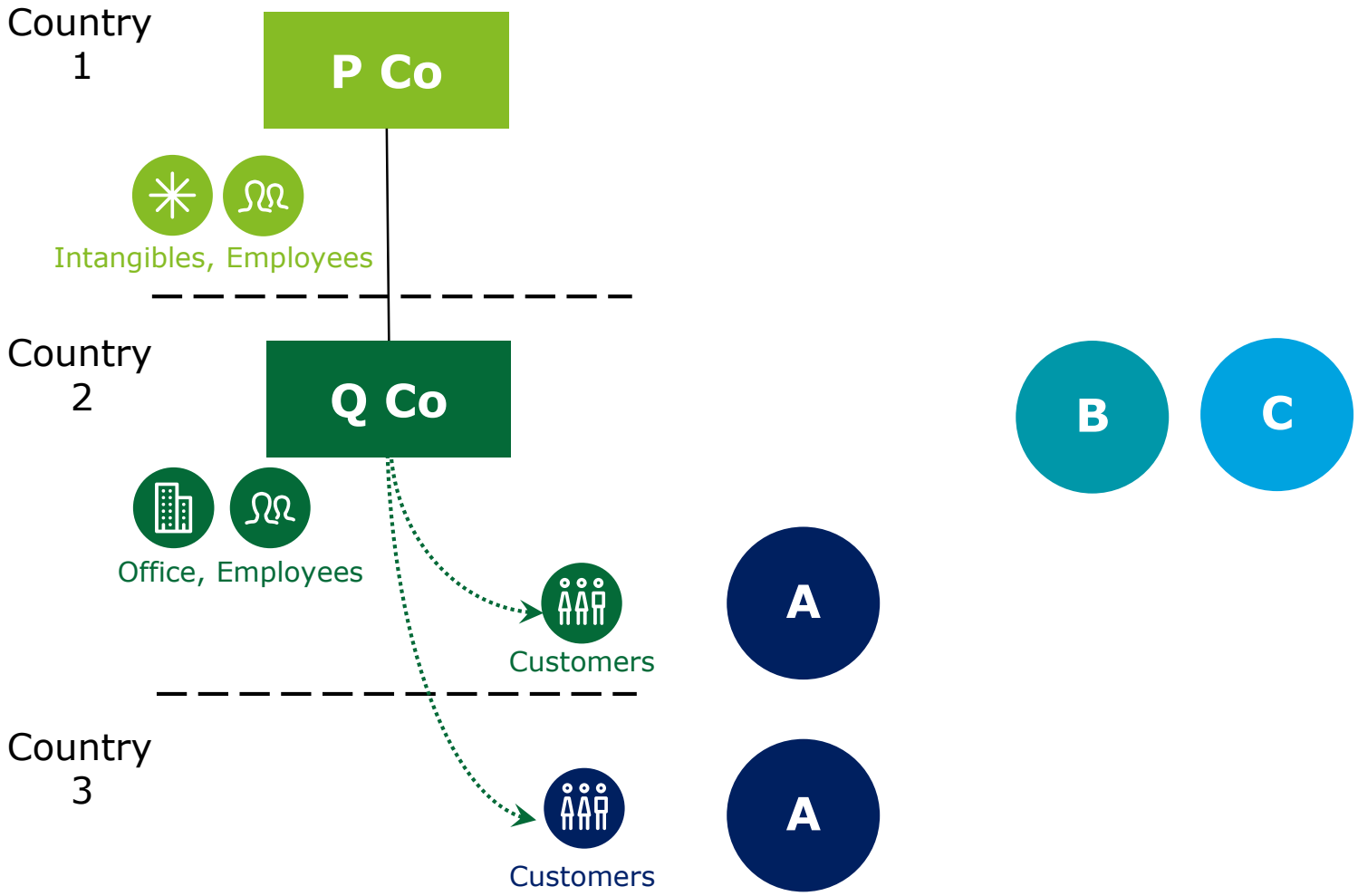
- **Q Co**
  - Performs marketing and distribution activities
  - Sells streaming services to country 2 customers

- **Q Co**
  - Also sells streaming services to country 3 customers
  - No physical presence in country 3

Source: OECD Public Consultation Document

OECD's illustration on how Unified Approach works (Contd.)

Group X provides a streaming service



Source: OECD Public Consultation Document

Unified approach – some issues from India perspective

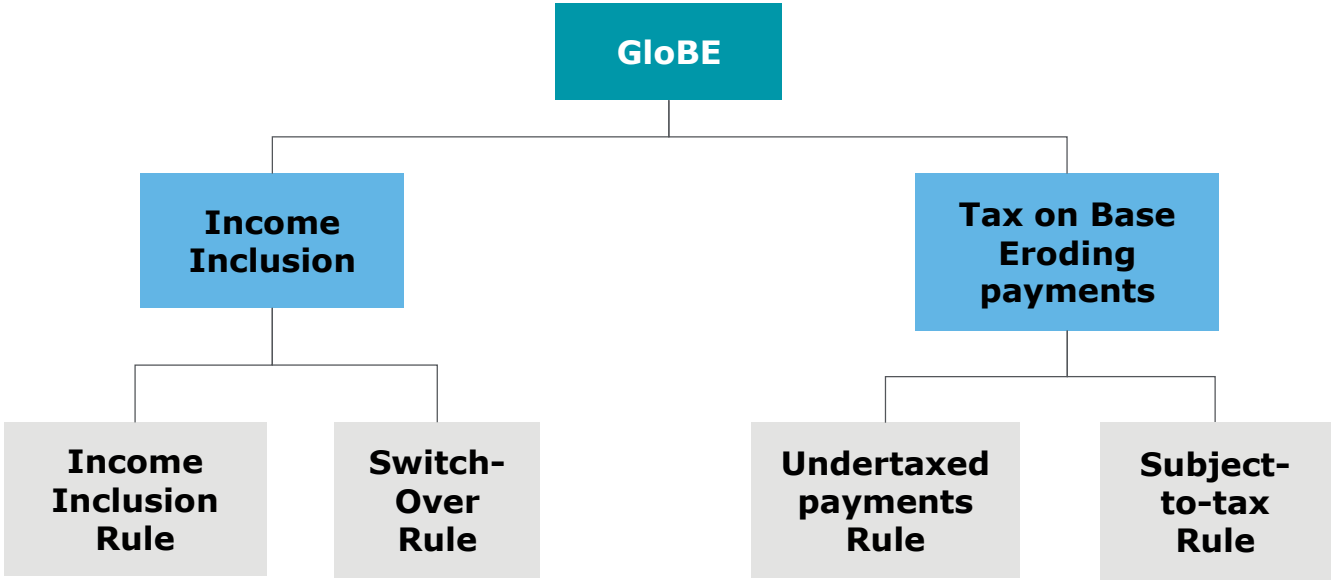
1. Do the residual profits constitute appropriate incremental basis for profit allocation to India
2. Since existing TP regulations apply to routine profits, how does the Unified Approach help to reduce TP disputes?
3. Should the possible revenue threshold of Euro 750 mn. be reduced by the OECD to tap more MNE's into the tax net of developing economies viz. India?
4. How will the claw back mechanism practically work in case of loss making entities in the Indian context?
5. While Arbitration (as referred to in BEPS / MLI context) is a dispute resolution mechanism, since India is particularly opposed to arbitration in tax disputes, for the Unified Approach too, India may not

Political consensus on various definitions and propositions under the approach – not easy… Any moves in the forthcoming Union Budget? Whether it be effective and by when?

OECD’s GLoBE approach – Pillar 2 – a brief snapshot

GloBE – Global Anti Base Erosion approach

- The Pillar 2 GloBE proposal goes beyond BEPS to address the need for global action to stop a 'harmful race to the bottom' on corporate taxes amongst countries.
- It seeks to develop rules that would provide jurisdictions with a right to "tax back" where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise taxed at an effective tax rate ("ETR") below a "minimum rate."
- There are 3 technical design aspects which OECD has outlined and seeks inputs on
- The proposal will operate as a top-up to an agreed fixed minimum rate. The GloBe proposal consists of two primary elements with four component parts:



The Globe approach recommends imposition of a globally mandated 'minimum tax' rate on MNEs

GLoBE – Income inclusion rules

Income inclusion rule

- This rule would tax the income of a foreign branch or a foreign controlled entity if that income was subject to an ETR below the minimum rate.
- Domestic CFC rules to be amended to avoid double taxation
- May result in making existing CFC rules more complex
- Similar to to U.S. Global Intangible Low Tax Income
- *This would require domestic implementation in resident country*

Income inclusion

Switch-over rule

- This rule proposes to alter the form of treaty credit available on a doubly taxed income, otherwise applicable to a specific type of income under a tax treaty.
- The rule will turn off the benefit of 'exemption method' in favor of a 'credit method' in a tax treaty in cases where incomes attributable to exempt foreign branches or income derived from foreign immovable property, are subject to an ETR below the minimum rate in that foreign country.
- *This would require treaty modification of resident country*

Income Inclusion concept requires a shareholder in a corporation to bring into account a proportionate share of the income of that corporation if that income was not subject to an ETR above a minimum rate.

GLoBE – Tax on Base Eroding payments

Undertaxed Payments rule

- Operates by denying a deduction or levying source-based taxation (including WHT), for payments made to associated entities if such payments were not subject to a minimum ETR.
- The said rule is somewhat similar to the U.S. Base Erosion Anti-Abuse Tax
- *This would require domestic implementation in source country*

Tax on Base Eroding Payments

Subject-to-tax rule

- Where the payment is not subject to minimum ETR.
- This is a rule which will complement the undertaxed payments rule, as follows:
  - By subjecting payments to WHT/ other source based taxes; and
  - By adjusting eligibility to treaty benefits on certain income items;
- This would require domestic implementation in source country

This concept is aimed at taxing base eroding payments (allowable as deduction in computing taxable income) which are made with an intent to gain tax advantage out of difference in tax rates among contracting countries

GLoBE approach – certain open issues from India perspective

01 Proposal does not mention about what the minimum rate would exactly be

02 MNE Groups to re-assess their financing and operational structuring before rules become effective

03 May not be feasible for countries with inadequate resources to manage this level of complexity

04 Substantial changes to be incorporated in existing domestic tax laws and tax treaties

05 Increase in MNE's Group current ETRs, increase in compliance costs, risk of double taxation

Indian revenue authorities views about the OECD approaches

Indian revenue authorities views about the OECD approaches

- ***While the aim of the OECD was to deliver a solution which is as simple as possible, it unfortunately seems to have drawn up a proposal which will pose more complexity***
- ***A simpler approach may be recommended which may not be may also not be accurate but at least results in some tangible and definite gains in supplementing resources of developing countries - Shri Rajat Bansal (IRS, Member of 20th session of UN Committee of Experts on International Co-operation in Tax Matters***

Challenges

- No sound basis for allocating non routine / residual profits across market jurisdictions
- Since all profits are generated from the business activities of MNEs, conceptual distinction between routine and non routine / residual profits is not simple exercise
- Since
  - the amount A under the Unified approach is confined to non-routine / residual profits
  - transfer pricing regulations apply in relation to allocation of routine profits
  - transfer pricing regulations continue to be the major reason for tax litigations,

  Tax disputes may not reduce
- Elimination of double taxation among countries may not be straightforward – complex multilateral dispute resolution mechanism essential
- Policy design for Pillar 2 must be simple, else it may overcomplicate international tax

Proposals

The approaches should be confined to the BEPS recommendations and not travel beyond ambit of digital economy or automated digital services

The scope of taxation of automated digital services should be the revenue derived directly from market jurisdictions and not through PE / subsidiaries present therein

Specific new articles may be introduced preferably in tax treaties to define nexus and profit determination rules

A global profit rate for the in scope services derived by factoring in local sales and margin based on fractional apportionment method

The road ahead….

The road ahead……..

Progress of the technical work by the TFDE on the pending questions / issues, policy design, OECD legislative models through Final Report on taxation of digital economy

Global political consensus on the approaches / proposals / recommendations

Changes to the Indian domestic law and tax treaties including possible MLI version 2 to incorporate certain measures as per the Programme of Work and consensus based approach of taxation

Enactments and administration of the new law

Imperatives for practitioners

1. Update on OECD's ongoing work

1. For enterprises with greater degree of digitalized business models – rigorous tracking of OECD's recommendations and country opinions / reservations

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

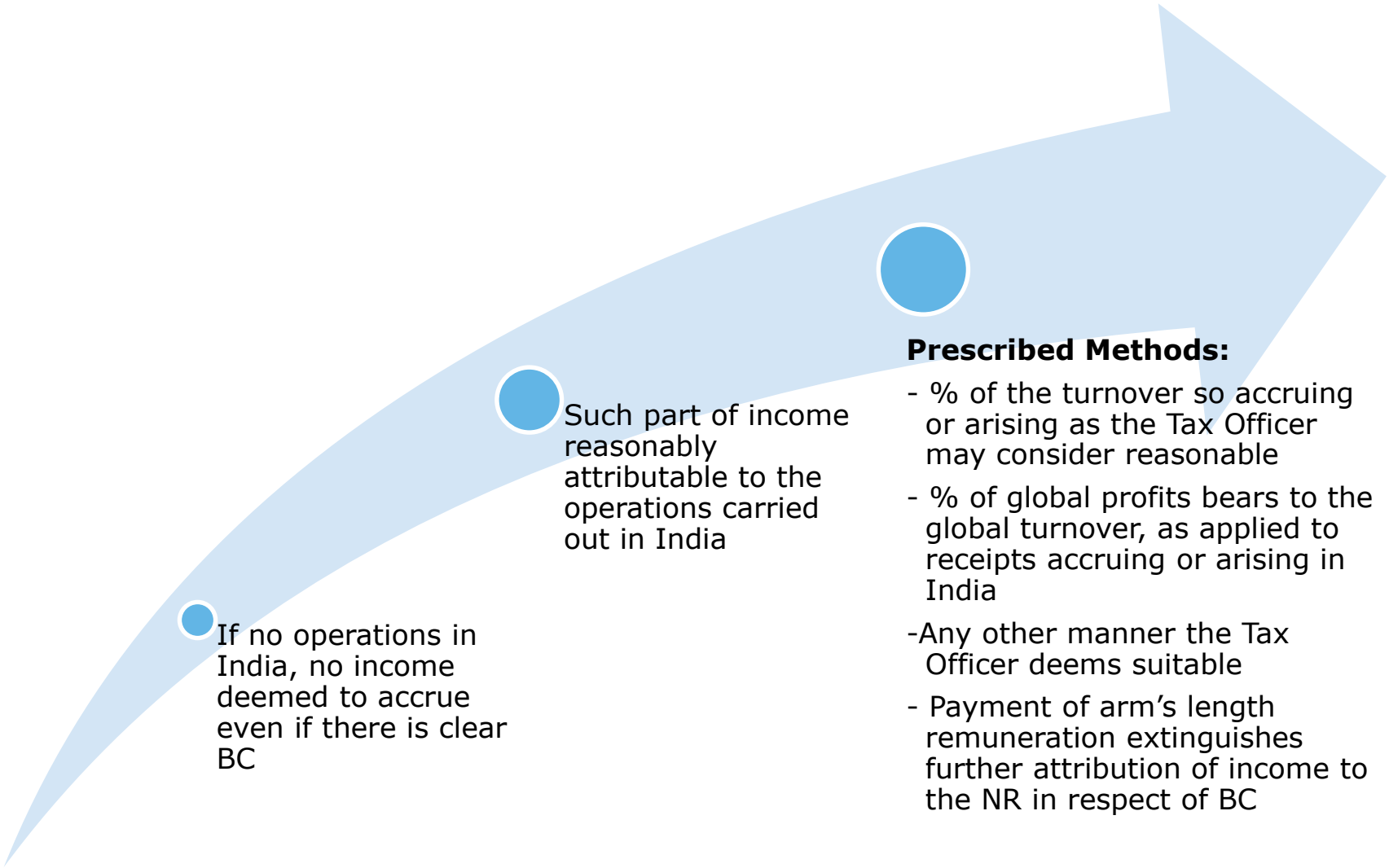
- Business operations so carried contributed to the earning of profits or gains of such business

- 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

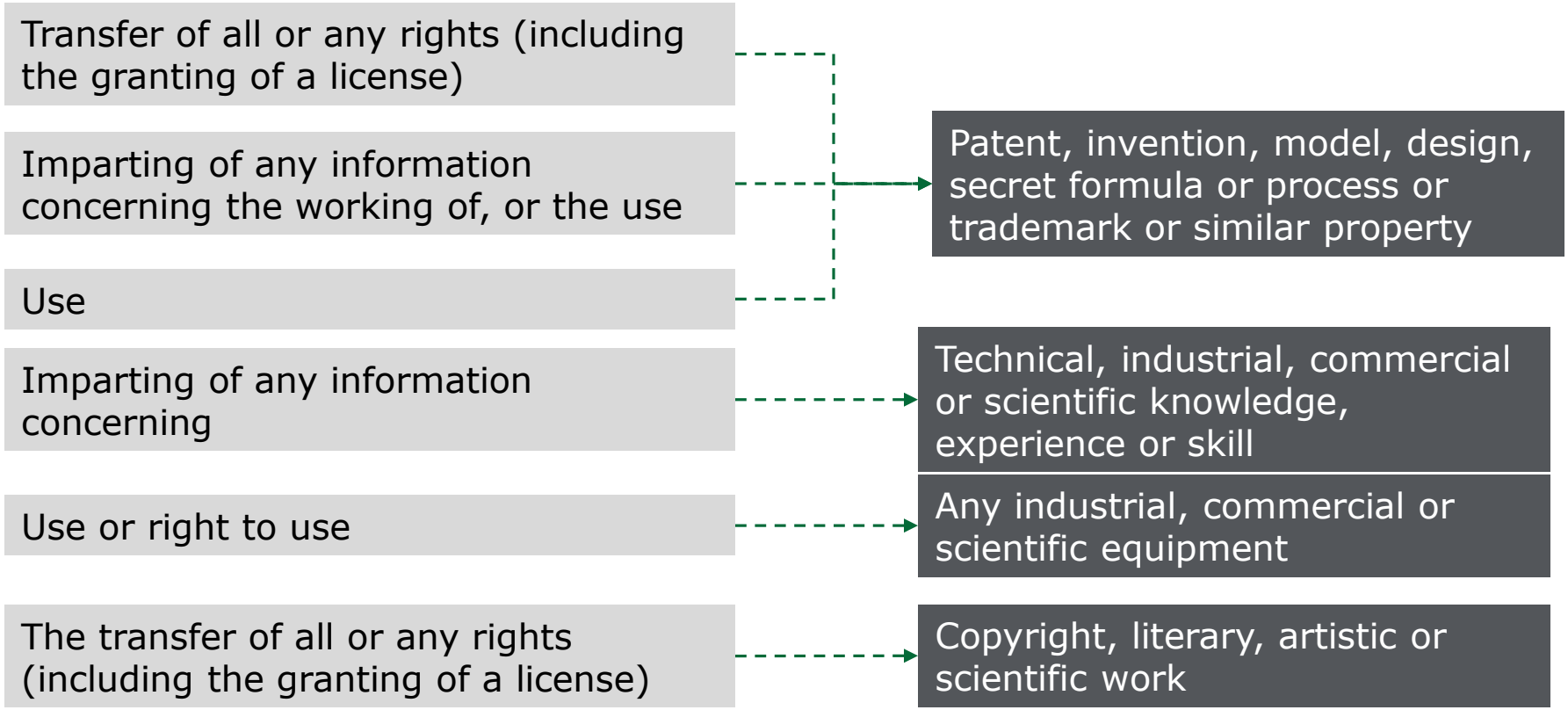
- Payment of arm's length remuneration extinguishes further attribution of income to the NR in respect of BC

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



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

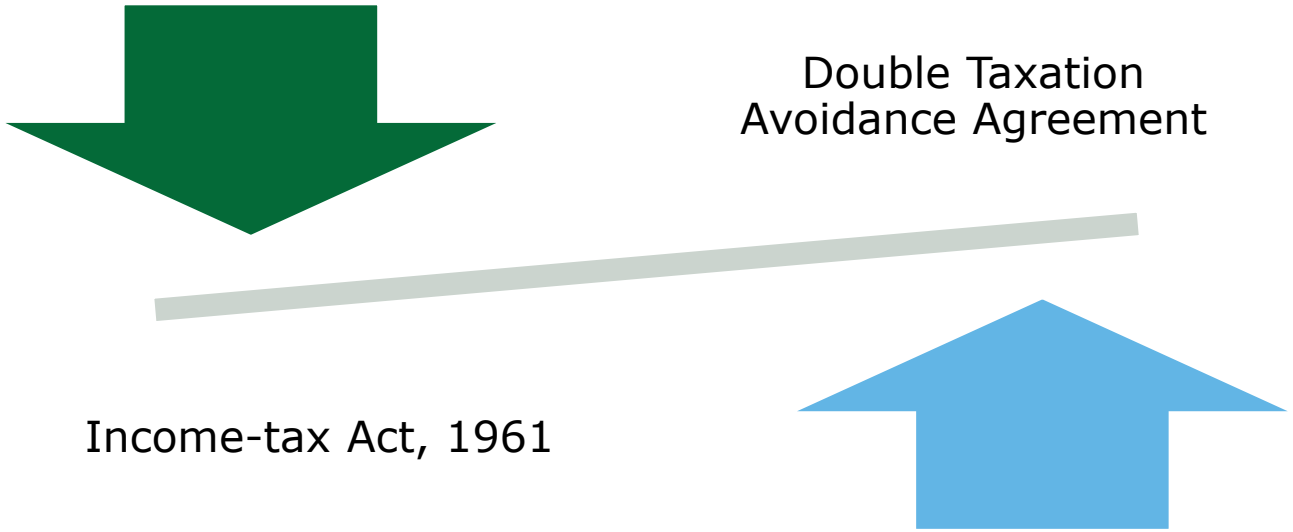
  - consideration which would be income of the recipient chargeable under the head " "Salaries"
- With the new explanation to section 9, the requirement of residence or place of business for rendering services in India has become irrelevant
- Even if no service is rendered in India the amount received 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

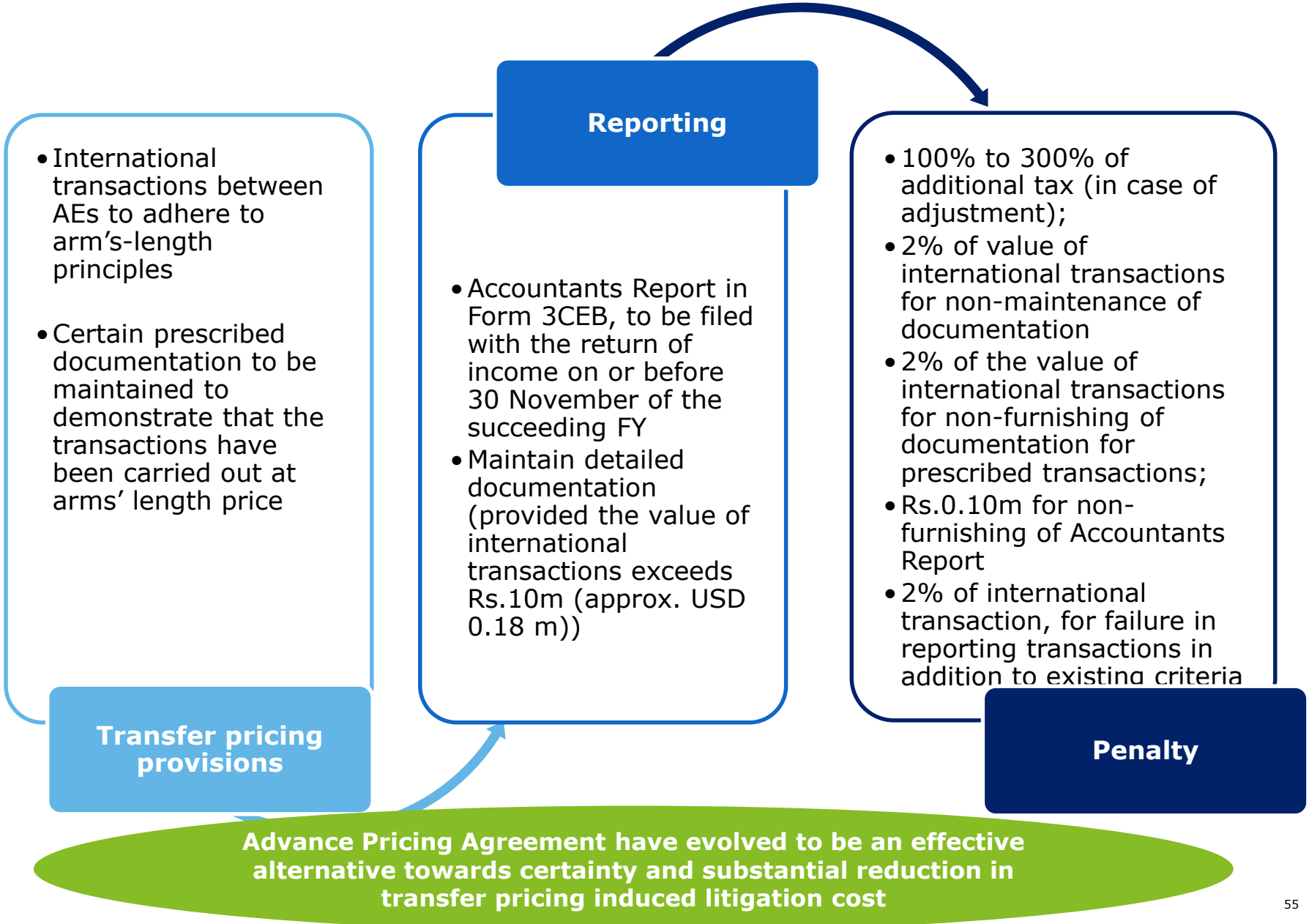
Double tax avoidance agreements (DTAAs)

- 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



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

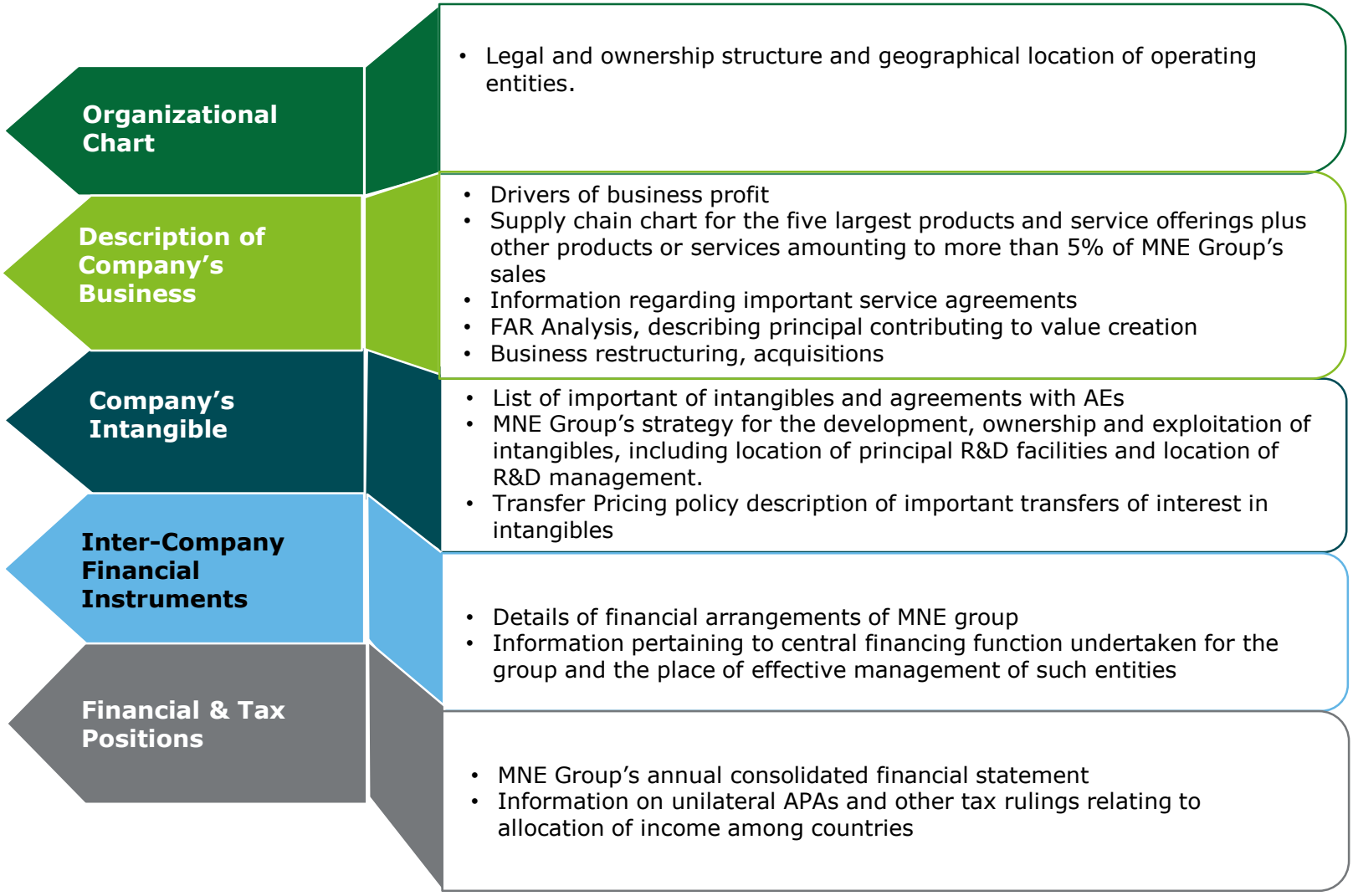
Tax Jurisdiction of organization or incorporation if different
Main business activity of each of the entity

Main business activity(ies)

- Research and development
- Holding or managing intellectual property
- Purchasing or procurement, Manufacturing or production
- Sales, marketing or distribution
- Provision of services to unrelated parties
- Internal financial services
- Holding shares or equity instruments, Dormant, Others

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
• Filing CbC report in India or notification of parent entity • Effective from Financial Year 2016-17	• MNE group having consolidated revenue exceeding € 750 million (in line with BEPS) • 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	• 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	Graded penalty structure from ₹ 5,000 to ₹ 50,000 per day for: • Non-furnishing of CbC report • Non- submission of required information Penalty of ₹ 500,000 for: • Furnishing of inaccurate particulars • Non-furnishing of master file data

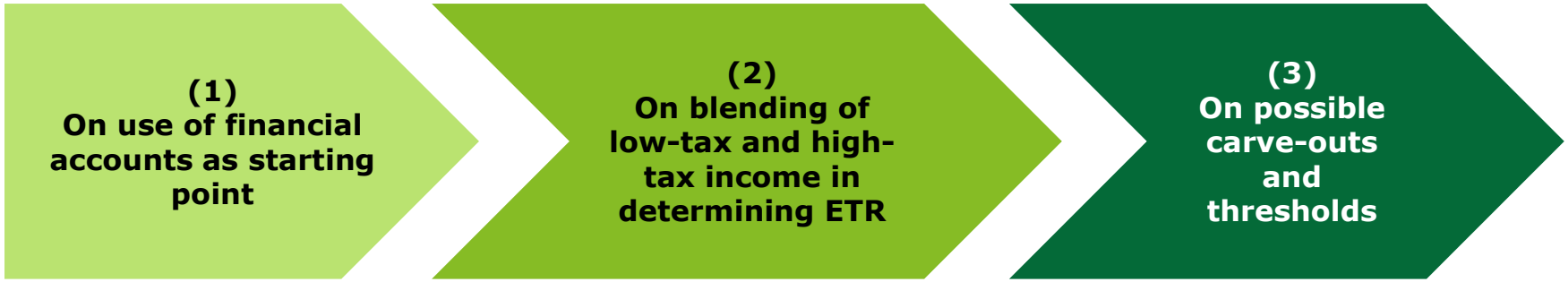
Local file

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

3 technical design aspects in works around OECD’s GloBE approach under Pillar 2

GLoBE – 3 Technical design aspects in works

- Though the consultation document specified that comments are welcomed from various stakeholders on all parts of the proposal, the consultation document seeks comments specifically on three technical design aspects of the GloBE proposal, which are as under:



I. On use of financial accounts as starting point

Consistent tax base

- Tax base to determined by reference to CFC rules or domestic corporate income tax rules of shareholder jurisdiction
- Yearly recalculation of income of each subsidiary of an MNE in accordance with the tax base calculations in the parent jurisdiction
- May result in increase compliance cost as well as administrative burden

Use of financial accounts to determine income

- Accounting standard of ultimate parent company to be applied to all subsidiaries.
- Income calculated for accounting purposes would be subject to agreed permanent and temporary adjustments to determine taxable income
- Income so determined would be used in the denominator of ETR fraction.

Adjustments

- Permanent differences
  - Exclusion of categories of income or expense from the financial accounts due to domestic policy requirements
- Temporary differences
  - carry-forward of excess taxes and tax attributes
  - Deferred tax accounting
  - A multi-year average effective tax rate

II. Blending of low-tax and high-tax income in determining ETR

- GloBE proposal is based on a test that compares ETR to a minimum tax rate (to be agreed by IF). Accordingly, the ETR will factor in various items of income together, some of which will be subject to high rate of tax while others might be chargeable at a lower tax rate.
- The extent to which GloBE proposal could allow the blending or mixing of such items of incomes with varied nature is an important point of consideration upon which the Secretariat has sought public opinion. The following three approaches are suggested:

Blending Approach	Requirement	Levy of additional GloBE tax liability on MNE	Quantum of additional tax liability
Worldwide	Aggregation of MNE's total foreign income & total foreign tax	When tax on the total foreign income is below the minimum rate	Tax as per minimum rate minus Tax on foreign income
Jurisdictional	Aggregation of income & tax amounts on a jurisdiction-by-jurisdiction basis	When tax on income apportioned to each jurisdiction falls below the minimum rate	Sum of the difference in each jurisdiction to bring their total tax on their income upto at par with minimum rate
Entity level	Determining income & taxes of each entity in MNE group (including foreign branch)	When ETR of a foreign entity/ branch was subject to tax below the minimum rate.	Same manner, i.e. difference in tax at minimum rate reduced by tax paid by such foreign entity/ branch.

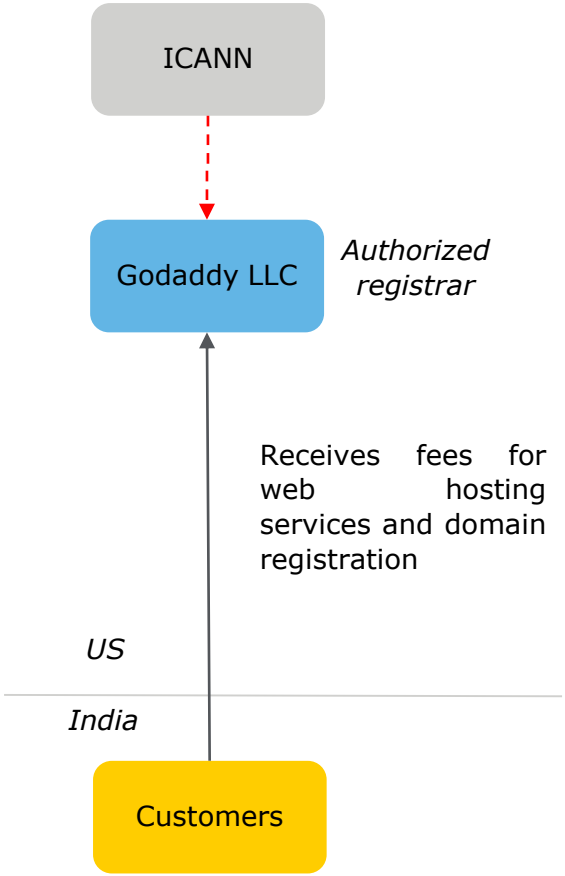
III. Carve-out and thresholds under GloBE rules

- Carve-out to exclude regimes compliant with BEPS Action 5 standards on harmful tax practices;
- Excluding controlled corporations whose related party transactions ("RPTs") fall below the prescribed threshold;
- Based on a return on tangible assets (may be in line with USA's Global Intangible Low-Taxed Income – "GILTI" provisions);
- Thresholds based on turnover or size of the MNE Group;
- Specific sector/ industry based carve-outs;
- De-minimus thresholds excluding transactions/entities with small amounts of profit/RPT.

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)**

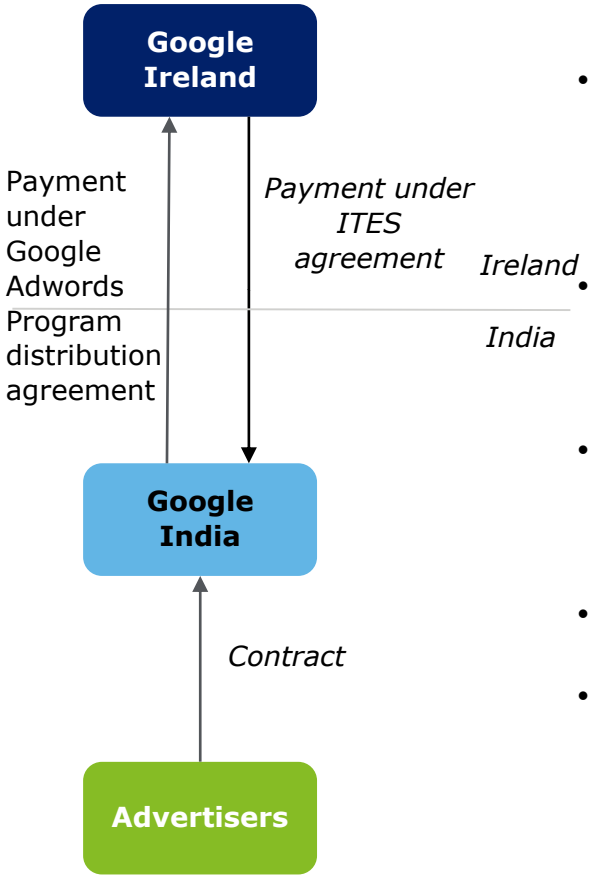
    Domain name is a valuable commercial right and it has all the characteristics of a trademark. Domain names are subject to legal norms applicable to trademark.
  - **Rediff Communications Ltd. (Bom. HC)**

    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.

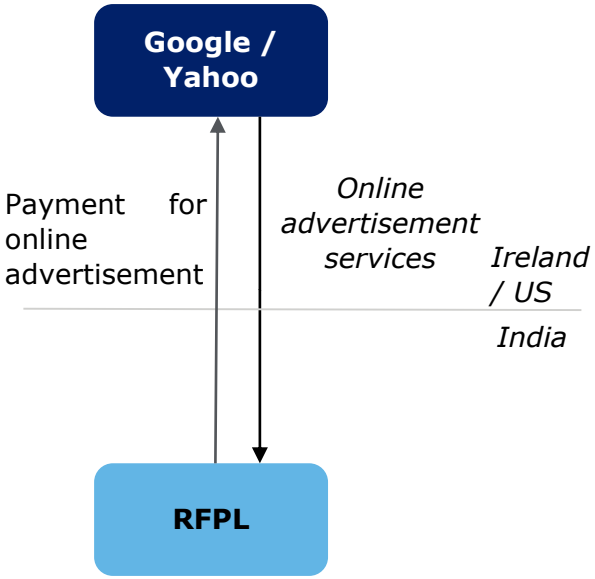
Issues:
Characterisation of amount payable by Google India to Google Ireland under the distributorship agreement

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)?

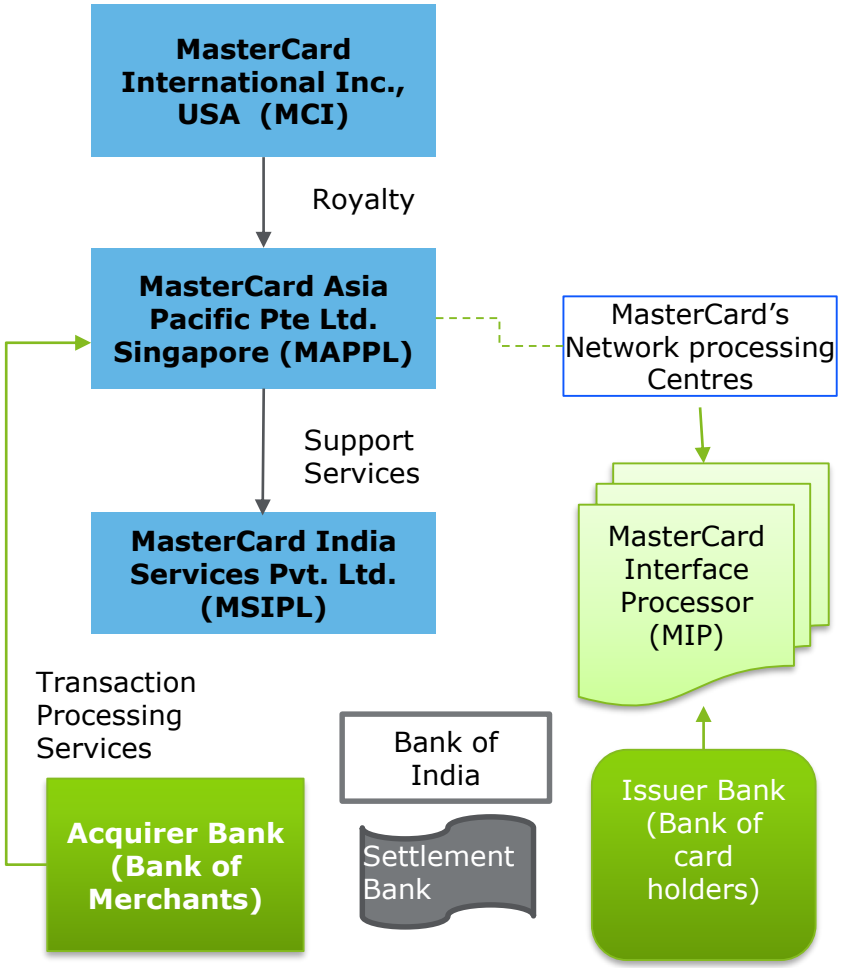
Right Florist (P.) Ltd [2013] 32 taxmann.com 99 (Kolkata - Trib.)

- 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