NEW ECONOMY

INANCE MINISTER'S ADDRESS to G20 reaffirrmed India's steadfast approach to taxing digital companies. The issue of large multinationals not paying their fair share of taxation has been explicitly acknowledged, and work on this has been undertaken under aegis of the OECD's Base Erosion and Profit Shifting Program. The program, however, has taken an interesting turn. Fissures have appeared in the international tax cooperation carved out nearly a century ago. The cause for this is the re-examination of international tax rules that could potentially reallocate taxing rights. The proposals being suggested can potentially shake up the source-residence balance crafted into law. Much to the dismay of developed countries, OECD has suggested the various proposals will be examined and developed without prejudice. This is also in contrast to the beginning of the century, when the rules were first designed. Developing

Digital companies, unlike brick-andmortar companies, can sustain significant economic relations with the market jurisdictions without physical presence. Imagine an e-commerce platform. It can bring together buyers and sellers with just a website that can be hosted through a server located anywhere in the world. Tax

countries, such as India, are now at the

Taxing the digitalised economy

Discussion on economic digitalisation must precede changes in law to ensure a level playing field and protect tax base of digital companies

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authorities have been riddled by such dislocation of taxable presence. It is a challenge to identify what qualifies as taxable presence. This question is being examined in detail bypolicy-makers. While developing countries, such as India, consider user participation or digital revenues as economic presence, others, such as USA, consider only a fraction of the economic profit to be attributable to market's contribution. As countries try to resolve these disagreements to find a long-term solution, Indiahas movedahead on its own by

implementing a series of measures. In 2016, India introduced the equalisation levy through the Finance Act. This levy is withholding on payments to non-resident companies by resident companies in lieu of digital advertising services. India is among the first to introduce this. However, the levy has been criticised widely, primarily, since it is not creditable in the country of residence. As a result, it could lead to over-taxation. As of now, for the thresholds prescribed, the tax is applicable to limited companies offering digital

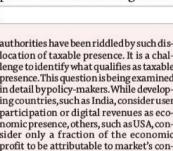
advertising services.

To be able to tax digital companies appropriately in India, the Income TaxAct was amended to add an explanation to the definition of business connection, in 2018. The definition prescribes economic presence based on the user base and sales revenue. Known as the test for significant economic presence, it has so far not been operationalised. The bigger challenge is that even if it were operationalised, it would not apply unless India's tax treaties, too, are suitably amended. Further, if a company is considered as having a taxable presence in India, it remains to be determined how much of its income is attributable to India. For example, hiring platforms may have one of the transactions located abroad. Would the entire value, then, be attributed to India? If not, then how much is the contribution of the Indian user?

Pre-empting such issues and in an effort to move ahead, CBDT recently called for comments on its discussion draft that recommends apportionment of

profits on various factors such as sales. assets and users. The draft proposes that in a situation where it is difficult to ascertain the income of a company, the tax department can use existing rules of the Income Tax Act to compute tax as a percentage of turnover, or in a manner it deems suitable. A seemingly simple solution, it comes with its own set of chal lenges. First, this rule would be triggered only under the condition that the income is not ascertainable. To add to that, where such exact language does not appear, relevant treaties will still have to be amended. More importantly, it is necessary to develop a consistent and nuanced methodology for an acceptable apportionment.

It is commendable that India is lead ing discussions on digital taxes. Undoubtedly, it is important to create a level playing field and protect the tax base. However, the progress of such measures, taken unilaterally, is not unfettered. A network of treaties based on international conventions supersede the domestic law. To find agreeable solutions to overhaul this outdated system, it is necessary that the discussion on economics of digitalisation precedes the change in law. If the question of what constitutes a taxable nexus remains unanswered, businesses may get caught in the crosshairs of unilateral measures.









forefront of discussions.









