History of Digital Taxation
from 1997 to 2021

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Brain Trust on Digital Taxation

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Query: What is so unique in Digital Taxation?

Response:
I am explaining 24 years' summary of developments in Digital Taxation in ten minutes. Let us consider the developments from – Domestic Income-tax to International tax to Digital tax.

1. **Difference** between Domestic Income-tax and International tax is that – In domestic tax we ignore Section 1 on Jurisdiction to tax, Section 5 on Scope of taxable income and Section 6 on residential status. For our regular tax practice, all these are taken for granted. In international tax practice one needs to first determine whether the income-earner is liable to Indian Income-tax or not. The liability to tax is determined by two "**Connecting Factors**".

(i) **Residential status** (Section 6) of the assessee determines the Country of Residence – **COR.**
(ii) **Source of Income** (Section 5) determines the Country of Source - **COS.**

2. Consider an **illustration.**

Tata Iran & Steel Co. Ltd. (**TISCO**) is a company registered in India. Hence under Section 6(3) read with S.2 (26) it is treated as Indian resident and its global income is taxable in India – Section 5(1).

Consider **Jaguar of UK.** It is a Non-Resident of India [Section 6(3)]. Hence, under Section 5(2) only the income sourced in India is taxable in India.

TISCO	India – **COR**	Global Income taxable in India.
Jaguar	India – **COS**	Only Indian sourced income is taxable in India.

3. Understanding COR & COS is very important.

3.1 COR is where the tax payer is Resident. COS is where the tax payer is Non-Resident, but he has a Source of Income.

Let us focus only on "**Business Income**" – **Article 7** of Double Tax Avoidance Agreements (DTA).

3.2 **OECD model** of DTA was **designed when India** was a British colony. European countries considered themselves as exporters of goods, technology & capital – hence essentially COR. Global colonies were COS – from whom the European companies earned profits, dividends, interests, royalties & FTS. From inception, the **OECD model has been designed in favour of COR.** Under Article 7 the Business income is to be wholly taxable only in COR.

3.3 However, if the assessee has a **Permanent Establishment (PE)** in any country outside it's COR, then the income of the PE will be taxable in that host country. The host country is called COS.

Only the income "**attributable**" to PE is taxable in COS. How much income can be attributed to the PE is a huge subject. For transfer between Head Office (HO) and PE, **Transfer Pricing** (TP) rules have been developed. Under the TP rules, prices are to be calculated at "**Arm's Length**".

TP Rules are largely **arbitrary & subjective**. Three persons can have five views. In real market, there is nothing like on "Arm's Length Price" (ALP). It is an arbitrary estimated figure. Hence by their very nature, TP assessments cause huge litigation. To provide for genuine difference of opinions and for administrative convenience, "**Safe Harbours**" have been developed. Thus for example, if the price declared by the assessee is different from the prices calculated by Transfer Pricing Officer (TPO) and the difference is within a prescribed margin (Safe Harbour); then the assessee's declared prices will be accepted.

4. What is a PE?

This concept was drafted around the **year 1920** - when computers, and internet were not even imagined. So the concept was: If a business entity has a "**fixed place of business**" in another country, then that place of business was considered a "Permanent Establishment". (We focus on relevant issues and in this note we ignore other categories of PE.) **Digital Commerce does not need any place of business (PE) in COS**. All issues start with an outdated definition of PE.

5. By the **year 1997**, computers, internet, tele communication, etc. had developed well. OECD realised that traditional rules of International Taxation – for **allocation of taxing rights between COR and COS** - were outdated. These cannot be applied to E-commerce. **OECD OTTAWA conference** declared in the **year 1998** that OECD must develop new principles for international taxation.

While everyone thought there is something wrong, no one had clear **diagnosis** of what is wrong; and what is the **cure**. OECD started studies.

6. In the year 1999 Indian – CBDT appointed **E-commerce Committee** under the chairmanship of CCIT Mr. Kanwarjit Singh to study the issue and recommend a solution. After extensive studies the committee reported in the **year 2001** that the **concept of PE was outdated.** A new connecting factor must be developed for E-Commerce.

OECD rejected this claim. In the **year 2005**, it published a report stating that E-commerce is not too big a business; existing rules are fine and there is no need to change the rules.

OECD is a club protecting rich countries' interests. They are generally COR. Any change in rules would mean loss to COR. So OECD would not recommend a change. Even Indian tax experts rejected the idea that the concept of PE needed revision.

Ecommerce Committee had briefly discussed that even the concept of **COR** will require review. In a truly **Global Corporation**, the country where a company was registered becomes irrelevant. However, this issue was not emphasised.

I continued to write articles stating that the International taxation rules for E-commerce were outdated.

Government of India, as a responsible government did not want to take any **unilateral steps**. Unless & until OECD/ UN take cognisance of the fact that the rules were outdated, taking unilateral steps would be improper.

7. Circumstances change. **Tables get turned**. Digital business expanded beyond imagination. UK, France, Australia & many countries realised that for E-commerce, they were COS and **only CORs were USA & China**. Digital Corporations did elaborate tax planning using tax havens like Ireland, Bahamas etc. They paid zero tax in COS.

UK and France would not tolerate their losses. At their instance, OECD and G20 together announced **BEPS programme in the year 2013. OECD reversed its 2005 opinion** and agreed that International tax rules were outdated and PE needed a review. As usual, no credit was given to Indian E-commerce Committee Report. Fifteen subjects were to be discussed – but priority was E-commerce taxation – renamed as Digital Taxation. Hope was, that for Digital Taxation, a solution will be presented in the year 2014.

8. Any transfer of taxing rights from "USA – the COR" to "rest of the world – COS" would mean **losses to USA**. Hence, internally USA decided that they will not allow the BEPS groups to come out with any Digital tax solution till the year 2020. But publicly it raise issues of bogus principles. And world went on discussing irrelevant issues.

Well before BEPS report could be finalised, USA came out with its anti-avoidance provisions – **GILTI & BEATS**. **US Tax Base** was secured.

Mr. Robert Stack was **IRS team leader at BEPS** Action One Task Force. On his retirement from IRS in the year 2017, in an interview he claimed credit for successfully preventing OECD BEPS Task Force One from coming to any conclusive solution. BEPS group could not come out with any solution till March, 2021.

9. In the meanwhile, in the **year 2015**, BEPS One published an interim report and mentioned three alternative systems of E-commerce taxation. India grabbed the opportunity. A second **Ecommerce committee** was appointed under the chairmanship of Mr. Akhilesh Ranjan. It quickly gave report in favour of **Equalisation Levy**. In **Feb, 2016**, Equalisation Levy was imposed. This was a simple taxation system based on revenue that a Digital Corporation would receive from India as the **Country of Market** (COM). This became a **third Connecting Factor** in addition to COR & COS. No Transfer Pricing, no ALP, a simple and effective system. Again, Indian tax profession objected to EQL. But this move was a good help in bargaining power at BEPS. This was the main purpose. In the **year 2020 second version of Equalisation Levy** was brought about expanding the scope. This generated a lot of heat & objections.

Also, the concept of **Significant Economic Presence (SEP)** was introduced in the Income-tax Act, section 9. Tax professionals focussed on interpretation. Rare were the professionals who tried to understand the global tax negotiations that were going on and the strategies that CBDT officers were trying at BEPS.

10. USA was angry with India over EQL. But country after countries expressed their frustrations that US was not allowing a good solution at BEPS One level. British Government imposed "**Diverted Profits Tax Act**" to tap the taxes avoided by Digital Corporations.

French Finance Minister aggressively pursued digital tax alternatives. US President **Mr. Trump** threatened European countries with a **Trade War** – if they brought in any unilateral tax on digital businesses.

There was a dead lock at BEPS one. The group did not give any report. Finally **OECD Secretariat** published some garbage called Pillars 1 & 2. Note: the word 'garbage' is used for a purpose. We Indians have a huge "awe" for OECD as a global leader in the field of Double Tax Avoidance Agreements. OECD model DTA & commentary are "Geeta" for us. Know that OECD is a tool in the hands of powerful vested interests. Its **failure in digital taxation** is 'writing on the wall'. OECD had no courage to offer any solution that would not be liked by USA. And OECD did not allow BEPS one –

which included non-OECD countries to make any progress. OECD proposals announced in the **year 2019 for Pillars 1 & 2** were extremely complicated, subjective & sure to generate litigation.

11. U.N. model of DTA is less unjust & unfair as compared to OECD model. In the year 2021 **UN committee** adopted **Article 12B** drafted mainly by Indian tax officer Mr. Rajat Bansal. This draft offered a simple & effective method for Digital Taxation. This boosted bargaining power at BEPS One. USA never accepted it but realised that the whole world governments were against US Unilateralism in Digital Taxation.

12. It has been a long struggle and many times under threats – Trade War threat by Mr. Trump; Sanctions threats by US Trade Representative – USTR and so on. Indian side has worked with far less resources than the resources available with US IRS officers and others. A large lobby and political support were available to the IRS officers.

13. The struggle is not yet over. Statement published on **1st July, 2021** is only a work-in-progress. A lot has yet to happen before the negotiations become law.

14. Now the team of tax officers representing Indian side at BEPS One consists of Shri Rashmi Ranjan Das & Shri Chetan P. S. Rao. Shri Das will tell us subsequent developments.

15. My observations:

1. There is nothing unique about Digital Taxation. Only issue has been:

2. New technology - Digital communications opened up new business models. Old system of allocating taxing rights amongst nations was unfit for new business models. OECD & others took 16 years (1997 to 2013) just to recognise this fact.

3. Old system was good for USA. Any changes would mean revenue losses to USA. So it did not allow OECD and the world to make any progress for 8 years (2013 to 2021).

   It only proves that the forces of Maya: Greed and ego (□□□ □□ □□□) apply to the world's most respected institutions and to Super Powers. Do not accept their statements just because they are "Super".