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Chamber of Tax Consultants
Compendium on International Taxation - 2019

Tax War on International Taxation For Digitalised Economy

Paper by
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Notes:

1. In last twenty years we have written many papers on E-commerce Taxation. This is one more paper. So what is new? **Tax War between COR & COS** countries has now reached a climax. We are explaining the factors behind the war & suggesting solution. Our own conceptual thinking has also improved by considering several views in the international arena.
Our proposal for Digital Taxation is given in **Part I** below.

2. OECD-G20-BEPS Action One – Digital Taxation - Task Force (In short **BEPS DT Committee**) is now expecting to make final report suggesting new rules for Digital Taxation. We are considering in this paper, the latest publication by BEPS DT committee. They have published Public Consultation Document (PCD) dated 13th February, 2019. It is available on the web link:
https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

We have presented our comments to **OECD** as a response to the PCD. It is published on OECD web link:
http://www.oecd.org/ctp/beps/public-comments-received-on-the-possible-solutions-to-the-tax-challenges-of-digitalisation.htm

This paper has been also submitted to and discussed with **CBDT** Chairman and CBDT Member Legal.

Present article is modified for the purpose of **Chamber's Compendium** on International Taxation. Our comments on the OECD PCD are presented in **Part II** of this paper.

3. **European commission's** directive on Digital Taxation & our comments on the same are presented in **Part III** of this paper.

4. **Names** of some large, popular/ successful companies have been taken in this paper. This is only to illustrate a kind of business that they undertake. We have no knowledge of real facts & taxation applicable to these specific companies. We have no comments on taxation of these specific companies.

5. **India** has two separate provisions to tax digital business – (i) Equalisation Levy and (ii) Significant Economic Presence. Our attempt is to present a complete system of digital tax taking good aspects of both provisions.

6. This is a long paper because (i) we are bringing out COR Vs. COS conflict and (ii) offering solution which is outside the OECD Framework. We have offered justification for the same.

Next Page: Part I
Proposal for Digital Tax – SEP & Data

Executive Summary:

1. Summary of the Paper & other details:

1.1 Terms used in this paper:

BEPS DT Committee: OECD-G20 BEPS Action One Task Force for Digital Taxation.

COR: The country in which the Digital Corporation is tax resident is called Country of Residence.

COS: The country other than COR in which the Digital Corporation performs certain functions and/or has assets, employees etc. is called Country of Source.

COM: The country in which the Digital Corporation markets and sells its goods and/or services without residence, without a PE & without any functions, assets or employees in that country is called the Country of Market. For illustrations of COR/COS & COM, please see paragraphs 2.3 & 2.4 below.

Digital Tax: For the sake of convenience in this paper, the tax covered under OECD/ G20 paper is called **Digital Tax.** Tax levied by the Country of Market - on profits earned from digitalised business is Digital Tax.

Name of this tax has changed several times. In 1990's it was called E-commerce Taxation. Then Digital Taxation. And now, Tax on Digitalised Economy. In near future, it is possible that people will be able to do business in a third country without having a PE and without using digital instruments. Probably then, as per OECD practise, a new name will have to be developed. That will mean changing almost three thousand treaties and a hundred domestic tax laws.

The name does not matter as long as we understand that we are referring to "taxation of profits arising to a Non-Resident from selling of goods or services in a Country of Market without a PE".

Digital Corporation: (DC) The Tax payer or the assessee conducting digitalised business liable to pay Digital Tax is referred to in this paper as Digital Corporation. In reality it may be a company, individual, or any other form of business entity. Sometimes, short form DC is used to indicate Digital Corporation.

"**Digital Commerce**" & "Electronic Commerce" or "**E-commerce**" – all terms are considered as indicating the same kind of business as far as taxation is concerned.

DT: Name of Tax covered under this subject: Digital Tax or DT.
EU: European Union.
EC: European Commission which has made the proposal for Digital Taxation rules within European Union.

G4: Group of Four Nations: U.S., U.K., Germany & France. Countries that favoured Residence based tax. COR.

G3: Group of Three Nations: U.K., Germany & France. COS for Digital commerce. COR for rest of the incomes.

Industrial Countries: There are tax havens. Countries which are not tax haven are referred to as **"Industrial countries"** – irrespective of whether they are "Developing Countries" or "Developed Countries".

PE	**:**	Permanent Establishment
RSA	**:**	Rashmin Sanghvi & Associates.
SEP	**:**	Significant Economic Presence -term used by India. This is a broad term that can be applied to whole economy.
SDP	**:**	Significant Digital Presence – term used by European Commission. This is a narrow term that can be applied only to digital business.

OECD/ G20 PCD : OECD/ G20's Public Consultation Document for addressing challenges of the digitalisation of the economy – dated 13th February, 2019.

Products: **Products** include goods as well as services. The term applies to digital as well as non-digital commerce.

WHT= TDS: Withholding of Income tax. Withholding tax is the term used in some countries. This is same as TDS or Tax Deduction at Source – the term used in India.

1.2 Need for Change in International Tax System:

(i) Inadequacy of old law to deal with modern business models:

It is now well accepted that existing rules of international taxation for establishing **Nexus** (Permanent Establishment) and for **Attribution of Profits** are not adequate to deal with digitalised business (Ecommerce). In absence of a PE which can be applied to Ecommerce, the non-resident Digital Corporation cannot be taxed by the Country of Market (COM) irrespective of the revenue earned by the entity from COM. Having

accepted these facts, the OECD/ G20 Public Consultation Document presents three proposals for addressing the tax challenges.

We have been saying this fundamental position from the year 2000. Now that BEPS DT Committee has accepted it, we proceed further. We need to find new ways of establishing Nexus and Attributing Profits that can be applied to Digital Taxation.

Compared to the term "Attribution of Profits", a simpler term will be computation of **Tax Base** for the COM. This matter is discussed further in paragraph 7 below in this paper. (Note: This is a very important shift in the approach. It makes things simple & fair.)

(ii) Residence Vs. Source Conflict:

Residence Vs. Source conflict for attribution of profits (or distribution of tax base) is an old controversy. Residence countries have won the battle. Major part of International Tax Base goes to Residence countries. We may broadly consider following countries as "favouring Residence based taxation"– U.S., U.K., Germany, France (**G4**) & a few other developed countries. Interestingly, E-commerce business has so developed that for E-commerce Tax Base, now mainly U.S. may be considered to be the COR. China is indifferent. Rest of the world is COS.

OECD/ G20's PCD– presents three proposals. We focus on the SEP proposal and explain why with further simplification, it can be a good proposal.

1.3 Scope of this Paper:

(i) Domestic Taxation: When the tax payer is resident in a country and sells its goods and services in the same country; COR, COS & COM are one and the same country. In such cases, there will be **domestic taxation**. It is **not discussed** in this paper.

(ii) Regular International Taxation: When the tax payer is resident in one country (COR) and performs its functions (or has assets/ employees etc.) in another country or earns revenue like royalty, fees for technical services, interest, etc. from another country (COS); there is **Regular International Taxation.** In this paper we are discussing regular international taxation only to the extent it is necessary for main issue: Digital Taxation.

(iii) Digital Taxation: We are discussing in this paper only the business which is conducted by the Digital Corporation (DC) in a country which is neither COR nor COS but which provides market. The DC markets its products or services in a third country without having any PE

etc. in that country. Taxation of such Ecommerce or **"Digitalised Commerce"** is discussed in this paper.

1.4 **Summary of the tax system proposed:** We suggest that profits derived from Digitalised Business/Ecommerce may be taxed by the COM in the following manner:

(i) Nexus: Simplified Significant Economic Presence (SEP): **Market** available in the COM is the SEP. It will establish the nexus for the Country of Market (COM) to tax a non-resident Digital Corporation's income from **prescribed business**. Revenue Realisation above **a threshold** will be the **Tax Base**. Article 5 of the OECD model may be amended and two clauses for SEP & Data may be added.

(ii) COM represents **demand side** of the business while COR & COS represent **supply side** of the business. Both sides should get distribution of taxing rights.

(iii) For establishing correct/fair **Attribution of Profits,** it will be necessary for the DC to file tax returns in scores of countries where it operates; and then provide substantial data in a manner in which the tax administrators of the COM can verify correctness of the data. Information Exchange Agreements and sharing of consolidated data will not be adequate for COM tax officers. DC will have to establish before Tax officers of all COM that it has not resorted to tax avoidance under BEPS, Transfer Pricing, GAAR, GILTI & BEAT etc. This can be extremely subjective matter causing disproportionately large costs for compliance and administration. This can cause litigation.

Instead of attribution of profits, we are suggesting **attribution of tax base.** Total revenue realised in the COM by the DC, will be the tax base in COM. A **Withholding Tax** on the revenue realised being a **final tax** (like tax on royalty) may be imposed as **Digital Tax**. Since this will be a tax on active business revenue, the withholding **tax rate may be 5**% or such other low rate. Royalty etc. are normally taxed at 10% or higher rate.

(iv) Digital tax will be applicable to **"B to B" & "B to C" –** all kinds of digital commerce. However, payments below a **threshold** will not attract liability to deduct tax at source. Hence home consumers will not be liable to deduct tax. DC will be liable to file return and pay tax.

(v) Tax Return Filing: There are two aspects to tax return filing.
Firstly, Compulsory filing of return.
Home Consumers will not deduct tax at source. Even business consumers paying below the WHT/TDS threshold will not deduct tax at source. It will be the responsibility of the DC to file return, calculate tax payable; and

pay the shortfall – difference between total tax payable and tax deducted at source.
Secondly, the DC may want to file return and claim that – either it has to pay a lower tax; or it is entitled to a refund. This option to claim refund will be granted to the DC provided that the DC can satisfy the tax officers in COM that it has not resorted to BEPS, TP, GAAR etc.
Please see paragraphs I.9.5 & I.10 below.

(vi) Elimination of Double Tax: The tax withheld in the Country of Market (COM) should be available for set off against the tax liability in the Country of Residence (COR).

(vii) SEP & Attribution of Profits are discussed separately for Data & other Ecommerce businesses.

(viii) Compliance & Administration Machinery: Under this proposal with WHT (TDS) as final tax, the tax system will be fairly simple for both – the tax payer (Digital Corporation) and the tax administrator – Government of COM.

(ix) Equalisation Levy (EQL) may continue until full digital tax has been legislated and necessary double tax avoidance agreements have been executed. For some period EQL & SEP both will be part of the law. However, income charged to tax under EQL shall be exempted from SEP based tax.

1.5 Observations on Global Trend:

1.5.1 Study of tax proposals by India, France, U.K., European Union and other countries shows a trend. All countries where digital services are sold without a PE, want to tax the digital corporations. Essentially, they all **want to levy a tax based on revenue**. However, following difficulties arise:

1.5.2 USA is insisting that:

(i) Any new proposal should not be a unilateral law. US have not signed MLI. US have made unilateral laws – FATCA, GILTI & BEAT. But US want all other nations to avoid unilateral law. This is known in the world as **US – Unilateralism** or Exceptionalism. It is clearly unfair.

(ii) All nations are to make laws within **OECD Framework**. The tax proposal should be **based on principles** and not an adhoc proposal. This demand is made when OECD framework is defective and OECD has taken twenty years to come to a proposal.

(iii) There should be **no Ring-Fencing** of Digital Taxation. In other words, any new tax proposal should be applicable to all commerce and not exclusively to digital commerce. Prima facie, this is a fair proposal. However, there are many more defects & inequalities in OECD model. These defects and inequalities need to be removed before making a tax law that applies to digital commerce as well as bricks & mortar commerce. Recognition of these defects & inequalities by OECD & USA may take other twenty-years. And COMs cannot wait for twenty years before taxing digital commerce.

(iv) Such a legal impossibility is faced because all major Digital Corporations are residents of USA. If other countries start taxing these DCs, **US Government will be the worst sufferer.** US Government will not allow it.

1.5.3 Some Governments cannot comprehend the difficulties and most cannot find a way out.

1.6 We are presenting separate parts for the following:

Part I **SEP:** Elaboration of the above referred (paragraph 1.4 above) summarised taxation system for digitalised business income; and justification for the same are given in Part I.

Part II **Other Two Proposals by OECD:** Our comments on the proposals – "**Marketing Intangibles" and "User Contribution"** are partly given in Part I. See paragraphs – 3 – especially 3.10, 5, 7.2, 7.6. Details on these two proposals are given in Part II of this paper.

(i) In our submission, both these proposals in OECD PCD will cause disproportionately large costs for compliance and administration.

(ii) These two proposals **allot unfairly small tax base to the COM.**

(iii) In our view both these proposals should be dropped and SEP as simplified in this Paper should be adopted.

Part III **European Commission** has published directive for digital taxation in European Union. This proposal is discussed in Part III of this paper.

Summary Completed.

Next page:
Part I – Simplified SEP based international taxation
for Digital Commerce business.

Part I: Simplified Significant Economic Presence (SEP):

2.1 Popularity of SEP:

(i) There is a substantial support for the concept of Significant Economic Presence. **European Union** (EU) has made concrete proposals for SEP. **India** has already proceeded with legislation of SEP. **USA** follows it for sales tax on interstate trade. Several other countries are at different stages of legislation for taxing Non-resident's Ecommerce income. The work on SEP is incomplete because of non-conclusion of BEPS Action 1 Report. The remaining work can be completed soon after OECD/ G20 publish final report on BEPS Action 1.

(ii) US practices for Sales Tax on interstate trade:

Within USA states levy sales tax. When a corporation of one state sells goods in a second state (interstate trade) without having any presence in the second state; can the second state levy sales tax on the sale transaction? **US Supreme Court in the case of South Dakota V. Wayfair Inc.** upheld the right of the second state to levy the sales tax. Honourable Supreme Court has stated following important principles for validating sales tax:

*"Validity of state taxes, …will be sustained so long as they (1) apply to an activity with a **substantial nexus** with the taxing State, (2) are fairly apportioned, (3) do not discriminate against interstate commerce, and (4) are fairly related to the services the State provides."*

Observation – Sales without physical presence has been accepted as substantial nexus by US Courts & Government. This is distribution of taxing rights within USA. However, when it comes to international taxation, USA is not accepting sales as nexus. US Government is ready to accept "sales as nexus" for indirect taxes; but not ready to accept it for direct taxes.

The ratio of the decision is comparable with the concept of SEP.

Translating these principles for international income-tax we can say that:

1. Any country can levy a tax only if there is a substantial **nexus** between the country and the activity.

2. The tax should be **fairly apportioned** between COR, COS and COM.

3. The tax should **not discriminate** against international business.

And

4. The tax should be related to the **Contribution by that state** to the international business.

With highest respect for the US SC, we are trying to apply these principles to our proposal in this paper.

2.2 Inequity in Existing Tax Base Distribution:

A. Digital Corporations' global profits are a **global tax base** for all countries that contribute to these profits. But many countries do not get their due share of global taxes. Global tax base is not fairly apportioned/ distributed amongst different countries.

Let us try to understand in this paper:

(i) **Inequity** in the Existing Treaty Models & practices.
(ii) Attempt to **continue** similar inequity for Digital taxation.

B. Consider **tax base distribution** under existing Model.

It is clear that in global taxation, major profits are made by MNCs. The earnings by individuals etc. are a fraction of MNCs' earnings. Within MNC earnings major portion is Business profits. Whole of Business income is taxable in COR. In case of Permanent Establishment (PE) the profit attributable to the PE –is available to the host country. But this is a small portion of business profits available to COR as tax base. **Largest portion of tax base – Business income stays with the COR.**

C. So far, all the discussion on profit attribution amongst different countries is based on the **functions performed by the assessee - Digital Corporation.** Tax jurisdiction under existing model is based on **supply side** of goods & services. The **demand side** or **Market is given zero attention** in distribution of tax base. OECD/ G20 PCD specifically states that these are "not relevant for allocation of a firm's profits under general tax framework." See page No. 12, paragraph No. 33. This is denial of Tax Base distribution on the basis of contribution to profits by the Country of Market. This basic defect in the OECD treaty model needs to be amended. It is necessary to develop the concept of Country of Market (COM) as a distinct concept, separate from COR & COS. A country must get taxing rights because it provides market. **Market is the nexus just as Residence is the nexus.**

Since the fundamental existing method to determine Nexus is unfair, the distribution of Tax Base to COS & COM remains unfair. If this system is to be made fair, OECD model needs fundamental modifications.

It is said: "Think out of the Box." However, if an organisation remains controlled by COR countries and if COMs do not get a fair share in global tax base, a stage may come when countries will say: "Discard the box". Create a new organisation which is fair to all countries.

2.3 Consider an illustration of Bricks & Mortar /traditional business:

A Japanese automobile company manufactures automobile cars in Japan. So Japan is **COR**. The company manufactures through its PE steel components in India. It has a factory in Malaysia to manufacture rubber tyres. Now India & Malaysia are **COS**. This company sells cars in USA without having any PE in USA. (This is assumed for illustration. In reality it is impractical to sells cars in USA without establishing a PE in USA.) Now in our illustration USA is **COM**. It gets zero tax base under the present OECD & UN model treaties.

2.4 Illustration of Digitalised Business:

Consider an MNC in digitalised business. It is tax resident of USA. Hence USA is **COR**. It has set up a giant server farm in North Ireland. The MNC has a team of 3,000 employees managing these servers which form an integral part of MNC's global business. Let us say, this is an Irish branch for the US MNC. It is treated as a Permanent Establishment in Ireland. Hence North Ireland is **COS** for the profits attributable to Irish Branch.

The MNC earns billions of dollars from rest of the world (other than USA & North Ireland). These other countries are Countries of Market (**COM**). They are entitled to zero tax base. Under the existing OECD & UN Models, they cannot get single dollar tax revenue from this MNC. This suits COR of the Digital Corporation.

Please note the difference between (i) COR & COS on **Supply side** & (ii) COM on the **Demand side**.

3. Brief History of OECD work on Ecommerce Taxation during last 20 years:

3.1 In or before the year 1997 OECD started working on Ecommerce taxation. In the **year 1998** it published Ottawa report and stated that "*Electronic commerce has the potential to be one of the great economic developments of the 21st Century.*" The report further stated that:

"Box 4. The post-Ottawa agenda (continued) International tax arrangements and co-operation:

(viii) With regard to the OECD Model Tax Convention, clarifying how the concepts used in the Convention apply to electronic commerce, in particular:

*(a) To determine taxing rights, such as the concepts of "**permanent establishment**" and the **attribution of income**; and ……."*

Note that two important concepts for a better Ecommerce taxation system were identified in the year 1998: (i) Permanent Establishment & (ii) Attribution of Income. After twenty years, in 2019, OECD is still debating these issues. Why it could not find a solution for twenty years? Digital taxation is not inter-galactic travel science. Then what has prevented a good, sound tax proposal?

3.2 **In the year 2001,** Indian Committee on Ecommerce Taxation presented its report. Committee reported that:

Page 12, Summary: "*PE should be abandoned and a serious attempt should be made within OECD or the UN to find an alternative to the concept of PE."*

However, Committee did not want unilateral action by India. Hence it reported that:

Page 14, Summary: *"No changes in the Act or the DTAs are required till international consensus on abandoning the concept of PE is reached."*

3.3 **In the year 2005,** OECD published a report stating that Ecommerce business was small, existing rules of international taxation were fine and there was no need for change. See OECD TAG report at:
http://www.oecd.org/tax/treaties/35869032.pdf

Conclusion: Page 72, Paragraph 350:

*"350. As regards the various alternatives for fundamental changes that are discussed in section 4-B above, the TAG concluded that it would not be appropriate to embark on such changes at this time. Indeed, at this stage, **e-commerce** and other business models resulting from new communication technologies **would not, by themselves, justify a dramatic departure from the current rules**. Contrary to early predictions, there does not seem to be actual evidence that the communications efficiencies of the internet have caused any significant decrease to the tax revenues of capital importing countries."*

3.4 **In the years 2007 onwards** USA & Europe suffered serious economic crisis. This made loss of tax revenue unacceptable.

3.5 **Around year 2012 UK Parliament** was frustrated with aggressive tax avoidance by Starbucks, Google and Amazon. **Public Accounts Committee** investigated the matter. **Ms. Margaret Hodge**, who chaired

the parliamentary committee, told the BBC that she thought it was right for customers to boycott the three companies.

"One of our concerns is that the ability of global companies to choose where they put their costs and their profits gives them an unfair tax advantage that damages UK-based businesses," she said.

This Committee published a report in the month of June 2013. Summary:

"To avoid UK corporation tax, Google relies on the deeply unconvincing argument that its sales to UK clients take place in Ireland, despite clear evidence that the vast majority of sales activity takes place in the UK. The big accountancy firms sell tax advice which promotes artificial tax structures, such as that used by ***Google and other multinationals, which serve to avoid UK taxes rather than to reflect the substance*** *of the way business is actually conducted. HM Revenue & Customs* ***(HMRC) is hampered by the complexity of existing laws****, which leave so much scope for aggressive exploitation of loopholes, but it has not been sufficiently challenging of the manifestly artificial tax arrangements of multinationals. HM Treasury needs to take a leading role in driving international action to update tax laws and combat tax avoidance."*

This is an important report and researchers on the subject of Digital Tax may read it at:
https://publications.parliament.uk/pa/cm201314/cmselect/cmpubacc/112/112.pdf

3.6 **Britain, France & Germany – G3** did not find tax avoidance by US MNCs as acceptable. At their insistence, in the year **2013, BEPS programme** started. Since they considered tax avoidance by Ecommerce MNCs as the most important issue, it was listed as BEPS Action 1.

3.7 **In November, 2015,** BEPS Action reports 2 to 15 were published. But Action 1 could not be finalised. Only an interim report was published. Till March, 2019, there is no solution on Ecommerce taxation.

3.8 **In year 2016** European Union found a novel way to address tax avoidance by highly digitalised business corporation – Apple. EU levied a penalty on North Ireland – to be recovered from **Apple Corporation** for Euro 13 billion. This was a **beginning of Tax War between EU & USA**. This cold war continues.

3.9 **In the year 2018 EC** has published reports recommending taxation based on **Significant Digital Presence**.

3.10 **In February 2019** OECD/ G20 have published a Public Consultation Document (PCD) analysed in this paper. The PCD presents three proposals. For all three proposals there are (i) factors to determine **nexus**;

and (ii) factors for **attribution of profits**. When it comes to attribution of profits, the PCD provides that routine profits will be taxable only in COR. Out of "**non-routine profits"** attribution to COM may be a small component. Going by British experience with Amazon, Google & Starbucks, the COM will get a small fraction of profits as British Tax base. The **fears expressed** in June 2013 by the British Public Accounts Committee (See paragraph 3.5 above.) have not been addressed at all. In fact, these fears now seem too real & permanent. Even the third paragraph for **anti-avoidance provisions** will help only COR; and may not help COM. If a US corporation avoids US – COR taxes, US IRS can apply GILTI & tax the corporation. But Britain as COM cannot apply such rules stated in the PCD.

PCD proposals ignore demands by several nations to distribute tax base fairly. It proposes to distribute tax base mainly to COR. Serious efforts by UK & EU have not given results – at least so far.

We can say that PCD proposals for Marketing Intangibles and User Contribution will lead to a law so complex that many tax departments around the world will find it difficult to administer; and digital corporations may find it difficult to comply with.

4. Why US is against any significant change in Ecommerce taxation:

If COM countries levy tax on American MNCs, USA will lose that much tax. See table below for a clear idea.

Comparison of Tax Consequences when US company avoids tax in COM	**No Avoidance in COM U.S.$**	**Successful Tax Avoidance in COM U.S.$**
U.S. Digital Corporation		
Revenue from COM	1,000	1,000
Tax payable in COM @ 10%.....	100	NIL
Tax payable in USA @ 21%	210	210
Set off under Article 23B of OECD Model…	100	NIL
Balance tax payable to U.S. Government	110	210
If no tax is paid in COM, the tax payable in USA		210
Since COM loses that tax; other tax payers in COM have to suffer additional burden		100

This is the reason why U.S. Government would be happy when U.S. MNCs avoid taxes of rest of the world. Gain for USA is loss for rest of the world.

5. Summary of discussions so far (Paragraphs 1 to 4):

Existing system of international taxation **needs to be modified** for **two reasons:**

(i) Under existing system, while considering taxation of Digital business conducted by a Non-Resident, it is difficult to determine **nexus & attribution of profits**. Concept of PE as defined under existing models cannot be applied to E-commerce business.

(ii) Existing system is **inequitable** with larger distribution to COR & smaller distribution to COS/COM.

This inequity is sought to be continued under the PCD proposals. Having understood the inequity in the OECD/ G20 PCD, let us consider alternatives. We propose a tax system based on SEP. It is explained below.

6. Our Proposal:

(i) SEP based system for distribution of Tax Base. Market is the SEP.

(ii) Revenue Realisation by DC in COM is the Tax Base for COM.

(iii) A low withholding tax rate on **Tax Base** as final tax in COM. (Option to assessee for claiming refund may be given subject to conditions.)

(iv) Tax borne by Digital Corporation at COM to be credited against tax payable at COR.

7. Simplified Significant Economic Presence:

7.1 (i) We are suggesting that instead of calculating **net profit** attributable to the SEP, calculate the **gross revenue** attributable to the SEP. Consider gross revenue as Tax Base. There is a difference between the two concepts: "Attribution of Profits" & "Attribution of Tax Base". [Please see paragraph 1.2(i) above.]

(ii) Attribution of Profits involves computation of: gross revenue, deduction of allowable expenses, computation of net profits (subject to several anti-avoidance measures), nexus with COR, COS & COM. Then based on certain formulae – attribute a portion of total profits to COS or

COM. (Whole of the profit is taxable in COR. Hence attribution is not necessary for computing COR tax liability.) Every formula for attribution of profit (FAR or FARM) and many components of the formulae – are subjective. **Litigation is built in.**

(iii) Tax Base Distribution: COS & COM find it difficult to verify several figures given by Digital Corporation. They need simplified methods to get their share of tax. Hence under Tax Base Distribution - the gross sales amounts received from COM by the DC will be distributed as Tax Base to COM. Thereafter it is the original right of the COM Governments to determine how to tax that revenue.

(iv) Distribution Rules: OECD uses language: "**Allocation** of taxing rights." As per late Professor Klaus Vogel's opinion, this is incorrect. Taxation is the Original Right of the Government. OECD is nobody to allocate any rights to any nation. A treaty is a voluntary restriction on taxing rights accepted by a Government in return for the other Government also accepting restriction on its own taxing rights. While negotiating a bilateral treaty, Governments use OECD/UN Model or any other model as a template. OECD's contribution is to provide a well-considered draft. OECD has zero authority over any Government. At best, the OECD model can be said to be suggesting "**Distributive Rules**". For specific details, please see the book: "Klaus Vogel on Double Taxation Conventions" published by Kluwer Law International, English – 3rd edition – pages 26 & 27. Paragraphs 45a to 45c.

(v) The COM Governments may find withholding tax on gross revenue as efficient. This eliminates examination of TP, BEPS, GAAR, GILTI, BEAT, etc. Many tax payers also may find it far easier to submit simple details and pay tax without any controversy.

7.2 Contributions by Countries: Benefits Theory:

We are presenting a principle: A **country contributes to the ability of a corporation/ business entity to earn profits.** This contribution by a country can be in the form of providing stability, etc. in the Country of Residence; or providing necessary facilities in the Country of Source; or providing a market in the COM. **COR & COS both refer to the supply side.** Both these concepts are applicable for the tax payer for providing goods or services; doing functions; or having assets or employees in the relevant country, etc. **COM is the demand side.** In absence of a market, there is no business and no profit. In absence of COR there is no tax payer. In absence of COS, goods do not get manufactured. Hence no business. In absence of COM, there is no sale, no revenue & hence no profit.

Supply side and Demand side are equally important for the business and hence equally important for tax jurisdiction. [However, please also see paragraph number 8.4 (iv) below for situations where Supply & demand sides may not have equal weightage in sharing of Tax Base.] Under the three proposals given in OECD/ G20 PCD; the COR takes away almost entire tax base leaving COM with a small tax base.

7.3 **Our proposal** is that because the COM contributes to the profits of the Digital Corporation by providing a market or Data; it has a nexus and a jurisdiction to tax the profits earned from sales within COM; or from the use of COM Data. The fact that COM provides a **market is adequate nexus. Market itself becomes SEP for the Digital Corporation. This is completely independent of whether the tax payer conducts any functions**, has any asset or employee in the COM or takes any risk etc. or not. **Half of the amounts** received by the Digital Corporation for the prescribed business from within the COM become its Tax Base. This half is taxable in COM and the other half is taxable in COR & COS.

7.4 **Weightage to be given to Supply Side & Demand Side should be equal.** In other words, from the total revenue earned by the Digital Corporation, half should be the tax base for Supply Side (COR & COS together); and the other half should be the tax base for Demand side – all the worldwide COMs. **This important change in existing OECD & UN model is necessary.**

Appropriate sub clauses may be added to Article 5 in the OECD model. It may be noted that separate sub-clauses will be required (i) for Data & (ii) for other digitalised businesses like advertisement or supply of goods & services through digitalised mode.

7.5 Core Principle for Distribution of Tax Jurisdiction Rules:

We are presenting two different ideas as core principles for the distribution of taxing rights.

(i) Benefits Theory:

Under this theory, a nation gets taxing right because it contributes in some manner for the concerned business to happen.

(ii) Functions etc. by the tax payer:

Under this theory, all functions etc. by the tax payer are considered. Thus, for example, functions, assets and risks including the DEMPE functions – all conducted/ held by the tax payer are to be considered. Under this theory, the fact that the Government of a country contributes to the business potential is completely ignored. If the tax payer has not conducted any functions in a particular country; or if the tax payer does not own any assets, does not employ any people in any particular country,

does not take any risk in that country; etc., then that country does not get right to tax the tax payer.

This principle is the primary reason why COMs have been deprived of taxing rights for digital commerce. In fact, COMs have been deprived of taxing rights for all kinds of import of goods & services. In **our submission**, this principle should be dropped and the "Benefits Theory" should be adopted. Under the "Benefits Theory", COM can tax all kinds of imports of goods and services without any ring fencing and without any twisting of logic.

7.6 "Data" & Other "Digital Commerce"- separate clauses:

Under Article 5 of the OECD Model permanent establishment has been defined. Primarily, a fixed base within the COS is considered as PE. However, this is not sufficient to cover different kinds of business activities which a non-resident can conduct within the COS. Hence, there are eight different sub-clauses under Article 5 and four kinds of PE: (i) Fixed Base PE, (ii) Construction PE, (iii) Service PE & (iv) Agency PE. In the same way, for digital tax also one sub-clause will not be adequate. There will be two sub-clauses required under Article 5 – one for data and second for all other Ecommerce businesses.

"Market" as the Nexus takes into account everything like – "Users", "Consumers", "Payers", "Market Intangibles", "Goodwill", or any other relevant factor. At the same time, this is utterly **simplified & principle based method to determine Nexus.**

When tax base is equally divided between Supply side & Demand side, a lot of controversies become irrelevant.

7.7 Drafting the definition of PE/SEP-
Factors other than Market to establish SEP:

SEP in COM can be established by several factors. Some factors can be "number of users", "**participation by the users**" or "marketing intangibles" deemed to be present in the COM. However, all these considerations have **uncertainties.** As an example, a tax payer like Face Book or WhatsApp may have number of users which keep fluctuating. Some users may use the platform extensively. Some users may use the platform sparingly. And these users may not pay any charges to the Digital Corporation. Hence, deciding a nexus based on fluctuating numbers can be difficult.

At present, certain **business models** are prevalent. The idea of "User Base" as Nexus is based on present popular business models. It can be considered a certainty that in future, there will be new business models

that have not been imagined by today's tax law draftsmen. Such new business models may require new characteristics to determine the nexus. If the definition of SEP / Nexus requires changes every time the business model changes; and if OECD etc. take a few years every time to change the definition; then the administration of international taxation will be very difficult. **We need a definition which will not change with the business models.** At the same time, the definition should be such that the Digital Corporation's profits & COM's jurisdiction are connected through the definition. The Nexus should be part of the definition.

Hence, we suggest that the **Market in the COM should be considered as the Digital Corporation's SEP. Total amounts received** from COM residents will be the **Tax Base for COM**. Once a payment for goods and services has been made from COM, the presence of users/ customers is proved. We need not go into counting the number of users, the length of user time etc. The kind of goods or services provided may change completely. Still, payment remains a common denominator.

7.8 **"Market is the SEP and Amounts Received Constitute Tax Base"** is a statement of principle in simple words. There will be certain modifications or conditions necessary. These are discussed below:

For the convenience of tax payer in compliance and of the tax department in administration, it is necessary that a practical **threshold** is fixed. Receipts equal to or below the threshold by the DC will not attract tax liability. Receipts above the threshold will attract tax liability. This threshold may be fixed differently by different countries depending upon their perception of their **cost benefit ratio**. Ideally, the threshold should be reasonably large. For India, we would consider the threshold of US $ 1,00,000 – equivalent amount in Indian Rupees – say, Rs. Seven million as a practical threshold.

7.9 Having established a tax base for the COM, computation of tax payable to COM - **"the machinery provisions"** can be drafted in different manners. One may adopt a simple method similar to Withholding Tax on royalty; or one may go into detailed computations.

7.10 **Tax Rate:**

Based on the principle that COM is entitled to 50% of the Tax Base, one can make some simple estimates of normal profits. Half the profits form Demand side - COM -Tax Base. Apply the COM tax rate & come to Digital Tax Rate. Alternatively, a Thumb Rule rate can be – say: 5% of the amounts received by Digital Corporation from COM. Each country can arrive at its own rate for digital tax rate. Even for the normal tax rates, each country takes its own decisions. Once the treaty is appropriately amended, tax rate in domestic Income-tax Act will be less important.

Countries negotiating the treaty may bilaterally negotiate & determine the WHT rate for COM.

8. Prescribed Business:

8.1 Which Businesses should be covered:

Technologies involved in global communication may be listed as computers, internet, satellite & under-sea-cable communication channels, phones, mobile smart phones, multitude of software applications (app), Big Data & Data Analytics, etc. All these technologies progress at a fast rate. Their **convergence** at different levels creates business opportunities and business models never imagined before. Drafting a definition for Digital Commerce that can prescribe businesses which would be covered under the digital tax regime; and which would not be covered - can be difficult. Howsoever broad definition may be made, some new business models will be developed which will be outside the definition. At the same time, provision of service through digital means should not, by itself attract the provisions of digital tax. Both these issues are illustrated below.

(i) Forever New Business Models: When PE definition was drafted, nobody imagined that business could be transacted in another country without a PE. When discussion on Ecommerce started in the 1990s, people did not imagine that business could be transacted through mobile phones. The business models of providing a platform without charging any fee at all was also never imagined. It was not understood that massive data could be collected, stored, processed and then licensed to advertisers for a fee. And yet, these business models are extremely successful today. If the past were to be projected into future, one can be certain that in a few years from now, there will be new business models which we do not even imagine today.

(ii) Extensive use of Digital Communication – not amounting to Digital Commerce:

(ii)(a) Consider the illustration of a **doctor** who is practicing in COR, advices a patient residing and situated in COS. The patient sends all his medical reports by emails. After studying the reports, the doctor holds a video conference with the patient. The advice is given on the video conference. Medicine prescriptions are sent by email. The patient makes payment also on the internet. While a lot of transactions have been completed digitally, the **business is of medical advice**. Importance is of medical knowledge. Digital communication is simply a matter of communication. Such business **cannot be considered under digital tax**.

(ii)(b) Another illustration: An architect or a **technocrat** is residing in COR. A client based in COS requests for technical designs and drawings.

These are supplied on the internet. Discussions are held on video conferences. Payments are made through the internet. Even in this case, **internet is merely a communication instrument**. Real importance is of the technical knowledge that the consultant has. Hence, even this business income **cannot be considered under digital tax**.

(ii)(c) A traveller may select an **airline and a hotel** on the internet. He can book his seat and hotel room on the internet and make payment on the internet. Thus, entire contract execution and payment have been made digitally. However, the service of carrying the passenger abroad; and the service of providing hotel accommodation are provided outside COM. The payment is for the services to be rendered abroad and not for the digital communication facilities. Hence, these businesses also **cannot be covered under digital tax.**

Thus, it will be difficult to draft a definition which: (i) Will **cover** the businesses that should be covered under digital tax; and (ii) will **exclude** the businesses that should not be covered. Assuming that we can develop such a definition, it may require frequent modifications. In the circumstances, it will be better if the COM Governments **prescribe** the businesses to be covered under digital tax. It will be a **positive list**. Hence all businesses which are not prescribed will be free from digital tax. Countries to a double tax avoidance agreement can together negotiate and modify the list of prescribed businesses as and when necessary. Such a provision will facilitate a **dynamic law** in keeping with the **dynamic technology.**

8.2 We suggest that relevant Government may **prescribe specific businesses** which would be covered under Digital Tax Regime. Payments to Digital Corporation for only the prescribed businesses will be covered under Digital Tax. Reasons for this suggestion: In the late 1990s OECD considered **Ecommerce** taxation and suggested that businesses conducted through **computers & internet** would constitute Ecommerce. Then **mobile phones** were used for cross border business. Mobile phones are not called computers. Hence business conducted through mobile phones would escape Ecommerce tax. Hence OECD/ G20 used a new term – **Digital Commerce.** Now OECD/ G20 have used another term: **Digitalised Businesses.** It is certain that soon there will be new business models which will not fit current definition/description also. In any case, designing a new tax system based on mere **Instrument of Communication** is not proper. There should be more fundamental principles to design the taxation system.

Practical way out of this situation is that OECD/ G20 and COM Governments may specify businesses that will be covered under this tax. Those businesses may use computers or any computerised instruments; or

may use something totally different. **Underlying common factor** should be that a person non-resident of COM can do business with COM residents without establishing a permanent establishment as defined under current Article 5 of the OECD model of Treaty. In simple terms, it may be called **"Remote Business".** Since the business models can be expected to change, OECD can go on specifying new businesses under Article 5 as Remote Business. All treaty countries may prescribe same businesses under their tax law for the purposes of **Remote Tax.**

Once the underlying factor has been known as "NR's business **without PE**", the **name** of the business may be Ecommerce or Digital Commerce or Remote Commerce or any other name.

8.3 There is an unnecessary **attachment towards computers and internet or digital methods of communications.** An important tax provision cannot, in principle, be based on the instrument of communication. One has to go for more fundamental issue.

Corporations can do remote business by using other instruments of communication also. For example, a business corporation can advertise its products through television, radio or any other media. With these - advertisement and other strategies, the corporation can generate a goodwill for itself in different countries. Once the brand name is known, potential buyers can visit the websites of the corporation and place orders for their requirements. Alternatively, they can simply telephone, write letters and place orders. The business transaction of goodwill generation, placement of order, supply of goods/ services and payment can be made partly or wholly without using digital means. **Canadian** companies marketing their products in USA through **catalogues** is an old and established method of doing business. Today, digital communication makes catalogues redundant. Tomorrow, there may be a method of doing business which will make digital communication redundant. Anything may happen. Our simple point is: "Do not emphasise on definition of a business and do not emphasise on instrument of communication. Just emphasise the fact that a non-resident can do business in COM without a PE."

8.4 Ring Fencing:

(i) A clarification at this stage is appropriate. Some people have strongly suggested that there should be no Ring Fencing of Digital Economy. Taxing rules should be same for the Bricks & Mortar economy as well as for the Digital Economy. We fully accept that there should be no Ring Fencing of digital or any other commerce. Distributive Rules once made should apply to all commerce irrespective of the instrument of communication.

(ii) It may be noted that the method of determining **Nexus**; and distributing **taxing rights** suggested by us can be applied to any commerce – whether digital or other commerce. This method can be applied even to completely new business models. There will be no need to change the method depending upon use of instrument of communication or business model.

(iii) However, if it is decided to extend this new method to all commerce, it may be necessary to have a complete exercise of **redrafting the treaty model from the 'drawing board level'**. Under the new distributive rules, supply side (COR & COS) & demand side – (COM) both should be given importance.

(iv) At this stage we have to recognise the fact that different kinds of businesses would have **different attribution of profits** amongst COR, COS & COM. Illustrations:

(iv-a) Some products may be - high technology products or products commanding huge demand and be in short supply. In such cases the company selling such goods & services may not have to spend much on marketing & advertising. Hence supply side will get higher distribution & demand side will get lower distribution.

(iv-b) Then there are products which command a high price largely because of marketing & advertisement. Also there are products where the seller has to put in considerable efforts to sell the products. These cases justify a higher distribution to demand side & a lower distribution to supply side.

There can be no scientific method of determining these percentages.

A Government may **prescribe** (i) the businesses covered under this tax and (ii) the percentage of profit attributable to COM.

Even **simpler method** will be for the COM to prescribe different **rates for withholding tax** for different businesses. For example, for import of digital services, the WHT rate may be 5%. For import of crude oil, the rate may be 1% and for some other products, the rate may be "Nil".

(v) This modification in treaty model requires constitution of another committee to examine existing treaty models thoroughly. Remove several weaknesses. Make the elimination of double taxation simple & efficient. A complicated method will give more chances for tax avoidance to large MNCs. A simplified system will significantly reduce the chances for tax avoidance. Make tax havens completely useless for any kind of tax

avoidance. Resolve the COR Vs. COS conflict & make the treaty model fair.

9. Simple Machinery provisions for Digital Tax:

9.1 Taxable Amount:

We are using the term **"Revenue Realised" as distinguished from "Revenue".** If we use the term "Revenue", then the question of accrued revenue, outstanding invoices etc. will come up. Then the accounting & auditing will be more elaborate. Simple computation of amounts received & tax payable will simplify everything.

9.2 Tax Liability:

A Digital Corporation receiving payments above the specified **threshold** for **prescribed business income** will be **liable to Digital Tax** in COM. Amounts received in a year upto or less than the threshold will not be liable to tax. Amounts received for purposes other than prescribed business – sale proceeds will not be liable to Digital Tax.

Illustration: An art library in COR displays photographs of several paintings & sculptures. A few visitors from COM visit the website; download some photos and pay small amounts to the website. If the total amounts will be less than the threshold, the art library will have no tax liability and no compliance responsibility in the COM.

9.3 Revenue Collection Machinery for the Digital Corporation:

Some years back it was not possible for tax administration of COM to verify correctness of tax returns to be filed by Digital Corporations. Now if following provisions are enacted into law, it will be practical to assess correctness of the returns filed by DC. A non-resident Digital Corporation wanting to earn revenue from COM through Digitalised business will be required to set up revenue collection machinery in the COM. The Digital Corporation may select one or more banks operating within COM for the collection. Notify these banks & accounts to the COM tax department. All payments to DC – whether by cheques, credit cards or debit cards; or by any other payment mechanism will be deposited in the specified bank accounts only. The DC may give account information and instructions for electronic transfer of money on its website or any manner it chooses. No COM resident will be permitted to make any direct payment for Digitalised Business outside COM.

Note: it is possible that the legal & regulatory systems in some countries may permit all these procedures. In some other countries, the legal system may not permit this payment restriction. Then they have to find out machinery appropriate in their country.

9.4 Withholding Tax (WHT):

All payers from COM making payments above a threshold to non-residents of COM for prescribed business may be required to **withhold digital tax @ 5%.** The threshold for withholding tax may be lower. Say, in India it would be Rs. 1,00,000 per year. Thus, any resident of COM paying equal to or less than Rs. 1,00,000 in a financial year will not be required to withhold tax at source. This will automatically exempt all home consumers from tax withholding responsibilities.

9.5 WHT & Final Tax Rate in COM:

The rate for final tax liability of the digital corporation, as well as the rate for withholding tax should be the same. We have proposed a tax rate of 5%. This is a suggestion. Countries may choose their own tax rates. The tax rate as per the domestic Income-tax Act may be a little higher as compared to the tax rate agreed under Double Tax Avoidance Treaty. This will be an incentive for Countries to sign Double Tax Avoidance Treaties.

9.6 Self-assessment Tax:

Payments by COM residents for the prescribed business may be small or large. A threshold may be prescribed. Only payers making **payments above the threshold will be liable to withhold the digital tax**. It is possible that several small payments under the threshold may be received by the Digital Corporation. There will be no tax withholding by payers of such small amounts. Tax attributable to such amounts should be paid by the Digital Corporation directly on self-assessment.

9.7 Digital Tax Return:

The Digital Corporation liable to Digital Tax will be required to file its income-tax return in the COM. The only figures to be provided in the return will be:

(i) Total **amounts received** for the prescribed business from the COM; and

(ii) Total **tax withheld** by different payers from the COM.

Five percent of the gross revenue received from COM will be tax payer's final tax liability. After deducting the tax withheld, balance short fall if any, will be payable by the tax payer to COM. In case, the DC wants to claim refund etc., it should follow the procedure given in paragraph 10 below.

9.8 There will be **separate thresholds** for the Digital Corporation's **tax liability** and for the payer's **liability to withhold tax.** Ultimate liability to comply with the law will rest on the Digital Corporation. It will be a fairly simple procedure.

9.9 Audit & Verification:

The Digital Corporation may be required to get its **return audited** by auditors. Since only three amounts are to be audited, audit function will be simple and practical. All sale proceeds have to be deposited in notified bank accounts. Tax department can get the amounts verified with the banks.

9.10 Business to Consumer (B to C):

COM government cannot expect home consumers to withhold digital tax & pay to the government. Since there will be a practical threshold for WHT, all home consumers will automatically get exempted from WHT responsibility. It will be practical to impose digital tax on Business to Business as well as Business to Consumer dealings. Tax not withheld by any consumers will be paid by the Digital Corporation on self-assessment. To illustrate this issue, let us consider the following:

Business companies may advertise their products and services on **Google, Facebook** and through **Amazon** on different media. This advertisement business is B to B. Withholding of tax by the payer is practical. However, **Netflix** and similar corporations may provide entertainment to consumers for a charge. Consumer making small payments to Netflix cannot be expected to withhold tax and make payment to the COM Government. Hence, the system should provide that it will be the responsibility of Netflix to file its tax return. Netflix will provide audited accounts for total amounts received within the COM. Netflix will compute tax payable @ 5% and make payment to the Government. In a complete system of digital taxation, the digital corporation will be liable to pay tax, file returns and comply with necessary provisions. In such a case, digital tax on B to C businesses will be practical.

9.11 Set-off in COR:

The Digital Corporation should get credit for the tax paid in COM against the COR tax liability.

10. Detailed Machinery for Digital Tax: Option to claim refund:

10.1 SEP will become a PE under revised Article 5 of treaties. Hence, SEP may be given an option to file Income-tax return & claim that the tax payable is NIL or the PE has made loss; or it is entitled to a refund of WHT/ TDS.

One has to notice the fact that large **MNCs are experts in devising elaborate ways for avoiding their taxes**. The published figures of net profits cannot be taken as a base to start with. There can be huge diversions of entire revenues to tax haven SPVs. There can be phantom

expenses. These are not imaginary allegations. Global actions under Transfer Pricing, BEPS, GAAR, GILTI, BEAT & FATCA prove that worldwide Governments have taken actions against MNCs avoiding taxes. There are tax consultants & tax havens helping them.

Hence, the tax department of COM cannot rely on just gross turn over or consolidated profit figures. Hence **Formulary method of attribution of profits is not practical.** COM tax department should get entire information necessary to examine whether - the MNC has avoided taxes under various planning methods available. If it has avoided, further information on the extent to which tax has been avoided. It will be a **full scrutiny assessment** of the non-resident Digital Corporation in the same manner in which the COM may be taxing its own large corporations.

10.2 **COM tax department cannot rely on information shared by the tax department of COR**. There are some countries which practise a policy with their tax payers: "Do not avoid my taxes. If you are smart to avoid other countries' taxes, fine. We will help you in avoiding taxes levied by other countries."

In short, if the Digital Corporation wants to exercise the option of claiming that its liability to pay Digital Tax is less than 5% of receipts from COM; then it must file return and submit global information as the tax department may consider necessary. This option may be exercised separately for each COM. Alternatively it may simply pay up 5% tax on gross receipts.

10.3 Anti - Avoidance provisions:

To protect its tax base, the COM Government can adopt following procedure for Digital Corporations that want to exercise the option of claiming lower tax liability compared to 5% on gross receipts.

Note to the Reader: Do not worry that the following seems to be too radical a suggestion. This has been largely suggested in the OECD/ G20 PCD in the 3rd paragraph titled "Global Anti-Base Erosion Proposal". Only problem is, this proposal mainly protects COR tax base and protects COS tax base to a smaller extent.

Procedure:

(i) Ask the MNC SEP to file its tax return declaring its profits taxable in COM. Submit on oath that it has not resorted to any tax avoidance arrangement under Transfer Pricing (TP), BEPS, GAAR etc.

(ii) Disallow fully all expenses paid to tax haven entities.

(iii) Disallow all "Imported Arrangements". This covers expenses paid to entities in industrial countries – which in turn make dis-proportionately huge payments to tax haven entities.

(iv) Make a list of tax haven countries which cause tax losses to COM. Declare the list. Negotiate tax treaties with such tax havens & prevent tax avoidance.

(v) In case of non-deductible incomes like dividends paid to Tax Haven entities, levy full COS tax without giving any treaty or unilateral relief.

(vi) While taking action against tax haven entities, note the fact that USA has five tax havens within its boundaries. While US treaty may be continued, all entities in US tax havens should be treated like any other tax haven entity. This suggestion is similar to the following fact. U.K. has got some colonies which act as tax havens. However, U.K. treaties do not apply to those colonies. Similarly U.S. treaties should not be applied to U.S. tax havens. Similar provisions need to be made for all industrial countries that support tax havens.

Summary: Only those companies which are ready to pay honest taxes in COM and ready to establish their honesty - may be given the option of claiming lower tax liability. In case of doubt, pay 5% and close the matter.

11. Tax Avoidance apprehensions:

The apprehension of payments by non-residents of COM to avoid COM tax is considered below. The resident of COM may enjoy goods or services provided by a non-resident digital corporation. However, that corporation may collect its fees from an Associated Enterprise of the consumer which is resident outside COM. In such cases, it will not be practical to enforce the provisions of withholding of tax.

This may not be very serious issue. When a resident business entity of COM makes payment from within COM, it may be able to claim the payment as expenditure. By claiming the expenditure, it will reduce its tax liability which may be much higher than 5% withholding tax. If a non-resident makes payment, then the expenditure will not be available for deduction.

Similarly, amounts payable by COM – home consumers may be paid by their relatives resident abroad. These amounts will be so small that one may not indulge in such practices for saving 5% tax. And if somebody does resort to such practice, it may be ignored as insignificant activity.

12. Note:

Brick & mortar Business: The principle that "**the market constitutes SEP** and the amounts received constitute tax base" can be applied to digitalised business as well as to **all other businesses**. However, applying this principle to all businesses would require consideration of more factors and a separate paper. In the current paper, our focus is on E-commerce or Digitalised business. Hence, we are not considering other business incomes in any details.

13. Digital tax on data:

13.1 In the digital business, data is valuable. The data pertaining to the COM will be an asset owned by the Digital Corporation. For illustration, if Google has collected substantial data about Indian users, that data base is owned by Google and pertains to India. Since, India as a nation has provided a business opportunity to Google, India has a nexus adequate to tax Google on the profits arising directly or indirectly out of data. The fact that the **users for Google do not pay any charges to Google is not relevant.** The fact that the data may be stored on a **server outside COM** is also not relevant. A server is only a machine to store and process data. **Server cannot determine the location of the SEP**.

An analogy may be drawn from **goodwill**. A businessman accumulates goodwill – which is an intangible asset. The goodwill is not stored anywhere and may not be registered anywhere. And yet, for tax purposes, goodwill shall be deemed to be located in the Country of Market. Similarly, the data shall be considered to be situated in the country to which the data pertains.

13.2 **Data is the asset** based on which the Digital Corporation is **earning revenue.** Hence it is the **SEP like Immovable Property.** Hence all income earned by the Digital Corporation by using the COM data should be taxable in the COM. The income may be **revenue income or capital gains.** A Digital Corporation may have data pertaining to several countries. It will be liable to digital tax in a particular COM only on the profits arising from that COM's data.

This data may be used by the tax payer in any manner. It may be used for generating **advertisement** revenue. It may be l**icensed** to other advertisers or users for their businesses. In case of such licenses, the license fee will be similar to royalty. In case of digitalised businesses, a digital tax @ 5% may be levied. The person making payment to the Digital Corporation shall be liable to withhold tax and make payment to the Government of COM if the payer is a resident of COM. In case of payments received from non-residents of COM, it will be the responsibility of the tax payer to pay the relevant tax to COM.

13.3 **Data Security & Privacy:** There have been serious investigations by Governments of USA and UK on the activities by digital corporations. There are several allegations against such organisations. However, we are not concerned with the allegations. Underlying fact remains that EU as well as India want these digital corporations to store their data within the COM. In other words, for security purposes, Governments want that data pertaining to COM residents should be stored on servers located within the COM. Further, the data should not be stored anywhere outside the COM. Such laws may be effective very soon. These Servers will then be subject to regulations by COM.

In India, the **Central Board of Indirect Taxes & Customs** (CBITC) has made certain provisions for non-residents of India earning revenue from India. The law requires the non-residents to appoint an agent in India. All revenues from within India must be received through the agent. It will be the responsibility of the agent to pay the indirect tax – GST to the Government of India. Same agent can also be made liable to pay digital tax to the Government of India.

Once a digital corporation is required to store data within the COM, it may have to set up either a branch or a subsidiary to collect, process, store and safeguard the data. This function can be assigned to a third party as outsourcing of business functions. Whosoever performs the function of collecting, processing, storing and safeguarding the data shall be considered as the **SEP of the digital corporation**.

These functions may be outsourced to several different organisations by **splitting the functions**. Any amount of splitting operations will not reduce the Digital Corporation's liability to pay Digital Tax in COM.

It shall be the responsibility of the SEP to file return and declare **global revenue** earned by the digital corporation out of data pertaining to the COM. Please note that in case of data, revenue received from anywhere in the world; but pertaining to COM data – will be liable to tax in COM. For other digital commerce, only the revenue from within COM will be liable to COM tax. After computing total tax liability @ 5%; and after deducting tax withheld by residents of COM; the balance tax will be paid by the digital corporation to the Government of COM. This tax paid to COM should be available as set off against the tax liability in COR.

13.4 **Different uses of Data:**

At present, the widely known business model for generating income from data is – "Advertisement Revenue". Data collection as well as processing is done with a target for "directed advertisement". However, it is possible that other business models also may be developed. The owner

of data may licence the use of data to other corporations for their businesses. Some such models which are already in existence but are not considered as digital business are illustrated below.

There are large companies dealing in **agricultural commodities**. These companies collect **weather data** from countries growing agricultural commodities on a large scale. The companies use this data for projecting possible agricultural production and movement in agricultural prices. In this business model, no advertisement is involved. However, data is an essential instrument for trading.

Similarly, **financial institutions** investing in shares and securities of a country collect massive data about the country's economy, different companies, share price movements, changes in GDP of the country, applicable laws, etc. All this data will be utilised for projecting future price movements of shares and securities. Again, this is not a digital business. This illustration is given only to show that data can be collected and used for purposes other than advertisement. When the owner of data permits / licenses the use of data, it earns licence fee. Normally, such licence fees would be considered as royalty. However, for the purposes of digital business and for maintaining uniformity in tax rates, we propose that licence fees earned on data should be charged digital tax @ 5%.

13.5 Final Tax: We propose that the tax withheld or paid by the digital corporation in COM should be the final tax. In case, the Digital Corporation wants to exercise the option of claiming that either the tax liability is lower than 5% of revenue or that the digital corporation has incurred losses; it will have to comply with procedures described in paragraph (10) above.

14. Difference between Direct & Indirect Tax:

When a flat income-tax is imposed on gross revenue, without permitting deduction of expenses, etc., one may compare it with indirect tax. Following factors may be noted:

(i) Flat income-tax is proposed only for non-residents of COM. It is a well-accepted principle that flat tax is the most convenient method when a non-resident is being taxed. This principle is applied for royalty, fees for technical services, interest and dividend. In case of modern digital corporations that conduct businesses in several countries, it is not possible for them to submit their data to scrutiny by several Governments. For details, please see paragraph No. (10) above.

(ii) The important difference between direct and indirect tax is that an indirect tax imposed by COM is borne by the consumers of COM. Direct

tax imposed by COM is borne by the Government of COR. For a clarification of this statement please see paragraph No. (4) above.

Part I of the Paper completed.

Next Page – Part II – Comments on OECD/ G20 PCD

Part II Comments on OECD/ G20 Public Consultation Document (PCD):

The PCD presents three different proposals.

Para 2.2.1 User Participation Proposal.
Para 2.2.2 Marketing Intangibles Proposal.
Para 2.2.3 Significant Economic Presence Proposal.

In paragraphs 1 to 3 we are presenting our views on all these three proposals. BEPS DT Committee has asked certain specific queries. Responses to these queries are given in paragraphs 4 to 11 below.

1. User Participation Proposal:

(i) Please see page 10, para 21 of the PCD, profits will be "allocated" to COM based on number of active users in the COM. This proposal is good in that it recognises contribution to a business by the "Users". So far, OECD considered only Tax Payer's functions as relevant for distribution of Taxing rights. Now this proposal considers **even the supply side's importance.**

(ii) Please note that this mechanism can be used only for digital commerce. If a non-resident business corporation sells motor cars in the COM, can we distribute taxable profits to the COM based on motor car users? If not, by definition we are bringing in **Ring Fencing**. Such a distribution rule will be applicable only to the digital commerce. If, in future, OECD decides to expand this principle to all commerce, User Base may not be relevant for many types of commerce. For example, export of crude oil. It is not very practical to count the number of users.

(iii) Also, the **value of a User Base is in the revenue that it can realise.** For example, India may have a vast number of users for You Tube. And yet, India may contribute lower revenue compared to USA. There is a significant difference between the Indian Rupee converted into US Dollar on the basis of (i) Purchasing Power Parity and (ii) Market Value. In practise, a service provider has to charge service fees based on Purchasing Power Parity. However, when it comes to its own Profit & Loss Account, the service provider is interested in the amount of Rupees that it can convert into US Dollars – which will be at market rate. Taking Revenue as the base for taxing right distribution includes all factors like Users, Marketing Intangibles and any other such factor based on Demand Side.

(iv) In future, within digital commerce, there will be new business models where user base will not be a relevant or practical measure. Will new rules be drafted? In our view, this proposal is not a long term solution.

2. Marketing Intangibles Proposal:
Please see page 12, para 32 of the PCD.

"The proposal considers that the market jurisdiction would be entitled to tax some or all of the "non-routine" income properly associated with such (marketing) intangibles and their attendant risks ……."

This proposal has following issues to be noted:

(i) So far intangibles were considered to be situated where the owner of the intangibles was situated or where the intangible property was registered. It was not considered to be located in the Country of Market. In India, this is a controversy going on at present. In Foster's Australia Ltd. case, the Authority for Advance Rulings decided that Goodwill was situated where goods/ services were marketed. [2008](170 Taxman 341 (AAR). However, on appeal, Honourable Delhi High Court held that it is situated where the owner is situated. [2016] 71 Taxman.com315 (Delhi).

Now BEPS DT Committee is ready to accept that marketing **intangibles are situated in "marketing jurisdiction"**. It is a good though incomplete development. On finalisation of BEPS Action One report, India may consider appropriate deeming legislation.

(ii) BEPS DT Committee uses the term "**Marketing Jurisdiction**". We are using the term "**Country of Market**". Functionally both the terms mean one and the same. This is also a good development.

(iii) It seems, the intention is to restrict this proposal to only digital business. Consider PCD Page 12, paragraph 32.
"….. Market Jurisdictions would be given a right to tax highly digitalised businesses…..".

However, please see page 17, paragraph 42 of the PCD. It says – "*the proposal contemplates that changes to the profit allocation and nexus rules for situations involving* ***highly digitalised businesses would need to apply equally to similarly-situated structures utilised by traditional consumer businesses."***

Illustrations: **Harley Davidson** motor cycles are sold by a US company in India. **Mont Blanc** – luxury pens are sold by a German company in India. Such premium products owe their sales to (i) Superior technology and (ii) Marketing intangibles. Under the revised OECD model, under this second proposal, India should be able to levy income-tax on Harley Davidson – US company and Mont Blanc – German Company based on Marketing Intangibles deemed to be situated in India.

(iv) Division of Routine & Non-Routine profits; and distribution amongst COR, COS & COM will be extremely complicated & subjective effort. It will also be unfair to COM as they will get only a small tax base to charge tax.

(v) "Marketing Jurisdictions **would be given a right to tax".**

As discussed earlier, this is incorrect language. Please see paragraph 7.1 (ii) in Part I. OECD does not & cannot give any rights to any Government.

(vi) Please see PCD Page 14, Note No. 6 at the bottom of the page giving definition of marketing intangibles.

Extract from OECD PCD

"The definition of marketing intangibles in the OECD TPG includes: customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers." Highly ***digitalised businesses have revolutionised*** *the availability and depth of usable micro data on customers, potential customers, including their interests and preferences. Such consumer data is typically acquired* ***in exchange for free services****, such as free search functions, free emails etc. ……".*

This is an illustration of the issue raised by us in paragraph 7.7 of Part I pertaining to drafting of PE definition. Today digitalised businesses have revolutionised the business model. Tomorrow there will be something else that will again revolutionise the business model. Most draftsmen are obsessed by the conditions present when they are drafting any definition. Even though past experience has proved that conditions change so much that the definition becomes irrelevant. This lesson is learned from the past but not applied to future.

Entire focus for BEPS DT Committee is on digital business. It fails to recognise the fact that the core issue is not instrument of communication; but the fact that business can be conducted by corporation without having any kind of presence in COM. Future will certainly show ways of doing "Remote Business" without using computers & mobile phones.

In our view this second proposal is also not a long term solution.

3. Significant Economic Presence:

Please see PCD page 16 onwards, paragraph 2.2.3.

This proposal accepts the reality that a DC can be heavily involved in the economic life of a jurisdiction without a significant physical

presence. It proposes that revenue generated in the market jurisdiction should be a criteria to determine jurisdiction. So far, this is acceptable. We beg to differ for further issues.

(i) The proposal requires other factors in addition to revenue – for the COM/ Marketing Jurisdiction to have a right to tax.

There can be a vast variety of such "other factors". To build them into a definition would be difficult. Instead, these factors can be considered while "prescribing" the kinds of businesses that would be covered for Digital Tax.

(ii) From paragraph 52 onwards, the proposal is to **attribute profits** to the SEP based on **Fractional apportionment**. In short, the tax officer may have to adopt the following mechanism:

Take global profits of the DC. This is tax base.
Now divide the total tax base –
depending upon sales, assets & employees;
and Users.

Our submissions are: How will the tax officer of COM determine whether the declared profits are correct? MNCs are known for resorting to massive tax avoidance methods. If one MNC operates in fifty different countries, all countries other than COR will find it very difficult to ascertain correctness of these figures.

Even the DC will find it difficult to prove its correctness before 49 COMs. Instead of this subjective exercise, taking just the **revenue realised** as the **tax base** will simplify entire tax assessment process and help tax payer as well as tax administrator.

The PCD proposal in para 53 considers "Sales" as one of the factor for apportionment of profits. Our submission is – take that as the only factor and **simplify SEP.**

All this discussion is to show that all three proposals by OECD still amount to Ring Fencing. They also cause complicated procedures for tax compliance and tax administration.

Hence, in our submission, the first two proposals in the PCD may be avoided. The third proposal of SEP may be simplified.

Chapter 1 Page 23. OECD/ G20 Questions: Para 87.
Our comments on all three proposals in the PCD:

4. Litigation:

These proposals involve several **subjective** estimates & formulae. Within a tax payer corporation group, different associated enterprises can have different opinions on attribution of profits. There can be many differences of opinions between tax payers & tax collectors. And there will be no objective guidance to resolve the differences. It will result into **avoidable litigation**.

5. Dynamic Business; Stagnant Tax Laws:

Several different technologies keep growing at a fast pace. These technologies then converge and give **new products** and **new business models** which were not imagined earlier. Today, several businesses can do business in several countries without residence & without PE. Tomorrow there will be many more such businesses. Technology & business are dynamic.

However, tax laws have been stagnant. A big gap has arisen between the real market and the tax law. This huge gap has created a situation where many governments feel aggrieved. They are losing their fair share of tax revenue. US are opposing any change in the old, outdated system of taxing Digital Commerce. This has created a **Cold Tax War** like situation. There are loud talks of Trade War, threats to impose tariffs etc. In this tension Tax War adds fuel to the fire.

Complicated methods of attributing profits will not work. For the Countries of Market, a simple & efficient method needs to be developed. Residual Profit Split method etc. will not be practical in this dynamic world.

6. Most important **considerations** for a new method of taxation for –

(i) Considering Nexus; and (ii) Distributing tax base should be:

(a) The system should be practical, simple & objective for compliance as well as administration and **should not cause litigation.**

(b) Should be **fair to** COR, COS & COM.

All three proposals in the OECD/ G20 PCD do not pass these tests and need to be dropped.

7. Best approach would be a low tax withholding rate as a final rate.

8. Observation: China has blocked U.S. Digital Corporations from doing business in China. Hence, China does not have COR Vs. COS conflict.

PCD Page 29. Paragraph 110.
Our comments on Anti- Base Erosion Proposal:

9. Tax Havens:

PCD suggests an elaborate provision in paragraph 3 on pages 24 to 29. It is apprehended that digital corporations may avoid their digital taxes by resorting to several planning procedures despite BEPS. Hence, it is suggested that provisions similar to GILTI and BEAT may be introduced under the OECD Model as well as in the domestic tax laws.

10. General View:

Existing International Taxation with Transfer Pricing, GAAR, BEPS, GILTI & BEAT is extremely complicated and prohibitively costly for compliance. This proposal will increase the complications & cost of compliance & administration. Worldwide governments look at large corporations avoiding taxes within the four corners of law. Then governments legislate anti-avoidance provisions making the law complicated. At the OECD stage, drafts are made to give wider powers to tax officers in **assessment of incomes on subjective distribution and formulae**. Then the governments make drastic **penal & prosecution** provisions. Together, they give rise to terrible harassment by tax officers. The honest tax payers bear maximum brunt of these laws. Tax payer protection laws have limited effect.

US tax consultants complain that the GILTI and BEAT provisions incorporated in US tax law have not yet stabilised. Many tax consultants find it difficult to understand these provisions. The corporations may find it difficult to comply with the law. The existing **unpredictability** of final tax assessment together with **high cost of compliance** is unacceptable. Why complicate the tax law further?

Another issue is that the GILTI and BEAT provisions are targeted towards **protecting the COR and COS taxes**. There is little protection for COM. These proposals may not help COM.

In international taxation, there are massive anti-avoidance provisions. On top of existing provisions, BEPS Action Reports 2 to 15 have introduced further complexities. Interpretation of tax treaties is already complicated. And yet it is feared that digital corporations will still avoid taxes. Hence PCD suggests further anti-avoidance provisions. Information exchange agreements are another set of provisions.

Such massive impractical provisions can cause a **collapse of international taxation system**. The law needs to be simplified. It cannot be made more complicated.

COM can avoid complicating its tax law by making a simple tax provision: Flat digital tax rate (say 5% or lower) on Revenue Realised from COM (Simplified SEP) - as a final tax. **No amount of tax planning can escape taxation in such simple legal provision.**

11. **Best approach** to reduce complexity, ensure early tax certainty (predictability) and to avoid multi-jurisdictional disputes would be – to adopt "Flat digital tax rate (say 5%) on Revenue Realised from COM - as a final tax. The COR to give credit for tax paid in COM."

Part II - Comments on OECD PCD Completed.

Next Page – Part III – European Commission's Directive on Digital Taxation.

Part III – European Commission (EC) Directive dated 21st March, 2018

This directive is available on the following web-link: https://ec.europa.eu/taxation_customs/sites/taxation/files/communication_fair_taxation_digital_economy_21032018_en.pdf

Summary of EC Directive: Paragraphs 1 to 3

1. **Two Key Suggestions by EC:** The EC directive provides for (i) a definition of permanent establishment that can cover digital commerce – **Significant Digital Presence** (SDP); and (ii) rules for **Attribution of Profits**. This way, EC is trying to fill up the inadequacies in the existing OECD Model of Double Tax Avoidance Agreements (DTA).

2. EC has given a common directive. Individual member countries were expected to pass legislation before 31st December, 2019. The tax proposals would be within the existing frame work of corporate taxation of every country. EC has tried to stay within OECD framework also. EC wants EU member nations to have their DTAs to be amended so that Digital Tax can be levied as per this directive. EC also suggests that EU member nations may have DTA with other countries also, on these lines.

3. **Finality or otherwise of Directives:**

Such modified tax law would be applicable in each member nation with effect from the financial year starting immediately after 31st December, 2019.

European Union did not want to wait for the conclusion of BEPS Action 1 Report. That report is estimated by OECD to be published sometime in the year 2020. At the same time EC directive makes it clear that the legislation made under these directive would be temporary solution until a final comprehensive system is worked out.

USA has taken strong objection against EU proposal. EU is uncertain as to what it will be able to legislate.

Our analysis - Paragraphs 4 to 14.

4. AOA:

EC directive has tried to ostensibly stay within the Authorised OECD Approach (AOA). For this purpose, it is suggesting addition to the **permanent establishment** clause and not making suggestion for any fundamental changes in the tax system. EC claims that it does **not** accept **market** as a nexus. If we look at the directive in depth, it is clear that the location of SDP as well as attribution of profits depend upon Country of Market. This fact is explained below.

5. Article 4 – SDP:

Article 4 (3) of the EC directive provides two step conditions to constitute a significant digital presence (SDP):

(i) The SDP provides digital services through digital interface in the member nation; and

(ii) Any one or more of the following conditions are fulfilled:

(a) **Revenue** obtained by the service provider from supply of digital services to **users located in the member state** exceeds Euro 7,000,000.

(b) Number of **users located in the member state** exceeds 100,000**.**

(c) Contracts concluded by **users located in the member state, exceeds 3,000.**

Look at all the three sub-clauses – (a), (b) & (c). All of them consider users located in the member state. It is abundantly clear that the EC directive is referring to the **country of market**. If the services are provided to users within member state; and revenues are earned from within the country of market, SDP is established. It is **irrelevant** (as per EC directive) whether the service provider is resident of EU member nation; & whether the services are **provided** from within EU member nation.

As long as services are **utilised** by users located within a member state, the SDP will be presumed to be existing. Even the user's residential status is not important. If a person uses the digital services through the equipment (computer/ mobile phone/ television, etc.) located in the member state; it is sufficient to establish the nexus.

For attribution of profits (Article 5) abundant clarity is necessary. A Digital Corporation may provide all its digital services from its COR and/ or from one or more tax havens. It may have absolutely no physical

presence, no functions and assets in the COM and no one to take risk in the COM. Still, because the **users are present in the COM**, it shall be **presumed** that the **SDP is situated in COM**.

Now, the Functions, Assets & Risk Analysis (FAR) for the Digital Corporation –which may be situated in COR; shall be **deemed** to be FAR of the SDP which would be **deemed** to be situated in COM. Hence, profits attributable to the FAR will be taxable in COM.

In our paper, we have called such a country as a Country of Market and we have submitted that the market itself should be treated as Significant Economic Presence or Nexus. EC directive has given a similar direction by using different terminology and **two deeming provisions**. This issue is further clarified in paragraph 7 below.

6. Please refer to Article 4 (7). The EC directive provides that the **revenue earned** by the digital corporation will be apportioned amongst different countries based on "Number of times that devices are used …". This is again reference to the Country of Market where **services are used** irrespective of country from where services are provided. The number of times a device is used has no connection with the revenue earned. It is common knowledge that companies charge different prices in different countries. And foreign exchange rates of different countries cause different contributions to the DC.

7. Article 5 Profits Attributable:

Article 5 (3) of EC directive **ostensibly** provides for attribution of **profits based on FAR Analysis**. The Explanatory Memorandum clarified that Market shall not be considered for attribution of profits. However, in reality, it is adopting Country of Market for attribution of profits.

It is clear that in most cases of digital commerce, the tax payer's functions, assets & risks will be outside the COM. Without using the term "Market" but connecting profit attribution to users located in the COM, EC directive is bringing into consideration the market. (Please see paragraph 5 above.)

Article 5(5). This article provides for – "collection, storage processing, analysis, deployment and sale of data" to be considered for attribution of profits. All these functions shall be **deemed to have been carried out** by the Significant Digital Presence. It should be noted that this is a deeming provision. Actually, the digital corporation would be carrying out all these functions outside the COM. The digital corporation will be deemed to be providing the services from within the COM and then made liable for tax in the COM. This is a simple case of rejecting the

"Market" as a basis for attribution of profits; and then deeming that FAR of COR is carried out in COM.

For even more clarity, let us consider an **illustration**. A digital corporation's business is to provide entertainment material – films, songs, serials, talks, etc. The DC produces, stores & preserves all this entertainment content in digital form on its server farms in COR. It has absolutely zero presence in COM.

This entertainment material is enjoyed by users situated in a country called COM. The volume of business is large enough to fulfill the threshold provided in Article 4.

Now under Article 4, it shall be presumed that an SDP exists within COM. Further under Article 5, all the functions carried out in COR will be deemed to have been carried out by the SDP in COM. Hence profits attributable to the SDP's FAR will taxable in COM.

Then global profits of the DC will be split in the proportion of "number of times the digital services have been used" globally and in COM. In the process, completely ignore pricing differences between different countries.

Whole process is artificial.

8. Instrument of Communication:

Complete focus of the EC directive is on services provided through **digital instruments**. We have argued in our presentation that an instrument of communication cannot be the base for taxation. This instrument can keep changing. There can be a time when people will transact cross country business without using digital communication.

OECD started discussions on E-commerce taxation in the year 1997. It is hoping to provide the E-commerce tax rules in the year 2020. Thus, OECD has taken 23 years to come out with rules for E-commerce taxation. If tomorrow, the technology changes and digital communication is replaced by some other communication, will the world take further ten years to draft new legislation?

9. For Nexus, EC directive clearly depends upon Market.

For Attribution of Profits, EC refers to use of digital service and Profit split method based on FAR. And then presumes FAR to be based in the Country of Market. Having worked out these factors, the provisions are still not final for compliance & administration. EC has considered a few steps & then stopped short before coming to logical conclusions.

10. **Ring Fencing:** EC directive is restricting itself to **digital services**. In other words, **goods** sold through digital commerce and the whole of **Bricks & Mortar** business are **not covered**. Very clearly, there is ring fencing of digital services business. This issue is strongly objected to by digital corporations.

11. **Country of Consumption / Market & not Performance or Residence:**

The revised laws of all EU member countries would be applicable to all suppliers of digital services **irrespective of their country of residence**; and irrespective of the country from where the Digital Services will be provided. The effect of these provisions is that the law will be applicable based on the **Country of Market** in which the services are **used.**

India has taken a position under Section 9 (1) (vi) & (vii) that "**Royalties" and "Fees for Technical Services"** will be taxable in India based on the country of **consumption** of the service irrespective of the place of **performance** of the service. This Indian position was criticised by many. EC directive in essence provides for the same. But does not accept it.

12. **Level Playing Field:**

One of the major issues raised by EC is that:

Digital corporations can stay outside the member nation, supply digital services and earn profits. Under the present OECD model, such non-residents' profits will go tax free. However, another corporation providing digital services from within the member nation will suffer regular tax. Thus, there will be unequal tax liability. EC wants Level playing field for all member states. This stand is similar to the **Equalisation Levy concept.** But EC is not using the term Equalisation Levy.

13. The definition for Significant Digital Presence is useful. By considering the number of users and number of contracts concluded, EC directive **includes even those services where the users do not pay any charges**. The non-resident service provider will be considered to have an SDP in the COM.

14. There are following fundamental weaknesses in the EC directive:

(i) Ring Fencing.
(ii) Considering an instrument of communication as the basis for new tax rules,
(iii) Rejecting Market as a base for SDP & attribution of profits; and yet adopting market as the base.

(iv) Profit attribution is un-realistic and subjective.

Part III of the paper completed

Conclusion: Our proposal is:

All governments may impose a tax based on revenue realised by non-residents from their countries. This tax may be levied at a rate between 3% and 5%. Only non-residents realising revenue above a monetary threshold will be liable to pay tax and file return. Once this tax is paid, the non-resident will not be liable to income tax in the COM. Payers within COM will deduct tax and pay to COM Government. Payments above a monetary threshold only will be liable to deduct tax at source. The tax suffered in COM will be available for credit against COR tax. This mechanism can be applied to digital as well as non-digital commerce. It will minimise tax avoidance chances and make tax havens irrelevant for avoiding this tax. It will simplify assessment process. Even the tax compliance by the non-residents will be simple.

OECD has caused a delay of more than twenty years in coming out with a good tax system. This has created Cold Tax War like situation. We hope, an efficient proposal emerges – which is fair and hence acceptable to a majority of countries. Such a fair proposal can diffuse the Cold Tax War like situation.

Thanks.

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