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E-Commerce Committee Report proposing Equalization Levy

The Central Board of Direct Taxes (CBDT) had constituted a Committee on Taxation of E-commerce to provide suggestions for resolving taxation issues related to e-commerce. Mr. Rashmin Sanghvi was a member of this Committee and provided considerable suggestions to the committee.

The Committee's report submitted in February 2016 was accepted by the CBDT and its recommendation of introducing an Equalisation Levy on specified transactions forms part of the Finance Bill 2016.

India is perhaps the first country to introduce this Levy based on the OECD BEPS Report on Action 1 – "Addressing the Tax Challenges of the Digital Economy".

An article by Mr. Rashmin Sanghvi explaining the provisions of this Levy is available here. We welcome comments from the legal fraternity and industry players on this novel concept. Please email us at rashmin@rashminsanghvi.com .

With best regards,

Rashmin Sanghvi & Associates.

PROPOSAL FOR

EQUALIZATION LEVY

ON

SPECIFIED TRANSACTIONS

(Report of the Committee on Taxation of E-Commerce)

PROPOSAL FOR EQUALIZATION LEVY ON SPECIFIED TRANSACTIONS

(Report of the Committee on Taxation of E-Commerce)

February, 2016

Prepared by the Committee on Taxation of E-Commerce formed by the Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, Government of India

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Executive Summary

The Committee on taxation of E-Commerce examined the tax issues arising from the new business models employed in the digital economy, in particular issues relating to tax nexus rules under existing law and tax treaties, characterization of payments made for services and facilities provided primarily through digital means and issues related to valuation of data and user contribution in profits of digital enterprises. The Committee took cognizance of the Report on Action 1 of Base Erosion & Profit Shifting (BEPS) Project, wherein very significant work has been undertaken for identifying the tax challenges arising from digital economy, the possible options to address them and constraints likely to be faced. The Committee also notes that this report has been accepted by G-20 countries, including India and OECD, thereby providing a broad consensus view on these issues. The Committee took note of the work done in this field by other experts, as well as the lack of uniformly accepted standards in taxation of royalty and fee for technical services, and the resultant tax disputes. The Committee also took note of the divergent approaches to characterization of such income taken by the taxpayers, tax authorities and appellate authorities, and the litigation arising from such inconsistencies. The Committee acknowledges the need for addressing all these issues in a holistic manner.

The Committee notes that the BEPS Report on Action 1 clearly brings out that the physical presence nexus in existing international taxation rules, which were developed in the last century keeping in view the business models of that time, provided a reasonable nexus test for identifying significant participation of a traditional brick & mortar enterprise in the economic life of a jurisdiction. However, with the evolution of new business models in digital economy, where revolutionary technological developments have made the need for physical presence redundant, it is no more a justifiable indication of nexus. The BEPS Report also brings out very clearly the challenges that are faced in characterizing the payments for digital goods and services, which are likely to be faced more often by countries like India, which opt for taxation of royalty and fee for technical services in the source jurisdiction. Lastly, the BEPS Report also recognizes the new issues that have emerged in respect of multidimensional business models, like valuation of data belonging to residents of source jurisdiction and the user contributions to the profitability of enterprises, both for the purpose of determining nexus and attributing profits.

The Committee notes that the ability of multinational enterprises to avoid taxes completely in the source jurisdiction under the existing rules, poses significant challenges and concerns for countries like India. The unfair advantage enjoyed by them over their Indian competitors can make Indian enterprises, both digital as well as brick & mortar ones, relatively less competitive

in the long run, resulting in detrimental impact on growth of Indian enterprises. Further, their ability to avoid payment of taxes in India can also adversely impact revenue collections, and lead to a rising tax burden on Indian enterprises and Indian citizens that could be even more detrimental to Indian economy as a whole. Thus, the Committee considers that there is a need for addressing these issues without any further delay.

The BEPS Report on Action 1 clearly highlights the need for modifying existing international taxation rules, and identifies three options, i.e. a new nexus based on significant economic presence, a withholding tax on digital transactions, and Equalization Levy. The Report elaborates in detail the characteristics of these options and their possible tax design. The Report does not recommend any of these options at this stage, in view of the work that may be required in the area of attribution of profits, but concludes by recognizing the right of any country that may wish to adopt any of these options, either under its domestic law or in its bilateral tax treaties.

After examining the three options identified in the report, the Committee notes that compared to the first two options, i.e. a new nexus based on significant economic presence and the withholding tax on digital transactions, which would require changes in a number of tax treaties, the third option of 'Equalization Levy' provides a simpler option that can be adopted under domestic laws without needing amendment of a large number of tax treaties. Accordingly, the Committee recommends the adoption of this option to address the tax challenges of digital economy and provide greater certainty and predictability in its taxation. The Equalization Levy imposed on the payment for digital transactions, would not be a tax on income, and hence would not be covered by tax treaties. As Equalization Levy is not proposed as tax on income, it would need to be imposed outside the Income-tax Act, 1961.

The Committee proposes that the Equalization Levy may be imposed on specified digital services and facilities including online marketing and advertisements, cloud computing, website designing hosting and maintenance, digital space, digital platforms for sale of goods and services and online use or download of software and applications. The Committee recommends that only payment exceeding Rs. one lakh made by a person resident in India or a permanent establishment of a non-resident person to a non-resident enterprise be covered by this levy, which may be charged at a rate between 6 to 8 % of the gross payment made for specified services. Such a threshold will keep almost all B2C transactions, as well as a very large number of B2B transactions outside the scope of the Equalization Levy, thereby limiting its impact.

The Committee notes that income arising from payments subjected to Equalization Levy should not be subjected to income-tax, and hence proposes that income from transactions that are chargeable to Equalization Levy, and on which such levy is paid, may be exempted from income-tax. The Committee considered different options for ensuring compliance, and came to

a view that it can be done by way of deduction of Equalization Levy by the payer, but such obligation should be limited to only those payers who wish to claim that payment as a deductible expense for determining taxable profits in India. Committee also notes that deduction by payment gateways and by authorized foreign exchange dealers can significantly reduce the obligations on payers, and strongly recommends that work should be initiated for exploring this possibility. The Committee also recommends that reporting obligations for Equalization Levy may be kept simple with facility of filing return being made available online. The Committee also acknowledges the need for continuously monitoring further developments in digital economy as well as further developments in international taxation rules.

Section 1

Objective of the Committee's Work

1.1 Introduction

1. With expansions of information and communication technology, the supply and procurement of digital goods and services has undergone exponential expansion everywhere, including India. It has also made it possible for the businesses to conduct themselves in ways that did not exist earlier, and given rise to new business models that rely more on digital and telecommunication networks, do not require physical presence, and derive substantial value from data collected and transmitted through such networks. These new business models have also created new tax challenges in terms of nexus, characterization and valuation of data and user contribution. These challenges have been recognized by the international community, leading to their inclusion in the Base Erosion and Profit Shifting (BEPS) Project endorsed by G-20 and OECD. The findings and conclusions of Action 1 of this Project aimed at addressing these challenges, resulted in the publication of a detailed Report in September 2015 that has since been accepted and endorsed by the G-20 and OECD and thus provides a broad international consensus on these issues.

2. The issue of characterization of payments related to digital goods and services, and the inherent ambiguities therein, have been universally recognized as a challenge. These issues are faced more commonly by countries like India, which have included provisions that allow taxing rights to the source jurisdiction to tax royalty and fee for technical services in their tax treaties, and thereby have a difference in position with the OECD in respect of these provisions. The combination of inadequacy of physical presence based nexus rules in the existing tax treaties and the possibility of taxing such payments as royalty or fee for technical services creates a fertile ground for tax disputes, particularly in countries like India, where the taxpayer rights are fully protected by the appellate authorities, and imposition of tax under ambiguous laws are often not sustained.

3. The ambiguities in taxation of income arising from the digital economy, and the resultant tax disputes are also a constraint for the taxpayers, who may end up getting subjected to inconsistent approaches on the part of assessing as well as appellate authorities, making the tax regime in respect of such income ambiguous and unpredictable, a situation which has been noted as an area of concern by the taxpayers as well as tax authorities.

1.2 Constitution of the Committee

4. Recognizing the significance of issues relating to e-commerce transactions and the need to have a simple way to resolve them and bring greater clarity and predictability in the applicable tax regime, the Central Board of Direct Taxes (CBDT), Department of Revenue, Ministry of Finance, directed that a Committee be constituted, whose terms of reference should include detailing the business models for e-commerce, the direct tax issues in regard to e-commerce transactions and a suggested approach to deal with these issues under different business models. It was further directed that the Committee may include experts from industry and officers from CBDT and the field and also a nominee from the Institute of Chartered Accountants of India.

5. Accordingly a committee was constituted consisting of the following members[1]:

(i) Shri Akhilesh Ranjan, Joint Secretary (FT&TR-I), CBDT, Department of Revenue, Ministry of Finance & Chairman of the Committee

(ii) Ms. Pragya Sahay Saksena, Joint Secretary (TPL-I), CBDT, Department of Revenue, Ministry of Finance

(iii) Shri Pradip Mehrotra, Commissioner of Income Tax (ITA), CBDT, Department of Revenue, Ministry of Finance

(iv) Ms. Chandana Ramachandran, Commissioner of Income Tax (International Taxation), Bengaluru

(v) Shri Nihar N Jambusaria, Chairman, Committee on International Taxation of the ICAI, representative of the Institute of Chartered Accountants of India (ICAI)

(vi) Shri Pramod Jain, Head of Taxation, Flipkart, Industry representative

(vii) Shri Rashmin Sanghvi, Chartered Accountant, Expert on International Taxation and Taxation of E-Commerce

(viii) Dr. Vinay Kumar Singh, Director (FT&TR-I), CBDT Department of Revenue, Ministry of Finance & Member Secretary of the Committee

1.3 Work of the Committee

6. The Committee held its meetings in New Delhi from time to time to examine the issues and find possible alternatives to address them. Part of the work was undertaken by members working in sub-groups, as decided by the Committee. The Committee heavily relied upon the

[1] Ms. Krupa Venkatesh, Head of Taxation, Amazon was also nominated as a Member, but could not participate in the proceedings of the Committee. Shri Sumeet Hemkar, Chartered Accountant, BMR & Associates LLP represented Amazon, and participated in one meeting of the Committee, and provided his inputs, which were taken into account by the Committee.

BEPS Report on Action 1, wherein the new business models of digital economy as well as the tax challenges arising from it in respect of nexus, characterization, valuation of data and user contribution have been examined in detail. The BEPS Report also identifies options to address these challenges and also recognizes the right of countries to adopt any of those options in their domestic laws or bilateral tax treaties. The Committee took note of the fact that India was an active participant in the BEPS Project, including Action 1, and the BEPS Report on this action has been endorsed by the G-20 and OECD countries.

7. The Committee took note of all aspects of digital economy that have been recognized and taken note of in the BEPS Report on Action 1, keeping the Indian context in view, and explored possible options to find a solution in accordance with the conclusions of this report. The Committee aimed at identifying a solution that will provide simple, predictable and certain taxation of digital economy. This Report is a result of this endeavour.

1.4 Organization of the Report

8. The following sections of this Report are organised in the order that the Committee approached the issues. The second section notes the current status of digital economy and its future growth projections. Section 3 details the tax challenges arising from digital economy and the work in Action 1 of the BEPS Project undertaken in this regard. Section 4 details the observations of the Committee related to the need for achieving tax neutrality between multi-national enterprises and domestic enterprises, as well as between digital and traditional (brick & mortar) enterprises. Section 5 provides an overview of the underlying principles for allocating taxing rights between the jurisdiction of residence and the jurisdiction of source, the factors that lead to profitability of businesses, and a historical review of existing rules. Section 6 identifies the tax challenges in digital economy that have now been recognized by the international community, including those related to nexus and characterization, as well as the tax disputes that can arise from them, particularly in the Indian context. Section 7 takes a look at the issues related to valuation of data owned by residents in the source jurisdiction and their contributions as 'users' in the profitability of the enterprises in multidimensional business models. Section 8 reviews the recent international literature on tax issues arising from digital economy that was also taken cognizance of during the BEPS project. Section 9 details the options identified by the BEPS Report on Action 1, and their conclusion that countries may adopt any of these options in their domestic laws or bilateral tax treaties. In Section 10, the Committee puts forward a proposal for the Equalization Levy that can be adopted under Indian laws. Section 11 provides a summary of the conclusions and recommendations of the Committee.

Chapter 2

Digital Economy: Current status and Growth Prospects

2.1 Introduction

9. Rapid and progressively evolving changes in information and communication technology have led to cataclysmic changes in the manner businesses are conducted around the world. Technological advancements and cheaper innovations have ensured widening spread of these techniques to hitherto unexposed populations. Entrepreneurs across the world have been quick to evolve their businesses to take advantage of these changes. The digital means of doing business have perpetrated so fast that the Task Force on Digital Economy (TFDE) of the Committee on Fiscal Affairs of the OECD has commented in its report that the digital economy is fast becoming the economy itself. The digital economy[2] has not only forced radical departures in ways of doing business it has also created entirely new businesses and opened up new markets and growth and new job opportunities. The growing prevalence of E-Commerce[3]

[2] Section 4.3 of the BEPS Report on Action 1 describes the characteristics of digital economy as under:

> *"4.3 Key features of the digital economy*
>
> *151. There are a number of features that are increasingly prominent in the digital economy and which are potentially relevant from a tax perspective. While these features may not all be present at the same time in any particular business, they increasingly characterise the modern economy. They include:*
> - *Mobility, with respect to (i) the intangibles on which the digital economy relies heavily, (ii) users, and (iii) business functions as a consequence of the decreased need for local personnel to perform certain functions as well as the flexibility in many cases to choose the location of servers and other resources.*
> - *Reliance on data, including in particular the use of so-called "big data".*
> - *Network effects, understood with reference to user participation, integration and synergies.*
> - *Use of multi-sided business models in which the two sides of the market may be in different jurisdictions.*
> - *Tendency toward monopoly or oligopoly in certain business models relying heavily on network effects.*
> - *Volatility due to low barriers to entry and rapidly evolving technology."*

[3] Paragraph 117 of the BEPS Report on Action 1 (2015) describes e-commerce or Electronic Commerce as under:

> *"117. Electronic commerce, or e-commerce, has been defined broadly by the OECD Working Party on Indicators for the Information Society as "the sale or purchase of goods or services, conducted over computer networks1 by methods specifically designed for the purpose of receiving or placing of orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or service do not have to be conducted online. An e-commerce transaction can be between enterprises, households, individuals, governments, and other public or private organisations" (OECD, 2011). E-commerce can be used either to facilitate the ordering of goods or services that are then delivered through conventional channels (indirect or offline e-commerce) or to order and deliver goods or services completely electronically (direct or on-line e-commerce)…."*

and new services like Cloud Computing[4] indicate the rising significance of digital economy in international commerce.

10. Part of the reasons for the rapid expansion of the ICT sector is progressive fall in prices of ICT devices and services because of the tendency for greater standardization, commoditization and interoperability in this sector. Technological innovations in hardware and greater integration of hardware and software produced commodities with greater value for money and led to expansion of use. Coupled with improving telecom network infrastructure, open source codes leading to development of software applications and self-propagating user generated content have led to increasing penetration.

2.2 Forms of Prevalent Businesses in various segments of Digital Economy

11. There has been a consistent expansion of E-Commerce businesses over the last couple of decades. The BEPS Report on Action 1 (2015) lists some of the more prevalent forms of these in paragraphs 118 to 121, as under:

> *"**4.2.1.1 Business-to-business models***
> *118. The vast majority of e-commerce consists of transactions in which a business sells products or services to another business (so-called business-to-business (B2B)) (OECD, 2011). This can include online versions of traditional transactions in which a wholesaler purchases consignments of goods online, which it then sells to consumers from retail outlets. It can also include the provision of goods or services to support other businesses, including, among others: (i) logistics services such as transportation, warehousing, and distribution; (ii) application service providers offering deployment, hosting, and management of packaged software from a central facility; (iii) outsourcing of support functions for e-commerce, such as web-hosting, security, and customer care solutions; (iv) auction solutions services for the operation and maintenance of real-time auctions via the Internet; (v) content management services, for the facilitation of website content*

[4] Notes to Chapter 4 of the BEPS Report on Action 1 (2015) describe Cloud Computing as under:

> *"Cloud computing is defined in the report of the US National Institute of Standards and Technology (NIST) as 'a model for enabling ubiquitous, convenient, on-demand network access to a shared pool of configurable computing resources (e.g. networks, servers, storage, applications, and services) that can be rapidly provisioned and released with minimal management effort or service provider interaction.' According to NIST, the cloud model is composed of five essential characteristics:*
> - ***On-demand self-service**: A user can unilaterally act without requiring human interaction with each service's provider.*
> - ***Broad network access**: Capabilities are available over the network and accessed through standard mechanisms that promote use by heterogeneous client platforms (e.g. mobile phones, laptops, and PDAs).*
> - ***Resource pooling**: The provider's computing resources (e.g. storage, processing, memory, network bandwidth, and virtual machines) are pooled to serve multiple users using a multi-tenant model.*
> - ***Rapid elasticity**: Capabilities can be rapidly and elastically provisioned.*
> - ***Measured Service**: resources use can be monitored, controlled, and reported providing transparency for both the provider and consumer of the utilised service."*

management and delivery; and (vi) web-based commerce enablers that provide automated online purchasing capabilities.

4.2.1.2 Business-to-consumer models

119. Business-to-consumer (B2C) models were among the earliest forms of e-commerce. A business following a B2C business model sells goods or services to individuals acting outside the scope of their profession. B2C models fall into several categories, including, for example, so-called "pureplay" online vendors with no physical stores or offline presence, "click-and-mortar" businesses that supplemented existing consumer-facing business with online sales, and manufacturers that use online business to allow customers to order and customise directly.

120. The goods or services sold by a B2C business can be tangible (such as a CD of music) or intangible (i.e. received by consumers in an electronic format). Through digitisation of information, including text, sound, and visual images, an increasing number of goods and services can be delivered digitally to customers increasingly remote from the location of the seller. B2C e-commerce can in many cases dramatically shorten supply chains by eliminating the need for many of the wholesalers, distributors, retailers, and other intermediaries that were traditionally used in businesses involving tangible goods. Partly because of this disintermediation, B2C businesses typically involve high investment in advertising and customer care, as well as in logistics. B2C reduces transaction costs (particularly search costs) by increasing consumer access to information. It also reduces market entry barriers, as the cost of maintaining a website is generally cheaper than installing a traditional brick-and-mortar retail shop.

4.2.1.3 Consumer-to-consumer models

121. Consumer-to-consumer (C2C) transactions are becoming more and more common. Businesses involved in C2C e-commerce play the role of intermediaries, helping individual consumers to sell or rent their assets (such as residential property, cars, motorcycles, etc.) by publishing their information on the website and facilitating transactions. These businesses may or may not charge the consumer for these services, depending on their revenue model. This type of e-commerce comes in several forms, including, but not limited to: (i) auctions facilitated at a portal that allows online bidding on the items being sold; (ii) peer-to-peer systems allowing sharing of files between users; and (iii) classified ads portals providing an interactive, online marketplace allowing negotiation between buyers and sellers."

2.3 Extent of Digital Economy in World & Prospects of its Growth

12. A report by the Boston Consulting Group in 2012 had estimated that there would be 3 billion internet users in the world by 2016.The digital economy which contributed USD 2.3 trillion in G-20 countries in 2010 would expand to USD 4.2 trillion. The digital economy is growing at 10% a year, significantly faster than the global economy as a whole. With increasing penetration, the emerging economies are now becoming the drivers of innovation.[5] The number of Internet-connected devices (12.5 billion) surpassed the number of human beings (7

[5]Boston Consultancy Group

billion) on the planet in 2011, and by 2020, Internet-connected devices are expected to number between 26 billion and 50 billion globally.[6]

13. The growth of internet and this so called 'digital economy' has been all encompassing around the globe. The volume and scope of its expansion is aptly summarized in the BEPS Report on Action 1 (2015) as under:

> *"123. For example, e-commerce in the Netherlands has increased as a share of total company revenue from 3.4% in 1999 to 14.1% in 2009. Similarly, between 2004 and 2011 this share increased from 2.7% to 18.5% in Norway and from 2.8% to 11% in Poland. Based on comparable data, as illustrated in the chart below, e-commerce is nearing 20% of total turnover in Finland, Hungary, and Sweden, and 25% in the Czech Republic (OECD, 2012).*
>
> *124. In 2014, B2C e-commerce sales were estimated to exceed USD 1.4 trillion, an increase of nearly 20% from 2013. B2C sales are estimated to reach USD 2.356 trillion by 2018, with the Asia-Pacific region expected to surpass North America as the top market for B2C e-commerce sales in 2015 (Emarketer, 2014). According to the research firm Frost and Sullivan the B2B online retail market is expected to reach double the size of the B2C market, generating total revenues of USD 6.7 trillion by 2020. Such B2B online sales will comprise almost 27% of total manufacturing trade, which is estimated to reach USD 25 trillion by 2020 (Frost and Sullivan, 2014)."*
>
> *"139. Internet advertising is rapidly growing, both in terms of total revenues and in terms of share of the total advertising market. PwC estimates that Internet advertising reached USD 135.4 billion in 2014. The market for Internet advertising is projected to grow at a rate of 12.1% per year during the period from 2014 to 2019, reaching USD 239.8 billion in 2019. Internet advertising would by that point surpass television as the largest advertising medium. Within the online advertising market, search advertisement holds the greatest share. Paid search Internet advertising revenue is forecast to grow from USD $53.13 billion in 2014 to USD $85.41 billion in 2019, accounting for over 35% of total Internet advertising by then, although video and mobile advertising are experiencing rapid growth. While video Internet advertising only accounted for 4.7% of total Internet advertising revenue in 2014, it is expected to grow at over 19% a year, rising from USD $6.32 billion to USD $15.39 billion in 2019. Similarly, mobile Internet advertising grew from just 5% of total Internet advertising in 2010 to 16.7% of the global share in 2014 and is expected to increase as mobile devices continue to proliferate (PwC, 2015)."*

14. More than two billion people globally are expected to use mobile devices to connect to the Internet in 2016, with countries like India, China and Indonesia leading the way. More than a billion people use the Internet to bank online, to stream music, and to find a job. More than

[6]Department of Electronics and Information Technology (DeiTY), Government of India

two billion use email and read news online and more people than ever before are making purchases online, it added.[7]

15. The growth and development of digital economy is reported and analyzed in great detail in Chapters 3 and 4 of the BEPS Report on Action 1 (2015), in statistical terms as well as in terms of their reliance upon information and communication technology as the primary means of doing business, along with the various business models that have emerged in the process. Because of their extensive reliance upon telecommunication and exchange of data, arising primarily from the revolutionary breakthroughs in their costs, these businesses are characterized by features that make them stand apart from the traditional brick & mortar businesses in many ways. Paragraph 158 of this summarises them as under:

> *"158. In addition, technological advances increasingly make it possible for businesses to carry on economic activity with minimal need for personnel to be present. In many cases, businesses are able to increase substantially in size and reach with minimal increases in the number of personnel required to manage day-to-day operation of the businesses (so-called "scale without mass"). This has been particularly true in the case of Internet businesses, which have in many cases quickly amassed huge numbers of users while maintaining modest workforces. As a result, the average revenue per employee of top Internet firms, as shown in Figure 4.8, is substantially higher than in other types of businesses within the ICT sector."*

2.4 Digital Economy in India

16. The Indian story in this regard is similar. According to Internet and Mobile Association of India (IAMAI), India's internet user base grew over 17% in the first six months of 2015 to 354 million. It took 10 years for India to get her first 10 million users and another 10 years to clock the first 100 million. As the rate picked up, the next 100 million users came in three years and the third 100 million took only 18 months. Internet users crossed 300 million in December 2013. India was expected to reach 402 million internet users by December 2015, registering a growth of 49 per cent over 2014 and surpassing the number of users in the United States. About 306 million of these are expected to access Internet from their mobile devices. At around that time the number of mobile users crossed one billion. With greater penetration, improving speeds and cheaper devices hitting the market, the target to reach 500 million internet users is likely to be achieved by 2016.[3]

17. The Department of Electronics and Information Technology (DeiTY), Government of India, is of the opinion that with the advent of the Internet of Things (IoT), which is defined as the interplay of software, telecom and electronic hardware industry, the number of connected sensors will soon reach trillions, working with billions of intelligent systems involving numerous

[7] Economic Times articles dated 6th February, 2015, 3rd September, 2015 and 1st January, 2016; the Internet and Mobile Association of India (IAMAI)

applications which will drive new consumer and business behaviour. The demand for increasingly intelligent industry solutions based on IoT will drive trillions of dollars in opportunity for IT industry and even more for the companies that take advantage of the IoT. The draft IoT policy of DeiTY has set an objective of creating an IoT industry in India of USD 15 billion by 2020 assuming that India would have a share of 5-6% of global IoT industry.[8] The launch of the Digital India Campaign also points to the high priority the Government of India accords to changes in the broadband infrastructure and favourable regulatory policy.

18. A report by Cisco estimates that all Internet of Everything (IoE) pillars - Internet of things, Internet of people, Internet of data, and Internet of Process for India have a value at stake (VAS) of INR 31.880 trillion (about half a trillion U.S. dollars) for the next ten years.[9]

19. Within the larger universe of the digital economy, India's e-commerce market was estimated to be worth about $3.8 billion in 2009 which went up to $12.6 billion in 2013. In 2013, the e-retail segment was worth US$ 2.3 billion. A large part of India's e-commerce market was travel related, but that may be changing now. According to Google India, there were 35 million online shoppers in India in 2014 Q1 and is expected to cross 100 million mark by end of year 2016. Electronics and Apparel are the biggest categories in terms of sales. Overall the e-commerce market is expected to reach Rs 1,07,800 crores (US$24 billion) by the year 2015 with both online travel and e-tailing contributing equally.[10]

20. A research conducted by octane.in has revealed interesting insights regarding the state of online marketing in India. According to it, 85% of the Indian marketers are tracking revenues generated through e-marketing activities. 50% of respondents share that e-marketing activities are contributing to more than 10% share of their revenues. It also reports that social media updates was the top choice for achieving maximum customer engagement (46%) followed by email campaigns (28%). Social Media (66%) also topped the list of marketing activities planned for 2016. Email marketing was not far behind, with a 53% share of Indian marketers.[11]

21. These figures clearly indicate that digital means of communication and social interaction are giving rise to new businesses that did not exist very long ago. Many of these businesses that have generated only in last two decades, occupy considerable share of market segments, and form a significant part of the economy and tax base. Their growth in India has also reached proportions that make them significant actors in Indian economy.

[8] The website of the Department of Electronics and Information Technology (DeiTY)
[9] Article “Opportunities for India in the Digital Economy” by Shri V C Gopalratnam, CIO, Cisco, published in CIO Review
[10] Wikipedia
[11] 2016 Annual Research Study on State of Online Marketing in India – Octane.in

2.5 Committee's observations

22. In view of the aforesaid details and observations, as well as the details provided in the BEPS Report on Action 1[12], this Committee is of the view that this rapidly expanding segment of business that extensively relies upon the new advances in information and communication technology, the telecommunication networks and the internet, has now become a significant segment of economy around the world, including India. The Committee notes that these developments have made it essential that its impact in terms of the applicability of existing tax laws and the challenges posed by it, is properly appreciated, understood and taken into account in the tax systems. The Committee is also of the view that these challenges need to be addressed at the earliest, and also monitored on a regular basis.

[12] Chapter 3 Information and communication technology and its impact on the economy & Chapter 4 The digital economy, new business models and key features

Section 3

Tax Challenges from Digital Economy & Action 1 in BEPS

3.1 Evolution of new Business Models in Digital Economy

23. The advancements in the Information & Communication technology in the last few decades have literally revolutionized the human society in ways that may not have been envisaged a hundred years back. The extraordinary reduction in communication costs and the widespread connectivity at a small fraction of what it used to cost in the middle of the last century has changed most aspects of our life, including the way modern businesses are conducted.

24. Till a few decades back, it was essential for businesses aiming to supply goods and services to a large number of consumers to be in proximity to the market where they wish to have a significant presence, as otherwise the prohibitive costs of communication and transport, apart from other potential constraints, would make it impossible for them to access such markets. This need for proximity made it essential for such businesses to have a physical presence in proximity to the markets, even more so for the suppliers of services, in an era when services were provided primary in the form of human intervention. However, with advancements of ICT, it is now possible for the businesses to have significant participation in the economic life of a jurisdiction without any physical presence, as the digital or telecommunication networks become a substitute for physical proximity. This has enabled the evolution of new business models that enable them to have significant participation in a jurisdiction without necessitating physical presence. In particular, business models have emerged that can be conducted primarily by exchange or transmission of data. These digital enterprises have already acquired significant space in global economy, and as per current and anticipated trends, their proportion in the total economy will continue to rise. Due to their ability to cater to international markets at low transactions costs, many of these enterprises are already among the most valued enterprises globally.

3.2 Impact of Taxation

25. The international taxation rules on the basis of which taxing rights are allocated under Double Taxation Avoidance Agreements for avoiding double taxation are largely derived from the recommendations made by a group of four economists[13] appointed by the League of Nations in the 1920s, long before such new technological advancements were even

[13] Professor Gijsbert Bruins, Professor Luigi Einaudi, Professor Edwin Seligman and Professor Sir Josiah Stamp

conceptualized. They recommended division of rights of taxation between the Country of Residence and the Country of Source while recognizing the rights of both to levy tax on such income. The existing rules that were developed as a consequence of their analysis, provide for a threshold for taxation of business income in the form of "permanent establishment" largely conceived as a physical presence of business entity, which differentiate businesses having significant economic presence in a tax jurisdiction from those having an economic participation of occasional nature. The permanent establishment based threshold thus derives its justification from the rationale that attempts at taxing a business that has a less than significant economic presence in a jurisdiction can lead to costs of compliance and administration that are unlikely to be commensurate with the revenues obtained by such taxation.

26. While the physical presence threshold has served an important purpose in optimizing compliance burdens for businesses that existed and were prevalent at the point of its conceptualization, its relevance stands undermined now with the emergence of digital enterprises, creating a need to modify the international tax rules so as to adopt them for the new business models of digital economy. This challenge related to the nexus thresholds in the existing rules is further complemented by challenges relating to characterization of certain incomes that arise from digital economy, challenges in developing rules for fairly attributing such income, as well as the challenges in valuation of contributions made by users and data belonging to them in the profitability of a digital enterprise in multidimensional business models. Thus, the emergence and evolution of new business models in the digital economy have given rise to substantial tax challenges that need to be addressed.

3.3 Action 1 of BEPS Project: Address Tax Challenges of Digital Economy

27. There have been growing concerns around the globe, raised by political leaders, media outlets and civil society, about the exploits of the multinational enterprises avoiding taxes in the economies from where their profits are derived. These concerns led to the adoption of Base Erosion & Profit Shifting (BEPS) Project by G-20 and OECD to analyze the loopholes in the existing international taxation rules that enable the multinational enterprises to avoid taxes. A BEPS Action Plan detailing the activities of the BEPS project was published in July 2013. The need for undertaking work for analyzing the tax challenges arising from digital economy were noted in the action plan of BEPS as under:

> *"the spread of the digital economy also poses challenges for international taxation. The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. This raises fundamental questions as to how enterprises in the digital economy add value and make*

their profits, and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes. At the same time, the fact that new ways of doing business may result in a relocation of core business functions and, consequently, a different distribution of taxing rights which may lead to low taxation is not per se an indicator of defects in the existing system. It is important to examine closely how enterprises of the digital economy add value and make their profits in order to determine whether and to what extent it may be necessary to adapt the current rules in order to take into account the specific features of that industry and to prevent BEPS."

28. The Action 1 of the Base Erosion and Profit Shifting (BEPS) Project of G-20 and OECD included addressing the tax challenges of the digital economy as the first of the fifteen actions that were planned as part of this project. The following action was planned to be undertaken under this action:

Action 1 – Address the tax challenges of the digital economy

Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector.

29. The BEPS Action Plan, including Action 1, prepared by the OECD was adopted and endorsed by the G-20 countries, including India, in the G-20 declaration issued by its Leaders after their meeting in St. Petersburg on 5-6th September, 2013.

30. For implementing Action 1, the "*Task Force on the Digital Economy*" (TFDE) was established in September, 2013, with representatives of OECD, G-20 and other countries associated in the BEPS project. The mandate of the Task Force was to undertake work on Action 1 and submit a report on the same. As part of its work, the Task Force also held public consultations with the stakeholders including industry (both digital as well as brick & mortar industry), academicians and non governmental representatives. The report of the Task Force was finalized by September, 2014, wherein it analyzed in detail, the new business models which have come into existence as a result of advances in information and communication technology and the expansion of digital and telecommunication networks around the world. This report

concluded that important issues related to nexus, characterization and data have arisen in the wake of development of digital economy that need to be examined further.

31. Further work on these issues was subsequently carried out by the task force and its focus groups, in consultations with renowned academicians and experts who have been working on this subject, while also seeking feedback from industry and other stakeholders from time to time. As a part of this work, the Task Force further detailed the broader tax challenges that have come into existence, including contributions made by the users and the value of data belonging to them, which contribute to profits of digital enterprises in multidimensional business models. In view of these challenges and the need to find solutions to address them, the Task Force identified and analyzed in great detail, the potential options that can be adopted to address these challenges.

32. The Final Report on Action 1 was finalized by the Task Force in September, 2015 and has since been endorsed by the G-20 as well as the OECD. The Report provides an internationally accepted recognition of the broader tax challenges arising from digital enterprises, their unprecedented business models including multi-dimensional businesses, mobility of these enterprises, their ability to relatively easily avoid taxes in jurisdictions that significantly contribute to their profitability, and the challenges and difficulties that arise in the application of currently practiced international taxation rules in their case.

33. The Executive Summary of the Report describes the contents of the report in the following manner:

> *"This final report first provides an overview of the fundamental principles of taxation, focusing on the difference between direct and indirect taxes and the concepts that underlie them as well as double tax treaties (Chapter 2). It then examines the evolution over time of information and communication technology (ICT), including emerging and possible future developments (Chapter 3) and discusses the spread and impact of ICT across the economy, providing examples of new business models and identifying the key features of the digital economy (Chapter 4). It then provides a detailed description of the core elements of BEPS strategies in the digital economy (Chapter 5) and discusses how they will be addressed by the measures developed through the work on the BEPS Action Plan and the OECD work on indirect taxation (Chapter 6). It identifies also the broader tax challenges raised by the digital economy and summarises the potential options to address them that have been discussed and analysed by the TFDE, both in the areas of corporate income tax (Chapter 7) and of indirect tax (Chapter 8). Finally, it provides an evaluation of the broader direct and indirect tax challenges raised by the digital economy and of the options to address them (Chapter 9), taking into consideration not only the impact on BEPS issues of the measures developed in the course of the BEPS Project, but also the economic incidence of the different options to tackle these broader tax*

challenges. The conclusions of the TFDE, together with determination of the next steps, are included at the end of the report (Chapter 10)."

34. This Report, the first of its kind, and a result of a two year effort undertaken by representatives from around the world, with contributions of experts and governmental representatives, has been finalized after several rounds of public consultation with stakeholders[14] and taking their views and suggestions into account. This report, which has since been adopted and endorsed by the G-20 and OECD provides a detailed overview of the tax challenges arising from digital economy. It is a first of its kind recognition of the limitations of the existing international taxation rules, as embodied in the Model Tax Conventions recommended by OECD and UN Committee of Experts, in respect of the digital enterprises that conduct their businesses in a manner that was not conceivable at the time the existing taxation rules were being written in the last century. The Report also provides a broad international consensus on what can be done, by recognizing the possible measures that can be considered or undertaken for addressing the tax challenges arising from digital economy. The Conclusions of the Report do not recommend any measures for universal adoption at this stage, but recognize the right of countries that may prefer to address these challenges by adopting any of the options in their domestic laws, or in their bilateral tax treaties.

3.4 Committee's Observations

35. In view of its acceptance by G-20 and the OECD, the Committee has placed extensive reliance on the BEPS Report on Action 1 (2015) in its work. However, the Committee also took into account the Indian perspective, the work done in this field by other experts as well as its independent analysis in preparing this report.

[14] The stakeholders included representatives from industry, tax consultants, tax experts, academicians and non-governmental organizations. The details of public consultations held by the Task Force are provided in paragraph 8, which is reproduced below for ease of reference:

"Considering the importance of stakeholders' input, the OECD issued a public request for input on 22 November 2013. Input received was discussed at the second meeting of the TFDE on 2-3 February 2014. The TFDE discussed the evolution and pervasiveness of the digital economy as well as the key features of the digital economy and tax challenges raised by them. The TFDE heard presentations from delegates outlining possible options to address the BEPS and tax challenges of the digital economy and agreed on the importance of publishing a discussion draft for public comments and input. The input received was discussed by the TFDE and contributed to the finalisation of an interim report, which was published in September 2014. In accordance with the interim report, the TFDE continued its work until September 2015 in order to (i) ensure that work carried out in other areas of the BEPS Project tackles BEPS issues in the digital economy, and that it can assess the outcomes of that work; and (ii) continue the work on the broader tax challenges related to nexus, data, and characterisation, so as to refine the technical details of the potential options and enable their evaluation in light of the outcomes of the BEPS project."

Section 4

Issues related to Tax Neutrality between Domestic & Multi-National Enterprises and their Implications

4.1 Principles of Tax Policy & Tax Neutrality

36. As part of its work, the Task Force on Digital Economy revisited and reviewed the fundamental principle on tax policy. It recalled that these principles were the basis of discussion in the 1998 Ottawa Ministerial Conference, and have been deemed appropriate for an evaluation of the taxation issues related to e-commerce. The Task Force listed these principles as neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility in its 2014 Report[15], paragraphs 27 to 30 of which are reproduced below for ease of reference:

> ***"1. Overarching Principles of Tax Policy***
>
> *27. In a context where many governments have to cope with less revenue, increasing expenditures and resulting fiscal constraints, raising revenue remains the most important function of taxes, which serve as the primary means for financing public goods such as maintenance of law and order and public infrastructure. Assuming a certain level of revenue that needs to be raised, which depends on the broader economic and fiscal policies of the country concerned, there are a number of broad tax policy considerations that have traditionally guided the development of taxation systems. These include neutrality, efficiency, certainty and simplicity, effectiveness and fairness, as well as flexibility. In the context of work leading up to the Report on the Taxation of Electronic Commerce (see Annex 1 for further detail), these overarching principles were the basis for the 1998 Ottawa Ministerial Conference, and are since then referred to as the Ottawa Taxation Framework Conditions. At the time, these principles were deemed appropriate for an evaluation of the taxation issues related to e-commerce. Although most of the new business models identified in Section IV did not exist yet at the time, these principles, with modification, continue to be relevant in the digital economy, as discussed in Section VIII. In addition to these well-recognised principles, equity is an important consideration for the design of tax policy.*
>
> - ***Neutrality****- taxation should seek to be neutral and equitable between forms of business activities. A neutral tax will contribute to efficiency by ensuring that optimal allocation of the means of production is achieved. A distortion, and the corresponding deadweight loss, will occur when changes in price trigger different changes in supply and demand than would occur in the absence of tax. In this sense, neutrality also entails that the tax system raises revenue while minimizing*

[15] The work under Action 1 was initially scheduled to be completed by September, 2014. Accordingly, the Task Force prepared its Report in September, 2014. In this report, it was decided to carry on follow-up work, which was undertaken after September, 2014 and led to the 2015 Report.

discrimination in favour of, or against, any particular economic choice. This implies that the same principles of taxation should apply to all forms of business, while addressing specific features that may otherwise undermine an equal and neutral application of those principles.

- ***Efficiency-*** *compliance costs to business and administration costs for governments should be minimised as far as possible.*
- ***Certainty and simplicity-*** *tax rules should be clear and simple to understand, so that taxpayers know where they stand. A simple tax system makes it easier for individuals and businesses to understand their obligations and entitlements. As a result, businesses are more likely to make optimal decisions and respond to intended policy choices. Complexity also favours aggressive tax planning, which may trigger deadweight losses for the economy.*
- ***Effectiveness and fairness-*** *taxation should produce the right amount of tax at the right time, while avoiding both double taxation and unintentional non-taxation. In addition, the potential for evasion and avoidance should be minimised. Prior discussions in the Technical Advisory Groups considered that if there is a class of taxpayers that are technically subject to a tax, but are never required to pay the tax due to inability to enforce it, then the taxpaying public may view the tax as unfair and ineffective. As a result, the practical enforceability of tax rules is an important consideration for policy makers. In addition, because it influences the collectability and the administrability of taxes, enforceability is crucial to ensure efficiency of the tax system.*
- ***Flexibility-*** *taxation systems should be flexible and dynamic enough to ensure they keep pace with technological and commercial developments. It is important that a tax system is dynamic and flexible enough to meet the current revenue needs of governments while adapting to changing needs on an ongoing basis. This means that the structural features of the system should be durable in a changing policy context, yet flexible and dynamic enough to allow governments to respond as required to keep pace with technological and commercial developments, taking into account that future developments will often be difficult to predict.*

28. Equity is also an important consideration within a tax policy framework. Equity has two main elements; horizontal equity and vertical equity. Horizontal equity suggests that taxpayers in similar circumstances should bear a similar tax burden. Vertical equity is a normative concept, whose definition can differ from one user to another. According to some, it suggests that taxpayers in better circumstances should bear a larger part of the tax burden as a proportion of their income. In practice, the interpretation of vertical equity depends on the extent to which countries want to diminish income variation and whether it should be applied to income earned in a specific period or to lifetime income. Equity is traditionally delivered through the design of the personal tax and transfer systems.

29. Equity may also refer to inter-nation equity. As a theory, inter-nation equity is concerned with the allocation of national gain and loss in the international context and aims to ensure that each country receives an equitable share of tax revenues from cross border transactions (OECD, 2001: 228). The tax policy principle of inter-nation equity has been an important consideration in the debate on the division of taxing rights between source and residence countries. At the time of the Ottawa work on the taxation of electronic commerce, this important concern was recognised by stating that "any adaptation of the existing international taxation principles should be structured to maintain fiscal sovereignty of countries, [and] to achieve a fair sharing of the tax base from electronic commerce between countries…".(OECD, 2001: 228)

30. Tax policy choices often reflect decisions by policy makers on the relative importance of each of these principles and will also reflect wider economic and social policy considerations outside the field of tax."

4.2 Tax Neutrality: An Important Concern

37. Among these, the issue of tax neutrality, which was listed as the first of these principles in the report, was considered in detail during the work by the Task Force.[16] The principle of tax neutrality provides that tax should seek to be neutral and equitable between various forms of business activities. When tax neutrality is violated, the unfair tax advantage enjoyed by some market enterprises can distort the market economy and the dead weight loss arising from it can adversely impact market efficiency. The Task Force noted that a neutral tax contributes to market efficiency by ensuring optimal allocation of resources in the market.

38. In the context of digital economy, tax neutrality has emerged as a major concern. While a purely domestic enterprise is taxed at the marginal tax rate under the domestic laws, a multi-national enterprise may not be taxable at all in the country of source due to the ability of digital enterprises to conduct their business through digital and telecommunication networks without requiring any physical presence in the country of source. As the existing international taxation rules in the treaties require the presence of permanent establishment based on physical presence, the multinational enterprises conducting digital businesses in the same way as their domestic competitors would not be taxed on the income derived by them from the source country. The multinational digital enterprises are characterized by high mobility, can easily locate in low tax jurisdictions and thereby minimize their global tax liability, resulting in significant tax advantages over their domestic competitors.

[16] These observations were retained in a summarised form in the 2015 Report in paragraph 6 and Box 1.1 of that Report.

4.3 Committee's Observations

39. Taking the aforesaid issues related to tax neutrality into account, the Committee is of the view that the asymmetry in tax burden faced by purely domestic and multi-national enterprises can have distortionary impact on the market competition and can adversely affect the development of purely domestic enterprises. The clear tax advantage faced by foreign enterprises over their Indian counterparts also creates strong incentives for Indian enterprises to either locate themselves in a low tax jurisdiction outside India or sell their businesses to such an enterprise. Thus, distortionary taxation arising from the limitations of existing international taxation rules and the lack of tax neutrality are likely to pose significant constraints in development of Indian digital industry, and thereby pose significant long term challenges for this extremely important sector of economy.

40. Another important manifestation of lack of tax neutrality and its implications is the difference between the tax burden faced by the traditional brick and mortar businesses and digital enterprises competing with them. The traditional brick and mortar businesses are likely to be taxable fully on their business income arising in source jurisdictions, such as India, either as a tax resident, or as the permanent establishment of a foreign company, and thus face a much higher tax burden on their profits than their multinational counterparts conducting their businesses by digital means. This lack of tax neutrality between digital enterprise and traditional enterprises can distort the market in favor of the former and thereby disrupt the existing market equilibriums.

41. These violations of tax neutrality can result in significant impacts on the economy. The tax advantage faced by multinational digital enterprises can adversely impact the growth of digital industry in India and profitability and expansion of traditional brick and mortar businesses in India. The long term impact of these distortions can be adverse to Indian businesses in general and Indian brick and mortar enterprises in particular, and in addition to the adverse impact on the economy, can also lead to fiscal constraints for Government of India. These fiscal shortfalls may need to be compensated by additional tax burden on local tax residents, which may further erode their competitiveness, thereby creating a vicious downward cycle.

Section 5

Principles for Allocating Taxing Rights, Factors that contribute to Profitability & Historical Review of Existing Rules

42. While endorsing the BEPS Action plan, the G-20 Declaration also emphasized the need to ensure that profits are taxed where economic activities deriving the profits are performed and their value is created. The profitability of a business is dependent upon the supply of goods or services to those wishing to pay for it. The primary economic activities that lead to profits of any business are production and sale.

5.1 Factors that contribute to profits of an Enterprise & Role of Public Resources and Taxation

43. The economic theory makes its obvious that the price of the goods and services that it can seek from the buyers, the volume of its sales, and costs that it incurs for production are the primary determinants of its profits. The market price as well the volume of sales, in turn, results from the interaction of demand and supply within a market, and are contributed by factors on both demand side and supply side. The supply side factors are related to production and marketing, whereas the primary demand side factor that influences the price of a good or service and the profitability of the enterprise supplying them, is the paying capacity of consumers.

44. The paying capacity of consumers is a function of the state of that economy, including availability of public goods, law and order, market facilitation, infrastructure as well as redistribution of resources (subsidies) to the consumers directly or indirectly, using public resources. The profits arise only when an economic good produced by supplier is paid for by a consumer during the sale transaction. The performance of sale, thus has two limbs – the buyer and the seller and their interaction leads to creation of value and profits. By stabilizing, promoting, preserving and augmenting the paying capacity of the consumers, the Government and the public resources belonging to that economy play a vital role in contributing to the profits generated by enterprises having a significant economic presence in that jurisdiction, and the resultant value of the enterprise.

This also serves as the primary justification for collection of taxes by that jurisdiction on profits and income earned by any enterprise having a significant economic presence therein.[17]

45. Similarly, factors that contribute on the supply side include the availability of economic stabilization, supply of public goods, law and order, market facilitation, infrastructure as well as subsidies provided to enterprises directly or indirectly. These factors contribute significantly to the ability of the enterprise to produce at competitive prices, and their provisioning from public resources provides a justification for the jurisdiction in which supply side activities are carried out by an enterprise to impose a tax on its profits or income.

46. In case of purely domestic enterprise, the demand side factors as well as the supply side factors are contributed by the same jurisdiction, which also levies taxes on it. However, in case of a multi-national enterprise, producing and selling in different jurisdictions, the contribution of demand and supply side factors to its profitability are made from the public resources of different tax jurisdictions, both of which can claim justification for taxing it. The possibility of resultant double taxation can be detrimental to the enterprise and its ability to carry its business across borders. Therein lies the origin of Double Taxation Avoidance Agreements, commonly referred to as "tax treaties" that evolved in the last century keeping in view the business models that were the focus on international trade and taxes at that point of time.

5.2 Historical Overview of International Taxation Rules

47. Action I Report finalized by the Task Force in 2015 provides a detailed historical overview of the conceptual basis for allocating tax and rights, wherein it recognizes two aspects to a state's sovereignty: the power over a territory ("enforcement jurisdiction") and the power over a particular set of subjects ("political allegiance"). It reports that relationship to a person (i.e. a "personal attachment") or on the relationship to a territory (i.e. a "territorial

[17] A Special Report by Bloomberg BNA titled "Multistate Tax Report 2015 Survey of State Tax Departments, Vol 22, No. 4, reports that 31 of the states in the United States now resort to "significant economic presence" criteria for establishing tax nexus, instead of the 'physical presence", and thereby tax intangible digital goods and services provided through the digital or telecommunication networks. The introduction of the reports states as under:

> *"To avoid potential revenue loss, an increasing number of states are rejecting the bright-line physical presence test. States are adjusting to the new economy by taxing out-of-state businesses based on their ''economic presence'' within their borders. They are also adopting new rules aimed at taxing out-of-state companies' receipts from services and intangibles that are attributable to in-state customers. .....For example, the taxation of digital products and services (software downloads, Web hosting, and Software as a Service transactions) has become a popular area for states to expand beyond the taxation of tangible personal property to intangibles and services as well."*

attachment") were usually adopted as the basis for taxation.[18] It describes the significance of source in such taxation in paragraph 26 as under:

> *"26. With respect to the taxation of inbound investments of non-resident companies, both a worldwide tax system and a territorial tax system impose tax on income arising from domestic sources. Hence, the determination of source of the income is key. Sourcing rules vary from country to country. With respect to business income, the concept of source under domestic law often parallels the concept of permanent establishment (PE) as defined under tax treaties. Such income is typically taxed on a net basis. For practical reasons however, it may be difficult for a country to tax certain items of income derived by non-resident corporations. It may also be difficult to know what expenses a non-resident incurred in earning such income. As a result, taxation at source of certain types of income (e.g. interest, royalties, dividends) derived by non-resident companies commonly occurs by means of withholding taxes at a gross rate. To allow for the fact that no deductions are allowed, gross-based withholding taxes are imposed at rates that are usually lower than standard corporate tax rates"*

48. The existing tax treaties have their origins in the Model of Bilateral Tax Treaty drafted in 1928 by the League of Nations, the details related to which are provided in paragraphs 28 to 32, which are reproduced below for ease of reference.

> ***"2.3.2.1 A historical overview of the conceptual basis for allocating taxing rights***
>
> *28. As global trade increased in the early 20th century, and concerns around instances of double taxation grew, the League of Nations appointed in the early 1920s four economists (Bruins et al., 1923) to study the issue of double taxation from a theoretical and scientific perspective. One of the tasks of the group was to determine whether it is possible to formulate general principles as the basis of an international tax framework capable of preventing double taxation, including in relation to business profits.[2] In this context the group identified the concept of economic allegiance as a basis to design such international tax framework. Economic allegiance is based on factors aimed at measuring the existence and extent of the economic relationships between a particular state and the income or person to be taxed. The four economists identified four factors comprising economic allegiance, namely (i) origin of wealth or income, (ii) situs of wealth or income, (iii) enforcement of the rights to wealth or income, and (iv) place of residence or domicile of the person entitled to dispose of the wealth or income.*
>
> *29. Among those factors, the economists concluded that in general, the greatest weight should be given to "the origin of the wealth [i.e. source] and the residence or domicile of the owner who consumes the wealth". The origin of wealth was defined for these purposes as all stages involved in the creation of wealth: "the original physical appearance of the wealth, its subsequent physical adaptations, its transport, its direction and its sale". In other words, the group advocated that tax jurisdiction should generally be allocated between the state of source and the state of residence depending on the nature of the income in question. Under this approach, in simple situations where all (or a majority of) factors of economic allegiance coincide, jurisdiction to tax would go exclusively with the state where the relevant elements of economic allegiance have been characterised. In more complex situations in which conflicts between the relevant factors*

[18] Paragraph 20 of the BEPS Report on Action 1 (2015)

of economic allegiance arise, jurisdiction to tax would be shared between the different states on the basis of the relative economic ties the taxpayer and his income have with each of them.

30. On the basis of this premise, the group considered the proper place of taxation for the different types of wealth or income. Business profits were not treated separately, but considered under specific classes of undertakings covering activities nowadays generally categorised as "bricks and mortar" businesses, namely "Mines and Oil Wells", "Industrial Establishments" or "Factories", and "Commercial Establishments".[3] In respect of all those classes of activities, the group came to the conclusion that the place where income was produced is "of preponderant weight" and "in an ideal division a preponderant share should be assigned to the place of origin". In other words, in allocating jurisdiction to tax on business profits, greatest importance was attached to the nexus between business income and the various physical places contributing to the production of the income.

31. Many of the report's conclusions proved to be controversial and were not entirely followed in double tax treaties. In particular, the economists' preference for a general exemption in the source state for all "income going abroad" as a practical method of avoiding double taxation[4] was explicitly rejected by the League of Nations, who chose as the basic structure for its 1928 Model the "classification and assignment of sources" method – i.e. attach full or limited source taxation to certain classes of income and assign the right to tax other income exclusively to the state of residence. Nevertheless, the theoretical background enunciated in the 1923 Report has survived remarkably intact and is generally considered as the "intellectual base" (Ault, 1992: 567) from which the various League of Nations models (and consequently virtually all modern bilateral tax treaties) developed (Avi-Yonah, 1996).

32. Before endorsing the economic allegiance principle, the group of four economists briefly discussed other theories of taxation, including the benefit principle (called at the time the "exchange theory"), and observed that the answers formulated by this doctrine had to a large extent been supplanted by the theory of ability to pay. Several authors consider that the decline of the benefit theory is undeniable as far as determination of the amount of tax liability is concerned, but not in the debate on taxing jurisdiction in an international context (Vogel, 1988). Under the benefit theory, a jurisdiction's right to tax rests on the totality of benefits and state services provided to the taxpayer that interacts with a country (Pinto, 2006), and corporations, in their capacity as agents integrated into the economic life of a particular country, ought to contribute to that country's public expenditures. In other words, the benefit theory provides that a state has the right to tax resident and non-resident corporations who derive a benefit from the services it provides. These benefits can be specific or general in nature. The provision of education, police, fire and defence protection are among the more obvious examples. But the state can also provide conducive and operational legal structures for the proper functioning of business, for example in the form of a stable legal and regulatory environment, the protection of intellectual property and the knowledge-based capital of the firm, the enforcement of consumer protection laws, or well-developed transportation, telecommunication, utilities and other infrastructure (Pinto, 2006)."

5.3 Permanent Establishment: Historical Overview

49. It can be observed that the initial conceptualization of Permanent Establishment based on physical presence was undertaken keeping in view certain industries of that time and the business models employed by them, such as mines, oil wells, factories and commercial establishments. These industries, part of the brick and mortar businesses, were based on physical presence, and based on their analysis, physical presence was conceived as a reliable threshold indicative of the intent and capacity of an enterprise of having a significant participation in the economic life of an economy. It is also not difficult to appreciate that the high costs of transportation and communication at that point of time ensured that most enterprises intending to cater to the needs of a significant market would usually prefer to locate itself in close proximity to the markets in which that enterprise intends to have a significant share, in which case, the demand side as well as supply side factors, contributed by public resources, arose in the jurisdiction where it was physically located, and aptly justified the allocation of taxing rights to that jurisdiction on the basis of physical presence. The concept of permanent establishment as a threshold for taxation of business profits in the source jurisdiction is elaborated in paragraph 35 of the Report as under:

> *"35. The PE concept effectively acts as a threshold which, by measuring the level of economic presence of a foreign enterprise in a given State through objective criteria, determines the circumstances in which the foreign enterprise can be considered sufficiently integrated into the economy of a state to justify taxation in that state (Holmes, 2007; Rohatgi, 2005). A link can thus reasonably be made between the requirement of a sufficient level of economic presence under the existing PE threshold and the economic allegiance factors developed by the group of economists more than 80 years ago. This legacy is regularly emphasised in literature (Skaar, 1991), as well as reflected in the existing OECD Commentaries when it is stated that the PE threshold "has a long history and reflects the international consensus that, as a general rule, until an enterprise of one State has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits".[5] By requiring a sufficient level of economic presence, this threshold is also intended to ensure that a source country imposing tax has enforcement jurisdiction, the administrative capability to enforce its substantive jurisdiction rights over the non-resident enterprise."*

5.4 Evolution of Permanent Establishment since its initial conception[19]

50. The concept of Permanent Establishment has also evolved since its original conceptualization in the last century. These include the interpretational expansion in the Commentary on OECD Model Tax Convention, of the phrase "*fixed place of business*" that literally means a business that is completely immobile, to include businesses having a

[19] Paragraph 36 of the BEPS Report on Action 1(2015)

commercial and geographical coherence within a particular jurisdiction.[20] The scope of permanent establishment has also evolved beyond the physical presence to include "*a person acting on behalf of an enterprise and habitually exercising an authority to conclude contracts on its behalf*"[21]. Further, provision of services beyond a threshold duration[22], construction activities beyond a threshold duration[23], and collection of insurance premiums[24] have now been recognized as alternative thresholds that constitute permanent establishment, without the need to satisfy the "*fixed place of business*". Each of these developments can be seen to have resulted from the need of international taxation rules to adapt to the new business models that have evolved and become prevalent over time in international commerce. With time, the differences in preferences and willingness of different economies to agree with such expansions, arising expectedly from their own fiscal interests, have also become clearly documented in the form of parallel evolution of the OECD and the UN Model Tax Conventions, with significant differences in the definition of permanent establishment. These differences have become more contrasting in rules on attribution of profits to a permanent establishment.[25] In the light of these developments, it becomes clear that the concept of permanent establishment based on physical presence would need to be updated in view of the new business models characterizing digital economy in the same way as it has been updated earlier to adapt to the need of service industries, construction industries and insurances. However, the persistence of differences between countries preferring source based taxation and those preferring residence based taxing rights[26] also indicates that such expansion will be resisted by those who stand to lose, and may not be as easy to achieve as it might appear from an almost apparent need to do so.

5.5 Tax on gross payments in the absence of a PE

51. The Model Tax Conventions developed by the OECD and UN provide for certain categories of income to be taxed in the jurisdiction in which they arise without the need for satisfying the permanent establishment based threshold. These have been elaborated in paragraph 38 and 39 of the Report on Action 1 (2015) as under:

[20] Paragraph 5.3 and 5.4 of the OECD Commentary on Article 5
[21] Paragraph 5 of Article 5 of OECD and UN Model Tax Conventions
[22] Paragraph 3 (b) of Article 5 in the UN Model Tax Convention
[23] Paragraph 3 of Article 5 of OECD and UN Model Tax Conventions
[24] Paragraph 6 of Article 5 in the UN Model Tax Convention
[25] The amendment of Article 7 of OECD Model Tax Convention in the last decade has not been accepted by many countries like India, that prefer greater taxing rights for the source jurisdictions.
[26] Economies that are net exporters of capital and technology may prefer greater allocation of taxing rights to the jurisdiction of which taxpayer is a resident; economies that are net importers of capital and technology may prefer greater allocation of taxing rights to the jurisdiction from where the payments arise.

"38. By virtue of separate distributive rules which take priority over the PE rule, some specific items of income may be taxed in the source jurisdiction even though none of the alternative PE thresholds are met in that country. These include:

- *Income derived from immovable property (and capital gains derived from the sale thereof), which generally may be taxed by the country of source where the immovable property is located.*
- *Business profits that include certain types of payments which, depending on the treaty, may include dividends, interest, royalties or technical fees, on which the treaty allows the country of source to levy a limited withholding tax.*

39. In the case of outbound payments of dividends, interest, and royalties, countries commonly impose tax under their domestic law on a gross basis (i.e. not reduced by the deduction of expenses) by means of a withholding tax. Bilateral tax treaties commonly specify a maximum rate at which the source state may impose such a withholding tax, with the residual right to tax belonging to the state of residence.[6] However, where the asset giving rise to such types of income is effectively connected to a PE of the non-resident enterprise in the same state, the rules for attribution of profits to a PE control (Article 10(4), 11(4) and 12(3) of the OECD Model Tax Convention)."

52. These exceptions to the permanent establishment threshold indicate the adaptation of permanent establishment based rule of taxing income to the needs of simplicity and predictability, which are recognized as important principles in designing a tax.[27] If the existence of a permanent establishment is seen as an evidence of significant participation of an enterprise in the economic life of a jurisdiction, then the taxing of these payments at a concessional rate on a gross basis provides a simple alternative way of taxing income on the basis of a simple presumptive thumb rule, without getting caught in the difficulties that arise in determining the existence of a permanent establishment and the profits that may be attributable to it. The simple tax rule for taxing these payments also suggests an alternate to the complex methodology inherent in permanent establishment based taxation of income, and a way to avoid the potential disputes that can arise from its application.

5.6 Committee's Observations

53. In view of the extensive analysis of these aspects provided in the BEPS Report on Action 1 and the observations made above, the Committee is of the view that the physical presence based threshold for taxing income in the economy from where the payments arise, was conceptualized in an era when it reasonably indicated the significant economic presence of an enterprise in the economy of a jurisdiction. The evolution of the definition of permanent establishment, both in terms of its interpretation, as well as in terms of alternate conditions that give rise to it, is an evidence of the adaptation of this rule to the evolving ways in which business conducts itself. It signifies the dynamic evolution of taxable nexus

[27] Ottawa Taxation Framework, 1998

with business modes, and justifies its further evolution to the needs of new business models of digital economy.

54. At the same time, the lack of universal acceptance of a single definition of permanent establishment rule and the divergence in the preference for attribution rules indicates a wedge between preferences of different countries that may not be easy to fill up. In this light, the gross taxation of payments in the jurisdiction where they arise, at a concessional rate of tax, offers a potential option that has already been relied in tax treaties as an alternative to the permanent establishment based rule. In broad terms, both these alternatives allocate taxing rights to jurisdictions that contribute to the profitability of an enterprise by way of demand or supply side factors provisioned by public resources belonging to that jurisdiction.

Section 6

Broader Tax Challenges related to Nexus and Characterization of Income from Digital Transactions and common Disputes

6.1 Broader Tax Policy Challenges

55. The primary tax challenges that arise from digital economy largely relate to the issues of nexus and characterization.[28] The BEPS Report on Action 1 (2015) details them in paragraphs 376 to 380 as under:

> ***"10.3 Broader tax policy challenges raised by the digital economy***
>
> ***376. The digital economy also raises broader tax challenges for policy makers.*** *These challenges relate in particular to nexus, data, and characterisation for direct tax purposes. These challenges trigger more systemic questions about the ability of the current international tax framework to deal with the changes brought about by the digital economy and the business models that it makes possible and hence to ensure that profits are taxed in the jurisdiction where economic activities occur and where value is generated. They therefore have a broad impact and relate primarily to the allocation of taxing rights among different jurisdictions. These challenges also raise questions regarding the paradigm used to determine where economic activities are carried out and value is generated for tax purposes, which is based on an analysis of the functions, assets and risks of the enterprise involved. At the same time, when these challenges create opportunities for achieving double non-taxation, for example due to the lack of nexus in the market country under current rules coupled with lack of taxation in the jurisdiction of the income recipient and of that of the ultimate parent company, they also generate BEPS issues in the form of stateless income. In addition, in the area of indirect taxes, the digital economy raises policy challenges regarding the collection of VAT.*
>
> ***377. The challenges related to nexus, data and characterisation overlap with each other to a certain extent.*** *Although the challenges related to direct tax are distinct in nature, they often overlap with each other. For example, the collection of data from users located in a jurisdiction may trigger questions regarding whether that activity should give rise to nexus with that jurisdiction and regarding how data should be treated for tax purposes.*
>
> ***378. Evolving ways of carrying on business raise questions about whether current nexus rules continue to be appropriate.*** *The continual increase in the potential of digital technologies and the reduced need in many cases for extensive physical presence in order to carry on business in a jurisdiction, combined with the increasing role of network effects generated by customer interactions, raise questions as to whether rules that rely on physical presence continue to be appropriate. The number of firms carrying out business transactions over the Internet has increased dramatically over the last decade. In 2014, B2C e-commerce sales were estimated to exceed USD 1.4 trillion, an increase of nearly 20% from 2013. According to estimates, the size of total worldwide e-commerce,*

[28] The third major issues recognized by the BEPS Report on Action 1 (2015) is dealt with in Section 7 of this Report.

when global B2B and consumer transactions are added together, equalled USD 16 trillion in 2013.

379. Increasing reliance on data collection and analysis, and the growing importance of multi-sided business models raise questions about valuation of data, nexus, and profit attribution, as well as characterisation*. The appropriate allocation of taxable income among locations in which economic activities take place and value is created may not always be clear in the digital economy, particularly in cases where users and customers become an important component of the value chain, for example in relation to multi-sided business models and the sharing economy. The growth in sophistication of information technologies has permitted companies in the digital economy to gather and use information to an unprecedented degree. This raises the issues of how to attribute value created from the generation of data through digital products and services, whether remote collection of data should give rise to nexus for tax purposes, and of ownership and how to characterise for tax purposes a person or entity's supply of data in a transaction, for example, as a free supply of a good, as a barter transaction, or some other way.*

380. The development of new business models raises questions regarding characterisation of income. *The development of new digital products or means of delivering services creates uncertainties in relation to the proper characterisation under current rules of payments made in the context of new business models, particularly in relation to cloud computing. Further, to the extent that 3D printing becomes increasingly prevalent, it may raise characterisation questions as well, as direct manufacturing for delivery could effectively evolve into licensing of designs for remote printing directly by consumers."*

6.2 Issues related to Nexus

56. The issues in respect of nexus relate largely to the ability of digital enterprises to carry on their business in a particular jurisdiction and have a significant economic presence there, without crossing the threshold rules or criteria that are used for determining nexus between an enterprise and a tax jurisdiction for the purpose of imposing taxes. These issues have been analyzed and elaborated in detail in paragraphs 253 to 261 in the BEPS Report in Action 1 (2015), which are reproduced below for ease of reference:

"***7.3 Nexus and the ability to have a significant presence without being liable to tax***

253. Advances in digital technology have not changed the fundamental nature of the core activities that businesses carry out as part of a business model to generate profits. To generate income, businesses still need to source and acquire inputs, create or add value, and sell to customers. To support their sales activities, businesses have always needed to carry out activities such as market research, marketing and advertising, and customer support. Digital technology has, however, had significant impact on how these activities are carried out, for example by enhancing the ability to carry out activities remotely, increasing the speed at which information can be processed, analysed and utilised, and, because distance forms less of a barrier to trade, expanding the number of potential customers that can be targeted and reached. Digital infrastructure and the investments

that support it can be leveraged today in many businesses to access far more customers than before. As a result, certain processes previously carried out by local personnel can now be performed cross-border by automated equipment, changing the nature and scope of activities to be performed by staff. Thus, the growth of a customer base in a country does not always need the level of local infrastructure and personnel that would have been needed in a "pre-digital" age.

254. This increases the flexibility of businesses to choose where substantial business activities take place, or to move existing functions to a new location, even if those locations may be removed both from the ultimate market jurisdiction and from the jurisdictions in which other related business functions may take place. As a result, it is increasingly possible for a business's personnel, IT infrastructure (e.g. servers), and customers each to be spread among multiple jurisdictions, away from the market jurisdiction. Advances in computing power have also meant that certain functions, including decision-making capabilities, can now be carried out by increasingly sophisticated software programmes and algorithms. For example, contracts can in some cases be automatically accepted by software programmes, so that no intervention of local staff is necessary. As discussed below, this is also true in relation to functions such as data collection, which can be done automatically, without direct intervention of the employees of the enterprise.

255. Despite this increased flexibility, in many cases large multinational enterprises (MNEs) will indeed have a taxable presence in the country where their customers are located. As noted in Chapter 4, there are often compelling reasons for businesses to ensure that core resources are placed as close as possible to key markets. This may be because the enterprise wants to ensure a high quality of service and have a direct relationship with key clients. It may also be because minimising latency is essential in certain types of business, or because in certain industries regulatory constraints limit choices about where to locate key infrastructure, capital, and personnel. It is therefore important not to overstate the issue of nexus. Nevertheless, the fact that it is possible to generate a large quantity of sales without a taxable presence should not be understated either and it raises questions about whether the current rules continue to be appropriate in the digital economy.

256. These questions relate in particular to the definition of permanent establishment (PE) for treaty purposes, and the related profit attribution rules. It had already been recognised in the past that the concept of PE referred not only to a substantial physical presence in the country concerned, but also to situations where the non-resident carried on business in the country concerned via a dependent agent (hence the rules contained in paragraphs 5 and 6 of Article 5 of the OECD Model). As nowadays it is possible to be heavily involved in the economic life of another country without having a fixed place of business or a dependent agent therein, concerns are raised regarding whether the existing definition of PE remains consistent with the underlying principles on which it was based. For example, the ability to conclude contracts remotely through technological means, with no involvement of individual employees or dependent agents, raises questions about whether the focus of the existing rules on conclusion of contracts by persons other than agents of an independent status remains appropriate in all cases.

257. These concerns are exacerbated in some instances by the fact that in certain business models, customers are more frequently entering into ongoing relationships with providers of services that extend beyond the point of sale. This ongoing interaction with

customers generates network effects that can increase the value of a particular business to other potential customers. For example, in the case of a retail business operated via a website that provides a platform for customers to review and tag products, the interactions of those customers with the website can increase the value of the website to other customers, by enabling them to make more informed choices about products and to find products more relevant to their interests.

258. Similarly, users of a participative networked platform contribute user-created content, with the result that the value of the platform to existing users is enhanced as new users join and contribute. In most cases, the users are not directly remunerated for the content they contribute, although the business may monetise that content via advertising revenues (as described in relation to multi-sided business models below), subscription sales, or licensing of content to third parties. Alternatively, the value generated by user contributions may be reflected in the value of business itself, which is monetised via the sale price when the business is sold by its owners. Concerns that the changing nature of customer and user interaction allows greater participation in the economic life of countries without physical presence are further exacerbated in markets in which customer choices compounded by network effects have resulted in a monopoly or oligopoly.

259. These various developments must be understood in light of their relationship to more traditional ways of doing business. For example, while having a market in a country is clearly valuable to a seller, this condition by itself has not created a taxing right in the area of direct taxation to this point. It is also true that data about markets and about customers has always been a source of value for businesses as illustrated by phenomena such as frequent flyer programs, loyalty programs, the creation and sale of customer lists, and marketing surveys (in which customers participate for no remuneration), to name a few. The traditional economy also benefited from "network" effects in ways that are perhaps less obvious than the network effect present in social networks. Sellers of fax machines, for example, were dependent on a sufficiently broad supplier of purchasers in order to ensure that their product had value. The digital economy has, however, enabled access to markets with less reliance on physical presence than in the past. In addition, the digital economy has enabled collection and analysis of data at unprecedented levels, and has enhanced the impact of customer and user participation in the market, as well as the degree of network effects. It has been suggested that the lower marginal costs in digital businesses coupled with increased network effects generated by higher levels of user participation may justify a change in tax policy. See, e.g., Crémer (2015); Pistone and Hongler (2015). In considering policy changes to reflect customer interactions to the imposition of income tax, however, potential impact on traditional ways of doing business must be taken into account in order to maintain coherence in cross border tax policy. In addition, consideration should be given both to solutions based on income tax and to solutions focused on indirect taxes.

260. Another specific issue raised by the changing ways in which businesses are conducted is whether certain activities that were previously considered preparatory or auxiliary (and hence benefit from the exceptions to the definition of PE) may be increasingly significant components of businesses in the digital economy. For example, as indicated in Chapter 6, if proximity to customers and the need for quick delivery to clients are key components of the business model of an online seller of physical products, the maintenance of a local warehouse could constitute a core activity of that seller. Similarly, where the success of a high-frequency trading company depends so heavily on

the ability to be faster than competitors that the server must be located close to the relevant exchange, questions may be raised regarding whether the automated processes carried out by that server can be considered mere preparatory or auxiliary activities.

261. Although it is true that tax treaties do not permit the taxation of business profits of a non-resident enterprise in the absence of a PE to which these profits are attributable, the issue of nexus goes beyond questions of PE under tax treaties. In fact, even in the absence of the limitations imposed by tax treaties, it appears that many jurisdictions would not in any case consider this nexus to exist under their domestic laws. For example, many jurisdictions would not tax income derived by a non-resident enterprise from remote sales to customers located in that jurisdiction unless the enterprise maintained some degree of physical presence in that jurisdiction. As a result, the issue of nexus also relates to the domestic rules for the taxation of non-resident enterprises."

57. The challenges arising from the digital enterprises to conduct their businesses, with business models that did not exist not so long ago, gives rise to situations where they derive significant profits from a tax jurisdiction, by making use of its resources and people, and yet, can claim not to have a taxable nexus with that jurisdiction, because of the limitations of the nexus rules existing in Model Tax Conventions and tax treaties that were made long back at a time, when such business models were not conceivable. The challenges related to nexus make a strong case for changing the nexus rules that are based on a physical presence threshold today, to adopt them to ways in which modern businesses can conduct themselves.

6.3 Issues related to Characterization

58. Characterization of income continues to remain an important and often contentious aspect in the taxation of income arising from digital enterprise. The importance of characterization issues arises primarily from the differences in the threshold for taxation of different types of income in the jurisdiction of source[29], as well as the difference in the tax rates applicable on different kind of incomes[30]. Another reason that makes characterization very important is the lack of uniformity in the interpretation and application of characterization rules by different countries. These differences often relate to characterization of income as "Royalty" or "Fee for Technical Services". In particular, payments made for using software or automated digital platforms consisting of software, or for services obtained by using a digital or mobile network can often be a bone of contention. While characterization issues can arise in case of any business, they become particularly important for digital enterprises, in view of their

[29] Under the UN Model Tax Convention and most tax treaties entered into by India, business income of an enterprise can be taxed in the jurisdiction from where the payments arise only if the enterprise has a permanent establishment. However, income characterized as royalty or fee for technical services would generally be taxable under the tax treaties entered into by India.

[30] Business income of a foreign enterprise is taxed in India at 40% of the net income, whereas the tax rate on royalty or fee for technical services is 10% of the gross amount.

ability to carry on businesses without having a physical presence in the source country and consequently avoid paying taxes on their income derived from that jurisdiction.

59. With the rapid growth of digital economy, and in the wake of significant revenue and profits being earned by multinational digital enterprises without being liable to pay any tax in the source country, there have been attempts by tax authorities around the world, including India, to tax the income of such digital enterprises by arguing that their virtual presence through a website or through digital networks amount to permanent establishment, or by characterization of their income as royalty or fee for technical services. Compared to the former, the treatment of payments as royalty or fee for technical services have more often sustained the scrutiny of appellate authorities and hence, are resorted to more often by the tax authorities.

Differences between OECD and UN Model Tax Convention

60. The issues related to characterization of income as royalty have their origin in the strong differences between the preferences of developed countries that are technology exporting economies and developing economies, most of whom are technology importing ones. These get documented as differences between the OECD Model Tax Convention and the UN Model Tax Conventions. While the OECD Convention allocates all taxing rights in respect of royalty to the jurisdiction where the taxpayer is a resident, the UN Convention provides for dividing the taxing rights on royalty between the jurisdictions of source and residence. This difference is also reflected in the positions taken by countries regarding the scope of royalty and fee for technical services. Given the fact that OECD Model Tax Convention does not allocate any taxing rights to the jurisdiction from payments for royalty have generated[31], it becomes questionable as to whether the OECD Commentary developed with the intention of preventing the taxation of royalty in the source jurisdiction, can be said to be applicable in a treaty where taxing rights are allocated to the source jurisdiction. This question of applicability of OECD Commentary on a tax treaty having Article on royalty that is not based on OECD Convention, becomes even more important, when the scope of royalty is narrowed down by a future amendment of OECD Commentary, particularly where one of the Contracting States in a treaty has clearly documented its position as being different from that of OECD.

Work of OECD Technical Advisory Group & High Level Committee in India

61. Given the positions of India on the OECD Commentary that document its differences with the OECD on whether a payment for software or its use can constitute royalty, and the fact

[31] It may be interesting to note that not having Article 12 in the OECD Model Tax Convention would make no difference as then the royalty income would be taxable as business income under Article 7, which would be the case even in the presence of Article 12.

that most Indian tax treaties precede the OECD interpretation of software payments that evolved in the 21st century, it becomes clear that OECD Commentary on Article 12 interpreting payments for software cannot be applied unquestionably for interpreting the definition of royalty in Indian tax treaties. These differences have also led to differences in the positions between OECD and India on characterization and taxation of e-commerce payments.

62. The need for examining taxability of payments made for using software was first emphasized by the OECD in the mid-eighties, when the report titled "*Software: An Emerging Industry*" was prepared for its *Committee for Information, Computer and Communications Policy* by an ad hoc group of experts from Member countries of OECD. Subsequently, the issues related to cross border taxation of royalty income from software were dealt in a report titled "*The Tax Treatment of Software",* which was adopted by the OECD Council on 23 July, 1992. The texts suggested in Appendix 3 of the report were adopted as paragraph 12 to paragraph 17 of the OECD Commentary on Article 12 by a report titled "*The Revision of Model Convention*", on the same day, i.e. 23 April, 1992. These changes, thus, were based on the views obtained from the member countries of OECD, without taking into account the views of countries outside OECD, including India. Thus, from the very outset, the views being developed by OECD regarding taxation of royalty from software are only governmental views of the member countries of OECD, and do not in any way represent the views of Government of India.

63. Subsequently, further amendments have been made in the OECD Commentary on 29 April, 2000 by the report titled "*The 2000 Update to the Model Tax Convention*" which was adopted by the OECD Committee on Fiscal Affairs on the same day. Later, a number of new paragraphs were added on this topic on 28 January, 2003 by the report titled *"The 2002 Update to the Model Convention"*, which was based on another report titled "*Treaty Characterisation Issues arising from E-Commerce", prepared by a Technical Advisory Group (TAG), commonly referred as* the TAG Report, that was adopted by the OECD Council on 23 July, 2002. The TAG report recommended taking a very narrow application of the term royalty in respect of payments made for software and e commerce services and businesses, which can be considered largely in accordance with the preference of OECD of not allocating taxing rights on royalty payments in the source jurisdiction.

64. None of these OECD reports (as drafted by government representatives of OECD member countries) ever took into account the views or the position of the Government of India in respect of the tax treaties already entered into it, or its views, suggestions or concerns regarding the phrases or terms already existing in the various tax treaties entered into by India. Thus, the views of the Government representatives of member countries of OECD regarding the scope of royalty from software, as reflected in the OECD Commentary do not necessarily represent the views of the Government of India in this regard, neither can they be said to

reflect the intention of the Government of India while using any phrase or term in the tax treaties entered into by ita with the Government of another country or specified territory.

65. Immediately after the publication of tax report by the OECD, a High Powered Committee (HPC) was constituted by the Ministry of Finance in India to examine its recommendations. This Committee, which included tax experts from both within and outside the Government, comprehensively analysed the issues and aspects of e-commerce, and made recommendations that were completely at variance with the conclusions adopted by the TAG Report. While the TAG Report recommended a very narrow interpretation of Royalty and Fee for Technical Services and concluded that most payments arising from e-commerce would not be taxable as Royalty and Fee for Technical Services, the Indian High Powered Committee advocated a much broader interpretation and scope of these terms and concluded that most of the payments made and received for e-commerce would constitute royalty and fee for technical service and would be taxable under the Indian tax treaties.

66. The differences between the views of the TAG report of OECD and the Indian High Powered Committee indicate the presence of a significant wedge between the position of India and the OECD, which has persisted since, and continues to remain a major source of tax disputes.[32] It would be even more important to note that as per Article 3 of the Model Tax Conventions on definitions of the terms used therein, which also finds place in most Indian treaties, any phrase not defined in the treaty itself is to be understood as meant in the domestic laws. As the definition of royalty[33] refers to use of copyright, the meaning of the word 'copyright' and the implications of that term need to be obtained from the Indian Copyrights Act, 1957 and the way it is interpreted under Indian laws. Indian positions on paragraphs in the OECD Commentary related to application of Article 12 to payments made for software, as documented by OECD along with its Commentary also makes it clear that it does not completely accept the OECD guidance on this important characterization issue.

67. BEPS Report on Action 1 acknowledges that for several categories of payments in the context of digital economy, characterization remains ambiguous and uncertain. Paragraphs 268 to 272 of the BEPS Report on Action 1 describing these issues in detail are reproduced below for ease of reference.

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[32] OECD Commentary is prepared by a group of governmental representatives from the OECD countries, not including India, and position taken by it cannot have a binding effect on India or its tax authorities, particularly, when clear disagreements have been expressed by India on a view therein.

[33] Paragraph 3 of Article 12 of the UN Model Tax Convention defines "royalty" in following words….. *"The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience."*

"7.5 Characterisation of income derived from new business models

268. Products and services can be provided to customers in new ways through digital technology. The digital economy has enabled monetisation in new ways, as discussed in Chapters 3 and 4, and this raises questions regarding both the rationale behind existing categorisations of income and consistency of treatment of similar types of transactions.

269. Prior work by the Treaty Characterisation Technical Advisory Group (TAG), discussed further in Annex A examined many characterisation issues related to e-commerce. Although this work remains relevant, new business models raise new questions about how to characterise certain transactions and payments for domestic and tax treaty law purposes.[1] For example, although the TAG considered the treatment of application hosting, cloud computing has developed significantly since that work, and the character of payments for cloud computing is not specifically addressed in the existing Commentary to the OECD Model Tax Convention. The question for tax treaty purposes is often whether such payments should be treated as royalties (particularly under treaties in which the definition of royalties includes payments for rentals of commercial, industrial, or scientific equipment), fees for technical services (under treaties that contain specific provisions in that respect), or business profits. More specifically, questions arise regarding whether infrastructure-as-a-service transactions should be treated as services (and hence payments characterised as business profits for treaty purposes), as rentals of space on the cloud service provider's servers by others (and hence be characterised as royalties for purposes of treaties that include in the definition of royalties payments for rentals of commercial, industrial, or scientific equipment), or as the provision of technical services. The same questions arise regarding payments for software-as-a-service or platform-as-a-service transactions.

270. In the future, development and increasing use of 3D printing may also raise character questions. For example, if direct manufacturing for delivery evolves into a license of designs for remote printing directly by purchasers, questions may arise as to whether and under what circumstances payments by purchasers may be classified as royalties rather than as business profits, or may be treated as fees for technical services.

271. Under most tax treaties, business profits would be taxable in a country only if attributable to a PE located therein. In contrast, certain other types of income, such as royalties, may be subject to withholding tax in the country of the payer, depending on the terms of any applicable treaty. Whether a transaction is characterised as business profits or as another type of income, therefore, can result in a different treatment for tax treaty purposes. There is therefore a need to clarify the application of existing rules to some new business models.

272. At the same time, when considering questions regarding the characterisation of income derived from new business models it may be necessary to examine the rationale behind existing rules, in order to determine whether those rules produce appropriate results in the digital economy and whether differences in treatment of substantially similar transactions are justified in policy terms. In this respect, further clarity may be needed regarding the tax treaty characterisation of certain payments under new business models, especially cloud computing payments (including payments for infrastructure-as-a-service, software-as-a-service, and platform-as-a-service transactions). In addition, issues of characterisation have broader implications for the allocation of taxing rights for direct tax purposes. For example, if a new type of business is able to interact extensively with customers in a market jurisdiction and generate business profits without

physical presence that would rise to the level of a PE, and it were determined that the market jurisdiction should be able to tax such income on a net basis, modifying the PE threshold and associated profit attribution rules could permit such taxation. Source taxation could also be ensured by creating a new category of income that is subject to withholding tax. As a result, the issue of characterisation has significant implications for the issue of nexus."

68. Paragraph 380 of the 2015 Report aptly summarises the challenges related to characterisation of income that emanate from digital economy, as under:

> *"**380. The development of new business models raises questions regarding characterisation of income.** The development of new digital products or means of delivering services creates uncertainties in relation to the proper characterisation under current rules of payments made in the context of new business models, particularly in relation to cloud computing. Further, to the extent that 3D printing becomes increasingly prevalent, it may raise characterisation questions as well, as direct manufacturing for delivery could effectively evolve into licensing of designs for remote printing directly by consumers."*

6.4 Common Tax disputes related to Digital Economy

69. Tax disputes related to taxation of income arising from businesses conducted primarily through digital and telephonic communication networks, have been reported from different countries. The commoner forms of these disputes are related to the existence or otherwise of a permanent establishment in case of digital or e-commerce enterprises. The other category of disputes relating to whether payments for digital goods or services constitute royalty or fee for technical services, are expectedly uncommon in developed world due to the absence of taxing rights allocation to source jurisdiction on royalty and fee for technical services payments, but are more likely to be faced by countries such as India, where the source jurisdiction is allocated such taxing rights in tax treaties.

70. The disputes or questions related to permanent establishment have been observed frequently, such as whether installation of software on a server in the source jurisdiction constitutes a permanent establishment[34]; whether business conducted through a software owned by an enterprise that is installed on a server not owned by it constituted a permanent establishment[35]; whether websites hosting advertisements, payments for which arose from that jurisdiction constituted a permanent establishment[36]; whether a foreign enterprise selling on internet directly to customers in a jurisdiction but having registered there as a business entity and having an agent there to handle sourcing, storage etc. has a permanent

[34] Western Union Financial Services Inc. v. ADIT [2007] 104 ITD 34 (ITAT Delhi)
[35] Target Number 4890-13 dated 6.122013 (Supreme Court of Sweden)
[36] ITO v. Right Florists Pvt. Ltd. [2013] 32 taxmann.com 99 (ITAT Kolkata)

establishment[37]; whether a gaming company offering various kinds of games online constitutes a permanent establishment[38]; whether sale and leasing of pictures electronically through the internet constituted permanent establishment[39]; whether carrying on business activity through a website hosted on a server outside the source jurisdiction constituted a permanent establishment[40] and whether business activities carried out through a website operated by local unrelated individuals constituted a permanent establishment[41]. The fact that most of these questions were decided against the existence of permanent establishment is a testimony to the fact that significant economic activities through digital or telecommunication networks can be carried today without giving rise to the existence of a permanent establishment, an apparent anomaly, that was the basis of the Action 1 of the BEPS Project.

71. While most disputes relating to whether new business models give rise to a permanent establishment within the existing rules or not, have gone in favor of the taxpayer, there have been some interesting decisions that indicate a different view. In case of Dell Products, Ireland[42], the Spanish Central Economic-Administrative Court held that the selling of goods in Spain by the taxpayer through a website located on a server outside Spain created a 'virtual permanent establishment' that was sufficient tax nexus for its taxation in Spain.

72. Another interesting developments that has caught the attention of experts is a recent Judgment of Delhi High Court[43] in a non-tax dispute, wherein it held that the "*availability of transactions through the website at a particular place is virtually the same thing as a seller having shops in that place in the physical world*". Placing reliance on the principles laid down by the Supreme Court in *Dhodha House v. S. K. Maingi 2006 (9) SCC 41*, the Court observed that the condition of "*carries on business in Delhi*" was satisfied since appellant's customers were located in Delhi, accessed the website in Delhi, communicated their acceptance to the offer of merchandise advertised on the website, at Delhi, and received the merchandise in Delhi, even though the server for the appellant's website was not located in Delhi. This observation of the Court may have greater impact on the applicability of "business connection" under domestic laws to digital enterprises, than "permanent establishment" under the tax treaties, but more importantly, it indicates signs of acknowledgement by the judiciary of the fact that digital enterprises undertake business in ways that were not conceived when the existing laws were

[37] Case Number 6479-12 dated 16.9.2014 (Court of Appeal, Gothenburg)
[38] SKM2011.828 SR (Tax Board, Denmark)
[39] Case Number 68/2001 dated 15.8.2001 (Central Board of Taxation, Finland)
[40] Ruling Number IP-PB3-423-891/08-4/PS dated 5.5.2008 (Ministry of Finance, Poland)
[41] Tax Resolution Number 65/06 dated 13.3.2007 (Taxation Authority, Israel)
[42] Resolution Number 00/2107/2007 dated 15.3.2012 (Central Economic Administrative Court, Spain)
[43] World Wrestling Entertainment, Inc. (WWE) v. M/s Reshma Collection & Ors.FAO (OS) 506/2013 and CM Nos. 17627/2013 and 18606/2013 decided on 15.10.2013

made, and applying those laws to these new realities of digital world necessitates a flexible interpretation.

73. An interesting observation related to interpretation of statutes with reference to digital economy has been made in a recently published article[44], wherein the author has referred to the work of Francis Bennion[45] who has argued in favor of applying the "***doctrine of updating construction***", which suggests that in construing an "ongoing Act", the interpreter is to presume that Parliament intended the Act to be applied at any future time in such a way as to give effect to the true original intention and thus, the interpreter is to make allowances for any relevant changes that have occurred since the Act's passing, in law, in social conditions, technology, the meaning of words, and other matters. Applying this doctrine, an enactment made earlier, may be read today in light of dynamic processing received over the years, with such modification of the current meaning of its language as will now give effect to the original legislative intention. Indeed, the decision of the Spanish Central Economic-Administrative Court in the case of Dell Products Ireland (supra) and the Delhi High Court interpreting "*carries on business in Delhi"* implicitly apply this doctrine, which has reportedly been relied upon by the Supreme Court of India in some cases[46].

74. The question of whether the "***doctrine of updating construction***" can be applied on existing provisions of tax treaties, does not seem to have been taken up as yet in a tax dispute in India or outside. However, in its essence, it would be the basis of, and necessary justification for changes that are made from time to time in Commentaries on OECD and UN Model Tax Conventions with the aim and objective of modifying the interpretation of provisions existing in treaties based on these Models. Holding this doctrine inapplicable would mean negating the legitimacy of these changes, and accepting it may open the possibility of dynamic interpretation of tax treaties that may allow the taxability of digital economy to be covered by existing provisions. Either way, such an application has the potential to open new areas of interpretational disputes, greater uncertainty and unpredictability.

6.5 Committee's Observations

75. The Committee concludes that in view of the extensive work undertaken as part of the Action 1 of BEPS Project, and the observations made in the Report, it is now internationally recognized and accepted that significant tax challenges arise from the difficulties in applying the existing international taxation rules, as they exist in our tax treaties today, in respect of

[44] Ashish Karundia , Permanent Establishment: The Continuing Conundrum, 31.12.2015; ITAT Online , available at http://www.itatonline.org/articles_new/permanent-establishment-the-continuing-conundrum

[45] Francis Bennion, Statutory Interpretation, Fifth edition, section 288 at pp. 889-890

[46] State (Through CBI/New Delhi) v. S. J. Chaudhary (1996) 2 SCC 428 (Supreme Court, India) & CIT v. Podar Cement (P.) Ltd. [1997] 226 ITR 625 (Supreme Court, India)

digital economy. The issues related to taxable nexus between the taxable enterprise and the taxing jurisdiction, which is traditionally based on physical presence, is not appropriate for determining taxable presence in respect of the business models of digital economy. Similarly, there remains considerable ambiguity regarding the characterization of income arising from transactions involving telecommunication networks, software and data exchange. These disputes on characterization of payments are more commonly observed in countries like India, having tax treaties that allocate taxing rights to the source jurisdiction in respect of royalty and fee for technical services.

76. The continuing ambiguity related to nexus and characterization of the payments have the potential of giving rise to tax disputes, particularly in countries like India, where the tax treaties allocate taxing rights to the source jurisdiction[47]. If the underlying difference in the position of OECD, which does not prefer allocating taxing rights to source jurisdiction on royalty and fee for technical services payment and developing countries like India, which have tax treaties providing such rights to source jurisdictions are taken as an indication, it may be difficult, if not impossible, for the international community to arrive at a consensus on these issues, anytime soon. The resultant ambiguity, uncertainty and unpredictability can develop as a significant constraint for the expansion of digital economy in India. This makes an important case for finding a solution to all these issues, in the form of a simple, clear and predictable tax rule that unambiguously defines the tax liability of digital enterprises, thereby facilitating their business planning, reducing their tax risk and contingent liabilities, while also reducing compliance costs, disputes and administrative burden.

[47] Existing disputes till now relate more often to payments made in respect of online advertising, online advertising rights, software download for commercial exploitation etc. However, with expanding scope of digital economy, this list can potentially expand, and the tax disputes may also become more frequent.

Section 7

Issues related to Value of data & User Activity in Multidimensional Business Models

7.1 Contribution of data to profitability of business

77. The Report on Action 1 (2015) lists "*Reliance on data, including in particular the use of so-called big data"* as one of the significant characteristics of digital economy.[48] What distinguishes the digital economy from the traditional businesses is its ability to gather large amount of data and to process and exploit this data for furthering the ends of business and generating more value, particularly by tailoring product offerings based on this data. There are various methods employed by digital platforms for collection of remote data. This may range from direct online surveys seeking specific responses from users to indirect methods like analysis of user location and online behavior. Increasingly, most of this data is generated by the users themselves, and used by enterprises in a manner that significantly contributes to the profits arising in their business models. These aspects have been examined in detail in the BEPS Report on Action 1.

78. As per the report, big data is created when the scale of data is beyond the ordinary methods of collection and is not amenable to analysis using typical database management tools. Value is created because companies are able to target their advertisements and offer goods and services according to consumer preference after analyzing the data. The use of data for improving business efficiency is not unique to digital economy, but what characterizes its use in digital economy is the massive scale at which this is undertaken. Multisided business models create value by using the data gathered from the use of a product or service by a user as an input either in improving existing products and services or in providing products and services to another group of customers. These aspects are analyzed in detail in paragraphs 137, 138 and 145 of the Report, as reproduced below:

> *"137. Online advertising involves a number of players, including web publishers, who agree to integrate advertisements into their online content in exchange for compensation, advertisers, who produce advertisements to be displayed in the web publisher's content and advertising network intermediaries, who connect web publishers with advertisers seeking to reach an online audience. Advertising network intermediaries include a range of players, including search engines, media companies, and technology vendors. These networks are supported by data exchanges, marketplaces in which advertisers bid for access to data about customers that has been collected through tracking and tracing of*

[48] Paragraph 151 of the BEPS Report on Action 1 (2015)

users' online activities. These data can be analysed, combined, and processed by specialist data analysers into a user profile.

138. In advertising-based business models, publishers of content are frequently willing to offer free or subsidised services to consumers in order to ensure a large enough audience to attract advertisers. The most successful advertising companies have been those that combine a large user base with sophisticated algorithms to collect, analyse, and process user data in order to allow targeted advertisements. While traditional advertising involved payment for display of ads for a specified period of time, with little way to monitor visibility or user response, online advertising has given rise to a number of new payment calculation methods, including cost-per-mille (CPM), in which advertisers pay per thousand displays of their message to users, cost-per-click (CPC), in which advertisers pay only when users click on their advertisements, and cost-per-action (CPA), in which advertisers only pay when a specific action (such as a purchase) is performed by a user."

"145. In the consumer markets, many cloud services (e.g. email, photo storage, and social networks) have been provided free of charge, with revenue generated through advertising or the sale of data on user behaviour, or on a "freemium" basis in which basic services are provided for free and expanded services require payment. Other consumer cloud services, such as web hosting or hard drive backup, are sold on a monthly subscription basis. In B2B markets, cloud services are most typically sold by subscription, although "pay as you go" models are increasingly available."

7.2 Growing Significance of Data

79. With better servers, greater computing power and the expanding internet of things, the volume of data and its significance is likely to keep on increasing. BEPS Report on Action 1 (2014) quotes the Data Driven Marketing Institute which found in its report that Data Driven Marketing Economy (DDME) added USD 156 billion to the US economy in 2012. This data can be classified three ways. Firstly, collected data, whereby data entered by a user is tracked; secondly, submitted data, i.e. data that is specifically entered by a user, e.g. on a search engine; thirdly, inferred data, data that is compiled via pooling together various strands of data from a variety of sources.[49]

80. Websites can collect an extensive personal profile of users within a short span of browsing time. Information such as location, specific address, name, email address and phone number is obtainable. Companies are also interested in knowing about specific shopping habits, and which keywords are used to find their site and whether or not you were interested in advertisements on their pages. Internet tools that make this possible are IP addresses, Web browser cookies, e-tags and image files called Web beacons or Web bugs. A particular type of **third-party ad-serving cookie**, monitors the web browsing of users to show them advertisements relating to their interests.

[49] Working paper on Digital economy by Expert Group on Taxation of Digital Economy of the European Commission, March, 2014

81. Social networking websites gather large amounts of personal information about users, including ages, friends and interests, from account signing up forms as well as from browsing habits on their sites. Some of it is collected without users being aware of it. Companies are thus able to gather data about the location of visitors, what sites users have visited, what they have shopped for, preferred modes of payment, etc. From this they can infer other personal details, such as their income, self-owned or rented house and so on. These issues find mention in paragraphs 165-166 of the 2015 Report, as under:

> *"165. Data can include both personalised data and data that is not personalised, and can be obtained in a number of ways. In the case of personal data, as mentioned in Chapter 3 (3.1.5 Use of data), it can be obtained directly from customers (for example, when registering for an online service), observed (for example, by recording Internet browsing preferences, location data, etc.), or inferred based on analysis in combination with other data. It is estimated that sources such as online or mobile financial transactions, social media traffic, and GPS co-ordinates generate in excess of 2.5 exabytes (billions of gigabytes) of data every day (World Economic Forum, 2012). The dividing line between personal and non-personal data is not always clear; however, as data obtained from multiple private and public sources will frequently be combined in order to create value. A recent study quantifies the value of the Data-Driven Marketing Economy (DDME) and looks at the revenues generated for the US economy. The study found that the DDME added USD 156 billion in revenue to the United States economy in 2012 and notes that the real value of data is in its application and exchange across the DDME (Data-Driven Marketing Institute, 2013).*
>
> *166. Although the use of data to improve products and services is not unique to the digital economy, the massive use of data has been facilitated by an increase in computing power and storage capacity and a decrease in data storage cost, as shown in Figures 4.9 and 4.10, which has greatly increased the ability to collect, store, and analyse data at a greater distance and in greater quantities than was possible before. The capacity to collect and analyse data is rapidly increasing as the number of sensors embedded in devices that are networked to computing resources increases. For example, while traditional data collection for utility companies was limited to yearly measurement, coupled with random samplings throughout the year, smart metering could increase that measurement rate to 15 minute samples, a 35 000 time increase in the amount of data collected (OECD, 2013). This has manifested itself in particular in the concept of "big data", meaning datasets large enough that they cannot be managed or analysed using typical database management tools. Data analytics, defined as the use of data storage and process techniques to support decisions, are becoming a driver for innovation in a number of scientific areas and are used increasingly in collaborative and crowd-based projects. In this regard, a text search performed on one of the largest repositories of scientific publications shows that articles related to data mining doubled during the last decade, as shown in Figure 4.11. The value of the ability to obtain and analyse data, and big data in particular, is increasingly well documented by market observers."*

82. Paragraph 168 of the Report (2015), that refers to the findings of the McKinsey Global Institute on ways in which data can create value, is also reproduced below for ease of reference:

"168. The McKinsey Global Institute Report notes five broad ways in which leveraging big data can create value for businesses:

i. *Creating transparency by making data more easily accessible in a timely manner to stakeholders with the capacity to use the data.*
ii. *Managing performance by enabling experimentation to analyse variability in performance and understand its root causes.*
iii. *Segmenting populations to customise products and services.*
iv. *Improve decision making by replacing or supporting human decision making with automated algorithms.*
v. *Improve the development of new business models, products, and services."*

7.3 Significance of User Data in Nexus and Value Creation

83. Thus, the exploitation of user generated data for value creation and use of multisided business models has been identified as one of the broader challenges of the digital economy by the Report on Action 1, which not only give rise to BEPS concerns but also have wider implications for jurisdictional allocation of taxes.

84. As a result, users and customers become an important part of the value creation chain. The logical sequence to this inference is whether the value creation achieved in this manner should be brought to taxation in the locations from where the user data is generated. Coupled intricately with this question would be queries related to measurement of value of user generated data. Action 1 Report acknowledges that this raises fundamental questions such as:

"*whether the current international tax framework continues to be appropriate to deal with the changes brought about by the digital economy and the business models that it makes possible, and also relate to the allocation of taxing rights between source and residence jurisdictions. These challenges also raise questions regarding the paradigm used to determine where economic activities are carried out and value is created for tax purposes, which is based on an analysis of the functions performed, assets used and risks assumed. At the same time, when these challenges create opportunities for achieving double non-taxation, for example due to the lack of nexus in the market country under current rules coupled with lack of taxation in the jurisdiction of the income recipient and of that of the ultimate parent company, they also generate BEPS issues.*".

It goes on to say this:

"*The expanding role of data raises questions about whether current nexus rules continue to be appropriate or whether any profits attributable to the remote gathering of data by an enterprise should be taxable in the State from which the data is gathered, as well as questions about whether data is being appropriately characterised and valued for tax purposes…… If remote collection of data gives rise to nexus (or in the case of an existing taxable presence) what impact this would have on the application of transfer pricing and profit attribution principles, which in turn require an analysis of the functions performed, assets used and risks assumed.*"

85. While companies in the business of collection and analysis of data have evolved means of valuing data (one such means being customer lifetime value, CLV), the valuation of data from a taxation and nexus point of view has additional challenges. What has been clearly acknowledged now is that user generated data and its valuation, should be taken into account for deciding allocation rights to tax jurisdictions.

7.4 Issues related to User activities and contribution

86. Another unique feature of many business models is their ability to get value created by users and their contributions. Paragraphs 266-67 of the BEPS Report on Action 1 (2015) introduces these issues as under:

> *"266. Additional challenges are presented by the increasing prominence in the digital economy of multi-sided business models. A key feature of two-sided business models is that the ability of a company to attract one group of customers often depends on the company's ability to attract a second group of customers or users. For example, a company may develop valuable services, which it offers to companies and individuals for free or at a price below the cost of providing the service, in order to build a user base and to collect data from those companies and individuals. This data can then be used by the business to generate revenues by selling services to a second group of customers interested in the data itself or in access to the first group. For example, in the context of internet advertising data collected from a group of users or customers can be used to offer a second group of customers the opportunity to tailor advertisements based on those data. Where the two groups of customers are spread among multiple countries, challenges arise regarding the issue of nexus mentioned above and in determining the appropriate allocation of profits among those countries. Questions may also arise about the appropriate characterisation of transactions involving data, including assessing the extent to which data and transactions based on data exchange can be considered free goods or barter transactions, and how they should be treated for tax and accounting purposes. However, as discussed more generally above, the location of advertising customers and the location of users are frequently aligned in practice, such that the value of the user data is reflected in the advertising revenue generated in a country. The scale of this challenge may, in addition, be mitigated by the fact that advertising will frequently require a local presence to attract advertisers.*
>
> *267. The changing relationship of businesses with users/customers in the digital economy may raise other challenges as well. The current tax rules for allocating income among different parts of the same MNE require an analysis of functions performed, assets used, and risks assumed. This raises questions in relation to some digital economy business models where part of the value creation may lie in the contributions of users or customers in a jurisdiction. As noted above, the increased importance of users/customers therefore relates to the core question of how to determine where economic activities are carried out and value is created for income tax purposes."*

87. The role of 'users' who neither charge the enterprise for their contributions (such as personal data, content created by them or network benefits brought to the enterprise from their presence), nor pay to the enterprise for accessing the digital / virtual platforms owned by

it, pose an unprecedented challenge for taxation of profits contributed by their contributions. These multi-dimensional business models can be viewed as a combination of two simultaneous transactions – for instance, a multidimensional business model of online advertising has two limbs, one between the enterprise and the user where the enterprise provides access to the users in lieu of their contributions in the form of their personal data and content created by them, and the other between the enterprise and its customers, for services that involve display of customized advertisements shown to the users based on their personal data collected from them. In such a business model, one limb may be more like barter, while the other involves exchange of financial payments. User contributions in the form of data, content and networking benefits act as a substitute for services that an enterprise could obtain from individuals by paying them wages or contracted amounts, with the right to access and use the digital network substituting for salary or contract payments. These issues have been analyzed in the BEPS Report on Action 1 (2015) in paragraphs 258-259 as under:

> *"258. Similarly, users of a participative networked platform contribute user-created content, with the result that the value of the platform to existing users is enhanced as new users join and contribute. In most cases, the users are not directly remunerated for the content they contribute, although the business may monetise that content via advertising revenues (as described in relation to multi-sided business models below), subscription sales, or licensing of content to third parties. Alternatively, the value generated by user contributions may be reflected in the value of business itself, which is monetised via the sale price when the business is sold by its owners. Concerns that the changing nature of customer and user interaction allows greater participation in the economic life of countries without physical presence are further exacerbated in markets in which customer choices compounded by network effects have resulted in a monopoly or oligopoly.*
>
> *259. These various developments must be understood in light of their relationship to more traditional ways of doing business. For example, while having a market in a country is clearly valuable to a seller, this condition by itself has not created a taxing right in the area of direct taxation to this point. It is also true that data about markets and about customers has always been a source of value for businesses as illustrated by phenomena such as frequent flyer programs, loyalty programs, the creation and sale of customer lists, and marketing surveys (in which customers participate for no remuneration), to name a few. The traditional economy also benefited from "network" effects in ways that are perhaps less obvious than the network effect present in social networks. Sellers of fax machines, for example, were dependent on a sufficiently broad supplier of purchasers in order to ensure that their product had value. The digital economy has, however, enabled access to markets with less reliance on physical presence than in the past. In addition, the digital economy has enabled collection and analysis of data at unprecedented levels, and has enhanced the impact of customer and user participation in the market, as well as the degree of network effects. It has been suggested that the lower marginal costs in digital businesses coupled with increased network effects generated by higher levels of user participation may justify a change in tax policy. See, e.g., Crémer (2015); Pistone and Hongler (2015). In considering policy changes to reflect customer interactions to the imposition of income tax, however, potential impact on traditional ways of doing business must be taken into account in*

order to maintain coherence in cross border tax policy. In addition, consideration should be given both to solutions based on income tax and to solutions focused on indirect taxes."

88. In this context, the questions that come to fore are the extent to which nexus gets created by the activities of users, and the value of the contributions made by the users to the profitability of the enterprise. Paragraph 280 of the Report (2015) concludes that presence of users and their contribution can be indicative of significant participation of an enterprise in the economic life of a tax jurisdiction, as under:

"***7.6.1.3 User-based factors***

280. Given the importance of network effects in the digital economy, the user base and the associated data input may also be important indicators of a purposeful and sustained interaction with the economy of another country. A range of factors based on users could be used to reflect the level of participation in the economic life of a country, namely:

- ***Monthly active users (MAU)**. One factor reflecting the level of penetration in a country's economy is the number of "monthly active users" (MAU) on the digital platform that are habitually resident in a given country in a taxable year. The term MAU refers to registered user who logged in and visited a company's digital platform in the 30-day period ending on the date of measurement. A factor based on MAU presents the advantage of measuring the customer/user base in a given country both in terms of size and level of engagement. Given that little material is publicly available on the process of defining and identifying MAU, more detailed metrics would need to be developed in consultation with businesses and IT experts for the purpose of using this factor, such as how to identify a unique "user" or what level of engagement is required for a user to be considered "active". Reliability and veracity of the information would also need to be ensured, to address fraudulent accounts, multiple accounts, false information volunteered by users, and "bot"-produced data, to name a few.*
- ***Data collected.** Another factor which could be considered to reflect an enterprise's level of participation in the economic life of a country is the volume of digital content collected through a digital platform from users and customers habitually resident in that country in a taxable year. The focus would be on the origin of the data collected, irrespective of where that data is subsequently stored and processed (e.g. data warehouse). The range of data captured by the threshold would not be confined to personal data, but would cover also, e.g. user created content, product reviews, and search histories. This core element could be coupled with proportionality tests, such as whether the volume of digital content collected exceeds a percentage of the enterprise's overall stored digital content. Information on data collected is increasingly available, reliable and up-to-date, especially if the factor is focusing on data collected that is effectively stored by the non-resident enterprise on a server. At the same time, businesses may not necessarily maintain separate and comprehensive track records of the volume of data collected and stored on a country-by-country basis. In addition, the volume of data collected (and stored) from users in a country may not necessarily reflect an effective contribution to the profits generated by the non-resident enterprise, as the value of raw data is rather uncertain and particularly volatile."*

7.5 Committee's Observations

89. The Committee, after taking cognizance of these observations and detailed analysis provided in the BEPS Report on Action 1, and after analyzing the role and contribution made by the users by way of data, content creation and the networking benefits, considers that users are a significant indicator of both nexus and creation of value in the jurisdiction of source. In the view of the Committee, the presence of users of a digital or telecommunication network in a multi-dimensional business model signifies value creation and economic participation in that tax jurisdiction, and should give rise to the threshold nexus for taxing that enterprise in that jurisdiction, particularly, when such user contribution is relied upon for earning income from that jurisdiction. The Committee, however, notes that at this stage, quantifying such value creation can be a challenging task, and therefore considers that a simple tax rule that broadly covers such value or a significant part of it, without creating the difficulties associated with quantification of such value, may be preferable.

Section 8

Recent International Literature on Taxation of Digital Economy Enterprise

90. Taxation of digital economy and the need and feasibility of modifying international taxation rules have attracted a lot of attention recently, leading to significant and very interesting academic work by experts. Some of these experts were requested to share their detailed analysis with the Task Force on Digital Economy during the work on Action 1 and the influence of their work can be easily seen in its Report. Most of such works revolve around the possible ways in which the limitations of existing nexus rules (physical presence), can be addressed by either extending the scope of existing permanent establishment definition in Article 5 of the Model Tax Conventions and tax treaties, or by a way of a final withholding tax levied on payments made for digital business transaction without necessitating them to the need to have a permanent establishment. Some of these works find mention in the Bibliography of the Report on Action 1. This Committee took cognizance of some of these papers and the views stated therein, which are summarized in this section.

8.1 *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy by Peter Hongler & Pasquale Pistone; IBFD Working Papers*[50]

91. This paper by two renowned authors[51] put forth the need for a new criteria in the existing definition of the permanent establishment in the following words:

> *"The core of the PE concept was gradually adapted over the past decades with a view to reflecting more closely the actual part of business operating from the market country. Accordingly, it was first deprived of the force of attraction principles and then more closely linked to the actual situations in which the fixed place of business was in fact directly involved in the business.*
>
> *The PE concept continued meeting the needs of the economy to the extent that the latter remained mostly physical. However, it slowly turned into a cage for the exercise of the*

[50] Hongler, Peter & Pistone, Pasquale, "***Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy***", IBFD Working Paper; 20 January 2015

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taxing jurisdiction of the market country, which could be targeted by international tax planning aimed at confining business activities of non-residents outside the PE framework. Avoiding a taxable presence means, for instance, that a non-resident company might interact with customers of another country without having a tax nexus with the jurisdiction of such state, i.e. not forming a PE through a fixed place of business. The digital economy merely enhanced such inexorable process.

There are potentially various ways of addressing the problems of taxation of business profits of non-resident enterprises caused by the erosion of the actual boundaries of the PE concept.

One potential solution is to do away with the idea of linking business profits to a PE concept, for instance by strengthening the use of withholding taxes. The merits of this solution can be manifold and include a simplification in the exercise of taxing powers on business income derived by non-residents, but also manifold are the additional problems this would bring. Furthermore, withholding taxes can be used as a kind of toll charge by the state of source in order to preserve the exercise of its jurisdiction on business income. As we all know, the PE concept currently serves various significant functions in international tax law, such as those of being a nexus rule, a source rule, a threshold rule or a tool to secure net taxation of foreign enterprises, thus securing equal treatment with their local competitors and avoiding trade and investment distortions whose business profits are taxable in the PE state. Such elements show that the path towards the implementation of such solution should also address a much broader change than that which is strictly needed to allow an effective and balanced taxation of business income derived by non-resident enterprises. The use of withholding taxes is not per se incompatible with the PE concept,7 but the analysis of such issues falls outside the scope of this paper.8 Besides, and as also argued in detail by Baez and Brauner,9 the IBFD academic taskforce views the new PE nexus as the superior solution to the introduction of new withholding taxes.

Another option is to restrict the scope of the PE limitation to source taxation of business income in tax treaties; for instance, by including an additional provision on taxation of services based on the model that India consistently follows in its tax treaties. Besides the merits that such position may have in the framework of a policy that strengthens the taxing rights of the state of source, it is undeniable that adding one more treaty article will increase the potential for disputes as to which provision should govern a given income derived by non-residents. The interpretation by Indian authorities and courts has in some cases shown an inclination to keep taxing powers with the state of source in respect of both types of income, thus reducing the relevance of the dividing line and leading to a general stronger protection of taxing rights in respect of income derived by the non-resident in India. However, this paper will only partly further explore the merits and shortcomings of a solution based of strengthening taxation at source and the interpretative issues arising in such framework."

92. The authors go on to analyze the limitations of existing international taxation rules that govern the allocation of taxing rights to source jurisdictions, and the findings of their work are well presented in the Executive Summary of the paper, which reads as under:

"1. Introduction

This paper outlines the core issues of the introduction of a new PE nexus based on digital presence. It puts forward its essential features and rethinks the foundations of the concept of sourcing for income tax purposes in the global economy. Our proposal of a new PE

nexus based on digital presence is also supported by a theoretical reconstruction in the light of a new dimension for the benefit theory. Our work directly relates to Action 1 of the OECD/G20 BEPS Project. However, the development of a new PE nexus is in fact not an instrument to counter BEPS, but reflects a structural revision of the criteria for allocating taxing rights on cross-border business income in the era of the digital economy.

This paper should be understood as a discussion paper and first proposal to shed further light on (i) whether there is a theoretical justification for a new PE nexus based on digital presence, (ii) how a new PE nexus based on digital presence could be defined and (iii) whether and how potential implementation issues could be resolved. By publishing the present blueprints for a new PE nexus, the authors wish to provoke a more concrete discussion on this particularly important matter.

2. The need for amending the existing PE definition

The current PE definition provided by the OECD Model, as also suggested within Action 7 of the OECD/G20 BEPS Project, requires certain structural changes, including a new framework for the PE threshold, in order to satisfactorily address the new business models developed in connection with the digital economy (see section 2. in the main text).

The envisaged amendments to the current PE definition, however, would only affect certain e-commerce enterprises as part of the digital economy, but would not otherwise affect enterprises that do not sell any physical goods (see section 2.4.). By amending the current PE definition and still relying on a physical presence threshold, no reallocation of income within the digital economy occurs.

3. Developing a theoretical framework for the new nexus

The immediate goal of the new PE concept is not to strengthen taxation at source, but rather to allow the state of source to preserve its sovereignty on the taxation of business income derived in connection with activities effectively linked to its territory and jurisdiction (see section 3.1.).

In particular, our analysis suggests establishing a new PE nexus based on digital presence. Such new nexus finds its inspiration in a revised theoretical framework for the traditional sourcing theory, reflects the benefit theory and reduces the existing bias in the tax treatment of cross-border digital and physical business activities with a view to achieving a broader consistency between the two categories.

Theoretical analysis contained in this paper develops a new dimension for the sourcing theory and provides the background for drawing a nexus with the taxing jurisdiction, shifting away from the association of the PE nexus with physical presence and more closely reflecting value creation in respect of business income, taking into account its more prominent role in the era of the digital economy (see section 3.2.). Value creation within the digital economy means that not only the supply side of an enterprise but also the market itself enhances the value of an enterprise.

4. Our proposal

The theoretical framework allows this paper to conclude that the new PE nexus should consist of four main elements or requirements: (i) digital services; (ii) user threshold; (iii) a certain time threshold and (iv) a de minimis revenue threshold (see section 4.2.). Our proposal supports the introduction of a new article 5(8) of the OECD Model with the following wording (see section 4.2.):

If an enterprise resident in one Contracting State provides access to (or offers) an electronic application, database, online market place or storage room or offers advertising services on a website or in an electronic application used by more than 1,000 individual users per month domiciled in the other Contracting State, such enterprise shall be deemed to have a permanent establishment in the other Contracting State if the total amount of revenue of the enterprise due to the aforementioned services in the other Contracting State exceeds XXX (EUR, USD, GBP, CNY, CHF, etc.) per annum.

Due to the existence of a user threshold, we expect the new PE nexus to eventually cover more enterprises operating B2C than B2B. However, we provide arguments to support that this is also a natural consequence of the theoretical framework. Besides, the e-commerce business (understood in a narrow sense) should not be substantially affected by the new PE nexus. Due to the physical flow of goods, some of these enterprises might already form a PE in the state of consumption on the basis of the traditional criteria currently included in Article 5 of the OECD Model.

Obviously, such definition does not resolve existing and new ambiguities created by the new nexus. Further guidance is required, for instance, with regard to the term "users", since it would need to be defined whether users having access to the free services also count and whether the user amount is calculated based on sign-ons (see also the case studies in the Annex). Other terms contained in the new PE nexus should also be defined in more detail, such as "database", "advertising services", "website", "per month" and "domiciled".

An Annex with case studies enriches the content of this paper, showing that reference to a time frame is necessary due to the fast growth of certain enterprises within the digital economy, since the risk of non-compliance would otherwise be very large. These case studies also prove that the new PE nexus should also work if an enterprise offers various digital (and other) services (see, for instance, case study "Company H" in the Annex).

We understand that following our theoretical framework, the actual wording of our proposal could also rely on other thresholds such as, for instance, data usage. Nevertheless, we are of the opinion that our proposal is a feasible option and should launch a more concrete discussion concerning a new PE based on digital presence.

Our proposed changes and the specifications of the sourcing theory and benefit theory as guiding justifications for a new PE nexus based on digital presence will also require that further elements of the current PE definition should be subject to revision, including in particular the exemption for auxiliary activities (see section 4.5.).

For the purposes of the new PE nexus, it should not be decisive whether the digital service is a main part of the business of an enterprise (see section 4.6.) nor may the user requirement lead to an unintended removal of the fundamental distinction between VAT and corporate income tax (see section 4.7.).

The innovative approach of this paper to the allocation of taxing powers can be implemented in line with the arm's length principle or through a shift to formulary apportionment. As regards the former scenario, we submit that the current OECD Transfer Pricing Guidelines be amended in order to apply to income allocation between an enterprise and its PE based on digital presence. We suggest that the profit split method, combined with an upfront allocation of one third of the profit to the market jurisdictions, serves as the most suitable transfer pricing method to operate in this framework (see section 4.8.).

5. Tax enforcement

Our study recommends extraterritorial tax enforcement by one state on behalf of several other states be considered as a feasible option in order to ensure the taxation of PEs based on digital presence (see section 5.2.). Since in some instances enterprises may not have any physical presence in the PE state, we suggest that the group company invoicing the services serves as the taxpayer for the PEs in different jurisdictions (see section 5.3.). However, we are also aware of the risk that such a system could lead to "accounting rules shopping".

6. Implementation

The interaction between the new PE nexus, the existing PE definition and other articles of the OECD Model, such as article 12 (see section 6.2.), is likely to determine additional repercussions, which are to be addressed more precisely in the framework of a dedicated study. With regard to the implementation process of the new nexus and in order to rebalance the exercise of tax sovereignty, either a soft or hard law approach could be taken, since multilateral action appears required as most suitable in this respect (see section 6.3.)."

93. Thus, the paper provides a theoretical justification of expanding the existing definition of physical presence permanent establishment by introducing a new threshold criteria for taxation of business income in the source jurisdiction. **Their suggested criteria consists of a 1000 users in combination with a revenue threshold for a minimum period like one year**, that in their view, would be sufficient evidence and indication of a non-occasional nature of business undertaken by an enterprise in a tax jurisdiction. They consider it a superior option to the other option of having a final withholding tax on gross payments. The proposal is perhaps one of the first authentic recognition of the role and significance of users in determining the tax nexus and in that sense, can be perceived as an important milestone.

8.2 *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy* by *Prof. Yariv Brauner & Prof. Andrés Baez, IBFD*[52]

94. This paper by two recognized experts[53] analyzes the need for adjusting to the changing dynamics of business in a digitalized world, from the perspective of finding a simple but workable solution, by focusing upon the option of a final withholding tax that can be levied on payments without the need for satisfying the permanent establishment criteria. The proposal of the authors and their justification is aptly presented in their Executive Summary, which is reproduced below for ease of reference:

[52] Brauner, Yariv & Baez, Andrés, "***Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy***", IBFD; 2 February 2015

[53] Prof. Dr. Yariv Brauner is Professor of Law with the Levin College of Law at the University of Florida (United States of America) & IBFD Professor in Residence in 2014. Prof. Dr. Andrés Baez is IBFD postdoctoral research fellow and Associate Professor of Tax Law at Universidad Carlos III in Madrid (Spain).

"Executive Summary

This position paper of the IBFD Academic Task Force (hereinafter IBFD Task Force) relates to the OECD's work on BEPS Action 1 and is devoted to withholding tax aspects. It provides possible solutions to the challenges presented to the international tax regime by the digital economy. This paper considers both the option of installing a withholding tax mechanism as the primary response to these challenges and the option of using withholding taxes in support of a nexus-based solution of the kind explored by a companion position paper authored by P. Hongler and P. Pistone (hereinafter Hongler & Pistone Paper).

The IBFD Task Force views the nexus-based solution as superior to the withholding tax solution proposed herein since it better fits the system in place and therefore it is both more consistent with the OECD's conservative evolutionary approach to the matter (it is likely to be more efficient, i.e. less wasteful) and it would likely be easier to fine-tune in order to reach a stable balance between source and residence taxation.

The two key issues addressed by this position paper, as well as the entire BEPS Project, are (i) under-taxation of so-called stateless income and (ii) an unacceptable division of tax revenues (collected from the digital economy) that leaves source jurisdictions wanting. These are two distinct issues and a solution to one may negatively impact the other. We therefore chose to, first, address the former, emphasizing the negation of base erosion and, second, correct for the latter, providing mechanisms to further correct if necessary.

Consequently, we propose the design of a globally standard 10% final withholding tax on all base-eroding business payments to registered non-residents, with specific, again globally standard, exemptions to payees registered to be taxed under a net taxation scheme. Such net taxation scheme may be a nexus-based solution or an elective scheme to avoid the withholding tax proposed here. This proposal depends on a reliable, globally standard, quick, cheap and automatically shared registration system shared by at least the major economies, such as the BEPS countries.

Other exemptions may also be standardized for payments subject to in-place withholding schemes (e.g. employment), to non-base-eroding payments (e.g. dividends) and to non-digital goods and services (e.g. material, rents and services performed by humans on the ground).

Payments to unregistered payees will be subject to a higher 15% withholding tax. These would include payments to accounts in or owned by low- or no-tax jurisdictions (say, a 15% general corporate tax threshold). This tax may be non-final and partially refundable upon filing.

B2C transactions should initially be exempt as non-base eroding. Yet, if countries are already concerned with the revenue division implications of such a decision, a complimentary final withholding tax of 15% could be collected on all payments cleared by financial institutions, unless the payees register to be taxed under any net taxation scheme. Strict regulation and international cooperation are crucial for this solution to work.

C2C transactions do not necessitate a distinct taxing scheme.

The withholding tax scheme is not perfect; however, in the case that countries cannot reach agreement on a nexus-based scheme it permits a simple, if crude, response to the challenges of the digital economy. As such, however, it requires monitoring and perhaps

tweaking over time. Therefore, the scheme should be accompanied by a review mechanism.

The proposed solution does not directly employ a definition of the digital economy, on which it is notoriously difficult to achieve a consensus. Nevertheless, if countries insist on basing a withholding tax on a legal definition, this paper offers to follow a functional definition that, similarly to the whole withholding tax solution, although not perfect, could cover most of the bases at this time. We view this option as the least desirable of the solutions mentioned in this paper.

Lastly, the proposal raises several potential interactions with related BEPS matters. Most directly, the VAT response to the challenges of the digital economy may well correspond to our proposal, especially in the need for a coordinated, standard registration-based response. One should bear in mind, however, the tax mix implications. Furthermore, the multilateral instrument (Action 15) may be used for efficient standardization of the solution. Advances in reporting (e.g. CbC) and automatic information exchange, as well as all monitoring aspects (Actions 11-13) also fit well with the necessary review mechanism. The treatment of capital income is left to other Actions (2-6)"

95. **The authors, while recommending a final withholding tax at 10% rate on gross payments, put forth several possible options**. One option suggested by them could be to restrict the payments only to business-to-business (B2B) segments on the ground that they are the ones that erode the tax base. Another option could be to extend such tax to business-to-consumer (B2C) segment as well, if the tax jurisdiction views it essential. A third implicit option, arising from their work, consists of a **two step imposition, wherein B2B segment is subjected to tax before the B2C segment**. They recommend exempting the Consumer-to-consumer (C2C) segment completely from this tax. The influence of this paper can be seen in the approach taken in the BEPS Report on Action 1 that has since been endorsed by the international community.

8.3 *Taxation and the digital economy: A survey of theoretical models- Final report by France Strategie in combination with several Universities*[54]

96. This extensive report prepared by several authors[55] provides the findings arrived at by a group of academicians and researchers, working on various theoretical models dealing with the tax challenges of digital economy. This work, again a first of its kind, backed by extensive analysis conducted with various theoretical models, provides significant insights into this challenge and puts forward several recommendations that are relevant to the work undertaken by this Committee. Their findings are reproduced below for ease of reference:

[54] Bacache et al, "***Taxation and the digital economy: A survey of theoretical models- Final report***", France Stratigie; 26 February 2015, www.strategie.gouv.fr

[55] Maya Bacache, Francis Bloch, Marc Bourreau, Bernard Caillaud, Helmuth Cremer, Jacques Crémer, Gabrielle Demange, Romain de Nijs, Stéphane Gauthier, Jean-Marie Lozachmeur.

*"**Summary - Recommendations***

Summary

The digital economy creates new challenges for taxation. The emergence of powerful internet platforms, transforming entire industries like commerce or advertising, has affected the ability of national authorities to tax transactions and corporate profits. The main actors of the digital economy localized outside the jurisdiction of national tax authorities, use transfer prices to reduce their tax bills inducing thus a net loss in tax revenues from corporate taxation. In addition, the shift away from traditional forms of commerce affects the tax authorities' ability to collect taxes based on sales and financial transactions, leading again to a loss in fiscal revenue. Overall, the tax base of major internet platforms is reduced both because of difficulties in locating activities to specific geographical jurisdictions and because major elements of the revenue-generating chain, like the use of personal data uploaded by users, do not result in financial transactions.

Faced with this situation, tax authorities should reform and adapt their instruments to take into account the new conditions created by the emergence of the digital economy. The digital economy is characterized by four important features : (i) a blurring of geographical frontiers which makes the assignment of activities to jurisdictions more complex, (ii) large network externalities which give monopoly power to platforms because of coordination issues, (iii) multi-sided markets, where platforms are used to connect different actors, and pricing strategies on different sides of the platform are interdependent, (iv) the collection of data uploaded by users and used as inputs to generate profits for the platform. Any discussion of taxation in the digital economy must take into account these specific features.

In this report, we have developd five original theoretical models to analyze the effects of taxation in the digital economy. The five models focus on specific aspects of the digital economy and reflect the four important features described above.

- *The first model, inspired by platforms for social networking, deals with network externalities, coordination and competition in the presence of taxation.*
- *The second model, focused on two-sided markets, considers a platform mediating between users and advertisers, and allows for a comparative study of taxation on either side of the market.*
- *The third model centers on the amount of data collection and exploitation and studies how different taxes affect the level of data exploitation.*
- *The last two models deal with the blurring of geographical frontiers and analyze how the emergence of electronic commerce affects fiscal competition between countries fixing sales taxes. One model centers around exchange platforms which cannot discriminate among consumers according to their geographical origin, like eBay. The other model considers substitution effects between electronic commerce and cross-border shopping.*

We briefly summarize how the five models shed light on the different trade-offs and on effects of taxation in the digital economy.

Taxation of network rents

Internet platforms collect network rents because of their positions as intermediaries between users or between the two sides of the market. Taxation of profits (or revenues) of internet platforms is just a transfer from the platforms to the government, with no distortive effects on productive and allocative efficiency. In the presence of fixed costs,

taxation may generate negative effects on the platform's incentives to develop new services or improve the quality of existing services.

Taxation on two-sided markets

On two-sided markets, taxation on one side may lead the platform to shift revenues to the other side. This explains why, contrary to classical markets, ad valorem commodity taxation may be worse than unit taxation. Charging a tax on advertising revenues may induce the platform to charge a subscription price to users, resulting in exclusion of users with the lowest values. A tax on data flows may lead the platform to start charging a subscription price in order to limit the amount of data voluntarily uploaded by users. Taxes per user, whether charged to the platform or directly to the user, also result in exclusion of users with the lowest values.

Taxation and privacy protection

The revenues of internet platforms can be decomposed into revenues linked to onetime access and revenues generated by data collection. Data collection by platforms is excessive from the point of view of users. Taxes based on the platform's revenues are ineffective, and taxes based on the number of users or accesses result in an increase rather than a decrease in data collection. A tax differentiating between the sources of the revenues of the platform, and imposing a higher tax level on revenues generated by data collection, could lower the level of data collection. Giving the user the possibility to « opt out » may actually harm the average user by inducing the platform to increase data collection on all other users. A pricing policy by which users are paid for data collection improves the welfare of users and of the platform, whereas a pricing policy by which users pay to opt out increases the profit of the platform at the expense of users.

Taxation of platforms and fiscal interactions

Taxation of data or online advertising or new privacy regulation may result in a shift in the business models of the platforms. Taxation reduces the volume of activity on the platform, lowering revenues from VAT. However, for small levels of taxation on data or online advertising, the direct effect of the tax dominates the indirect effect on VAT, and fiscal revenues are increased. Taxes on data and advertising are not perfect substitutes, and a tax on advertising results in more distortions than a tax on data. If the platform pays users for uploading personal data, part of the platform's profits can be taxed as additional income received by resident users.

Taxation and competition

Taxation affects the market structure and competition among internet platforms. If platforms invest in quality to attract users, taxation may increase the joint profit of the platforms by preventing unproductive investments, but will result in lower quality for users.

On two-sided markets, when two platforms compete to attract users on one side of the market, taxation has no effect on the market structure when the platforms are symmetric, but may distort the sizes of the platforms when the platforms are initially asymmetric.

E-commerce and fiscal competition

The development of e-commerce has changed the conditions for fiscal competition between countries setting their rate of VAT. E-commerce leads to a decrease in cross-border transaction costs and a possibility of evading taxation, which strengthens competition between countries under the origin principle, resulting in a decrease in VAT rates. On the other hand, under the destination principle, e-commerce substitutes for

cross-border shopping, and reduces competition between countries, leading to higher VAT rates. Typical e-commerce platforms prevent sellers from price discriminating among buyers according to their country of residence. When price discrimination is banned, and buyers have a bias in favor of domestic goods, tax competition between the two countries is mitigated and tax rates are higher than when sellers can adjust their prices to buyers according to their geographical location.

Based on these findings, we would like to issue the following recommendations.

Recommendations

***1. Develop a statistical apparatus to measure the activity of internet platforms**.*

Any specific tax on internet activity requires a precise measure of the activity of internet platforms. To measure this activity, tax and regulatory authorities must have access to data on users, numbers of clicks, advertisers. It is thus extremely important to construct a statistical apparatus to measure the activity of internet platforms.

2. Determine a sharing rule for corporate profits reflecting the number of users in the jurisdiction of the tax authority

Current rules for the corporate taxation of multinationals are based on transfer pricing and territorial definitions which are obsolete. In the context of international negotiations, new rules must be put in place to adapt definitions to the digital economy. These sharing rules should reflect the number of users in the jurisdiction of a tax authority, as the presence of these users is a necessary condition for the platform to make profits. Taxes based on profits are not distortive and enable tax authorities to capture some of the network rent generated by network externalities.

3. In the absence of a fair sharing rule on corporate profits, consider using a specific tax based on revenues (sales or advertising) generated in the jurisdiction of the tax authority

In the absence of a transparent and fair sharing rule, the national tax authority may implement an ad valorem taxation based on the profits generated in the jurisdiction. Given that variable costs are negligible, profits can be identified with revenues. Sales revenues can easily be observed; revenues generated by advertising are more difficult to assess if contracts between advertisers and platforms are located outside the country. Specific rules can be put in place to assess advertising revenues based on statistical information on the activity of internet platforms in the country.

4. In the absence of a fair sharing rule on corporate profits and if taxes on revenues generated in the country cannot be implemented, consider using a specific tax based on activity (number of users, flow of data or number of advertisers). This tax should be calibrated at very low rates, and preferably be based on the collection of data.

A unit tax, based on number of users or adwords, or number of clicks reflecting data flows, is distortive and will change the behavior of the platform, advertisers and users. It has negative effects on participation on the platform, and can lead the platform to change its pricing behavior, excluding some users from the platform. In addition, it will likely result in an increase in data exploitation. Hence tax instruments based on direct measures of internet activity should only be used as a last resort, if it is impossible to base a tax on revenues or profits.

5. Differentiate tax rates according to the origin of revenues: revenues generated by one-time access should be taxed at lower rates than revenues generated by data exploitation.

There are two sorts of revenues of the platform: a basic revenue generated by one-time access (sale of an item, advertising revenue linked to a keyword) and revenue linked to data exploitation (sale of data on searches to third parties, storage of sales data for future targeting). Given that platforms choose excessive levels of data exploitation, differentiated taxes on revenues reduce a platform's incentive to collect and exploit data, and results in an increase in the welfare of consumers.

6. ***Encourage platforms to offer menus of options with different degrees of data exploitation and to compensate users for uploading personal data.***

By offering different options to consumers with different levels of data exploitation, generalizing procedures like the choice to accept cookies or to be geo-localized, platforms will sort consumers according to their privacy costs. Offering different levels of compensation (monetary or through higher quality services) will increase the welfare of users. This compensation for data already exists in some industries. For example, supermarket chains offer discounts to consumers using loyalty cards which store their history of purchases. In addition, if platforms use monetary compensations, this creates a monetary value for the data which can be taxed as additional income from resident users.

7. Strengthen the technology watch to anticipate future changes in services, quality and market structure. Provide targeted tax breaks and subsidies to encourage innovation.

Taxation of profits or revenues of internet platforms distort a platform's long-term decision to invest. Hence, in order to prevent taxation from hampering innovation, it is imperative to ask regulatory authorities to keep a careful watch on the evolution of internet platforms, services, products and competitive structure. In order to encourage innovation and an increase in service quality, targeted tax breaks and subsidies should be put in place.

8. Generalize the principle of destination and harmonize the level of sales taxation

Under the principle of origin, electronic commerce reinforces tax competition, resulting in a race to the bottom. Under the principle of destination, electronic commerce instead reduces tax competition, allowing for an increase in the level of taxation.

Concluding remarks

The models presented in this report set the stage for the analysis of the effects of taxation in the digital economy, but leave a number of questions unanswered. They highlight qualitative trade-offs, but fall short of quantifying exactly the effects of different policies. In addition, the analysis supposes that business models remain fixed, whereas the digital economy is characterized by fast technological changes and a continuous evolution of business models and pricing strategies. The implementation of our recommendations requires a more detailed understanding of the quantitative effects of taxation and the reactivity of internet platforms. In order to advance the discussion, and refine our recommendations, we need to enrich the analysis in the following directions.

- *The exact quantification of the optimal tax rate on data requires a calibration of the models and to run simulations to analyze the welfare impact of different tax rates.*
- *The analysis of likely reactions of actors of the digital economy to changes in taxation régimes.*

- *The analysis of fiscal competition and electronic commerce needs to be validated by empirical data. Empirical studies on the effect of exchange platforms on geographical discrimination, and on the effect of the passage to the destination principle for electronic services on January 1, 2015, should be developed.*
- *Theoretical models should be enriched to take into account competition between platforms subject to different jurisdictions, and the dynamics of market structure and competition.*
- *Theoretical models should be developed to help determine the optimal sharing rule for profits across jurisdictions based on different activities."*

97. This work represents one of the most elaborate attempts to analyze the issues related to allocation of taxing rights in digital economy, based on economic modeling. The report comes out with useful insights such as the likely economic impact of taxing various segments of the business models followed in digital economy. **It recognizes the need for data based sophisticated sharing of tax between jurisdictions, but recognizing the unlikelihood of that being achieved at this stage, it proposes a fix tax on gross payments (revenue) and a last option, puts forward the possibility of a tax on digital activities (byte tax).** The recognition in the report of the limitations of the existing rules today, and its emphasis on approaching the issue in a systematic manner by considering options depending upon their feasibility is an interesting approach to take.

8.4 Committee's Observations

98. These works, in the view of the Committee, represent the global recognition of the need to address broader tax challenges arising from digital economy. The recommendations made therein for expanding the definition of permanent establishment, taking users and their contributions into account, and considering a final tax on gross payments provide a pragmatic and feasible option. The Committee acknowledges the contribution of these papers in its work.

99. These works supplement the findings arrived in the BEPS Report on Action 1, regarding the tax challenges arising from the difficulties in application of existent rules of nexus in the tax treaties, persisting and significant ambiguities in respect of characterization of payments that frequently lead to disputes and tax uncertainty and the yet to be explored challenges of quantifying the value of user data and contributions in profitability of an enterprise relying upon them.

100. Taking these into account, the Committee considers the need to explore all possible options for addressing these challenges in the Indian context.

Section 9

Options to address broader tax challenges of Digital Economy in the Indian Context

101. A large part of the follow up work on Action 1 undertaken by the Task Force of Digital Economy, after its 2014 Report related to the development and analysis of possible options that can be adopted for addressing the broader tax challenges arising from digital economy. This work is documented in Chapter 7 of its 2015 Report, which provides details of the three options that were considered by it – (i) a new nexus based on "significant economic presence"; (ii) withholding tax on digital transactions; and (iii) Equilization Levy. For the ease of reference, the relevant extracts of this chapter, relating to the details of these options are reproduced below.

9.1 Option 1: New Nexus based on Significant Economic Presence

102. As the broader tax challenges in digital economy arise primarily from the difficulties in application of existing physical presence based nexus threshold that constitutes the definition of permanent establishment, the first option to address the tax challenges in digital economy proposes that "*significant economic presence*" should be considered adequate fulfillment of nexus between the taxable enterprise and the taxing jurisdiction. The option would require appropriate modifications of nexus rules in the tax treaties ('permanent establishment') as well as domestic laws ('business connection).

> ***"7.6.1 A new nexus based on the concept of significant economic presence***
>
> *277. This option would create a taxable presence in a country when a non-resident enterprise has a significant economic presence in a country on the basis of factors that evidence a purposeful and sustained interaction with the economy of that country via technology and other automated tools. These factors would be combined with a factor based on the revenue derived from remote transactions into the country, in order to ensure that only cases of significant economic presence are covered, limit compliance costs of the taxpayers, and provide certainty for cross-border activities. The following sections describe the details of such an option, together with potential approaches for attributing income to the new nexus.*
>
> ***7.6.1.1 Revenue-based factor***
>
> *278. As a general matter, revenue that is generated on a sustained basis from a country could be considered to be one of the clearest potential indicators of the existence of a significant economic presence. This is based on the assumption that even in multi-sided business models, and particularly those dependent on network effects, the two markets are likely to be strongly interrelated, and as a result are likely to be situated in the same country. To the extent that the country of the users and country of*

the paying customers are aligned, the value of an enterprise's users and user data would generally be reflected in the enterprise's revenue in a country. In other words, because user data serves to enhance the value of the services an enterprise offers, a strong user network (and the attendant user data) is likely to result in enterprises either selling more or enterprises charging more for its core products/services, or both. Under such circumstances, the revenues earned from customers in a country are a potential factor for establishing nexus in the form of a significant economic presence in the country concerned. Revenues will not be sufficient in isolation to establish nexus but they could be considered a basic factor that, when combined with other factors, could potentially be used to establish nexus in the form of a significant economic presence in the country concerned. In addition, the use of revenue as a basic factor could limit the compliance costs of taxpayers and provides a high degree of tax certainty for cross-border activities. In developing a revenue factor, consideration was given to the following technical issues:

- ***Transactions covered.*** *One approach that could be considered in defining a basic revenue factor is to include only revenues generated from digital transactions concluded with in-country customers through an enterprise's digital platform. Specifically, these transactions would involve the conclusion of a contract for the sale (or exchange) of goods and services between two or more parties effectuated through a digital platform where the contract conclusion primarily relies on automated systems. Such an approach could however create incentives for particular ways of doing business with remote customers. For example, such an approach would treat remote digital transactions differently from mail-order transactions (e.g. catalogue shopping) and telephone transactions (e.g. sale through call centres). Although in practice the latter transactions are less likely to enable a business to generate a significant amount of revenue, all three ways of transacting enable businesses to engage in sales transactions without physical presence in the country of the customer. In addition, businesses may leverage digital technology to reach a broader range of customers in another country without entering into digital transactions (e.g. website displaying the products but routing the customers to a call centre to perform the final purchase). Accordingly, to ensure that taxpayers in similar situations carrying out similar transactions will be subject to similar levels of taxation, it may be preferable to define the factor so as to include all revenue generated by transactions concluded by the non-resident enterprise remotely with in-country customers. Potential adverse effects associated with such a broad scope would in any case be addressed by the application of the other factors (see further below at 7.6.1.4).*

- ***Level of the threshold.*** *The core element of the revenue factor could be the gross revenues generated from remote transactions concluded with customers in the country concerned. This amount should be framed in absolute terms and in local currency, in order to minimise the risk of manipulation. A key objective in setting the level of threshold would be to set it at a high enough level to minimise the administrative burden for tax administrations as well as the compliance burden on and level of uncertainty for the taxpayer, while ensuring that nexus is less likely to be created in cases in which minimal tax revenue would be collected. The size of the country's market might also be a relevant factor in setting the level of the revenue threshold. Given the relative mobility and flexibility in choosing the location of automated functions related to revenue-generating activities in the digital economy, the factor could be applied on a related-group basis rather than on a separate-entity basis to prevent any risk of artificial fragmentation of distance selling activities with customers*

of the same country among a variety of foreign affiliated entities. This aggregation rule could be introduced as a rebuttable presumption, with the taxpayer being able to demonstrate that it did not artificially fragment the distance selling activities in order to manipulate the revenue threshold.

- ***Administration of the threshold.*** *An accurate application of the revenue threshold would depend on the ability of the country to identify and measure remote sales activities of the non-resident enterprise. One possible approach to address this challenge could be to introduce a mandatory registration system for enterprises that meet the factors giving rise to a significant economic presence. On the other hand, it could be difficult for tax authorities to know when activities are taking place and at what scale, to identify remote sellers, and ultimately to ensure compliance. Similarly, in the case of transactions concluded and fulfilled entirely online, it may be difficult for enterprises to identify with certainty the country of residence of clients. In this respect, regimes introduced to ensure compliance with VAT/GST rules by non-resident suppliers could prove extremely useful (see also chapter 8 for additional details).*

7.6.1.2 Digital factors

279. In the case of "brick and mortar" businesses, the ability to reach significant numbers of customers in a country generally depends on a variety of factors, including a store's location, local marketing and promotion, payment options, and sales and customer service employees. In the digital economy, the ability to establish and maintain a purposeful and sustained interaction with users or customers in a specific country via an online presence depends on analogous factors. A range of digital factors based on the current development of the digital economy could be used as part of a test for significant economic presence, including the following:

- ***A local domain name****. A non-resident enterprise targeting customers or users in a country will generally obtain the digital equivalent of a local "address" where the non-resident enterprise establishes its store front, typically taking the form of a localised or specialised domain name. For example, while an enterprise's "home" domain name might be ".com", the enterprise's site targeting one country would likely use a domain name reflecting that, in order to make it more likely that a local user would find the local site. This is reinforced by the need of enterprises to protect their trademarks by purchasing related domain names, including a local country domain name. In summary, while it is possible for an enterprise to do business in a country without a local domain name, the choice to do so carries reputational risk from potential domain "squatting" and trademark infringement from not protecting the enterprise's business name, trademarks and trade names across various domains. Accordingly, MNEs doing substantial cross-border business would very likely operate in a country via a local domain name. Whether local domain names will remain the predominant method for accessing markets, however, is uncertain. In the near future, merchants selling camera equipment globally may, for example, use a generic ".camera" domain name, thus reducing the relevance of country specific domain name.*

- ***A local digital platform****. Non-resident enterprises frequently establish "local" websites or other digital platforms in order to present the goods or services being offered in the light that most appeals to the local users or customers, taking into account language and cultural norms in particular. Local websites or digital platforms could include features intended to facilitate interaction by local users*

and customers with the site's content, services and functions. Such features include language, local marketing such as targeted discounts and promotions, and local terms of service for users and customers that reflect the commercial and legal context of the local environment. Although some enterprises may elect to only operate only in one language and not attempt to undertake local marketing or promotional efforts, establishing a local platform is often critical to attracting meaningful numbers of local users and customers. Note, however, that local platforms do not necessarily correspond to political boundary lines.

- ***Local payment options**. A non-resident enterprise that maintains a purposeful and sustained interaction with the economy of a country will frequently ensure that local customers have a seamless purchasing experience with prices reflected in local currency, taxes, duties and fees already calculated, with the option of using a local form of payment to complete the purchase. Integration of local forms of payment into a site's commercial features is a complicated technical, commercial, and legal exercise requiring substantial resources, and an enterprise would normally not undertake such an investment unless it purposefully participates in the country's economic life. While this factor may be less relevant in countries that share a common currency, it generally is a critical commercial requirement in countries that have stringent banking regulations, currency controls, or low penetration of international credit cards.*

7.6.1.3 User-based factors

280. Given the importance of network effects in the digital economy, the user base and the associated data input may also be important indicators of a purposeful and sustained interaction with the economy of another country. A range of factors based on users could be used to reflect the level of participation in the economic life of a country, namely:

- ***Monthly active users (MAU)**. One factor reflecting the level of penetration in a country's economy is the number of "monthly active users" (MAU) on the digital platform that are habitually resident in a given country in a taxable year. The term MAU refers to registered user who logged in and visited a company's digital platform in the 30-day period ending on the date of measurement. A factor based on MAU presents the advantage of measuring the customer/user base in a given country both in terms of size and level of engagement. Given that little material is publicly available on the process of defining and identifying MAU, more detailed metrics would need to be developed in consultation with businesses and IT experts for the purpose of using this factor, such as how to identify a unique "user" or what level of engagement is required for a user to be considered "active". Reliability and veracity of the information would also need to be ensured, to address fraudulent accounts, multiple accounts, false information volunteered by users, and "bot"-produced data, to name a few.*

- ***Online contract conclusion.** Another factor indicating the level of participation of an enterprise in the economic life of a country is the regular conclusion of contracts. This is the focus of the existing "dependent agent" PE test contained in Article 5 of the OECD Model which, in broad terms, requires that this contract conclusion be carried out in the country by a person acting on behalf of the non-resident enterprise. In the digital economy, contracts can frequently be concluded with customers via a digital platform without the need for the intervention of local*

personnel or dependent agents. For example, online platforms providing free services to their users often specify on their websites that by accessing or using the products and services of the company the user agrees to the "Terms of Service" and each use of the platform results in the conclusion of a legally binding agreement. The number of contracts concluded through a digital platform with customers or users that are habitually resident in the country in any taxable year could therefore be considered an important factor.

- ***Data collected.*** *Another factor which could be considered to reflect an enterprise's level of participation in the economic life of a country is the volume of digital content collected through a digital platform from users and customers habitually resident in that country in a taxable year. The focus would be on the origin of the data collected, irrespective of where that data is subsequently stored and processed (e.g. data warehouse). The range of data captured by the threshold would not be confined to personal data, but would cover also, e.g. user created content, product reviews, and search histories. This core element could be coupled with proportionality tests, such as whether the volume of digital content collected exceeds a percentage of the enterprise's overall stored digital content. Information on data collected is increasingly available, reliable and up-to-date, especially if the factor is focusing on data collected that is effectively stored by the non-resident enterprise on a server. At the same time, businesses may not necessarily maintain separate and comprehensive track records of the volume of data collected and stored on a country-by-country basis. In addition, the volume of data collected (and stored) from users in a country may not necessarily reflect an effective contribution to the profits generated by the non-resident enterprise, as the value of raw data is rather uncertain and particularly volatile.*

7.6.1.4 Possible combinations of the revenue factor with the other factors

281. For purposes of this potential option, total revenue in excess of the revenue threshold would be an indicator of the existence of a significant economic presence.

282. Total revenue, however, may not by itself suffice to evidence a non-resident enterprise's regular and sustained participation in the economic life of a country. To be an appropriate measure of participation in the economic life of a country, the revenue factor could be combined with other factors, such as the digital and/or user-based factors that indicate a purposeful and sustained interaction with the economy of the country concerned. In other words, a link would have to be created between the revenue-generating activity of the non-resident enterprise and its significant economic presence in the country. The choice of which factors should be combined with the revenue factor to ascertain whether a significant economic presence should be deemed to exist is likely to be driven by the unique features and economic attributes of each market (e.g., size, local language, currency restrictions, banking system).

283. This concept may be illustrated by an example. If a non-resident enterprise generates gross revenues above the threshold from transactions with in-country customers concluded electronically through a localised digital platform where the customer is required to create a personalised account and utilise the local payment options offered on the site to execute the purchase, it could be considered that there is a link between the revenue generated from that country and the digital and/or user-based factors evidencing a significant economic presence in that country. In contrast, it would be more difficult to find such a link where a non-resident enterprise generates

gross revenues above the threshold from transactions with in-country customers through in-person negotiation taking place outside of the market jurisdiction, if the enterprise only maintains a passive website that provides product information with no functionalities permitting transactions or intensive interaction with users (including data collection).”

103. The Report also notes that to apply this nexus, appropriate modifications would be required in the rules related to attribution of profits to the entity, and observes that existing rules of attributing profits may face limitations when applied to the digital economy.[56] It notes that the existing methods for attributing profits may need to be modified substantially before they can be applied to determine attributable income that would be subject to tax in the source jurisdiction on the basis of the new nexus based on significant economic presence. The Report analyses in greater detail, the possibility of applying fractional apportionment, and states that it was not pursued further because of the difficulties in its application. It also considers the option of applying a “*modified deemed profit method*” and suggests that the “*deemed profit method*” based on presumptive profits may offer a feasible and simple solution for this problem, although there would be issues that will need to be considered and sorted before it could be applied. It also suggests that “deemed profits” can be adopted as a rebuttable presumption, wherein an enterprise will have an opportunity to show that its actual profits attributable to the tax jurisdiction are lesser or not there (as in the case of a loss making enterprise).[57]

104. **After considering these observations made in the BEPS Report on Action 1 (2015), the Committee arrived at a view that while a new nexus based on significant economic presence is fully justified and can be adopted in the domestic laws and the tax treaties, the consequent issues of attribution of profits in a bilateral tax treaty may need to be analysed in greater detail in order to find solutions that could ensure simplicity, predictability and certainty in the tax regime, without imposing costs of compliance and administration that could become prohibitive or detrimental to its application. It also becomes apparent that till these issues related to the attribution of profits are sorted out more clearly and accepted by the international community, a simpler option might be preferable, particularly in the Indian context.[58] The Committee also noted that the lack of clarity and uniformity of views in respect of attribution of profits can be a significant constraint in including this option in the bilateral tax treaties.**

[56] Paragraphs 284 to 291 of the BEPS Report on Action 1

[57] Paragraph 291 of the BEPS Report on Action 1

[58] The Committee also noted that in respect of Attribution of Profits, India has taken positions on the modified Article 7 in the OECD Model Convention that indicate its differences with the OECD approach. While the existing tax treaties of India are based on the UN Model, the differences in approach to attribution of income could pose additional challenges in the Indian context.

105. **The Committee, however, was of the view that necessary changes in the domestic laws to clearly provide that "significant economic presence" constitutes a business presence needs to be considered by including this option as a nexus criteria for taxing income that is "deemed to arise in India". The Committee considers that this can be done irrespective of whether this option is included in the tax treaties, while also noting that such an option would be sufficient for taxing income unless the tax treaties also provide for such taxation of income.**

9.2 Option 2: Withholding tax on digital transactions

106. The second option identified by the Task Force on Digital Economy is application of a withholding tax on payments arising from within a tax jurisdiction, on digital transactions. In essence, this option is substantially similar to the similar withholding tax that already exists in respect of payments made as interest, dividend, royalty and fee for technical services in tax treaties. Such tax can be levied at a concessional rate, on the gross amount of the payment, and offers a relatively easier solution of addressing the tax challenges of digital economy, when applied as a standalone final tax. Alternatively, it can also be combined with the new nexus based on significant economic presence, as an effective means for collecting tax, particularly in the context of B2B transactions. The Report details this option in paragraphs 292 to 298, which are reproduced below for ease of reference:

> *"**7.6.3 A withholding tax on digital transactions***
>
> *292. A withholding tax on payments by residents (and local PEs) of a country for goods and services purchased online from non-resident providers has also been considered. This withholding tax could in theory be imposed as a standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services ordered online or, alternatively, as a primary collection mechanism and enforcement tool to support the application of the nexus option described above, i.e. net-basis taxation. Both approaches raise similar technical issues with respect to the scope of transactions covered and the collection of the ensuing tax liability. In addition, the application of a standalone final withholding tax raises specific challenges regarding trade obligations and EU law.*
>
> ***7.6.3.1 Scope of transactions covered***
>
> *293. The scope of transactions covered by the tax must be clearly defined, so that taxpayers and withholding agents will know when the tax applies, and to ensure that tax administrations will be able to ensure compliance. The scope should also be defined as simply as possible in order to avoid unnecessary complexity and classification disputes. The need for clarity and simplicity, however, must be balanced against a need to ensure that similar types of transactions will be taxed similarly, in order to avoid creating incentives for or against particular ways of structuring them.*
>
> *294. For this purpose, although listing specific types of transactions covered would provide a degree of clarity, it would also likely result in disputes over the character of transactions, particularly as technology continues to advance. Such an approach also*

could lead to differences in treatment for tax purposes between economically equivalent transactions depending on their form. For this reason, a more general definition of covered transactions appears more appropriate. The tax could be applied, for example, to transactions for goods or services ordered online (i.e. digital sales transactions), or to all sales operations concluded remotely with non-residents. The latter would have the advantage of flexibility, and would ensure tax neutrality between similar ways of doing business, and may reduce disputes over characterisation. In addition, if withholding is used as a tool to support net-basis taxation, a broad scope covering all distance selling would be more consistent with the sales threshold discussed above in the context of a nexus based on significant economic presence.

7.6.3.2 Collection of the tax

295. In practice, the liability to pay a withholding tax on outbound payments is often shifted from the non-resident enterprise to a local collecting agent, such as the customer or a third-party payment processing intermediary. For such a mechanism to function efficiently, the agent responsible for withholding must have access to information about the covered transactions sufficient to know when the tax will apply, and must be reasonably expected to comply with its obligation to withhold.

296. In the case of B2B transactions, businesses resident in the source country may reasonably be expected to comply with the withholding obligation. In the case of B2C transactions, however, requiring withholding from the payor would be more challenging as private consumers have little experience nor incentive to declare and pay the tax due. Moreover, enforcing the collection of small amounts of withholding from large numbers of private consumers would involve considerable costs and administrative challenges.

297. One possible solution would be to require intermediaries processing the payment to withhold on the payment in a B2C context. As a practical matter, however, this presents several technical issues. For example, an intermediary would generally not have access to transaction-identifying information enabling it to determine its character and hence the amount of tax due. In practice, it would only see a value without any description of the underlying transaction, in which case it would not be able to determine with sufficient certainty when it was required to withhold. The task of the intermediary could be facilitated if the collection regime is supplemented by a mandatory registration system for non-resident enterprises whereby all remote sellers of goods and services must designate a dedicated bank account for all payments received from local customers. In the latter situation, intermediaries may be required to withhold the tax only for payments made to these specific bank accounts. However, the application of this approach may pose challenges in imposing compliance obligations on intermediaries that are situated in third-countries with no connection to the jurisdiction of the customer, thereby creating opportunities for tax avoidance strategies.

7.6.3.3 Negative impact of gross-basis taxation and relationship with trade and other obligations

298. The initial development and hosting of the technology required to provide products and services online typically requires substantial up-front investment of resources, including labour and capital. After initial creation of the technology, however, providing products and services online frequently requires only limited marginal costs for businesses. Where this is the case, it has been argued that payments made in consideration for digital goods or services share common features with

royalties and fees for technical services, i.e. that gross revenue is a reliable proxy for net income. In many businesses, however, providing products and services online will require ongoing expenditures for continued product development (including maintenance of products and addition of new features), marketing, and ongoing customer support due to rapid product cycles as technology and competition evolve. Where this is the case, imposition of withholding tax on gross revenues will be an imperfect proxy for tax on net income. One potential way to reduce the negative impact of gross-basis taxation would be to fix the rate at a relatively low amount that would reflect typical profit margins. Such margins could be determined, for example, on the basis of a statistical analysis of actual profit margins of local domestic taxpayers operating in the same specific class of industry or type of business."

107. The Report proposes the option of Withholding Tax as a simple, predictable and pragmatic solution that avoids many of the difficulties associated with the first option, and can be applied on payments for digital services that share characteristics with royalty and fee for technical services. It also details the possible alternative ways in which it can be planned and designed to take care of the compliance issues and gross amount taxation concerns. It acknowledges that the withholding tax can be expected to be complied through the process of withholding by payers in the B2B transactions, but would pose greater challenges in B2C transactions. Regarding the hardships associated with taxing gross amount, instead of the net income, it suggests considering a relatively lower tax rate.

108. **After taking cognizance of these observations, the Committee considers that the option of "withholding tax" offers a practical way of allocating partial taxing rights in respect of income from digital economy, which shares attributes that may be similar to royalty or fee for technical services, and which can be complied in respect of B2B transactions by the process of withholding. However, such a tax on income would be feasible only if it is included in the tax treaties, which take precedence over Indian domestic laws, unless it is designed as a tax on the gross payment.**

9.3 Option 3: Equalization Levy

109. The third option considered by the Task Force on Digital Economy, is termed as "Equalization Levy". The word 'equalization' represents the objective of ensuring tax neutrality between different businesses conducted through differing business models or residing within or outside the taxing jurisdiction. In particular, this levy seeks to bring the foreign enterprises that earn significant income from a jurisdiction that erodes its tax base.[59] This option is detailed in paragraphs 302 to 308, which are reproduced here for ease of reference:

[59] The base erosion can take place either directly in a straight forward manner, by claim of deduction in respect of payments by businesses in B2B transactions, and indirectly by reducing the resources available for the domestic suppliers of goods and services

"7.6.4 Introducing an "equalisation levy"

302. To avoid some of the difficulties arising from creating new profit attribution rules for purposes of a nexus based on significant economic presence, an "equalisation levy" could be considered as an alternative way to address the broader direct tax challenges of the digital economy. This approach has been used by some countries in order to ensure equal treatment of foreign and domestic suppliers. For example, in the area of insurance, some countries have adopted equalisation levies in the form of excise taxes based on the amount of gross premiums paid to offshore suppliers. Such taxes are intended to address a disparity in tax treatment between domestic corporations engaged in insurance activities and wholly taxable on the related profits, and foreign corporations that are able to sell insurance without being subject to income tax on those profits, neither in the state from where the premiums are collected nor in state of residence. As discussed below, an equalisation levy could be structured in a variety of ways depending on its ultimate policy objective. In general, an equalisation levy would be intended to serve as a way to tax a non-resident enterprise's significant economic presence in a country. In order to provide clarity, certainty and equity to all stakeholders, and to avoid undue burden on small and medium-sized businesses, therefore, the equalisation levy would be applied only in cases where it is determined that a non-resident enterprise has a significant economic presence.

7.6.4.1 Scope of the levy

303. If the policy priority is to tax remote sales transactions with customers in a market jurisdiction, one possibility is to apply the levy to all transactions concluded remotely with in-country customers. To target the scope of the levy more closely to the situation in which a business establishes and maintains a purposeful and sustained interaction with users or customers in a specific country via an online presence, the levy would be applied only where the business maintains a significant economic presence as described above.

304. An alternative would be to limit the scope to transactions involving the conclusion through automated systems of a contract for the sale (or exchange) of goods and services between two or more parties effectuated through a digital platform. Although this would create an incentive to choose non-digital means of conducting transactions, it would also focus more closely on the specific types of transactions that have generated concern. There is no rule, however, that prevents a broader scope of application. Indeed, focusing too narrowly on specific types of transactions may limit the flexibility of the levy to accommodate future developments, which would limit its ultimate effectiveness in addressing the tax disparity between foreign and domestic suppliers of products through an online presence. The levy would be imposed on the gross value of the goods or services provided to in-country customers and users, paid by in-country customers and users, and collected by the foreign enterprise via a simplified registration regime, or collected by a local intermediary.

305. Alternatively, if the policy priority is to tax the value considered to be directly contributed by customers and users, then a levy could be imposed on data and other contributions gathered from in-country customers and users. For that purpose, a number of options could be available. One option would be to impose a charge based on the average number of MAU in the country. As noted above, however, measuring MAU accurately may prove to be challenging. Moreover, the number of MAU of a foreign enterprise may not be directly related to in-country revenue generated by a foreign enterprise. Setting an appropriate rate for a levy measured by active users

would also be challenging, as the average value of each user to a non-resident enterprise may vary widely. Another option would be to base the levy on the volume of data collected from in-country customers and users. Similar to MAU, however, data may also vary widely in value depending on its content and the purpose for which it was gathered, and it would be challenging to identify a reliable direct connection between the in-country revenue and the data collected from in-country customers and users.

7.6.4.2 Potential Trade and other Issues

306. As is the case with the imposition of a gross-basis final withholding tax, a levy that applied only to non-resident enterprises would be likely to raise substantial questions both with respect to trade agreements and with respect to EU law. In order to address these questions, potential solutions that would ensure equal treatment of domestic and non-resident enterprises would need to be explored, as discussed above in section 7.6.3.3. Depending on the structure of the levy, one option that could be considered would be to impose the tax on both domestic and foreign entities. If this approach were to be taken, however, presumably consideration would also need to be given to ways to mitigate the potential impact of applying both the corporate income tax and the levy to domestic entities and foreign entities taxable under existing corporate income tax rules.

7.6.4.3 Relationship with corporate income tax

307. Imposing an equalisation levy raises risks that the same income would be subject to both corporate income tax and the levy. This could arise either in the situation in which a foreign entity is subject to the levy at source and to corporate income tax in its country of residence or in the situation in which an entity is subject to both corporate income tax and the levy in the country of source. In the case of a foreign entity, for example, if the income is subject to corporate income tax in the country of residence of the enterprise, the levy would be unlikely to be creditable against that tax. To address these potential concerns, it would be necessary to structure the levy to apply only to situations in which the income would otherwise be untaxed or subject only to a very low rate of tax.

308. Another approach could be to allow a taxpayer subject to both CIT and the levy to credit the levy against its domestic corporate income tax. Such an approach would ensure that foreign entities with no nexus for corporate income tax purposes would be subject only to the levy in the source country, while the tax burden of entities subject to corporate tax would effectively be limited to the greater of the corporate income tax or the levy"

110. **The Committee observes that the BEPS Report conceptualizes Equalization Levy as a tax that is different from the Corporate Income Tax, and thus may not necessarily be subjected to the limitations of tax treaties. The Report does not prescribe any particular design that must be adhered to, but suggests that it could be a tax on the gross payment arising from digital economy. Such a tax on the gross amount of payment, would thus be very similar to the second option of withholding tax, except that it, not being a tax on income, would not be covered by the obligations of the tax treaties, and hence can be levied under domestic laws, even without changes in the tax treaties.**

9.4 Various Options as Alternatives or Compliments

111. The three options identified in the work in Action 1 need not be considered in exclusion to each other. Paragraph 276 of the Report observes as under:

> *"Like the challenges they are intended to address, the impact of these options overlaps in a number of respects. They have therefore been conceived in a way that allows them to be either combined into a single option or chosen individually. More specifically, elements of the 3 potential options could be combined into a new concept of nexus for net-basis taxation (a "significant economic presence"), with the intent to reflect situations where an enterprise leverages digital technology to participate in the economic life of a country in a regular and sustained manner without having a physical presence in that country. In this context, the application of a withholding tax on digital transactions could be considered as a tool to enforce compliance with net taxation based on this potential new nexus, while an equalisation levy could be considered as an alternative to overcome the difficulties raised by the attribution of income to the new nexus."*

112. Thus, the Report on Action 1 acknowledges the possibility of combining more than one option together. This also opens up the possibility of beginning with the option that is most feasible at a given point of time, and then supplementing it with other options that subsequently become feasible. In the light of its observations as reproduced above, it becomes clear that it may be preferable to tax the income on a net basis by adopting a new nexus consisting of "significant economic presence", and using the option of withholding tax as the means for collecting the tax, particularly in business to business transactions where such a mechanism already exists in the tax laws of many countries and can be implemented, relatively easily. The Task Force considered the option of Equalization Levy as an alternative to the first two that is simpler, avoids the difficulties arising from lack of clarity and universal consensus on how to attribute the profits to different jurisdictions, and hence as an option that may be more feasible to implement at this stage, where several issues in respect of the first option remain unclear.

9.5 Recommendations of BEPS Report on Action 1 on these options

113. These options were considered in detail by the Task Force on Digital Economy, which took note of the various issues relevant to each of these options, and concluded as under:

> *"357. As regards the different options analysed, TFDE has concluded that:*
>
> - ***The option to modify the exceptions to PE status in order to ensure that they are available only for activities that are in fact preparatory or auxiliary in nature has been considered by the TFDE and adopted as part of the work on Action 7 of the BEPS Project.*** *In order to ensure that profits derived from core activities performed in a country can be taxed in that country, it was agreed to modify Article 5(4) to ensure that each of the exceptions included therein is*

restricted to activities that are otherwise of a "preparatory or auxiliary" character. In addition, a new anti-fragmentation rule was introduced to ensure that it is not possible to benefit from these exceptions through the fragmentation of business activities among closely related enterprises. These changes to the definition of PE of the OECD Model Tax Convention are included in the report Preventing the Artificial Avoidance of PE Status (OECD, 2015) and are now expected to be implemented across the existing tax treaty network in a synchronised and efficient manner via the conclusion of the multilateral instrument that modifies bilateral tax treaties under Action 15.[2]

- ***The collection of VAT/GST on cross-border transactions, particularly those between businesses and consumers, is an important issue**. In this regard, countries are recommended to apply the principles of the International VAT/GST Guidelines and consider the introduction of the collection mechanisms included therein. Implementation packages will be developed to ensure that countries can implement the International VAT/GST Guidelines in a co-ordinated manner. Work in this area will be carried out by the WP9, with the Associates in the BEPS Project participating on an equal footing.*

- ***Some aspects of the broader direct tax challenges currently raised by the digital economy are expected to be mitigated once the BEPS measures are implemented**. This is because once implemented, the BEPS measures are expected to better align the location of taxable profits with the location of economic activity and value creation. This will address BEPS and restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates. In addition, even in the modern digital economy many businesses often still require a local physical presence in order to be present in a market and maintain a purposeful and sustained interaction with the economy of that country. In this context, BEPS measures such as the modification of Article 5(4) of the OECD Model Tax Convention are expected to also mitigate some aspects of the broader tax challenges. As a consequence, a quick implementation of the BEPS measures is needed, together with mechanisms to monitor their impact over time.*

- ***None of the other options analysed by the TFDE were recommended at this stage.** This is because, among other reasons, it is expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country. The options analysed by the TFDE to address the broader direct tax challenges, namely the new nexus in the form of a significant economic presence, the withholding tax on certain types of digital transactions and the equalisation levy, would require substantial changes to key international tax standards and would require further work. In the changing international tax environment a number of countries have expressed a concern about how international standards on which bilateral tax treaties are based allocate taxing rights between source and residence States. At this stage, it is however unclear whether these changes are warranted to deal with the changes brought about by advances in ICT. Taking the above into account, and in the absence of data on the actual scope of these broader direct tax challenges, the TFDE did not recommend any of the three options as internationally agreed standards.*

- ***Countries could, however, introduce any of the options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties.*** *The adoption of the options as domestic law measures could be considered, for example, if a country concludes that BEPS issues exacerbated by the digital economy are not fully addressed, or to account for the time lag between agreement on the measures to tackle BEPS at the international level and their actual implementation and application. The options may provide broad safeguards against BEPS and ensure that a domestic taxing right is available for remote transactions involving digital goods and services, which is currently not the case under most countries' domestic laws. Countries could take this approach with the intent to address their concerns about BEPS issues in the short term and gain practical experience with the application of the options over time, fostering coordinated domestic law approaches and informing possible future discussions. In addition, countries could bilaterally agree to include any of the options in their tax treaties.*
- ***Adoption as domestic law measures would require further calibration of the options in order to provide additional clarity about the details, as well as some adaptation to ensure consistency with existing international legal commitments****. Consistency with bilateral tax treaty obligations would have to be ensured, for example by applying the options solely with respect to residents of non-treaty countries, or in situations in which benefits of the treaty may be denied due to the application of anti-abuse rules that are in conformity with tax treaty obligations."*

114. The Committee notes that while the Task Force on Digital Economy did not recommend any of the options at this stage, primarily since adopting them ***"would require substantial changes to key international tax standards and would require further work"***, it also concluded that "***Countries could, however, introduce any of the options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties***". It also notes that the Task Force concluded that "***The options may provide broad safeguards against BEPS and ensure that a domestic taxing right is available for remote transactions involving digital goods and services, which is currently not the case under most countries' domestic laws. Countries could take this approach with the intent to address their concerns about BEPS issues in the short term and gain practical experience with the application of the options over time, fostering coordinated domestic law approaches and informing possible future discussions***." The Committee also noted that these conclusions may have been derived as much from the political preferences of the participating countries, as much by the technical analysis undertaken as part of this work.[60]

[60] The Committee also took note of the fact that there were differences in individual preferences of the countries participating in the BEPS Project on this issue, arising largely from their respective national interests. Countries that benefit from existing international taxation rules that limit the taxing rights of the source jurisdiction, are more likely to resist any changes, and supported maintaining a status quo in the work on BEPS Action 1, whereas countries with large markets, who are losing out as a result of outdated nexus rules preferred changes in the rules. The conclusions of the Task Force represent a compromise between the differing views of the participants, and can be seen as the best possible solution that could be arrived as a consensus in this work at this stage. It may not be

115. **Thus, the Committee takes cognizance of the fact that an international consensus has now emerged among G-20 and OECD Countries, which recognizes and accepts the right of a country to adopt any of the options identified in the Report on BEPS Action 1, in its domestic laws or in its bilateral tax treaties. The Committee also notes that since the Task Force did not "recommend" these options at this stage, they have not yet acquired the status of a "universally applicable standard", which may limit the feasibility of adoption of these options in the bilateral tax treaties.**

116. **The Committee also notes that among the options recognized and examined by the Task Force, the option of "*a new nexus based on significant economic presence*" can be adopted in the Income-tax Act, 1961, but will not be sufficient for taxing income on the basis of this new nexus, unless any applicable tax treaty[61] is also amended by inserting this new nexus. Similarly, the adoption of a final (or intermittent) "*withholding tax on digital transactions*" in the Income-tax Act, 1961, may also be rendered ineffective unless the same option is also included in the applicable tax treaty. The Committee also notes that India is committed to the obligations made by it under the tax treaties, which largely limit the application and effectiveness of adopting these options in Income-tax Act, 1961.**

117. **The Committee takes note of the fact that these limitations, however, do not limit the adoption or application of the third option, i.e. '*Equalization Levy*' which has been recognized in the BEPS Report on Action 1 as being different from corporate income tax. Thus, unless it is levied on 'income' that may fall within the scope of taxes covered under the tax treaties that relate to taxes on income, this option can be implemented under the domestic laws. The Committee also notes that this option is put forth in the BEPS Report on Action 1 as one that can be considered as an alternative to the other two, as a simpler option devoid of the difficulties that are associated with the more intractable issue of attribution of profits.**

118. **In view of the conclusions drawn by the BEPS Report 1 on Action 1, the Committee is of the view that among the three options that can be adopted under domestic laws, the 'Equalization Levy' is the most feasible option.**

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wrong to say that the conclusions of the BEPS Report on Action 1 (2015) represent a result that derived largely from the political interactions among the participants. The Committee notes that having accepted and endorsed the BEPS Report on Action 1, it would be preferable for India to adhere to the conclusions that have been made in the BEPS Report on Action 1.

[61] Under Section 90 (2) of the Income-tax Act, 1961, the provisions of an agreement entered into by the Central Government with another country of specified jurisdiction, will apply to the extent they are more beneficial to the taxpayer.

9.6 Need for adopting an Option at this stage

119. The Report on BEPS Action 1 is ambivalent on whether an option should be adopted at this stage or not. It stops short of recommending adoption of an option to address the broader challenges of digital economy at this stage or suggest any immediate modifications in the Model Tax Conventions, but also makes it clear that countries that wish to do so may adopt such options either in their domestic laws in a manner that is not restrained by tax treaty obligations, and/or in their bilateral tax treaties, where other Contracting State also agrees.

120. As the BEPS Report on Action 1 also seems to recommend further work in this area, the Committee considered the need for adopting an option at this stage, along with the other alternative of leaving such action for a future date. In this consideration, the Committee notes that while the BEPS Report suggests further work, no clear framework for undertaking this work has been determined. The further work suggested in the Report[62] focuses primarily on monitoring the developments in digital economy, and reviewing the same in 2020, which is another four years from now. Even after that, it is not clear as to whether it will be possible to have a combined exercise on the scale undertaken in the BEPS Project, and so, even if any further work is undertaken, it is not clear as to whether such work can be expected to lead to any actionable outcomes.

121. The Committee also takes cognizance of the fact that there are differences in the preferences and positions of countries on allocation of taxing rights, as apparent from the differences between the OECD Model and the UN Model, and notes that such differences that pertain to the issue of allocation of taxing rights between the jurisdiction of residence and the jurisdiction of source have always been difficult to lead to any agreements, or further changes in the status quo. Given this important limitation, and the fact that while making a suggestion for further work, the Task Force concluded to leave it to countries to adopt any of the options, the Committee is of the view that there appears to be no justification for not taking action at this stage. The Committee further notes that the evolution of the consensus for changing the international tax rules may actually be expedited by the adoption and implementation of the options that have now been made available to the source jurisdictions, either under their domestic laws or bilateral treaties.

122. The Committee also considered the observation made by the Task Force that the recommendations of BEPS work in other action points may mitigate some aspects of the BEPS in digital economy. The Committee notes that the BEPS Report on Action 1 clearly differentiates the "BEPS Issues in digital economy" that consist of artificial arrangements to avoid paying taxes, from the "broader tax challenges from digital economy" that consist of the limitation of

[62] Chapter 10 of the BEPS Report on Action 1

existing international taxation rules for establishing a taxable nexus, and while certain recommendations like those in Action 6 of BEPS for preventing treaty abuse, or those in Action 7 of BEPS for preventing artificial avoidance of PE Status, may have some impact on the "BEPS issues in digital economy", there is virtually nothing in the outputs or outcomes of any of the other Action Points of BEPS Project that can address the broader tax challenges related to nexus, characterization and data that formed the core of the work in Action 1 of BEPS Project. Thus, the Committee is of the view that the tax challenges that are proposed to be addressed by the options identified in the BEPS Report on Action 1 are unlikely to be addressed or mitigated by actions recommended in other Actions of BEPS, and can only be addressed by adopting one of the options identified in Report on Action 1.

9.7 Committee's Observations

123. **In view the above considerations, the Committee is of the view that there is a need to consider the feasibility of adopting the 'Equalization Levy' under domestic laws of India to address the tax challenges arising from the digital economy at this stage. The Committee is also of the view that adopting such a measure at this stage will bring greater certainty and predictability to all the stakeholders, enable them to take it into account while making their future business plans and pricing of products, and thereby contribute to a more stable tax environment in India for digital economy.**

Section 10

Characteristics of the Proposed 'Equalization Levy'

124. Among the three options which were considered under Action 1 of BEPS Project, and which can be implemented by various countries under their domestic laws, the only option that appears to be feasible and can be resorted to, without violating the obligations under a Double Taxation Avoidance Agreement, is '*Equalization Levy*'. The BEPS Report on Action 1 does not provide any detailed design of such Equalization Levy but makes a suggestion that it can be designed as tax on the gross payments for digital goods and services, which is different from corporate income tax, but similar in design to the withholding tax.

10.1 Objective of Equalization Levy

125. **Equalization Levy is intended to be a tax imposed in accordance with the conclusions of the BEPS Report on Action 1 that has been endorsed by G-20 and OECD, on payments made for digital services to foreign beneficial owner[63], who enjoy an unfair advantage over their Indian competitors providing similar services by digital or more traditional means, with the objective for equalizing their tax burden with other businesses that are subjected to income-tax in India, without disturbing the existing tax treaties. Another objective of Equalization Levy is to provide greater clarity, certainty and predictability in respect of characterization of payments for digital services and consequent tax liabilities, to all stakeholders, so as to minimize costs of compliance and administration and minimize tax disputes in these matters.** The target transactions would be those conducted primarily through digital or telecommunication networks, heavily relying upon latest telecommunication technology, and thereby avoiding the need of a physical presence in India, i.e. transactions which lead to profits that are not appropriately taxed in India because of the limitations of the existing international taxation rules. As stated in the BEPS Report, it is intended to be an interim measure that may not be required once the international taxation rules are modified to address the broad tax challenges that are imposed by the limitations of the existing international

[63] The Committee notes that the phrase "Beneficial Owner" may need to be defined appropriately in accordance with the international standards.

taxation rules in terms of nexus, characterization and valuation of user data and contributions.[64]

10.2 Differences from Withholding Tax

126. Conceptually, such a tax may have features that are also shared by the withholding tax that is often levied on payments that give rise to income. However, the significant difference, between an 'Equalization Levy' that is proposed to be imposed on gross amount of payments, and the withholding tax under the Income-tax Act, 1961 would be that under the latter, withholding tax is only a mechanism of collecting tax, whereas an 'Equalization Levy' on gross payments would be a final tax. In case of withholding tax under the Indian Income Tax Act, 1961, the tax liability of a taxpayer is determined with reference to its total income as determined under the provisions of the Act, and the tax rate that may be applicable on it. If the tax collected by withholding mechanism is more than the tax determined under the Income-tax Act, the taxpayer becomes entitled to a refund, while, if the tax liability is more than the amount withheld, the difference needs to be paid by the tax payer. On the contrary, **an Equalization Levy would be determined with reference to the gross amount of the payment and the rate of Equalization Levy applicable on it, which would be a full and final tax.**[65]

10.3 Tax on Amount of Payment for Specified Services & Not on Income: Hence Tax Treaties not Applicable

127. As the Equalization Levy is imposed on the gross amount of transaction, and not on the income arising from such transaction, it is applicable irrespective of whether any income arising from the transaction is taxable in India or not. As the Equalization Levy is not imposed on income, it does not fall within the scope of "income-tax" or "tax on income" or "any identical or substantially similar taxes", which typically define the scope of taxes covered within the tax treaties.[66] Thus, the inherent concept of **'Equalization Levy' as suggested in the BEPS Report on Action 1 keeps it outside the purview of the limitations imposed by tax treaties**, a feature, which makes it the only option that can be adopted without violating or in any other way affecting the treaty obligations of the Contracting States in a tax treaty.

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[64] In view of the Committee, the modification of existing international taxation rules may take a few years, or even more, given the differences in the preferences of different countries and the likely resistance from the countries that benefit from the limitations of the existing rules.

[65] In the proposed Equalization Levy, the nexus between Indian jurisdiction and the taxpayer is proposed to be broadly similar to the nexus existing for royalty and fee for technical services, and would consist of payment arising from India or the utilization of services of rights in India.

[66] Article 2 of the Model Tax Convention and most of the tax treaties (Double Taxation Avoidance Agreements) defines the taxes that are covered by it. The provisions of the treaty are limited to these taxes and do not apply on other taxes, nor in any way affect the sovereign rights of either Contracting States to apply any other tax.

10.4 Advantages of adopting Equalization Levy in Domestic Laws instead of tax treaties

128. As every country including India has several bilateral tax treaties, and since there could be lack of uniformity on the preferred design of an equalization levy among different countries, including the Equalization Levy in the tax treaties may, apart from being a prolonged, uncertain and a time consuming process, also result in a number of variations in the design of the equalization levy imposed that could make the implementation of such a levy very difficult, uncertain and costly for all stakeholders including the Government of India. **Thus, compared to the option of including equalization levy in a tax treaty, the option of imposing the same under the domestic law appears to have significant advantages in terms of providing simplicity, uniformity and consistency as well as minimize the cost of administration and compliance, and is therefore, a preferred option. Such a levy cannot, however, be imposed on income and would need to be imposed on the transacted amount or payment itself.**

10.5 Placement in domestic laws: Outside the Income-tax Act, 1961

129. If the equalization levy is to be imposed under the domestic laws of India, if it is not to be imposed on income, and if it is not to be covered by the treaty obligations imposed by the tax treaties, then it will need to be separated from the laws determining the tax imposed on income in India. As the Equalization Levy on a transaction is, in any case, inherently different from a tax on income, it need not be included within the laws governing tax on income. Accordingly, it would be necessary to impose the Equalization Levy through statutory provisions outside the Income Tax Act, 1961. Instead, the provisions for Equalization Levy can be included in the Finance Act. Past precedence exist for imposition of similar taxes on transactions, like the Security Transaction Tax (STT)[67] and the Service Tax[68]. In view of these precedents, and the need to keep the 'Equalization Levy' separate from the taxes on income, this Committee is of the view that the 'Equalization Levy' on payments for digital goods and services should be imposed through statutory provisions in the Finance Act.

10.6 Constitutional Validity of Equalization Levy imposed by the Union

130. In view of the constitutional division of taxing rights between the Union and the States[69], it will need to be ensured that the Equalization Levy is consistent with the constitutional provisions. Equalization levy on gross amounts of transactions or payments made

[67] The Securities Transaction Tax was imposed by the Chapter VII of the Finance No. 2 Act of 2004
[68] The Service Tax was imposed by Finance Act 1994
[69] Article 246 of the Constitution of India divides the powers to makes laws between the Union and the States. List I in the Seventh Schedule lists the items on which the Parliament has the exclusive powers of legislation.

for digital services appears to be in accordance with the entries at Serial Number 92C[70] and 97[71] of the First List in the Seventh Schedule of the Constitution of India. The existing precedent in the form of the Service Tax appears to remove any ambiguities and doubts in this regard. **Thus this committee is of the view that Equalization Levy as a tax on gross amounts of transactions, imposed by the Union through a statute made by the Parliament, would satisfy the test of constitutional validity.**

10.7 Defining the Tax Base: Scope of Digital Services/transactions on which Equalization Levy can be imposed

131. The Equalization Levy should be limited to the payments made for intangible services, including payments for use or right to use any intangible, access a digital, telecommunication or similar network, or avail any service or other benefit received from a foreign company or a person resident outside India, provided the services are either received, utilized, provided or performed in India, and thus have a nexus with India, irrespective of whether the payment is made by a resident or a non-resident person. Thus, the payment made by the permanent establishment of a foreign company in India to its headquarters outside India would be covered if it otherwise falls within the scope of Equalization Levy.

132. The BEPS Report, while analyzing the option of 'Equalization Levy' suggests striking a balance between specifying the services (that will make it simpler, predictable and certain) and having a broader, more flexible description of services that would be covered (to take care of further technological advances and to avoid the need for frequent additions).[72] The Committee

[70] 92C. Taxes on services.

[71] 97. Any other matter not enumerated in List II or List III including any tax not mentioned in either of those Lists.

[72] Paragraphs 145-146 of the BEPS Report on Action 1 states as under:

> *"7.6.3.1 Scope of transactions covered*
>
> *145. The scope of transactions covered by the tax must be clearly defined, so that taxpayers and withholding agents will know when the tax applies, and to ensure that tax administrations will be able to ensure compliance. The scope should also be defined as simply as possible in order to avoid unnecessary complexity and classification disputes. The need for clarity and simplicity, however, must be balanced against a need to ensure that similar types of transactions will be taxed similarly, in order to avoid creating incentives for or against particular ways of structuring them.*
>
> *146. For this purpose, although listing specific types of transactions covered would provide a degree of clarity, it would also likely result in disputes over the character of transactions, particularly as technology continues to advance. Such an approach also could lead to differences in treatment for tax purposes between economically equivalent transactions depending on their form. For this reason, a more general definition of covered transactions appears more appropriate. The tax could be applied, for example, to transactions for goods or services ordered online (i.e. digital sales transactions), or to all sales operations concluded remotely with non-residents. The latter would have the advantage of flexibility, and would ensure tax neutrality between similar ways of doing business, and may reduce disputes over characterisation. In addition, if withholding is used as a tool to support net-basis taxation, a broad scope covering all*

considers that both aspects are important, but in view of the fact that it will be a new tax, is of the view that the need to achieve simplicity, predictability and certainty and minimizing disputes on characterization will be of greater importance. **Thus, the Committee is of the view that to the extent possible, the categories of payments that would be subjected to Equalization Levy should be listed clearly.** In view of the Committee, it may not be advisable to include broad categories as that may introduce an element of greater uncertainty and lead to disputes on characterization, avoiding which is one of the objectives of imposing Equalization Levy.

133. As the objective of the levy is to tax only those entities that enjoy an unfair tax advantage, **payments that are made to the permanent establishment in India of a foreign company or a non-resident person, would be exempt from the Equalization Levy, if that payment forms a business receipt of that permanent establishment, and the income arriving from it is attributable to that permanent establishment in India and hence subject to tax under the provisions of the Income-tax Act, 1961. A verified declaration of the beneficial owner to this effect, in the prescribed form mentioning its Permanent Account Number (PAN) in India or its Tax Identification Number in its country of residence should be treated as sufficient for such exemption.**

134. After detailed analysis, the Committee suggests that the following categories of payments may be subjected to 'Equalization Levy' at this stage:[73]

135. **Any sum paid or payable or credited as a consideration for any of the following:**

- **(i) online advertising or any services, rights or use of software for online advertising, including advertising on radio & television;**
- **(ii) digital advertising space;**
- **(iii) designing, creating, hosting or maintenance of website;**
- **(iv) digital space for website, advertising, e-mails, online computing, blogs, online content, online data or any other online facility;**
- **(v) any provision, facility or service for uploading, storing or distribution of digital content;**
- **(vi) online collection or processing of data related to online users in India;**

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distance selling would be more consistent with the sales threshold discussed above in the context of a nexus based on significant economic presence."

[73] The Committee also considered the possibility of levying the Equalization Levy on tangible goods like electronic goods sold to Indian customers by online transactions, but concluded that tax issues related to such remote transactions involving sale of tangible goods are different than the issues involving online services. The Committee arrived at a view that the tax issues related to remote transactions of tangible goods can be examined separately.

(vii) any facility or service for online sale of goods or services or collecting online payments;

(viii) development or maintenance of participative online networks;

(ix) use or right to use or download online music, online movies, online games, online books or online software, without a right to make and distribute any copies thereof;

(x) online news, online search, online maps or global positioning system applications;

(xi) online software applications accessed or downloaded through internet or telecommunication networks;

(xii) online software computing facility of any kind for any purpose; and

(xiii) reimbursement of expenses of a nature that are included in any of the above;

Explanation – For the purposes of above, 'online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.

136. The Committee acknowledges that in view of the rapid changes in technology and the way business models are continuing to evolve, this list may be need to be reviewed and modified from time to time. The Committee also notes that some of these payments could be taxable currently as royalty or fee for technical services, and by bringing them under the purview of Equalization Levy combined with exemption from income-tax, the effective rate of taxation on them will be reduced from 10%[74] to 6 to 8%[75]. The Committee also notes that in respect of some of these payments, there could also be issues relating to characterization and potential for tax disputes. The Committee also took into account this possible overlap with taxation as royalty or fee for technical services, as well as the prolonged litigations that keep arising in respect of their taxability under the Income-tax Act, 1961. Having considered these issues, it is the considered view of the Committee that bringing such payments under the purview of Equalization Levy, as included in the list above, and the consequent exemption of income under the Income-tax Act, will bring about more certainty, predictability and stability to the tax regime, reduce costs of compliance as well as administration, and could significantly contribute to reducing tax litigation. Thus, the Committee recommends the aforementioned list of services for Equalization Levy.

137. Keeping in view the possibility that such transactions may be given a label by the parties that is not included in this list, it would be essential that it may be specified that these services would be subject to Equalization Levy, irrespective of whatever they may be called by the parties. Similarly, to prevent the possibility of avoiding the Equalization Levy by having the

[74] Existing tax rate on royalty payments
[75] Proposed rate of Equalization Levy

payment made by a third party outside India, which is subsequently reimbursed by the actual user, with a claim that no Equalization Levy is payable on reimbursements, it may need to be clarified that the Equalization Levy will be also payable on any payments made by a payer in India for reimbursements of expenses incurred by a third party outside India in respect of services covered under this levy. Lastly, it would need to be clarified that the Equalization Levy will become applicable once a payment is credited or paid – whoever is earlier, to the beneficial owner in the books of accounts, irrespective of when and how the actual payment is made.

10.8 Restricting application on B2B transactions & Having a Revenue Threshold

138. The Committee considers that from a policy perspective, it would be preferable to avoid placing the burden of compliance and administration related to Equalization Levy in cases, where the revenue collected would not be commensurate with cost of compliance and administration. For this purpose, it would be preferable to limit the application of Equalization Levy only to business-to business (B2B) transactions, and not apply it to the business-to-consumer (B2C) transactions, which are more frequent, but of smaller amounts, at this stage, or till that point of time when a mechanism becomes available, by which Equalization Levy can be seamlessly collected in B2C transactions, without burdening the consumer.[76]

139. The purpose of restricting the burden of deducting the Equalisation Levy by the Payers – to 'B2B' transactions will be achieved by fixing the revenue thresholds significantly high. 'B2C' & 'C2C' transactions may not be specifically exempted under the law, simply because, for the assessee – the beneficial owner of revenue, it is not practical to find out whether a receipt is on B2B, B2C or C2C account. The revenue thresholds suggested here are unlikely to apply to home consumers.

140. The Report on Action 1 also advocates having a revenue threshold in the possible options that are included therein to address tax challenges of digital economy. The committee is of the view that having a revenue threshold for taxing such transactions will prevent the hardship that may be faced by small taxpayers, and avoid the compliance burden as well.

141. The Committee considers that both these measures will optimize the compliance and administration burden related to this new tax, and thereby minimize its negative impact on the digital economy. **The Committee also considers that both these objectives can be largely achieved by having a single criteria of a reasonable revenue threshold of Rupees one lakh per annum, where the equalization levy is to be deducted by the payer** or the authorized foreign exchange dealers**.** The applicable threshold in case of Equalization Levy being collected by the

[76] Such a mechanism can be in the form of an obligation of the beneficial owner to pay the Equalization Levy, or the collection of Equalization Levy by the payment gateway through which the payment is made.

payment gateways could be different and with reference to the payments made by that gateway to that taxpayer during the year.

10.9 Rate of Equalization Levy

142. The basic objective of the Equalization Levy is to bring the tax burden on businesses that are able to avoid paying any taxes in India, at par with the tax burden likely to be faced by competing Indian businesses. Thus, the Committee was of the view that the rate of Equalization Levy needs to be fixed in a way that will lead to a tax incidence that is as close as possible, to the tax incidence that it might have faced had its income been taxable under the existing tax treaty rules. In a way this would make the Equalization Levy closer to the "deemed profit" taxation, except that unlike in a case of deemed profit taxation, there cannot be any rebuttal available, and the tax would be imposed irrespective of what the profits of the subject enterprise may actually have been. The Committee also notes that there is no single margin of profit that can be presumed universally in all businesses. Thus, the rate would need to be kept at a level where it does not lead to a tax burden that is prohibitively higher than that faced by its Indian competitors.

143. The Committee notes that Income-tax Act, 1961 imposes a tax rate of 10% for taxing royalty. The concessional rate of taxation for royalty and fee for technical services in the tax treaties entered into by India with other countries, which are also imposed on the gross payments, are also around 10-15% in most cases. However, the Committee also took note of the fact that unlike royalty, the marginal cost in many of the payments proposed to be subjected to Equalization Levy may not be close to zero, and unlike the tax treaties, there would not be any tax credits available to the taxpayer in its country of residence for the Equalization Levy paid in India.

144. Keeping these considerations in view, along with the fact that digital economy is in an evolving stage, and its growth has positive externalities for the Indian economy, the **Committee is of the view that the rate of Equalization Levy may be set between 6% to 8%[77] of the gross payment. Since, this is the first time such a levy is imposed, and the businesses may take time to fully adjust to it, a lower rate may be preferable at this stage.** In any case, the Committee is of the view that the impact of Equalization Levy would need to be reviewed, and its rate can be revised upwards or downwards at a later stage, after reviewing and analyzing its likely impact on enterprises and economy.

[77] In view of the Committee, it may be a preferable option to restrict the rate of Equalization Levy at 6% at the time of its introduction, and then review it in subsequent years, to evaluate the desirability of raising it.

10.10 Need to prevent double economic taxation

145. As the Equalization Levy is aimed at achieving greater tax neutrality by targeting those payments which lead to income that does not become taxable under the existing international taxation rules, it is important to ensure that Equalization Levy is not levied to transactions, where the resulting income is also taxed separately under the Income-tax Act, 1961. The Committee considered three possible options of achieving this objective.

146. The first option could be exempting income arising from specified transaction on which Equalization Levy has been paid.[78] This provides ones of the simplest ways of avoiding double economic taxation, and also offers the advantage of providing a simple, certain and predictable solution to the challenge of characterization of income arising from digital transactions, which is often a matter of tax disputes. In this option, as the income becomes completely exempt, and if the rate of Equalization Levy is lower than 10%, there would be an inherent incentive for the taxpayer to pay Equalization Levy and avoid all consequences arising from taxation of income from that transaction. As the income from such a transaction would become exempt on payment of Equalization Levy, the compliance burden associated with income-tax obligations is also significantly obviated with this option.

147. The other two options that the Committee considered were providing a deduction from the total income, of an amount of income that has arisen from the payment on which Equalization Levy has been paid, and providing a tax rebate from the total tax liability of the taxpayer. However, both these options leaves the possibility of having a dispute between the taxpayer and the tax authorities, on what is the exact amount of income arising from the transaction covered, and thereby does not achieve the simplicity, certainty and predictability provided by the first option.

148. **In view of these considerations, the Committee considers that the first option of exempting the income arising from a payment on which Equalization Levy has been paid, from income-tax under Section 10 of the Income-tax Act, 1961. This would be the most preferable way of avoiding double economic taxation on transactions subjected to Equalization Levy.**

10.11 Payment and Reporting Obligations of the Beneficial Owner

149. The beneficial owner of the payment should be responsible for paying the Equalization Levy to the Government, and reporting the details of such transactions in a prescribed return annually. However, since the beneficial owner may be outside India, and not always within the

[78] A precedence of exempting income in this manner exists in the form of Section 10(38) of the Income-tax Act, 1961, which exempts long term capital gains from transactions on which Securities Transaction Tax has been paid.

ambit of enforcement by Indian laws and procedure, an appropriate mechanism of collection to ensure that the beneficial owner is not able to escape the Equalization Levy would need to be put in place. A similar mechanism in respect of income-tax exists in the form of tax deduction at source by the payer.

10.12 Compliance and Collection Mechanism

150. The BEPS Report on Action 1 (2015), while analyzing the various option for addressing broader challenges of digital economy considered two possible ways in which such taxes can be collected. The first is deduction of equalization levy by the payer making the payment, where the obligations of the payer would be largely similar to those of the person required to withhold income-tax. The other possible option could be to get the tax deducted by the payment gateways, such as banks, credit or debit cards, digital wallets etc. through which payments are made by consumer in India to an enterprise abroad.

A. Deduction by Payer

151. The option of getting the Equalization Levy deducted by the person making the payment for the specified transaction, has the advantage of simplicity, is workable and can be implemented straightway, without requiring any major changes in the regulations governing payments abroad. The negative side of this option is that it can place compliance burden on payers in India, and in some cases where the beneficial owner insists for receiving full payment irrespective of taxes, the payer may have to bear the tax burden as well.

152. The compliance burden on the payers in India can be significantly minimized by restricting the Equalization Levy to B2B transactions with a reasonable revenue threshold, as then the cases covered under Equalization Levy would be very restricted. There would be no compliance burden at all on consumers in India, and the revenue threshold will further ensure that there is no compliance burden on businesses in respect of occasional payments of smaller denominations. Another advantage of restricting the compliance burden to business payments is that the allowability of a business payment as deduction can be linked with the deduction of Equalization Levy by the payer, thereby creating a simple and reliable mechanism of compliance. As this mechanism of ensuring allowability of deduction is already in place in respect of withholding tax, and all businesses are fully well versed with it, it can be easily implemented and relied upon for ensuring compliance, without any major constraints.

153. **In view of the above, the Committee is of the view that the obligation to deduct the Equalization Levy may be limited to businesses, by exempting payers who do not wish to claim the payment as either revenue expense or capitalized expense in a business the profits of which are taxable in India. The Committee is also of the view that linking the allowability**

of such payments as deduction for computing taxable profits under the Income-tax Act, 1961 can serve as a reliable mechanism for its compliance.

154. The Committee recognizes that one way in which the payer and the beneficial owner, particularly if they are associated enterprises, can avoid the payment of Equalization Levy, could be by giving a label to their payment that is somewhat different from the description of the payments covered under Equalization Levy, and claiming that the payment does not fall within the scope of payments on which Equalization Levy is imposed. It is also important to note that in the light of the decisions of the Hon'ble Supreme Court of India in the case of Transmission Corporation[79] and GE Capital[80], it is not necessary for the payer to always seek a certificate for non-deduction of taxes. The ambiguity arising from nomenclature of payments can thus become a valid excuse for non-compliance by the payer. Thus, to plug this potential loophole that may facilitate non-compliance, and also lead to litigation, it would also be advisable to put in place a mechanism that ensures credible deterrence against it. Such a mechanism can be put in place by making use of the existing mechanisms that already exist in the Income-tax Act, 1961, in the form of Section 195 (7) of the Act that states as under:

> *"(7) Notwithstanding anything contained in sub-section (1) and sub-section (2), the Board may, by notification in the Official Gazette, specify a class of persons or cases, where the person responsible for paying to a non-resident, not being a company, or to a foreign company, any sum, whether or not chargeable under the provisions of this Act, shall make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum chargeable, and upon such determination, tax shall be deducted under sub-section (1) on that proportion of the sum which is so chargeable."*

155. **The Committee suggests that the payments subjected to Equalization Levy may also be notified under this provision, along with an exemption provided in the notification itself to those cases where Equalization Levy is paid.** This, in effect, means that cases on which Equalization Levy was payable but has not been paid, would be mandatorily required to seek a certificate under section 197, irrespective of whether they include any income that may be taxable in India. Thus, in effect, such notification would cast an additional obligation on those who have failed to comply with payment of Equalization Levy, to seek a certificate under section 197, thereby providing an inherent mechanism for getting such non-compliance reported to the tax authorities. In such cases, the proceedings for issue of a certificate under section 197 would be independent of the obligation of deducting Equalization Levy, but would open the possibility of such defaults coming to the notice by the Assessing Officer, and thereby strengthen the deterrence required for its compliance.

[79] Transmission Corporation of A.P. Ltd. and Ors. v. CIT [1999] 239 ITR 587 (SC)
[80] GE India Technology Cen. P. Ltd vs CIT & Anr. on 9 September, 2010, in Civil Appeal Nos.7541-7542 of 2010

156. The Committee recognizes that there is considerable uncertainty in respect of taxability of payments made for digital services and facilities, with differences of opinions between the taxpayers and the tax authorities leading to disputes in some instances. Such disputes, that also have their origin, to some extent, in the differences of positions taken by India and OECD countries in respect of scope of royalty and fee for technical services taxable in the source jurisdiction under the tax treaties, can escalate further and adversely affect all stakeholders, including the Government of India and large digital enterprises earning profits from India. This also creates uncertainties for Indian payers, who need to deduct income-tax on income of the beneficial owner that is chargeable in India. Although the obligation to deduct Equalization Levy may not be welcomed by those having to bear it, but the greater simplicity, certainty and predictability of Equalization Levy, along with a possible advantage of lower tax rate[81] should more than offset this negative impact.

157. The Committee also recognizes that a likely criticism could be that due to asymmetrical bargaining powers between a small Indian consumer and a large multinational enterprise to which the payment is being made, the burden of tax may have to be borne by the Indian payer in many cases. The committee took into an account this argument and noted that this issue has already been dealt in sufficient detail by the Task Force on Digital Economy during the work on Action 1. Annexure E of the BEPS Report on Action 1 (2015) provides a comparative analysis of the economic incidence that is likely to result from the three possible options included in the Report, wherein, after detailed analysis, it was concluded that the economic burden of all the three options would be completely similar. In other words, the economic burden on Indian consumers or payers is likely to be the same, irrespective of whether the additional tax is to address broader tax challenges of digital economy is imposed in the form of tax on income by expanding the definition of Permanent Establishment, by means of a withhold tax on digital transactions or an Equalization Levy. In view of the fact that this analysis and these consequences have been uniformly accepted by the OECD and G20 Countries including India and also conform to the basic principles of economics, the committee is of the view that burden of Equalization Levy is unlikely to be different from other ways of imposing additional tax on hitherto non-taxable income of multinational digital enterprises in India.[82] The Committee also observed that in a completely asymmetrical bargaining, even the burden of income-tax or any

[81] Presuming the rate of Equalization Levy is less than 10%, it would be lower than existing tax rate that may be applicable on such transactions under the Income-tax Act, 1961 and relevant tax treaties.

[82] As per the Economic Theory, the economic burden of taxes is different from the legal burden, and primarily dependent upon the elasticities of demand and supply. In the General Equilibrium Model, the taxes get partly shifted forward to the consumers, or backwards, to the factors of production like capital, labor and technology, and the final tax burden gets spread on the economy as a whole. Detailed analysis is available in Annexure E of the BEPS Report on Action 1 (2015). In case of a Monopoly, the prices are set to maximize revenue, and higher the surplus of the monopoly, the lesser is the likely economic burden of taxes on the consumers.

other tax may be shifted by a foreign supplier on the Indian payers, and in that way, the Equalization Levy is no different from any other tax. The Committee also noted that given the size and growth of Indian consumer market, it is highly unlikely that any major digital business would be in a position to ignore it, and a more likely outcome is that it would make necessary adjustments to maximize its participation in Indian markets.

B. Deduction of Equalization Levy by the payment gateway

158. The Committee considered this option, which also finds mention in the BEPS Report on Action 1 (2015), for ensuring compliance with Equalization Levy. A very large volume of payments made for digital transactions are made through certain specific payment gateways, like Banks, Credit/ Debit cards, Digital/Electronic Wallets and new gateways like Paypal. These payments gateways that enable parties in India to make payments to parties outside India are covered by Foreign Exchange Management Act (FEMA), as well as the applicable rules and regulations of Reserve Bank of India. The Committee was of the view that it may be possible to amend such regulations and the relevant laws for imposing a liability on these payment gateways to deduct Equalization Levy on specified transactions made by Indian payers to entities oversees and deposit such tax with the Government. This mechanism of collection of the equalization levy, if feasible, can have a very significant advantage of low costs of compliance, particularly if and when the equalization levy is extended to business–to–consumer (B2C) transactions, which take place in very large volumes involving smaller denominators. Another major advantage with this mechanism of collection could be that it will obviate the compliance burden placed on Indian deductors. The automated collection can also reduce the other problems associated with the deduction of Equalization Levy by payers.

159. In view of these possible advantages, the Committee examined the feasibility of resorting to this mechanism, and also held discussions with authorities in the Reserve Bank of India. However, after examining the existing mechanisms, it has become apparent to the Committee that the existing systems, processes, laws, rules and regulations governing these payment gateways would need to be substantially modified for collecting Equalization Levy through this mechanism.[83] The Committee also came to realize that since the payments that are likely to be the subject of Equalization Levy can also be made by way of credits in the books or adjusted in a manner that obviates the need for an actual payment, particularly in a B2B transaction. This suggests that while the collection through payment gateways may be a more preferable mechanism for collecting Equalization Levy in case of B2C transactions (as and when

[83] There may also be a need for developing proper monitoring mechanism to ensure compliance of laws related to equalization levy by the payment gateways. In view of these requirements that would need significant time to develop and evolve, at substantial costs, this mechanism of collection will take its own time to develop.

that becomes applicable), this mechanism would not be feasible for the B2B transactions that are intended to be covered at this stage.

C. Deduction of Equalization Levy by the Authorized Foreign Exchange Dealer

160. The Committee also considered the possibility of getting the Equalization Levy deducted by the Authorized Foreign Exchange dealer, as many of the B2B transactions are likely to be routed through the Authorized Foreign Exchange Dealer. The Committee recognized that this is an important option that can obviate the obligations placed on the payers, but also noted that it will also require modifications in rule and regulations governing these dealers, and putting into place a mechanism for ensuring compliance by them. Further, such a mechanism would not work in case of credit of payments made by parties in their books of accounts without actual transactions. The Committee also noted that the existing mechanism for verification of nature of payments and in particular characterization of payments is not sufficiently robust for such a mechanism to operate, and necessary changes to ensure that Authorized foreign exchange dealers are able to deduct Equalization Levy in all cases will need to be put in place. The Committee considers that there is a need to explore this option and if found feasible, it may replace or supplement the obligation of the payer after putting the necessary mechanism for its implementation in place.

161. **Keeping in view the limitation of the other options, the Committee prefers the compliance by placing the obligation of deducting the Equalization Levy on the payer, in a manner similar to the obligation that exists in case of withholding tax under Income-tax Act, 1961, with the following modifications:**

- **The obligation to deduct Equalization Levy may be limited to businesses, by exempting payers who do not wish to claim the payment as either revenue expense or capitalized expense in a business the profits of which are taxable in India.**
- **The allowability of the payment as an expense for determining the taxable profits under the Income-tax Act, 1961 may be linked with the payment of Equalization Levy, similar to the allowability under Section 40 of that Act.**
- **Payments subjected to Equalization Levy may also be notified under Section 195 (7) of the Income-tax Act, 1961, along with an exemption provided in the notification itself to those cases where Equalization Levy is paid, so as to strengthen the deterrent against non-compliance.**

162. However, the Committee also recognizes the potential of collecting Equalization Levy through the payment gateways and authorized foreign exchange dealers. The Committee considers that deduction of Equalization Levy by them with proper systems in place can reduce the compliance costs and thereby improve compliance. **The Committee is of the view that with**

increasing scope of digital services that may be covered by Equalization Levy in future, a three pronged approach for compliance, consisting of deduction by authorized foreign exchange dealers in B2B payments, deduction by payment gateways in B2C payments, and deduction by payers in other cases, like payment by credit in books of accounts could provide a way forward for seamless compliance with minimum costs of compliance and administration. Thus, the Committee strongly recommends that work on developing the necessary rules and regulations as well as the systematic requirements for implementation of a mechanism that will enable collection of Equalization Levy through payment gateways and authorized foreign exchange dealers may also be initiated at the earliest.

10.13 Reporting and Auditing Mechanism for Deductors of Equalization Levy payments

163. The Committee recognizes the need to put in place a mechanism for auditing and reporting such compliance. **The Committee is of the view that a certificate of the Auditor that Equalization Levy has been deducted and paid on all payments as per law would go a long way in ensuring proper compliance. The mechanism for reporting compliance is required to be put in place, but should be simple and consist of an online form which can be filled and submitted online.** However, the Committee also recognizes the need to ensure that smaller businesses are not burdened with costs that may create a hardship for them. Accordingly, the Committee is of the view that a person who is not required to maintain books of accounts under any law in India, should be exempted from the obligation of filing a return on deduction of Equalization Levy. Similarly, a person, who is not required to get its accounts audited under any law in India, should be exempted from the obligation of obtaining a certificate of the Auditor. The Committee is also of the view that harmonizing the reporting obligations in respect of Equalization Levy with the existing obligations in respect of withholding tax could be a possible way for avoiding duplication, and can be considered as a means for further reducing the costs of compliance. After takin into account the existing forms for Auditor's Certification, the Committee is of the view that modification of Form 3CD can be a convenient option for obtaining Auditor's Report on deduction of Equalization Levy.[84] Alternatively a form can be prescribed for this purpose.

10.14 Efficient Risk Assessment Tools to obviate Random Scrutiny

164. The Committee noted that in order to minimize the compliance and administration costs, there would be a need for efficient risk assessment tools. As the scope of Equalization Levy is proposed to be restricted to B2B transactions at this stage, and many of payment made

[84] Suggested modifications to Form 3CD are annexed in Appendix-3 of this report.

may also be subject to Service Tax as well as likely to be claimed as Reverse Charge therein, the reconciliation of Equalization Levy database and Reverse Charge claims in Service Tax may provide a useful risk assessment tool for this purpose. The Committee strongly recommends the use of similar non-intrusive tools that would provide highly efficient risk assessment and obviate the need for scrutiny in the administration of Equalization Levy.

10.15 Monitoring of Impact and Possible Expansion in Future

165. The Committee is of the view that there would be a need to monitor the impact of Equalization Levy on a regular basis, particularly as the digital services that can be provided and availed without physical presence continue to evolve and expand in India. There could be a need to modify the list of services covered under it, and find better ways of compliance that will enable a seamless collection of Equalization Levy, reduce the compliance burden on payers. With better mechanisms of collection, it may be possible in future to collect this levy on B2C payments too, without burdening the consumers with its collection and compliance.

10.16 Possible Grounds of Criticism of Equalization Levy & Explanations of the Committee

166. The Committee notes that following criticisms may arise in respect of this proposal, and attempts to provide explanation in respect of them.

- ***The greatest disadvantage and source of criticism of Equalization Levy is that it is an additional tax over and above all other taxes that are already in place, and that such additional tax burden may further affect ease of doing business in India.***

  The Equalization Levy is an additional tax only on foreign enterprises escaping tax in India due to the existing limitations in the existing international taxation rules, and does not affect other Indian or foreign enterprises that are already having a permanent establishment in India and getting taxed on their business profits in India. Further, the aim and objective of Equalization Levy is to ensure that unfair tax advantage to multi-national enterprises is minimized, thereby improving the competitiveness of businesses in India (including foreign businesses having a taxable presence in India). The lower rate of 6% Equalization Levy and corresponding exemption from income-tax for payments that are very often a source of tax dispute and tax litigation, actually amounts to lowering the tax rate on such payments. Lastly, by bringing greater clarity in tax obligations in respect of digital businesses, particularly in respect of characterization disputes and consequent taxability of income (e.g. disputes related to characterization

of payments as royalty/FTS), the Equalization Levy will stabilize the tax environment in India, and facilitate businesses in India.

- ***The tax burden of Equalization Levy is likely to fall on the Indian businesses having to deduct it, and would therefore only be detrimental to them***

  This burden is not different from the burden of withholding tax under the Income-tax Act, 1961 and relevant tax treaties, and by having a rate lower than that applicable for withholding tax on royalty & fee for technical services, it actually reduces the burden both in terms of actual tax payable, as well as in terms of greater certainty and predictability. The burden is likely to be restricted in India due to the revenue threshold and since deduction is not required to be made in respect of a payment either to an Indian entity, or to a foreign entity having a permanent establishment in India, or if the payment being made is not part of business expenses. The incidence is intended to fall primarily on the payment being made by the Indian subsidiaries to their associated enterprises outside India, and payments made by Indian businesses to an entity outside India of an amount more than the threshold that are claimed as deductible business expenditure in India, without leading to any corresponding taxable income in India in the hands of the beneficial owner. By having a clear and undisputable tax liability, the payer in India would be in a better situation to assess the tax impact and negotiate with the foreign beneficial owner. Lastly, even in cases where the economic burden of tax deducted falls on the Indian payer, the lower rate of 6 to 8% in respect of those payments that are potentially taxable as royalty or fee for technical services, would provide significant relief to them, and therefore should be seen as a relief and not additional burden.

- ***The imposition of such a levy may be a violation of international tax practices***

  The Equalization Levy is identified by the G-20 and OECD as a possible option that countries can adopt in their domestic laws. The Conclusions of the BEPS Report on Action 1 clearly state that. Thus the imposition of Equalization Levy under domestic laws is completely in accordance with the consensus view accepted by the G-20 and OECD.

- ***Why should India impose such a levy when it is not imposed by any other country***

  India is not the only country to have imposed a tax to address the concerns arising from the ability of digital multi-national enterprises to avoid paying taxes in the jurisdiction from where they are earning their income. UK has imposed a “Diverted Profit Tax” from 1.4.2015 to address these concerns. Australia has imposed a “Multinational Anti Avoidance Law” from 1.1.2016, Italy is reported to be considering a new “Digital Tax”

consisting of 25% withholding tax on payments. Some countries, like Brazil already impose withholding tax on such payments. These instances, along with the fact that the G-20 and OECD countries now agree on the rights of every country to impose any of the actions identified in the BEPS Report on Action 1, is a clear indication that countries across the World are thinking about it. Compared to the taxes being imposed in other countries, the Equalization Levy proposed by the Committee is completely in accordance with the international consensus and suggestions

- ***There will be no foreign tax credit available to the taxpayer in lieu of Equalization Levy, which would amount to double taxation of their income. If it is to imposed, it should be under the tax treaties so that there is no double taxation***

  This is acceptably an inherent limitation of Equalization Levy or any other option that may be imposed under domestic laws, not covered by the tax treaties. However, it must be noted that there is nothing to prevent the country of which the taxpayer is residence from granting relief to the taxpayer, under its own domestic laws, to avoid such double taxation. In case such a country also imposes an Equalization Levy, there can even be the possibility of a reciprocal agreement between India and that country to provide relief from income-tax on account of such levy. Further, it is always open for a taxpayer being subjected to have a permanent establishment in India, and thereby get exemption from Equalization Levy completely. Thus, the Equalization Levy serves to create incentives for digital multinational enterprises to establish permanent establishment in India and get taxed only on its net income attributable in India, while creating disincentives against artificial arrangements to avoid paying taxes on income arising from India by exploiting the systemic weaknesses in the existing international taxation rules. The double taxation arising from Equalization Levy should be viewed from this perspective. Lastly, even for a taxpayer that has to bear such double taxation, partial relief may still be available in the form of deduction of the Equalization Levy from its taxable income as a business expense.

- ***The Equalization Levy may adversely affect the competitiveness of Indian digital enterprises***

  As it is levied only on foreign enterprises not having a taxable presence in India, the Equalization Levy improves the competitiveness of digital enterprises in India, including foreign enterprises having a permanent establishment in India, by reducing the tax disadvantage that they currently face in comparison with their foreign competitors. The existing tax advantage enjoyed by foreign enterprises over their Indian counterparts creates strong incentives for Indian enterprises to locate outside India, and thereby

poses a strong challenge for the growth and expansion of Indian digital industry. The Equalization Levy aims at neutralizing this disincentive, and facilitating an environment, where Indian digital enterprises can compete with their foreign competitors without having to locate outside India.

Section 11

Conclusions & Recommendations of the Committee

167. In view of the observations made in the earlier sections of this Report, the conclusions and recommendations of the Committee are summarized in this section.

11.1 Conclusions

168. Digital Economy has now become a significant segment of economy around the world, including India. The ability of enterprises to conduct their business on a non-occasional basis, and have significant participation in the economic life of a jurisdiction, without having a physical presence there, gives rise to significant tax policy challenges in terms of nexus, characterization and valuation of user data and contributions. Challenges also exist in respect of valuation of user data and contributions, that are relied upon by enterprises for earning profits from a jurisdiction and which need to be taken into account for determining taxable nexus and attribution of profits to the jurisdiction.

169. The asymmetry in tax burden between Indian and multi-national enterprises is likely to have a distortionary impact on the market competition and can adversely affect the development of Indian digital enterprise industry, apart from creating strong incentives for Indian enterprises to either locate themselves outside India or sell their businesses to foreign enterprises. The asymmetry in tax burden also adversely affects the competitiveness of traditional brick and mortar businesses in India (including permanent establishments of foreign companies in India). The resultant adverse impact on the profitability of enterprises paying taxes in India can lead to significant detrimental impact on the fiscal health of Indian economy and consequently, on its growth.

170. The limitations of physical presence based threshold for taxing income from business, which was conceptualized long before the development of digital economy is now widely recognized and accepted by international community. It is also recognized and accepted that significant tax challenges arise from the difficulties in applying the existing international taxation rules, as they exist in tax treaties today, in respect of digital economy. Physical presence cannot be considered an appropriate test for determining taxable presence in respect of business models in digital economy.

171. There is considerable ambiguity regarding the characterization of income arising from transactions involving telecommunication networks, software and data exchange. These disputes on characterization of payments are more commonly observed in countries like India, that have tax treaties wherein taxing rights are allocated to the source jurisdiction in respect of royalty and fee for technical services. Many of these disputes arise from the insistence of taxpayers to apply the guidance developed by OECD, even though India has documented its disagreements with such guidance, and its position in tax treaties precede the development of that guidance.

172. In view of the challenges faced by India in terms of characterization of income, and the lack of universal consensus on adopting the new nexus based significant economic presence, as well as the likely difficulties faced in attributing profits under existing rules, there appears to be a strong case for finding a solution to all these issues, in the form of a simple, clear and predictable tax rule that unambiguously defines the tax liability of digital enterprises, reduces their tax risk and contingent liabilities, and minimizes compliance costs, disputes and administrative burden.

173. In view of the role and contribution made by the users by way of data, content creation and networking benefits, users need to be considered as a significant indicator of both nexus and creation of value in the jurisdiction of source. However, quantifying such value creation can be a challenging task, and therefore a simple tax rule that broadly covers such value or a significant part of it, may be preferable.

174. Recent works of experts on the tax challenges in digital economy represent the global recognition of the extent of the tax challenges of digital economy.

175. The BEPS Report on Action 1 (2015), which has been endorsed by the G-20 and OECD provides a broad international consensus on the tax challenges arising from digital economy and identifies the options to address them. The Report did not recommend any of the options at this stage, primarily since adopting them *"would require substantial changes to key international tax standards and would require further work"*, but by concluding that "*Countries could, however, introduce any of the options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties*", an international consensus has now emerged among G-20 and OECD countries, which recognizes and accepts the right of a country to adopt any of the options identified in the Report on BEPS Action 1, in its domestic laws or in its bilateral tax treaties.

176. In view of the differences between the preferences of different countries, it may take a long time for the international community to arrive at a recommendation that is likely to be adopted uniformly by all countries in a way that will completely harmonize international

taxation on digital economy. Thus, a practical and pragmatic solution to address these challenges would need to be adopted in the domestic law by any country wanting to address these challenges.

177. Among the options recognized and examined by the Task Force, the option of "*a new nexus based on significant economic presence*" can be adopted in the Income-tax Act, 1961, but will not be sufficient for taxing income on the basis of this new nexus, unless any applicable tax treaty is also amended by inserting such nexus. Similarly, the adoption of a "*final (or intermittent) withholding tax on digital transactions*" in the Income-tax Act, 1961, may also be rendered ineffective unless the same option is also included in the applicable tax treaty. The Committee also notes that India is committed to the obligations made by it under the tax treaties, which largely limit the application and effectiveness of adopting these options in the Income-tax Act, 1961. These limitations, however, do not limit the adoption or application of the third option, i.e. '*Equalization Levy*' unless it is levied on 'income' that may fall within the scope of taxes covered under the tax treaties. The Committee also notes that this option is put forth in the BEPS Report on Action 1 as one that can be considered as an alternative to the other two, and is a simpler option devoid of the difficulties that are associated with the more intractable issue of attribution of profits.

178. Thus, among the three options that can be adopted under domestic laws, the 'Equalization Levy' is the most feasible option. Such a levy cannot, however, be imposed on income and would need to be imposed on the transacted amount or payment itself.

179. While the BEPS Report on Action 1 suggests further work on tax challenges arising from digital economy, no clear framework for undertaking this work has been determined and even if any further work is undertaken, it is not clear as to whether any actionable outcomes from such work can be anticipated in foreseeable future, particularly in view of the likely resistance to such work from countries that benefit from existing rules. Thus, there does not appear to be any justification for postponing measures for addressing tax challenges in digital economy.

180. BEPS Report on Action 1 clearly differentiates the "*BEPS Issues in digital economy*" that consist of artificial arrangements to avoid paying taxes, from the "*broader tax challenges from digital economy*" that primarily relate to the non-applicability of a physical presence based tax nexus on digital businesses, characterization of income and valuation of user data and contribution. While certain recommendations like those in Action 6 for preventing treaty abuse, or those in Action 7 for preventing artificial avoidance of PE Status may have some impact on the "BEPS issues in digital economy", there is virtually nothing in the outputs or outcomes of any of the other Action Points of BEPS Project that can address the broader tax challenges.

181. In view of the Committee, there is a need to consider the feasibility of adopting the 'Equalization Levy' under domestic laws of India to address the tax challenges arising from the digital economy at this stage. The Committee is also of the view that adopting such a measure at this stage will bring greater certainty and predictability to all the stakeholders, enable them to take it into account while making their future business plans and pricing of products, and thereby contribute to a more stable environment that would exit in the absence of such a measure.

182. Compared to the option of including Equalization Levy in a tax treaty, the option of imposing the same under the domestic law appears to have significant advantages in terms of providing simplicity, uniformity and consistency as well as minimizing the costs of administration and compliance, and is therefore, a preferred option.

183. Past precedence exist for imposition of similar taxes on transactions, like the Security Transaction Tax (STT) and the Service Tax. In view of these precedents, and the need to keep the 'Equalization Levy' separate from the taxes on income, this Committee is of the view that the 'Equalization Levy' on payments for digital goods and services should be imposed through statutory provisions in the Finance Act.

184. Equalization levy on gross amounts of transactions or payments made for digital services appears to be in accordance with the entries at Serial Number 92C and 97 of the First List in the Seventh Schedule of the Constitution of India. The existing precedent in the form of the Service Tax appears to remove any ambiguities and doubts in this regard. Thus this committee is of the view that Equalization Levy as a tax on gross amounts of transactions, imposed by the Union through a statute made by the Parliament, would satisfy the test of constitutional validity.

185. The Equalization Levy should be limited to the payments made for intangible services, including payments for use or right to use any intangible, access a digital, telecommunication or similar network, or avail any service or other benefit received from a foreign company or a person outside India, provided the services are either received, utilized, provided or performed in India, and thus have a nexus with India, irrespective of whether the payment is made by a resident or a non-resident person. Thus, the payment made by the permanent establishment of a foreign company in India to its headquarters outside India would be covered if it otherwise falls within the scope of Equalization Levy. To the extent possible, the categories of payments that would be subjected to Equalization Levy should be listed clearly.

186. To prevent and avoid the possibility of double economic taxation from levy of both Equalization Levy and Income-tax, relief would need to be provided from income-tax in respect of payments on which Equalization Levy is already paid. Such relief can be provided in three possible ways – by exempting income arising from transactions on which Equalization Levy has

already been paid; by providing deduction from total income; or by providing tax rebate. Among these, the exemption of income appears to be the simplest option with least unintended consequences, and hence may be preferable.

187. The scope of such Equalization Levy may be restricted by keeping out smaller transactions where the compliance and administrative costs would not be commensurate with the revenue collected. Thus having a revenue threshold (such as Rs. one lakh) for a single transaction, as well as a revenue threshold for the total sum paid in a year (such as Rs. ten lakh) would be preferable. Such thresholds should practically exempt all payments made by consumers for personal consumption, and would thereby ensure that no Equalization Levy is payable on B2C transactions.

188. The compliance of Equalization Levy can be ensured largely by getting it deducted by the payer. This obligation should only be restricted to business-to-business payments, where the amount paid is claimed as a business expense (including capitalized expense) for determining taxable profits of that business. A certificate of an auditor that Equalization Levy has been deducted and paid to Government in cases where it was chargeable, and filing of a simple annual return online should be sufficient compliance with this obligation.

189. The beneficial owner of the Equalization Levy should be required to pay the Equalization Levy chargeable on sums received by it, to the Government. Thus, if it has received a sum on which Equalization Levy is chargeable, and not deducted by the payer, it would be liable to pay the same to the Government. However, if Equalization Levy has already been deducted on payments made to it, no further amount would be payable by it to the Government. The reporting obligations of the beneficial owner can be minimized by providing the facility of a simple online return on annual basis, subject to a minimum threshold of receipts, like, Rs. 10 crores in the year.

11.2 Recommendations of the Committee

A. Equalization Levy may be imposed on payments to non-residents for specified services by a separate chapter in the Finance Act, 2016

190. In accordance with the conclusions of the BEPS Report on Action 1, which have been endorsed by G-20 and OECD, it is recommended that an “Equalization Levy” may be imposed on digital transactions, by introducing the necessary statutory provisions by a separate chapter in the Finance Act, 2016. This will not be a part of the Income-tax.

191. The Equalization Levy should be chargeable on any sum that is received by a non resident from a resident in India or a permanent establishment in India as a consideration for the specified digital services.

192. The rate of Equalization Levy may be between 6 to 8 percent of the gross sum received

193. Specified services may be defined as following:

(i) online advertising or any services, rights or use of software for online advertising, including advertising on radio & television;
(ii) digital advertising space
(iii) designing, creating, hosting or maintenance of website
(iv) digital space for website, advertising, e-mails, online computing, blogs, online content, online data or any other online facility
(v) any provision, facility or service for uploading, storing or distribution of digital content
(vi) online collection or processing of data related to online users in India
(vii) any facility or service for online sale of goods or services or collecting online payments
(viii) development or maintenance of participative online networks
(ix) use or right to use or download online music, online movies, online games, online books or online software, without a right to make and distribute any copies thereof
(x) online news, online search, online maps or global positioning system applications
(xi) online software applications accessed or downloaded through internet or telecommunication networks
(xii) online software computing facility of any kind for any purpose
(xiii) reimbursement of expenses of a nature that are included in any of the above

194. It may be clearly explained in the provision that for the purposes of the above, 'online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network including radio & television, whether analog or digital.

195. It may also be clearly explained that Equalization Levy would be payable if the sum received is a consideration for any of the above, irrespective of how it may be described in the books of the beneficial owner or the payer

196. Equalization Levy should not be charged unless the consideration received for specified services **in a year from a person** in India is **more than one lakh rupees**.

197. Equalization Levy should also not be charged on payments received by a permanent establishment of a non-resident in India, which are attributable to that permanent establishment and taxable under Income-tax Act, 1961. A written declaration by the beneficial owner in a prescribed form including Indian PAN and a Tax Identity Number in country of residence for this purpose should be sufficient.

198. Every person that has received any sum chargeable to Equalization Levy, would be required to pay the Equalization Levy chargeable on that sum to the central government. The Equalization Levy payable by that person will be the Equalization Levy payable on the sum chargeable to Equalization Levy as reduced by the Equalization Levy deducted by the payers from such sum at the time of payment or credit of such sum.

199. Every person that has received any sum chargeable to Equalization Levy, would be required to file a return of Sum chargeable to Equalization Levy as prescribed, if such total sum received by that person in a year exceeds ten crore rupees. Necessary facility for filing of such return online in a simple form should be made available. The details sought in the form should include the name and address of the payer, amount and date of payment of each payment of sum that is received by that person and the amount of Equalization Levy deducted by the payer on it.

200. The payer should be liable to deduct the Equalization Levy, if the payment is incurred for the purpose of a business in India and likely to be claimed as an expenditure (including capitalized expenses). This obligation should be similar to the obligation that exists in respect of Tax deducted at source under Income-tax Act, 1961.

201. The payer should also be required to get a certificate from an Auditor, within 60 days after the end of the year, that Equalization Levy has been deducted from all sums chargeable to it, and paid to the Central Government within 30 days of such deduction. The payer should also be required to file an annual return of deduction of Equalization Levy, in a simple form including the name and address of the payer, amount and date of payment of each such payment, the amount of Equalization Levy deducted on it and the details of payment of such deducted amount to the Government.

B. Corresponding Changes in the Income-tax Act, 1961

202. Any income arising from a transaction on which Equalization Levy has been paid should be exempted from income-tax, by necessary amendment in Section 10 of the Income-tax Act, 1961

203. The allowability of the payment as an expense for determining the taxable profits under the Income-tax Act, 1961 may be linked with the payment of Equalization Levy, similar to the allowability under Section 40 of that Act, including the allowance of such deduction in the year in which it is paid.

204. Payments subjected to Equalization Levy may also be notified under Section 195 (7) of the Income-tax Act, 1961, along with an exemption provided in the notification itself to those cases where Equalization Levy is paid, so as to strengthen the deterrent against non-compliance.

C. Other Recommendations

205. The definition of "business connection" in section 9 of the Income-tax Act, 1961 may be expanded to include the concept of significant economic presence

206. Work on exploring the possibility of deduction of Equalization Levy by the payment gateways should be initiated immediately, and should include a review of rules and regulations as well as the systematic requirements for implementation of such a mechanism, which may substitute or complement the deduction of Equalization Levy by the payer.

207. The implementation and impact of Equalization Levy may be monitored on a regular basis, particularly as the digital services that can be provided and availed without physical presence, continue to evolve and expand in India. A Standing Committee may be constituted for this purpose.

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Appendix -1

A Summary of the Proposed Equalization Levy

Charged on

Consideration received by a non-resident for specified services, from a resident in India or a permanent establishment in India

Provided that Equalization Levy shall not be charged unless

- the consideration received from a person for specified ~~transactions~~ services in a year is more than Rs. 1 lakh

Rate

At a rate that is between 6 to 8 % of the gross amount of consideration for specified transactions[85]

Payable by

The beneficial owner of the consideration for specified transactions

Specified Services

(i) online advertising or any services, rights or use of software for online advertising, including advertising on radio & television;

(ii) digital advertising space

(iii) designing, creating, hosting or maintenance of website

(iv) digital space for website, advertising, e-mails, online computing, blogs, online content, online data or any other online facility

(v) any provision, facility or service for uploading, storing or distribution of digital content

[85] In view of the Committee, it may be a preferable option to restrict the rate of Equalization Levy at 6% at the time of its introduction, and then review it in subsequent years, to evaluate the desirability of raising it.

(vi) *online collection or processing of data related to online users in India*

(vii) *any facility or service for online sale of goods or services or collecting online payments*

(viii) *development or maintenance of participative online networks*

(ix) *use or right to use or download online music, online movies, online games, online books or online software, without a right to make and distribute any copies thereof*

(x) *online news, online search, online maps or global positioning system applications*

(xi) *online software applications accessed or downloaded through internet or telecommunication networks*

(xii) *online software computing facility of any kind for any purpose*

(xiii) *reimbursement of expenses of a nature that are included in any of the above*

(For the purposes of above, 'online' means a facility or service or right or benefit or access that is obtained through the internet or any other form of digital or telecommunication network.)

(Equalization Levy would be payable if the sum received is a consideration for any of the above, irrespective of how it may be described in the books of the beneficial owner or the payer)

Exemptions

Equalization Levy would not be chargeable if the beneficial owner of the consideration for specified transactions

- has a permanent establishment in India, and
- the consideration forms a business receipt of that permanent establishment, and
- the income derived from the sum is attributable to such permanent establishment in India, and taxable under the provisions of the Income-tax Act, 1961, and
- the beneficiary makes a declaration in writing in the prescribed form to this effect.

Mode of Payment

The beneficial owner shall pay the Equalization Levy to the Government on the total Equalization Levy payable by that person, as reduced by any Equalization Levy that is already deducted by payers.

Mode of Reporting Compliance

The beneficial owner shall file an online annual return of receipts for specified services, if such receipts exceed ten crore rupees. There will no such obligation if such receipts from India do not exceed ten crore rupees.

Obligation of Deduction at Source by Payer

Any person paying or crediting a sum on which Equalization Levy is chargeable shall deduct the Equalization Levy at the applicable rate from that sum if such payment is made for the purpose of a business in India

(A PE in India making a payment to the Headquarters or to any other non-resident on which Equalization Levy is chargeable shall also deduct the Equalization Levy at the applicable rate from that sum)

Mode of Reporting Compliance of Deduction

The deductor shall file an online annual Return of Deduction of Equalization Levy

> Provided that a person who is not required to maintain its books of accounts under any law in India shall not be required to file such return

The deductor shall obtain a certificate of the Auditor in the prescribed form to the effect that Equalization Levy has been correctly deducted on payments

> Provided that a person who is not required to get its books of accounts audited under any law in India shall not be required to obtain such a certificate

Whether the payment chargeable to Equalization Levy would include indirect taxes/levies paid in India

The Committee recommends that Equalization Levy should be chargeable on the amount received by beneficial owner excluding any indirect taxes/levies paid in India.

Corresponding Changes in Income-tax Act, 1961

Exemption of Income from a specified transaction on which Equalization Levy has been paid

Any income arising from a transaction on which Equalization Levy has been paid should be exempted from income-tax, by necessary amendment in Section 10 of the Income-tax Act, 1961

Payment for specified transactions on which Equalization Levy is chargeable not to be allowed as expenses if Equalization Levy has not been deducted

The allowability of the payment as an expense for determining the taxable profits under the Income-tax Act, 1961 may be linked with the payment of Equalization Levy, similar to the allowability under Section 40of that Act, including the allowance of such deduction in the year in which it is paid.

Non Statutory Measures

Notifications on specified transactions under section 195 (7)

Payments subjected to Equalization Levy may also be notified under Section 195 (7) of the Income-tax Act, 1961, along with an exemption provided in the notification itself to those cases where Equalization Levy is paid, so as to strengthen the deterrent against non-compliance.

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Appendix -2

Clarifications regarding Equalization Levy

1. ***Objectives of Equalization Levy***

   To address the base erosion faced in digital economy from limitations of existing international taxation rules, in accordance with international agreement arrived in the BEPS Project. This base erosion happens when a deductible payment is made for the purpose of business and claimed as business expense, but the income arising from such payments is not taxable because of the limitations of existing international taxation rules.

   To reduce the unfair tax advantage enjoyed by a multinational digital enterprise over its Indian competitors, and thereby ensure fair market competition. The unfair tax advantage arises when domestic enterprises are taxed but multinational enterprises are not taxed on their income arising from India.

   To provide greater certainty and predictability with regard to taxation of payments for digital services by way of a stable tax regime.

   'Equalization Levy' has been recognized and accepted in the BEPS Report on Action 1 as one of the options that can be resorted to by countries under their domestic laws.

2. ***Payment covered***

   It will be levied only on payment made for certain specified services and facilities provided by multinational enterprises not having a permanent establishment in India.

3. ***Payments not covered***

   It will not be levied on goods to be imported. The fact that orders are placed & payments are made on the internet will not attract Equalization Levy. In other words, what is normally understood as E-Commerce or digital Commerce need not necessarily attract Equalization Levy. Sellers or buyers selling tangible goods by using internet will not be affected, except in respect of payments for specified services.

   It will also not be levied on services that are not specified, even if such services are procured by making payments from within India over the internet. For example, an Indian resident books hotel rooms abroad. Booking is made and payment is made on the net. However, hospitality services are not specified services for the purpose of Equalization Levy. Hence Equalization Levy will not be levied. Such transactions are normally known as E-Commerce. However, they will not attract Equalization Levy.

Thus, the Equalization Levy is not necessarily chargeable for all E-Commerce transactions.

4. Payment Thresholds for Equalization Levy

No Equalization Levy will be charged for payments below the threshold limit of Rs. one lakh for a single payment, or Rs. ten lakh of total payments made in a year by a payer to a single party. **Thus, no Equalization Levy would be levied in the following instances:**

(i) An Indian resident makes a single payment for Rs. 95,000 to a foreign enterprise for a specified service;

(ii) An Indian resident makes several payments to a foreign enterprise for specified services, but total of all payments made to that enterprise in the year is less than Rs. one lakh;

(iii) An Indian resident makes several payments to several foreign enterprises for specified services, but the total of all payments made to each of those enterprises in the year is less than Rs. one lakh.

These high thresholds are likely to ensure that payments of smaller amounts made by Indian consumers for personal consumption of services are not affected by it. In a case, where a total payment exceeding Rs. one lakh is made by a consumer for non-business purposes (such as personal consumption) to a single foreign enterprise in a year, Equalization Levy would be chargeable, but even then there would be no liability on the consumer to deduct it. Thus, Equalization Levy would not affect non-business consumers.

5. Payments to Residents & Permanent Establishments of Non-Residents not Liable

Equalization Levy will not be chargeable on payments for specified services made to Indian Residents. In fact, the levy is proposed to protect Indian residents from unfair competition arising out of unfair tax advantage enjoyed by their foreign competitors.

Equalization Levy will also not be chargeable on payments for specified services made to permanent establishment of non-residents in India. Thus, it also protects non-residents paying taxes on their income in India from unfair competition.

6. Indian Nexus necessary

Equalization Levy will be levied only where payments for specified services are made by a resident of India or a permanent establishment of a non-resident for the purpose of its business in India. Payments made by a non-resident from within India

will not attract Equalization Levy, unless it has a permanent establishment and payment is borne by that permanent establishment in India.

7. Deduction at Source liability only on businesses

The payer is required to deduct the Equalization Levy from a payment for specified services only if it is a payment made for the purpose of business, and the payer intends to claim a deduction for expenses on account of such payment for determining its taxable profits in India.

Thus, a person making payments for personal use and not intending to claim any deductions for that payment will not be required to make any deductions.

8. Possibility of deduction of Equalization Levy by Payment Gateways

The Committee recommends that necessary work for evolving a mechanism for deduction of Equalization Levy by payment gateways need to be initiated. However, the Committee recognizes that such a mechanism may take some time to develop.

9. Filing of Returns

Non-resident beneficial owner will have to file his tax return only if its annual receipts chargeable to Equalization Levy are in excess of Rs. Ten Crore. For receipts below Rs. Ten Crore, tax will be payable, but there will be no obligation for the non-resident to file a return. Tax deducted by Indian resident payers will be accepted as final payments, and if Equalization Levy has been deducted on all specified payments by payers in India, no further payment will be required from the beneficial owner.

Payers in India will be required to file a simple online return annually providing basic details of Equalization Levy deducted and paid to the Government.

10. No Payment, no Levy

If no payment is made for a service, there will be no levy. For instance, Equalization Levy will not be chargeable on services that are available freely on the internet, or free apps that are available to the Indian consumers.

11. Payments subjected to Equalization Levy exempted from Income-tax

All payments for specified services that are liable to Equalization Levy shall be exempt from Indian Income-tax in the hands of the non-resident beneficial owner. This will ensure that payments will not be covered by both Equalization Levy as well as Income-tax Act, and thereby ensure that there is no double taxation in India on those payments. This would also help in minimizing income-tax disputes relating to

characterization of payments and their consequent taxability under the Income-tax Act.

Thus, the income of a non-resident from services that are covered by Equalization Levy, and on which Equalization Levy is paid will be fully exempt from income-tax.

12. Outside Income-tax Act – Not a tax on income

The Equalization Levy will be outside Income-tax Act. It is not a tax on income, as it is levied on payments. It is therefore also payable by enterprises not making any net profits.

However, Equalization Levy is not chargeable on payments made to permanent establishments of foreign enterprises in India, and thus, enterprises that would prefer to be taxed on their net income have the opportunity to have a permanent establishment in India and thereby get taxed only on their net income.

13. Tax Treaties (Double Taxation Avoidance Agreements) Not Applicable on Equalization Levy – No Foreign Tax Credit in the other country

As the Equalization Levy is not charged on income, it is not covered by Double Taxation Avoidance Agreements or tax treaties. Thus, no tax credits under the tax treaties will become available to the beneficial owner in the country of its residence, in respect of Equalization Levy charged in India.

The Committee recommends that in case the other country also levies a similar Equalization Levy, Government of India may explore the possibility of having a reciprocal agreement with that other country for allowing tax credits under the domestic tax laws for Equalization Levy paid.

14. Positive Aspects of Equalization Levy

(i) Internationally Recognized Option: Equalization Levy has been recognized as one of the possible options that can be resorted to by countries for addressing the tax challenges arising from digital economy, under their domestic laws.

(ii) The design of the Equalization Levy avoids many complications related to determination of nexus, characterization of payments and attribution of profits. As it is levied on gross payments at a flat, low, final rate, there is no need for determining taxable income.

(iii) Since this levy is not under the Income-tax Act, the provisions of transfer pricing and General Anti Avoidance Rules will not be applicable to it.

(iv) It does not affect consumers making payments up to Rs. one lakh.

15. Administration

The Equalization Levy can be administered in the same way as Securities Transaction Tax, by the Income-tax authorities.

16. Obligation to record in Books of Accounts and get them Audited

The deductor in India, if it is making the payment for purpose of its business, will be expected to record the transactions in its books of accounts that it is required to maintain for its business under any law in India. No such obligation would be there for a person, who is not required to maintain books of accounts.

Similarly, a deductor that is required to gets its books of accounts audited, would be expected to obtain a certificate that Equalization Levy has been deducted and paid to the Government as per law. No such obligation would be there for a person, who is not required to get its books audited.

17. Expected Revenue

The Equalization Levy is designed in a way to keep its impact limited at this stage to only certain specified transactions above a high threshold limit. Accordingly, it is not expected to be a major source of revenue at this stage. However, its prime significance lies in initiating a process of addressing tax challenges of digital economy; minimizing the unfair tax advantage enjoyed by multinational enterprises over their Indian competitors; bringing greater certainty and predictability in respect of certain disputed payments; and creating incentives against base erosion and in favor of compliance with Indian tax laws, without disrupting the economy or adding to the cost of compliance or administration. Its overall contribution as a tax policy measure is likely to be significant in the long run.

Even though the greatest benefits of this measure will become available later, it is important to introduce it now, so as to enable the businesses to adapt to its impacts. Such a measure will also introduce long term certainty, predictability and avoid the need of surprise measures in future.

18. Ease of Compliance and Administration

Compliance of Equalization Levy can be completed on the internet, including payment of Equalization Levy and filing of returns. In view of the simple and certain design of Equalization Levy, the administrative interventions are expected to be minimal, thereby minimizing the need for scrutiny, investigations and appeals. By exempting such income from income-tax, compliance and administrative costs in respect of income-tax are also likely to be reduced.

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Appendix -3

Draft clause to be added to Form 3CD or Draft of a separate form for Audit Report under the [Equalization Levy] Act

(a) Whether the assessee has made specified payments to a non-resident covered under the [Equalization Levy] Act

(b)

S.No.	Specified payments made by the assessee	Amount paid	Equalisation Levy Deducted	Date of payment

(c) Amounts inadmissible under section 40(a) as payment to non-resident referred to in sub-clause (_):

(A) Details of payment on which tax is not deducted:

(I) date of payment
(II) amount of payment
(III) nature of payment
(IV) name and address of the payee

(B) Details of payment on which tax has been deducted but has not been paid on or before the due date specified in sub- section (1) of section 139:

(I) date of payment
(II) amount of payment
(III) nature of payment
(IV) name and address of the payer
(V) amount of tax deducted
(VI) amount out of (V) deposited, if any

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SINGATURES
OF THE MEMBERS OF THE COMMITTEE

SIGNED BY THE MEMBERS OF THE COMMITTEE ON TAXATION OF E-COMMERCE

On February 3rd, 2016

(i) Shri Akhilesh Ranjan[86]

Chief Commissioner of Income-tax (OSD), FT&TR-I, CBDT, Department of Revenue, Ministry of Finance & Chairman of the Committee

3/2/2016

(ii) Ms. Pragya Sahay Saksena

Joint Secretary (TPL-I), CBDT, Department of Revenue, Ministry of Finance

3/2/16

(iii) Shri Pradip Mehrotra

Commissioner of Income Tax (ITA), CBDT, Department of Revenue, Ministry of Finance

3/2/16

(iv) Ms. Chandana Ramachandran

Commissioner of Income Tax (International Taxation), Bengaluru

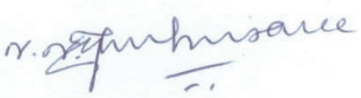
4/2/2016

(signed on 4th February, 2016 in Bengaluru; conveyed by e-mail)

[86] Shri Akhilesh Ranjan was Joint Secretary (FT&TR-I), CBDT, Department of Revenue, Ministry of Finance at the time of commencement of the work of the Committee, but was promoted as Chief Commissioner of Income-tax just before the signing of the report

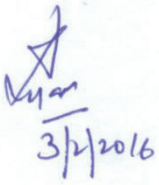
(v) Shri Nihar N Jambusaria

Chairman, Committee on International Taxation of the ICAI, representative of the Institute of Chartered Accountants of India (ICAI)



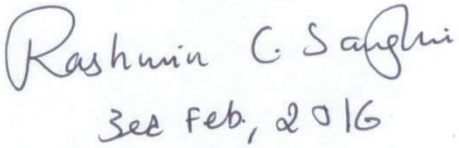
(vi) Shri Pramod Jain

Head of Taxation, Flipkart, Industry representative



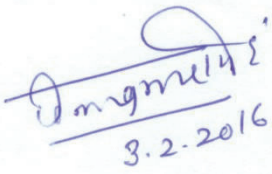
(vii) Shri Rashmin Sanghvi

Chartered Accountant, Expert on International Taxation and Taxation of E-Commerce



(viii) Dr. Vinay Kumar Singh

Director (FT&TR-I), CBDT Department of Revenue, Ministry of Finance & Member Secretary of the Committee



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