International Journal of Research in Finance and Management

P-ISSN: 2617-5754
E-ISSN: 2617-5762
IJRFM 2020; 3(2): 72-74
Received: 16-05-2020
Accepted: 12-07-2020

Dr. Santosh Kumar Yadav
M.Com., M.Ed., Ph.D., Near L.C.S. College, Darbhanga, Bihar, India

Corresponding Author:
Dr. Santosh Kumar Yadav
M.Com., M.Ed., Ph.D., Near L.C.S. College, Darbhanga, Bihar, India

Emerging dimensions of taxation of digital economy in India

Dr. Santosh Kumar Yadav

Abstract
Digital economy refers to an economy that is based on digital computing technologies although we increasingly perceive this as conducting business through markets based on the internet and the World Wide Web. The digital economy is also sometimes called the Internet Economy, New Economy or Web Economy. In a nutshell, it refers to an economy based on digital technologies. In the last decade, there has been a paradigm shift in the way of conducting business. Today, the biggest cab aggregator Uber does not own any cab, the largest accommodation provider Airbnb does not own any apartments and many other frontiers like make my trip, Amazon, Flipkart, Paytm, etc. do not function the way conventional businesses functioned but they thrive on the digital technology. The current tax rules were devised decades ago based on the functionality of the brick and mortar economy. However, with the advent of the digital economy the present tax regime stands redundant. The profits of the digital businesses have been increasing alarmingly, but there do not exist commensurate tax laws to tax such profits. Accordingly, it is need of the hour for all the countries to devise and revamp their tax laws, as the digital economy is ripe for taxation.

Keywords: Digital Economy, Internet, Technology, Tax.

Introduction

The use of the internet has led to the transformation of the physical world into a digital one. Various concerns arise in the digital economy ranging from the issue of big data to taxing of the economy. At present, the international, as well as the Indian tax regime in India, seems unequipped to deal with various taxing issues arising out of the digital economy. Tax plays a crucial role in the development of an economy especially when the case is of a developing one like India. In the recently concluded G20 Summit 2019 the issue of taxing the digital economy comprising of various tech giants like Google, Facebook, Amazon, etc. found a top place in its agenda. The imposition of tax on these global tech companies has taken a prominent place at the international level, owing to the complexity involved in the process as digital business is conducted using intangibles like algorithms, internet domains, user data, etc. However, the revenue generated based on these algorithms is starkly high in various local jurisdictions like India, France, Italy, Hungary, etc. prompting these countries to take advance measures to tap the revenues generated under the local tax laws. In the Financial Year 2018, Facebooks worldwide total revenue reached $55.838 billion. In India alone, Facebook collected total revenue of Rs 521 crores. As per the reports, Googles total revenue in India crossed Rs 10000 crores last year. However, Google and Facebook paid a total tax of only 200 crores to the Government of India.

In light of this disparity in the amount of revenue generated and collection of tax by the Government, the taxing regime needs to be reassessed to accommodate taxation of the digital economy in India. This article focusses on the difficulties that would arise in the adoption of digital tax along with international perspective and the way forward.

International tax regime primarily focusses on dealing with taxation of physical business activities. The digital enterprises like Google, Amazon, Facebook, etc. operate their business on virtual space making it difficult to bring them under the local tax radar, which is only limited to physical business activities. To cater to this problem, the concept of digital tax has emerged to maximise on revenue-based taxes vis-à-vis digital business in local jurisdictions. It is sometimes referred to as Google tax or digital service tax (DST) imposed by the source country on the revenue generated by global tech companies in such countries.

Digital tax has not been defined in any domestic law or an international treaty. It is an informal name given to a tax collected on income generated through digital services.

India's approach towards digital tax

Reports have suggested that internet usage in India has surpassed half a billion users and is expected to reach 627 million by the end of 2020. Due to the expansive proliferation of internet in the urban and rural space, digital economy is poised to undergo explosive growth and is expected to touch the $266 billion mark in 2020, accounting for nearly 7% of our GDP. As digital businesses are distinct from traditional business, India has introduced the concept of equalization levy (EL) through the Finance Act, 2016. The levy was charged at the rate of 6% on payments made to beneficial foreign owners for providing digital services in India. But the levy is only limited to advertisement services. Thereafter, the concept of significant economic presence (SEP) was introduced through the Finance Act, 2018 with the object to widen the scope of business connection in India. At present, the SEP provision remains ineffective due to India being a signatory to various double taxation avoidance agreement (DTAA) with other countries.

Issues related to taxation of digital economy

Characterization of income generated through digital economy

Section 9 of the Income Tax Act 1961, which is applicable to non residents, has categorized income into three classes as business income, royalty and fee for technical services. The issue of income characterization becomes relevant for the determination of tax as the tax consequences are different based on the head under which the income is classified. The Act provides for different rates for different categories of income. The problem, which exists in the case of a digital economy, is regarding the characterization of income generated by its business model. One such concern that arises in such a model is whether to characterize the profits earned on the digital marketplace as business income or fees for technical services.

The problem of permanent establishment

For a non-resident entity's business income to be taxed in India, it is required that the entity maintains a PE or a business connection in India. In case of digital economy, establishing a PE becomes problematic owing to the business model of such an economy, which places reliance on intangibles like patents, algorithms, etc. and can conduct business by residing in a foreign jurisdiction, as a place of their central functions. For this reason, it becomes immensely complicated to tax these entities as they conduct business in India and generate revenue without having any physical presence in the territory.

The double taxation avoidance agreement (DTAA) treaties

The taxation of digital economy would lead to instances of double taxation of various tech enterprises being taxed in multiple jurisdictions. By widening the aspect of "business connection" by introducing the concept of SEP, undue hardship of double taxation will be caused for the tech company as its PE will be situated in one country and SEP in multiple countries, rendering it liable for double taxation. This would defeat the objective of the double taxation avoidance agreement (DTAA) treaties signed between India and other countries in which the global tech companies are based.

Organization for economic cooperation and development (OECD) propositions and the initiatives

The proposals discussed under the public consultation document issued by the inclusive framework on base erosion and profit shifting (BEPS) working through its task force on the digital economy (TFDE) pursuant to its release of the Interim Report in 2018, form part of a long-term solution to the broader tax challenges arising from the digitalization of the economy. The key proposals are the "user participation" proposal and the "significant economic presence" proposal.

The user participation proposal

It is premised on the concept that soliciting the sustained engagement and active participation of users is a critical component of value creation for certain highly digitalized businesses. Various platforms like social media spaces, search engines and online marketplaces predominantly work on the user participation model to create value based on which huge revenues are generated. Under the current international tax framework, which focuses primarily on the physical activities of business itself in determining where profits should be allocated. Profits derived from value created by user participation or user data continues to be outside the scope of taxation as it fails to establish a physical business connection with the value generated through user-oriented data.

The proposal aims at taxing the value generated by user participation by modifying the traditional profit allocation rules and recommends that profits allocated to a user jurisdiction, in respect of the activities/participation of users, be calculated through a non-routine or residual profit split approach. To streamline its implementation, the proposal could rely on formulas that would approximate the value of user data, and the users of each country, to a business. This would also help in avoiding disputes between countries based on their subjective view of value generated by user participation.

The significant economic presence proposal

This proposal is motivated by the view that the digitalizations of the economy and other technological advances have enabled business enterprises to be heavily involved in the economic life of jurisdiction without a significant physical presence. Under this proposal, a taxable presence in a jurisdiction would arise when a non-resident enterprise has a significant economic presence on the basis of the following factors, which evidence a purposeful and sustained interaction with the local jurisdiction via digital technology and other automated means: firstly, revenue-based factor, which would include the threshold level of revenue. Secondly, digital factors that would include domain name, local digital platform, etc. And, thirdly, user-based factors such as number of active users and volume of digital content collected through digital platform. Revenue generated on a sustained basis is the basic factor, but such revenue would not be sufficient in isolation to establish nexus. Only when combined with other factors would revenue potentially be used to establish nexus in the form of a significant economic presence in the country concerned.

India's significant economic presence approach

India has been a frontrunner in introducing the concept of SEP into its domestic law through the Finance Act, 2018, which has enlarged the scope of "business connection" to enable taxation of non-residents having a SEP in India. However, it remains ineffective till the time the treaty rules are amended in accordance with the international framework, which is to see the light of the day in 2020.

Localization of data and tax ramifications

It is widely considered that when a website or data or software is hosted on a local server, it constitutes equipment having a physical location and the same can be treated to be a fixed place of business of the enterprise and can constitute PE given certain conditions stand satisfied. Therefore, if the non-resident entities localize their servers, they very well can be brought under the taxation regime. In India, various measures have been undertaken to ensure data localization for e-commerce as well as entities holding large chunks of personal data. The draft national policy on e-commerce and the Justice B.N. Srikrishna Committee proposed Personal Data Protection Bill, 2018 has mandated for data localization by foreign entities conducting digital business in India. This will ensure the creation of a local host server, which will be treated as PE and thus, bringing the entities under the present taxation regime.

Unilateral measures adopted by foreign jurisdictions

Currently, there is no international consensus for taxation of digital economy. OECD is still working to form international consensus over this issue. But there are some countries which have gone ahead and introduced the laws to address the issue of digital tax. These are: France, Italy and Malaysia.

France

Recently, France approved 3% DST (or digital tax) on the revenues generated by the global tech companies like Google, Apple, Facebook and Amazon in its territory. The tax would apply to digital companies generating worldwide revenues on their digital services of at least 750 million euros ($845 million), with 25 million euros ($28 million) from France only. The Act called the Digital Service Tax Act will be applied retrospectively from 1-1-2019.

Italy

Italy is one of the first countries in Europe which has taken measures to tackle the issue of digital tax. Italian Government has introduced 3% DST through the 2019 Italian budget. The DST would apply to the taxable entity if it comes under two conditions, firstly, the tech companies generating revenues from the digital services that underpin user participation, which includes online advertising space or digital intermediary activity or sale of data generated from user-provided information and secondly the taxable entities generates total worldwide revenues on their digital service not less than 750,000,000 euros, with not less than 5,500,000 euros from Italy only.

Malaysia

Malaysian Government approved the Service Tax (Amendment) Bill, 2019, which provides for the taxation of digital services. Through this Bill the Malaysian Government inserted Part IX-A in the Service Tax Act, 2018, the part mainly deals with the imposition of tax on giant tech companies registered overseas and providing digital services to the Malaysian consumer. This law has been effective from 1-1-2020 after that Malaysian Government will be imposing service tax (referred as "digital tax") at the rate of 6% on digital services that are provided by the foreign services provider (FSP) by consumers in Malaysia under a business to consumer (B2C) regime.

Conclusion

India has been a frontrunner in laying down a framework for establishing a digital taxation regime by introducing changes in the existing nexus rule in order to enlarge the scope of "business connection" by making it not just being limited to the concept of PE for the purpose of taxing non-residents in India. Out of the various measures recommended by the OECD in its public consultation document, India has already endeavored to tax foreign digital entities by adopting the significant economic presence methodology, although inoperative. Apart from this, it has also embraced the concept of localization of digital data to bring the corresponding revenues under the taxation regime by sticking to the PE principle.
However, the road to taxing of digital content through implementation of these plans does not run straight and has rather challenging turns and various hurdles. As regards India's endeavors on taxing the digital economy by introducing various concepts like SEP and data localization such efforts will bore the fruit of successive implementation once an international consensus on the said issue becomes a reality.

References

1. Brondolo J, Zhang Z. Tax Administration Reform in China: Achievements, Challenges, and Reform Priorities. International Monetary Fund, Washington, DC 2016, P 120.
2. Law SB. Technical Services Fees in Recent Tax Treaties. Bulletin of International Taxation, IBFD 2010, P 64.
3. Yojana 2019, P 27.
4. India Today 2019, P 49.
5. The Hindu Newspaper 2019, p. 11