DIGITAL ECONOMY AND ITS IMPACT ON INDIAN TAXATION

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Digital India, a programme to transform India into digital empowered society and knowledge economy was one of the main election manifestos of the BJP in 2014. When launched in 2015, it was considered as an ambitious programme of our government, with a project of Rs.1,13,000 crores were to develop a Digital India with an aim to make every house digitally literate and India a Global Market hub. This is in time with the current trend growth of digital economy globally. In today's time, the digital industry is playing a bigger role in a country's economic growth. Since then, India is undergoing rapid Digitalization and our time can be marked as digital revolution.

While in Indian the economy is getting digitally revolutionized, taxation becomes an important aspect for the growth.In fact, how to tax the digital economy is one of the difficult questions to be tackled by the economies of various countries including India.

Issues faced by India

The typical direct tax issues relating to e-commerce were difficult in characterizing the nature of payment and establishing a nexus or link between a taxable transaction, activity and a taxing jurisdiction, the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes. The digital business fundamentally challenges physical presence-based permanent establishment rules. If permanent establishment (PE) principles are to remain effective in the new economy, the fundamental PE components developed for the old economy i.e. place of business, location, and permanency must be reconciled with the new digital reality.

There is a need for countries to develop a framework to regulate and to get a 'fair' share of taxes from the revenues generated by such businesses. The business models of the companies who are doing business through internet in the markets where they do not have a permanent establishment are not getting taxed effectively in the country from where they are earning profits.

Where does India Stand?

There is a major void in India's ability to tax offshore technology firms such as video streaming and social media companies that have a big market presence in India. To combat this, Equalization Levy was introduced in India in 2016, Chapter VIII of the Finance Act, 2016, to give effect to one of the recommendations of the BEPS (Base Erosion and Profit Shifting) Action Plan.

The rationale for the equalisation levy was to create a level playing field by making multinational digital entities without a permanent establishment in the country liable to pay tax @ 6% in India. Until June 2016, such companies didn't pay any tax on their income in India. Though the revenue from this tax has been growing sharply since its introduction, but it covers only a small part of the digital economy.
Companies like Amazon, Google, Netflix, Facebook, Twitter, provide online services and have large user base in India.

India then proposed in Finance Act 2018 the introduction of the concept of 'Significant Economic Presence' (SEP) in the Income Tax Act under Section 9(1)(i) for taxation of non-residents in India by increasing the scope of the definition of 'business connection'.

SEP was defined to mean any transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India if the aggregate of payments arising from such transaction or transactions during the previous year exceeds the amount as may be prescribed.

Also systematic and continuous soliciting of its business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means would also constitute as SEP.

However, this needs an amendment to India's tax treaties, which in itself is agruelling process.

Digital economy taxation, OECD Roadmap and suggestions for India

In March 2018, the Organisation for Economic Cooperation and Development (OECD) released an interim report on digitization's tax challenges, building on an earlier BEPS report in 2015 under Action 1. As per the report OCED has proposed that profits of multinational companies (MNCs) should be available for taxation in the country where their customers are, irrespective of any physical presence in that market and that a formula should be evolved for such taxation.

As per the recent report released by OECD, the proposed solution to deal with tax aspects arising on account of the digital economy has been discussed. This can potentially have far-reaching consequences for India as well.

The report lays down a roadmap to rework the nexus and profit allocation rules. The report discussed various options that could be considered with a common thread of "importance of value being created in a market jurisdiction through remote participation" running through all of them. Assigning taxation rights to countries based on remote participation or value creation is currently not recognized widely.

From an India tax perspective, the report highlighting the 'fractional apportionment approach' as one of the methods being considered is particularly important. It is pertinent to note that the CBDT profit attribution discussion paper, recently released, also highlights the fractional apportionment approach as a profit attribution mechanism. Further, with the significant economic presence proposal already being introduced, it appears that the steps taken by India to address problems of taxation of digital economy is in line with the global approach.

What is the time line of the implementation of new road plan?

The OECD plan for the new approach to taxation of MNCs is likely to become a reality once participating countries incorporate it in a multilateral deal signed in 2017 to amend all bilateral tax treaties of the signatory nations. This is expected to happen by 2020-21.