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CHANGING FACE
of
Permanent Establishment
8th March, 2019

Agenda

- BEPS Action Plan-7 and MLI Articles 12 to 15
- Revised Article-5 in OECD MC-2017
- Changes in Indian Domestic Law.
- Recent Judicial developments.
- Digital PE- in the offing.

BEPS Action Plan - 7

- Commissionaire arrangement/ DAPE - Changes
- Exempted activities – Changes
- Anti Fragmentation rules.
- Anti splitting up of contracts.

Article 12 of MLI : Artificial Avoidance of PE through Commissionaire and similar arrangements

MLI provision

Article 12 of MLI seeks amendment to Article 5 of the tax treaties, which defines the term 'permanent establishment' (PE), on the following aspects:

- scope of agency PE to counter the commissionaire arrangement entered into by foreign enterprise in order to avoid PE in the source state;
- Creation of agency PE when the agent habitually plays principal role leading to conclusion of contracts with routine approval of the principal;
- Agent will not be considered to be an independent agent if he acts exclusively or almost exclusively on behalf of a ***closely related enterprise.***

Article 12 of MLI : Artificial Avoidance of PE through Commissionaire and similar arrangements

India's position

India *has not made any reservation* on adoption of this article of MLI and hence it would get adopted in the Indian tax treaties subject to matching.

Article 13 of MLI : Artificial Avoidance of PE status through Specific Activity Exemptions

MLI provision

Article 13 provides for curbing specific activity based exemptions to avoid PE in the source country through activities which were hitherto considered as preparatory and auxiliary in nature.

Here the Article provides that Parties may have two options;

(i) Option A

this replaces existing treaty provisions so as not to change the negotiated list of activities but consider within this list/activities that is done from the fixed place of business which shall fall within its ambit as preparatory or auxiliary in nature.

(ii) **Option B**

on the other hand, does not relate to activities from the fixed place of business but provides a carve out. In that sense option B gives more flexibility to treaty partners.

Article 13 of MLI : Artificial Avoidance of PE status through Specific Activity Exemptions

India's position

India *has not made any reservation* *and* has taken a position ***to go by option A*** and India tax treaties will be modified from its existing provision with respect to specific activity exemption. It will additionally be necessary to prove that these activities are of a proprietary or auxiliary character.

This can have a conflicting effect from other treaty partners if they choose for Option B.

Article 14 of MLI : Splitting-up of contracts

MLI provision

Article 14 of MLI addresses avoidance of PE by splitting the contracts between related enterprises to circumvent the threshold of creation of PE.

India's position

India *has remained silent*; so neither expressed any reservation nor has adopted this language of splitting of contracts in its tax treaties. Some of the India's treaty partners have opted not to adopt these provisions in the tax treaties hence this article would be adopted in Indian tax treaties subject to matching.

Article 15 of MLI : Person closely related to an enterprise

MLI provision

Article 15 of MLI gives definition of the term "person closely related". This term is used in Article 12, Article 13 and Article 14 of MLI and the definition of Article 15 would be relevant in this context.

India's position

India *has not made any reservation* in respect of this Article. However if the treaty partners have adopted this definition, this article would be adopted in Indian tax treaties subject to matching.

Para 4.1 of Article 5 -OECD MC

Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and

(a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

(b)the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,

provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

Para 5 of Article 5 -OECD MC

Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are

(a) in the name of the enterprise, or

(b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or

(c) for the provision of services by that enterprise,

Para 8 of Article 5 -OECD MC

For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

Para 8 of Article 5 -OECD MC (summary)

- a person or enterprise is closely related to an enterprise if,

  i. one has control of the other or
  ii. both are under the control of the same persons or enterprises.

- In any case, a person or enterprise shall be considered to be closely related to an enterprise if,

  i. one possesses directly or indirectly more than 50 per cent of the beneficial interest in the other or
  ii. another person or enterprise possesses directly or indirectly more than 50 per cent of the beneficial interest in the person and the enterprise or in the two enterprises.

Business Connection –Indian Tax Laws

- The Finance Act 2018, has *inter-alia* broadened the scope of the term 'business connection' under section 9 of the Income-tax Act, 1961 (the Act) thereby aligning it with the modified scope of Dependent Agent PE ("DAPE") under the MLI in line with BEPS Action Plan 7.

- The Finance Act 2018 has also introduced the concept of 'significant economic presence' by inserting Explanation 2A after Explanation 2 to section 9(1)(i) which has enlarged the scope of taxability of incomes accruing to non-residents by bringing within its ambit the existence of a business connection even without the physical presence of the non-resident or its agent in India.

Business Connection –Indian Tax Laws

Explanation 2 to sec.9(1)(i):

Business connection shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are—

(i) in the name of the non-resident; or

(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or

(iii) for the provision of services by the non-resident; or

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Business Connection –Indian Tax Laws

Explanation 2 to S.9(1)(i)

Person acting on behalf of the NR habitually concludes contracts, or habitually plays the principal role leading to conclusion of contracts by the NR

- In the name of the NR
- For the transfer of ownership of or granting of right to use property owned by the NR, or that the NR has right to use
- For the provision of services by that NR

BEFORE FA -2018

Actual conclusion of contracts required to have business connection

AFTER FA-2018

NR has business connection when a person acting on behalf of the NR habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the NR

Explanation 2A to sec.9(1)(i):

Emerging business models such as digitized businesses, which do not require the physical presence of itself or any agent in India, is not covered within the scope of Explanation 2 to section 9(1)(i) of the Act.

In order to overcome this lacuna, Explanation 2A was introduced by the Finance Act, 2018 clarifying that the existence of a significant economic presence in India will constitute business connection in India irrespective of whether the non-resident has a residence or place of business in India or renders services in India.

Business Connection –Indian Tax Laws

Explanation 2A to sec.9(1)(i):

For the removal of doubts, it is hereby clarified that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

*(*a*) 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 such amount as may be prescribed; or*

*(*b*) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:*

Provided *that the transactions or activities shall constitute significant economic presence in India, whether or not,—*
*(*i*) the agreement for such transactions or activities is entered in India; or*
*(*ii*) the non-resident has a residence or place of business in India; or*
*(*iii*) the non-resident renders services in India:*

Provided further that *only so much of income as is attributable to the transactions or activities referred to in clause (*a*) or clause (*b*) shall be deemed to accrue or arise in India.*

Business Connection –Indian Tax Laws

<u>Explanation 2A to sec.9(1)(i)</u> (summary)

Definition of 'Business connection' expanded to include non-residents having "significant economic presence" (SEP) in India through digitized businesses and includes:

a. Revenue based condition: Provision for download of data or software in India;

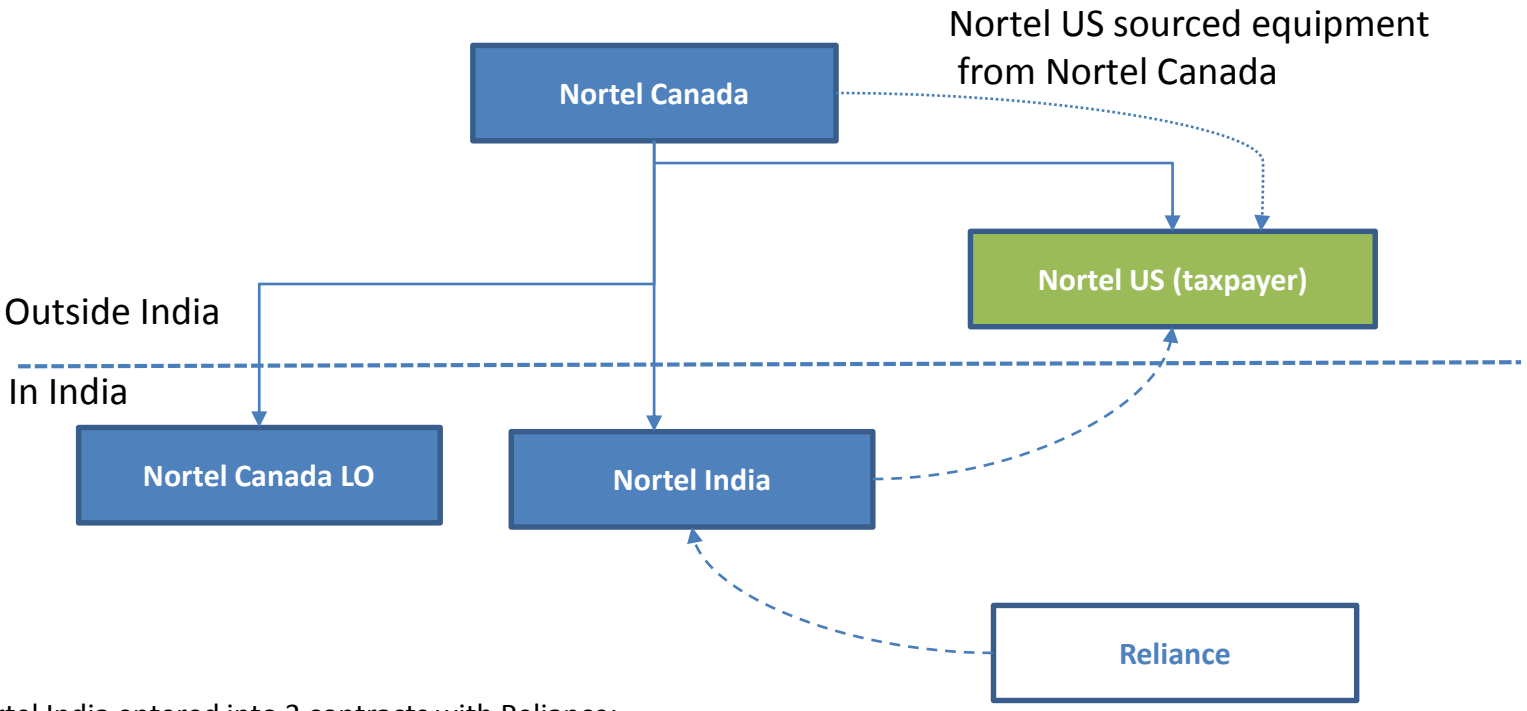
OR

b. User based condition: Systematic and continuous soliciting of business activities or engaging in interaction with user base in India

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—
(i) the agreement for such transactions or activities is entered in India; or
(ii) the non-resident has a residence or place of business in India; or
(iii) the non-resident renders services in India

Recent Judicial Developments in India

Nortel Networks India International Inc (Delhi-HC) [2016] 69 taxmann.com 47 (Delhi)



Nortel India entered into 3 contracts with Reliance:

- Optical Equipment Contract ('the Equipment Contract'),
- Optical Services Contract ('the Services Contract') and
- the Software Contract ('the Software Contract').

Nortel Networks – HC Judgment

- The HC concurred with the conclusion that the **taxpayer was a shadow company of the Canadian company, and assumed that the equipment contract was performed by the Canadian company**.

- Relying on the Supreme Court ruling in Ishikawajima-Harima Heavy Industries, the HC held that even **in cases of turnkey contracts, it was not necessary to consider the entire contract as an integrated one for tax purposes**. Thus, the amount paid for supply of equipment from overseas would not be chargeable to tax under the Act.

- On the issue of **transfer of title, it held that the title in equipment was transferred outside India,** and possession of equipment by the Indian company till final acceptance by the Indian Telco did not indicate that taxpayer's income from equipment supply was taxable under the Act.

- **Neither the taxpayer nor the Canadian company performed any installation or commissioning activity in India**. These activities were performed by the Indian company on its own behalf under the contract entered with the customer, and not on behalf of the taxpayer or the Canadian company.

Nortel Networks – HC Judgment (contd..)

- The HC found no material on record to indicate that any obligation other than supply of equipment was performed by the taxpayer in lieu of the amounts received.

- The HC held that **no part of the taxpayer's income could be apportioned to operations carried on in India, as there was no material on record, either to hold that the Indian company habitually exercised authority to conclude contracts, or that it maintained stocks in India for regularly delivering goods on behalf of the taxpayer or the Canadian company.**

- The HC then examined the question of the taxpayer's PE in India for the sake of completeness, and held that there was **no material on record** to indicate that:

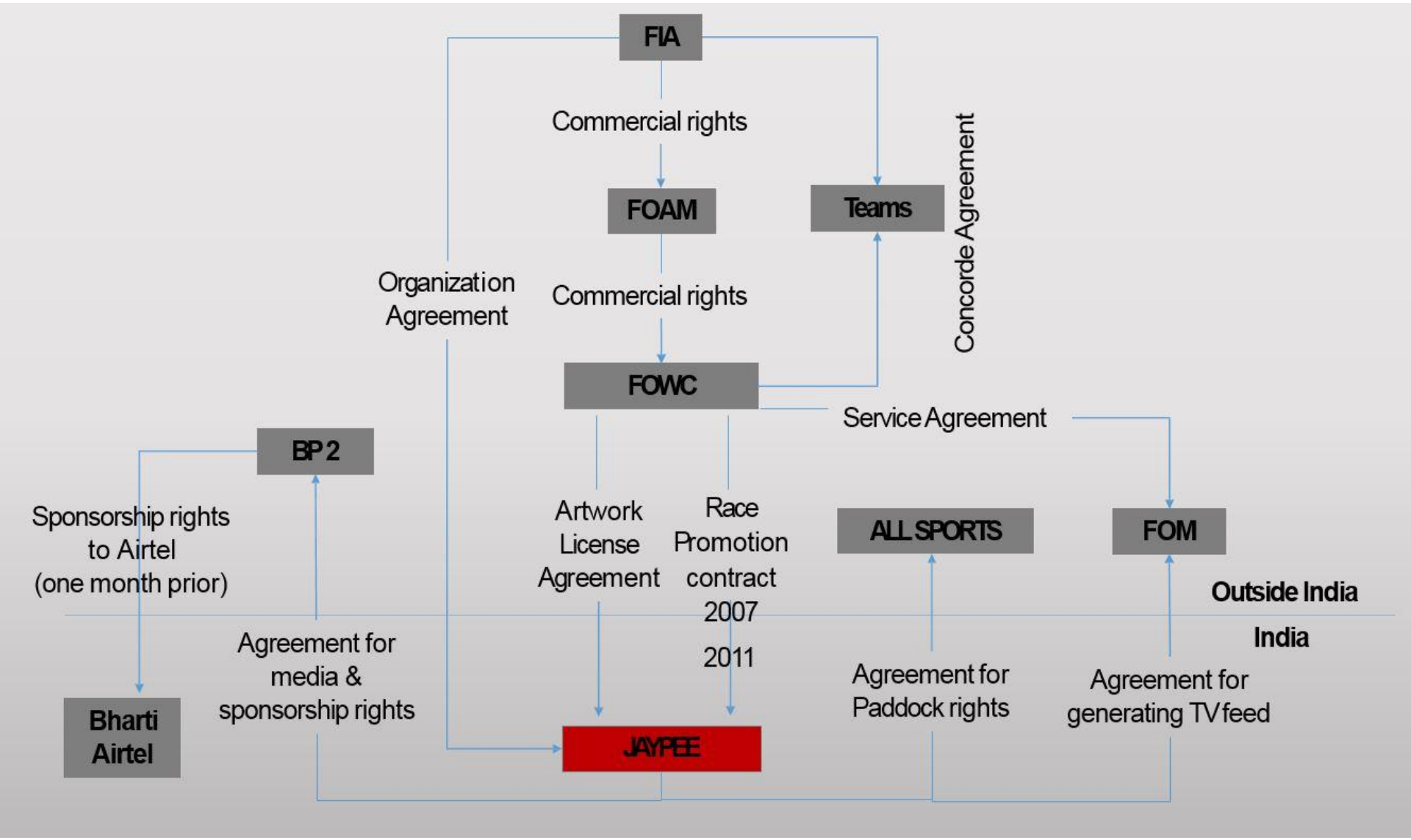
  - the LO **acted on behalf of the taxpayer** or the Canadian company in concluding contracts on their behalf;
  - the office of the Indian company was **at the disposal of the taxpayer** or the Canadian company;
  - the LO or the Indian company **acted as a sales outlet** of the taxpayer;
  - the Indian company performed installation or other services on behalf of the taxpayer.

Nortel Networks – HC Judgment (contd..)

- Subsidiary company was an independent tax entity.
- Income from installation, commissioning, testing and activities performed by Group's expatriate employees seconded to Indian company would be taxable in Indian company's hands, and could not be considered as taxpayer's income.
- As income from supply of equipment was not taxable in India, the question of attribution of such income to activities in India did not arise.

SLP admitted in Supreme Court

Formula One World Championship
[2017] 80 Taxmann.com 347 [SC]



Formula One – SC Judgment

On FOWC having Business Connection/PE in India

- The track, teams and spectators are required in order to conduct the race. Furthermore, there would be advertisements, media rights, etc. as well to augment earnings from the event. It is FOWC and its affiliates who are responsible for all these activities. Thus, as a part of its business activities, FOWC undertook these commercial activities in India.

- Mere construction of the track by Jaypee at its expense is of no consequence. Jaypee's ownership or organising other events by Jaypee are also immaterial.

- No doubt, FOWC is in the business of exploiting various rights. However, it became possible only with the actual conduct of the races and active participation of FOWC in these races with access and control over the circuit.

- The circuit is a virtual projection of FOWC in India.

- All the characteristics (stability, productivity and dependence) of a PE are present in the instant case.

Formula One – SC Judgment (contd..)

On FOWC having Business Connection/PE in India

- The wholesome reading of various agreements reveal the real transaction between the parties and clearly demonstrates that the entire event is taken over and controlled by FOWC and its affiliates.

- There cannot be any race without competing teams, circuit and paddock. All these are controlled by FOWC and its affiliates. Thus, the commercial rights with FOWC are exploited with the actual conduct of the race in India.

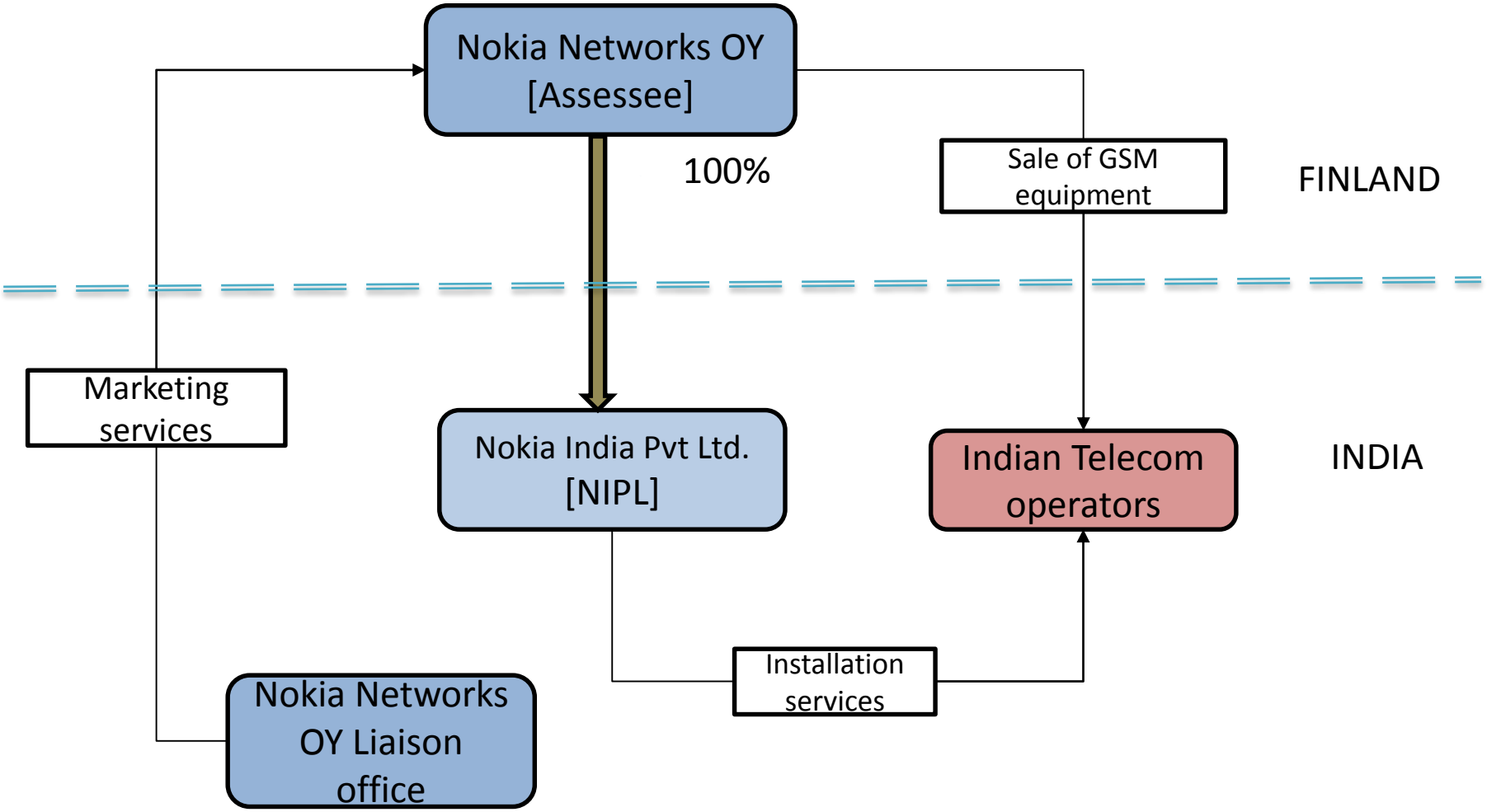
- The omnipresence of FOWC and its stamp over the event is loud, clear and firm.

- Common sense and plain thinking of the entire situation would lead to the conclusion that FOWC had made earnings in India through the track, over which FOWC had complete control during the period of race.

- Even RPC-2011, which had been analysed by the Delhi High Court, in a flawless manner, points towards the same conclusion.

- The Delhi High Court has rightly concluded that the limited number of days for which FOWC had full access would not make any difference having regard to the duration of the Event.

M/S Nokia Networks OY- SB
[2018] 94 taxmann.com 111 [Delhi ITAT- SB]



Nokia Networks- Delhi ITAT (SB) Judgement

View of majority Bench members

- The concept of "virtual projection" does not mean that even without a fixed place, virtual projection itself will lead to an inference of a PE.

- There was no evidence on record to indicate that premises of Indian subsidiary ("Ico") were at the disposal of the Taxpayer. Further, it was noted that the activities carried on in India were the business activities of ICo and not the Taxpayer, and, hence, the business activity test was not met qua the premises of ICo.

- The activities of negotiation of off-shore contract, network planning and signing of contracts are preparatory and auxiliary in nature, and therefore, cannot result in constitution of a PE in India.

- Since all the offshore supply was carried outside India and no activities in relation to such supply were carried on in India, The Taxpayer did not have a business connection in India.

- ICo was an independent party carrying onshore activities of installation and technical support on principal-to-principal basis and in absence of any evidence that ICo concluded any contracts in India, ICo did not create DAPE of the Taxpayer in India.

Nokia Networks- Delhi ITAT (SB)- Dissent order

View of minority Bench member

- When a subsidiary company is merely an **alter ego**, or virtual projection, of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a permanent establishment of the non-resident parent company for that reason alone.
  (Based on the ruling in ABC In Re(Application No.P-8)[(1997) 223 ITR 416 (AAR)])

Dissent order - Reasons

- The High Court has merely set aside to decide the issue -confided with the facts of the case of the assessee.

- The Assessee has provided guarantee to the Indian customer on services to be provided by the NIPL.

- The Assessee would not reduce the shareholding below 51% until the technical support agreement remains outstanding.

- NIPL is a PE of the Assessee company under the basic rule on interdependence and interplay of activities.

- The Foreign Company has direct and complete control over the activities of the subsidiary.
- NIPL less than one year in existence -when the marketing support agreement was signed all the expertise of the expatriate employees was with the Assessee.

- Mr. Hannu was part of both the companies (Assessee and NIPL).

Dissent order - Reasons

- The marketing and technical support agreements are more a device to artificially block creation of PE.
- The commercial arrangement between NIPL and assessee is not inline with the normal course of the business between two independent enterprises.
- Role played by the Assessee company in ensuring business for its subsidiary and the role played by the subsidiary in furtherance of the business interests of the assessee company.
- All contracts of Installation were awarded to NIPL.
- Assessee played the decisive role in deciding as to who should be awarded the erection contract.

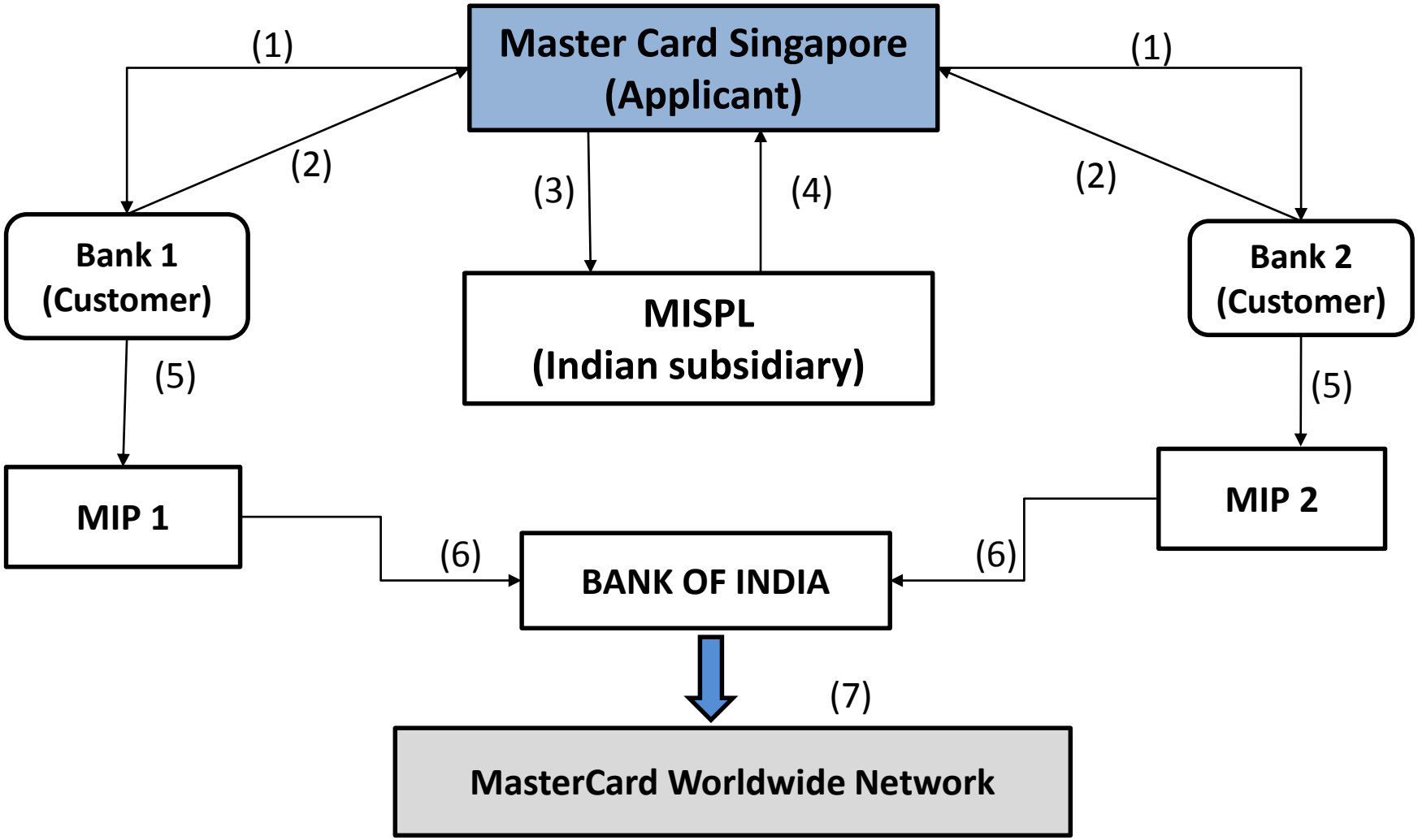
Dissenting Member's opinion on Article 5(8)

- There is no bar on the subsidiary of a foreign company being treated as a PE of the parent company, mere existence of the subsidiary of a company resident in the treaty partner country would not imply that such a foreign enterprise has a PE in India.

- The underlying rationale of Article 5(8) is the presumption about independence of the principal and subsidiary in day to day operations and management of their business as separate entities but once this presumption is demolished, the very raison d'etre for exclusion of Subsidiaries from being permanent establishments of the overseas parent companies and vice versa ceases to hold good.

Mastercard Asia Pacific Pte Ltd. Singapore

[2018] 94 taxmann.com 195 (AAR - New Delhi)



Mastercard Asia Pacific Pte Ltd. Singapore

1) The customer is provided with a MasterCard Interface Processor (MIP) that connects to MasterCard's Network and processing centers

2) The applicant receives from its customers processing fees relating to authorization, clearing and settlement of transactions.

3) The Indian subsidiary owns and maintains the MIPs placed at the customers' locations in India.

4) MISPL charges the cost of maintenance and up gradation of MIP with mark-up to the applicant

5) MIPs do preliminary validation/examination.

6) The actual settlement by passing debit or credit entry is done by Bank of India in India.

7) Then the MasterCard Network helps in transmission of information amongst various entities.

Mastercard- AAR Ruling

- Held that **there exists Fixed place PE** on account of
  - Presence of MIP and global card network
  - Indian subsidiary
  - Bankers in India

- Visits by Employees constitutes Service PE

- Indian subsidiary was Dependent Agent PE of Applicant

Mastercard- AAR Ruling (contd..)

- On Fixed Place PE – MIP and Network Systems

  - MIP and global card network remained at particular site - fixed place test met

  - Ownership test is immaterial if other tests are satisfied

  - Though the MIP was not involved in all three stages of the transaction processing, the involvement at initial stage would create PE, as without it, the initial validation and authorization would not happen. Thus these services were regarded as not being preparatory or auxiliary in nature.

  - The MIP in India performed preliminary verification and encryption of data using the related network of transmission tower, leased lines, fiber optic cable, internet, etc. Such related network in India performed transmission of data, which was significant activity in the context of overall functions of transaction processing, and not merely preparatory and auxiliary.

Mastercard- AAR Ruling (contd..)

- On Fixed place PE – Indian Subsidiary

  - Erstwhile LO was admitted as PE and 100 percent of its income was attributed to this PE.

  - On transfer of all assets and employees by the LO to Indian subsidiary, some functions and risks related to transaction processing (which were earlier carried out by the PE), were subsequently carried out by the Indian subsidiary.

- On Fixed place PE – Bankers in India

  - Constituted fixed place PE in India, as significant activity of the transaction process (more than 90 percent of the actual movement of funds) was performed from its office

Mastercard- AAR Ruling (contd..)

- On Service PE

  - Visits of applicant's employees constituted service PE in India.

  - The presence in India exceeded 90 days; and - The activities carried in India, namely, meeting customers to understand the future requirement, informing new products to clients, etc. were part of the transaction processing service, and not stewardship activities.

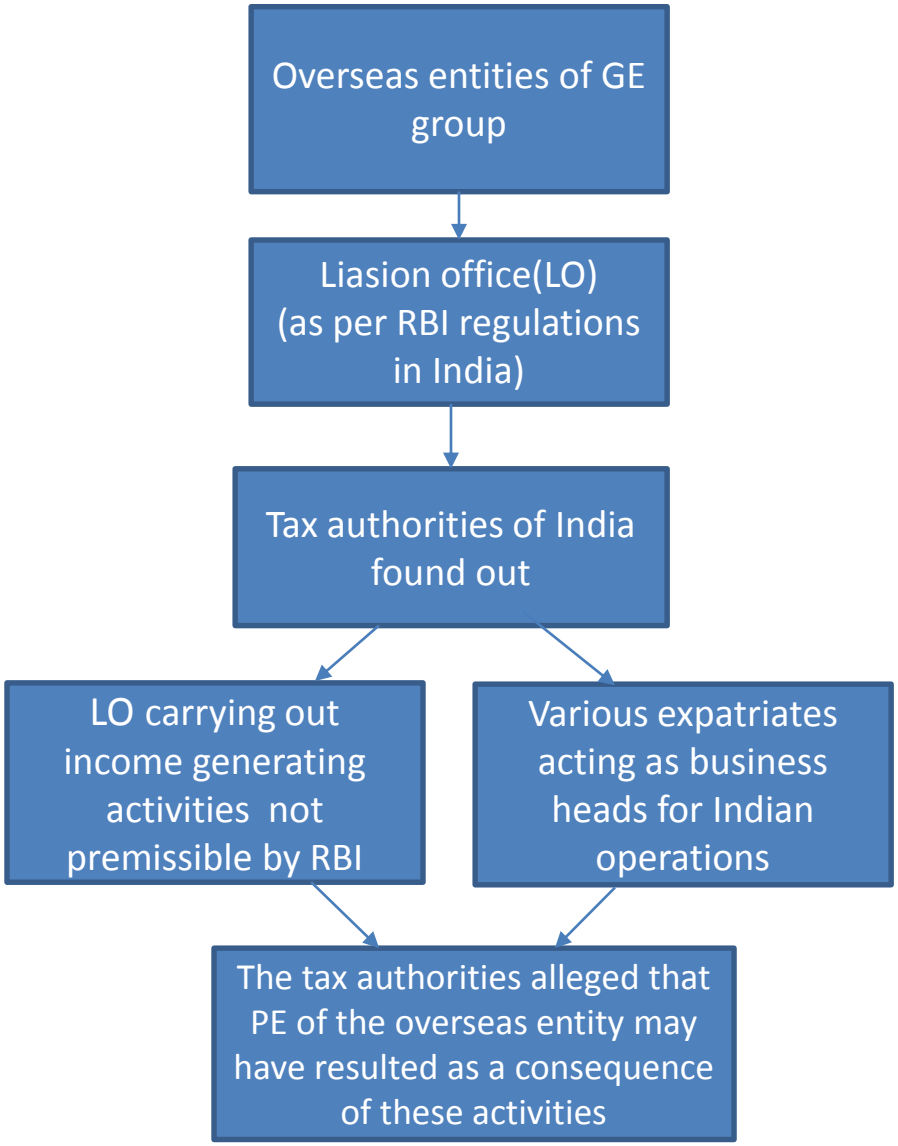
- On Dependent Agent PE

  - The Indian subsidiary was legally and economically dependent on the applicant, and thus, dependent agent PE of the applicant.

  - The Indian subsidiary obtained instructions and remuneration from, and catered only to the applicant.

  - The term "habitually" was to be interpreted in the context of the business. Though only 2-3 contracts were entered per year, and finalization of these contracts was done by the applicant in Singapore. However, all the orders were routed through the Indian subsidiary. Thus, it satisfied the requirement of "habitually securing orders".

GE ENERGY PARTS INC- (Delhi HC)
[2019] 101 taxmann.com 142 (Delhi HC)



GE ENERGY PARTS -HC Judgment

- Place of business' had been understood to mean any premises, facilities or installations used for carrying on the business of the enterprise. Moreover, having space at disposal did not require a legal right to use that place – mere continuous usage was sufficient if it indicated being at disposal. HC ruled that, as per Article 5(1) of the subject DTAA, GE's overseas enterprises *had* a place of business in India.

- HC placed reliance on the Supreme Court decision rendered in case of Formula One[TS-161-SC-2017] regarding PE and applied the facts to the present case.

- HC noted that GE India was located in the space leased by GEIOC in the AIFACS building, New Delhi which was at its constant disposal.

- Further, this was proven by the fact that specific chambers/rooms and secretarial staff were allotted to GE staff which was used for their work, thereby signifying the expression PE vis-a-vis continuity of space available.

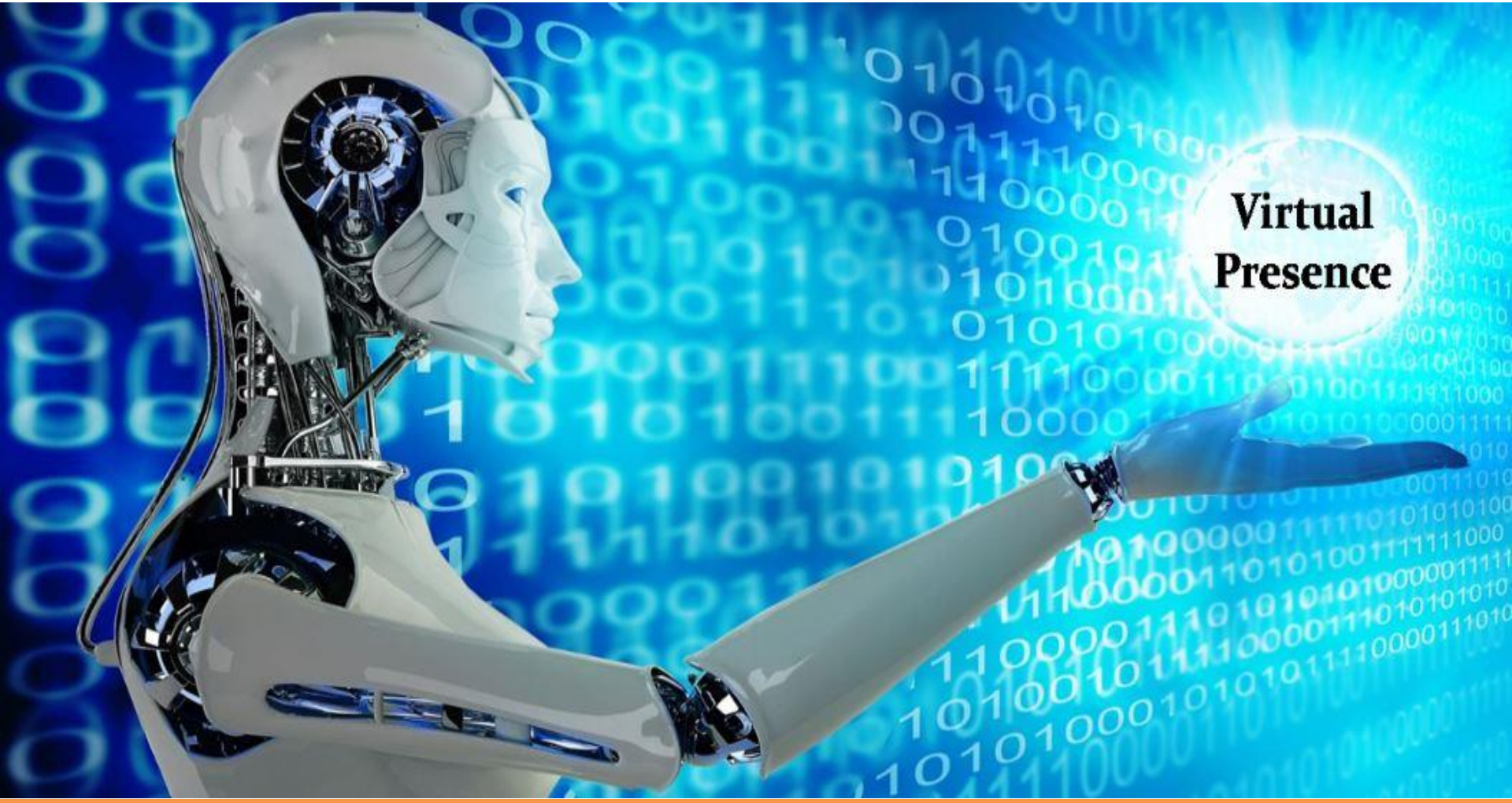
GE ENERGY PARTS -HC Judgment (contd..)

- HC rejected assessee's argument that there was a difference between sales made from the AIFACS building and the presence of GE India employees at the premises.

- Moreover, it was professed that merely because expatriates and employees were found at the premises, it could not lead to the conclusion that the sales were made from that place.

- HC concurred with ITAT's findings that the core of the sales activity was done from the AIFACS building. Next, HC held that if the premises were not where the relevant business activities occurred, then the location where they did would likely form the fixed place PE, thereby terming GE India's argument as unpersuasive.

DIGITAL PE- in the offing



Impact of Digitalization on International Tax Matters- A study by European Parliament

Key Findings:

- The digital economy is growing exponentially while the whole economy is going digital. Digitalization transforms entire industries by changing the nature of innovation, product development and producer-consumer interactions.

- Digital businesses have a tendency towards monopolization due to network effects, scale effects, restrictions of use, potential to differentiate and multi-sided platforms. Yet, they are volatile and easily contestable by disruptive newcomers, as barriers of entry and exit are low.

- The Fourth Industrial Revolution marked by 'a range of new technologies that are fusing the physical, digital and biological worlds, impacting all disciplines, economies and industries' fundamentally changed the way of doing business.

DIGITAL PE

- The intensity, magnitude, speed and transformational power of the digital economy puts pressure on governments to design and address modern and innovative policies fit for the digital age.

- LuxLeaks, Panama Papers and Paradise Papers as wells the EU investigations on digital tech giants shed light on a wide range of tax evasion schemes used by large businesses triggering a heated public debate on the need for fair taxation.

- The main tax challenges of the digital economy include lack of nexus, reliance on intangibles, data and user-generated content, income characterization, spread of new business models, in which the buyer and seller are in different jurisdictions and the expansion of e-commerce.

- New digital business models are emerging and expanding as a consequence of AI, IoT, adaptive manufacturing and autonomous supply chains.

- The European Commission (EC) divides digital businesses into online retailer model, social media model, subscription model and collaborative platform model while the OECD defines them as multi-sided platforms, resellers, vertically integrated firms and input suppliers.

DIGITAL PE

- Some traditional industries, such as automotive manufacturing, have begun to digitize their processes and services.

- The digital transformation puts into question the existing taxation framework and the role of new technologies as well as high-skill jobs for value creation, with market jurisdictions highlighting the income-generating contribution of data and user interaction. According to the Commission, in some digital business models, including social media, distant sales, platforms and advertising, value is not linked to taxation.

- The OECD discusses three value creation processes: value chain, value shop and value network, the latter of which represents the strongest case for value creation in the market and accounts for online advertising and intermediation services.

- There is no strong consensus within the OECD on whether or not user contribution shall be taken into consideration to determine how value is created for taxation purposes.

- Although user data are in the centre of discussion at present time, the digitalization of the economy underpins that broad spectrums of data could be turned into smart data in the near future.

Conclusions and policy recommendations:

Rapid digitalization of the economy, new business models and the challenges they pose to the international tax system.

- Only after some 20 years of their inception, the **ever-increasing prominence of tech companies** is unstoppable. **Business models are rapidly evolving** and new business models are emerging due to Internet of Things (IoT), Artificial Intelligence (AI), collaborative economy and other technological advancements.

- With digitalisation allowing businesses activities to spread across the globe, it is more and more **complex to identify the location of value creation** and to decide on how to allocate profits.

- In addition to globalisation, '**environmental unsustainability, demographic change, inequality and political uncertainty'** may all be relevant to thoroughly address digital transformation

Conclusions and policy recommendations:

- **Tax competition** and the ensuing race to the bottom also contributes to inequality. According to Oxfam, 62 people own the same wealth as the bottom 3,6 billion people in the world. Over the last thirty years, net profits by the MNEs tripled from USD 2 trillion in 1980 to USD 7.2 trillion by 2013. This increase shall be properly reflected in the amount of taxes they pay instead of being accumulated in tax havens.

- Soon, a fully digital world disrupting some fundamental assumptions of the international tax system could emerge. The Block chain technology, collaborative economy, AI, robotics and 3D printing started already changing the taxation landscape.

- **The current PE threshold** is not sufficient for fair allocation of profits. The **unilateral measures** in countries such as France, Italy, Israel, India, as well as at the EU level show a search for a **new nexus** to capture companies with a solely digital presence. **Developing countries**, such as India, argue that paying capacity of the consumer is made possible due to the state's contribution via public goods, law, order, market facilitation, infrastructure and redistribution.

Conclusions and policy recommendations:

- The reluctant states might eventually agree **to limitations to their fiscal sovereignty** in favour of globally accepted standards, as digitalization limits their legitimacy and ability to tax.

- **Multilateralism** as a 'new tax principle' could be the response to the global solutions needed given the fact that unilateral measures proved insufficient to stop double non-taxation.

OECD's BEPS Measures and the Ambition to Reach International Consensus on Key Taxation Matters

- The **OECD supports the principle of aligning the application of tax rules with the legal form** unless the legal reality is totally disconnected from the economic reality.

- The broader tax challenges, including nexus, characterization and data, also largely remain unaddressed.

- It remains unclear whether there is **consensus** at the OECD level whether the digital economy should and can be ring-fenced or not.

DIGITAL PE

- The lack of consensus on **value creation** leads to a multitude of profit allocation methods, which somewhat diverge from the arm's length principle.

- **Possible scenarios for taxing the digital economy** include specific taxes for the digital sector, to continue work on BEPS measures, especially regarding transfer pricing and value creation by amending the PE concept, granting more power to source countries via withholding taxes, radically changing the tax system by adopting a destination-based tax and integrating the digital sector in a formula-based transfer pricing regime, a formulary apportionment regime such as profit-splitting method or robust VAT measures to ensure compliance and collection.

Source:
http://www.europarl.europa.eu/RegData/etudes/STUD/2019/626078/IPOL_STU(2019)626078_EN.pdf

DIGITAL PE

RECENTLY INTRODUCED UNILATERAL TAX MEASURES GLOBALLY

Italy's Web Tax	Australia's Multinational Anti-Avoidance Law (MAAL)
Austria's Online Advertisement Tax	New Zealand's Digital Services Tax
Slovakia's Intermediation Tax	Israel's New Nexus and Significant Economic Presence Test
France's YouTube Tax	India's New Nexus and Equalisation Levy
Belgium's Fairness Tax	Saudi Arabia and Kuwait's Virtual PE
Hungary's Advertisement Tax	Taiwan's New Nexus
UK's Diverted Profits Tax	Turkey's Withholding Tax on E-payments

DIGITAL Taxation in US

- While the US recognises the challenges posed by digitalisation, it is in favour of a system-wide reform rather than ring-fencing the digital economy. On multilateral platforms, the US does not support the opinion that tech giants permit base erosion and is of the view that no changes to the scope of the PE are needed on the basis that large multinationals are changing their structures to use local Low Risk Distributors.

Source:

http://www.europarl.europa.eu/RegData/etudes/STUD/2019/626078/IPOL_STU(2019)626078_EN.pdf

OECD/G20 Inclusive Framework- Public Consultation Document on Digital Economy

- In the process of addressing the tax challenges of the digitalization of economy, following a mandate by G20 Finance Ministers in March 2017, the Inclusive Framework on BEPS, working through its Task Force on the Digital Economy (TFDE), delivered an Interim report in March 2018, *Tax Challenges Arising from Digitalization- Interim Report 2018*.

- It was agreed to review the impact of digitalization on **nexus and profit allocation rules** and committed to work towards a final report in 2020.

- The work on these proposals is being conducted on a "without prejudice" basis; their examination does not represent a commitment of any member of the Inclusive Framework beyond exploring these proposals.

- In this context, the Inclusive Framework agreed to hold a public consultation on possible solutions to the tax challenges arising from the digitalisation of the economy on 13 and 14 March 2019 at the OECD Conference Centre in Paris, France. The objective is to provide external stakeholders an opportunity to provide input early in the process and to benefit from that input.

- In this process a consultation document describing the proposals discussed by the Inclusive Framework at a high level was released to seek comments from the public on a number of policy issues and a technical aspects.

Source: *https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf*

Three factors frequently observed in highly digitalized business models

- **Scale without mass**

  - Highly digitalized businesses create value by activities closely linked with jurisdiction without needing to establish a physical presence

  - This “remote” participation in the domestic economy enabled by the digital means but without a taxable physical presence is often seen as the key issue in the digital tax debate.

- **Heavy Reliance on Intangible Assets**

  - Strains the rule for allocating income from Intangible assets among different parts of an MNE group, creating uncertainties and opportunities for locating income in low or no tax entities.

- **Data, user participation and their synergies with Intellectual Property**

  - As per the existing rules no taxable presence in the jurisdiction where the users are located.

Revised profit allocation and nexus rules

- Inclusive Framework (IF) is currently examining three proposals for revising the profit allocation and nexus rules, which seek to expand the taxing rights of the user or the market jurisdiction

a) USER Participation proposal

- Social media platforms
- Search engines
- Online market places

b) Marketing Intangibles proposal

- Brand & trade name
- Customer data, customer relationships and customer list

c) "Significant Economic Presence" proposal

THANK YOU

KAASYAPA