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◆ Unilateral Actions by different tax jurisdictions on digital taxation.

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, GAFA Tax	India's New Nexus, Equalisation Levy and newly introduced withholding tax provisions
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

◆ **European Parliament's Report on digital taxation.**

- The digital economy is growing exponentially while the whole economy is going digital.

- 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 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

◆ **European Parliament's Report on digital taxation.**

- With digitalization 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.

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

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

Action Plan- 1 : Journey from AP-1 to present date

◆ European Parliament's Report on digital taxation.

- **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_

Action Plan- 1 : Journey from AP-1 to present date

◆ OECD's interim report on tax challenges arising from digitalization – March 2018.

◆ Addressing the Tax Challenges of the Digitalization of the Economy - Policy Note – January 2019.

◆ OECD - Program of Work to Develop a Consensus Solution to the Tax Challenges Arising from Digitalization of the Economy.

➢ Unified Approach - Pillar One – October 2019
- Three proposals presented are
1. User participation
2. Marketing Intangibles
3. Significant Economic Presence ("SEP")

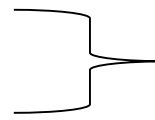- These proposals would entail solutions that go beyond ALP

Pillar two published in November 2019 on anti-avoidance

➢ **These 3 alternatives have significant commonalities**

- Though there is some variation in how the proposals address the digitalization issue, to the extent that highly digitalized businesses are able to operate remotely, and/or are highly profitable, all proposals would reallocate taxing rights in favor of the user/market jurisdiction;

- All the proposals envisage a new nexus rule that would not depend on physical presence in the user/market jurisdiction;

- They all go beyond the arm's length principle and depart from the separate entity principle; and

- They all search for simplicity, stabilization of the tax system, and increased tax certainty in implementation.

Action Plan- 1 : Journey from AP-1 to present date

➢ Reallocation of Taxing rights to market jurisdictions

- Marketing intangibles ⎤
⎥ portion of non routine profit
- User participation ⎦

- Significant Economic Presence - portion of all profits
(routine & non routine)

Action Plan- 1 : Journey from AP-1 to present date

➤ Summary of the Proposal

- Amount A – a share of deemed residual profit out of MNEs consolidated profits allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right;

- Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and

- Amount C – binding and effective dispute prevention and resolution mechanisms relating to all elements of the proposal, including any additional profit where in-country functions exceed the baseline activity compensated under Amount B.

The above approach is called Three- Tier profit allocation mechanism.

➢ The key features to be identified for arriving at a solution are as under

- Scope
  – Consumer facing businesses.
- New Nexus
  – non physical presence based on sales.

- New Profit Allocation Rule going beyond the ALP
  – complimented by formulae based solutions

- Increased Tax Certainty delivered via a Three Tier Mechanism

Digital Tax : US status update

- The U.S. Treasury Secretary's letter (3 December 2019) stated that the United States opposes digital services taxes because of their "discriminatory" implications for U.S. businesses, and recommended that taxpayer concerns could be addressed and the goals of Pillar One could be substantially achieved by making Pillar One a safe-harbor regime.

- The OECD letter (dated 4 December 2019) agrees with the position of the United States "that a global solution is needed to stop a proliferation of unilateral measures" and that the goal would be to arrive at an international tax system that avoids double taxation and taxes net income, and not gross income.

- The OECD letter further states:

  Throughout the extensive consultation process, however, we had so far not come across the notion that Pillar 1 could be a safe-harbour regime. We raise this concern, as it may impact the ability of the 135 countries that are now participating in this process, to move forward within the tight deadlines we established....

CBDT Draft Report- Proposed Rule 10

◆ CBDT Draft Report on Profit Attribution to market jurisdictions – proposal to amend Rule 10

➢ Existing Profit Attribution Rule to PE under IT Act and DTAAs

➢ Problems faced under existing Rule 10 and Court Decisions.

➢ Need for clarity in India's approach on PE attribution.

➢ Significant Economic Presence as a Nexus for Profit Attribution in case of New Business Models.

➢ Demand recognized as requirement for income generation

➢ Covers digital as well as remote business

CBDT Draft Report– Proposed Rule 10

Final Conclusions and Recommendations

Approach of the Committee and Proposals

- Emphasized that business profits are contributed by both demand and supply side, hence, profits should be allocated to market jurisdiction as well.

- Discusses different approaches to profit attribution – (1) 'supply based approach'; (2) 'demand based approach'; and (3) 'mixed or balanced approach' (based on both demand / supply);

- Rejects functional, asset and risk ("FAR") approach by underlining India's reservation on OECD Model Convention as amended in 2010, and commentary.

- Prescribes Fractional apportionment method (rejects formulary) (refer next slide for recommendations)

- Considers that the fractional apportionment method can be applied in treaty cases since Indian Tax Treaties do not follow FAR based approach and permit use of an apportionment based approach

CBDT Draft Report– Proposed Rule 10

Final Conclusions and Recommendations

Profits attributable to PE proposed to be determined based on the following formula#

$$= Profits\ derived\ from\ India \times \left\{ \left(\frac{SI}{3 \times ST} \right) + \left(\frac{NI}{6 \times NT} \right) + \left(\frac{WI}{6 \times WT} \right) + \left(\frac{AI}{3 \times AT} \right) \right\}$$

where,

'Profits derived from India' = Revenue derived from India x Global operating profit margin

SI = sales revenue derived by Indian operations from sales in India

ST = total sales revenue derived by Indian operations from sales in India and outside India

NI = number of employees employed with respect to Indian operations and located in India

NT = total number of employees employed with respect to Indian operations and located in India and outside India

WI = wages paid to employees employed with respect to Indian operations and located in India

WT = total wages paid to employees employed with respect to Indian operations and located in India and outside India

AI = assets deployed for Indian operations and located in India

AT = total assets deployed for Indian operations and located in India and outside India

CBDT Draft Report– Proposed Rule 10

Final Conclusions Recommendations

For digital businesses, a variant formula (with weightage to users) has been prescribed as follows

Profits attributable to operations in India in cases of <u>**low and medium user intensity**</u> business models=

'Profits derived from India' x [0.3 x SI/ST + (0.15 x NI/NT) +(0.15 x WI/WT) + (0.3 x AI/3xAT)] + 0.1]

In case of digital models with high user intensity, the users should be assigned a weight of 20%, while the share of assets and employees be reduced to 25% each after keeping the weight of sales as 30%, as under:

Profits attributable to operations in India in cases of <u>**high user intensity**</u> business models =

'Profits derived from India' x [0.3 x SI/ST + (0.125 x NI/NT) +(0.125 x WI/WT) + (0.25 AI/3xAT)] + 0.2]

Its time for
Pannel disussions!