

Unilateral, Bilateral and Multilateral solutions for digital economy challenges

Lecture Meeting

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What is the Digital Economy Challenge? Why?



Time is running out!

What is the Digital Economy Challenge? Why?



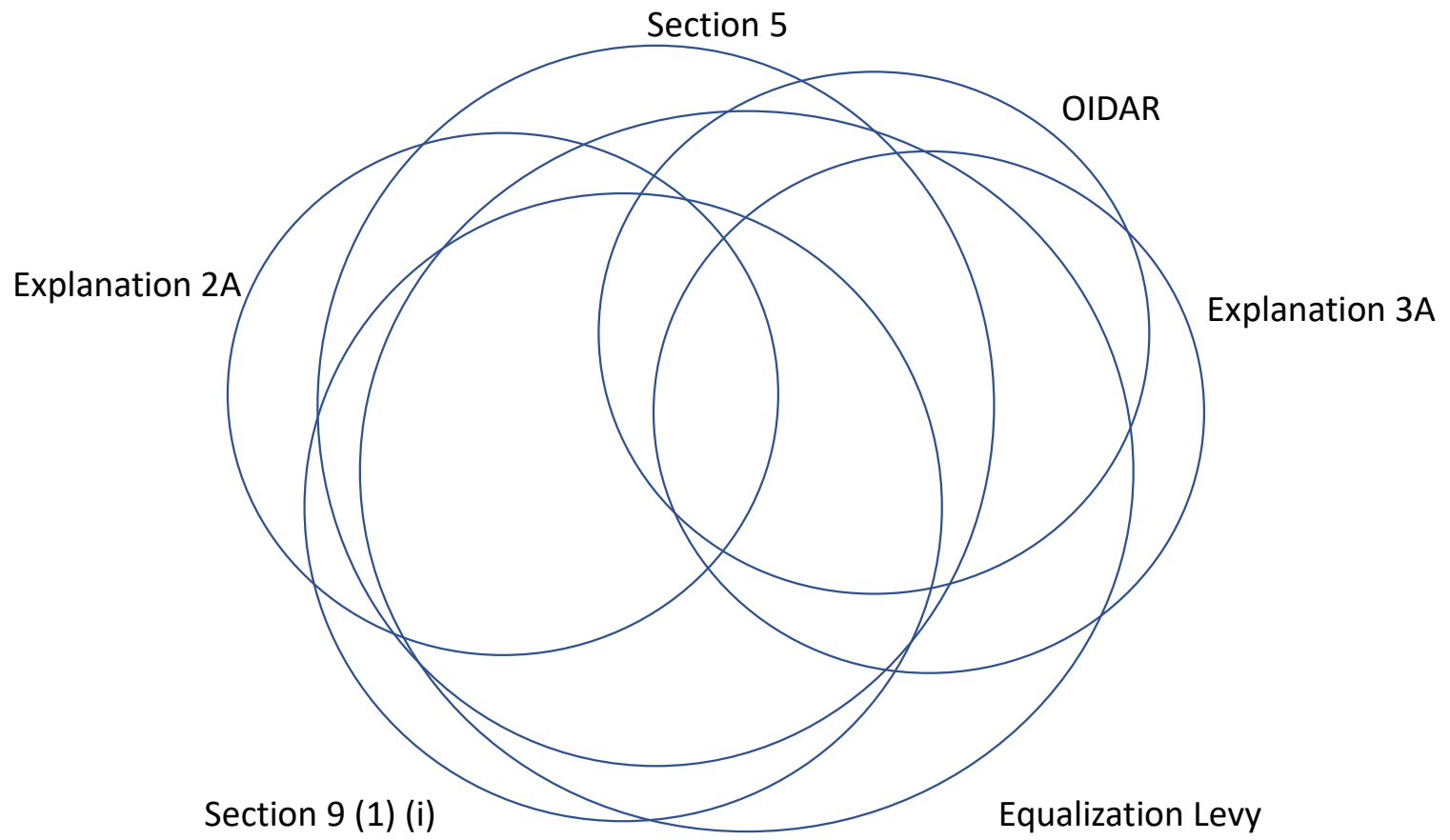
Pillar Two?

What is Unilateral, Bilateral, Multilateral?

Indian approach to digital economy



Measures		Key features
A	Equalisation Levy (EQL) on online advertisement and related services provided to residents	EQL is charged @6%. This is effective June 2016.
B	Equalisation Levy (EL) on online sale of goods or provision of service.	EQL is charged @2%. This is effective April 1, 2020.
C	Significant Economic Presence (SEP) [Explanation 2A] Net income is subject to tax @40%. This is effective April 1, 2021.	SEP is created on account of: - download of data, software and other transactions, if the aggregate value crosses the threshold. - continuous solicitation of business, interaction with certain users in India.
D	Income from advertisement, sale of data and products [Explanation 3A] Net income is subject to tax @40%. This is effective April 1, 2020.	Subjected to tax in India: - Income from advertisements targeted at Indian resident. - sale of data collected from Indian residents. - sale of goods and services using such data.
E	Section 194-O	TDS
F	Section 52 CGST Act	TCS
G	OIDAR	Online information and database access and retrieval services



Unilateral Solution

Unilateral Measures

- June 2022 status
 - ✓ Twenty seven countries have enacted DSTs or similar measures
 - ✓ Fifteen countries have announced or proposed similar tax policies
 - ✓ Rates range from 1.5% to 7.5%

[Source: Tax Analysts article]

Unilateral Measures – Difficulties

- Complexities
- Approach of tax authorities
- Credit in the home country of e-commerce operator?
- Availability of treaty benefit?
- Discriminatory in nature?
- Trade tariffs

Availability of Treaty benefit?

Article 2 of India-France Tax Treaty

“1. The taxes to which this Convention shall apply are:

(a) in India:

(i) the income-tax including any, surcharge thereon; (ii) the surtax; and (iii) the wealth-tax,

(b) in France:.....

2. The Convention shall also apply to any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of the present Convention in addition to, or in place of, the taxes referred to in paragraph 1. The competent authorities of the Contracting States shall notify each other of any substantial changes which are made in their respective taxation laws.”

Does EQL qualify as “covered tax”?

- EQL is substantially similar to and is levied in place of income tax.
- Specific exemption u/s 10(50).
Section 10(50) also makes a reference to income.
- Levy of income tax on “gross basis” is not unusual in the Income Tax Act.
- The provisions of Equalization Levy would be implemented by the Income Tax Authorities.
- Several provisions of the Income Tax Act, 1961 are also borrowed in Chapter VIII of the Finance Act, 2016 and hence would be applicable.

Availability of Treaty benefit?

Section 90(2)

*(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, **under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.***

Similar provision in Finance Act, 2016?

Treaty benefit

Section 90(1)

90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax **under this Act** and income-tax in that country or specified territory, as the case may be, or

(ii) income-tax chargeable **under this Act** and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income **under this Act** and under the corresponding law in force in that country or specified territory, as the case may be,.....

or

(c) for exchange of information or

(d) for recovery of income-tax **under this Act**

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

Similar provision in Finance Act, 2016?

USTR Proceedings

- January 6, 2021 : Section 301 Investigation Report on India's Digital Services Tax, UNITED STATES TRADE REPRESENTATIVE (USTR)
- Key Findings:
 - India's DST discriminates against U.S. companies,
 - Unreasonably contravenes international tax principles,
 - The text of the DST to be unclear and ambiguous. Creates uncertainties, no official guidance to resolve these ambiguities.
 - The DST taxes companies with no permanent establishment in India, taxation absent a territorial connection to that country.
 - The DST taxes companies' revenue rather than their income.
 - Burdens or restricts U.S. commerce
 - The DST creates an additional tax burden for U.S. companies. USTR estimates that the aggregate tax bill for U.S. companies could exceed US\$30 million per year.
 - India's DST is an outlier: it taxes numerous categories of digital services that are not leviable under other digital services taxes adopted around the world.
 - Compliance costs could run into the millions of dollars for each affected company.
 - The DST burdens U.S. companies by subjecting them to double taxation.

USTR Proceedings

GOI's response

- India's Equalisation Levy does not discriminate against non-resident e-commerce operators. The purpose is to ensure a level-playing field with regard to e-commerce activities undertaken in India.
- It does not discriminate against companies based in the United States as it applies equally to all non-resident e-commerce operators not having permanent establishment in India, irrespective of the origin of such companies.
- The concept of Equalisation Levy BEPS Action 1 Report which was accepted by India and other members of the OECD, thereby representing a broad consensus view on the issues discussed in the report.
- EQL addresses symmetry in tax burden faced by purely domestic enterprises on the one hand, and multinational enterprises on the other, and the resulting distortionary impact on the market competition which can adversely affect the development of purely domestic enterprises.

Action taken

- June 2, 2021: The U.S. Trade Representative determined to take action in the form of additional duties of 25 percent on products of India specified in Annex A.
- November 29, 2021: The end of the 180-day suspension period for the additional duties

USTR Proceedings – Transitional Approach

- On October 21, 2021, the United States AND Austria, France, Italy, Spain, and the United Kingdom reached an agreement on a transitional approach to existing Unilateral Measures while implementing Pillar 1. The agreement is reflected in the joint statement that was issued by those six countries on that date (“October 21 Joint Statement”).
- MOF Press Releases dated November 21, 2022:
 - India and United States have agreed that the same terms that apply under the October 21 Joint Statement shall apply between the United States and India with respect to India’s charge of 2% equalisation levy on e-commerce supply of services and the United States’ trade action regarding the said Equalisation Levy.
 - The final terms of the Agreement shall be finalised by 1st February 2022.

Unilateral others

- Bilateral unilateral
- Multilateral unilateral

Audience poll – Question 1

- Is the unilateral approach of charging Equalisation Levy fair?
 - A. Yes. So many countries are doing it.
 - B. Yes. A country cannot forgo revenue till final solution is found?
 - C. No. Unilateralism will create chaos

Bilateral Solution

UN solution - Article 12B

- New Articles 12B on the lines of articles for “interest”, “dividend”, “royalties” and “fees for technical services”
- Taxing right given to the source country for “income from automated digital services”
 - *5. The term “automated digital services” as used in this Article means any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider.*
 - *6. The term “automated digital services” includes especially: (a) online advertising services; (b) supply of user data; (c) online search engines; (d) online intermediation platform services; (e) social media platforms; (f) digital content services; (g) online gaming; (h) cloud computing services; and (i) standardized online teaching services.*
 - Payments qualifying as “royalties”, “fees for technical services” excluded
- The tax payer can select the option of getting taxed on “gross basis” or “net basis” [30% of qualified profit, qualified profit is relevant revenue x profitability ratio].

UN solution - Article 12B

- UN dynamics

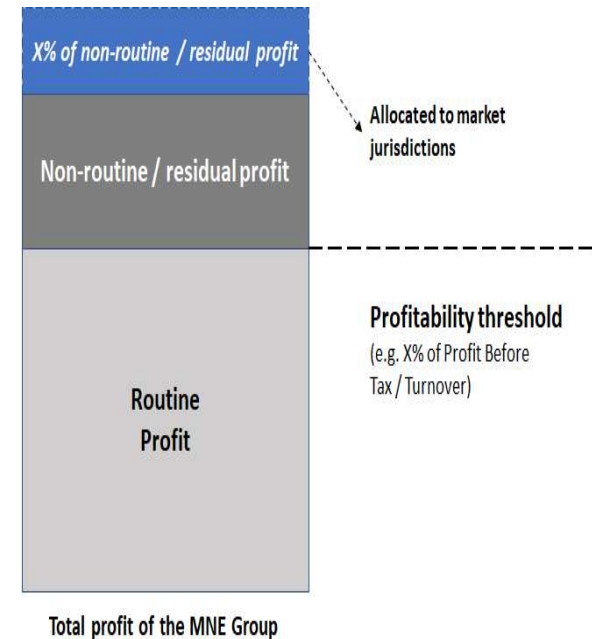
Bilateral Solution – Difficulties

- Not a consensus solution
- Absence of mechanism to quickly implement Article 12B in tax treaties.
- Need for UN MLI
 - <https://www.radhakishanrawal.com/post/conceptualizing-the-u-n-mli>
- Initiation of work by UN Tax Committee

Multilateral solution

Pillar One

- *Scope* - Group revenue of €20 billion and profitability above 10%. Applicable to all businesses (excluding extractives and regulated FS)
- Amount A – New taxing right without PE
- Amount A allocation 25% of residual profit (above 10% of revenue)
- Amount B – Simplified TP for standard marketing and distribution functions
- Specific Rules
 - Revenue sourcing
 - Nexus
 - Group approach
 - Tax Certainty
- Withdrawal of unilateral measures

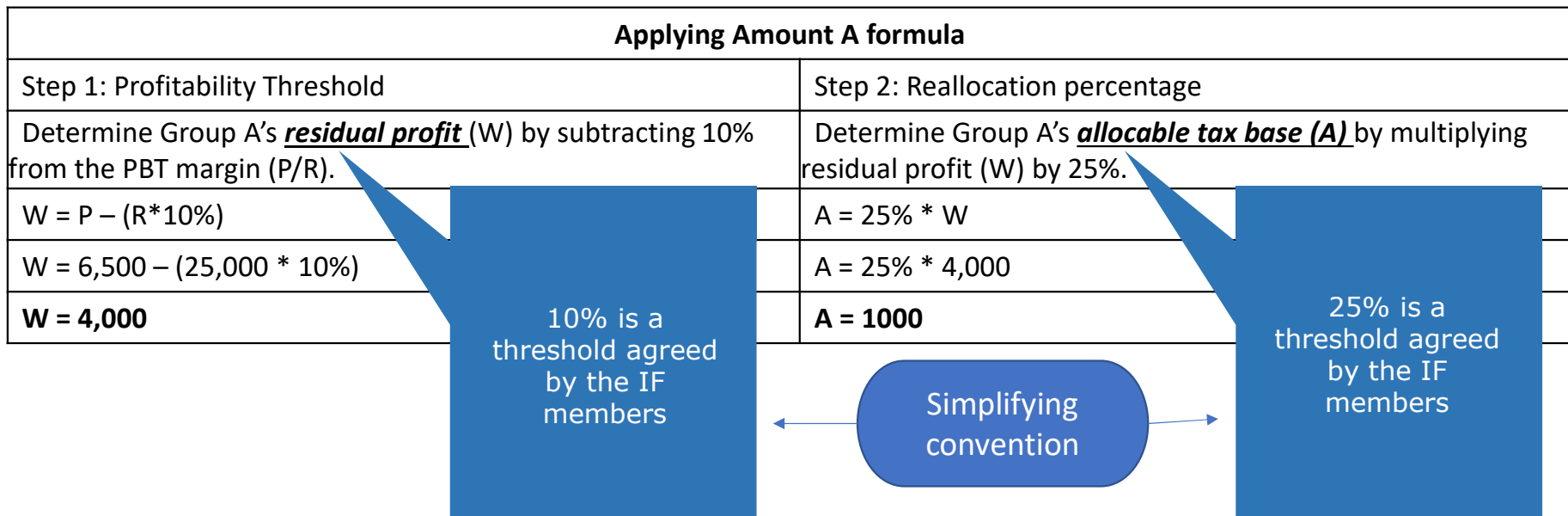


Facts

Group A is a large MNE group providing exclusively in-scope ADS via an online platform. It is assumed that Group A is treated as one segment for Amount A purposes and that it has the following simplified income statement:

	in million EUR
Revenue (R)	25,000
Profit before tax (P)	6,500
PBT margin (P/R)	26%

	Local revenue (S) (mn euro)	
Market 1	2,000	local subsidiary
Market 2	18,000	remote activity
Market 3	5,000	remote activity
Total	25,000	

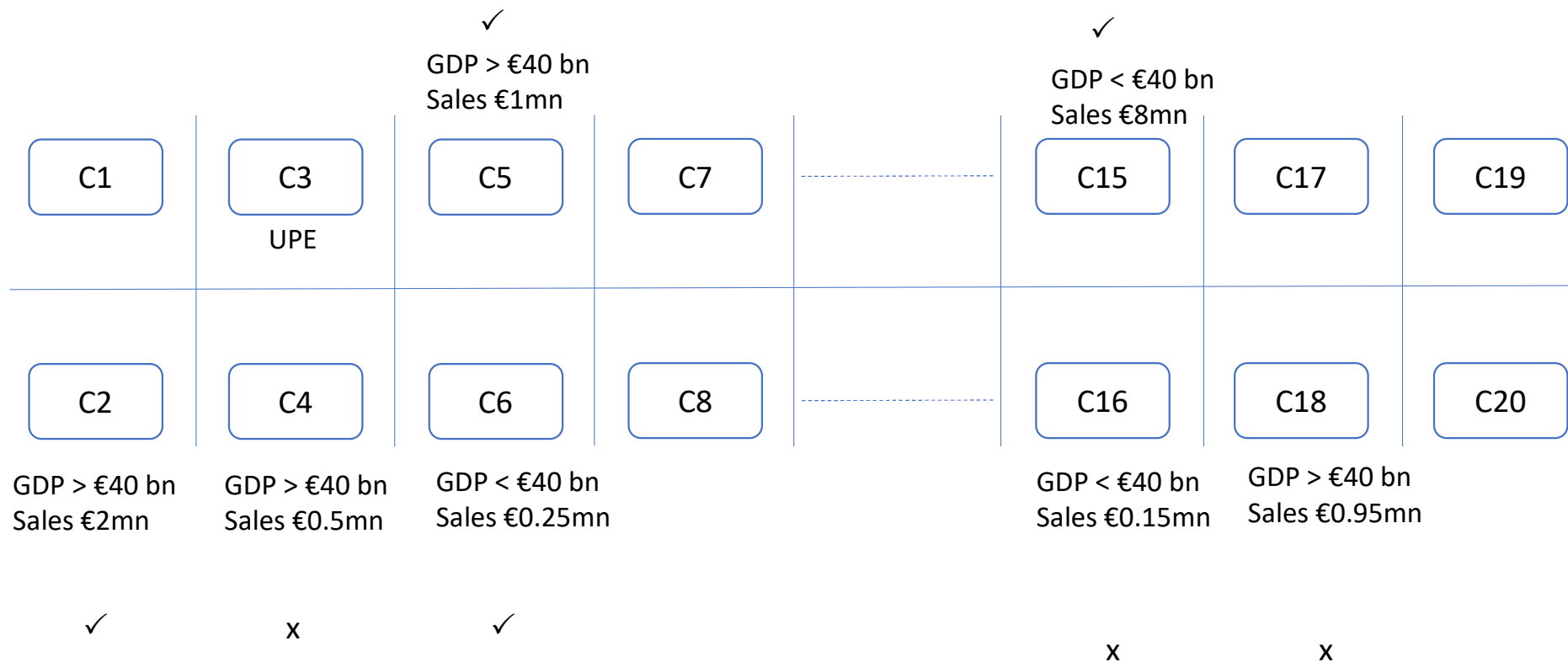


Amount A – Nexus for new taxing right

	Nexus Threshold (Local sales to create Nexus)	
Countries with GDP over €40 billion	€1,000,000	Revenue to be determined as per the “revenue sourcing rules”
Countries with GDP less than €40 billion	€250,000	

A market country will only be entitled to an allocation of Amount A if there is a nexus

Country with nexus gets new taxing right - Amount A



Previous work: <https://www.radhakishanrawal.com/post/design-a-stunning-blog>

Revenue Sourcing Rules

- Revenue sourcing rules determine when Revenue derived by a Covered Group are treated as arising in a Jurisdiction.

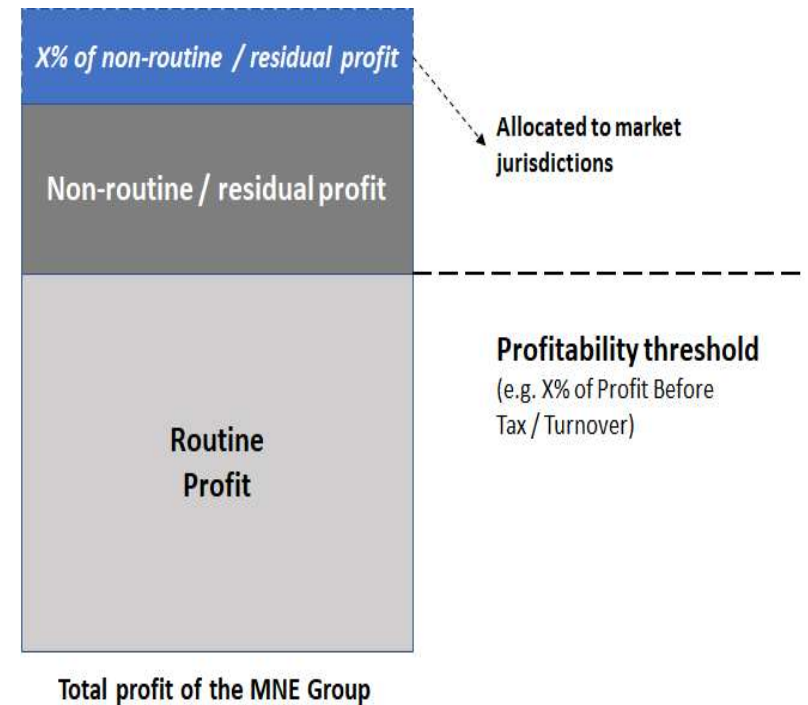
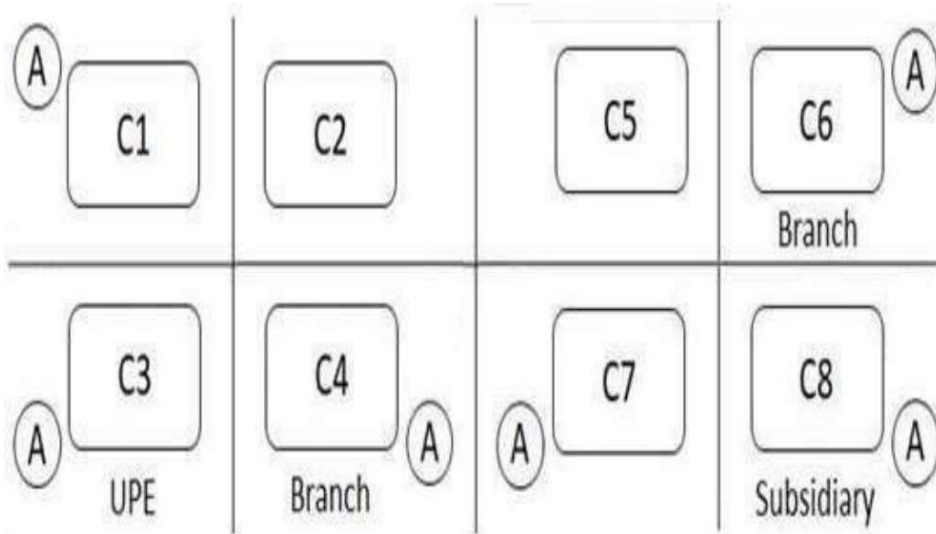
Goods	Services	Other Revenue
Finished Goods	Location Specific Services	Intangible property
Components	Advertising Services	User Data
Digital Goods	Online Intermediation Services	Real Property
	Transport Services	Government Grants
	Customer Reward Programs	Non-customer revenue
	Other Services	

b. Advertising Services:

- Revenues derived from the provision of online Advertising Services are treated as arising in a Jurisdiction when the **Location of the Viewer** of the advertisement is in that Jurisdiction.*
- Revenues derived from the provision of Advertising Services other than those covered in subdivision (i) are treated as arising in a Jurisdiction when **the place of display or reception** of the advertisement is in that Jurisdiction.*

Revenue sourcing rules have the effect of shifting taxing rights from one country to another

Issue of double counting



Is there a double counting?

Marketing and Distribution Safe Harbour (MDSH)

- $M = \text{MIN} ((EP - PEP) \times [Y\%], Q)$
- Justification for Return on Depreciation and Payroll (RoDP)?
- Keep “Y” at minimum
- Inconsistent approach for residual profit

Residual profits of the MNE	Residual profits of the jurisdiction
Tax base (EP) of the MNE – 10% of revenue of the MNE	EP of the jurisdiction – PEP Where PEP is determined on the basis of RoDP
Tax base (EP) of the MNE – 10% of revenue of the MNE	EP of the jurisdiction – 10% of revenue recorded in the books of the jurisdiction

Elimination of double taxation

- A four-tiered approach is adopted and the RoDP thresholds for the tiers are as follows:
 - Tier 1: RoDP of 1500%
 - Tier 2: RoDP of 150%
 - Tier 3A: RoDP of 40%
 - Tier 3B: Group RoDP (Elimination Threshold RoDP)
- Issues
 - Too complex and long method
 - Does not follow the basic principles for elimination of double taxation under the tax treaties
 - Large profitable entity will pay first

Previous work: <https://www.radhakishanrawal.com/post/manage-your-blog-from-your-live-site>

Elimination of double taxation

State A

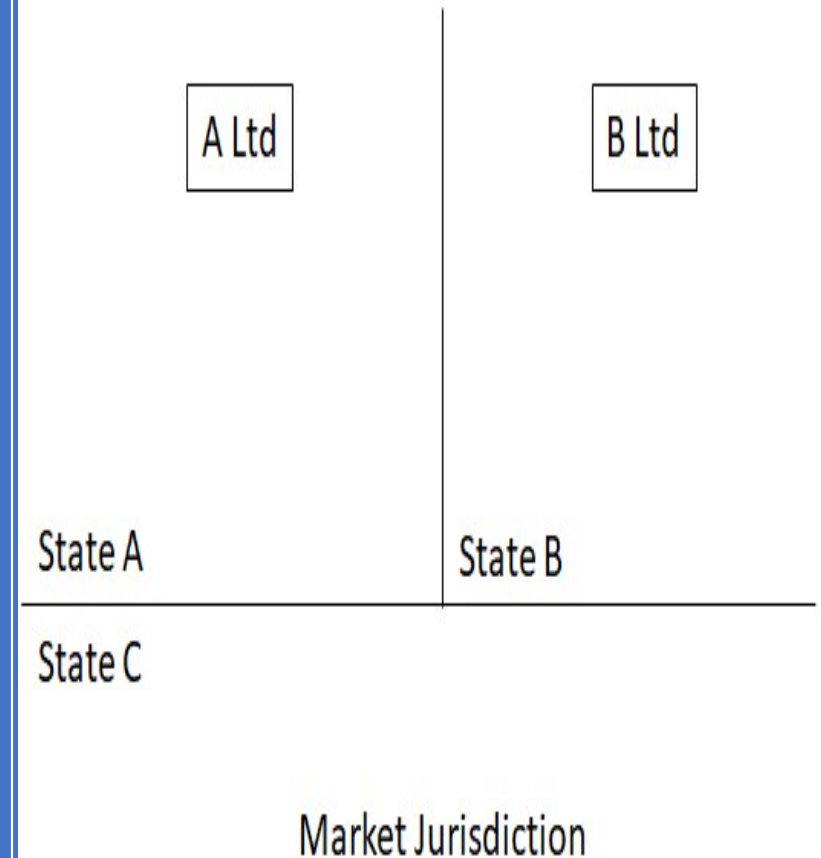
The revenue generated by the group from the market jurisdiction is recorded in the books of A Ltd.

State B

As a result of the application of bilateral tax treaty State B has a source country taxing rights.

State C

As a result of the application of the pillar 1 rules, amount A is allocated to State C, revenue arises in State C as per revenue sourcing rules.



Tax Certainty

- Assessment at Group level
- Lead Tax Administration
- Review panel
- Determination panel
- Process for panels
- Scope Certainty Review
- Advance Certainty Review
- Comprehensive Certainty Review
- Tax certainty for issues related to Amount A

Standstill and rollback provision

*“In addition to the operative provisions of Amount A, the MLC will contain provisions requiring the withdrawal of **all existing digital service taxes (DSTs) and relevant similar measures with respect to all companies**, and will include a definitive list of these existing measures. The MLC will also include a commitment not to enact DSTs or relevant similar measures, **measures, provided they impose taxation based on market-based criteria, are ring-fenced to foreign and foreign-owned businesses, and are placed outside the income tax system (and therefore outside the scope of tax treaty obligations)**. The commitment would not include value-added taxes, transaction taxes, withholding taxes treated as covered taxes under tax treaties, or rules addressing abuse of the existing tax standards. The development of the MLC will include work to further develop the definition of DSTs and relevant similar measures, and to provide for the elimination of Amount A allocations for jurisdictions imposing future measures that are within the scope of this commitment.”*

Progress Report - Overview

Progress Report released on July 11

- Consolidated version
- MDSH (Article 8)
- Elimination of double taxation (Article 9)

Documents yet to be released

• Pillar One

- Rule for “Administration of new taxing rights” – To be released before October 2022 meeting
- Tax Certainty – To be released before October 2022 meeting
- Multilateral Convention (MLC) – Signing ceremony in the First half of 2023
- Amount B – To be delivered by year end

• Pillar Two

- Implementation Framework and STTR – ongoing work

Critical mass

“The MLC will enter into force only upon ratification by a critical mass of countries, which will include the residence jurisdictions of the ultimate parent entities of a substantial majority of the in-scope companies whose profits will be subject to the Amount A taxing right, as well as the key additional jurisdictions that will be allocated the obligation to eliminate double taxation otherwise arising as a result of the Amount A tax.”

- Progress Report, Cover Note

Multilateral Solution – Difficulties

- Complex solution
- Fair allocation of taxing rights?
 - Absence of data – impact assessment
 - Nexus rules
 - Only 25% allocation
 - MDSH
 - Withdrawal of DST on ALL Companies
- Political uncertainties
 - Challenges in US Senate
 - Impact data
 - 2/3rd majority in Senate

Are DSTs here to stay?

- DST on non-qualifying MNEs
- Pillar One commitment
 - New Zealand's consultation
 - EU members prefer DSTs?
 - Kenya has indicated that it will not withdraw DST even after P1
 - Nigerian approach
- DSTs by non-Inclusive Framework countries
 - Nepal DST (July 2022)
 - Tanzania

Audience poll – Question 2

- Given the technical difficulties and political uncertainties, when do you believe Pillar One provisions will be operational?
- A. Never
- B. 2024 or 2025
- C. After 2025

Thank you for your attention!

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