

# Key takeaways from ITRAF's 2019 conference on 'International Taxation in the Digital Era'

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## ITRAF - Conference on 'International Taxation in the Digital Era' - Key takeaways

After the successful launch of International Tax Research and Analysis Foundation ('ITRAF') in August 2015, ITRAF has engaged in various activities leading to it being a successful research based organization today. ITRAF is engaged in continuous research and has already produced three extensive edited volumes on international taxation challenges (a fourth one is in the works) and has also successfully conducted multiple round tables and conferences on International Tax.



This two-day conference in Bangalore themed around 'International Taxation in the Digital Era' was opened by a welcome address by Dr. Parthasarathi Shome (Chairman, ITRAF). He began by acknowledging ITRAF's growth over the last 4 years of its existence, its steadily expanding annual conferences, lengthening reach of researchers across the country and widening readership of its publications. Stating that in the last 20 years India's tax policy has gone through many cyclical movements, both positive & negative, Dr. Shome acknowledged that the purpose of research is to

connect these policies with ground reality. He then gave an overview of the topical issues that would be covered during the course of the conference like angel taxation, digital economy, residence-based taxation, GAAR, POEM etc.

The first technical session was presented by Mr. S. Krishnan, who dwelt on imminent and burning issue of angel taxation. Pointing out that the angel tax is unique to India, as no other country taxes capital contribution, he elaborated on the emergence of the concept, initial implementation of the tax and multiple changes in its structure since its inception. Highlighting that angel taxation has not met its objective of arresting the practice of conversion of unaccounted money, Mr. Krishnan lamented that many other existing provisions in the Income-tax Act could have been used for taxing unaccounted money and it is unfortunate that angel tax has only resulted in harassment of startups and investors.

Chairman of the session, Mr. T.V. Mohandas Pai added that tax authorities have been 'overawed' by huge valuation of startups and that has resulted in bulk of the litigation. He stressed that the testing point should be whether money invested is legitimate or unaccounted and once legitimacy is established, valuation should not matter. Mr. Pai finally highlighted a startling fact that the whole angel tax mess has prompted 18 out of 32 unicorns in our country to be headquartered outside India, resulting in export of significant value outside India. Commenting on the angel tax controversy, Mr. Shome stated that the reason for confusion in a series of tax legislations are that they utilize a 'presumptive form' of tax instead of taxing on actuals, which is a 'primitive form of taxation'. In other words, instead of getting into income stream, it is presumed that income is represented by capital and while this results in ease of collection, there is no fundamental economic concept that backs it. He stressed that this form of tax has impacted investment climate, production & GDP.



The second technical session was on the hot button issue of digital economy taxation. To begin, Mr. Alok Prasanna and Ms. Vinti Agarwal from Vidhi Centre for Legal Policy explained the peculiar features of business models in the digital economy, the role of the OECD in setting the tone of an international agenda, and various unilateral measures taken by India to address the digital economy challenges. Regarding India's equalization levy, they explained how it has resulted in double taxation within India (as a result of levy of equalization levy and IGST on the same income, though objectives under both the Acts are different) as well as globally (as no Foreign Tax Credit can be claimed on equalization levy). They also left the audience with an interesting thought on how equalization levy can be argued to be unconstitutional after the levy of GST. Mr. Shome added that equalization levy was wrongly located and it should have been located & subsumed under IGST as it is a 'supply of service'. On the way forward, Mr. Prasanna and Ms. Agarwal advocated on introduction of nexus rules/ significant economic presence in the DTAAs and introduction of data localization laws. Chairman of the session, Mr. Indraneel Chaudhury, elaborated on how Functions, Risk, Assets & Market (FARM) analysis could help in solving the digital economy conundrum.

This session was followed by an insightful presentation from Dr. Suranjali Tandon who examined the economic impact of digitization and unilateral country decisions to tax it in the context of BEPS. Reflecting

the dispersion of their structures across the world, she pondered over the future of international tax rules. She mulled whether India could move out of the OECD framework and therefore not adopt the proposed BEPS recommendations as India is not part of the OECD? Chairman of the session, Mr. K.R. Sekar concluded that there is no global consensus on digital economy taxation but highlighted that if Article 7(1) is implemented in the right manner, it should be sufficient to deal with the digital economy taxation challenges.



In the next session, Ms. Shikha Mehra and Mr. Rohit Roy took up the particular case of block chain and bitcoins, explaining how this newly emergent phenomenon is working and can help in solving the digital economy taxation problem. Ms. Mehra highlighted a startling fact that 90% of the revenue generated by internet transactions worldwide goes to only 9 companies like Amazon, Facebook, Google, Uber etc. which merely own, control & store user information on their databases. Criticizing OECD's March 2019 Report which proposes marketing intangibles as the way to attribute profit to the source country, she proposed to 'turn this formula on its head' and tax business profits in the market jurisdiction where value is actually created and only give an arm's length remuneration to the firms aggregating/ intermediating the transactions as they act as merely central clearing houses. Chairman of the session, Mr. K.R. Girish agreed that moving to a more residence based taxation, SEP being a precursor to this concept, should be the way forward. This session was followed by a presentation by Mr. K.R. Sekar and Ms. Krupa Venkatesh who illuminated the audience with many interesting domestic & international judicial cases in the direct tax and indirect tax areas on the topic of digital economy taxation.

During the panel discussion on lessons learned on digital economy challenges, Mr. Suresh Senapaty highlighted that there is a disruption of traditional models and it is essential that there is a global alignment to the pace of change. Mr. Mohandas Pai also agreed that the correct solution would be an international solution so that there are no global conflicts.

On Day 2, the session on residence-based taxation saw Mr. K.R. Girish compare the OECD versus UN model conventions on residence versus source-based taxation and connect it to the tax challenges of the digital economy highlighted in BEPS Action 1. It was highlighted that while the concept of 'residency' is defined in the Act/ DTAA, 'source' has not been defined though it is traditionally understood that act/ activity/ asset forms the basis for source of income. Mr. Khincha explained that BEPS like concerns in India were expressed as early as 1976 it was felt that there was lot of tax evasion because of this traditional concept of source of income and accordingly the statute was amended to change the concept of source from activity/asset to payer-based concept for interest/royalty/FTS payments. However, he stated that the concept of source is still evolving significantly and questions have been raised whether a deduction can be considered as a source of income, whether location savings can be considered a source of income etc. and this is giving rise to a lot of conflicts globally. It was then deliberated whether e-commerce taxation is inherently moving away from income-based tax towards consumption/ transaction based tax with suggestions of equalization levy, withholding tax etc. Interestingly, Mr. Khincha mentioned that US itself in 1996 propagated residence based taxation, stating at the time that it was becoming very difficult to figure out where income was being earned/ sourced. Taking a cue from shipping & airline businesses, which are typically taxed based on residence, Mr. Girish & Mr. Khincha reiterated & explained how the answer to e-commerce taxation possibly lies in residence based tax, so long as it is consistent across countries.



During the final panel discussion summing up the conclusions and way forward, Mr. Indraneel Chaudhury batted for levy of transaction tax as the solution to digital economy taxation but Mr. K.R. Sekar opposed it saying that while transaction tax appears to be a simpler norm for administration, it will throw up challenges for countries to follow. Further, Mr. Sekar stated that even if transaction tax is implemented, it should be a part of indirect taxes and not direct taxes. Mr. Sekar also

suggested that instead of all countries negotiating their treaties which is a cumbersome & time consuming process, they should all agree on an acceptable model based on judicial principles, come to a common understanding and bring out an exclusive treaty for digital economy which will apply to all countries. On whether adoption of a formula based apportionment method will address digital economy challenges, Mr. P.V. Srinivasan opined that a formula based apportionment method itself recognizes the economic factors (assets, employee, users etc.) that contribute to the income but there are challenges associated with defining these factors. He advocated for a composition levy (like equalization levy) but also for a choice to be given to taxpayers to choose between formulary approach or composition levy. Regarding the nexus principle/ SEP for taxing digital economy transactions, Mr. Khincha explained that the primary condition to be satisfied to constitutionally sustain the levy is the linkage between the transaction to the territory of India. In

the context of digital economy, he questioned whether the basis for levy in India should be digital infrastructure or users, though there is no clarity on how these terms should be defined, and stated that it is therefore important to establish economic parameters for the levy to have territorial nexus.

The conference also saw some interesting presentations on GAAR by Mr. Saurav Bhattacharya and Mr. P.V.S.S. Prasad (on its slow progress, the compliance nightmare and analysis of some judicial precedents which raises the question whether legitimate tax planning can survive under the prevailing regime), exchange of information and international tax transparency by Mr. Navneet Manohar (reflecting his experience from a tax administration point of view with G20 and BEPS on automatic exchange of financial account information and international common reporting standard), capital gains taxation by Prof. N. Nigam (assessing the Principal Purpose Test (PPT) rule in tax treaties in the post- BEPS era) and POEM by Ms. Ashrita Prasad Kotha (discussing the importance of residence rule under POEM & some case studies).