

# Digital Economy

## - some thoughts



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# Issue No. 1 – Permanent Establishment

- Conventional Economy – brick and mortar concept – business income linked to PE
- the concept is idealistic – but over the years taxpayers had business income without PE
- Tax administrators and taxpayers focused on proving or otherwise of the existence of fixed place of business instead of focusing on whether business income arose to the taxpayer





## Issue No. 1 – Permanent Establishment contd...

- Proving the existence of PE became an artificial barrier for taxation – giving scope for taxpayer to escape from taxation even though it has business income in that State
- Definitely the intention of policy makers was not to encourage non-taxation of business income
- The Models and treaties should have been amended earlier delinking fixed place of business from business income – it did not require digital economy to grow to realize fixed place of business is not required to earn business income





## Issue No. 1 – Permanent Establishment contd...

- There is a tendency in policy makers to define a Virtual PE (or digital presence) for digital economy just like a fixed place of business PE in conventional economy
- Are we falling into the trap once again? Whatever we may define as Virtual PE (may be a server, website, software, etc) there will be ways and means to avoid attracting Virtual PE criteria just as it happened for fixed place of business
- Proving existence of Virtual PE more difficult than existence of fixed place of business in view of the high end technology that may be used





## Issue No. 2 – Resident State vs Source State

- Understandably there is a tussle between resident State and source State for taxation rights under a treaty
- The tax foregone by a source State is the gain of residence State and vice versa – but things are quite different in digital economy
- In digital economy it is very easy to shift source of an income to a low or nil tax jurisdiction – it is equally easy to shift residence of the enterprise to another low or nil tax jurisdiction





## Issue No. 2 – Resident State vs Source State contd...

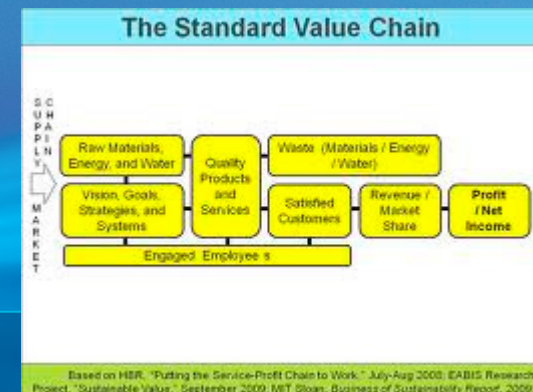
- Residence and source States should be alert to unravel the whole transaction being routed through low or nil tax jurisdictions
- This requires synergy and co-operation between residence and source States
- Parts of the transaction chain where actual economic activity is not taking place should be ignored – limitation of benefits? or anti-abuse provisions?
- Substance over form should prevail – income should undergo fair taxation – CFC rules?





## Issue No. 3 – Income linked to value creation

- Value of any product or service depends on a number of factors like the idea by which it is created, where it is manufactured, brand value, reach to the consumers, purchasing power of consumers, etc.
- Income that is earned by selling such product or service should ideally be apportioned to the points where value is created
- If all the stakeholders are involved, then profit shifting by enterprises becomes that more difficult





## Issue No. 3 – Income linked to value creation contd...

- In an eagerness to corner the complete taxation right by any one stakeholder, such stakeholder ignores the adverse impact it creates - no support from other stakeholders - it is easy for the taxpayer to hoodwink that one stakeholder
- Identifying the correct value chain is very important and do not isolate any stakeholder





## Issue No. 4 – withholding taxes an effective tool?

- Withholding taxes on payments for purchase of goods or services is a better option but not a foolproof option
- Whether will it be effective if the payments are in virtual currencies
- Separate rules have to be formed now itself for dealing with payments in virtual currencies





## Issue No. 5 – who should take the lead?

- Digital economy is increasing at a rapid pace
- At present only a small set of countries are working on methods to tackle tax evasion in digital economy
- All countries should take the lead and not only developed countries – need not wait till they are affected
- A bigger body like UN or Global Forum should frame rules for all the countries





*THANK YOU*