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# **International Taxation- Issues and Challenges**

# SOME EMERGING ISSUES

- ❖ **Digital Economy**
- ❖ **Characterisation of Income**
- ❖ **Attribution of profits**
- ❖ **Capital Gains – Indirect Transfer**



# DIGITAL ECONOMY



# DIGITAL ECONOMY-PE

## New business models -

- have made brick and mortar concept of fixed place PE outdated.
- have engaged several key players in an average global commercial transaction
- have led to income generation in the hands of key players in multiple geographical locations
- have created a blur to the single point of reference in the traditional model wherein the management / factory / office / technology were identifiable
- have made 'physical presence' redundant

**The above have made it complex to ascertain the geographical location of the PE.**

# DIGITAL ECONOMY :

No longer a seller – buyer transaction

- Key Players :
  - Network Provider
  - Internet Service Provider (ISP)
  - User
  - Website
  - Payment Providers
  - Payment System Provider
  - Software Architect
  - Advertiser
  - Content Provider
  - Back End System

# DIGITAL ECONOMY- RESIDENTIAL STATUS

- In the E-commerce/E-Business / Multiparty business era,
  - it is possible to hold a board meeting with directors in more than one places
  - the company's effective place of management can either exist in more than one location, or render the same incapable of being pinpointed to a specific location.

This could pose difficulties in determination of tax residency and place of effective management .

# DIGITAL ECONOMY: TAXATION CHALLENGES

- The existing definition of PE which gives prominence to fixed place of business is 100 years old and needs to be synchronised with the increasing mobility in the business, particularly Digital Economy.
- There is need to re-examine the right of source countries to tax in this era of digital economies.



# DIGITAL ECONOMY : SOME ANSWERS

- Expanding the scope of agency PE
  - Treatment of franchise / distributor agent as dependent agency PE of multi layered marketing companies
  - Treatment of Indian subsidiary / distributor agent generating Income from Interactive Financial Information Network Services for the foreign principal
  - Treatment of distributor / subsidiary / dealer of a foreign auto manufacturer as a PE

# CHARACTERISATION OF INCOME





## ***Characterization of software payment as 'Royalty' – Amendment in Law***

- Domestic law has been amended to provide that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any *right for use or right to use a computer software* (including granting of a license) irrespective of the medium through which such right is transferred.
- It has lead to characterization of payments towards use of computer software as 'royalty' under the domestic tax law retrospectively.
- Position of amendment vis-a – vis Treaty definition.

## Characterization of Income : Dividend / Interest V/s Capital Gains

- **Asset transferred by an entity in a jurisdiction where capital gain is exempt under DTAA:**

An entity subscribing to debt / hybrid instrument of an Indian entity - as per terms and conditions agreed, the instrument to be redeemed at a premium based on interest- **capital gain or interest income?**

**Tax payer's claim** : Capital gain hence exempt

**Revenue's Position** : Income relates to debt instrument based on interest, hence taxable as Interest.

# ATTRIBUTION OF PROFITS



# Apparent vs Real state of business

- Criticality of functions performed in India are either suppressed or underreported.
- Place of effective management.
- Ability to collect information from outside the country limited which is exploited by the MNCs.
- Substantial income neither reported nor taxes paid in any of the jurisdiction globally.

## Attribution of Profit : Challenges

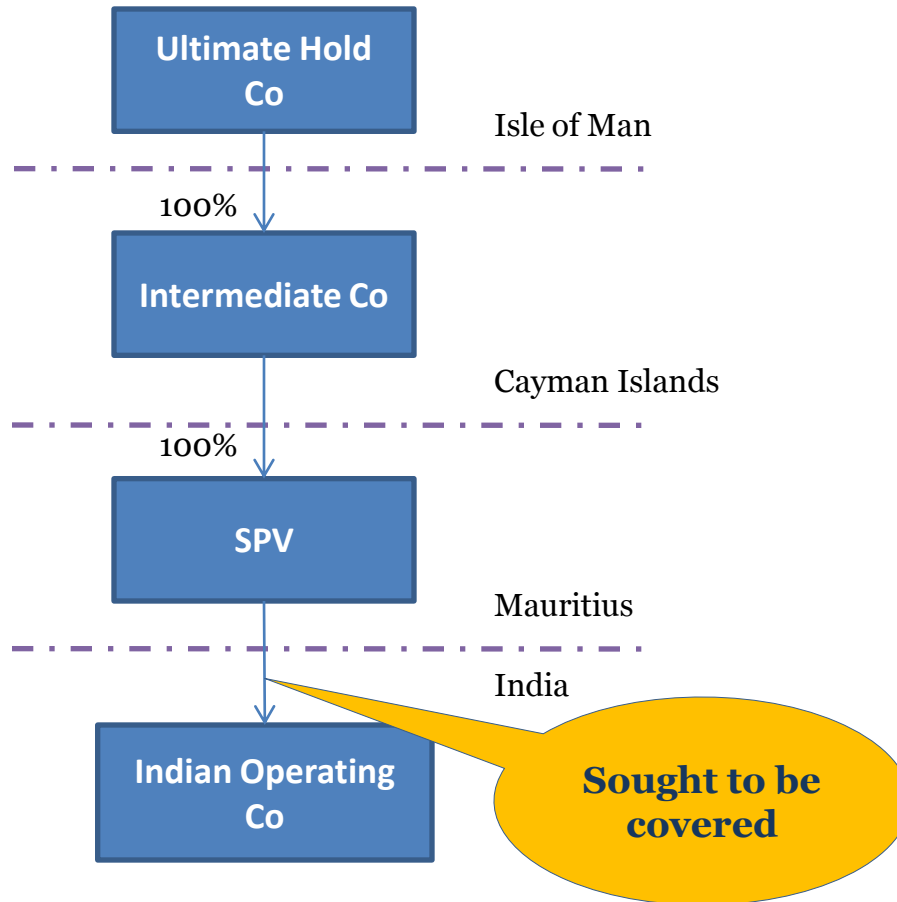
- The basic problem in attribution of profit revolves around allocation of the profits on the basis of the functional analysis.
- There are no robust guidelines internationally as to how to allocate the profits on the basis of functional analysis in the cases where transfer pricing provisions are not applied.
- The attribution of profit is more challenging in cases involving composite contracts for following reasons:
  - Artificial splitting of composite contract
  - Non transparent allocation of revenue to artificially split contracts.
  - Offshore supplies.



# Capital Gains – Indirect transfer



# Overseas transactions



# Overseas transactions

- Income-tax Act to cover indirect transfer of capital asset being shares or interest in a foreign entity deriving its value substantially from assets in India.
- Reporting obligations on Indian concern through which the assets are held in India.
- Tax deduction obligation whether or not non-resident transferor has any India presence

Thank you