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Digital Economy & Permanent Establishment: A Case Study of India

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Abstract

"21st Century is the time of digital economy and as a result many scholars have been safely sayingthat "data is oil" for the reason that in mast decades many businesses which are involved in technology and data have been able to drive the traditional oil, mining business out of the top largest companies of the world list. Many countries are trying to convert themselves into digital company and as result E-Commerce has a good share in the development of GDP of a country. However, as the share of e-commerce is increasing, problems relating to the same like privacy issues, taxation are also popping up. Double taxation avoidance by these digital companies have become a problem for many countries especially the developing countries which are not able to tax the companies as their law doesn't allow it traditionally and as a result they suffer huge lossto revenue. In this research, the author shall put forward various business models existing in e-commerce and how the companies are able to ditch the laws of the countries. This research shall have special focus to India' taxation laws and the judgments in regards to PE in relation to e-commerce."

Keywords: Permanent Establishment, International Taxation, Income Tax Act, Digital Economy, Data

INTRODUCTION TO DIGITAL ECONOMY

In the era of 1990s, there were several economic changes and among them was conceptualizing the economy according to the internet revolution which established the ground for digital economy.[1] However, during the 2000s and 2010s a progression of new data and innovations (ICTs) has diffused and supported monetary change. This incorporates the inserting of connecting sensors into an ever increasing number of objects (the Internet of things); new end user gadgets (cell phones, cell phones, tablets, net books, PCs, 3D printers); new computerized models (distributed computing, advanced stages, computerized administrations); developing power of information utilization through spread of enormous information, information investigation and algorithmic dynamic; and new computerization and apply autonomy advances.[2]We can understand the importance of the internet by simply stating the statistics that almost 4.4 billion people around the world in 2019 are active users of the internet which accounts for almost56% of the world population[3] and revenue from E-Commerce retail is expected to be almost $4.3trillion in the year 2020.[4]

Emerging from these advancements is a lot of computerized affordances: potential activities an individual or association with a reason can embrace with an advanced framework inside the setting of the condition inside which they work. These incorporate datafication (a development of the marvels about which information are held), digitisation (transformation of all pieces of the data esteem bind from simple to advanced), virtualisation (physical disembedding of procedures), and generativity (utilization of information and advances in manners not arranged attheir beginning through reconstruction and recombination).[5] The effect of any innovation can be comprehended as the result of its size of dissemination and profundity of impact. With quick dispersion remembering for creating nations – and expanding profundity of impact with ever-

1.1. DEFINITION OF DIGITAL ECONOMY

The term "digital economy" is often associated with the definition proposed in 1997 book *"The Digital Economy: Promise and Peril in the Age of Networked Intelligence"*[7]. But the often cited definition reads out: *"the global network of economic and social activities that are enabled by platforms such as the Internet, mobile, and sensor networks."* [8] This definition though is a good understanding for a digital economy however it's not useful in case of international taxation.

Sec. 4.3 of the BEPS Report on Action 1 provides a list of key features of digital economy. These features have been provided under Para 151 of the report. The paragraph states in its starting only that there are ever increasing number of characteristics of digital economy which plays an important role in the perspective of taxation. Though these features may not be present every time in every business, they still can be used as a characteristic of "modern economy". These are as follows:

- "Mobility". This depends on three important elements which are: (i) intangibles which are a basic requirement of any digital economy; (ii) Users of those intangibles and (iii) business models which are less dependent on the on the need of any local personnel present physically in the concerned market and therefore this allows a flexibility to the seller to operate remotely.
- Increasing use of data which is generated by the use of the customers and this data is famously called as "big data" used by the companies to generate revenue.
- Network effects which can help the company to integrate the choices according to the needs of the customer

The issue rises considering the way that a critical number of payments, perhaps most business installments, relate to a great

extent or another to cutting edge economy frameworks, realizing inconvenience in choosing when this association is sufficient to order holding. Also, payments are consistently made with a far off relationship with modernized things yet with a speedy relationship with non-propelled things in conditions where the payer (and certainly the payee) is oblivious to the affiliation. Such conditions may show an appropriate circumstance for non- holding, yet it is irksome to stick to a significant limit here and to isolate certifiable versus basically articulated deadness in these cases. The definition may be under-far reaching since it indicates explicit stages that may not be careful without a doubt, even at present and are most likely not going to be so in future. Various suggestions don't improve affirmation.[9]

1.2. IMPACT OF E-COMMERCE

In today's world E-Commerce indeed has caught the "collective imagination" of the business houses and the individuals worldwide which became more than just a pipe dream. While it is truethat international transactions are not something new, however businesses engaging themselves through this platform are exacerbating the already complex taxation system.[10] Today the scenariois that instead of visiting a physical store and buying articles, individuals, enterprises and other taxable enterprises are more looking forward to doing business through web servers and the internet where the transaction is nothing more than electronic transactions.

With regards to definition of the term "e-commerce" BEPS Action Report 2015 plays an important role in this regard. Paragraph 117 of the report defines the term "e-commerce" as:

On the off chance that we take a gander at the point of view of the buyers, the significance of a physical area of a business particularly the specialist organization firms are decreased.[12] There is normally no clarification behind banding together an on-line seller with a physical territory since clients use only the IP address or Internet space name to execute the agreement with the vendor. For sellers, associations are successfully moved since it just proposes migration of PC hardware.[13] This is also jumbled by the limit of web development to change gigantic measures ofinformation from physical to automated structure. The real mechanics might be shown in a basic model:

Under E-Commerce, the transactions of goods can be classified into digitized and non-digitized products. By the name only, non digitized products arethe one which are traded offline and cannot be presented in the form of binary or other codes. It cannot be in the form of software and in such products the internet comes into the picture only for the purpose of resailing or wholesale market.[15] These types of transactions can be easily referred to as sale of goods rather than a royalty as the ownership under this transaction is transferred to the buyer and he has to bear the risk of the goods afterwards.[16]

1.3. ROLE OF BILATERAL TREATIES AND MULTILATERAL TREATIES ININTERNATIONAL TAXATION

Basic rules under private and international law states that a country in which the company has the closest economic presence shall have the power to tax the company.[17] As a principle, the country which is the residence of the company should have the power to tax the company but on the other hand, the country where the company is doing its business should have the power of taxation for there is a great economic nexus between the company and the source country.[18] In transnational business, there is a great risk of double taxation of the company and hence the formation of Double Taxation Avoidance Agreements (DTAAs) is required in order to remove the confusion as to which country should have the power to tax the company.[19]

The main purposes of tax treaties are twofold:

- To avoid the menace of double taxation.
- To prevent fiscal evasion.

The treaties provide the right to one country which has the power to tax the company and on the other hand provides a duty to other country to not to double tax the company. If as per the national laws of both the countries, they have the power to tax the enterprise, then treaty plays the role as to which country i.e. residence or source has the right to tax the company.[20] The additional test which is applied by several countries is the establishment of PE.[21] Tax assessment of the revenue generated cannot be differentiated merely on the ground of active or passive line but in many situations the concept of PE is required as all the active business cannot be taxed in the source country unless the income generated can be attributed to the same.[22]

1.4. BUSINESS MODELS

In the digital economy, business models can be defined as "the global network of economic and social activities that are enabled by platforms such as the Internet, mobile and sensor network".[23] Due to increasing demand of Artificial intelligence, formation of OTT platforms, new digital business models are coming up and are expanding. Even if we try to characterize the different digital business models, it becomes a challenge in itself. The European Commission in one of its reports of 2017 differentiated the digital business models into: "**Online retailer model, social media model, subscription model and collaborative platform model".**

Whereas OECD in its interim report on "Tax challenges arising from Digitization" dated 16th march 2018 identified four business models:[24]

(a) Multi-sided platforms

This includes companies like Uber, Facebook which "allow end-users to exchange and transact while leaving control rights and liabilities towards customers mostly with the supplies".

(b) Resellers

It covers companies like Amazon, Alibaba which purchase products from the suppliers and then resell the same to the buyers or its customers.

(c) Vertically integrated firms

It includes the companies like Amazon, Huawei who integrate "the supply side of themarket within their business".

(d) Input Suppliers

It includes companies like Intel which supply "intermediary inputs required for aproduction process of goods and services in another firm".

But again, the above mentioned categories are nowadays not possible because one company is involved in various categories of online business models. For instance the popular company Netflix which was in the beginning a pure reseller has now entered into the business of integrated firms as it is now integrating film production with it. Same is the case with Alibaba, which is though a giant commerce retailer company has opened up a bank and now applies its arithmetic data skills to provide loans to its customers.

1.5. PROBLEMS OF DIGITAL ECONOMY IN TAXATION

In recent times, the leakage of LuxLeaks, Panama papers, paradise papers have thrown out an all out debate among the tax authorities around the world with regards to the taxation on the revenuegeneration of the corporate giants. The features of the digital economy which include BEPS poses a great challenge to tax policies.[25] These challenges are not something out of the blue and they have been in existence for quite some time however due to the ever increasing use of technology and internet based business models, the problems for tax authorities and the decreasing tax revenue of the government is becoming a challenge.[26]

Some of the tax challenges as noted by OECD includes:[27]

- Presence of nexus is missing or taxable jurisdiction is not identified.
- Heavy reliance on intangible data, increase use of information technology based businessmodels.

(a) Presence of Physical property missing

In a common understanding, the major issue which comes before the tax authorities is how to taxthe company which does not have any office, building or machine or establishment in the source country and no idea as to how much the company is earning. This gives an edge to the digital companies to continue to work and when the revenue is generated, the same is transferred to the tax havens.[28]

(b) Excessive reliance on intangible properties

Today the digital companies are excessively relying on intangible properties so that they canshift them without any problem of increased taxation problems and in such a situation the authorities are not able to tax the companies properly.

(c) Data and user generated Content being used

There have been debates with regards to the situation where the consumers provide their data to online companies in exchange for free access and thus this data providing comes under the ambitof value creation or not.[29]

1.6. BEPS REPORTS AND ACTIONS

Since 2015, OECD tried to address the problems faced by the digital economy and how the taxation system is being questioned by the same system and what all the governments around theworld have to do in order to tackle the situation of taxing the profits and the income. The

summary of Action Plan of Base Erosion Profits (BEPS) reports in the context of PE are as follows:

1.6.1. 2015 OECD Action Plan 1 discussed the various problems posed to international taxation system due to the digital economy and discussed some methods to solve the same like new nexus situation, equalization levy, tax withhold without recommending any of the same.

1.6.2. Action 7 on PE: Under this 2017 model developed by OECD, it tried to tackle the principles of PE by recommending changes in the commissionaire arrangements, preparatory and auxiliary activity and also fragmentation of group activities. Again the problem under this action plan was that it failed to address the mobile MNCs which can take the advantage of virtual business model and saving themselves from the taxing net of the governments. However a new development was introduced through this report i.e. "Service PE" which was endorsed by UN and different from OECD approach because itis less focused on the physical presence.

ISSUE OF PERMANENT ESTABLISHMENT IN INDIA

The famous programme launched in India after 2014 general elections and a major dream of the Prime Minister Narendra Modi is the Digital India Programme in 2015 which provides a visionof transforming the country into a digitally innovative and empowered society.[1] As per this programme, the vision is threefold:[2]

- Digital infrastructure as utility to every citizen
- Governance and service on demands
- Digital empowerment of citizens.

It is not a hidden fact that the economy of India is the fastest growing economy in the world and also as per the reports India has the second largest internet subscription in the world.[3] It is also tobe noted that as per Digital Index Score, India's score has increased from 17 in 2014 to 32 in 2017. It is also worth mentioning that as per the government reports; the digital growth or digital economy of India can add a value of almost $ 1 trillion to the GDP of the country by 2025.[4] Due to the increasing dependency on digital economy, the problem which is attached with the digital economy is also on the rise and the country is facing several issues with regards to generation of taxation revenue through this digital economy. This includes, taxing the transactions which happen on web servers and cloud computing.

1.1. WEB SERVER UNDER INDIAN LAW

As per OECD, it is important to distinguish between the web

server and web site as it's the latter which is stored in the former because usually the enterprise which handles the server is different from the enterprise which carries out the business through that server.[5] Under this type of agreement, the enterprise which carries out its business through that website can pay the requiredfees in the form of rent to the Internet Service Provider (ISP) but the OECD says that this type of agreement do not give the power to the enterprise to have control over the web server unlike the website. The server and the enterprise shall not be considered to be at the disposal of the enterprise, however if the enterprise which owns the website also owns the physical land or the place where the server is located then it can be considered as PE if other requirements can be fulfilled.[6]

Going further with regards to the taxing problem of the web server business in India, there have been adjudications on the same matter by various tribunals across the country. One of the major arguments which has been raised by the authorities was that the service which is rendered by the web server to display the business and then the payment done for those advertising shall be treated as royalty. Therefore it is imperative for us to have a look as to this angle of argument.

It is worth mentioning Sec. 5(2) of the Income Tax Act, 1961 which provides as to whatconstitute total income of the non resident of the previous financial year:

"(a) is received or is deemed to be received in India in such year by or on behalf of suchperson ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year."

With regards to the "income which accrues or deemed to accrue" is not being defined anywherein the Income Tax Act. Sec. 9 only lists down the incomes which can form part of this term but this Sec. does not define this term. The Apex court in the case *Hyundai Industries*[7] stated that the term "income accruing or arising in India" means such income which is accrued or arises in the business being carried out by the foreign company and such income can be "attributed tosuch business". If the income cannot be attributed to such business, then such income cannot fall within the ambit of section 9 of ITA. Also it is to be mentioned that such income which accrues or arise through the business, this business should have presence in India in the form of an office or a project site or a factory or anything which can come within the ambit of the definition of "Permanent Establishment".

Coming to the situation as to what will be the tax liability in the case of a company which is providing online service through its website in the source country for another enterprise. In two ways the liability of the company can be brought in the payment of tax to the authorities. They are: Payment in the form of Royalty and payment in the form of technical services.

1.1.1. Payment for technical services

Payment for technical services has been dealt under Sec. 9(1)(vii) of the Income Tax Act. Explanation 2 mentioned in the section is of importance and it reads out:

"Explanation 2.—For the purposes of this clause, fees for technical services means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head Salaries."

In the above provision, it is only mentioned that when a fees or an income can be treated as a technical fees. However the problem is that the term "technical services" has not been defined anywhere and thus it has been held that the terms associated with it should be interpreted in the normal meaning.[8] According to ITAT Mumbai, the term technical services include the *"services are of technical nature when special skills or knowledge or education related to a technical field are required for the provision of such services. A mere use of a standard facility does not result in availing of technical services although such facility has been developed with the usage of technology."*[9] Also in another judgment in *Raymonds v. CIT*[10] the tribunal observed that in the plain interpretation of the term "technical services" "*is that a mere rendering of services not roped in unless the person utilising the services is able to make use of technical knowledge, etc. by himself in his business and or for his own benefit and without recourse to the performer of services, in nature".* The court also noted that there is a difference between rendering technical services and performing technical services. The same legal proposition is supported by two High Courts as well i.e. Delhi[11] and Karnataka[12].

First we have to understand whether the website shall constitute a PE in India under current income tax laws. According to OECD, webpage cannot constitute a PE however the Governmentof India maintained reservation with regards to websites being not considered as PE. The GOI stated:

"India does not agree with the interpretation given in para 42.2; it is of the view that website may constitute a PE in certain circumstances."

However in the case *Right Florists*[13] ITAT tried to interpret the reservation of India in respect ofthe website not being treated as PE. According to the tribunal when interpreting these reservations in the judicial matter, the words used in the treaty cannot be read as *"contemporanea expositio".* Also the country didn't mention in what cases the website shall be treated as PE thus providing a ground of doubtful interpretation. The tribunal concluded on this aspect that when interpreting a bilateral tax treaty, the intention of OECD shall not be considereda fair index. Rest it cannot go beyond that area of interpretation.

In regards to the payment in rendering of advertising services by the digital companies, there have been some judgments given in respect to the same. The major being the decision given by the Income Tax Appellate Tribunal Mumbai in *Right Florists case*[14] in which the tribunal was faced with the issue of payment of services for advertisement of the assesee by the digital web search companies i.e. Google and Yahoo. In this case the AO said that the fees paid by the assesee to Google Ireland and Yahoo India shall come under technical services under Sec. 9(1)(vii) of the Income Tax Act and hence taxable. However the tribunal was impressed by the said argument and observed that the web search technique of the Google involves no human touch and is fully automated and according to the established rules a technical services cannot come under Sec.

9(1)(vii) of the act unless it has a human touch and hence the fees paid by the company for advertising to Google is not taxable under ITA.

Again in other cases also, the tribunals decided in the favor of the assesee for the simple reason that the assesee didn't had any PE in the tax jurisdiction and when considering the argument on the basis of the server, the same wasn't held valid because the services provided by the company was not a technical service as provided under Sec. 9(1)(vii) of the act because there was no human touch involved in the same and the whole procedure was done by the software only and hence it cannot considered to have given rise to "income deemed to accrue or arise in India".[15]

1.1.2. Payment as "Royalty"

The term royalty has been defined under Explanation 2 to Sec. 9(1)(iv) of the Income Tax Act and it reads out:

"Explanation 2.—For the purposes of this clause, royalty means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head Capital gains) for—

(i) the transfer of all or any rights (including the granting of a licence) in respectof a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in Sec. 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibitionof cinematographic films ; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v)."

Also it is worth mentioning Sec. 9(1)(iv) which talks about *"income by way of royalty payable"*

under which clause (iii) reads out:

" (c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income fromany source in India."

In the case of PinstorM Technologies Ltd. case[16], the Income Tax tribunal while dealing the issue as to whether the payment paid by the company in India for the advertising done for its business by the Google search engine shall constitute a royalty payment and hence payable in India observed the following:

"I am unable to accede to the argument of the appellant. It is not in dispute that the payment has been made for the comprehensive services rendered for digital data display in their server and that the same will fall within the meaning of royalty as has been envisaged u/s.9(1)(vi) of theAct. From the facts it is clear that the said Google or for that matter yahoo etc. allot the space to the appellant company and its clients in their server and that whenever any internet user search for certain webs the appellants or its clients name would appear and its contents be displayed onthe computer screen. Thus in the instant case the payment made to the foreign company for advertising services rendered through the search engine would fall within the definition of royalty as defined u/s.9(1)(iv) of the Act. Since the payment is termed as royalty in nature the amount paid on such account would be liable to be taxed in India and such the appellant company was liable to deduct the tax on such payment and since no tax was deducted at source the AO was right in invoking the provisions of Sec. 40(a)(i) of the Act."

Though it should also be noted that on the similar facts another judgment given by the coordinated bench of Income Tax Appellate Tribunal in *Yahoo India case*[17] wherein the court decided in the favor of the assesee and held that the payment made by the enterprise for the services rendered by the Yahoo in the form of putting up online advertisements of the enterprise while search keywords is a part of business profits and not royalty under Sec. 9(1)(vi) of the Income Tax Act, 1961. However this judgment cannot be said that it had dealt with all the other parts of the payment of the advertising as it dealt with only one aspect i.e. Sec. 9(1)(vi) of the act. There is certainly more than this interpretation.

In another case, the issue before the tribunal was that the payment made by the enterprise to a Non resident company for the purchase of copyrighted articles shall constitute a "royalty" under the realm of Sec. 9(1)(vi) of the act. Also there were certain other cases having similar facts and they were on the issue of whether the payment given to the non resident company for providing certain digital services shall constitute a "royalty" or not. In both the situations, the tribunals affirmatively held that the payment for these services shall not constitute "royalty" under Sec. 9(1)(vi) of the act.[18]

1.2. CLOUD COMPUTING & PE IN INDIA

In the previous chapter, I have discussed in detail as to what actually a cloud computing is, the business models which are farmed under the same and likes. But since it is relatively a new concept, the laws in relation to taxation regarding same are unknown especially in India. However courts have tried to deal with this aspect. In *Rackspace case*[19]the issue before the Income Tax Appellate Tribunal **was whether the royalty (specifically Explanation 2 under Sec. 9(1)(vi) of Income Tax Act, 1961) can be charged upon the income earned through cloud computing service?** The court observed that the agreement between the assesee and its customer is only for making the hosting service simpler and the customer did not had any controlover the equipments of the assesee nor the

customer knew about the whereabouts of the data centre, web mail, websites etc and therefore such service income cannot be attributed under royalty hence non taxable.

1.3. EQUALIZATION LEVY

Report of the Committee of E-Taxation prepared by Central Board of Direct Taxation (CBDT) in2016 on the "Proposal for Equalization Levy on Specified Transactions" studied the changes in the business models due to digital revolution and there is a loss of revenue to the government exchequer because the profits attributed to the business is not taxed because there is no proper enforcement of the same and therefore the committee recommended a provision for taxing such income generate through E-business which is known as "Equalization levy".

The main purpose of levying this tax is to equalize the tax which is imposed on the business profits by a resident company and the foreign company which does not have such physical presence in the concerned jurisdiction but has economic presence, hence the need of equalizationlevy.

Taking into consideration a large amount of transactions being done online between residents and non residents, Indian government via Finance Act 2016 introduced the concept of "Equalization Levy" which was applied at the rate of 6% on some specified service.[20] This Sec. says that a levy shall be put on the consideration given to the services provided by the non resident by:

- *"a person resident in India and carrying on business or profession; or*
- *a non-resident having a PE in India"*[21]

The term "specified service" has been defined under Sec. 164(i) of the Finance Act 2016 which defines this term as: *"means online advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Central Government in this behalf."*

It is also to be noted that after Finance Act, 2020 a new Sec. 165A has been added and its heading reads out: *"**Charge of equalization levy on e-commerce supply of services".*** Under this Sec., a levy of 2% charge shall be made on the consideration received by the E-Commerce company which provides supplies and other services to the people who are already mentioned in Sec. 165 of the Act. It is also to be noted that under Sec. 165A(1)(ii) states that the equalization levy shall be charged on the consideration received by the E-commerce company for providing services to a non resident in "specified circumstances". The term "specified circumstances" is defined under sub-Sec. (3) of Sec. 165A which reads out:

"(3) For the purposes of this Sec., specified circumstances mean—

(i) sale of advertisement, which targets a customer, who is resident in India or a customer who accesses the advertisement though internet protocol address located in India; and sale of data, collected from a person who is resident in India or from a person who usesinternet protocol address located in India".

1.4. SIGNIFICANT ECONOMIC PRESENCE (SEP)

The concept of SEP was introduced by OECD through its Action Plan 1: "Developing options to address the broader direct tax challenges of the digital economy" on the backdrop of increasing use of digital transactions and BEPS. According to this concept, a non resident shall be considered to have a taxable presence if they have a substantial economic presence by interacting with customers based in that tax jurisdiction through digital mode.

The concept of SEP was introduced by the Government vide Finance Act 2018 and was inserted as Explanation 2A to Sec. 9(1)(i) of the ITA. The explanation states that the significant economic presence shall mean that the said business has "business connection in India". This is required for the purpose of bringing the said business under the taxation system of the country. This provision can be considered as one of the major breakthroughs in the field of taxation of PE in digital economy. The provision states that:

" (a) transaction in respect of any goods, services or property carried out by a non- resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(a) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means"

Moreover, a proviso is also added to this explanation which provides that a transaction or any activity carried out by a business entity shall be considered to have SEP in India whether

"(i) the agreement for such transactions or activities is entered in India; or the non-resident has a residence or place of business in India; or

(ii) the non-resident renders services in India"

To classify that the enterprise has SEP in the tax jurisdiction, some criteria can be taken into consideration:[22]

- ***"Revenue based criteria:** this criterion is based on a simple basis of the earning revenue of the enterprise from the customers who are residing in that particular tax jurisdiction where the SEP is claimed."*
- ***"Digital Based Criteria:** Taking the clue with regards to how the companies which carry out their business through websites get away from tax to the countries due to lack of PE, this criteria can be used in order to determine the presence of websites and use of local domain name by the enterprise in the tax jurisdiction."*
- ***"User based Criteria:** Another way of establishing SEP of the enterprise in the jurisdiction is the number of users using the digital website of the company and this can be calculated by using Monthly Active Users (MAU)."*

1.4.1. Widening the scope of SEP (Stand of Judiciary)

In the above point, we saw as to how a company can be taxed under the Income Tax Act, 1961 by the way of "significant economic presence". But the question arises as to whether the above mentioned provisions are sufficient in nature or in other words are exhaustive in nature?

In a latest judgment given by Income Tax Appellate Tribunal in *Volkswagen Finance Pvt. Ltd. case*[23] which was pronounced on 19th March, 2020 introduce an important new changein the meaning of "significant economic presence". The facts of the case are that an event was held in Dubai for launching Audi 8A and that event was targeted specifically for Indian market only. The question before the court was that whether the income generated in that event shall be considered as an income deemed to accrue or arise in India? **It is pertinent to note that the court in this judgment did not considered the previous judgments of SC orHC on the matter of "PE" or "income accrued or deemed to accrue in India" for a fact that all these cases were somewhere or the other based on "brick and mortar" PE and not on virtual presence or on the principle of "below the line advertisement". So the court held that the income generated in that even shall be liable to be taxed under Sec. 9of ITA**

1.4.2. Widening the scope of SEP vide legislature

While introducing the SEP concept in the income tax act, the problem which was coming before the taxation authorities was the non mentioning of the threshold which is required for the company to be declared as having SEP in the tax jurisdiction of India. The reason behind this is that the countries who are party to the G-20 summit failed to come into conclusion as to what shall be the threshold for the same and the same is expected to come by December, 2020.[24]

As a result of this, the government has introduced a wide range of changes in Sec. 9 of the income tax in order to include the digital presence of the companies in the tax jurisdiction of this country. Some of the changes include:

(i) Change in Clause (i) of sub-Sec. 1 of Sec. 9

In Explanation 1 of Sec. 9(1)(i) of the act, clause (a) of the explanation shall be amended.The provision which reads out as:

"(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India."

The expression "in the case of business" shall be substituted by *"in the case of a business, other than the business having business connection in India on account of significant economic presence,"* and this provision shall come into force on 1st April, 2022.

(ii) Substitution of Explanation 2A

The explanation 2A which was added by Finance Act, 2018 shall be substituted by a new explanation which is provided in Finance Act, 2020. The new provision reads out:

"Explanation 2A.—for the removal of doubts, it is hereby declared that the significant economic presence of a non-resident in India shall constitute business connection in India and significant economic presence for this purpose, shall mean—

(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or

(b) systematic and continuous soliciting of business activities or engaging in interaction withsuch number of users in India, as may be prescribed:

Provided that the transactions or activities shall constitute significant economic presence inIndia, whether or not—

(i) the agreement for such transactions or activities is entered in India; or

(ii) the non-resident has a residence or place of business in India; or the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall bedeemed to accrue or arise in India."

The above mentioned provision shall come into force from 1st April, 2022 whereas theexisting explanation 2A shall stand omitted from 1st April, 2021.

(iii) Insertion of Explanation 3A

Moreover after explanation3, Explanation 3A shall be inserted which shall come into force from 1st April, 2021. The provision reads out:

"Explanation 3A.—For the removal of doubts, it is hereby declared that the income attributable to the operations carried out in India, as referred to in Explanation 1, shall include income from—

(i) such advertisement which targets a customer who resides in India or a customer whoaccesses the advertisement through internet protocol address located in India;

(ii) sale of data collected from a person who resides in India or from a person who usesinternet protocol address located in India; and

(iii) sale of goods or services using data collected from a person who resides in India or froma person who uses an internet protocol address located in India."

Also, the proviso to this explanation also provides that this shall be an explanation to the newly inserted Explanation 2A as well.

CONCLUSION AND SUGGESTIONS

Recently, Government of India notified Finance Act, 2020 through which certain amendments were brought in Income Tax Act among which a new Sec. was inserted ***Sec. 194-O*** which deals with the ***payment of certain sums by E-Commerce***

operator to E-Commerce participator.

Explanation was added to this Sec. under which the term "electronic commerce" is defined as: *"means the supply of goods or services or both, including digital products, over digital or electronic network".* The Finance Act of 2020 brought many new changes in the income tax act in relation to e-commerce business as we have mentioned above.

It is to be noted that the above provisions which are mentioned and brought by the Finance Act, 216 and 2020, it isn't the case that the courts previously did not discussed such issues or there were no issues at such. A much mature decision which caught the eye of taxation expert was the decision of the Delhi High Court in the case of *WWE v. M/S Reshma*[1], in which the court held that, *"availability of transactions through the website at a particular place is virtually the same thing as a seller having shops in that place in the physical world".* The Court placed reliance on Supreme Court judgment[2] and observed that the conditions of appellant carrying business in Delhi is satisfied as the customers of the appellant is located in Delhi, its customers use its website in Delhi, receive the merchandise in Delhi hence it can be attributed that all these virtual activities are carried out by a physical person, hence taxable. Infact Spain Central Economic- Administrative Court[3] held that selling of goods through a website in Spain even when the web- server is located outside Spain is enough to constitute a physical presence of that enterprise in theSpain.

In other way round, let's consider that there were no such cases or deliberations on the interpretation of the statue or international taxation in respect of the digitization so would it had stopped the present courts to interpret the treaties according to the present situation or they had to follow the traditional system of physical presence of enterprise only? The answer is plain NO. There is a theory in the interpretation of a law which is known as *"**doctrine of updating construction".*** This theory was proposed by Francis Bellon[4] which states (in the language of the scholar):

"the interpreter is to presume that Parliament intended the Act to be applied at any future timein such a way as to give effect to the true original intention and thus, the interpreter is to make allowances for any relevant changes that have occurred since the Act's passing, in law, in social conditions, technology, the meaning of words, and other matters."[5]

Going by the above meaning, even if there were no discussions or BEPS Action Plans then also considering the circumstances, the courts would have adjudicated the same according to the changing circumstances. But it is again easy said than done. You need authorities, you need reports, you need the opinion, and you need the precedent over a particular situation.

Considering India's stand on International Taxation with respect to OECD Commentary, it had made its stand clear already as well as in G-20 Summit which was held in 2020. The Finance Act 2020 had also made sweeping changes in the taxation system of our country considering the prevalent situation in respect of the increase in the digital payment and also considering the fact that the digital economy shall be playing a major role in generating revenue for the GDP of our country.

However certain aspects have to be kept in mind for these E-Commerce Businesses. For instance in the case of Facebook/Whatsapp acquisition, the contentions were raised against it in regards tothe anti-competitive elements but what about the user data which the Facebook acquired by the acquisition of Whatsapp. How data is a big generator of profits can be understood by the working paper prepared on international taxation by *Aqib Aslam and Alpa Shah*[6] in which the scholars observes that even raw data collected by the company is of value. Though the companies argue that an actual value of data comes after processing like algorithms but the scholars rightfully argue that if you on the first instance don't have a raw data then on what grounds you can process it and generate more value? In a tradition world even a raw material hassome value and the goods sold in the market are the finish goods. The same is the case with these digital data. Though it can be said that the value of data cannot be determined in a straight jacket formula as there is no price attached to the same however an idea can be imputed by some transactions like Facebook acquiring instagarm by $ 42 per user data and like that.

My point here being, taxation becomes a hefty problem when you don't have a particular value attached to the data and therefore when you don't have a value attached to the same then how you can tax something? Though when the companies acquire another company, a value is obviously attached to the same and therefore tax is imposed on the same. But if the true value of the merger is hidden as the correct value of the data being acquired by the company is not knownthen what the procedure to rectify that mistake is?

In the same way the questions regarding PE through virtual world keeps on popping up because there is no end to the enhancement of the digital business and as the time will pass, many new business models will come up which can again question the whole taxation system and the governments shall be force to recognize the same and work accordingly. The author would liketo suggest some points in regards to the same:

- Since there is taxation is done on raw material as well, it is necessary for the government to identify raw material in the case of digital business establishment and tax accordingly because taxing by equalization levy may not prove to be effective keeping in mind the changing business models. Government levy's tax on raw material imported and thus no matter what, domestic companies or the companies which have to work in a physical presence are at a lower point as compared to the companies which just have to analyze and process data digitally and do their business. Therefore it is a need to charge a tax on the raw material of a data. What will be the raw material; it is something no one can answer affirmatively.

- Another problem which all the countries generally face especially developing companies is the lack of consensus over taxing regime globally. Two countries may have different understanding and view over a particular fact and because of this; it can become a hectic problem for a country to tax a foreign company operating virtually in its tax jurisdiction because of Double Tax Avoidance Agreement (DTAA) between these two countries. Therefore there is a need of hour that some firm international cooperation is done to analyze the working of taxation on digital companies.

An interesting step has been taken by the Government of India in regards to the generation of data and it can thus be corroborated with the value that data and that is Personal Data Protection Bill, 2019. This bill has been though introduced on the lines of K.S. Puttuswamy Judgment on the need of

protection of privacy of the individuals stored with digital data companies. Under this bill, Sec. 2 which talks about the application of the provisions is to be applied as per the analysis to every digital company whether they have PE in India or not but what matters is that the data isbeing collected in India and processed. Specifically Sec. 2(c) can have a huge impact over the businesses which run away from the obligation of paying tax by the help of being virtual and the provision reads out:

"Sec. 2: The provisions of this act shall apply to…

(a) The processing of personal data by data fiduciaries or data processors not present within theterritory of India, if such processing is—

(i) in connection with any business carried on in India, or any systematic activity of offeringgoods or services to data principals within the territory of India; or

(ii) in connection with any activity which involves profiling of data principals within the territoryof India."

However, again if we analyze some Sec.s of this bill there are some gaps left which can still be taken with benefit by the data processing company. For instance Chapter-II of the act talks about "Obligations of the Data Fiduciary" and under it Sec. 5 which reads: *"Limitation on purpose of processing of personal data"* says that the personal data of an individual can be processed **reasonably** keeping in mind the data privacy of that individual.

Moreover Chapter VII which talks about "Restriction of transfer of personal data outside India"had put some conditions on the transfer of data outside India but not complete prohibition. For instance Sec. 33 under this chapter says *"Prohibition on processing of sensitive personal data and critical personal data outside India".* It states:

"33. (1) Subject to the conditions in sub-Sec. (1) of Sec. 34, *the sensitive personal data may be transferred outside India, but such sensitive personal data shall continue to be stored in India."*

4.1.1.A.1. The critical personal data shall only be processed in India.

"Explanation.—For the purposes of sub-Sec. (2), the expression "critical personal data" means such personal data as may be notified by the Central Government to be the critical personal data."

The term "sensitive personal data" includes sexual orientation, genetic data, transgender data etc.as per Sec. 3(36).

If we read the above provisions, there is no blanket ban on the processing of data outside India and this data can be used by the digital companies for increasing value and thus generating more profits. GOI has taken great steps keeping in mind privacy of data as well as the taxation system but only time will tell whether all these provisions becomes a success or a failure.