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"CHALLENGES IN TAXING THE DIGITAL GOODS AND SERVICES"

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ABSTRACT:

The global economy's increasing digitisation has changed the way that products and services are distributed and consumed, which presents serious problems for established taxation schemes. It is becoming more and more difficult for governments throughout the world to categorise, regulate, and tax digital goods and services, which range from software and streaming platforms to e-commerce and ride-sharing apps. This essay explores the advent of unilateral policies like the Digital Services Tax (DST), which has been embraced by nations like the UK, France, Italy, and India, as well as the changing definitions of digital commodities and services and the shortcomings of current tax structures. The Equalisation Levy and changes to India's tax laws are among the legal and regulatory remedies that are given particular attention. Global initiatives spearheaded by the OECD and the difficulties in reaching an agreement when national interests clash are also covered in the paper. Important issues like tax jurisdiction, tax incidence, discrimination against foreign companies, and double taxation are examined severely. Finally, without impeding innovation or economic growth, the report promotes a concerted multilateral strategy to guarantee equitable, open, and effective taxation in the digital economy.

Key Words: Digital Service Tax, Digital Goods, Digital Services,

Introduction:

We are in a digital age where everything is online whether its entertainment or sell-purchase of goods or access of any service or anything else. According to a new study from Fiserv, 74% of online purchaseworldwide are for digital goods and services.[1] The covid 19 lockdown made people engaged more into online transactions, that revolutionised the digital world. European Central Bank president Christine Lagarde noted, in September 2020, "e corona pandemic has accelerated this trend toward digitalisation. . . . As our lives have suddenly gone digital, so have our payments: there has been a surge in online payments and a shift- towards contactless payments in shops. . . . e trend is unlikely to be reversed once the pandemic is over. In other words, the pandemic has served as a catalyst, accelerating the transition towards a digital new normal."[2] But the main concern of states across the world is taxing the digital goods and services. As digital goods are intangible in nature it is difficult to classify what all can be considered as goods and what as services. For e.g. software, games, music, electronic books, Netflix, YouTube, Ola, Uber, Flipkart, Amazon etc. The other concern is taxing the digital goods and services as it is one of the growing fields of economy and the taxation system under which it should be taxed and also the challenges that is being faced due to adoption of different taxation methods by different countries.

So, this paper focuses on the Digital goods and services and the taxation systems adopted by multiple countries to tax the digital goods and services including Indian legal frame work regarding it and the challenges of taxing such digital goods and services.

Digital Goods and Services Defined:

Thing that are delivered and consumed digitally come under the purview of digital goods and services. Specifically Digital goods can be referred to any goods that are sold, delivered and transferred in any digital form. Most common examples of digital goods are media files, including music files, video files containing movies or television programming, branded multimedia files and other similar types of products.[3]Whereas in "Proposal for COUNCIL DIRECTIVE laying down rules relating to corporate taxation of a significant digital presence" under article 3 (5) provided digital services as services which are delivered over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention and impossible to ensure in the absence of information technology, including in particular: the supply of digitised products generally, including software and changes to or upgrades of software, services providing or supporting a business or personal presence on an electronic network such as a website or webpage and many more.[4] These definitions are somewhere not sufficient to identify, which will come under goods and which under services. For e.g. Software, whether it is a good or a service? In this regard Brazilian Supreme Court held in 1998 in a landmark judgement5 defined that ‘Off-the-Shelf-Software’ fitted into the concept of goods & merchandise, while ‘Sole Copy Software’ needed to be treated as services to the extent that it was adapted to a particular user. Indian Supreme Court had a distinct view in Tata Consultancy Services vs. State of Andhra Pradesh6 held that whether software is customized or packaged or branded; it comes under the category of goods for the purpose of taxation. But in the year 2018 Central Government of India has provided clarification through the Central Board of Indirect Taxes and Customs (CBIC)7 that " Development, design, programming, customization, adaptation, upgradation, enhancement, implementation of information technology software shall be treated as supply of services as per No. 5 (2) (d) of schedule II of the GST Law." Still there is a state of confusion among states about the software and its specificity.

History of Digital Goods and Services:

New global taxation challenges posed before the world, as highly digitalized businesses become mainstreamed in the 21st century economy. More specifically, the traditional international tax nexus and profit allocation rules, which allocate tax revenue among relevant countries, no longer work effectively in the digitalized economy. The traditional physical presence requirement for a market country to exercise tax jurisdiction was considered reasonable when the rule was developed in the early 20th century.[8] When a business renders services to foreign customers, somebody must go to that market country and be present there. If it suffices to render the service remotely, it is not considered enough to constitute a tax nexus in that market country. However, such rationale has become inadequate as many businesses offer remote services. It is further difficult to justify the rationale for the highly digitalized businesses with multi-sided platforms, where firms' revenue relevant to the market country is not paid by the consumers in the market, not to mention the lack of physical presence there. In February 2019, the OECD released the Public Consultation Document with three proposals on the taxation of the digital economy: 1) the User Participation Proposal; 2) the Marketing Intangibles Proposal; and 3) the Significant Economic Presence Proposal.[9] Realizing the need to address the tax challenges of the digital economy, the European Union ("EU"), the G20, and the OECD, which are important voices in international taxation, have discussed this issue as their top priority and offered three proposals to address the issue. First is expanding the tax nexus rules to include significant digital presence and introducing new profit allocation rules based on formulae ("Significant Economic Presence Proposal"). Second is modifying both tax nexus and profit allocation rules and reallocating an amount of income deriving from specific intellectual properties, called marketing intangibles, to market countries ("Marketing Intangibles Proposal"). Third is modifying only profit allocation rules to require an amount of profit be allocated to market countries where user participation is active, irrespective of whether the businesses have a local physical presence, or tax nexus ("User Participation Proposal"). This proposal is later embodied more aggressively in supporting countries, such as the United Kingdom and France, by introducing a new tax, called Digital Services Tax ("DST"). All three proposals attempt to give market countries greater taxing right, but are different as to how and to what extent they modify the taxing rights.[10]

Unfortunately, the global community failed to reach a consensus on any of the above proposals in March 2019. In response, market countries, especially in Europe, have unilaterally introduced, or plan to introduce, a DST for certain highly digitalized businesses, which has ignited heated debate across the globe. For example, France has started imposing a 3% DST on the gross revenue of certain highly digitalized firms generated in France from July 2019, retroactively in effect on January 1, 2019. United Kingdom will also introduce a 2% DST in 2020.[11]

Digital Services Tax: Unilateral Measures By Countries:

Despite the failure to adopt either DST or digital PE at the level of the European Union, several supporting member states have taken various levels of unilateral action, which are largely skewed towards multiple distinct versions of a DST. This Subpart explores the most noteworthy cases in Europe [and other countries] to understand the implications on the international tax policy and identify common key features of DSTs.

United Kingdom was the first country to adopt DST and impose the taxation on the digital platforms for providing goods and services. DST applies at a rate of 2% on UK digital services revenues above the annual allowance. It is a tax on revenue not on profits. In UK digital services activities cover: social media service, an internet search engine or an online market place. When there is cross border transaction the revenue may be linked to both a UK user and a non UK user. All the transactions belong to digital service revenues.[12]

France is another country leading the unilateral change, following the EU's epic fail in March 2019. In the same month of March of 2019, the French Finance Minister, Bruno Le Maire, released a policy document detailing the country's unilateral approach to the DST.[13] France imposes 3% of DST on the revenues generated from the provision of digital interface, targeted advertising and the transmission of data collected about users for advertising purposes.[14] Although France is the second country that introduced a DST, the new tax bill retroactively established the tax to tax revenues generated from January 1, 2019,[15] which chronologically makes France the first country to impose a DST.

The other European countries like Italy, Spain, Australia also included DST in their tax system. The Italian Budget Law 2020[16] provides for the entry into force- as of January 1, 2020, of a new DST replacing 'web tax' introduced by the Italian Budget Law 2019(law No. 145 of 2018) which imposes 3% DST. Here DST only applies to revenues derived from : provision of advertising on digital interface targeted to users of the same interface and the Transmission of data collected from users and generated by the use of digital interface but does not include direct supply of goods and services as apart of digital intermediation service, provision of a digital interface whose exclusive or principal purpose is that of supplying the users of the interface, by the person who manages it, the interface of : digital content, communication services or payment services, digital interface used or managed specific traditional platforms, interbank or the performance of the activity of the organisation and management of telematics platforms for the exchange of electricity, gas, environment certificates and fuels, as well as the transmission of the related data and any other related activity.[17] Spain also do have the same tax rate of 3% as of France.[18]Australia imposes a 55 tax on gross revenues from digital advertising services provided in Australia.[19]

India And The Digital Goods And Services:

India is one of the biggest and fastest growing market of digital goods and services. Companies like Facebook, Google, YouTube are generating most of their revenues from India only. Due to which it become important to include digital goods and services under the taxation system. On classification issues, the challenge is a categorization of the offerings in e-commerce as 'goods' - inviting the payment of VAT/CST, or as 'services' - inviting the payment of Service Tax. Both State VAT/CST authorities and Service Tax authorities want to exercise their right over digital transactions like downloads of software, music, e-books, etc., leading to disputes and endless litigation. The Central Government has been collecting the Service Tax on the services provided by various e-commerce operators.

During the 2015-16 Budget, the tax base was further widened by bringing in the concept of 'aggregator' and taxing the services provided by him. An aggregator has been defined as a person who owns and manages a web-based software application. By means of the application and a communication device, he enables a potential customer to connect with the persons providing services of a particular kind under the brand name or trade name of the aggregator. Soon thereafter, the liability for collecting and depositing Service Tax was shifted to the Aggregator, thus enabling a reverse charge mechanism, which allows charging Service Tax from the receiver instead of the provider of service.[20]

To solve this issue Indian Parliament has undertaken two significant unilateral actions in taxing the digital economy since 2016. As part of the Indian Government's Finance Act of 2016,[21] the country introduced a turnover-based tax designated as a "equalisation levy,"[22] which is comparable to DST. Equalisation Levy is a direct tax, which is withheld at the time of payment by the service recipient. The two conditions to be met to be liable to equalisation levy: The payment should be made to non-resident service provider; or the annual payment made to one service provider exceeds Rs.1,00,000 in one Financial Year. In 2018, following India's participation and review of the OECD's BEPS continuing research, the country also expanded the definition of PE in its income tax statute to include digital companies that would otherwise not be taxed due to its lack of physical presence in India.[23]

Recently, in the year 2020, India, through the Finance Act Amendment24 brought the 2% Digital services Tax on the revenues generated from a broad range of services offered in India, including digital platforms services, digital content sales, digital sales of company's own goods, data related services, software as a service and several other categories of digital services.

Clara Hathorne & Robert Breunig in their research paper25 discussed about the challenges faced due to digitalization as: "Digitalisation of the global economy has allowed corporations to reach new markets and create employment around the globe without a physical presence, leading to concerns about tax avoidance by MNEs. In addition, these digital companies rely on intangible and highly mobile assets. These two factors make it relatively easier for MNEs to engage in profit shifting and other forms of tax avoidance. DST proponents point to the geographical mismatch of where digital companies are based and pay tax and where the majority of their consumers reside. For example, the United States is home to 37% of the digital economy yet only 11% of global internet users.26 This mismatch in the distributions of digital producers and users raises political pressure to realign taxation with the location of users. Digital MNEs create value from users' data, frustrating governments in countries with users but without the physical presence of digital companies. Current taxation models make it difficult for these "destination" countries to tax this value creation."27

Challenges Of Taxing Digital Goods And Services:

To overcome the issues of prior taxation system digital services tax brought into picture but that itself a challenge. On June 02, 2020, the United States Trade Representative initiated an investigation against United Kingdom, Spain, Australia, Brazil, Czech Republic, the European Union, Indonesia, Turkey and India for implementing Digital Services Tax under section 301 of the Trade Act of 1974.28 Under the USTR investigation Report against India,29 allegations are being made as: "First, our investigation indicates that India's DST discriminates against U.S. digital services companies. India's DST is discriminatory on its face. The law explicitly exempts Indian companies, while targeting non-Indian firms. The result is that U.S. "non-resident" providers of digital services are taxed, while Indian providers of the same digital services to the same customers are not. This is discrimination in its clearest form. Indeed, one Indian government official confirmed that the very "purpose" of the DST is to discriminate against non-resident foreign companies, Second, DST targets digital services, but not similar services provided no digitally. Because U.S. companies are global leaders in the digital services sector, U.S. companies face an inordinate share of tax burden. Indeed, of the 119 companies that USTR has identified as likely liable under the DST, 86 (72%) are U.S. companies; third, India's DST unreasonably contravenes international tax principles as India adopted the DST in the midst of on-going Multilateral Negotiations regarding Digital taxation"

DST would consider as a turnover tax as it applies on the gross revenue of specific digital business models where revenues are linked to the participation of its local users rather than the other traditional taxes like income tax etc. where the tax levied on the profit or something like that. Turnover taxes have existed for over a century, but they have recently become a topic of tax policy scholarship as a "few countries have enacted or proposed a turnover tax on digital services as an interim measure to address" current international tax issues.30 This turnover tax is criticized in part simply because they "are not based on profits, measures of income, or any other indicator of consumption power that is targeted by most other tax instruments in modern developed economies."31 Moreover, turnover taxes, in general, may be distortionary due to so-called "tax cascading"—that is, when multiple firms touch in the development of a product, "the total tax paid will be higher for goods passing through several firms to their final sale than for those which do not."32

Another challenge is the double taxation that is most probably, possible to be done while imposing taxes on digital goods and services. Even DST has been criticized as a disguised direct tax, or corporate income tax, which may result in double taxation in income tax treaties. The majority of countries have income tax systems and enter into income tax treaties with their major trading partners to eliminate double taxation on certain income when two or more countries concurrently contribute to that income. One country might contribute to the income as a residence country of a taxpayer, and another country might contribute to the same income as a source country where the taxpayer deploys investment. However, if the two countries claim to collect tax on the same income, double taxation occurs. Putting the double taxation problem in the digital economy, a digital firm's profits, including those generated from market countries, have been subject to corporate income tax in the firm's residence country. Now, however, market countries are introducing a DST on the firm's gross revenue generated from the market country. From the firm's perspective, it now faces two different taxes to two different countries, respectively.33 These are some of the basic questions which come to the mind while thinking about the Taxation of Digital Goods and Services.

Another challenge is Tax incidence of the DST, that means who will bear the economic burden of DST. The statutory incidence of tax is placed on the individuals, entities or sectors of the economy that have "the legal obligation to remit taxes to the government. In the case of DST, the statutory incidence has been placed on those digital businesses with high enough gross revenues that offer the digital goods and services, targeted by the tax.

Conclusion:

The main ultimate aim of the taxation of digital goods and services is to collect fair share of tax from each and every sector that is earning profit in any part of the world and pay tax to that country with full transparency. For this the adoption of new taxation should have to be done but the challenges that are posed in this paper should also be looked into. Digital goods and services is a vast area and the companies which are in this area are monopolistically covering the field, so there is a great need of the good taxation system across the world but with that the multilateral way should be adopted so that the taxation system cannot hinder the growth of economy and over burdensome the taxpayer, whether it is company or a consumer.

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