

## Google, Others Prepare for India's Tough Digital Tax Rules

By Benjamin Parkin

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- India making "economic presence" rule final before April effective date
- Companies restructuring, applying for pricing agreements as they prepare

Digital companies are bracing for India's introduction of tax guidelines that will make the country one of the world's toughest for online businesses.

The tax department is preparing final guidelines for taxing companies that do business online without a physical presence. The "significant economic presence" standard is due to go into effect in April after being introduced into law in 2018.

Companies and tax professionals say they are trying a raft of measures to minimize the impact of the provision, from setting up physical establishments in India to applying for new intercompany-pricing deals and lobbying the tax department to tread carefully with its changes.

"Everybody is a little worried about their particular business model," said Rohinton Sidhwa, a partner at Deloitte Haskins & Sells LLP. "If I were Amazon, or I were Google, or I were GoDaddy, how would this impact me?"

At the same time, companies want India's big market potential. One industry participant abroad, who didn't want to be identified said "There's a big constituency that says, 'We need to be in India, we need to do business there. This is what it is, we'll live with it.'"

India has been at the forefront of the global search for new ways to tax the digital economy, concerned that large foreign companies are sapping its revenue. The Organization for Economic Cooperation and Development has been coordinating efforts to find an international consensus by 2020.

Tax officials say the issue requires urgent attention. "Businesses are able to participate in the economic life of a country without a physical presence," Rasmi Ranjan Das, joint secretary of India's Finance Ministry, said at the International Taxation Conference in December.

In 2016, India pioneered an online tax on digital advertising known as the equalization levy. Indian courts have also found that digital companies like Alphabet Inc.'s Google owe tax on international transfers they deemed royalty payments. Practitioners say the significant economic presence provision would cement India's place among the trickiest for online companies, despite being one of their most promising markets.

## Preparation

Under the significant economic presence provision, companies that engage with or sell to Indians online above a certain threshold will be liable to pay tax. The tax department is currently working out what those thresholds will be.

With the levy due to take effect in a matter of months, business groups say companies are already taking action and adapting their businesses.

The Internet and Mobile Association of India (IAMAI), which represents the Indian arms of major digital companies like Google, Facebook Inc. and Amazon.com Inc., said it has seen more businesses moving to set up permanent establishments—actual business units of one kind or another—in India, which would help shield them from the tax on foreign-company revenue.

“Major international service providers are setting up PE in India as they have long term targets for doing business in India,” IAMAI said. “All businesses understand authorities will demand taxes and are agreeable to reasonable demands.”

The National Association of Software and Service Companies (Nasscom), which represents companies like Microsoft Corp., Oracle Corp. and International Business Machines Corp., said it is engaging with the government to ensure that the provision reflects the changing realities of the digital economy. For example, many online businesses no longer make profits in a traditional sense, said Ashish Aggarwal, Nasscom’s head of public policy, and the rules have to reflect these and other changes.

“We have encouraged the tax department to have further discussions,” Aggarwal said. “It will be beneficial for the authorities to take a deeper dive into the business models, to understand some of the challenges in applying some of the proposed rules.”

Practitioners are also urging the government to ensure its guidelines don’t unwittingly ensnare non-digital businesses. Because India opted for “significant economic” presence over “significant digital” presence, traditional brick-and-mortar companies that sell some goods online could unwittingly be required to pay tax. Deloitte’s Sidhwa said the measure “opened the door a crack more than what was originally envisaged.”

## Deal-making

India’s intensifying efforts to tax the digital economy have prompted businesses to take a number of other steps.

More companies are applying for advance pricing agreements, said Meyyappan Nagappan, leader at Nishith Desai Associates’ international tax practice. The agreements allow a company to negotiate with authorities the rates for payments between global subsidiaries, helping avoid the risk of costly litigation.

The number of companies applying for the advance agreements rose 66 percent to 168 in the year ended March, the most recent date of available data, the tax department said. Practitioners say the practice’s popularity has continued since that time. Almost 70 percent of agreements signed during the year came from the service sector, which includes digital companies.

Other companies are taking their concerns to court. Google is fighting its case after a tribunal ruled in May that payments made from the company's Indian unit to its Irish unit were taxable royalty payments. The company said it would appeal the ruling.

### **Global Efforts**

The action in India reflects broader changes, as multinationals re-examine practices around the world in light of global efforts to clamp down on tax avoidance.

With more countries adopting their own measures, the OECD said in a report earlier this year that companies like Amazon, Facebook and eBay Inc. were restructuring to conduct sales locally instead of remotely. Others have "on-shored" assets to countries where they operate and re-examined their transfer pricing practices, the OECD said.

Companies are keen to ensure they're compliant in India, said Mukesh Butani, founder of BMR Legal, but aren't "looking at reorganizing their affairs in isolation."

"Frankly, businesses globally are relooking at their entire models," he said.