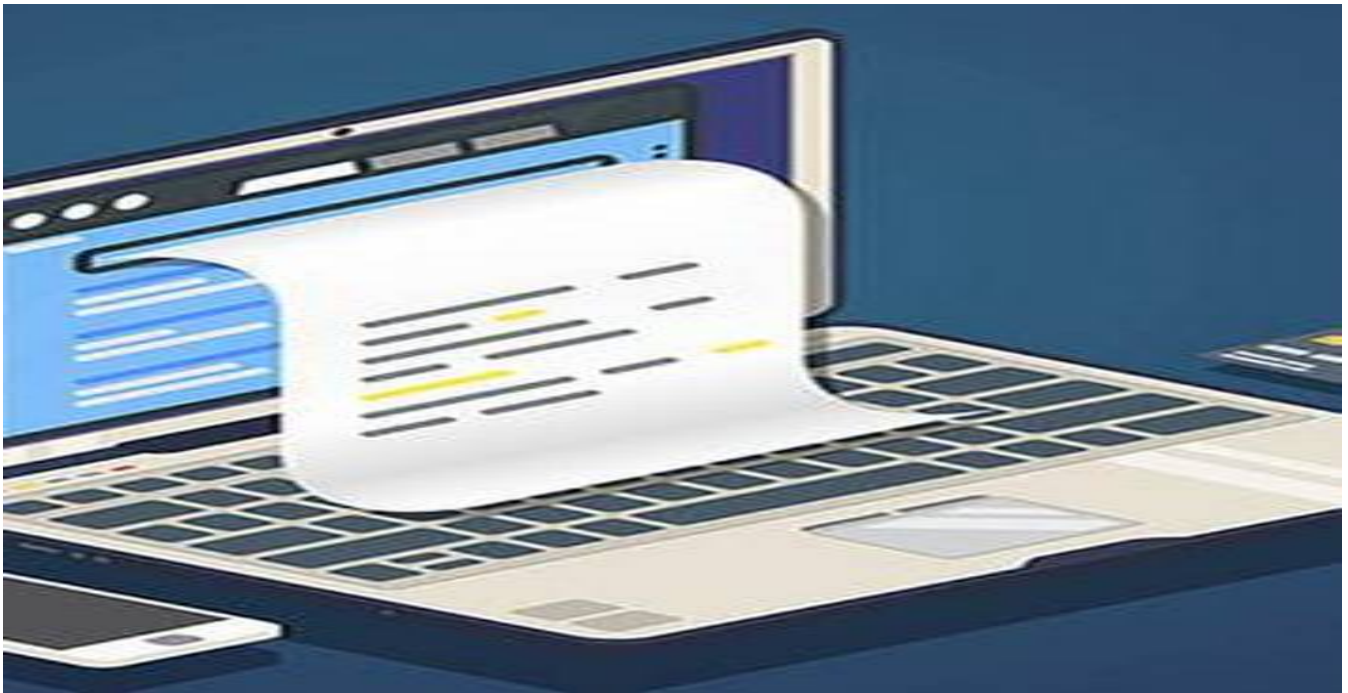


Opinion

## Taxing digital services

Meyyappan Nagappan | Updated on July 07, 2021



### The UN model suffers from multiple issues

Recently, the G-7 agreed on the key aspects of a proposal aimed at taxing multinational companies. After several years of negotiations, this is significant step and progress towards a final resolution of this highly debated issue in recent time. Despite varying interests, the countries have come together to build consensus, as a starting point amongst them and hopefully, it may serve as a basis for building consensus at the G-20 level and with the inclusive framework where several developing countries are a part of this discussion.

While the political support appears to be coalescing around Pillar I and Pillar II, which are the OECD proposals in this regard, in April 2021, the United Nations Tax Committee approved an alternative proposal, Article 12B, as an addition to the UN Model Tax Convention (MTC) and its commentary. Article 12B is on paper an alternative to this vexed issue and is intended to enable a country like India to tax payments made to offshore digital service providers. While it is touted as addressing the needs of developing countries, its narrow scope, reliance on impracticable bilateral negotiations, and departure from a multilateral approach raises serious doubts as to whether its implementation is feasible or even desirable.

## Complicates matters

While the effort is laudable, the 12B proposal suffers from multiple issues. Firstly, compared to the other proposed solutions, Article 12B has a much narrower scope, resulting in a narrower tax base. It targets only services that are provided on the Internet with minimal human involvement where the payment is emanating from India. A broad-based solution instead allows taxation of income from non-digital operations in addition to a right to tax income that companies derive from multi-sided models. Such an approach is also likely to provide the basis for a stable long-term tax regime which does not distort commercial operations of businesses due to perverse tax incentives.

On the business end, Article 12B complicates matters through its simplification attempt: by not having any threshold requirements. While discarding the archaic criteria of sustained physical presence is a good step forward for taxation in the era of digitalising businesses, the absence of a revenue threshold is concerning for smaller businesses and administrability for the tax department. Moreover, there is tax uncertainty since the rate of taxation is for countries to negotiate. More importantly, the proposed allocation of 30 per cent of taxable profits with equal weightage to assets, employees and revenue, under the UN model also appears arbitrary and without basis.

The provision is also likely to be politically unfeasible. The UN Tax Committee which worked on Article 12B comprised 25 members from various countries, working in their personal capacity. A significant minority of members dissented on several aspects of the provision. Compared to this limited capacity, the OECD has representatives from 139 countries which are invested in a multilateral consensus-based solution. It is unlikely that they would go through tedious bilateral negotiations with various states to implement the suggestion from a less-representative committee.

The adoption of Article 12B would also not benefit India since the Equalisation Levy currently has a wider ambit in terms of tax base and revenue sourcing rules. Theoretically, both Article 12B and the Equalisation Levy could operate together, since the levy exists outside the tax treaty. Yet, there is no useful purpose for which India would go through several bilateral negotiations with countries, when it already gains significant revenue through the EL. Although a significant step in terms of principles, its impracticable nature might render Article 12B a paper tiger amidst the various proposals that seek to address the tax challenges of a digitalising economy.

India has expressed its commitment towards a multilateral solution at the OECD level in the past and a multilateral solution presents the best path forward for a stable tax regime.

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