



TAXATION ON DIGITAL ECONOMY

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It may be too early to comment upon the exact taxation approach, however, the possibility cannot be ruled out that appropriate taxation on Digital Economy may lead to a wider tax base and a new source of Tax Avenue for the government.

Fast technological modifications play a very important role on the accelerated development of the digital economy. New business models evolve to fulfill customer's expectations and enhance the services provided. E-commerce increases cross border transactions, opens new markets and improves relationships among customers. It has been estimated that by 2022, over 60% of global Gross Domestic Product (GDP) will be digitized and 70% of the new value created in the economy over the next decade will be based on digitally enabled platforms. As the Organization for Economic Cooperation and Development (OECD) puts it, the digital economy is increasingly becoming the economy itself.

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Digital economy has imposed new challenges on tax policymakers. This is the case in relation to the application of tax rules designed for brick-and-mortar activities to new disruptive business models, but also with regard to the effective enforcement of such tax rules against companies that do not have a physical presence within the country. These threats to national tax systems derive from the absence of physical presence, the strong dependence on intangible assets, the complex nature of the transactions carried out in the digital economy, and the difficulty of qualifying assets, activities and types of income.

The digital tax is gaining popularity across the globe, as a result almost 50 jurisdictions have made changes in their current legislation regarding the taxation to include the digital tax, or presented new laws focused on taxation of digital economy.

Digital Tax Base

International income tax system rule is based since the 1920s on the "origin of wealth" principle. Traditionally, the factors creating value were relatively immobile and required intensive use of labor and tangible assets, justifying generally taxation at "residence" states. The nexus (or Permanent Establishment) rule – "fixed place of business" complements this principle in the case of non-resident enterprises performing a sufficient level of economic activity in a jurisdiction and profit allocation rules, based on the "arm's length principle", guide the determination of the profits that will be subjected to taxation in every jurisdiction implied in cross-border Multinational Enterprises' activities.

The current nexus rules capture only the physical presence, with the "digital presence" out of reach, even when it is significant

Current international tax rules allow the source country to tax the non-resident's business profits only if its local presence constitutes a permanent establishment. However, in a digitalizing world, a business can be conducted through a website in the market jurisdiction without any physical presence; even the website servers need not be set locally. With advancing digital technology, in-person services can be delivered online, allowing a business to avoid creating a permanent establishment in the market country. In summary, the current nexus rules capture only the physical presence, with the "digital presence" out of reach, even when it is significant.

Tax Policy Issue

- a. **Nexus:** The continual increase in the potential of digital technologies and the reduced need in many cases for extensive physical presence in order to carry on business, combined with the increasing role of network effects generated by customer interactions, can raise questions as to whether the current rules to determine nexus with a jurisdiction for tax purposes are appropriate.

Nexus, Data and Characterization are the three broad categories of main policy challenges raised by the digital economy

- b. **Data:** The growth in sophistication of information technologies has permitted companies in the digital economy to gather and use information across borders to an unprecedented degree. This raises the issues of how to attribute value created from the generation of data through digital products and services, and of how to characterize for tax purposes a person or entity's supply of data in a transaction or some other way.
- c. **Characterization:** The development of new digital products or means of delivering services creates uncertainties in relation to the proper characterization of payments made in the context of new business models, particularly in relation to cloud computing.

The main tax challenges related to Value Added Tax (VAT) in the digital economy relate to –

- (i) Imports of low value parcels from online sales which are treated as VAT exempt in many jurisdictions, and
- (ii) The strong growth in the trade of services and intangibles, particularly sales to private consumers, on which often no or an inappropriately low amount of VAT is levied due to the complexity of enforcing VAT payment on such supplies.

OECD Updates

With the widespread of Multinational Enterprises (MEs) across the world along with new modality of business, it becomes pertinent to address the issues of taxation on digital economy. In response to this concern, OECD published an Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan, OECD, 2013) in July 2013. The BEPS Action Plan identified 15 actions to address BEPS in a comprehensive manner, and set a deadline to implement those actions.

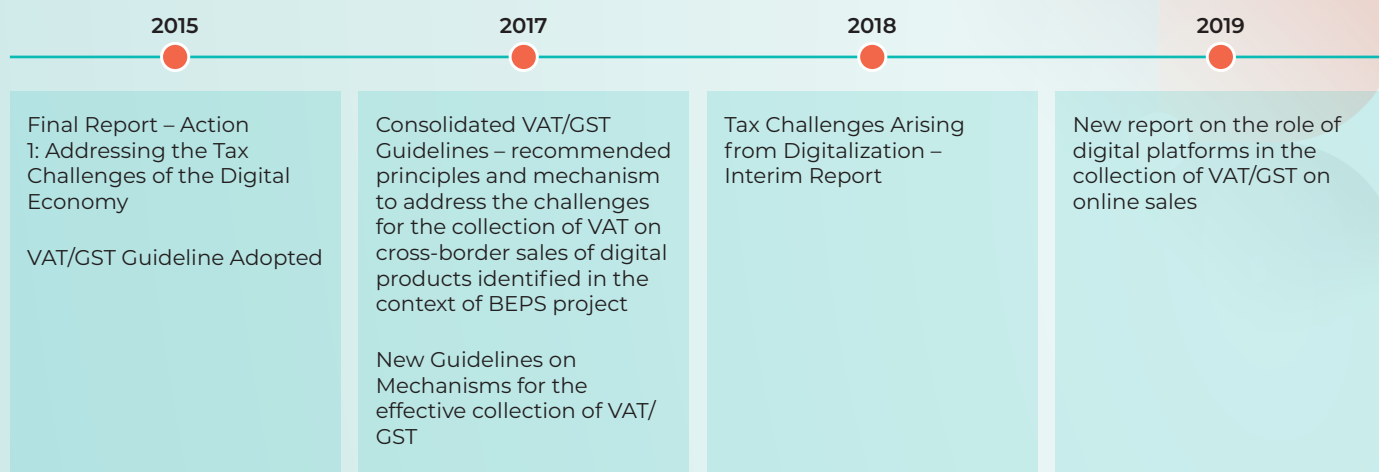
OECD's Final report addressing taxation on Digital Economy is expected to release by 2020

As noted in the BEPS Action Plan, the spread of the digital economy also poses challenges for international taxation. The BEPS Action Plan included various description of the works which have undertaken in relation to the digital economy and are summarized in the following chart.

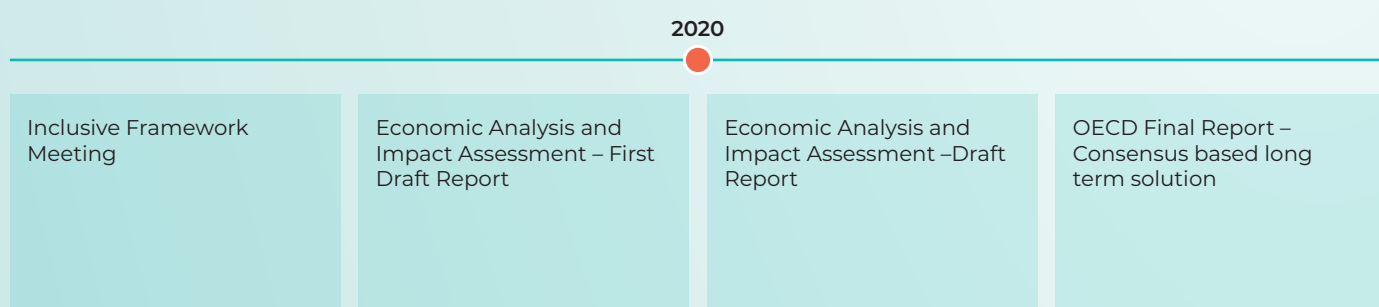
Development - Direct Taxes

2015	2017	2018	2019
<p>Final Report – Action 1: Addressing the Tax Challenges of the Digital Economy</p>	<p>Call for input, comments and public consultation</p>	<p>Tax Challenges Arising from Digitalization – Interim Report</p> <p>Policy note on Tax and Digitalization</p>	<p>Policy note on Tax and Digitalization</p> <p>Discussion Draft Released</p> <p>Policy brief on Tax and public consultation</p> <p>Program of work to develop a consensus solution to the Tax arising from the digitalization of the economy</p> <p>G-20 leaders welcome the recent progress on addressing the tax challenges arising from digitalization and endorse the work program developed by the inclusive framework of BEPS</p> <p>Secretariat proposal for a 'Unified Approach Pillar One'</p> <p>Secretariat proposal on Global Anti-Base Erosion (GloBE) under Pillar Two</p>

Development - Indirect Taxes



2020 Roadmap



Status of Some Countries on Digital Taxation

Various jurisdictions have adopted unilateral measures on digital taxation and some jurisdictions are waiting for global solution.

France has implemented 3% Digital Service Tax (DST) on receipts from certain digital services sourced to France. Affected taxpayers are those who, on a group basis, have gross receipts from services in the scope of the DST (i) exceeding €750 million worldwide and (ii) exceeding €25 million in France in the previous year. The French DST applies to three categories of taxable services:

1. Digital intermediary services that allow users to enter into contact and interact with one another
2. Advertising services with the aim to advertise on digital interfaces and based on user data, including related data sales and services
3. Sales of data collected or generated from users located in France

Some Jurisdictions like France, Greece, Hungary, Turkey, Indonesia, Malaysia, Pakistan including India have unilaterally implemented while Denmark, Finland, Singapore including US are waiting for global solution

Turkey has implemented 7.5% Digital Service Tax (DST) on gross revenue from certain services provided in Turkey including

- Advertisement services provided through digital platforms
- Sales of auditory, visual or digital contents on digital platforms
- Services related to the provision and operation of digital platforms so that users can interact with each other

Intermediary services of digital service providers on digital platforms are also subject to digital services tax. Digital services tax liability applies with regard to those qualifying entities with a Turkey-sourced

revenue exceeding Turkish Lira 20 million (Approx. €2.6 million) and worldwide revenue exceeding €750 million.

India has introduced 'Equalization Levy' by Finance Act, 2016 at a rate of 6% on certain 'specified services' – such as online advertisement and any provision for digital advertising space or any other facility or service for the purpose of online advertisement. Finance Bill, 2020 proposed to expand the scope of the "equalization levy" to include consideration received by e-commerce operators from e-commerce supply or services, and taxed at a rate of 2%, applicable from 1 April 2020.

An "e-commerce operator" is defined as a non-resident that owns, operates or manages a digital or electronic facility or platform for online sale of goods or the online provision of services.

The "e-commerce supply or services" on which the levy applies are –

- Online sale of goods owned by the e-commerce operator
- Online provision of services provided by the e-commerce operator
- Online sale of goods or provision of goods facilitated by the e-commerce operator
- Any combination of the above














The levy is applicable when the goods or services are provided/facilitated by the e-commerce operator to –

- A person resident in India
- A non-resident (in respect of sale of advertisements targeted at person resident in India or using IP address in India)
- A person who buys goods or services using an IP address located in India

There are certain situations when the equalization levy is not applicable. These include situations when –

- The non-resident has a permanent establishment in India and the e-commerce supply or services are effectively connected to such permanent establishment
- The equalization levy at 6% (now it is 2%) on "specified services" (as defined above) applies to such services
- The gross receipts/turnover in respect of goods sold/services provided to residents, non-residents and persons using IP address in India (referred to above) is less than Indian Rupees 20 million (Approx. USD 267,000) in a year.

The following is the summary status of various jurisdictions with respect to implementation of taxation on Digital Economy.

Legislation Implemented		Draft Legislation/ Public Consultation		Waiting for Global Solution	
Austria		Malaysia		Belgium	
Costa Rica		Mexico		Chile	
France		Pakistan		Czech Republic	
Greece		Taiwan		Italy	
				Singapore	

Hungary		Turkey		Nigeria		Sweden	
India		Uruguay		Slovakia		Switzerland	
Indonesia		Vietnam		Spain		US	
Kenya		Zimbabwe		Thailand			
				UK			

Coverage of Nepal Tax Law on Digital Taxation

The taxability of the income of a person in Nepal is based on two broad principles.

- For residents: on the basis of “Residence Principle”
- For non-residents: on the basis of “Source Principle”

An entity is resident in Nepal if it is registered/formed as per the laws of Nepal. In other words, in case of person who is resident of Nepal, the tax will be levied and collected if the income of a person is derived whether in Nepal or outside, and the income of non-resident is taxed on the income for which source is in Nepal.

The existing taxation law of Nepal lacks the coverage of services that is supplied through digital platform targeting the customers of various boundaries

From ‘residence principle’ perspective following are the relevant provisions of Income Tax Act of Nepal.

Foreign Permanent Establishment (FPE) means a Permanent Establishment of the institution or organization which is not situated in the country in which it is resident.

Permanent Establishment (PE) means a place where a person fully or partially conducts his business; the term includes the following place –

1. A place where a person fully or partially conducts his business through an agent, other than a general agent who functions in an independent manner, in the ordinary course of conducting business
2. A place where the main equipment or the main machinery of a person is kept, used or installed.
3. One or more places of a country where a person has provided any technical, professional or consultancy service through his employees or otherwise for more than 90 days in one or several lots within a period of twelve months, or
4. A place where a person is engaged in construction, assembly, or establishment project for 90 days or more, and the place from where the supervision activities of the project are conducted.

[Section 2(bb) of Income Tax Act 2058 (2002 AD)]

From ‘source principle’ perspective, the following payments shall be deemed to have its source in Nepal.

Payment received by a person operating the business of transmitting news or information through such means of communication as cable, radio, optical fiber or earth satellite in consideration of transmission of news or information through machinery and equipment installed in Nepal, irrespective of whether or not such news or information has originated in Nepal

[Section 67(6)(h) of Income Tax Act 2058 (2002 AD)].

In digital economy, there could be supply of goods/services having local/foreign establishments targeting the customers in different locations/territories. The basic necessary ingredients and tax-contributors are server, software, network, targets etc. whose locations could be in any part of world. The existing taxation law of Nepal lacks the coverage of services that are supplied through digital platform targeting the customers of various boundaries.

Way Forward

Every country has a sizable contribution of Digital Economy to its GDP. Nepal is also no exception. Undertaking unilateral measures like implementation of Digital Service Tax (DST) or in the form of 'Equalization Levy' could be one of the short term measures for taxing the untapped area of digital platform from the regulator perspective, however, long term solution would resolve the issue permanently. This will neither be good for business community and other stakeholders nor help to increase any tax revenue unless covered/amended by tax treaties.

Necessary amendments in applicable laws like taxation laws, commercial laws, banking laws, contract laws etc. is another step going forward

Developing a multilateral instrument as necessitated in BEPS Action plan warrants immediate action. Though every country might not be agreeing on multilateral instrument, entering/negotiating the tax treaties will be of paramount assistance in tackling this issue.

Necessary amendments in applicable laws like taxation laws, commercial laws, banking laws, contract laws etc. addressing the issues involved in Digitization is another step going forward. Data protection and privacy of customer, for example, could be one of the major concern in digital era which can be properly addressed through legal framework.

It may be too early to comment upon the exact taxation approach, however, the possibility cannot be ruled out that appropriate taxation on Digital Economy may lead to a wider tax base and a new source of Tax Avenue for the government.

Reference

OECD Report: "Unpacking E-Commerce: Business Models, Trends and Policies"
World Economic Forum "Shaping the Future of Digital Economy and New Value Creation"
www.blog.taxamo.com
Income Tax Act, 2058 (2002 AD) of Nepal

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