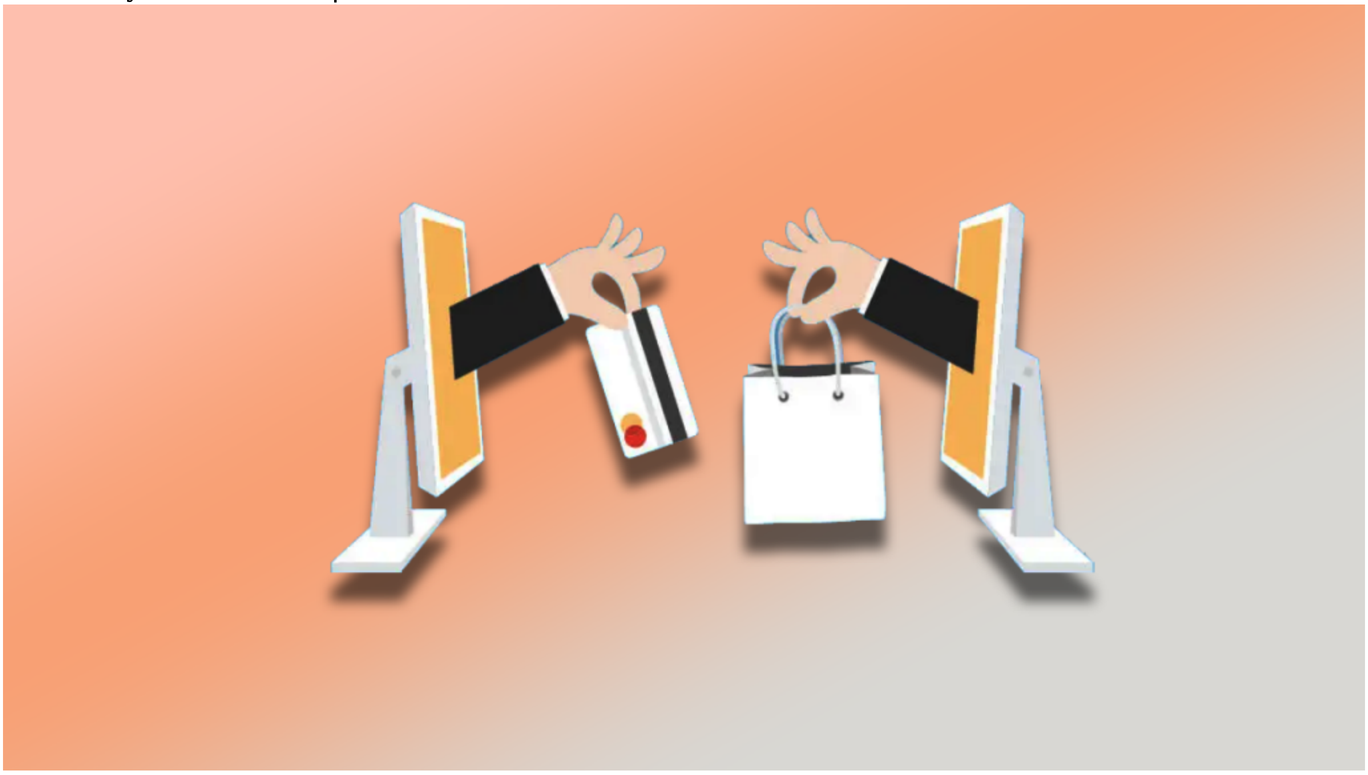
Digital Tax in India and Challenges and Associated Challenges

written by iasexam.com | 25/11/2022



[GS Paper 3 – IT and Computers]

Context – Over the past four years, 137 countries have engaged intensively with the OECD to find a solution to the tax challenges arising from digitalisation. Like any international agreement, finding a middle ground has been difficult and a series of compromises have been made.

It was agreed initially that the unique features of the digital economy — firms can operate seamlessly across borders and users and their data contribute to their profits — made it harder to tax such an economy.

What is Digital Tax?

- Digital tax is a tax that is levied on digital business activities. The digital businesses include both the digital-only brands that focus on virtual commodities and services and the services traditional market players use for transforming their businesses with digital technologies.

- Virtual commodities include downloaded software, website applications and digital assets like ebooks, image files, audio clips/audio files, movies or digital files.

- Digital services include those provided by social media companies, collaborative platforms etc.

Need for Digital Tax

- The growth of the digital economy over the last few decades has made sure that there is a limited need for the physical presence of the businesses in a country to make a profit there.

- Presently, there is a significant increase in participation in the digital economy due to the COVID-19 lockdown and digital tax is one of the many ways to boost the governments' stressed revenue.

- The current tax regime is built around the traditional brick and mortar businesses and digital entities are not taken into account because of loopholes in the taxation system.

- Many countries are developing a new framework to regulate and get a "fair" share of taxes from the revenues generated from virtual goods and services by focusing on these aspects.

Advantages of Digital Tax

- Tech giants like Google, Facebook, Amazon etc., which have a huge consumer base in developing countries like India will not be able to avoid taxation by shifting their offices to low-tax regimes.

- If the law prevents profit shifts, the countries from which the cross-border digital companies profit will be able to stop losing corporate tax revenue.

- Digital tax will ensure a level playing field for both domestic and foreign players. In the absence of such a law, the goods and services provided by firms based in a foreign country would get taxed less and hence have a significant competitive advantage over the domestic firms.

Disadvantages

- Taxing the gross revenues instead of the firm's profits is problematic. It may harm start-ups– especially during their initial expansion stages.

- There is a risk of 'double taxation' when shifting from a 'country-of-establishment' principle to a 'country-of-destination' principle.

- These platforms and broker service providers would pass on the burden of tax to the end consumers or the sellers. This will affect their affordability and popularity.

- The government had opted for low taxation on digital businesses to promote innovation. Increasing taxes may impede global economic and technological advancement.

Proposals made by OECD

- One of the compromises suggested by the OECD is that the countries be given the right to tax profits incurred based on sales in their jurisdiction. This would give the USA limited rights to tax European luxury goods companies in addition to covering the US-based tech giants for the other countries. This is to address the concerns regarding the first pillar of the talks.

- Regarding the second pillar of talks, a global minimum corporate tax rate would prevent countries from lowering their tax rates to attract these tech firms to set bases in their jurisdiction. This leg of the talks is closer to agreement than the first leg.

Way Forward

The e-commerce market is set to expand to $200 billion by 2026. This is a largely untapped revenue source for not only the Indian government but also many of the world's economies. The digital tax could help address some of the revenue shortages that the governments are bound to face in light of the economic crisis following the pandemic and the Great Lockdown. In this perspective, the talks on digital tax is not really a niche issue but one of the low hanging fruits.