

DIGITALIZATION AND ITS IMPACT ON INDIAN TAXATION**Deepshree Chauhan**

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Abstract

After Globalization, the world is shifting towards digitalisation. The business, trade and commerce have come over to this digital platform. Without a doubt, this digital platform is very boon for business houses and as well as it has also given a lot of relief to the people around. But with that, it has affected the taxation of the country. The enhanced technology of digitalization has given evaders several creative methods for tax evasion.

Based on this the researcher has divided the research paper into the following:

1. The first part of the research paper is "Introduction" which gives a general idea of the topic that is digitalization and its impact on Indian Taxation.
2. The second part of this paper talks about the meaning of digitalization and taxation.
3. The third part is the historical perspective, which gives a glance at the history of digitalization and taxation.
4. The fourth part is the main part of the whole paper in which the concern has been raised regarding issues in Indian taxation because of digitalization.
5. The fifth part of the paper gives the legal provisions for digitalization and taxation.
6. The sixth part is the concluding part of the whole research work in which suggestions and international perspectives has been taking in to account to overcome the issue.

Keywords: *Digitalization, Income Tax, Tax Evasion,*

Introduction

Tax evasion has always been a problem for the world whether its India or any other country of the world. The reason for this tax evasion is that people don't want to give their sharing of there earning to the government may be they don't trust the working of it or just of the human nature or because of unawareness regarding the importance of tax for the countries development. That's why they try to avoid tax or to minimise tax as far as they can. They always find out some smarter means and now with the advent of digitalization, things has become more easy and advance. Someone the loopholes in the law is also one of the main reason for the tax evasion. There were already number of loopholes in the taxation law which already give number of tricks to evade tax. Now, with the entry of digitalization things has become more worse. It is ver well known fact that with the digitalization things has become very easy and convient in our life. The world has switched to the online world, from the global world. As there is no law which deals with both this concept together as a separate law. This somehow bring a burden for the judiciary, as all the issues need to be sort out by the judicial pronouncements because of no exsisting law to deal with the concept of digitalization and taxation together. The taxation law of

the country don't have any provision to deal with the taxation issues by the digitalization and nor the cyber law is sufficient enough with all the provisions to deal with the tax evasion. All this things is not just related with the any specific types of tax, but this evasion is for both direct as well as indirect tax, but as per the research it has been found the major portion of the tax evasion is done on the direct taxation in comparative to the indirect tax.

From the time ago, it has always been seen a very dynamic relationship between technology and taxation. The Indian law is bit slow in adapting and implementing new things, this is not just on the taxation law specifically but this about every laws. And this is one of the main reason that Indian taxation law is facing so many challenges due to digitalization.

The main concern of digitalization and taxation is e-commerce. E-commerce means electronic commerce or online commerce where buying or selling of products and services are done in online mode using the Internet and other digital products which are accessible to the Internet such as laptops, computers, mobile phones, tablets etc...

Meaning of digitalization

The term digitalization basically means the method of the using the digital technology. The term and the technology has transformed the world. For this there is a need of digital gadgets and technology such as computer, laptop, mobile, tablets etc... and most important thing internet. The digitalization has great advantage to human civilization by giving automation. This automation has made things so simple and easy for the people that one click is all enough to do the work.

Concerning about the tax, the digitalization has been a great advantage for the tax as well, as now with the online mechanism of collection of tax people can pay tax online and the Income Tax Authorities too can easily record and collect data of tax payers.

According to Forbes, "*Digitization essentially refers to taking analog information and encoding it into zeroes and ones so that computers can store, process, and transmit such information*".¹

According to Cambridge Dictionary, "*to change something such as a document to a digital form (= a form that can be stored and read by computers)*".²

Digitalization is a wider term, for this research paper, the concern is specifically over e-commerce, which has become one of the main reasons for tax evasion in the country. There are many reasons for tax evasion in this digitalization era and some of those challenges and issues are been discussed in this research paper. The challenges of e-commerce and taxation is mainly due to the number of loopholes in the taxation law of country.

Meaning of Taxation

Tax is a part of income which we give to the taxing authority that is to the government. It is believed that tax is one of the most important sources of revenue for the government of any country, which is used to pay salaries to the public servants and used for the welfare and development of the citizens of

¹ <https://www.forbes.com/sites/jasonbloomberg/2018/04/29/digitization-digitalization-and-digital-transformation-confuse-them-at-your-peril/?sh=4e2335572f2c>

² https://dictionary.cambridge.org/dictionary/english/digitalize#google_vignette

the country. The tax is the compulsory thing which every citizen has to pay, not just the compulsion but as well as it is the duty. The person not paying the tax is not performing the duty and therefore it's a crime for the country the crime is known as tax evasion which is one of the grievous white-collar crimes and for that there is the penalty provisions.

The concept of tax is not just in India, but every country impose tax on their citizens mainly for generating revenue in the country.

History of India Taxation and Digitalization

The Indian history is divided into four parts that is :

- Ancient
- Medieval
- Modern
- Independent India

The researcher has made an attempt to the explain the history of Indian taxation law based on this three division.

Ancient History of Indian Taxation

The Manusmriti and the Arthshastra were the two main laws which used to govern the taxation law. In both of this laws, it has been stated that tax is an important source of revenue for a kingdom and it is the duty of people of kingdom, to pay tax to the king, which can be used for the welfare of the citizen of the kingdom itself. But with that it should be taken care of that the tax should not become burden for the taxpayer.

Medieval History of Indian Taxation

Medieval era is era when Mughlas advent the country and there was the flourishing of Islamic culture and tradition in the country. The taxation in this era was divided between two that is Muslims and Non-Muslims. The ushr was imposed upon Muslims in which they have to give 1/10 of the produce, and the khiraj was levied upon non - muslims in which they have to give 1/3 or 1/2 of their produce, other than this there were other religios taxes such as jaziya, khams and jakat.

Modern History of Indian Taxation

It was the year 1860 which brought the enforcement of Income Tax Act, 1860³, and with this the systematic tax provision was established in the country. After this the another act came in the year 1886⁴ and then in the year 1922⁵.

Independent History of Indian Taxation

After independence, in the year 1961 The Income Tax Act of 1961⁶ was passed which came into effect on 1st April 1962.

History of Digitalization and Income Tax

The advent of digitalization came with the introduction of internet in the country by Videsh Sanchar

³ Income Tax Act, 1860

⁴ Income Tax Act, 1886

⁵ Income Tax Act, 1922

⁶ Income Tax Act, 1961

Nigam Ltd (VSNL) on August 15, 1995. In the year 2004, the Government of India has started up with the e-filing of income tax. Then in the year 2019, there comes the concept of faceless assessments scheme which has removed the human interference. With the increasing technology the digitalization and taxation are trying to shake hands with each other .

Challenges in Indian Taxation Due to Digitalization

From the start of this research paper, it has been seen that digitalization is a revolution for the entire world, but this revolution has come up with many challenges for the taxation authority. Some of the issues and the challenges are as follows:

1. Permanent Establishment
2. Base erosion and profit shifting
3. Attribution on allocation of taxation rights in source-based and resident- based economy (also called non-resident and resident)
4. Identity verification
5. Cybercrime
6. Tax avoidance
7. Jurisdiction
8. Characterisation of Income- Royalty or Business Profits

Permanent Establishment

The concept of permanent establishment states that companies are going to have a place of effective management in India will be termed as permanent establishment, and they will be taxed under the jurisdiction of India. However, with the introduction of e-commerce, it has been difficult to do so because the permanent establishment talked about the physical establishment but e-commerce doesn't need any permanent establishment. Many e-commerce businesses are earning permanently from India, but with no permanent physical establishment and hence, smartly performing tax evasion and creating loss for the country's economy.

The legal provision of permanent establishment has been stated in section 92F(iiiia) of the Income Tax Act, 1961 which states "permanent establishment", includes a fixed place of business through which the business of the enterprise is wholly or partly carried on".⁷

The tax authorities have scrutinized and found out that Netflix has a tax liability of Rs 55.25 crore (\$6.73 million).⁸ As well know Netflix don't have a physical establishment in the country but it has several subscribers and that's how it earns well enough from the country hence therefore it's

⁷ S.92F(iiiia), Income Tax Act, 1961

⁸ <https://economictimes.indiatimes.com/tech/technology/income-tax-department-looking-to-tax-netflixs-india-operations/articleshow/100168342.cms?from=mdr>

liable to pay to the country.

The main reason for the arising of such issues is that we don't have any legal provision for taxing profits earned through the internet, which is done by Netflix.

In the case of ITO v. Right Florists P. Ltd⁹

The Kolkata Income Tax Appellate Tribunal held that Google (Ireland) and Yahoo (USA) cannot be taxed in India in respect of sums received by them from an Indian florist for online advertising. ITAT found that Google and Yahoo did not have web servers in India and thus there was no PE in India since a website does not constitute a PE unless the servers on which websites are hosted are also located in the same jurisdiction.

Base Erosion and profit sharing

It is a method in which a company or a business entity shifts their profit from a higher tax imposing country to a lower tax imposing country or country who don't levy any tax known as a tax haven country.

Transfer pricing

The another issues is transfer pricing in which one division of company charges goods and services from the another division of that particular company. This kind of practice is done by holding companies and subsidiary companies.

Bases of Taxation

The basis of taxation is completely based on jurisdiction. This basis of taxation is good enough for tangible goods, but when it's about intangible goods then things become difficult. As tangible goods are services, and there is no clear definition of service provided in the law, therefore the companies who used to provide service easily avoid tax such as Google, Facebook etc... There are mainly two main bases of taxation that are:

1. Resident base
2. Source base

This means that resident of India has to pay taxes in India for all the income they have earned whether from India or even from another country of the world, but the non-resident has to pay income only which they have earned from India.¹⁰ The work-from-home facility given to the employees is another issue for the taxation authority as with the help of technology they change their working area to the tax haven country.

⁹ 2011

¹⁰ S.6(3), Income Tax Act, 1961

Identity Verification

Identity verification is another issue where people are using technology and changing their identity and other information which makes it difficult to find out whether they are residents or non-residents.

Cyber Crimes

This issue was from the beginning since the advent of the internet but now we can face this issue in tax as well. The hackers can easily hack data manipulate it and make it difficult for the authorities to come to the actual conclusion. The things are manipulated in such a way that it becomes difficult to find out the place or the location to catch the hackers. For this though we have one provision under the IT act which includes the act committed by anyone outside India. The section 75 of the IT Act, states¹¹

(1) Subject to the provisions of sub-section (2), the provisions of this Act shall apply also to any offence or contravention committed outside India by any person irrespective of his nationality.

(2) For sub-section (1), this Act shall apply to an offence or contravention committed outside India by any person if the act or conduct constituting the offence or contravention involves a computer, computer system or computer network located in India.

International Perspective

All these taxation issues are not just about India, but its been faced by all the countries whether developing, developed or underdeveloped countries. So, this issue is an issue of international concern as the problem for every country is similar and there is a need for solution at the international level only.

Taking all these issues into account the OECD, in the year 2013 initiated a plan to minimize the gap and this plan has been implemented for the G-20 countries. Well of course things were not so fruitful though and that's why now the OECD is planning to frame one uniform taxation law so that all these issues related to PE, BEPS, Cross border transaction will get resolved.

Conclusion

From the very start of this research paper, the researcher has highlighted the pros and cons of digitalization in India specially the problems faced by the taxation authority of the country. There need for new laws for taxation in the digital era, but researchers believe that is not sufficient enough. It's high time that the law needs to shake hands with the technology and cope with it.

Laws can only impose penalty but to catch the criminal or the accused person there is a need for

¹¹ Section 75, Information Technology Act, 2000

technology and a person who has well-versed knowledge of technology to be situated in every department. It has been seen that India believes slow and steady wins the race but that can't be applicable everywhere the country needs to understand new technology and adapt as soon as possible.

Of course, as we all know that issue is not just about India but of the world, so all the countries need to be united with each other to solve the issues. The OECD's idea of having uniform taxation law seems to be fruitful if implemented and executed properly to stop companies and other business entities from taking undue advantage of the technology.