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PROBLEM OF TAXATION IN THE VIRTUAL WORLD UNDER THE LAWS OFE-COMMERCE

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ABSTRACT

E-commerce has achieved unprecedented consumer engagement on a global scale, exhibiting remarkable growth momentum that foreshadows its transformation into an immense industry in the years ahead. However, the increasing forces of globalization and market liberalization pose challenges for international tax frameworks, particularly in taxing E-Commerce. An evolving business pattern has emerged, leveraging interconnected digital networks that transcend cross borders. E-commerce has pioneered a distinctive set of business strategies characterized by real-time management and modern techniques that boast remarkable reach. As such, formulating a comprehensive and rational tax policy demands a thorough and improved comprehension of the industry, the hurdles tax authorities face, and the intricacies of the virtual world. This article expresses the extraordinary global surge of E-Commerce, encompassing India, while appraising the legal and tax-related hurdles confronting the E-Commerce provisions. Since implementing the Goods and Services Tax (GST) in 2017, India's tax laws have posed challenges rather than support for the E-Commerce sector. To avoid potential double taxation issues, careful structuring of E-Commerce business models is essential. Also, this article highlights the top leading e-commerce companies with different business models such as B2C e-commerce marketplaces,

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B2C e-commerce aggregators, C2C e-commerce, and B2B e-commerce. The rise of e-commerce has not just changed conventional business practices and turned the world into an expansive worldwide marketplace but has also challenged the effectiveness and relevance of traditional global taxation principles in today's modern world. This article outlines key conceptual features of E-Commerce along with the legal and taxation hurdles that ensue. The problem of taxation in the virtual world under e-commerce is a complex and pressing issue that requires a nuanced understanding of the digital economy's dynamics and its implications for India's global taxation system.

KEYWORDS

E-Commerce, Taxation, Foreign Direct Investment (FDI), Business Models and Globalization.

INTRODUCTION

Operating an online business that caters to a worldwide clientele creates cross-border legal issues. The legality and enforceability of transactions can differ, making choosing a jurisdiction and concluding a contract more difficult. In the end, a court's discretion is needed to decide whether it is qualified to determine a particular case. Many courts worldwide have used theories such as the "minimum contact theory" to determine whether or not they have jurisdiction over a given case. Still, thereneeds to be set guidelines for applying these theories consistently. Therefore, a unified legal framework regulating Internet-based transactions is desperately needed.Several legal concerns must be resolved appropriately before e-commerce is accepted as a safe and effective business. One of the leading legal issues arising from e-commerce is the protection of non-repudiation and authentication. This involves devising techniques to authenticate the persons engaged in transactions and guaranteeing that they cannot subsequently retract their participation in the transaction. Corporate Income Tax (CIT) is levied on a company's income earned in India, regardless of whether it is a domestic or foreign entity (referred to as a resident or non-resident, respectively). The Union Budget is used each year to determine the precise tax rate. The Income Tax Act of 1961 governs and collects a company's income, also referred to as corporate or company tax. This Act establishes the taxation of a company's revenue.

A company is defined by the Income Tax Act of 1961 as an Indian company, a corporate entity formed in compliance with foreign laws and regulations, any institution or corporate entity that was previously registered under the previous Income Tax Act, or a foreign or Indian company that the Central Board of Direct Taxes (CBDT) has declared to be such. Income tax must be paid by any Indian resident who receives income within the nation according to the relevant tax slabs and rates. To put it another way, a company that does some business within Indian borders but is not registered there must still pay taxes in India on the income it receives from those activities. In India, income tax is imposed individually according to specific income slabs and rates. Discussions frequently Centre on what degree of affiliation or connection to India is sufficient to warrant taxing a foreign company there. The OECD[3] states that one of the deciding factors is effective management. Though it needs to be defined clearly, it refers to where important business-related management decisions are made to carry out economic activities. The board of directors meets in this location to make essential choices. There has been an urgent need for new IT security and tax solutions due to the growth of e-business and its effect on tax revenue. There are worries that online shopping could result in tax evasion.

CHALLENGES OF TAXATION ARISING IN INDIA

There are many obstacles in the Indian e-commerce market. The internet revolutionizes the country's domestic and international tax policies, which calls for changes to long-standing tax laws. Important business paradigms have changed due to this transition, creatinggovernance and tax law enforcement challenges. When deciding whether there is a physical or conceptual permanent establishment for economic activity carried out online. To allow for the taxation of a non-resident's profits in the source country, Article 5 of the Double Taxation Avoidance Agreement requires that a permanent establishment (PE) exist. To put it broadly, PE is a tool used to distribute tax rights among the tax authorities of various nations. When a company from

[3]OECD (2015) BEPS Final Reports <BEPS 2015 Final Reports – OECD>

one state makes money in another, the governments of those states share these rights. From the standpoint of tax policy, the rise in non-resident businesses operating in market jurisdictions is a result of the digital economy, and this rise differs from the patterns observed during the establishment of the international tax regime. The idea that non-residents can only operate in a market jurisdiction by physical presence—defined as a Permanent Establishment (PE) or a dependent agent—has been questioned by new business models like online retail, social media, and subscriptions. For instance, a foreign business involved in the digital economy might use a warehouse and exemptions for auxiliary and preparatory activities, or it might rely on the regulations that are in place regarding dependent agency PEs.

Article 7 of the tax treaties India has signed with other nations states that unless a foreign company has a PE in the source country, its business profits cannot be taxed. As a result, based on treaty law, Indian tax authorities can impose taxes on businesses that use PE. Nonetheless, in cases where there is no PE in India, most Indian tax treaties allow a minimum rate of withholding tax (often ten percent) on technical services. Put another way, business profits are not subject to taxation; however, if the services meet the criteria for "fees for technical services," then withholding tax is levied. However, there was no provision for taxing profits earned through internet-based activities.[4] Because everything is done digitally and online business operations are more complex than ever, obtaining the records needed for auditing and control purposes in e-commerce transactions can take time and effort. Essentially, the terms of the current treaties prevent source-based nations from taxing earnings from the provision of virtual services, which causes the market countries to lose out on income. Therefore, the ability of source countries to impose taxes on income generated within their borders depends on the physical presence of a non-resident, and one of the main factors causing revenue loss is the issue of Permanent Establishment.

Traditionally, jurisdiction is established by physical presence or the presence of a permanent establishment with the power to impose taxes, or disputes are settled within the geographic areas where the parties involved reside. This strategy leads to the international application of disparate

[4] IBEF, https://www.ibef.org/industry/E-Commerce.aspx (Indian Brand Equity Foundation)

principles in disparate regions. To address conflictsabout the Internet, it is imperative to define jurisdiction precisely, as this is a necessary precondition for initiating any legal proceedings. Tolimit internet jurisdiction, courts worldwide first looked to the US Zippo case for guidance. In this instance, three standards were examined to determine whether the courts should have specific personal jurisdiction over a non-resident defendant in Internet-related cases. However, the Zippo case, while influential at first, turned out irrelevant because of how widespread the internet is. Courts acknowledged that the internet included interactive websites in addition to information displays. As a result, a more detailed legal framework was needed. Because the harm happened in France, a U.S. court recognized a French court's ruling in the Yahoo! case in 2001. As a result, the issue was brought before foreign courts. It was discovered that this method needed to be revisedto establish jurisdiction. As a result, following lengthy discussions, the courts determined that the degree of interaction and the website's commercial nature would be the basis for defining jurisdiction. They divided websites into three categories: business sites that are fully interactive, passive sites that show information about others, and sites that have little to no interaction. It was concluded that passive websites operating outside the specific territory would not be subject to jurisdiction. Businesses were encouraged to restrict their websites to avoid being subject to jurisdiction in foreign states or nations.

Because each type is associated with a different transaction category, characterizing websites is extremely important. This differentiation results from differences in the threshold values. A transaction may be categorized as a royalty if it includes the partial transfer of product rights. In that case, the payment may be taxable in the country of origin. For instance, payments can be made online for products purchased from Amazon and Flipkart, but physical delivery is still required. On the other hand, delivery and payment are handled digitally in the iTunes Store. Conversely, business profit determines how long a website owner stays permanently established in the source state. The ability of the source nation to tax royalties and other services while being unable to tax business profits is the primary distinction. Royalties are defined broadly in Indian tax laws, and this definition includes the transfer of software and intellectual property rights.

IMPACT OF E-COMMERCE ON TAXATION

When a person or organization is tasked with remitting money to a non-resident that the Income Tax Act covers, they must deduct income tax from that money. It is assumed that the recipient will profit from this tax deduction in their home country, thereby saving them from paying taxes twice. Nevertheless, this result depends on India's agreements with other countries regarding Double Taxation Avoidance (DTA) and those agreements allowing set-offs for withholding taxes paid by companies registered under their jurisdiction. In light of this, asking whether a taxpayer hit with this withholding tax can claim a foreign tax credit in their nation of residence is relevant. It is important to note that there is no provision for giving foreign tax credits for taxes withheld under base erosion in India's DTA agreements with Australia, Belgium, the Netherlands, Germany, Malaysia, Singapore, the United States, and the United Kingdom. As a result, the High-Powered Committee's (HPC) suggestion to impose a withholding tax on online purchases doesn't seem like a practical solution.

Different kinds of transactions can have other tax implications; characterization is an important topic. For example, the transfer of partial rights in a product is deemed a royalty; therefore, the payment may be liable to taxation in the state of origin. However, the fee is classed as business profits if the website owner keeps a Permanent Establishment in the source state. Except for business profits, the source nation has the right to tax royalties and technical services. Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 defines royalty as the money received in exchange for transferring rights about scientific works or copyrights in the Indian context. A wide range of transfers can be taxed thanks to this thorough definition of royalty. As a result, under the Income Tax Act of 1961, any money paid in India for the online transfer of software or other digital goods is regarded as royalty. Therefore, under section 195 of the Income Tax Act of 1961, Internet users' paymentsto transfer software or digital products are subject to Tax Deduction at Source. Non-resident sellers can deduct the income tax TDS from their tax obligation in their home country regarding the withholding tax issue. The Indian government, not the seller's government, is responsible for the offset in the case of VAT. Therefore, objecting to the planned handling of e-commerce based on base erosion is invalid. Income tax on non-resident income can be avoided by imposing a single indirect tax on the import of goods and services, as this will ensure efficiency and convenience. Regarding how payments are classified, the OECD and India differ significantly. There are discrepancies in 11 categories out of the 28 issues. The OECD categorizes the transactions into these 11 categories as business profits, meaning that the country of payment cannot impose taxes on them. However, these transactions are considered royalties under the India Income Act and India's treaties with the United Kingdom and the United States of America, giving India the authority to impose Tax Deducted at Source (TDS).

JUDICIAL PRONOUNCEMENTS

In the case of **"ITO v. Right Florists P. Ltd.,"**[5]it was decided that Google (Ireland) and Yahoo (USA) were not liable to pay taxes in India on the money they received for online advertising from an Indian florist. A website does not constitute a PE unless the servers hosting it are located in the same jurisdiction, according to the Income Tax Appellate Tribunal (ITAT), which determined that Google and Yahoo did not have web servers in India and, as a result, there was no PE in India.

Considering the conversation that came before, it is still being determined if a company that operates in a market nation has a PE, an agency PE, or is governed by conventional tax laws. The French Google case provides a relevant precedent in light of the global setting. In this case, the structural question of whether Google Ireland Limited maintained a physical presence in France was addressed. Although Google Ireland approved advertising orders for display in France, Google France did not accept advertising orders from French customers for display in France. Instead, Google France charged service fees for its services to Google Ireland. From the standpoint of international law, many queries were brought up. The main question underlying these inquiries is whether a non-resident business that manages advertising services without entering into formal contracts with clients can be considered an agency PE when it offers those services to locals and other organizations in the market nation. In 2017, the Paris administration provided a negative response to this query. The French court found that Google France had no right to enter into contracts. In light of the factual circumstances and virtual services, this case

[5]ITO v. Right Florists Pvt. Ltd.(2013) 86 DTR 165/154 TTJ 142 /143 ITD 445(Kol.)(Trib.)

established a precedent for agency PEs that was subsequently adopted by courts worldwide. This case illustrates how modern digital business models can avoid being labeled as PEs and, consequently, avoid paying income taxes. It also emphasizes how conventional tax treaties might not sufficiently resolve these problems.

The production, marketing, and sales of Coca-Cola in different geographical areas are handled by separate companies under the ownership of **The Coca-Cola Company.** A legal dispute involving the transfer pricing of a royalty agreement, estimated to be worth $3.3 billion, is underway. The transfer of intellectual property (IP) value to its subsidiaries in South America, Europe, and Africa is the subject of this dispute. A settlement between the Internal Revenue Service (IRS) and Coca-Cola is still pending, so the case is still open.

Medtronic, an Irish-based medical device manufacturer, and the IRS got into a legal battle in 2020 over a dispute involving $1.4 billion. Medtronic has been charged by the IRS with worldwide intellectual property theft, allegedly to low-tax jurisdictions. This transfer relates to Medtronic's and its manufacturing affiliate in Puerto Rico's intangible asset valuation for the tax years 2005 and 2006. Despite a court decision that favored Medtronic, the matter is still pending because the IRS has since filed an appeal.

CONCLUSION

The problems mentioned above show how difficult it will be for India to switch to a digital economy. It is essential to update current regulations to facilitate smooth interactions with other nations, especially since international tax treaties were established many years ago. These treaties urgently need to be modified to meet the demands of the changing economic landscape. This article mainly discusses the general tax issues that arise from India's digital age and result in revenue loss. It is imperative to recognize that India, an emerging economy, has a substantial global customer base, which calls for a strong position. Due to aggressive tax planning and the recent expansion of the digital economy, businesses have taken advantage of tax loopholes and lowered their government tax obligations. This emphasizes how important it is to update both Indian domestic and international law to address the issues the e-commerce industry faces. These reforms seek to guarantee international justice while simultaneously improving economic efficiency. There is a global push for tax reforms, with several nations proactively implementing measures to impose taxes on digital profits. Due to pressure from competition, this has partly led to a notable drop in corporate tax rates. Many taxpayers view The international tax system as faulty and biased, especially in how it handles multinational corporations (MNCs). Moreover, others contend that tax havens harm a nation's fiscal policies and contribute to financial crises.

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