Technology, Media and Telecom (TMT)

Online businesses and disruptive technologies – key India tax and regulatory aspects

September 2020

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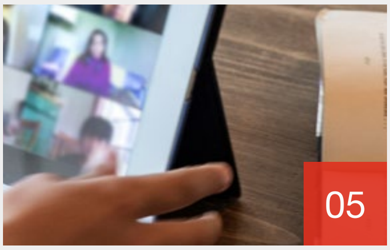


Foreword

The global pandemic has been a mixed bag of outcomes for technology, media and telecommunications (TMT) businesses. As with most sectors, disruptions to supply chains and the economic slowdown are likely to have a negative impact on these businesses. However, there has been an upswing in the demand for digital services across sectors in response to the changing consumption habits and need for ensuring business continuity.

Within TMT, the hardest hit segments are likely to be those that monetise social and physical interaction – such as cinema, hospitality, sports/events and out-of-home advertising (OOH) advertising. Telecom operators offering the critical commodity of reliable connectivity are reasonably isolated from the COVID-19 fallout. As people are forced to work remotely, enterprises are expected to accelerate their pace of digitisation, powered by cloud, automation, artificial intelligence and big data. Thus, the other segments that are likely to benefit are over-the-top (OTT) players, internet service providers (ISPs), data warehousing companies, and the likes.

This will present unprecedented opportunities for TMT companies. We are already seeing multiple collaborations amongst technology B2B players, Indian telecom operators and media companies as enterprises strive to meet new consumer dynamics and shifting preferences for digital applications and online services. The intersection of technology, media and telecommunications has never been more exciting. While the demand for technological innovation has largely been consumer-led, we expect to see a spike in demand from organisations as well, as they seek to build efficiencies and digitise operating models. Given the central role that TMT plays in the transformation of the business landscape, companies will need to continue to adapt and innovate in response to the pandemic and ensure compliance with regulations at a time when they may face increased scrutiny.

As more countries look at unilateral measures to tax remote activities and digital services, there are unique tax challenges for TMT companies who are global not only in terms of operations but also by aspiration. To remain fit for a growing digital economy, companies must ensure tax effectiveness with an operating model that factors in the risks of the digital age.

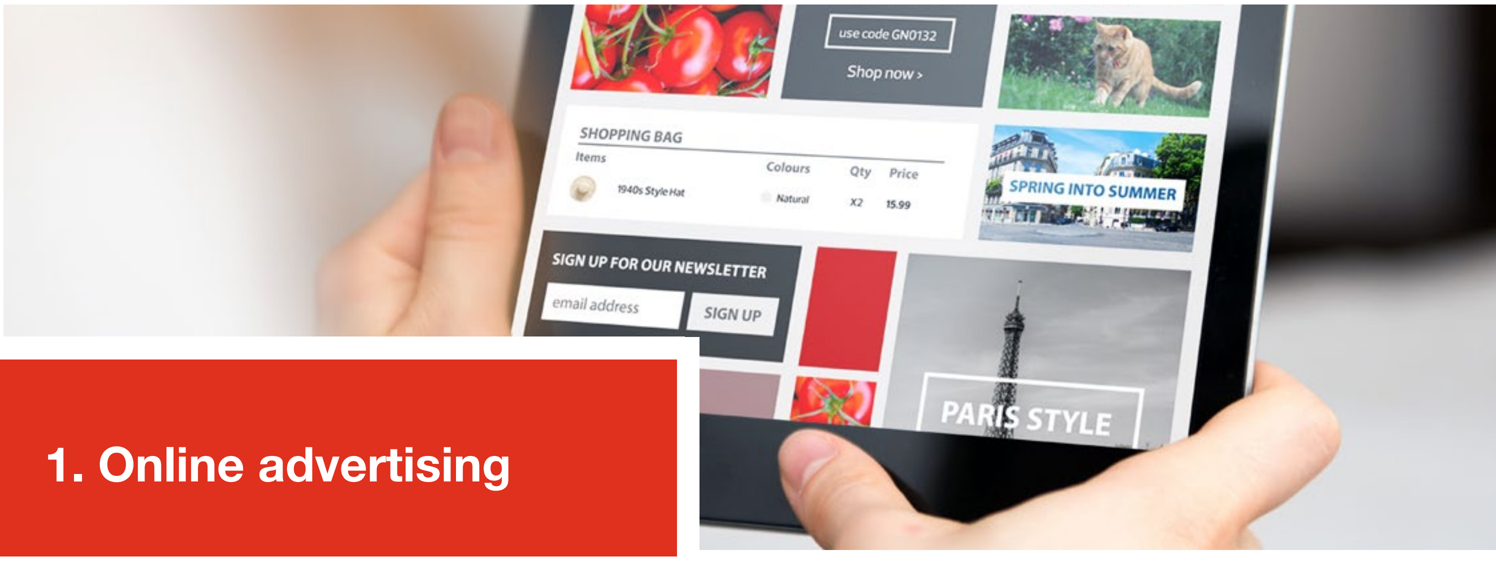
Over the past several years, the OECD/G20 Inclusive Framework on BEPS has been working on a project to update international tax rules to account for the tax challenges arising from the digitalisation of the economy. Taking a two-pronged approach, this endeavour involves the most significant reforms of the international tax system in decades: (i) a reallocation of taxing rights and revised nexus rules, and (ii) the introduction of a global minimum tax. This effort is made even more ambitious and significant because of the aim to produce a final report to the G20 by the end of 2020. Thus, all businesses with multinational operations must be aware of this project's scope and speed in order to prepare for the eventual impact (or fallout if the project fails, increasing the adoption of unilateral measures).

Several countries, including India, have introduced unilateral measures to tax digital transactions. Since the taxation system in India is largely based on the physical presence of an entity, the real test lies in bringing transactions in the digital environment that a foreign player has with Indian residents within the tax regime. Taking a cue from BEPS Action Plan 1, the Government of India (GoI) has introduced various measures such as the introduction of an equalisation levy (EL) on online advertisements (at the rate of 6%), and EL on e-commerce operators (at the rate of 2%); introduction of provisions relating to significant economic presence (SEP); withholding tax on certain e-commerce transactions; and inclusion of digital supplies in the scope of the Goods and Service Tax. In addition to the digital taxes, other significant recent developments like the multilateral instrument (MLI) coming in force from April 2020 (in the case of India), the implications of the Principle Purpose Test (PPT) and the new preamble in the covered tax treaties will have to be taken into account by TMT companies in addition to the evolution of regulations around data localisation laws, e-commerce policy, etc., while identifying the right business models for operations in India.

In this report, we have attempted to highlight aspects related to India's direct tax, indirect tax and regulatory laws that TMT businesses operating in seven select segments need to bear in mind for tax-efficient and compliant operations in India. There is considerable overlap between the tax and regulatory-related aspects of one TMT business and those of other businesses. In order to provide a comprehensive overview for all businesses on a standalone basis, we have captured the key aspects for each of them separately in this report.

We hope you find this report interesting and welcome your feedback.

Segment-wise perspectives on key direct tax, indirect tax and regulatory aspects



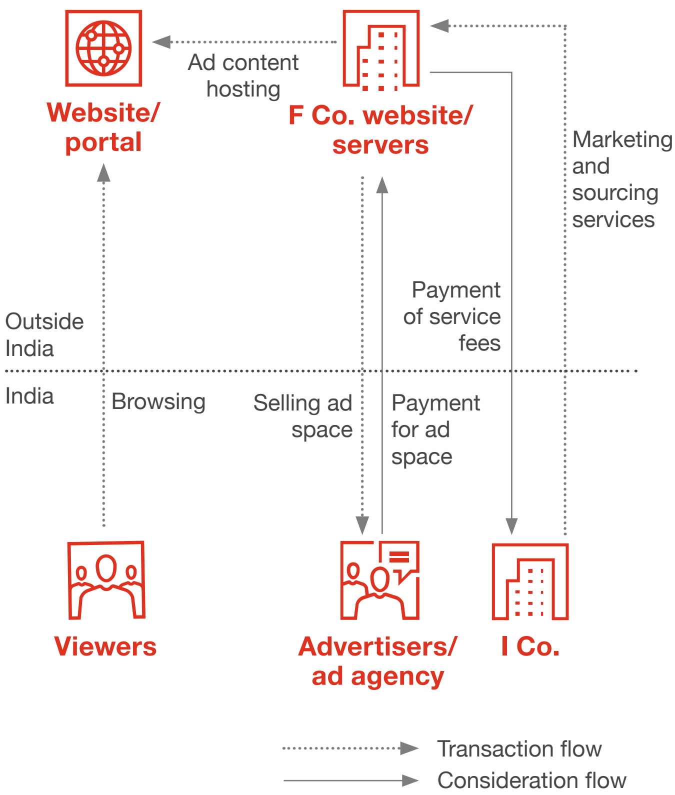
1. Online advertising

Post the COVID-19 crisis, new opportunities in digital advertising are emerging across various new platforms such as over the top (OTT), social media and online gaming. With the increase in awareness, access and monetisation opportunities, businesses are expected to focus more on digital advertising rather than traditional mediums.

The advent of voice-based search technology has led to increased consumption of video and vernacular content, and is expected to fuel digital ad spends. Businesses across sectors have embraced digital media for upscaling and are experimenting with non-traditional media platforms to connect with users. Technological advancements are driving increased engagement and giving rise to new ad formats such as location-based and targeted ads based on behavioural data. User analytics has become a staple.

There have been significant changes in the domestic and international tax arena, with a view to rationalise taxation of transactions in the digital economy. Online advertisement players (international and domestic players) have been following varied business models in India – selling of advertisement space directly to Indian customers, distribution of ad space through Indian subsidiaries, licensing of platforms to Indian subsidiaries which sell ad space in India, etc. We have covered the key Indian tax and regulatory aspects for select India business models.

Direct model



Direct model:

- An overseas company (to be referred as F Co.) is engaged in the business of selling advertisement space (ad space) on its web portal/website (including its Indian web portal/website which is hosted on servers located outside India).
- For its Indian business, F Co. enters into agreements with Indian advertisers/ad agencies for sale of ad space. F Co.'s Indian group entity/subsidiary (I Co.) supports F Co. with marketing activities and sourcing India-specific content for its web portal/website.
- F Co. raises invoices directly on Indian advertisers/ad agencies, and Indian advertisers/ad agencies make payments directly to F Co. in its foreign bank account. In many cases, I Co. also collects the payments from Indian advertisers/ad agencies on behalf of F Co. and remits the same to F Co.

Distributor model:

- F Co. enters into a distribution agreement with I Co. wherein I Co. shall act as a distributor of the ad space (on the web portal/website of F Co.) to Indian advertisers/ad agencies.
- As a distributor, I Co. purchases ad space from F Co. and sells the same to Indian advertisers/ad agencies.

Key direct tax aspects

F Co.:

Direct model:

- Business profits earned by an overseas entity are generally not subject to income tax in India in the absence of a permanent establishment (PE)/business connection, unless the profits qualify as royalties or fees for technical services (FTS). Thus, it needs to be evaluated whether the payment received by F Co. is taxable as royalty or FTS or business income, considering the provisions of the domestic income tax law and the relevant Indian tax treaty.
- Further, since income received by F Co. directly from India advertisers in this example is for sale of digital ad space, it is important to consider the applicability of equalisation levy at 6% (hereinafter referred to as 'Advertising EL') if the consideration exceeds INR 100,000 per annum per advertiser. In case Advertising EL is applicable on the advertisement income of F Co. derived from India, it will not be subject to income tax in India subject to satisfaction of certain conditions (e.g. F Co. not having a PE in India).
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as an 'e-commerce operator' as defined – including revenue from sale of advertisements to non-residents targeting customers either resident in India or using Indian IP addresses, and sale of data collected from either Indian residents or person who uses Indian IP addresses. Such ECom EL is applicable if receipts from specified 'e-commerce supply or services' exceed INR 20 million per annum. Thus, one will also need to evaluate the applicability of ECom EL on sale of digital advertising space or data by F Co., even if such a transaction is with another non-resident but fulfils the specified conditions.
- Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable to such income, then income tax will not be applicable, subject to satisfaction of specified conditions.
- Recently, in many cases, the tax authorities have evaluated marketing and sales support services provided by an Indian company through its employees and have insisted on documentation beyond the intercompany agreement to demonstrate that such on-ground activities are not being extended to facilitation of negotiation for its foreign affiliate, etc. In the absence of such documentation, the tax authorities have alleged that such Indian company constitutes an Agency PE of the foreign affiliate in India. Thus, one needs to bear in mind such PE-related aspects while considering the business model, depending upon specific facts of the case and the actual functions performed by I Co. (marketing activities, collection activities, content sourcing activities, etc.).
- Further, the implications of significant economic presence (SEP) provisions under the domestic income tax law will need to be kept in perspective. The Finance Act, 2020, has deferred the SEP provisions to FY 2021–22 and amended the existing provisions in relation to SEP by removing the reference to digital means in case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing business profits of a non-resident, and inclusion of SEP under the domestic income tax law may therefore not be extended to the tax treaty unless the tax treaties are amended.
- Also, with the Personal Data Protection Bill, 2019, and the draft national e-commerce policy mandating the maintenance of a copy of data/compulsory processing of certain data on a server located in India or the requirement of setting up of a registered business entity in India for all e-commerce apps/sites, etc., TMT companies may be required to revisit existing India business models. Thus, one would need to bear in mind related income tax implications, including any PE exposure, if any.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Last year, the Central Board of Direct Taxes (CBDT) released a draft amendment of rules for profit attribution to PEs, disregarding the

Authorised OECD Approach and suggesting that a mixed/balanced approach be followed, which allocates profits by giving appropriate weightage to both demand- and supply-side factors. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.

Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to a business connection in India, by including certain activities such as advertisements targeting Indian customers, sale of data collected from persons resident in India and sale of goods or services using such data.

These developments should be kept in perspective while computing profit attributable to a PE and related exposure.

Distributor model:

- Taxability of income received by F Co. from I Co. shall depend upon its characterisation, i.e. whether digital advertisement income or royalty income (i.e. software, equipment or process), based on the nature of the arrangement between F Co. and I Co. (e.g. limited/normal/full-risk distributor or providing rights to the web portal/website where I Co. acts as an entrepreneur, etc.).
- Subject to the above evaluation, some of the key income tax aspects which need to be kept in perspective include:
  - If income qualifies as digital advertising income – 6% Advertising EL may apply subject to satisfaction of certain conditions.
  - Alternatively, if F Co. qualifies as an 'e-commerce operator' and transactions undertaken by F Co. with I Co. or even with another non-resident fall within the specified 'e-commerce supply or services' 2% ECom EL may apply on the transaction value subject to satisfaction of certain conditions.
  - Conversely, if EL is not applicable and if there is any royalty or management service fee related arrangement – such consideration can be taxable at the rate of 10% (plus applicable surcharge and cess) under the domestic income tax law subject to any beneficial provisions under the applicable Indian tax treaty.
  - Other aspects around PE, attribution, etc., in the direct model would equally apply in this model. Also, other key aspects like India's reservation on PE exposure under a limited risk distributor (LRD) model, the tax authorities' approach of testing on-ground activities of I Co. vis-à-vis roles/responsibilities under the inter-company agreement etc., need to be kept in perspective.

Compliances under both models

- **India compliance requirement for F Co.**: Since F Co. shall earn income from Indian residents under both the models, it may be required to file an Indian income tax return (ITR) disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law. However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where nil taxation or applicability of treaty rates are claimed, F Co. may have to continue filing ITR in India.

  In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form disclosing specified e-commerce supply or services provided or facilitated by F Co.

  F Co. also needs to keep in perspective any requirements to withhold tax on payments to be made to Indian parties (e.g. content providers and other transactions) and whether related compliances therefore apply, especially considering the penal consequences prescribed for non-compliances.

I Co.:

- For I Co., it is important to consider withholding tax and Advertising EL-related withholding obligations and related compliances (including filings) while making payments to F Co., content providers, advertising agencies, payment gateways, play stores, partners, etc.

Key indirect tax aspects

F Co.:

Direct model

- F Co. is engaged in the business of selling ad space to customers in India. Provision of services by a company outside India to a customer in India is considered as import of services. I Co., in such cases, may be liable to pay GST under the reverse charge mechanism and avail credit of the taxes thus paid, subject to input credit restrictions.
- Under GST, provision of ad space can also qualify as online information and database access or retrieval (OIDAR) services. In such cases, the transaction may attract GST under reverse charge in cases where the services are rendered to the business entity. However, if the services are rendered to an unregistered customer, then F Co. may have to discharge GST and undertake GST compliances (including GST registration, discharging GST).

Distributor model

- Considering that the services will be from a business entity to another business entity, F Co. may not be required to undertake any GST obligations.

I Co.:

Direct model

- Provision of services by an Indian entity to a customer outside India could be considered as export of services subject to certain conditions. In the case of provision of services by I Co. to F Co., it is important to understand the place where services are supplied. The default provision of place of supply is the location of the service recipient. However, in exceptional cases, the place of supply can be different depending on the facts of the case.
- One such exception given to general provision of place of supply is provision of services by an intermediary. I Co. should evaluate whether the services provided to F Co. are intermediary in nature. In case these are intermediary in nature, the place of provision of services could be the location of the service provider in India, and GST could be applicable on the same (i.e. services cannot be considered as an export).
- Where provision of services by I Co. to F Co. is considered as an export of services, input tax credit related to exports can be claimed as refund by I Co.
- Services provided I Co. and F Co., being related parties, should be valued as per GST valuation provisions.

Distributor model

- In the case of procurement of services from F Co., I Co. may have to pay GST under the reverse charge mechanism and claim credit of GST thus paid, subject to input credit restrictions.
- Services provided by I Co. to F Co., being related parties, should be valued as per GST valuation provisions.
- E-invoicing is set to go live from 1 October 2020. In the initial implementation phase, the GoI has decided to make e-invoicing mandatory for companies with a turnover of INR 5 billion. If applicable to I Co., all B2B invoices need to be first uploaded on the Government portal (i.e. the NIC portal) and must have their Invoice Reference Number (IRN) generated from the portal. Further, B2C invoices of such companies must have a payment QR code printed on them. The GoI is expected to bring down the e-invoicing threshold to INR 1 billion. Hence, if I Co. has a turnover between INR 1 billion and INR 5 billion, it should start planning system changes soon.

Key transfer pricing (TP) aspects

Direct model

- Depending upon the key functions performed by I Co. and their bearing on the risks and assets, I Co. could either be compensated on a cost-plus basis or on a commission basis. The evaluation between a cost-plus model and a commission model will primarily hinge upon the intensity of the sales function/activity undertaken by the I Co. and its impact on the risks (such as bad debts) arising from performance of such functions.

Distributor model

- Based on the roles and responsibilities of employees of I Co. and intensity of the marketing functions, one needs to evaluate whether I Co. is a limited risk distributor (LRD), normal risk distributor (NRD) or full-fledged distributor (FRD), who is akin to an entrepreneur, depending upon the key functions performed by I Co. and their influence on the economically significant risks associated with the Indian operations.
- If I Co. is characterised as an LRD/NRD, it may be compensated on the basis of an arm's-length net operating margin/gross operating margin on its sales.
- If I Co. is an FRD (akin to an entrepreneur), it may pay an arm's-length compensation to F Co. for the intangibles owned by F Co. The compensation could be linked to sales in such a manner that the residual profits derived from India operations reside with I Co.
- Where I Co. assists in sourcing of Indian content for F Co., depending on the value-added functions performed by I Co. to source the content, one will need to evaluate whether I Co. is entitled to a facilitation fee or alternatively, a trading return (if the functions, assets and risks [FAR] of I Co. are akin to those of a trader). Such facilitation fee could either be computed on a cost plus basis or a commission basis.
- Certain contracts of I Co. with customers in India may fall under the ambit of a deemed international transaction if the terms and conditions of such contracts are influenced by I Co.'s Associated Enterprises situated outside India.
- The Finance Act, 2020, has allowed the question of determination of profits attributable to the business connection/SEP in India to be covered under Advance Pricing Arrangements.

Key regulatory aspects (related to Foreign Exchange Management Act [FEMA] and other key regulations)

- The permissibility of payments made by I Co. or Indian advertisers to F Co. will need to be analysed in light of import regulations read with the Current Account Transaction Rules. The remitter will need to have in place the required approvals/documentation (approvals to act as a collection agent or fulfil contractual obligations, invoices, etc.) for submission to Indian bankers in order to remit fees to F Co. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the Reserve Bank of India (RBI). Further, I Co. as well as the Indian advertisers/ad agencies should be mindful of adhering to the import timelines for payment.
- The Consumer Protection Act, 2019, aims to protect the interest of consumers by imposing several responsibilities on the goods and services provider to address the issues of misleading advertisements, false claims, etc. F Co. may need to keep recently released draft advertising guidelines in the context, which impose certain responsibilities on advertising firms, including online companies, for misleading ads and claims made on the product.
- The GoI released a draft national e-commerce policy in February 2019 that restricts cross-border data flow from specified sources and data generated by users in India by various sources, including e-commerce platforms, social media and search engines. Restrictions have also been imposed on sharing of sensitive data collected in India with other foreign business entities or third parties, even with customer consent. Other requirements in the policy include setting up a registered business entity in India for all e-commerce apps/sites and ensuring compliance with applicable laws and regulations.
- The draft policy received several comments from the industry on the proposed changes in the overall framework. The Department for Promotion of Industry and Internal Trade (DPIIT) has been working on the recommendations from various stakeholders and it is expected that a new draft e-commerce policy shall be released for further comments.
- The Ministry of Electronics and Information Technology has released draft intermediary guidelines seeking to amend the Intermediary Guidelines Rules of 2011. The draft guidelines require intermediaries to prohibit users from hosting certain content on their platform (e.g. obscene content), assist government agencies, and deploy technology-based automated tools to identify and remove public access to unlawful information. The draft guidelines also state that intermediaries with more than 50 lakh users must incorporate a company in India.
- The Personal Data Protection Bill (PDPB), 2019, was introduced in December 2019 with the purpose of protecting the data privacy of individuals. The provisions of the PDP Bill are applicable to personal data collected, disclosed, shared or otherwise processed within India, inter-alia by an Indian or foreign company. Further, the bill also proposes restrictions on transfer of data outside India and storage of personal data on a server in India.

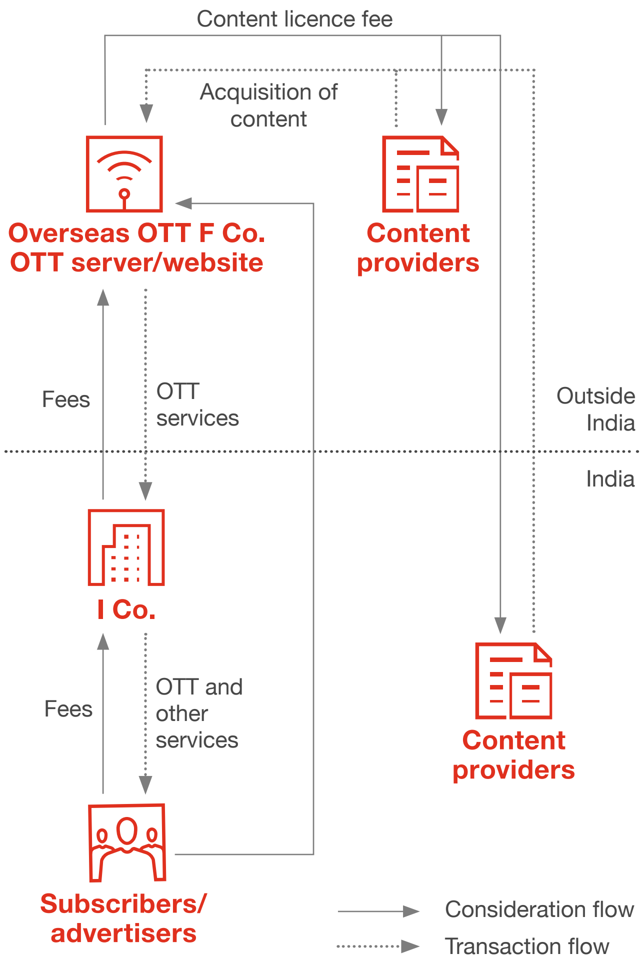
2. Over the top (OTT)

The new ‘at home’ environment has led to a significant rise in over-the-top (OTT) viewership, including paid subscriptions, as compared to the pre-COVID period.

In the last few years, India has seen increased consumption of personal entertainment content on OTT platforms. Various other factors, such as affordable data, smartphone prices and increased use of smart TVs, have played a role in the augmented use of OTT services. The market now looks at OTT as a mainstream technology used to deliver content. With the rise of OTT, the Indian audience, which has been has exposed to quality international content, now expects a certain quality of storytelling and cinematic experience from Indian content too. To compete with international players, local players are also upping their ‘value’ game by creating regional and relevant content for the Indian viewer at competitive prices.

As players explore the possibility of various combinations and partnerships amongst each other, with telecom players and with Indian content being consumed globally, there is a demand for clarity in tax laws in relation to the OTT business. OTT players (international and domestic players) have been following varied business models in India – provision of OTT services directly to Indian customers, sub-licensing OTT platforms to an Indian subsidiary, distribution/monetisation of OTT services through an Indian subsidiary, etc. OTT players also have different monetisation strategies, ranging from monetisation through advertisement revenue or subscription revenue to a combination of both. We have covered the key Indian tax and regulatory aspects for select India business models.

Distributor model



Distributor model

- The Overseas OTT Co. (F Co.) owns and/or operates an OTT platform (including the content) hosted on a server outside India.
- F Co. appoints an Indian subsidiary/group company/third party (I Co.) to distribute OTT subscriptions and/or advertisements for the India market.
- In addition, I Co. has business arrangements with telecom service providers and play stores (partners) who assist I Co. in referring subscribers for a fee. Partners collect subscription fees from the subscribers and then remit them to I Co. after deducting their commission or retaining their revenue share/fees.
- I Co. may get into an arrangement with partners in India to address latency-related issues.
- F Co. obtains a licence from content providers located outside India and in India on an on-going basis. In some cases, I Co. also provides local content sourcing/moderation services while the content rights are directly obtained by F Co.

Direct model

- Under the direct model, F Co. will sell subscription/advertisements directly to Indian customers. It may have its Indian subsidiary/group company (I Co.) provide marketing support services, content sourcing/moderating services, collection agent services, etc.

Key direct tax aspects

F Co.:

- **For subscription revenue**: F Co. will need to consider whether sale of subscription qualifies as royalty (e.g. copyright royalty, process or equipment royalty) considering the provisions of the domestic income tax law and the applicable Indian tax treaty. Legal aspects such as the recent Finance Act, 2020, amendment to remove the benefit of exemption on consideration from sale, distribution, exhibition of cinematographic film from royalty provision under the domestic income tax law, or applicability of the retrospective amendment in the domestic income tax law to tax treaties, or factual aspects such as whether the content can be downloaded on subscribers' devices and its period of validity and other aspects will also need to be kept in perspective to determine taxability under royalty provisions.
- **For advertisement revenue from advertisers/I Co.**: F Co. will need to consider any equalisation levy exposure at 6% (hereinafter referred to as 'Advertising EL') in case the consideration exceeds INR 100,000 per annum per advertiser. In case Advertising EL is applicable on the advertisement income of F Co. derived from India, it will not be subject to income tax in India subject to satisfaction of certain conditions, such as F Co. not having a PE in India.
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as an 'e-commerce operator' as defined – including revenue from sale of advertisements to non-residents targeting customer either residents in India or using Indian IP addresses, and sale of data collected from either Indian residents or person who uses Indian IP addresses. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum.
- Thus, one will also need to evaluate applicability of ECom EL on sale of OTT services by F Co. to Indian subscribers or sale of data by F Co., even if to another non-resident, subject to fulfilment of specified conditions. Aspects like whether F Co. could be regarded as an 'e-commerce operator', whether content viewing is provision of know-how or licensing of a copyrighted article or a service, fulfilment of the requirement of online provision of services under the distribution model/through aggregators, etc. should be considered while evaluating the applicability of ECom EL.
- Both, income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable on such income, then income tax will not be applicable, subject to satisfaction of specified conditions.
- Foreign companies operating in India via the direct or distributor model have witnessed a spate of litigation, especially due to allegations on significant difference in the role of the Indian group company/subsidiary as defined in the service/distribution agreement vis-à-vis actual on-ground conduct of such an Indian group company. In the above case, aspects like technology/digital infrastructure utilised/accessed/controlled in India by the foreign company, how latency arrangements provide (if any) supervision or control over any assets or infrastructure in India, role of an Indian group company in relation to the negotiation process, documentation beyond the inter-company agreement to demonstrate activities of the Indian group company and India's position in the multilateral instrument (MLI) have been considered to allege PE exposure for the foreign company in India.
- Further, implications of the SEP concept under the domestic income tax law will need to be kept in perspective. The Finance Act, 2020, has deferred the applicability of SEP provisions to FY 2021–22 and amended the existing provisions in relation to SEP by removing the reference to digital means in case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing business profits of a non-resident, and inclusion of SEP under the domestic income tax law may therefore not be extended to tax treaties unless they are amended.

- Also, with the Personal Data Protection Bill, 2019, and draft national e-commerce policy mandating the maintenance of a copy of data/compulsory processing of certain data on a server located in India and the requirement of setting up a registered business entity in India for all e-commerce apps/sites, etc., TMT companies may be required to revisit their existing India business models. Thus, one would need to bear in mind any income tax implications, including PE exposure.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Also, last year, the CBDT has released a draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach. It has suggested that a mixed/balanced approach be followed, which allocates profits by giving appropriate weightage to both demand- and supply-side factors. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.
- Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to a business connection in India, by including certain activities such as advertisements targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.
- These developments should be kept in perspective while computing profit attributable to a PE and related exposure.
- **India compliance requirement for F Co.**: Since F Co. shall earn income from Indian customers under both the models, it may be required to file an Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law. However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where nil taxation or applicability of treaty rates is claimed, F Co. may have to continue filing ITR in India.

  In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and file an annual statement in a prescribed form, disclosing specified e-commerce supply or services provided or facilitated by F Co.

  For payments to content providers, play stores, payment gateway service providers, etc.: A non-resident (like F Co.) may be required to comply with withholding tax provisions applicable to a variety of payments made to overseas or Indian parties for carrying out India operations. F Co. will need to keep in perspective the requirement to comply with Indian withholding tax provisions, where applicable, on the consideration paid to acquire content from overseas (under the second source rule) or Indian content providers or payment gateways, play stores, etc., especially in light of extensive penal consequences. The withholding tax rate can vary from nil to 10% depending upon the applicable withholding tax provisions, nature of contract (e.g. service vs work for hire vs licence contract), etc.
- The Finance Act, 2020, has introduced an obligation on an e-commerce operator to withhold taxes while making a payment to an e-commerce participant (one whose specified sale of goods or provision of services are facilitated through a digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on F Co. (as well as I Co. in the case of a distribution model) – specifically, whether it will qualify as an e-commerce operator under any of the business models.

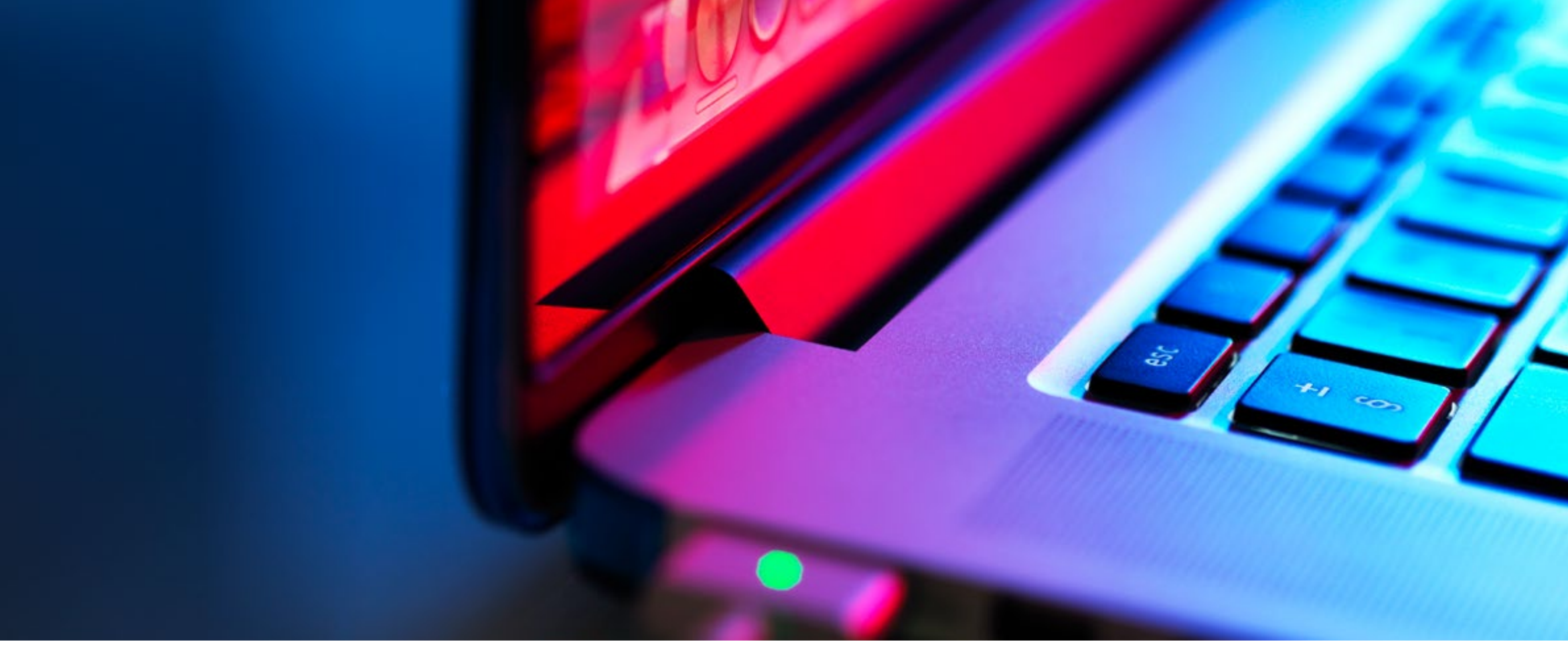
I Co.

- For I Co., it is important to evaluate withholding tax and Advertising EL-related obligations /compliances (including filings) for I Co. while making payments to F Co., the overseas content provider, other overseas advertising agencies, the Indian content provider, payment gateways, play stores, partners, etc.

Key indirect tax aspects

F Co.:

- **Subscription revenue/advertisement revenue**: If Indian customers sign an agreement directly with F Co. and pay subscription fees, it needs to be evaluated whether the services provided by F Co. can be classified as OIDAR services. In case services are considered as OIDAR in nature, F Co. is required to take registration in India and discharge GST. In the distributor model or in case services are not considered as OIDAR in nature, GST may liable to be paid by I Co./the partners under the reverse charge mechanism, which ought to be available as input credit, subject to credit restrictions.
- Similarly, in the case of receipt of advertisement revenue from advertisers/I Co., the applicability of OIDAR provisions needs to be evaluated depending on the nature of advertisement activity.
- **Payments to content providers, play stores, payment gateway service providers, etc.**: In the given case, the payments could be made to service providers in India/outside India by F Co. In case the payment is made outside India for services rendered outside India, the same could be considered as outside the purview of GST and may not be liable to GST. However, if the services are received from Indian service providers, it needs to be analysed whether they can qualify as export of services, subject to fulfilment of export conditions. In the case of exports, such services may not be liable to GST.



I Co.

- **Fees earned by I Co. from subscribers in India**: In case I Co. earns fees from subscribers in India, the services will be liable to applicable GST.
- However, if I Co. provides marketing and other local support services to F Co., the applicability of GST in light of the provisions of intermediary needs to be analysed. Thus, it needs to be analysed whether the nature of services provided by I Co. are merely in the nature of marketing support or in the nature of facilitating the overseas entity to provide subscriptions in India. In the former case, the services could be considered as export of services and outside the purview of GST. However, in the latter case, the services may be subject to GST.
- If any services are provided by I Co. and F Co., being related parties, they should be valued as per GST valuation provisions.
- Import of any goods in relation to abovementioned services may be subject to customs duty at the time of import.
- E-invoicing is set to go live from 1 October 2020. In the initial implementation phase, the GoI has decided to make e-invoicing mandatory for companies with a turnover of INR 5 billion. If applicable to I Co., all B2B invoices need to be first uploaded on the Government portal (i.e. the NIC portal) and must have their Invoice Reference Number (IRN) generated from the portal. Further, B2C invoices of such companies must have a payment QR code printed on them. The GoI is expected to bring down the e-invoicing threshold to INR 1 billion. Hence, if I Co. has a turnover between INR 1 billion and INR 5 billion, it should start planning system changes soon.

Key TP aspects

Direct model

- Depending upon the key functions performed by I Co. and their bearing on the risks and assets, I Co. could either be compensated on a cost-plus basis or on a commission basis. The evaluation between a cost-plus model and a commission model will primarily hinge upon the intensity of the sales function/activity undertaken by I Co. and its impact on the risks (such as bad debts) arising from the performance of such functions.

Distributor model

- Based on roles and responsibilities of the employees of I Co. and intensity of the marketing functions, one needs to evaluate whether I Co. is an LRD, an NRD or a full-fledged distributor (i.e. akin to an FRD), depending upon the key functions performed by the I Co. and its influence on the economically significant risks associated with the Indian operations.
- If I Co. is characterised as an LRD/NRD, it may be compensated on the basis of an arm's-length net operating margin/gross operating margin on its sales.
- If I Co. takes independent business decisions, drives/decides the content available to be viewed in India and undertakes significant advertising and marketing functions, it may be characterised as an FRD (akin to an entrepreneur). In such cases, I Co. may pay an arm's-length compensation to F Co. for the technology platform owned by it and a separate compensation for the international content acquired by it for viewing in India.
- If I Co. is also engaged in procuring Indian content for F Co., depending on the value-added functions performed by I Co. to procure the content, one will need to evaluate whether I Co. is entitled to a facilitation fee or alternatively, a trading return (if the FAR of I Co. is akin to that of a trader). Such facilitation fee could be computed either on a cost-plus basis or a commission basis. However, if I Co., is not actually assisting in procuring the content and merely monitoring the content with a view to ensure that it adheres to the censorship guidelines issued by the industry bodies/regulatory bodies, such monitoring activities can be viewed as being incidental to the main activity of distribution and, thus, could be aggregated and benchmarked with the overall distribution activity.

Key regulatory aspects (related to FEMA and other key regulations)

- The permissibility of cross-border trade payments between I Co. or its Indian subscribers and F Co. needs to be analysed in light of export and import regulations read with the Current Account Transaction Rules. The required approvals/documentation (approvals to act as a collection agent or fulfil of contractual obligations, invoice, etc.) for submission to Indian bankers for remittance of fees to F Co. should be in place. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the RBI. Further, I Co. as well as the Indian subscribers should be mindful of adhering to the timelines for settlement of import and export proceeds.
- If third-party payment aggregators are involved in collecting funds from individual subscribers (using payment modes such as net banking and debit cards) for remittance to F Co., it is imperative to ensure compliance with the Payments and Settlements Act and relevant RBI guidelines.
- Separate e-commerce rules have been notified under the Consumer Protection Act, 2019, that separately lay down the responsibility of e-commerce platforms and the sellers towards the consumers. F Co. and I Co. would need to analyse the applicability of the aforesaid rules, as well as the compliance requirements under them.
- The GoI released a draft national e-commerce policy in February 2019 that restricts cross-border data flow from specified sources and data generated by users in India through various sources, including e-commerce platforms, social media and search engines. Restrictions have also been imposed on sharing of sensitive data collected in India with other foreign business entities or third parties, even with customer consent. Other recommendations in the draft policy include the requirement for setting up a registered business entity in India for all e-commerce apps/sites and ensuring compliance with applicable laws and regulations.
- The draft policy received several comments from the industry on the proposed changes in the overall framework. The Department for Promotion of Industry and Internal Trade (DPIIT) has been working on the recommendations from various stakeholders and it is expected that a new draft e-commerce policy shall be released for further comments.
- The Information Technology Act, 2000, is the overarching law that governs electronic transactions in India today. The act has provisions for cyber security, data protection, intermediary liability, takedown, government interception, etc.
- The Ministry of Electronics and Information Technology has released draft intermediary guidelines seeking to amend the Intermediary Guidelines Rules of 2011. The draft guidelines require intermediaries to prohibit users from hosting certain content on their platform (e.g. obscene content), assist government agencies, and deploy technology-based automated tools to identify and remove public access to unlawful information. The draft guidelines also state that intermediaries with more than 50 lakh users must incorporate a company in India.
- The Personal Data Protection Bill (PDPB), 2019, was introduced in December 2019 with the purpose of protecting the data privacy of individuals. The provisions of the PDP Bill are applicable to personal data collected, disclosed, shared or otherwise processed within India, inter-alia by an Indian or foreign company. Further, the bill also proposes the restriction on transfer of data outside India and storage of personal data on a server in India.

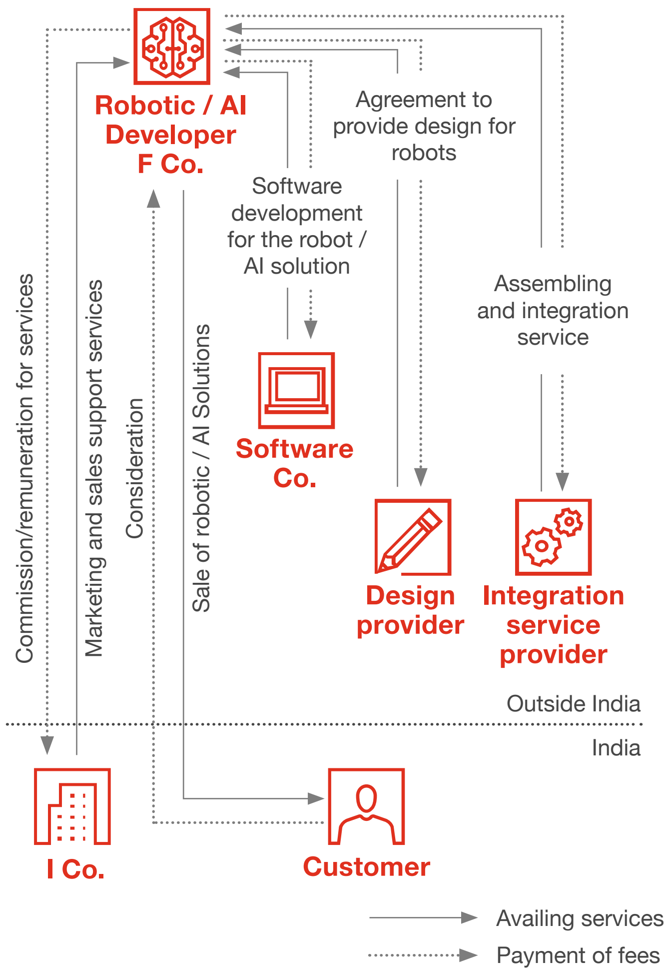
3. Robotics and artificial intelligence

Today, robots find usage beyond manufacturing in areas like e-commerce, logistics, retail and healthcare. There is a significant overlap between robotics and artificial intelligence (AI). Broadly, robotics refers to the branch of technology that deals with the design, construction, operation, and application of robots, as well as computer systems for their control, sensory feedback, and information processing. The advent of business process automation (BPA) has given rise to a concept called robot process automation (RPA), which is an emerging form of BPA technology in which software is used to automate high-volume, repeatable tasks that previously had to be performed by humans. However, RPA requires a huge capital investment which has given rise to another concept of robotics as a service (RaaS), where robots are offered as a service rather than as a product to manage an organisation's most manual, mundane, repetitive or hazardous tasks across multiple locations.

AI is a blanket term which includes deep learning, robotics, machine learning, speech recognition and cognitive computing. There has been increasing interest in AI across all industries in India, including the IT/ITeS sector.

We have covered the key Indian tax and regulatory aspects for select India business models.

Direct model



Direct model

- A robotic/AI developer, a foreign company (F Co.), is engaged in the development of robots and/or AI solutions in-house – which are customised for customers in India/outside India.
- F Co. may also have a separate arrangement with an overseas software company/robot designer/assembling and integration service providers.
- F Co. enters into an agreement directly with Indian customers for supply of robotic devices or integration of AI software in their application or product.
- The Indian subsidiary of the robotic/AI developer (I Co.) may provide marketing and sales support services to F Co.
- F Co. may raise separate invoices for sale of robots. Customers directly pay the consideration to F Co. in the case of AI solutions.
- I Co. may charge fees/remuneration for its services.

Distributor model

- F Co. appoints its wholly owned subsidiary (I Co). as a reseller/distributor for supply of robots or AI solutions in India.
- I Co. will enter into an agreement with customers in India to sell robotic devices or for integration of AI software in the application or product of the customer.
- I Co. will pay the purchase price to F Co. and earn a reseller margin (agreed or otherwise). I Co. will also provide technical support services, including repairs and maintenance. I Co. will be paid a separate service charge for these services.

Key direct tax aspects

- Business profits earned by an overseas entity are generally not chargeable to income tax in India in the absence of a PE/business connection, unless the profits qualify as royalties or FTS. Thus, it needs to be evaluated whether the payment received by F Co. for sale of robots is taxable as royalty, FTS or business income considering the provisions of the domestic income tax law and the relevant Indian tax treaty.
- Since robots comprise hardware with embedded software, the aspects of whether the software embedded in the hardware is taxable as royalty (software partaking the character of hardware) or business income (considering the fact that such software cannot be used independently and the sale is essentially of the product) has seen its share of protracted litigation in India. If the robots are separately upgraded online, the aspects of whether consideration for such online software upgrade can be taxable as software royalty or process royalty, especially in view of retrospective amendments under the domestic income tax law and implications under the Indian tax treaties has also witnessed protracted litigation.
- Furthermore, in the case of supply of products from outside India, the taxability of such offshore supply would depend on various factors – terms of sale, transfer of ownership, link of such supply with onshore implementation/customisation, etc. Also, it is important to analyse whether the payment made by F Co. to an overseas designer/software company for obtaining any customised design/software is taxable in India as royalty/FTS by virtue of the second source rule under the domestic income tax law and certain Indian tax treaties (e.g. the India–USA Tax Treaty).
- As regards AI software, F Co. needs to determine whether income earned as a developer/programmer from sale/licensing of AI software could be taxable as royalty under the provisions of the domestic income tax law as well as the applicable Indian tax treaty. Also, another important aspect to be decided by F Co. would be whether sale of self-developed software (i.e. standard software) could be treated as sale of a shrink-wrapped software. Taxability of payments received for providing standard/off-the-shelf software has also been a subject matter of extensive income tax litigation in India, with the Supreme Court in the process of deciding this issue.
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as an e-commerce operator as defined – including revenue from sale of data to non-resident collected from either Indian residents or person who uses Indian IP addresses, subject to fulfilment of specified conditions. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum. Thus, one will also need to evaluate the applicability of ECom EL on income earned by F Co. or sale of data by F Co., even if to another non-resident, subject to fulfilment of specified conditions. Key aspects in this evaluation could be whether F Co. qualifies as an 'e-commerce operator', whether sale of robots or subsequent software upgrades and AI solutions should be considered as online sale of goods or provision of services or facilitation of both, relevance of an online or offline contract, whether right to access data could be considered as sale of data, etc.
- Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable to such income, then income tax will not be applicable, subject to satisfaction of specified conditions.
- Depending upon the business model through which F Co. is operating in India and the activities carried on in India, one needs to be mindful of any PE exposure for F Co. in India:

  - whether marketing or on-site support services, technical services, consultancy services, etc., provided by employees of F Co. travelling to India qualify as FTS, fees for included services or create service PE exposure due to the presence of the employees/personnel of F Co. in India
  - any storage of warranty parts (in warranty vs out warranty) by I Co. for providing repairs and maintenance services could lead to questions around fixed place PE exposure, if the contractual terms are not clear.
- It is also important to ensure that the on-ground activities of I Co. reflect the exact terms of written contracts/arrangements and adequate documentation is maintained to demonstrate the same and address any PE-related aspects which the Indian tax authorities might want to test.
- Further, the implications of the SEP concept under the domestic income tax law will need to be kept in perspective. The Finance Act, 2020, has deferred the SEP provisions to FY 2021–22 and amended the existing provisions in relation to SEP by removing the reference to digital means in case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing the business profits of a non-resident, and inclusion of SEP under the domestic income tax law may therefore not be extended to the tax treaty unless the tax treaties are amended.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Last year, the CBDT released a draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach and suggesting that a mixed/balanced approach be followed, which allocates profits by giving appropriate weightage to both demand- and supply-side factors. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.

  Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to a business connection in India, by including certain activities such as advertisements targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.

  These developments should be kept in perspective while computing profit attributable to a PE and related exposure.
- **India compliance requirement for F Co.**: Since F Co. shall earn income from Indian customers under both the models, it may be required to file Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law. However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where F Co. claims nil taxation or applicability of treaty rates, it may have to continue filing ITR in India.
- In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form disclosing specified e-commerce supply or services provided or facilitated by F Co.

- The Finance Act, 2020, has introduced an obligation on an e-commerce operator to withhold taxes while making payments to an e-commerce participant (one whose specified sale of goods or provision of services are facilitated through a digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on F Co. as well as I Co. – specifically whether F Co. shall qualify as an e-commerce operator under any of the business models.
- F Co. should also consider the requirements to withhold tax on payments to I Co./Indian residents and to carry out related compliances. Non-compliance with the prescribed requirement may trigger interest and penal and prosecution risk in the hands of F Co.

Key indirect tax aspects

F Co.:

- F Co. (AI developer) needs to determine if the services would be in the nature of OIDAR or IT/IT-enabled services (ITeS). If F Co. supplies to an unregistered customer, the services provided by it with respect to licensing of AI software may be classified as OIDAR services. If the services qualify as OIDAR, F Co. needs to obtain GST registration in India and deposit tax. In case of business-to-business (B2B) supplies made by F Co., the recipient of services may be liable to pay GST on a reverse-charge basis.
- If the services are classified as IT/ITeS, then the business customers in India may be liable to pay GST under reverse charge and the overseas AI developer may not be required to undertake any GST-related compliances.

I Co.:

- Based on the nature and extent of the marketing support service agreement, services provided by I Co. could either qualify as export services (and hence not taxable) or intermediary services in case the services are in the nature of facilitation services (with GST exposure). Further, import of robots by Indian customers will also attract applicable custom duties. In cases where software is embedded over hardware, the valuation of imported goods will have to be determined in terms of the Customs Valuation Rules which (in certain circumstances) provide inclusion of software value in the value of hardware.
- Under the distributor model, Special Valuation Branch proceedings may apply to inter-company imports of robots, which determine the correctness of arm's-length pricing between related parties, including value of software being included in value of hardware for customs duty. Also, all other transactions between F Co. and I Co. (being related in nature) will be subject to GST valuation provisions.
- E-invoicing is set to go live from 1 October 2020. In the initial implementation phase, the GoI has decided to make e-invoicing mandatory for companies with a turnover of INR 5 billion. If applicable to I Co., all B2B invoices need to be first uploaded on the Government portal (i.e. the NIC portal) and must have their Invoice Reference Number (IRN) generated from the portal. Further, B2C invoices of such companies must have a payment QR code printed on them. The GoI is expected to bring down the e-invoicing threshold to INR 1 billion. Hence, if I Co. has a turnover between INR 1 billion and INR 5 billion, it should start planning system changes soon.

Key TP aspects

Direct model

- Depending upon the key functions performed by I Co. and their bearing on risks and assets, I Co. could either be compensated on a cost-plus basis or commission basis. The evaluation between a cost-plus model and a commission model will primarily depend upon the intensity of the sales function/ activity undertaken by I Co. and its impact on the risks (such as bad debts) arising from the performance of such functions.

Distributor model

- Based on the roles and responsibilities of I Co. employees and the intensity of marketing functions, it needs to be evaluated whether I Co. is an LRD, an NRD or a full-fledged distributor (i.e. akin to an entrepreneur [FRD]), depending upon the key functions performed by it and their influence on the economically significant risks associated with Indian operations.
- If I Co. is characterised as an LRD/NRD, it may be compensated on the basis of an arm's-length net operating margin/gross operating margin on its sales.
- If I Co. is an FRD (i.e. akin to an entrepreneur), it may pay an arm's-length compensation to F Co. for the intangibles owned by F Co. The compensation could be linked to the sales in such a manner that the residual profits derived from Indian operations reside in I Co.

Key regulatory aspects (related to FEMA)

- The permissibility of payments made by I Co. or Indian customers to F Co. will need to be analysed in light of import regulations read with the Current Account Transaction Rules. The remitter will need to have in place the required approvals/documentation (approvals to act as a collection agent or fulfil contractual obligations, invoices, etc.) for submission to Indian bankers for remittance of fees to F Co. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the RBI. Further, I Co. as well as Indian customers should be mindful of adhering to the import timelines for payment.

4. Online gaming

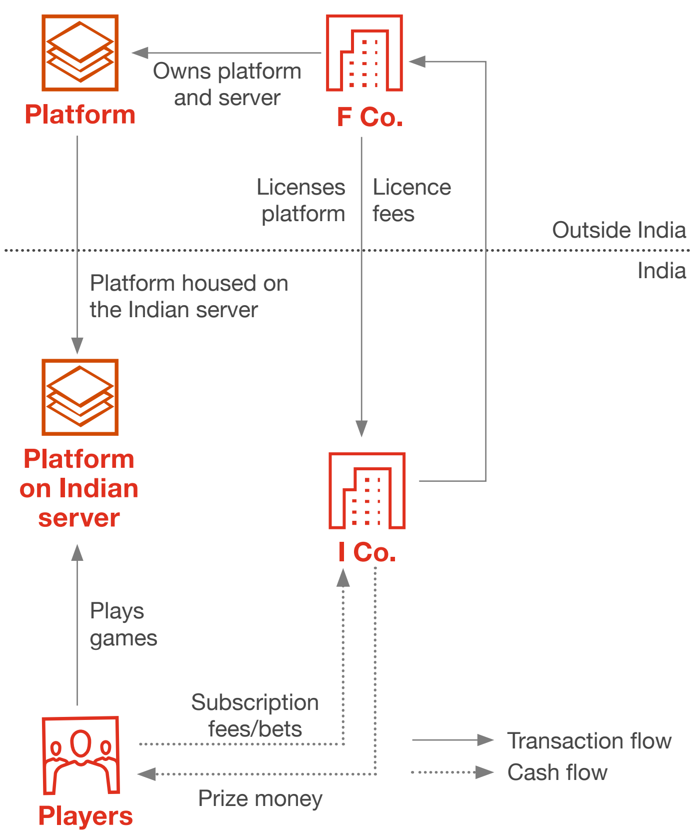
With major sporting events either cancelled or postponed indefinitely, e-sports or online gaming formats are expected to grow multifold as social games become a way to keep in touch with friends and stay connected.

The total revenue from video games and e-sports in India crossed the billion-dollar threshold in 2018, with a revenue of USD 1.1 billion – up from USD 350 million in 2014. It is forecast to grow very strongly at a CAGR of 18.9%, reaching USD 2.6 billion in 2023 and moving the country into the top ten global gaming markets by consumer revenue.[1] The increase in affordable smartphones, combined with an expanding internet user base and reduced data prices are considered to be the growth drivers for online gaming. The huge potential market size of online gaming in India has led to a surge in the number of online gaming platforms over the last few years. Many foreign players have already started game development centres in India to tap into the huge business potential. Online gaming can be divided into two types: (a) skill-based games and (b) non-skill based (i.e. luck-based) games.

Different types of revenue models are followed in online gaming segments – subscription, freemium subscription, in-game advertising, etc.

We have covered the key Indian tax and regulatory aspects for select India business models.

India inbound model



1 PwC's Global Entertainment & Media Outlook 2019–2023. Retrieved from https://www.pwc.com/gx/en/entertainment-media/outlook-2019/entertainment-and-media-outlook-perspectives-2019-2023.pdf

India inbound model

An overseas gaming company (F Co.) develops and/or maintains the platform/app where games can be played online/on mobile and registers the IP in its name. The platform is hosted on servers outside India. On the operational aspect, two illustrative business models are discussed:

(a) Licence for Indian business given to the Indian company (I Co.).

- F Co. grants an annual licence (or transfer for a lumpsum consideration) for a fee to its Indian group company/subsidiary (I Co.) to use the platform/app for India business.
- I Co. shall organise games on the platform for Indian players and earn income by way of participation fees, commission, rack fee or charge a subscription fee for providing access to specific games on the platform.
- I Co. could also earn income from in-game/app purchases (lives, power-ups, level ups, merchandise, etc.), in-game advertisements or advertisements on other spaces on its platform.
- For app/play store arrangements with technology companies, consideration from customers is first collected by app/play stores and then remitted to I Co. after deducting their fees.

(b) I Co. to act as distributor/reseller

- F Co. appoints I Co. as a reseller/distributor for online games (including in-game sales) and advertisements to be placed on the platform/app. I Co. will enter into agreements with customers, advertisers, etc. in India.
- I Co. will pay the purchase price to F Co. and earn a reseller margin (agreed or otherwise).

India outbound model

- I Co. develops and/or maintains the game platform/app and the IP is registered in its name. I Co. retains Indian rights and may grant an annual licence for a lumpsum licence fee to its foreign subsidiary for use of the platform/app for business outside India.

Key direct tax aspects

India inbound model

F Co.:

- Business profits earned by an overseas entity are generally not chargeable to income tax in India in the absence of a PE/business connection, unless the profits qualify as royalties or FTS. Thus, it needs to be evaluated whether the payment received by F Co. is taxable as royalty, FTS or business income, considering the provisions of the domestic income tax law and the relevant Indian tax treaty.
- F Co. needs to determine whether income earned from subscription and in-app purchases is taxable as business income, royalty or FTS under the domestic income tax law and/or under the relevant Indian tax treaty.
- In case the income of F Co. includes income from in-game advertisements and advertisements on the platform, it is important to consider applicability of equalisation levy at 6% (hereinafter referred to as 'Advertising EL') if the consideration exceeds INR 100,000 per annum from every advertiser. In case Advertising EL is applicable on the India advertisement income of F Co., it will not be subject to income tax in India provided certain conditions are met (e.g. F Co. not having a PE in India).
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as an 'e-commerce operator' as defined – including revenue from sale of advertisements to non-residents targeting customers either resident in India or using Indian IP addresses, and sale of data to non-residents collected from either Indian residents or persons who use Indian IP addresses. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum. Thus, one will also need to evaluate applicability of ECom EL on various streams of income from online gaming, particularly categorisation of each stream of income as goods or services, or on sale of data by F Co., even if to another non-resident, subject to fulfilment of specified conditions. Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable to such income, then income tax will not be applicable, subject to fulfilment of certain conditions.
- Further, the implications of the SEP concept under the domestic income tax law will need to be kept in perspective. The Finance Act, 2020, has deferred the applicability of SEP provisions to FY 2021–22 and amended the existing provisions in relation to SEP by removing the reference to digital means in case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing business profits of a non-resident, and the inclusion of SEP under the domestic income tax law may therefore not be extended to the tax treaties unless they are amended.

- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Last year, the CBDT released a draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach and suggesting that a mixed/balanced approach be followed, which allocates profits by giving appropriate weightage to both demand- and supply-side factors.

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  Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to business connections in India, by including certain activities such as advertisements targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.

  These developments should be kept in perspective while computing profit attributable to a PE and related exposure.

- **India compliance requirement for F Co.**: Since F Co. shall earn income from I Co., it may be required to file Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law.

  However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income-tax law). Thus, in cases where F Co. claims nil taxation or applicability of treaty rates, it may have to continue filing ITR in India.

  The Finance Act, 2020, has made it mandatory for an e-commerce operator to withhold taxes while making payment to an e-commerce participant (one whose specified sale of goods or provision of services are facilitated through a digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on F Co. as well as I Co. and evaluate specifically whether F Co. shall qualify as an e-commerce operator under any of the business models.

- In case ECom EL is applicable for F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form disclosing specified e-commerce supply or services provided or facilitated by F Co.

I Co.:

- It is important to evaluate withholding tax and Advertising EL-related obligations/compliances (including filings) for I Co. while making payments to F Co.

India outbound model

I Co.:

- I Co. will need to evaluate whether the business activity of development (and continuous updation) of the game software/platform could be considered as manufacturing activities and associated tax benefits (additional depreciation, optional lower corporate tax rate of 15%, etc.) could be availed.
- I Co. needs to analyse the withholding tax obligations while making payment of game winnings to the players, particularly when tax has to be withheld and on the computation of the amount that incurs withholding tax. The withholding tax obligations also need to be evaluated while making remittances to F Co. for use of the gaming platform.
- If I Co. has a game development centre, it can evaluate the eligibility of expenses on research and development (R&D) and, the possibility of registering under a patent box regime.

Key indirect tax aspects

India inbound model

- **Annual licence fees earned by F Co.**: The annual licence fees payable by I Co. can be considered as consideration for the app/platform provided. As this provision of an app/platform is in the nature of a service, the consideration can be subject to GST under the reverse charge mechanism. It can be claimed as input credit by I Co., subject to input credit restrictions.
- Participation fees, commission, rack fee, or charge-a-subscription fee, income from in-game/app purchases, income from advertisements: Income from such services earned by I Co., being in the nature of consideration for services provided to customers in India, should be subject to GST. GST paid on procurements by I Co. can be availed as input tax credit by I Co., subject to input credit restrictions.
- E-invoicing is set to go live from 1 October 2020. In the initial implementation phase, the GoI has decided to make e-invoicing mandatory for companies with a turnover

of INR 5 billion. If applicable to I Co., all B2B invoices need to be first uploaded on the Government portal (i.e. the NIC portal) and must have their Invoice Reference Number (IRN) generated from the portal. Further, B2C invoices of such companies must have a payment QR code printed on them. The GoI is expected to bring down the e-invoicing threshold to INR 1 billion. Hence, if I Co. has a turnover between INR 1 billion and INR 5 billion, it should start planning system changes soon.

- If the platform is operated by F Co. and not I Co., the concept of OIDAR services needs to be analysed, wherein the F Co. may be required to get registered in India for specified digital services provided for business-to-consumer (B2C) transactions. This has separate compliance-related obligations for overseas marketplaces and the impact needs to be analysed, based on facts and the nature of services provided.
- For the distributor/reseller model, I Co. has to analyse the functions that will be performed for F Co. and then determine whether the services would qualify as export of services, or would I Co. qualify as intermediary and hence liable to GST.

India outbound model

- Annual licence fees earned by I Co.: The annual licence fees payable by F Co. can be considered as consideration for the app/platform provided. In the given case, as the services are provided by a service provider in India to a service recipient outside India, the same can be considered as export of services, subject to fulfilment of all conditions related to exports.

Key TP aspects

India inbound model

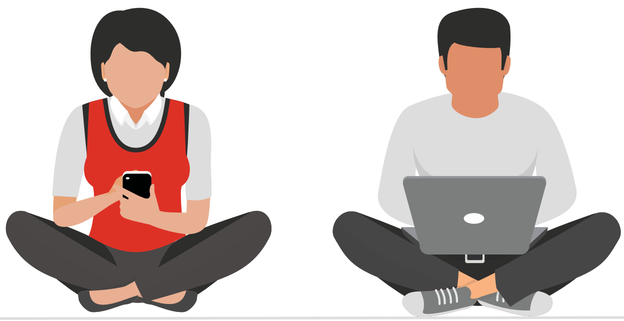
- Based on the roles and responsibilities of I Co. employees and the intensity of marketing functions, one needs to evaluate whether I Co. is an LRD, an NRD or a full-fledged distributor (i.e. akin to an entrepreneur [FRD]), depending upon the key functions performed by I Co. and their influence on the economically significant risks associated with its Indian operations.
- If I Co. is characterised as an LRD/NRD, it may be compensated on the basis of an arm's-length net-operating margin/gross-operating margin on its sales.
- If I Co. is an FRD (akin to an entrepreneur), it may pay an arm's-length compensation to F Co. for the intangibles owned by the F Co. The compensation could be linked to the sales in such a manner that the residual profits derived from India operations reside in I Co.

India outbound model

In the case of the outbound model, the same analogy discussed above can be applied in reverse, wherein F Co. can be compensated based on the net margin/gross margin or by payment of royalty to I Co. depending on the key functions performed by it to manage the economically significant risks faced by its Indian operations.

Key regulatory aspects (FEMA)

- If third-party payment aggregators are involved in collecting funds from individual subscribers (using payment modes such as net banking and debit cards) for remittance to F Co., it is imperative to ensure compliance with the Payments and Settlements Act and relevant RBI guidelines.
- The permissibility of cross-border trade payments between I Co. and F Co. needs to be analysed in light of the export and import regulations read with the Current Account Transaction Rules. The required documentation (fulfilment of contractual obligations, invoices, etc.) for submission to Indian bankers for remittance of purchase price to F Co. towards imports should be in place. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the RBI. Further, I Co. should be mindful of adhering to the timelines for settlement of import and export transactions.
- It is critical to evaluate the permissibility of foreign investment in online gaming business activities in India considering that there are overarching restrictions on investments in lottery or gambling business activities under the FDI policy.
- The Personal Data Protection Bill (PDPB), 2019, was introduced in December 2019 with the purpose of protecting the data privacy of individuals. The provisions of the PDP bill are applicable to personal data collected, disclosed, shared or otherwise processed within India, inter-alia by an Indian or foreign company. Further, the bill also proposes the restriction on transfer of data outside India and storage of personal data on a server in India.
- Separate e-commerce rules have been notified under the Consumer Protection Act, 2019, that separately lay down the responsibility of e-commerce platforms and sellers towards the consumers. F Co. and I Co. would need to analyse the applicability of the aforesaid rules, as well as the compliance requirements under them.

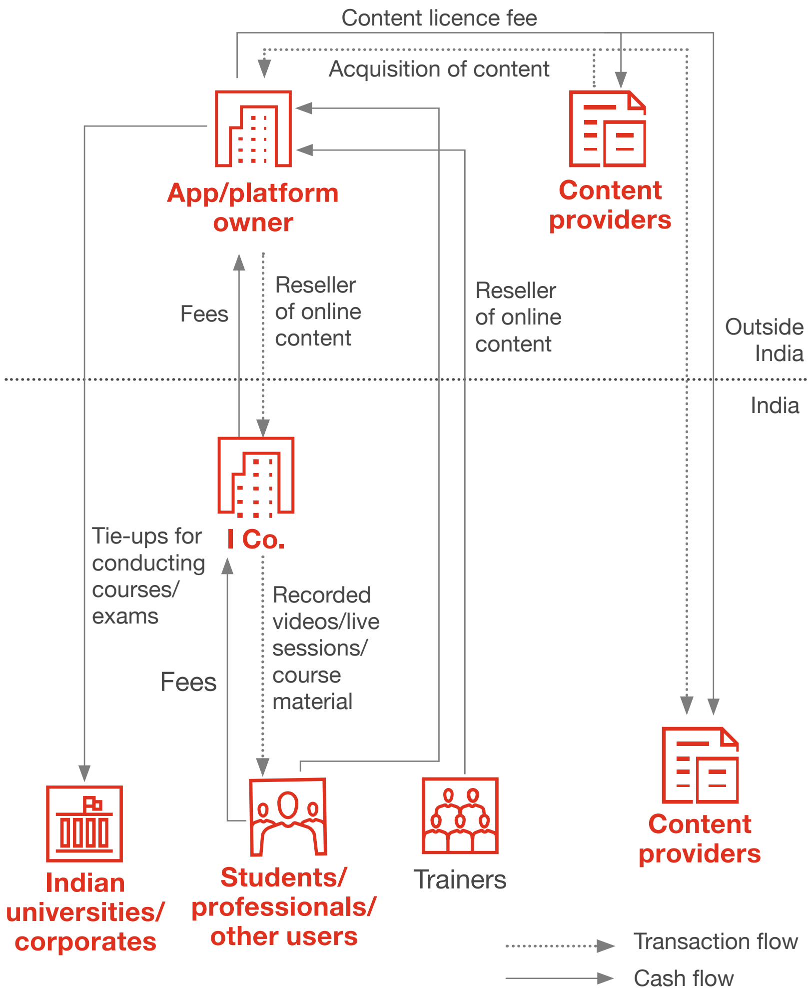


5. Online education

Online education utilising education technology (EdTech) has witnessed large-scale adoption as the COVID-19 pandemic has affected campus-based programmes/courses temporarily. In recent times, the best of global courses have become easily and conveniently available to even those residing in remote locations through education apps, thereby transforming the entire ecosystem. The National Education Policy (NEP), 2020, is expected to revamp the Indian education sector post implementation. Apart from a number of Indian EdTech start-ups, a considerable number of foreign EdTech companies are also investing in India to explore EdTech's untapped potential in the country. Travel restrictions due to the COVID-19 pandemic have led to foreign universities providing live as well as recorded classroom sessions. The various components of the sector are technology-based solutions, tutoring, vocational training/ courses and classroom education.

EdTech players (international and domestic) have been following varied business models in India – such as provision of services directly to Indian customers, sub-licensing EdTech platforms to Indian subsidiaries or

Distributor model



distribution/monetisation of EdTech services through Indian subsidiaries. These players also have different monetisation strategies, ranging from monetisation through subscription revenue, franchisee income, advertisement revenue, joint tie-ups, collaborations with Indian universities or educational institutes, or a combination of all these strategies. Apart from developing online content, foreign EdTech players may send trainers to India for the purpose of limited training as a part of online platform services.

We have covered the key Indian tax and regulatory aspects for select India business models.

Distributor model

- Overseas EdTech Co. (F Co.) operates a platform or runs an app hosted on a server outside India. It procures content or hires professionals or knowledge drivers (content providers) to run the online content on its app/platform.
- F Co. appoints an Indian subsidiary/group company/third party (I Co.) to distribute subscriptions and/or advertisements for the India market.
- In addition, F Co./I Co. has business arrangements/collaborations with educational institutes or local universities (partners) for content sharing, faculty travelling to India for training sessions, etc. In many cases, partners may collect subscription fees from the subscribers and then remit the amount to I Co. after deducting their commission or retaining their share of revenue/fees.
- F Co. obtains the licence from content providers located outside India and in India on an ongoing basis. In some cases, I Co. also provides local content sourcing/moderation services while the content rights are directly obtained by F Co.
- User data and content may be maintained on the server outside India.

Direct model

Under the direct model, F Co. will sell subscription/advertisements directly to Indian customers. It may have its Indian subsidiary/group company provide marketing support services, content sourcing/moderating services, collection agent services, etc.

Key direct tax aspects

F Co.:

- **For subscription revenue**: F Co. will need to consider whether the sale of subscription to Indian users qualifies as royalty (e.g. copyright royalty, information or equipment royalty) or FTS considering the provisions of the domestic income tax law and the applicable Indian tax treaty. Considering that F Co. only provides viewing rights and that neither is such content generally downloadable nor are any modification rights given to users, it would be important to decide whether such income can be taxed as royalty under the provisions of the domestic income tax law as well as applicable Indian tax treaty. Many Indian tax treaties exempt fees paid to educational institutions and such tax treaties also need to be taken into consideration.
- **For advertisement revenue from advertisers/I Co.**: F Co. will need to examine any equalisation levy exposure @6% (hereinafter referred to as 'Advertising EL') in case the consideration exceeds INR 100,000 per annum per advertiser. In case Advertising EL is applicable on the advertisement income of F Co. derived from India, it will not be subject to income tax in India, provided certain conditions such as F Co. not having a PE in India are met.
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as 'e-commerce operator' as defined – including revenue from sale of subscriptions to Indian users or using Indian IP addresses, and sale of data to non-residents collected from either Indian residents or person who uses Indian IP addresses. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum.
- Thus, one will also need to consider applicability of ECom EL aspects like whether content viewing is provision of know-how or licensing of a copyrighted article or a service. Due consideration would also be needed to be given to whether services rendered by faculties travelling to India would qualify as online provision of services, the implications on on-campus course fees for courses conducted on campus as well as online, etc., while evaluating the applicability of ECom EL. Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable on such income, then income tax will not be applicable, subject to satisfaction of certain conditions.
- Depending upon the nature of India business models, the nature/extent of collaborations with Indian universities or corporates with whom there is a tie-up for running F Co. courses in India, the role of the Indian subsidiary and/or its employees vis-à-vis contracts with Indian arrangements, and stay of the faculty/trainers travelling to India vis-à-vis purpose of such stay in India, one needs to be bear in mind any PE-related exposure (like an Agency PE or a Service PE, etc).
- Further, the implications of SEP under the domestic income tax law will need to be kept in perspective. The Finance Act, 2020, has deferred the applicability of SEP provisions to FY 2021–22 and amended the existing provisions related to SEP by removing the reference to digital means in case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing business profits of a non-resident, and inclusion of SEP under the domestic income tax law may therefore not be extended to the tax treaties unless they are amended.

- Also, with the Personal Data Protection Bill, 2019, and the draft national e-commerce policy mandating the maintenance of a copy of data/compulsory processing of certain data on a server located in India and the requirement of setting up a registered business entity in India for all e-commerce apps/sites, etc., TMT companies may be required to revisit existing India business models and to bear in mind the income tax implications, including any PE exposure.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Last year, the CBDT released a draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach and suggesting that a mixed/balanced approach that allocates profits by giving appropriate weightage to both demand- and supply-side factors be followed. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.

  Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to business connections in India, by including certain activities such as advertisement targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.

  These developments should be kept in perspective while computing profit attributable to a PE and related exposure.
- The Finance Act, 2020, has made it mandatory for an e-commerce operator to withhold taxes while paying an e-commerce participant (one whose specified sale of goods or provision of services are facilitated through a digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on F Co. as well as I Co., specifically whether F Co. shall qualify as an e-commerce operator under any of the business models, considering the content belongs to Indian content providers and how the business model operates.
- **India compliance requirement for F Co.**: Since F Co. shall earn income from Indian customers under both the models, it may be required to file Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law. However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where F Co. claims nil taxation or applicability of treaty rates, it may have to continue filing ITR in India.
- **For payments to content providers, play stores, payment gateway service providers, trainers etc.**: A non-resident (like F Co.) is required to comply with withholding tax provisions applicable to a variety of payments made to overseas or Indian parties for carrying out Indian operations. F Co. will need to keep in perspective the requirement to comply with Indian withholding tax provisions, wherever applicable, on the consideration paid to acquire content from overseas (under second source rule) or Indian content providers or payment gateways, play stores, etc., especially in light of extensive penal consequences. The withholding tax rate can vary from nil to 10%, depending on applicable withholding tax provisions, the nature of the contract (e.g. service vs work for hire vs licence contract), etc.
- In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form, disclosing specified e-commerce supply or services provided or facilitated by F Co.

I Co.:

- It is important to evaluate withholding tax and Advertising EL related obligations/compliances (including filings) for I Co. while making payments to F Co., overseas content providers, other overseas advertising agencies, Indian content providers, payment gateways, play stores, partners, etc.

Key indirect tax aspects

F Co.:

- Considering that the users in a majority of cases could be individuals and if the online content viewing services are to be classified as OIDAR services, F Co. would be required to take registration and pay GST in the case of a direct model. In the case of a distributor model or sale of subscriptions under a B2B model, I Co./the Indian customer would be required to pay GST under the reverse charge mechanism. GST thus paid under the reverse charge mechanism can be eligible for credit subject to credit restrictions.
- Similarly, in the case of receipt of advertisement revenue from advertisers/I Co., the applicability of OIDAR provisions needs to be evaluated, depending on the nature of advertisement activity.

I Co.

- **Fees earned by I Co. from subscribers in India**: In case I Co. earns fees from subscribers in India, the services will be liable to applicable GST.
- However, if I Co. provides marketing and other local support services to F Co., the applicability of GST in light of intermediary provisions needs to be analysed. Thus, it needs to be assessed whether the services provided by I Co. are merely in the nature of marketing support or in the nature of facilitating the overseas entity to provide subscriptions in India. In case it is the former, the services could be considered as export of services and outside the purview of GST. However, in case it is the latter, the services may be subject to GST.

- If any services are provided by I Co. to F Co., the two being related parties, I Co. should be valued as per GST valuation provisions. In case there is no separate charge for any of the inter-company services, such services may be subject to GST under transfer without consideration provisions.
- Import of any goods in relation to the abovementioned services may be subject to customs duty at the time of import.
- E-invoicing is set to go live from 1 October 2020. In the initial implementation phase, the GoI has decided to make e-invoicing mandatory for companies with a turnover of INR 5 billion. If applicable to I Co., all B2B invoices need to be first uploaded on the Government portal (i.e. the NIC portal) and must have their Invoice Reference Number (IRN) generated from the portal. Further, B2C invoices of such companies must have a payment QR code printed on them. The GoI is expected to bring down the e-invoicing threshold to INR 1 billion. Hence, if I Co. has a turnover between INR 1 billion and INR 5 billion, it should start planning system changes soon.

Key TP aspects

Direct model

- Depending upon the key functions performed by I Co. and their bearing on risks and assets, I Co. could either be compensated on a cost-plus basis or on a commission basis. The evaluation between a cost-plus model and a commission model will primarily hinge upon the intensity of the sales function/ activity undertaken by I Co. and its impact on the risks (such as bad debts) arising from performance of such functions.

Distributor model

- Based on the roles and responsibilities of the employees of I Co. and intensity of the marketing functions, one needs to evaluate whether I Co. is an LRD, an NRD or a full-fledged distributor (i.e. akin to an FRD), depending upon the key functions performed by I Co. and their influence on the economically significant risks associated with the Indian operations.
- If I Co. is characterised as an LRD/NRD, it may be compensated on the basis of an arm's-length net operating margin/gross operating margin on its sales.
- If I Co. takes independent business decisions, drives/ decides the content available to be viewed in India and undertakes significant advertising and marketing functions, it may be characterised as an FRD (akin to an entrepreneur). In such cases, I Co. may pay an arm's-length compensation to F Co. for the technology/ platform owned by it and a separate compensation for the international content acquired by it for viewing in India.
- If I Co. is also engaged in procuring Indian content for F Co., one will need to evaluate whether I Co. is entitled to a facilitation fee or alternatively, a trading return (if the FAR of I Co. is akin to that of a trader), depending on the value-added functions performed by I Co. to procure the content. Such facilitation fee could be computed either on a cost-plus basis or a commission basis. However, if I Co. is not actually assisting in procuring the content and merely monitoring the content to ensure that it adheres to the censorship guidelines issued by the industry /regulatory bodies, such monitoring activities can be viewed as being incidental to the main activity of distribution and could be aggregated and benchmarked with the overall distribution activity.

Key regulatory aspects (related to FEMA and other regulations)

- The permissibility of cross-border trade payments between I Co. or its Indian subscribers and F Co. needs to be analysed in light of export and import regulations as read with the Current Account Transaction Rules. The required approvals/documentation (approvals to act as a collection agent or fulfilment of contractual obligations, invoice, etc.) for submission to Indian bankers for remittance of fees to F Co. should be in place. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the RBI. Further, I Co. as well as Indian subscribers/ universities should be mindful of adhering to the timelines for settlement of import and export transactions.
- If third-party payment aggregators are involved in collecting funds from individual subscribers (using payment modes such as net banking and debit cards) for remittance to F Co., it is imperative to ensure compliance with the Payments and Settlements Act and relevant RBI guidelines.
- Separate e-commerce rules have been notified under the Consumer Protection Act, 2019, that separately lay down the responsibility of e-commerce platforms and the sellers towards the consumers. F Co. and I Co. would need to analyse the applicability of the aforesaid rules, as well as the compliance requirements under them.
- The Personal Data Protection Bill (PDPB), 2019, was introduced in December 2019 with the purpose of protecting the data privacy of individuals. The provisions of the PDP bill are applicable to personal data collected, disclosed, shared or otherwise processed within India, inter-alia by an Indian or foreign company. Further, the bill also proposes the restriction on transfer of data outside India and storage of personal data on a server in India.
- Other regulatory aspects would cover various agencies such as the University Grants Commission (UGC), the All India Council for Technical Education and other statutory professional councils.

6. Cloud

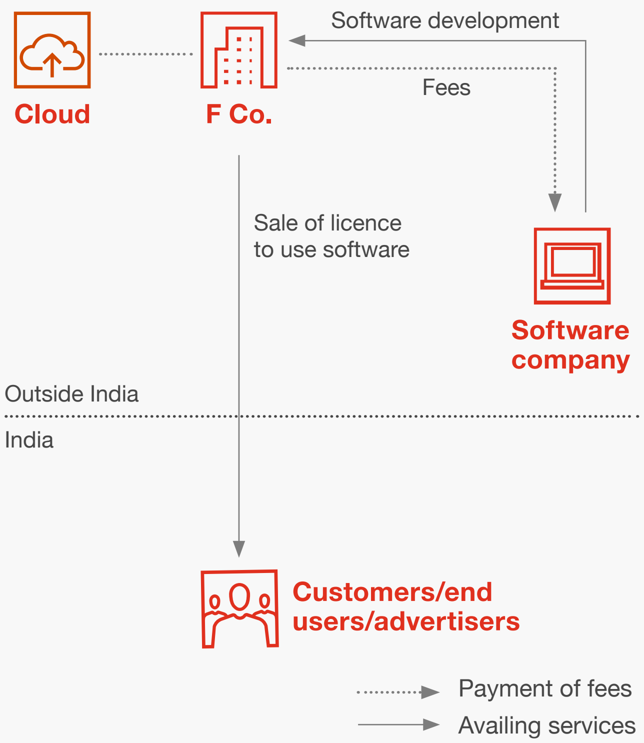
The impact of COVID-19 has accelerated the adoption of cloud. Enterprises are increasingly preferring cloud technologies due to their agility, cost-effectiveness and scalability. With increased focus on e-governance and digitisation, the adoption of cloud services in the public sector is also growing.

Cloud has been a major catalyst for significant shifts in business models, talent priorities and IT expenditure from capex to opex. The cloud model enables increased efficiency and is expected to partially mitigate some of the demand-related tailwinds from substantial growth of data and virtualisation of workload.

Cloud players (international and domestic players) have been following varied operational models in India – including the provision of cloud services directly to Indian customers and distribution of cloud services through Indian subsidiaries. We have covered the key Indian tax and regulatory aspects for select India business models.

Prevalent operating models

- Infrastructure as a service (IaaS): Users can rent IT infrastructure such as data centres and network infrastructure equipment to deploy and run applications or store data.
- Software as a service (SaaS): Users do not need to install or maintain software applications on their computers. Software runs on the provider's cloud infrastructure and a user can access it on the web.
- Platform as a service (PaaS) PaaS enables companies to develop applications by using programming languages and tools. The provider is responsible for maintaining and managing the IaaS platform on which the PaaS tools are hosted.



Thus, as one would expect, a cloud ecosystem witnesses a variety of operating models that bring in a host of direct tax, indirect tax and TP implications depending on the selected model. One needs to be mindful of tax issues that need to be addressed, depending upon the arrangement/ business model. In this part of the discussion, we have considered the SaaS operational model with a direct business model and highlighted key tax and regulatory aspects that can have larger implications on the way business is conducted through this operating model.

Direct model

- An overseas entity (F Co.) is engaged in the business of providing SaaS through the cloud infrastructure that is hosted on servers outside India. F Co. may have a separate arrangement with an overseas software company to obtain customised software to meet certain customer requirements.
- F Co. enters into agreement directly with Indian customers for providing SaaS through the cloud.
- F Co. can raise invoices for providing SaaS (annual) on its customers and customers directly pay the consideration to F Co.
- F Co. can set up an India company (I Co.), hire a third party or send its own employees for providing on-site support, technical services, consultancy services, etc.

Key direct tax aspects

F Co.:

- Business profits earned by an overseas entity are generally not chargeable to income tax in India in the absence of a PE/business connection, unless the profits qualify as royalties or FTS. Thus, it needs to be evaluated whether the payment received by F Co. is taxable as royalty, FTS or business income, considering the provisions of the domestic income tax law and the relevant Indian tax treaty.
- Whether payment received by F Co. from its customers for SaaS is taxable as software royalty or process royalty, especially in view of retrospective amendments under the domestic income tax law and implications under the Indian tax treaties, has witnessed protracted litigation. Taxability of payments received for providing standard/off-the-shelf software has also been a subject matter of extensive income tax litigation in India, and the Supreme Court is currently in the process of deciding this issue. Also, it is important to analyse whether the payment made by F Co. to an overseas software company for obtaining any customised software is taxable in India as royalty by virtue of the second source rule under India's domestic income tax law and certain tax treaties entered by India (e.g. the India–USA Tax Treaty).
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as 'e-commerce operator' as defined – including revenue from sale of advertisements to non-residents targeting customer either resident in India or using Indian IP addresses, and sale of data collected from either Indian residents or person who uses IP addresses. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum.
- Thus, one will also need to evaluate applicability of ECom EL on sale of cloud services or data by F Co., even if to another non-resident, subject to fulfilment of specified conditions. Aspects like whether F Co. (or I Co. in the case of the distributor) could be regarded as an e-commerce operator and whether SaaS can be treated as online sale of goods or supply of service need to be considered while evaluating the applicability of ECom EL. Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable to such income, then income tax will not be applicable, subject to fulfilment of specified conditions.
- Depending upon the business model through which F Co. is operating in India and the activities carried out in India, one needs to be mindful of any PE exposure for F Co. in India:
  - F Co. should be mindful of whether marketing or on-site support services, technical services, consultancy services, etc., provided by employees of overseas entities travelling to India qualify as FTS or Fees for Included Services or create Service PE exposure due to the presence of the employees/personnel of F Co. in India.
  - Any presence of shared servers/other equipment (owned by F Co.) in India can lead to questions around PE of equipment or Fixed Place PE exposure.

  Further, implications of SEP under the domestic income tax law will need to be considered. The Finance Act, 2020, has deferred SEP provisions to FY 2021–22 and amended the existing SEP provisions by removing the reference to digital means in the case of soliciting business with users in India. However, the existing Indian tax treaties provide for a conventional definition of PE for taxing business profits of a non-resident and inclusion of SEP under the domestic income tax law may therefore not be extended to the tax treaties unless they are amended.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Last year, the CBDT released the draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach and suggested that a mixed/balanced approach that allocated profits by giving appropriate weightage to both demand- and supply-side factors be followed. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.

  Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income to business connections in India, by including certain activities such as advertisements targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.

  These developments should be kept in perspective while computing profit attributable to a PE and related exposure.

- **India compliance requirement for F Co.**: Since F Co. shall earn income from Indian customers, it may be required to file Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law. However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where F Co. claims nil taxation or applicability of treaty rates, it may have to continue filing ITR in India.

  The Finance Act, 2020, has made it mandatory for an e-commerce operator to withhold taxes while paying to an e-commerce participant (one whose specified sale of goods or provision of services are facilitated through a digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on the F Co., (as well as I Co. in the case of the distributor model) – specifically whether it will qualify as an e-commerce operator under any of the business models.

  F Co. will need to evaluate the requirement to withhold tax on payments to I Co./Indian residents and carry out related compliances. Non-compliance with the prescribed requirement may trigger interest and penal and prosecution risk in the hands of F Co.

  In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form disclosing specified e-commerce supply or services provided or facilitated by F Co.

Key indirect tax aspects

F Co.:

- Development of software and transfer of right to use may be considered as services under GST. As the service provider is located outside India while the recipient is in India, the receiver of services in India may be liable to pay GST under reverse charge.

Key TP aspects

Provision of software development services by I Co.

- There is a need to evaluate whether I Co. will be entitled to arm's-length remuneration for providing software development services to F Co. Remuneration to I Co. will depend on its characterisation in view of its FAR.
- Typically, if I Co. does not perform significant activities with respect to software development, there is a need to evaluate whether all the significant assets are provided by F Co. and I Co. does not incur any significant risks emerging from software development. Accordingly, I Co. can be characterised as a low- risk bearing entity and can be remunerated on a cost-plus basis.
- If I Co. performs significant functions and faces material risks associated with software development, there may be a need to look at the eligibility of the share of profits generated by the software developed by it.

Selling of server space directly by F Co. – direct model

- Depending upon the key functions performed by I Co. and its bearing on the risks and assets, I Co. could either be compensated on a cost-plus basis or on a commission basis. The evaluation between a cost-plus model and a commission model will primarily hinge upon the intensity of the sales function/ activity undertaken by I Co. and its impact on the risks (such as bad debts) emerging from the performance of such functions.

TP considerations ought to be similar under different cloud models.

Key regulatory aspects (FEMA and other key regulations)

- There is a need to evaluate the permissibility of payments made by I Co. or the Indian customers of F Co. in the context of the import regulations in India and formulation of the required documentation (fulfilment of contractual obligations, invoices, etc.) for submission to bankers in the country for remittance of funds to F Co. It is important that contractual documents are drafted appropriately to avoid unnecessary queries from bankers or the RBI. Further, I Co. as well as Indian customers should be mindful of adhering to the import timelines for payment.
- If third-party payment aggregators are involved in collecting funds from individual subscribers (using payment modes such as net banking and debit cards) for remittance to F Co., it is imperative to ensure compliance under the Payments and Settlements Act and relevant RBI guidelines.
- The Information Technology Act, 2000, is the overarching law that governs electronic transactions in India today. It has provisions for cyber security, data protection, intermediary liability, takedown, government interception, etc.
- The Personal Data Protection Bill (PDPB), 2019, was introduced in December 2019 with the purpose of protecting the data privacy of individuals. The provisions of the PDP bill are applicable to personal data collected, disclosed, shared or otherwise processed within India, inter-alia by an Indian or foreign company. Further, the bill also proposes the restriction on transfer of data outside India and storage of personal data on a server in India.
- Separate e-commerce rules have been notified under the Consumer Protection Act, 2019, that separately lay down the responsibility of e-commerce platforms and the sellers towards the consumers. F Co. and I Co. would need to analyse the applicability of the aforesaid rules, as well as the compliance requirements under them.

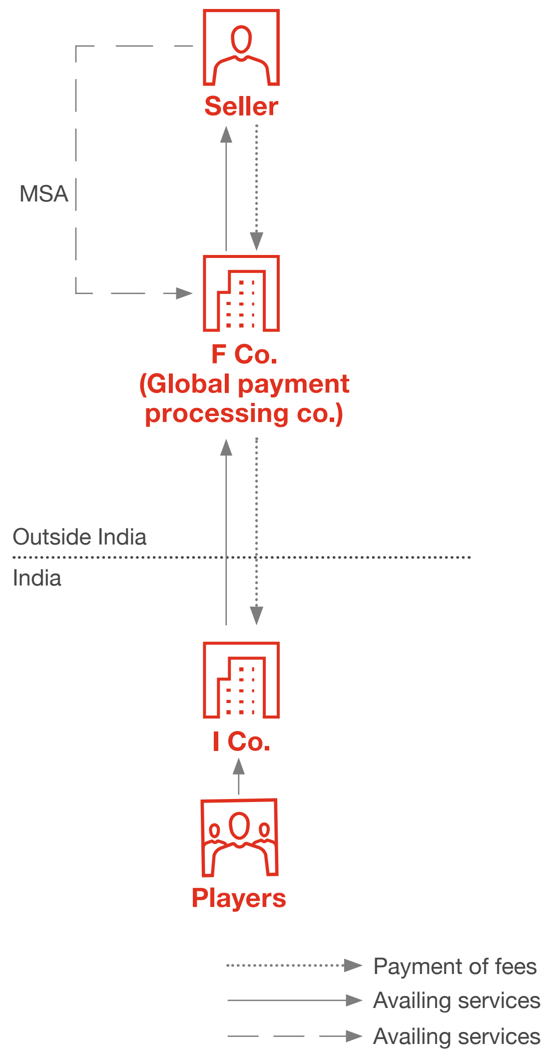
7. Digital payments

Digital payments solutions driven by mobile-centric internet penetration are becoming more relevant for the Indian economy. Digital payments transactions in India are expected to grow at a compound annual growth rate (CAGR) of 20.2% until 2023, reaching a value of USD 135.2 billion from USD 64.8 billion in 2019.[2] Online shopping, payment of utility bills and entertainment are expected to be the top three user activities. Recent initiatives by the GoI have triggered a strong drive towards adoption of digital payments and the rise of new market entrants. Prepaid payment instrument providers (offering mobile wallets) have been attracting the growing interest of consumers and have motivated banks to invest in their own digital payments offerings, while mobile wallet transactions have fast outstripped mobile banking transactions. There has been a significant growth in digital transactions, use of mobile wallets by consumers and mobile point of sale (PoS) machines by merchants. Mobile wallets are being used for a variety of purposes. The launch of the Unified Payments Interface (UPI) has made transactions easier and significantly boosted the overall growth of digital payments.

We have covered key Indian tax and regulatory aspects for select India business model.

Mechanics

- A foreign seller is engaged in the business of selling products online to its customers worldwide (including Indian customers).
- The foreign seller enters into a master service agreement (MSA) with a global payment processing company (F Co.) for providing worldwide payments collection services from its customers.



2 https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/publications/emerging-technologies-disrupting-the-financial-sector.pdf

- F Co. is supported by its India group company/ subsidiary (I Co.) for collecting payments from the foreign seller's India customers and remitting the same to F Co., pursuant to which F Co. deposits the funds to the foreign seller's bank account with support from its local group company/subsidiary located in the foreign seller's country.
- Foreign sellers will be charged with payment processing fees by F Co. It will pay payment processing fees to I Co. and the local group company for their payment processing services.

Key direct tax aspects

- Business profits earned by an overseas entity are generally not taxable in India in the absence of a PE/ business connection, unless the profits qualify as royalties or FTS. Thus, it needs to be evaluated whether the payment received by F Co. is taxable as royalty or FTS or business income, considering the provisions of the domestic income tax law and the relevant Indian tax treaty. F Co. needs to evaluate whether payment received from its customers for providing payment processing services is taxable as process royalty or equipment royalty, especially in view of retrospective amendments under the domestic income tax law and their implications under Indian tax treaties.
- Effective 1 April 2020, a new 2% equalisation levy (hereinafter referred to as 'ECom EL') has been introduced and will apply to consideration for specified 'e-commerce supply or services' provided or facilitated by a non-resident who qualifies as 'e-commerce operator' as defined – including revenue from sale of advertisements to non-residents targeting customers either resident in India or using Indian IP addresses, and sale of data collected from either Indian residents or person who uses Indian IP addresses. Such ECom EL is applicable if receipts from specified e-commerce supply or services exceed INR 20 million per annum. Thus, one will also need to evaluate applicability of ECom EL on provision of payment processing services or sale of data by F Co., even to another non-resident subject (subject to fulfilment of specified conditions). Both income tax and ECom EL may cover such income within the tax net of F Co. for FY 2020–21. However, effective FY 2021–22, if ECom EL is applicable on such income, then income tax will not be applicable, subject to satisfaction of specified conditions.
- Depending upon the model through which F Co. is operating and some of the activities carried out in India, one needs to be mindful of any PE exposure that may get created for F Co. in India. Some of the transactions/ arrangements which regulate India PE consideration are listed below:
  - If F Co. controls servers/other equipment that may be owned by I Co., then equipment PE exposure may arise. Ownership of server/equipment may not be a relevant factor to determine such PE.
  - Presence of servers/other equipment (owned by F Co.) in India can also lead to Equipment PE or Fixed Place PE exposure.
- PE exposure in India for F Co. can lead to its profits attributable to the Indian PE being subject to tax in India at the rate of 40% (plus applicable surcharge and cess) on a net basis. Also, the CBDT last year released the draft amendment of rules for profit attribution to PE (Draft Rules), disregarding the Authorised OECD Approach and suggesting that a mixed/balanced approach be followed, which allocates profits by giving appropriate weightage to both demand and supply side factors. Further, the OECD's proposal to allocate more taxing rights to overseas markets/consumer jurisdictions under the Pillar One Unified Approach needs to be kept in perspective.

  Additionally, the Finance Act, 2020, has expanded the scope of operations in India for the purpose of attribution of income for business connections in India, by including certain activities such as advertisement targeting Indian customers, sale of data collected from a person resident in India and sale of goods or services using such data.

  These developments should be kept in perspective while computing profit attributable to a PE and related exposure.
- **India compliance requirement for F Co.**: Since F Co. shall earn income from foreign sellers in relation to payment processing services carried out in India, it may be required to file Indian ITR disclosing such income, especially considering the expansive penal proceedings prescribed under the domestic income tax law.

  However, the Finance Act, 2020, has provided exemption from filing of ITR to non-residents earning income only from royalty or FTS (provided taxes have been withheld as per the rate prescribed under the domestic income tax law). Thus, in cases where F Co. claims nil taxation or applicability of treaty rates, it may have to continue filing ITR in India.

  In case ECom EL is applicable to F Co., it shall be required to carry out quarterly payment compliances and also file an annual statement in a prescribed form disclosing specified e-commerce supply or services provided or facilitated by F Co.

  F Co. will need to evaluate the requirement to withhold tax on processing fees paid to I Co. and carry out related compliances. Non-compliance with the prescribed requirement may trigger interest and penal and prosecution risk in the hands of F Co.

- I Co. will have to evaluate the liability to withhold taxes on payments collected from Indian customers of a foreign seller at the time of transferring the same to F Co. and carry out related compliances. Non-compliance with the prescribed requirement may trigger interest and penal and prosecution risk in the hands of I Co.
- The Finance Act, 2020, has made it mandatory for an e-commerce operator to withhold taxes while making payments to an e-commerce participant (one whose specified sale of goods or provision of services is facilitated through the digital platform of the e-commerce operator). It will be important to evaluate the implications of the same on F Co. as well as I Co., specifically in terms of whether F Co. shall qualify as an e-commerce operator.

Key indirect tax aspects

- Payment processing fees are paid by F Co. to I Co. In such a case, I Co. can consider such services as export under GST, subject to fulfilment of specified conditions of export of services. Further, the place where such services are deemed to be performed will have to be analysed.
- In such cases, I Co. can also consider claiming refund of input credit which is incurred in relation to export of services.

Key TP aspects

- Typically, if I Co. does not perform significant activities with respect to payment processing, there is a need to evaluate whether all the significant assets are provided by F Co. and I Co. does not incur any significant risks arising from the payment processing activity. Accordingly, I Co. can be characterised as a low-risk bearing entity and remunerated on a cost-plus basis. In case F Co. is providing the assets to I Co. for performing payment processing services, it needs to be evaluated whether such assets can be construed as free of cost under GST and whether I Co. is required to adjust its cost base for the notional cost (depreciation) on asset, and charge a markup on such notional cost.
- If I Co. performs significant functions in relation to the payment processing activity, an appropriate compensation needs to be determined for I Co., depending upon its influence on the economically significant risks associated with the Indian operations and contribution to the development of the intangible.

Key regulatory aspects (related to FEMA and other key regulations)

- Cross-border payments facilitated by non-bank players are regulated by the RBI and are subject to conditions, including limits on remittable amounts. In this case, the local payment-processing company will need to ensure its compliance with the prescribed conditions (opening of regulated accounts, submission of relevant documentation to Indian bankers, etc.) to facilitate the collection of funds from local buyers and make settlements with F Co./overseas sellers within prescribed time limits. On 6 April 2018, the RBI issued a circular on 'Storage of Payment Systems Data', advising all payment system operators in the country to store payments data within India. The RBI also issued a clarification on the data localisation circular covering aspects such as nature of the data to be stored in India and processing of payment transactions outside India.

How PwC can help

Globally, PwC follows a 'whole of business' approach to address tax and regulatory-related issues faced by any business, wherein our Corporate and International Tax, Indirect Tax, Transfer Pricing and Regulatory Services teams work in conjunction to provide solutions to problems arising from the functioning of businesses. We can help you address all present and possible business issues that may affect your organisation and offer a wide range of advisory and compliance services in this sector.

With newly introduced regulations such as EL and withholding tax on e-commerce transactions, MLI in relation to Indian tax treaties and SEP under domestic tax law, India is making dynamic changes to its tax laws. Considering that the players in the TMT sector are envisioned to be one of the key drivers of India's economy in the future, we can help you comply with the ever-changing reforms in the tax and regulatory ecosystem by providing guidance on how to effectively adopt a proactive approach in implementing such changes and continue to maintain a future-ready and regulatory-compliant business in India.

We will be happy to help an industry driver in the TMT sector (and its subsectors), such as your organisation, by providing well-thought-out and informed recommendations on a relevant future course of action, thereby enabling you to effectively address specific needs of your business.

Contact us

Gautam Mehra
Partner and Leader, Tax and Regulatory Services
PricewaterhouseCoopers Private Limited
Mobile: +91 98670 33822
Email: gautam.mehra@pwc.com

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