General Studies-3; Topic – Indian Economy: Issues

Taxing value-creation (GAFA Tax)

1) Introduction

- Recently France announced the introduction of a GAFA tax—named after Google, Apple, Facebook, Amazon—on large technology and internet companies in France from 1 January 2019.
- Similar proposals had surfaced in both the UK and the European Union (EU) earlier.
- This is all based on the perception that the digital economy is not contributing its "fair share" of tax revenues.

2) Why Tax Value-Creation

- Existing tax norms that are framed envisaging brick and mortar business models are not suitable to regulate online services.
- What distinguishes technology companies from traditional businesses is user participation in creating value, which, in turn, translates into revenue.
- The unique ability of digital businesses lies in their power to analyse big data collected via constant user interaction and data mining.
- Organisation for Economic Co-operation and Development (OECD) acknowledges the need to tax value at its source.
- It protects the interests of small and medium enterprises who suffer from the dominance of these tech giants.

3) International Examples

- Israel – VAT payable on digital services from 2016
- Russia – VAT payable on B2B digital services from 2017
- Saudi Arabia – VAT payable on digital services from 2018

4) India's Case

- The Finance Act, 2016, accommodated a 6% equalisation levy (EL) in lieu of specified digital services provided to residents in India.
- However, EL can only be imposed on advertising services.
- Through the Finance Act, 2018, the Income Tax Act was amended to expand the meaning of business connection to “significant economic presence”, which includes digital services.
- As a result, any income attributable to significant economic presence is taxable in India.
- However, it is not clear whether the assessment of attributability is based on value creation per se.
- As the basis of attributability to Indian services/activities is not clear, this can raise a serious problem at the time of assessing income tax.
- For instance, Uber use data of users as inputs to develop their surge pricing algorithm.
- This algorithm enables these companies to assess the maximum fare a user would be willing to pay based on passenger demand.
- Entities are not taxed in the source country for the revenue generated with the help of this created value.

5) Concerns / Challenges

- Difficulty to devise a definite method of assessing the value that users generate in a source country.
- People have argued such steps are disruptive of the international taxation framework.

- Political pressure to resist further delay of taxing these entities.
- OECD highlights that the assessment of value of user contribution in the source country is subjective.
- Government of the source country would always try to argue that the value of user contribution that has translated into the entity's revenue is far more than what the state where the entity is established would claim it to be.
- This could, in turn, create greater friction and undermine the efficacy of double taxation agreements.

6) **Way Forward**

- Countries like France have suggested imposing such an interim tax only on high profit big-tech businesses like Google and Amazon.
- It is imperative that policymakers deliberate upon the possibility and feasibility of adopting a methodology to assess value creation objectively to tax digital players more effectively in the source country.