

The background of the entire page is a photograph of the interior of Antelope Canyon. The walls are made of smooth, undulating sandstone, illuminated by warm, golden light that creates a series of flowing, wavy patterns. The perspective is from within the narrow slot of the canyon, looking down a path that leads towards a bright opening at the top. The overall mood is serene and majestic.

At the intersection of international
tax and digital transformation

The new geography of taxation

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EY is a regular contributor to CCH's *Global Tax Weekly*. As tax and technology professionals, from member firms around the world, we share our insight and technology perspective on topics of interest to executives faced with taxation issues resulting from disruptive innovation and technology-enabled digital transformation. The content contained in this document was first published in *Global Tax Weekly* – and is being reprinted with full knowledge and permission from Wolters Kluwer, copyright 2015 CCH.

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These local country and international dynamics present fundamental considerations for tax practitioners and international finance executives:

1. They need to understand the level of uncertainty they face as they monitor and prepare for ongoing change in technology taxation worldwide.
2. They should always keep in mind the current context of potentially varying tax treatment from country to country.
3. They should map the tax treatment of intellectual property (IP), transfer pricing, research and development (R&D) and other technology-related issues to their business models from the very outset, as they first develop their strategies and build in flexibility for the long term.

Overview

Sometime between the early 1990s (when the internet meant the “death of distance!”) and the not-too-distant future (when global cloud networking, the “internet of things” and 3D printing collide to transform business) a new geography of taxation will take hold. In fact, it is emerging today.

The global tax map is being redrawn for the digital economy. Its outlines are already evident around the world in the stark shift of value-added taxes (VAT) on electronically delivered services from the country of supply to the country of consumption. Its cartographers are also peering over the near horizon in the debate over permanent establishment (PE) – and whether there should be more PEs in the world than there are today – as the Organisation for Economic Co-operation and Development (OECD) readdresses international tax models within its Base Erosion and Profit Shifting (BEPS) Project.

Multinational enterprises may be driving this new geography, with increasingly borderless digital business models based on rapidly growing cloud networks, but they are currently in the throes of uncertainty about how the shape of taxation to come will affect their global efficiency, compliance requirements and bottom lines. And while the OECD has promised to complete the BEPS Project in 2015, some countries are jumping ahead with their own policies for digital economy taxation. (In other

words, uncertainty squared.) In the ensuing controversy, global innovators stand in the crossfire, whether they are technology multinationals or forward-leaning policymakers.


How timeless will current global tax deliberations look in the rearview mirror 5 or 10 years from now? Stay tuned. In the meantime, this edition of our column traces today's draft of a new geography of taxation.

We invite you to explore EY's *Worldwide Cloud Computing Tax Guide* (more than 120 jurisdictions and growing), which shows where governments stand today with regard to many of the issues addressed in this column, at ey.com/cloudtaxguide. Nearly every organization is using cloud computing to access new markets, products and services as well as achieve efficiencies and cost savings through technology that is scalable and flexible.

Critical tax issues for both cloud service providers and cloud users are covered in the guide. Whether your arrangement involves a foreign principal who provides digital content/services to a customer through a commissioned agent, through a commissionaire or through a buy-sell entity, the guide answers questions about withholding tax, nexus/PE risk, VAT and more. You can also read our newly updated *Cloud taxation issues and impacts*.

Highlights and takeaways

Tax update	Technology impact	Ask yourself
OECD proposals to prevent the perceived artificial avoidance of permanent establishment raise myriad questions.	Technology companies may be faced with more PEs around the world.	How could these proposals increase your compliance burdens and risk of double taxation?
VAT-type taxes are having a growing impact on technology companies around the world.	Rules are proliferating to tax electronically supplied services in the country of consumption instead of the country of supply.	Are your corporate structure and business models fit for recent and upcoming VAT legislative changes? What about pricing strategies, profit and cash flow forecasting and contractual arrangements with third parties in your supply chains?
The Indian Prime Minister's first budget emphasizes technology-led growth ...	Overall, there are many positives for the technology sector, as well as some challenges.	Have you reviewed your cost and operating models in light of the new budget?
... as India's technology hubs grow.	The city of Pune provides an example of government-spurred growth in India's information technology sector.	Is your tax department scanning the horizon for tax holidays and other incentives?
Digital-specific taxation is emerging in Greece, Israel, New Zealand and the US.	Increasingly, tax proposals look to "ring-fence" digital business for taxation, contrary to the OECD's stated position.	What are the potential implications for your cross-border services and value chains?
Australia and the UK partner in a campaign against perceived cross-border profit diversion.	Cloud-based, borderless business models draw greater scrutiny from tax authorities.	How rigorous is your allocation and documentation?



Item 1: Will PE proposals transform the tax landscape?

What should be the starting point for refining tax rules for the digital economy? Should it be presumption of artificial avoidance of taxes on the part of multinational enterprises? Or perhaps shared stakes in the advancement of global investment and trade?

In a departure from our column's usual global reporting on tax developments, this item also raises specific questions on how PE rules will be rewritten within the OECD's BEPS Project. (Note: What follows is a technology-focused overview of a broader treatment that was first published on 13 February 2015 in Bloomberg BNA's *Tax Management International Journal*.)

Our overarching geography question is this: will the OECD BEPS Project produce more PEs in the world than there are today? A reading of the OECD's discussion draft on BEPS Action 7: Preventing the Artificial Avoidance of PE Status would suggest that the answer is yes.

As currently written, the proposals would not merely impact the income of the tax haven entities that are cited as the primary BEPS concern. They also could impact all multinational enterprises operating globally, as well as small businesses expanding into foreign markets through the internet and other means.

Discussion draft premise

A basic premise of the discussion draft is that the current nexus threshold for determining whether a PE exists needs to be redefined in today's business environment. The thinking seems largely driven by a perception of inappropriate results where companies can realize substantial profit in low-tax locations and avoid local PEs in customer or sourcing locations if they manage their presence in those locations to fall below current PE nexus definitions. While refining the rules could be appropriate in some instances, the "solutions" proposed could potentially transform the tax landscape, as is often the case. The outcome could be more controversy – not less – and double tax burdens for all but purely local businesses or multinational enterprises that operate with a purely country-based business model – if any such companies still exist in today's global environment.

Should the discussion be reframed?

The discussion draft focuses on seven particular areas dealing with the definition of a PE included in Article 5 of the current OECD Model Tax Convention. The seven areas covered are commissionaires, preparatory or auxiliary activities, delivery of goods, purchasing offices, fragmentation of activities, splitting up of contracts and insurance. Each of these areas is considered in the context of "artificial avoidance" of a PE, as if any time activities in these areas fall below existing PE nexus thresholds, it is because of manipulation to achieve that result. All of which raises the question: should the discussion be reframed in its next iteration to eliminate the implicit prejudgment that companies structure their businesses primarily to avoid a PE?



Where does the BEPS mandate begin and end?

Framing the issues in the context of PE abuse may belie the original mandate in the initial BEPS report of February 2013, which focused on whether and how the PE threshold should be changed to take into account new business models. The original point was that “questions are being raised as to whether the current rules ensure a fair allocation of taxing rights on business profits, especially where the profits from such transactions go untaxed anywhere.” Does that concern justify sweeping in all cross-border activity regardless of whether and how the cross-border income is being taxed outside of the source country? If indeed a broader re-evaluation is needed regarding PE thresholds, there should be much more thorough analysis and debate than would be possible within the extremely restrictive BEPS action timeline.

When is a commissioner a PE?

The draft's first area of focus is commissionaires. A commissionaire arrangement is a common law concept that exists primarily outside the US where it could be equated to an undisclosed agent concept (i.e., a local distributor sells in its name for the benefit of an undisclosed principal).

Tax authorities have challenged this structure on the basis that it should create a PE for the principal, but they generally have not been successful in convincing the courts in Europe. On the contrary, taxpayers have successfully defended against local PE assertions in France, Italy and Norway on the basis that the commissionaire was not concluding contracts in the name of its undisclosed principal, as would be required for a PE under existing treaty language.

The discussion draft considers this result as fostering tax avoidance, saying, “It is clear that in many cases commissionaire structures and similar arrangements were put in place primarily in order to erode the taxable base of the State where sales took place.” No evidence is cited, nor is there acknowledgment of multinationals' regional or global business models that limit the local presence, decision-making and risk of local-country sales activities consistent with a low-risk distributor (LRD) model. (Transfer pricing specialists see the margins for an LRD as similar to a commissionaire's.)

Why change the PE threshold?

Multinational enterprises choosing between an LRD or commissionaire model for a local sales subsidiary in their global business model usually make that decision based on systems issues, indirect tax issues and US Subpart F consequences for their controlled foreign corporations (CFCs), among other factors – not based on local PE results.

An LRD should not result in a deemed PE for its suppliers and neither should a commissionaire. All of which raises another question: why change the existing PE threshold? Like many other aspects of the BEPS Project, it really comes down to transfer pricing – what is the correct margin for local distribution activities and what are the tax consequences of a business restructuring involving conversion from a local approach to a regional or global business model?

The discussion draft's "solution" for the commissionaire "problem" goes well beyond commissionaire arrangements. Four alternative proposals are provided for changes in the formulation of the agency PE standard in Article 5 (5) of the OECD Model Tax Convention. All four would lower the PE nexus requirement of "concluding" contracts, replacing that standard with more subjective standards, such as negotiating material elements of contracts or engaging "with specific persons in a way that results in the conclusion of contracts." Such soft concepts could be applied inconsistently, and in some cases aggressively, bringing controversy on a much wider basis than the commissionaire area. Notably, nothing in these proposals seems to limit the target zone to situations "where the profits on such transactions go untaxed anywhere."

Where do existing PE exemptions fit in?

Most of the remainder of the discussion draft focuses on the specific activity exemptions of Article 5 (4). That paragraph currently excludes five specific categories of activities from the definition of a PE, and it was meant to allow companies to conduct these limited activities without crossing the PE nexus threshold. The five activities are:

1. Use of facilities solely for the purpose of storage, display or delivery of goods or merchandise
2. Maintenance of inventory solely for the purpose of storage, display or delivery
3. Maintenance of a stock of goods solely for the purpose of processing by another enterprise
4. Maintenance of a fixed place of business solely for purchasing or collecting information
5. Maintenance of a fixed place of business solely for the purpose of carrying on any other activity of a preparatory or auxiliary nature

A further exclusion is provided for any combination of the above activities as long as the overall activity of the fixed place of business is of a preparatory or auxiliary nature.

The OECD drafters are concerned that these exemptions from PE status create the opportunity for BEPS. Therefore, a number of alternative proposals are made to limit their reach. The most encompassing proposal would require that for any of the individual exemptions above to apply, that individual activity must satisfy the preparatory or auxiliary criteria, so that such requirement would not be limited to the combination of the specific activities as in the current language of paragraph 5(4). This could effectively eliminate the PE exemptions for delivery of goods, purchasing and processing in many cases. Such a change would constitute a dramatic shift in policy with respect to these activities, which would result in major increases in compliance costs and administrative burdens. All of which raises another question: how does this change address the real BEPS concerns?

What is covered by draft alternative exemptions?

The discussion draft also contains alternative proposals focused on specific exemptions to be considered if the proposed broadening of the application of the preparatory or auxiliary requirement is not adopted.

One alternative, with respect to the exemption for delivery of goods, states the concern that “it is difficult to justify

the application of these exceptions where an enterprise maintains a very large warehouse in which a significant number of employees work for the main purpose of delivering goods that the enterprise sells online.” Despite the concern being about a very large warehouse with lots of dedicated employees and online sales, the alternative proposal regarding delivery of goods is to eliminate the delivery exception altogether and to limit the “maintenance of goods” exception to “maintenance of goods for storage or display.” If this alternative proposal were adopted, any maintenance of inventory for delivery at all could create a PE, with implications for matters ranging from same-day delivery to global trade.

When should purchasing be exempt?

On the matter of purchasing, the OECD drafters provide the example of a buying team with specialized expertise in an organization where virtually no sales effort is needed so that virtually all of the enterprise’s profit is due to its purchasing activities. In that example, the drafters view the purchasing office exception as inappropriate. Therefore, the alternative proposal is to eliminate the PE exception for purchasing activities altogether, which again seems like a solution well in excess of what is necessary to cure the perceived problems.



Will exemptions be consistently applied?

Another focus area deals with the “fragmentation” of activities. The discussion draft refers to language already in the commentary to Article 5(4), which states, “An enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.” The discussion draft is concerned with an enterprise fragmenting activities among separate related companies to achieve this goal and therefore proposes that the activities of related entities – whether resident in a jurisdiction or not – be aggregated if the activities constitute complementary functions that are part of a cohesive business operation.

This proposal would deny the PE exception for any of the specific activities of Article 5(4), even if they are clearly preparatory or auxiliary, if there is a related company resident in the country whose activities are considered complementary or part of a cohesive business. The question here is: how can such terms be clearly and consistently applied by all?

When is a contract a PE?

Along similar lines, another area covered by the discussion draft is the “splitting up of contracts.” The focus is on the 12-month exception for construction projects in Article 5(3) (and the 183-day version of this rule in the UN Model treaty). Similar to the fragmentation discourse, the concern of the drafters relates to the potential to split contracts in order to satisfy the 12-month test – and the ability to do so with multiple related parties.

Alternative objective and subjective tests are proposed. The objective test would aggregate the presence of all related companies working on a project, thus effectively resulting in a PE for all nonresident service providers where there is also a longer-term resident company involved on the project. The draft acknowledges “one difficulty” of this approach being that a nonresident entity providing specialists even for a few days would have a PE and suggests that perhaps a minimum period exception such as 30 days could be provided. This would obviously be a huge change from the current 12-month or 183-day threshold. The second alternative is a subjective anti-abuse test for cases where activities are separated for the principal purpose of avoiding creation of a PE (“subjective” being among the problematic aspects of this alternative).

Considerations

On the whole – and whichever alternatives might be chosen – the proposals in the discussion draft would significantly increase the number of PEs that would need to be reported and accounted for globally. The worry about the compliance burden is compounded by the fact that there is no discussion in the discussion draft about attribution of profits to the PE – other than a passing reference to prior OECD work in that area, which was not comprehensive and which in practice is much more uncertain than arm’s-length transfer pricing principles for related parties.

In answer to these proposals, one could suggest that, if the only activity a multinational group has in a country is distribution/ sales activity, the only profit that should be taxed in that country is an appropriate profit for that activity, regardless of whether there is a PE, a local subsidiary or both. But that would require the OECD drafters and local tax authorities to be on the same page with respect to profit attribution.

In this context, it is worth underscoring that PE issues are not only being taken up at the OECD level. Recently, for

example, a Russian court decided that a PE is created there when preparatory and auxiliary activities are performed on a regular basis in Russia by a nonresident company on behalf of its distributor. The diverted profits tax (DPT) proposal in the UK is another example of a country-based action (see item 6).

Lacking cohesion, the future could bring more claims of the existence of a PE by source countries, less acceptance of a PE by headquarters countries for purposes of allowing territorial exemption or double tax relief, and more disputes involving both countries and business enterprises over the amount of income subject to tax in the PE – all leading inevitably to lots more double taxation.

An important mission of the OECD is to boost investment and trade, a critical aspect of which has always been helping to minimize trade barriers. Exponential expansion of PE status, increased filing burdens and consequential double taxation would run contrary to this mission. OECD drafters and multinational enterprises need to come to a better, shared appreciation of the global commercial and trade implications of the BEPS Project.

Item 2: Cross-border services face shifting VAT requirements

VAT-type taxes are having a growing impact on technology companies around the world, with a trend in new rules increasingly taxing electronically supplied services in the country of consumption rather than the country of supply. Given current trends, VAT should be moving toward the top of tax agendas for companies of all sizes – ranging from start-ups in international expansion mode to multinational enterprises with established global footprints.

More than 150 countries have some type of VAT system in place (though not the US). Recent legislative changes in the European Union (EU), South Africa, Japan and elsewhere, along with global governmental cooperation on the OECD's BEPS Project, are ushering in a new pattern: subjecting technology supplies to VAT in the country of consumption, while increasingly making the supplier liable to charge the tax.

VAT has a wider scope than many other taxes. Businesses that have no PE subject to corporate income tax, no sales tax nexus or any other local presence (human or technical) can be subject to VAT in a particular jurisdiction. Technology companies' accounting systems and processes need to differentiate between their types of customer (business or non-business) and how their supplies should be categorized for VAT purposes. The contractual and invoicing position should be considered along with the substance of the supply when determining the VAT position. Often, this all needs to be done in real time – for instance, when a customer purchases a service over a website.

Mapping new VAT requirements

Electronically supplied business-to-consumer (B2C) services are often VAT-able where the recipient is resident. VAT registrations may be required for the supplier if the customer is resident in a country that determines the VAT place of supply in this way – for example, in the EU, Switzerland, Norway, Iceland, South Africa and Japan (from October 2015).

Electronically supplied business-to-business (B2B) services are also often VAT-able where the customer is established. However, VAT registrations may not be required for the supplier if the customer is established in a country where the recipient can apply a "reverse charge" mechanism in its own country to self-assess the VAT (similar in concept to a US use tax) – for example, the EU, Switzerland, Norway and Iceland.

Separate rules often apply to the supply of goods. If goods such as hardware and physical software are supplied, VAT registrations may be required in the countries from, to and through which the goods move.

If not managed effectively, VAT can quickly become a real cost to technology companies, as a result of VAT not charged to customers and paid over to tax authorities – or due to missed opportunities for recovering VAT on costs. Global VAT rates average around 20%, with penalties for noncompliance commonly up to 100% of the VAT due.

Monitoring VAT policymaking

It is against this backdrop that technology companies should closely review the OECD's BEPS Project, particularly the December 2014 discussion draft on *"Guidelines on place of taxation for business-to-consumer supplies of services and intangibles."*

The draft underscores the digital economy challenges to the conventional VAT approach, saying: "Advances in technology and trade liberalisation have increasingly enabled businesses to supply services and intangibles to customers around the world, leading to a strong growth in international B2C trade in remotely supplied services and intangibles." These developments have created "challenges for VAT systems, as the application of a proxy based on the supplier's location or the place of performance to determine the place of taxation is unlikely to lead to an appropriate result for such remote supplies."

Going forward, the draft suggests that countries structure their VAT systems on the basis of five main criteria: neutrality, efficiency of compliance and administration, certainty and simplicity, effectiveness and fairness. Of perhaps most interest to technology companies is guideline 3.6, which states that for VAT purposes, the jurisdiction in which the customer has its usual residence has the taxing rights over B2C supplies of services and intangibles, other than those that are physically performed at a readily identifiable location.

EU provides a case in point

In January 2015, B2C supplies of telecommunications, broadcasting and electronic services in the EU became subject to VAT in the customer's country of residence. Affected suppliers are now liable to be registered for and account for VAT in each EU country in which they have non-business customers.

The EU has introduced a simplified VAT registration and compliance mechanism called the Mini One Stop Shop (MOSS), an approach the OECD's draft appears to support. In doing so, the OECD recognizes the important role of technology for the simplification of VAT administration and compliance regimes for nonresident suppliers, and it encourages jurisdictions to implement effective and efficient registration-based collection mechanisms.

Considerations

The move toward consumption-based taxing models on digital supplies should be pushing VAT quickly up the agenda for technology companies, in particular for nonresident suppliers of B2C digital services. In addition to the VAT registration and compliance implications, companies should review whether their corporate structure and business models are fit for recent and upcoming VAT legislative changes, along with pricing strategies, profit and cash flow forecasting and contractual arrangements with third parties in their supply chains.

Of particular focus should be ensuring that these changes can be accurately and efficiently implemented via enterprise resource planning (ERP) system changes, while considering the impact on customer experience and customer interfaces, especially when the decision to charge VAT will often need to be made in real time.

For more details, please read EY's Global Tax Alert on the discussion draft: (<http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--OECD-releases-public-discussion-draft-on-international-VAT-GST-Guidelines>).

Contributors: Anne Freden (anne.freden@ey.com), Corin Hobbs (corin.hobbs@ey.com) and Liz Day (liz.day@ey.com), Ernst & Young LLP (US)

Item 3: Indian Prime Minister's first budget emphasizes technology ...

Expectations in the technology sector were high as this column went to press during India's parliamentary debate over Prime Minister Narendra Modi's budget proposal for 2015-16.¹ This is his Government's first full-year budget, since the 2014 budget was announced only two months after he was sworn in. The Modi Government's emphasis on technology-led growth is evident in key budget proposals, including:

Reduction in withholding tax rate on royalties and fees for technical services

The Government has announced various technology-intensive initiatives, such as "Digital India," "Smart Cities" and "Innovate in India." To facilitate technology transfer to India and make it more cost-effective, the withholding tax rate on royalty and technical services fees is proposed to be reduced from 25% to 10%.

Aggregators to pay service tax

Broadly speaking, an aggregator is a company that owns and manages a web or mobile application enabling the provision of services under its own brand name. Examples include apps connecting customers and taxi drivers under the app's brand name.

It was uncertain in the past whether aggregators were liable for a tax on services facilitated by them. Under the new budget proposal, however, such aggregators have now been made liable to a tax on services provided. Aggregators that do not have a presence in India should appoint an agent to pay service tax.

These provisions are likely to impact service providers such as taxi aggregators and e-commerce companies, including travel sites, matrimonial sites and online education application providers. They should review their cost and operating models in light of the budget proposal.

Reduction of corporate tax rates

The base tax rate for Indian corporates for tax year 2015-16 continues to be pegged at 30%. However, to make the tax rate in India internationally competitive, the tax rate is proposed to be reduced to 25% gradually over the next four years, while phasing out some exemptions. The Government is expected to announce a road map for the transition. Considering the Government's emphasis on making India a technology hub, it is unlikely that the tax holiday benefits enjoyed by technology companies operating from Special Economic Zones (SEZs) will be withdrawn. Even if the SEZ tax holiday were phased out, the impact would be marginal since businesses in these zones already pay 21% taxes by way of a so-called "minimum alternative tax."

GST proposals referred to select committee

The budget proposals indicate the Government's commitment to transitioning toward a goods and services tax (GST) by next year. GST would simplify the current multilayered indirect tax regime and streamline the credit system. The GST Bill has been referred to a Select Committee of the Upper House of the Indian Parliament for providing its comments on the revised draft of the Bill. Press reports indicate that the Government is optimistic that the referral process should not impact the timeline for implementation of the Bill – originally intended for April 2016.

Additional measures proposed by the Government and welcomed by industry include deferment of General Anti-Avoidance Rules until 2017, clarifications regarding indirect transfers and provisions to preclude tax authorities from filing appeals when an identical question of law is pending before the Supreme Court for earlier years. The latter is likely to mitigate the multiplicity of lawsuits.

Considerations

Overall, there are many positives for the technology sector in the budget and some challenges. The Government's intention appears to be to pave the way for growth while providing a stable and a non-adversarial tax regime.

¹ The Budget proposals were approved by the President of India on May 14, 2015.

Contributors: Rakesh Jariwala (rakesh.jariwala@in.ey.com), Ernst & Young LLP (Mumbai, India), and Neeraj Khubchandani (neeraj.khubchandani@ey.com), Ernst & Young LLP (US)

Item 4: ... as India's technology hubs grow

The city of Pune provides an example of India's Government-spurred growth in information technology, a sector that has grown 9% per year on average in the last decade, to reach total revenue of US\$118 billion in fiscal 2014, according to the National Association of Software and Services Companies (NASSCOM). One of India's major technology hubs, Pune hosts 15 of the approximately 110 IT-focused SEZs created by the Special Economic Zones Policy of 2005.

Companies operating in an SEZ unit enjoy a tax holiday from income tax for 15 years, involving a 100% deduction of export profits for the first 5 years and 50% of export profits for the remaining 10 years, subject to fulfillment of certain conditions in the last 5 years. During the tax holiday period, if the SEZ unit is housed in a company, it is subject to minimum alternate tax (MAT) that is approximately 21%, credit for which can be claimed in future years, when tax will be payable under normal provisions. The MAT credit can be carried forward for 10 years under existing provisions.

On the indirect taxes front, IT services exported from an SEZ unit are typically not subject to tax in relation to exports. In addition, inputs in the form of services and goods purchased (import as well as local) and used to produce exports are also eligible for up-front exemptions or refunds.

The state government also provides a host of incentives to eligible investors for investments in Pune. These include exemptions from stamp duty on the lease or purchase of real estate, exemption from electricity duty, refund of VAT and others.

A snapshot of Pune also reflects various reforms introduced over time in India to boost the IT sector and create jobs on a large scale for India's youth. Among the results: more than 50,000 graduates qualify every year from approximately 62 engineering colleges and 65 business schools in Pune, which overall has a literacy rate of greater than 85%, shared almost equally across the male and female demographic. Major foreign and Indian multinationals have located R&D centers and product development hubs side by side with the offices of many of the world's biggest banks.

Considerations

Across the world, as countries and localities look to grow their digital economies, tax professionals need to be alert to emerging opportunities. In India, this priority is today in full view.

Contributors:

Amit B. Jain (amit.b.jain@in.ey.com) and Mitesh Thakkar (mitesh.thakkar@in.ey.com), Ernst & Young LLP (Pune, India)

Item 5: Various proposals could ring-fence digital business for taxation

Digitally targeted tax proposals are on the rise in a number of countries. Recent proposals in Israel, New Zealand, Greece and the US would tax companies that operate in the digital realm.

Israel considers VAT for internet companies

A PE could exist in Israel even if a foreign corporation's business there is conducted primarily through the internet. This is one of the key points recently published in a draft circular by the Israel Tax Authorities (ITA) that emphasizes change needed for the transition from the "old" economy to the digital economy.

Going forward, the circular suggests, the placement of servers need not be a factor in determining a fixed place of business – a PE may be established in Israel even in the absence of local servers. A company may be considered as having a PE simply if it has the digital presence necessary to maintain client relations.

Additionally, if it has been established that a foreign corporation's services are provided in substantial part via the internet to Israeli clients and are connected to Israel, it may be claimed that the foreign corporation should be subject to the provisions of the Israeli VAT law and that VAT of 18% could apply.

New Zealand tax would target digital downloads

New Zealand is contemplating imposing GST on imports of intangible services, such as digital downloads and low-value goods. Currently, New Zealand has a GST of 15%, and imports of under NZD400 (about US\$300) generally attract no GST. Combined with the difficulties of servicing a small, geographically challenging, domestic market, New Zealand retailers argue they are struggling to compete with overseas online suppliers. The Government has asked the Inland Revenue Department and Treasury for an early report on how to implement reform and may adopt the OECD proposals of requiring nonresidents to voluntarily register for GST and charge GST to their customers, similar to the approach taken in South Africa.

While enforcement without multilateral agreement in this area presents challenges, Prime Minister John Key has backed calls for change. More detailed information is expected in the near term. In the meantime, please read about the current state of play in our EY Global Tax Alert: (<http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--New-Zealand-s-2015-16-work-programme-calls-for-development-of-BEPS-and-international-tax-related-reforms>).

Contributors:

Liz Day (liz.day@ey.com) and Anne Freden (anne.freden@ey.com),
Ernst & Young LLP (US)

Greece weighs indirect tax on digital video

Greece is contemplating the imposition of an indirect digital tax, as indicated in campaign statements prior to the new Government's election in January. Such a tax would be levied at a rate of 8% on a company's income derived from the broadcast of movies through the internet, video on demand and mobile phones. Proceeds would be contributed to the Greek Center of Cinematography. So far, since the Government took office, there have been no further developments nor has legislation been submitted to Parliament.

Another recent provision, introduced in March, could have an impact on technology companies, although it is not specific to digital business. Under this provision, companies resident in Greece for tax purposes must apply a 26% withholding tax on the following to be able to deduct the respective expenses:

- ▶ Transactions with entities located in what are deemed "non-cooperative jurisdictions" in tax matters
- ▶ Transactions with entities located in countries with a privileged tax regime (i.e., countries whose corporate income tax rates are less than 50% of Greece's 26% rate, such as Bulgaria, Cyprus and Ireland)
- ▶ Transactions with entities that, although being effectively associated with the Greek company, have not complied with the local transfer pricing documentation requirements
- ▶ Transactions with entities that do not have on their premises or on the premises of associated enterprises the required resources and infrastructure for carrying out similar transactions on a recurring basis

Refund or nonpayment of such tax may be possible if certain conditions are fulfilled.

The European Commission is reportedly investigating whether the new Greek withholding tax is in line with EU law. The investigation comes in response to a complaint from Bulgaria that the tax assumes that transactions originating from sources in lower-cost countries automatically constitute tax evasion. In response to these developments, a draft ministerial decree published for consultation narrows the scope of the withholding tax to payments made to entities for which the payer in Greece does not have sufficient evidence on the substance of the foreign counterparty, regardless of the country of the latter's establishment. Moreover, it excludes from its scope intragroup/intercompany transactions that are in accordance with the arm's-length rule and for which the liable affiliate fulfills transfer pricing documentation requirements within the deadlines set by law. Finally, royalty and interest payments are also excluded to the extent they are covered by the EU interest and royalty directive.

For more details, please read EY's Global Tax Alert at: (<http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert--Greece-tightens-substance-scrutiny-for-cross-border-transactions>).

Contributors:

Alexandros Karakitis (alexandros.karakitis@al.ey.com), Ernst & Young Albania Shpk. (Albania); Sharon Shulman (sharon.shulman@il.ey.com), Kost Forer Gabbay & Kasierer (an EY member firm in Tel Aviv) and Vetta Zournatzidi (vetta.zournatzidi@gr.ey.com), Ernst & Young Business Advisory Solutions SA (Greece)



US considers eliminating digital deferrals

As detailed in our last column, the Obama Administration has proposed “ring-fencing” digital business for specific taxes – in this case, by eliminating deferral of overseas income associated with certain digital transactions, as reported in our last column. The tax was included in the proposed federal budget, still in negotiations at press time.

Contributors: Liz Day (liz.day@ey.com) and Anne Freden (anne.freden@ey.com), Ernst & Young LLP (US)

Considerations

Some of these measures appear to contradict OECD guidance last year, within the BEPS Project’s Action 1 report on the digital economy, that “because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.” Technology companies should consider joining the public debate to weigh in with policymakers on this and other matters most relevant to their business and its taxation. These developments should be closely monitored.

Contributors:
Liz Day (liz.day@ey.com) and Anne Freden (anne.freden@ey.com),
Ernst & Young LLP (US)

Item 6: Australia joins UK in campaign against diverted profits

Soon after the UK's controversial new "diverted profits tax" (DPT) came into force in April, it was announced that Australia and the UK have formed a joint working group to "further consider and develop initiatives in relation to diverted profits by multinational enterprises." As a result, Australia intends to go "further and faster" than the OECD BEPS Project to tackle multinational tax avoidance.

The announcement came during the G20 meeting in Washington on 16-17 April and, while it concerned only the UK and Australia, an official press release confirmed that the working group would be open to all G20 members.

"By the United Kingdom and Australia coming together on this initiative, we are going to lead the world and work with the OECD and the G20 to ensure that companies pay the proper amount of tax where they earn the income," said Australia Treasurer Joe Hockey, in a televised interview.

"The OECD, through its base erosion and profit shifting program, is trying to set up consistent global definitions and rules in relation to companies. We welcome that," he added. "We are going for the next stage, which is to go after those companies that are not paying the proper amount of tax where they earn the income. So we are going one step further than what the OECD is doing."

Australia and the UK will also collaborate on the UK's new diverted profits tax, but a number of media outlets are reporting Hockey's comments that Australia would not need to implement a separate DPT but would tackle the issue of diverted profits by strengthening existing tax provisions. These comments were confirmed when the Australian Government announced in its Federal Budget statement on May 12, 2015 that it will make changes to its existing General Anti-avoidance Rule to target foreign multi-nationals that operate in Australia through structures that have the 'principal purpose' of avoiding a PE in Australia.

The UK's DPT rate of 25% is higher than its standard corporate tax rate of 21% to encourage companies to declare profits locally. Meanwhile, work on profit diversion is promised to conclude later this year within the OECD's BEPS Project, leaving open the question of whether the policies will coalesce.

Considerations

Tensions are mounting between multilateral groups and their national members, especially with the BEPS Project nearing its anticipated conclusion this year and with politics surrounding national economic issues. Technology companies need to track developments and do scenario planning for various outcomes, including what they might do if policies fail to coalesce in the end.

Contributors: Tony Cooper (tony.cooper@au.ey.com) and Sean A. Monahan (sean.monahan@au.ey.com), Ernst & Young Australia

About the authors

Channing Flynn (channing.flynn@ey.com), Stephen Bates (stephen.bates@ey.com) and Jess Martin (jess.martin@ey.com) are collaborating on this column with members of the global EY organization's network of tax professionals in member firm technology practices.



Channing Flynn

is an International Tax Partner of Ernst & Young LLP (US) based in both San Francisco and San Jose and EY's Global Technology Industry Tax Leader



Stephen Bates

is an Ernst & Young LLP (US) International Tax Principal based in San Francisco



Jess Martin

is an International Tax Senior Manager of Ernst & Young LLP (US), based in San Francisco

Additional contributors to this issue of our column include:

James J. Tobin and Channing Flynn

Item 1: Will PE proposals transform the tax landscape?

Anne Freden, Corin Hobbs and Liz Day

Item 2: Cross-border services face shifting VAT requirements

Rakesh Jariwala and Neeraj Khubchandani

Item 3: Indian Prime Minister's first budget emphasizes technology ...

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Item 4: ... as India's technology hubs grow

Liz Day, Anne Freden, Alexandros Karakitis, Sharon Shulman and Vetta Zournatzidi

Item 5: Various proposals could ring-fence digital business for taxation

Tony Cooper and Sean A. Monahan

Item 6: Australia joins UK in campaign against diverted profits

Note: The views expressed in this column are those of the authors and do not necessarily reflect the views of the global EY organization or its member firms. Check with your local EY tax advisor for the latest information regarding these rapidly developing topics.

Technology sector leader

Pat Hyek
Global Technology Industry Leader
+1 408 947 5608
pat.hyek@ey.com

Technology service line leaders

Channing Flynn
Global Technology Industry Leader
Tax Services
+1 408 947 5435
channing.flynn@ey.com

Jeff Liu
Global Technology Industry Leader
Transaction Advisory Services
+1 415 894 8817
jeffrey.liu@ey.com

Dave Padmos
Global Technology Industry Leader
Advisory Services
+1 206 654 6314
dave.padmos@ey.com

Guy Wanger
Global Technology Industry Leader
Assurance Services
+1 650 802 4687
guy.wanger@ey.com

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