# Government to approach UN for changes in tax convention

The government plans to approach the United Nations (UN) to get international taxation norms tweaked to make Web marketing companies and cloud computing-enabled firms, which do not have a permanent establishment in India and yet earn profits from Indian customers, pay tax in the country.

The government will suggest the changes under the United Nations Model Double Taxation Convention during the international tax summit in July in New York, according to two persons familiar with the development who spoke on condition of anonymity.

The concept of a "permanent establishment" is used in bilateral tax treaties to determine the right of a state to tax the profits of a business based in the other state. Specifically, the profits of an enterprise based in one state are taxable in the other only if the enterprise maintains a permanent establishment in the latter state and only to the extent that the profits are derived from its presence there.

Rapid technological change has prompted the government, which is trying to boost revenue collection, to consider approaching the UN to tweak the norms. In 2011-12, the government managed to garner only Rs4.95 trillion in direct taxes against a budget estimate of Rs5.32 trillion.

"One of the major issues developing countries are facing today is how to tax companies that do not have permanent establishment in the country but are generating profits within the country through Web marketing, database management and cloud computing where servers are located outside the country," said one of the two persons cited above.

Technologies such as cloud computing allow users and companies with just a screen, keyboard and an Internet connection to work from anywhere without needing to worry about software upgrades and offline workplaces—in other words, a permanent establishment.

"In the next five years, technology is going to drive every business, and the brick-and-mortar concept will no longer be applicable to them. If the regulations are tweaked, it can help us increase our taxpayer base, which has shown hardly any increase in the last five years," the second person said.

India, which is expecting most developing countries to support its proposal, expects a significant increase in the taxpayer base with a change in the tax norm relating to a permanent establishment.

Direct tax collections increased from Rs2.3 trillion in 2006-07 to Rs4.47 trillion in 2010-11, at an average annual rate of growth of 23.6%. The taxpayer base showed only a marginal increase from 31.3 million in 2006-07 to 33.58 million in 2010-11, registering an increase of just 7.3%.

According to a Comptroller and Auditor General of India report that was tabled in Parliament in April, the increase in tax collection was around 13 times the increase in the taxpayer base.

The government is targeting Rs5.7 trillion in direct taxes this fiscal, a growth of more than 15% over tax collections a year ago. Direct tax collections, especially corporate tax collections, have borne the brunt of the slowdown in economic growth. India's economy grew 6.5% in the year that ended 31 March, compared with 8.4% in the previous fiscal.

The UN Model Convention forms the basis for several thousand bilateral tax treaties between countries and aims at protecting taxpayers against double taxation in a bid to improve the flow of international trade and investment as well as the transfer of technology, while retaining appropriate taxing rights for governments.

The convention, which came into existence in 1991, allows developing countries more taxing rights on income generated by foreign investments in these countries.

Apart from India, the existing members of the UN Model Convention are Argentina, Brazil, Chile, France, Ghana, Israel, Germany, the Netherlands, Norway, Switzerland, the UK and the US, among others.

The task of getting the norms tweaked may not be easy.

"As per the international tax principles, the existence of the PE (permanent establishment) in India is a must for taxing any profits," said Punit Shah, partner, tax and regulatory service, at accounting and consulting firm KPMG. "Further, only profits attributable to such PE can be taxed in India. Hence, any amendment in the taxing rules and Convention will need to be in accordance with this well-established principle".

Earlier this month, *PTI* reported that the income-tax department is keeping a tab on Internet portals, services such as so-called push email offered on cellphones by various service providers, and cloud computing and multi-level e-marketing firms, and has asked its investigating units to understand the operation of these new technologies.

The units were asked to prepare staff to detect cases that have ramifications related to international taxes and transfer pricing, the report said.

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