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# **E-TAXATION ISSUE IN CYBERSPACE**

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## **ABSTRACT**

*This topic is all about e-taxation issue in cyberspace. The scope for taxation in cyberspace, issue in cyberspace which includes jurisdictional issue, identification of parties issue, and relative issues, all are mentioned in this topic. It talks about the arrival of E-commerce which had a transformative impact on the global marketplace, connecting suppliers from different countries. However, the tax administration framework for this sector is lacking in development, leaving individuals in technologically advanced and high-earning roles within E-commerce exempt from taxation. The challenges in taxation arises from the difficulty in knowing the exact moment when sales tax should be imposed. Unlike traditional retail sales, where various stages occur simultaneously, such as agreement, goods appropriation, delivery, payment, and property transfer, E-commerce transactions are more complex. The different stages of an E-commerce transaction do not occur simultaneously, necessitating a reevaluation of tax administration strategies to accurately capture the tax incidence at the right juncture.*

## **KEYWORD**

*Digital taxation, transaction, commercial transaction, equalization levy, sine qua non, modern tax, jurisdiction, government, e-space*

## **INTRODUCTION**

India has across a very long journey of doing the commercial transaction, right from the barter system to the electronic medium. Indeed, is one of the countries which is seeing continuous growth in transaction being concluded over the internet. Digital taxation is also known as equalization levy and India is the first country in the world to introduced the digital taxation in the year 2016. The sine qua non for taxing any person in India is either he should be resident of India, or the income should accrue or arise in India i.e. the source of income should be from India. E-taxation or electronic taxation, has emerged as a crucial aspect of modern tax system aiming to adapt traditional tax principles to the digital age. In the realm of digital taxation in India, a pivotal moment occurred in

2016 with the introduction of the equalization levy. This strategic move aligned with the OECD's Base Erosion and Profit Shifting (BEPS) initiative, focusing on the taxation of e-commerce transactions<sup>1</sup>. Enacted through the finance act of 2016, a new chapter was added, known as chapter VIII, specifically titled "Equalization Levy."<sup>2</sup> The inception of this levy was a direct outcome of a recommendations put forth by a committee on Taxation of E-Commerce, which was established by the Central Board of Direct Taxes within the department of Revenue under the ministry of Finance, Government of India. With the rise of e-commerce and the prevalence of cross-border transactions, there is an urgent need to address the challenges in taxing digital transactions effectively. The e-space has a vital role in the contemporary society and mainly e-commerce presents enormous challenges to the international tax regime, which focuses on territorial and personal bases of tax jurisdiction. The digital landscape plays a crucial role in today's society, and notably, e-commerce poses substantial challenges to the international tax system, which centres on territorial and personal foundations of tax jurisdiction. The strong connection between tax matters and other legal issues in cyberspace underscores the significance of addressing the cyberspace law literature in tax discussions. Overlooking this crucial aspect poses a significant problem. Closing this essential gap not only facilitates valuable research but also enriches the body of literature on cyberspace law.

### **SCOPE FOR TAXATION IN CYBERSPACE**

E-commerce stands as one of the recent advancements in technological progress. It encompasses the activities of purchasing, selling, marketing, and servicing products or services through computer networks. Initially, the internet facilitated electronic commercial transactions, typically for specific purposes, employing technologies such as Electronic Data Interchange. This facilitated the electronic transmission of commercial documents, such as purchase orders or invoices, during the sale of goods. However, over time, e-commerce has evolved from being merely a communication tool to becoming a platform for conducting the actual commercial activities themselves. Of course, any income earned by an e-service provider or an individual engaged in e-commerce is taxable as per the provisions of the Income Tax Act. A software's development can count as a means of taxation under excise law. The process of creating and installing software can be done through combined

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<sup>1</sup> *Indianlawportal- <https://indianlawportal.co.in/taxation-in-e-commerce/> (last visited on 28<sup>th</sup> January 2024)*

<sup>2</sup> *Taxguru - <https://taxguru.in/income-tax/digital-taxation-india.html> (last visited on 28<sup>th</sup> January 2024)*

efforts where shared computer resources are used or even remote access solutions like TeamViewer may be utilized. These rights may involve taxes relating to use, consumption, sales, or value-added tax when they are released or sold within the confines of the internet business world. Additionally, a service provider must fulfill tax obligations according to service tax regime for turnover from services rendered in digital domain.

### ISSUES IN CYBERSPACE TAXATION.<sup>3</sup>

Internet taxation, like any legal system, is not an easy road. The uniqueness of these tax issues on a global scale can be seen in the determination of who has the power to formulate, choose and execute local norms of taxation that govern cyberspace. Other causes of international legal complications could be related to disputes arising from application of different legal concepts. Whereas both countries have international tax laws under which residents pay income taxes for economic activity done in another state's territory, the same activity may be liable for double taxation by two countries according to their national legislation. The source principle allows for taxing in accordance with host country legislation while the residence principle permits home states to tax on basis of residency criteria.

#### Jurisdictional Issues in E-commerce

The transfer of goods and services across borders made possible by e-commerce inevitably raises questions about jurisdiction and applicable tax laws. A contract made online may have parties that are located in various countries, which could have a big impact on how the law is interpreted and applied. The issue is whether the other party's foreign jurisdictional law or the nation's domestic law applies in this situation. According to conventional private international law norms, a nation's jurisdiction normally extends to people living within its borders as well as transactions and events taking place inside its natural bounds<sup>1</sup>. These matters are governed by several fundamental principles.

(a) *Theory of Minimum contacts.*

The concept of minimum contacts implies that an individual can be subject to proceedings in a foreign court, even if not physically present in that country, as long as their website establishes

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<sup>4</sup> Cheshire and North, *Private International Law*, 11th edn. at p. 188

<sup>5</sup> lawyersclubIndia-<https://www.lawyersclubindia.com/articles/Key-Issues-on-Cyberspace-Taxation-3542.asp> (last visited on 28<sup>th</sup> January 2024)

minimal connections with that jurisdiction. This principle has broad applicability universally. Typically, a service provider has the option to include a suitable choice of law in online contracts, specifying the jurisdiction to which the parties in the contract would be subjected. Such clauses are legally binding on the involved parties<sup>2</sup>.

(b) *Source and Residence Principles.*

In direct taxation, the principles of source or residence usually determine the jurisdiction of taxing subjects. These principles state that income is taxable depending on the subject's place of residence or the source of the income. The use of these principles, however, may have an impact on regional balances when it comes to taxing e-commerce, especially in cases when a sizable amount of items are sourced in one region but are mostly consumed in another. Applying source rules to e-commerce sales in nations that have a large monopoly on software and other digital exports may cause regional imbalances unless the sales are attributed to a permanent establishment in the other nation. Additionally, there are restrictions on the residence concept in some sections of taxation that pertain to e-commerce sales, given that a majority of e-commerce service providers solely exist in cyberspace. In such cases, the residence of these sellers can be associated with the location of the server hosting the home website of the seller.

(c) *Concept of Permanent Establishment.*

A "permanent establishment" suggests that the primary right to tax an activity is with the country of origin, if the activity meets the requirements for a permanent establishment there. A permanent establishment is described as a fixed location of business where an enterprise conducts all or some of its operations under the OECD Model Tax Convention. This can apply to a factory, workshop, office, branch, or managerial location. An enterprise is said to have a permanent establishment in a place if a person acting on behalf of the enterprise regularly possesses the power to sign contracts in the name of the enterprise. But if a general commission agent, broker, or other independent agent is carrying out business as usual, in the normal course of their activities, it cannot be asserted that the enterprise has a permanent establishment merely because business is conducted through such individuals.

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<sup>6</sup>Compu Serve, Inc v. Patterson, 89 F.3d 1257 (6th Cir.1996).

For instance, if a foreigner entrusts the management of their domestic share portfolio to a stockbroker in a country, such agency does not constitute a permanent establishment. Consequently, a website hosted on a server owned by a domestic independent agent, like an Internet Service Provider (ISP), does not qualify as a permanent establishment. Neither a vendor's homepage on the internet nor the internet access provided to that homepage establishes a permanent establishment, as the vendor lacks control over the necessary transmission equipment within a country. Another perspective is that a web page may be deemed a permanent establishment in the country where the host computer is located. This is because a web page has a physical presence, being composed of binary or digital code and housed on a magnetic surface, typically a disk. This binary code becomes visible using a computer and communication device. That arrangement is still not considered a permanent establishment when a non-resident assigns a stockbroker in a given country the responsibility of managing their local share portfolio. A website that is hosted on a server owned by an Internet Service Provider (ISP) or any other domestic independent agent does not meet the threshold for being termed as a permanent establishment either. Since the vendor does not possess control over required hardware to enable data transmission within this country, the vendor's online site together with its internet access do not amount to permanent establishment. According to a different interpretation, a webpage could be considered a permanent establishment in the nation where the hosting computer is situated. This is rooted in the physical reality of a webpage, which is made up of digital or binary code and is kept on a magnetic medium, usually a disk. This binary code can be accessed with the use of a computer and communication equipment.

(d) *Theory of Physical Presence.*

The most important and widely recognized element affecting the application of taxes to online or e-commerce is the seller's or service provider's physical presence in the state where the client is located. Key indicators that help determine this physical presence or activity level are having employees located in that state, owning or renting real estate there, having a warehouse or fulfillment house there that stores inventory for the seller, and promoting your business there by attending trade shows or other events.

Regarding this, the US courts take a practical legal stance. They contend that a seller or service provider is not subject to state jurisdiction for legal actions if they only keep up a web presence in a location without engaging in any real economic activity there. The U.S. Supreme Court decided in the National Bellas Hess, Inc. case [3] that retailers could only be required to pay user taxes in jurisdictions where they have a particular degree of physical presence. States' ability to tax interstate

mail-order or catalogue transactions was severely limited by this ruling. The U.S. Supreme Court subsequently declared in the Quill <sup>[4]</sup> decision that defining the parameters of the nexus theory—which establishes the relationship between a firm and a state for tax purposes, falls within the purview of Congress to safeguard the interests of state revenue.

## **1. Issues in Identification of Parties.**

One of the biggest challenges with e-contracts is figuring out who the parties are. Internet communications lack an instant way to determine the precise locations of the people involved, in contrast to traditional postal communications, where the locations of senders and recipients are readily evident. Finding these places requires a time-consuming and highly technical procedure of decoding protocol addresses and using other technological methods. Online transactions sometimes include parties without prior relationships, especially when they are connected to consumer activities that result in sales or service contracts. This dynamic calls into question the persons' identities, including questions about their ability, authority, and right to participate in a contract.

## **2. Relative Issues of E-commerce Taxation.**

One of the key issues in taxing e-commerce is regulating the actual transportation of products or services. In the world of e-commerce, a major share of sales or services include intangible items, which eliminates the need to transmit physical personal property to customers. The transfer of intangible properties facilitates the selling and provision of services.

### *(a) Administration of Tax.*

In conventional trading systems, especially concerning brick-and-mortar retailers, tax administration is more straightforward. The taxation on sales or services is categorized as an indirect tax, and it falls upon the duty of traders or service

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<sup>7</sup> National Bellas Hess, Inc v. Illinois, 386 U.S. 753 (1967)

<sup>8</sup> Quill Corporation v. North Dakota, 504 U.S. 298 (1992)

providers to collect and transmit the tax to the state treasury. However, for e-commerce entrepreneurs, adherence to these statutory requirements might not be obligatory when there is a lack of regular business supervision. The importance of consumption tax, particularly in the context of tangible properties, becomes evident in such instances. In these cases, liability can be assigned to the importer or the individual consuming the goods.

In situations where intangible goods are electronically provided within a country, there is no notable difference as local vendors are required to collect taxes, and these transactions are subject to tax audits. Difficulties may arise, though, if the trader gets rid of their backup records. On the other hand, when a foreign supplier electronically supplies intangible goods, these transactions meet the requirements for import sales, enabling the imposition of tax on the importer who utilizes these goods. This use tax is common when the seller cannot impose a sales tax due to their lack of connection with the destination state.

E-commerce has transformed the global economy by linking providers from various locations. However, the tax administration structure for this industry is still under development, therefore persons in technologically proficient and high-paying professions within E-commerce are free from taxation. To overcome this issue, either substantially adjust sales tax principles or investigate other taxing techniques more suited to the specific nature of E-commerce.

The intricacies of E-commerce transactions, which include intangible items and downloads, make it difficult to determine the right taxes processes. Tax authorities are continually researching proactive solutions to prevent potential tax evasion in the field of e-commerce.

One particular obstacle in taxing stems from the difficulty in pinpointing the exact instant when sales tax should be imposed. Unlike traditional retail sales, where various stages occur simultaneously, such as agreement, goods appropriation, delivery, payment, and property transfer, E-commerce transactions are more complex<sup>5</sup>. The different stages of an E-commerce transaction do not occur concurrently, necessitating a re-evaluation of tax administration strategies to accurately capture the tax incidence at the right juncture.

(b) *Situs of Business.*

There is no discernible difference when intangible products are supplied electronically within a nation since local vendors must collect taxes and these transactions are vulnerable to audits by the government. But if the trader destroys their backup data, problems might occur. Intangible products, on the other hand, can be electronically supplied by a foreign provider and fulfil import sales rules, allowing the importer using the items to be taxed<sup>6</sup>. When the seller is unable to collect a sales tax because they are not connected to the destination state, they frequently apply this use tax.

(c) *Culmination of Contract.*

The determination of the situs of sale or service becomes crucial when it comes to the taxation of such transactions. A situs of sale or service must exist. A sale involves several elements, including the presence of goods that are being sold, a mutually agreed-upon bargain or contract, the transfer of property in the goods for a price upon execution, the payment or promise to pay the price, and the transfer of title. When all of these elements occur simultaneously, it is easy to determine the place of sale. However, if one or more of these elements occur in different locations, it becomes challenging to establish the situs of sale.

In the case of e-shopping, the situs of sale is uncertain. Goods can be ordered from one location, payment can be made from another, and the goods can be accessed from yet another place. Multiple incidents occur to finalize the sale of the goods. The question arises whether sales tax can be levied in all of these places.

When a sale involves physical goods and the sale itself causes the movement of goods from one place to another, it is relatively simple to determine the physical transfer of goods through delivery. However, this principle cannot be applied when intangible properties are transacted through cyberspace.

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<sup>9</sup>*King v. Dominion Engineering Co. Ltd., [1951] 2 STC 67 (PC).*

<sup>10</sup>*State of Bombay v. The United Motors (India) Ltd, [1953] 4 STC 133 (SC).*

## CONCLUSION.

E-commerce, as a technology-driven commercial activity, presents challenges in terms of supervision and taxation. The cross-border nature of E-commerce further complicates the matter. Taxation has traditionally been a function of individual countries, limited by territorial boundaries and the constitution of each country. In the case of E-commerce, where there is no specific territory associated with any sovereignty, formulating a universal tax formula becomes difficult without an International Charter. An International Charter could facilitate the exchange of information between countries, aiding tax authorities in their efforts. Coordination among countries can be achieved through information exchange agreements, as demonstrated by the Organization for Economic Cooperation and Development (OECD).

To address tax evasion in cyberspace, the theory of physical presence has been proposed<sup>7</sup>. According to this theory, the country where the seller or service provider has a physical presence is responsible for taxing their sales, services, or income. While this could serve as a universal rule, challenges arise when considering the concept of deemed physical presence. A uniform international charter may be necessary to address these issues, particularly for developing and third-world countries.

The concept of BIT-Tax (Bit Tax)<sup>8</sup> has emerged as a novel approach to combat concerns regarding tax erosion. It involves taxing internet usage based on volume and implementing a turnover tax on interactive digital traffic, regardless of the type of content. Collecting these taxes through internet service providers offers convenience for tax authorities. In countries like India, where the tax structure is complex, embracing the Goods and Service Tax (GST) could simplify taxation, with BIT tax becoming a part of GST as it is levied on internet services.

The scrutiny of income generation, e-services, or e-commerce sales by tax authorities is a crucial aspect. Determining the jurisdictional point of cyberspace transactions is a matter that requires examination. While tax authorities initially paid little attention to the potential tax erosion caused by e-commerce, they are now recognizing the importance of addressing this issue.

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<sup>11</sup>*Quill v. North Dakota, 504 U.S. 298 (1992)*

<sup>12</sup>*BIT tax is a method to tax all interactive digital information and the tax revenue will directly flow to the national revenue of the respective country. Under this tax system, the number of bits or bytes is considered as a more representative unit to provide an indication of such transmission intensity than time or distance. The BIT tax can be administered by collecting tax through ISP on the basis of actual web-surfing or usage.*