

EXECUTIVE SUMMARY

A sound and robust tax system plays a vital role achieving growth, sustainable development, and well-being of the society, providing resource to the government. The pace of economic change, especially, E-Commerce has brought new opportunities and challenges to the society. Governments are confronted by external environmental impacts on their tax policies, on the structure and operation of tax systems.

This policy paper analyzed direct tax challenges in the digital economy in the light of the OECD's BEPS project and studies of different scholars in the subject with a view to examining whether the existing taxation principles, definitions and concepts could be extended to cover taxation of online transactions, and to suggest necessary policy options for formulating an electronic commerce taxation policy for Sri Lanka. The methodology adopted was, existing literature including technical and conference papers, internet web pages, reports, commentaries, case law and judgments on the subject with special reference to the BEPS Report on Action 1.

In particular, it identified issues relating to tax nexus, valuation of data in cross border transactions, characterization of income and administrative challenges as main issues. It also examined the divergent approaches on those issues and the litigation arising from such inconsistencies. While assessing the recent initiatives in the area of E-Commerce taxation in international context, it identified that tax administrations have to work together to ensure that taxpayers pay the correct amount of tax to the right jurisdiction, as cross border activities have become the norm in the globalized world. The common feature identified was that the globalized world needs globalized solutions to plug loopholes and update international tax rules to meet emerging and future challenges.

The paper clearly highlighted the need for modifying existing international taxation rules, and identified three options, i.e. a new nexus based on significant economic presence, a withholding tax on digital transactions, and an Equalization Levy.

In accordance with the findings of the policy paper, it emphasized the urgency for Sri Lanka to take initiatives to face taxation challenges of E-Commerce and suggested that an "Inter Disciplinary Committee" be established to study how E-Commerce impacts on taxation and to recommend possible solutions. Further, it proposed alternative policy options to be considered with due attention to global consensus. More emphasis was given to the Equalization Levy which has been proposed by OECD and implemented in India.