Taxation of the digitalised economy - an informal update

Tony Stolarek to Melbourne Tax Discussion Group

July 17 2019

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Digital Service Taxes

EU Digital Services Taxes – current state at EU

- EU proposed a Digital Services Tax
- But lacked the necessary unanimous agreement
- Work is proceeding
- Linkage between indirect (DSTs) and direct tax measures
- ECOFIN presented the views expressed to G20 Finance Ministers' meeting on 8-9 June
- Agrees to revert back to EU approach if OECD consensus is delayed beyond 2020

- DST proposed at 3%
- Adjusted 2019 to limit to digital advertising revenues (originally to apply also to
  - Digital platforms that facilitate user interactions
  - Sale of collected user data)

Will momentum at OECD level impact those EU Member States (and others) who have already proposed DSTs?



Will some Member States retain a DST as well as implement the OECD recommendations?

Digital Services Taxes – Country updates (July)

Australia	DST paper, no action for now, but DPT & MAAL
Austria	DST announced in 2019, no further development
Belgium	Legislation proposed – 3% based on original EU proposal
Czech Republic	Formal legislative process started proposing 7% DST
France	DST 3% passed by Senate, waiting for Pres. Macron signature
India	Equalisation levy 6% (and income tax SEP (significant economic presence) test developing from 1 April 2018)
Israel	Initial planning stage by ITA and MOF (media reports)
Italy	3% DST based on previous EU proposals, to apply 60 days after Gazette publication
New Zealand	Discussion paper, open for comment
Poland	Plan to introduce in 2020
Spain	Govt. introduced Bill into parliament based on former EU plan
UK	DST 2% draft law, for comment
Uruguay	Expanded income tax for digital, from 2018

DST - Comparing France and UK directions

Feature	France	UK
DST rate	3% on in-scope revenue	2% on in-scope revenue
Scope	• Digital interfaces allowing user interactions, including for delivery of goods/services • Digital advertising targeted to users in France	Revenues derived from providing a social media platform, search engine or an online marketplace to UK users
Exclusions	• Digital interface mainly providing digital content, communication and payment services (so banking and finance excluded) • Direct sale of goods/services online	• First £25m of revenues derived from UK users will not be subject to DST • Safe harbour – loss-making UK activities exempt from DST • Carve out for financial services activities
Thresholds	• €750 million of worldwide revenue • €25 million generated in France	• £500 million of worldwide revenue • £25 million generated in UK
Application date	1 January 2019	Revenues earned from 1 April 2020
First Payment	November 2019	Annual payment in 2021
Status	Passed by the French Senate	Draft legislation and guidance released for comments

Country unilateral actions driving policy

- Country unilateral actions are a global trend and Australia seen as a unilateral player

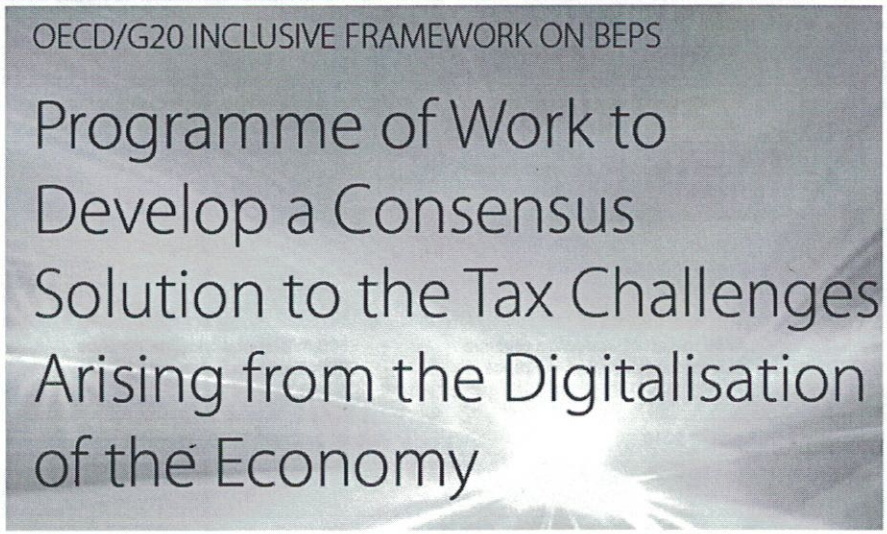
  "The French tax … is part of a much larger trend, with countries over the past few years proposing or putting in place a veritable alphabet soup of new international tax provisions. They have included Britain's DPT (diverted profits tax), ***Australia's MAAL (multinational anti-avoidance law)****, and India's SEP (significant economic presence) test … the European Union, Spain, Britain and several other countries have all seriously contemplated digital services taxes …"*

- A powerful driver for multilateral reform:

  "Another possible path would be for countries to see France's move as a portent of the disorder that could arise if they do not reach an agreement at the international level. This could push them to participate more fully in the OECD's digital tax project. The proposals being considered by that group could lead to significant changes to the international tax system, with the potential for increased taxes, taxation in more countries and new rules for companies. "

Source: Beware. Other Nations Will Follow France With Their Own Digital Tax. Lilian V. Faulhaber, NYT July 15

The IF programme to develop a consensus solution, led by OECD



Why

- Source: 2019 work program

- **[2015]** "OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, 2015 BEPS Action 1 Report (the Action 1 Report)
  - it would be difficult, if not impossible, to ring-fence the digital economy
  - broader tax challenges - "nexus, data and characterisation" – beyond BEPS
  - continued work (planning) … a further report … by 2020.
- **[2017]** Ongoing concerns … led the G20 Finance Ministers … in March 2017, to advance the timeline and request the Inclusive Framework to deliver an interim report by early 2018.
- **[2018]** the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE) … *Interim Report 2018* (the Interim Report).
- **[2019]** after … Interim Report … suggestions on how the work could be taken forward … Policy Note approved on 23 January 2019 ... to examine and develop these proposals on a "without prejudice" basis.
- Public consultation document (13 Feb-6 March)

The drivers, from the programme

- 8. While the two issues of the ongoing work on remaining BEPS challenges and a concurrent review of the profit allocation and nexus rules are distinct, they intersect and a solution that seeks to address them both could have a mutually reinforcing effect...
- 9. Since January 2019, and consistent with the Policy Note, the Inclusive Framework has continued to examine the proposals, including by considering how the gaps between the different positions of jurisdictions could be bridged ...
- 11. A further issue is the recognition that if the Inclusive Framework does not deliver a comprehensive consensus-based solution within the agreed G20 time frame, there is a risk that more jurisdictions will adopt uncoordinated unilateral tax measures. ... This dissatisfaction has created a political imperative to act in a significant number of jurisdictions.
- 12. This economic and political context is at the foundation of the programme of work for each Pillar outlined in this paper ... This timeline is extremely ambitious given the need to revisit fundamental aspects of the international tax system, but is reflective of the political imperative that all members of the Inclusive Framework attach to finding a timely resolution of the issues at stake.

US awareness

- US full awareness
  Policymakers' Statement April 10, 2019
  - *"The tax challenges that have arisen due to digitalization of the economy affect businesses headquartered all over the world, and solutions to these challenges are best negotiated multilaterally. We are supportive of the United States participating in the ongoing OECD negotiations on these solutions. We call on other countries to focus on and engage productively in the OECD dialogue in order to reach measured and comprehensive solutions, and abandon unilateral measures. Even on an interim basis, unilateral actions, such as digital services taxes proposed by some countries, can adversely affect U.S. businesses and have negative economic and diplomatic effects.*
  - https://www.grassley.senate.gov/news/news-releases/grassley-neal-wyden-brady-joint-statement-unilateral-digital-services-taxes-oecd

US awareness

- January 29, Lafayette G. "Chip" Harter III, U.S. Treasury deputy assistant secretary for international tax affairs - at a conference

  "there is a desire for this to succeed … I was encouraged by the pragmatism that I was seeing around the room… I don't see any other way forward … There simply is no mechanism that offers the capabilities of the OECD to try to broker a new multilateral agreement on allocating taxing jurisdiction… there is some hope that we can push this through successfully.

  … to the extent you get consensus, it will be around something that leaves the arm's-length standard in place for the vast majority of circumstances, but you have certain guardrails"

  https://www.taxnotes.com/editors-pick/us-hopeful-global-digital-tax-deal-after-oecd-breakthrough

- February 19

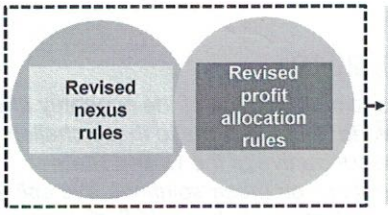
  "Harter … again said that if consensus among nations can, in fact, be reached to change the international tax rules in a coordinated way, any additional taxing rights granted to market countries would be "relatively modest" and likely based on the US-favored "marketing intangibles" approach.

  Brian Jenn, Deputy International Tax Counsel at the US Department of the Treasury, said … it is probably best as a policy matter to limit this rule only to certain businesses."I think it could make sense to focus this proposal on businesses that ultimately, directly or indirectly, are dealing with individual consumers rather than with other businesses just because I think marketing intangibles are most relevant in that context,"

  https://mnetax.com/marketing-intangibles-solution-to-digital-tax-dispute-should-apply-only-to-consumer-facing-businesses-us-official-says-32441

Workplan - Two pillar approach

1



Stated OECD objectives:

- ***Allocate more taxing rights to the jurisdiction of the customer***
- ***Find nexus in the absence of physical presence***

2

Global anti-base erosion proposal (GLoBE)

Stated OECD objectives:

- ***Address remaining BEPS risk of profit-shifting to entities subject to no or very low tax***
- ***Stop a harmful race to the bottom with respect to corporate tax rates***
- ***Shield developing countries from pressure to offer inefficient incentives for investment***
- ***Backstop Pillar 1***

The OECD Workplan
Planned activity

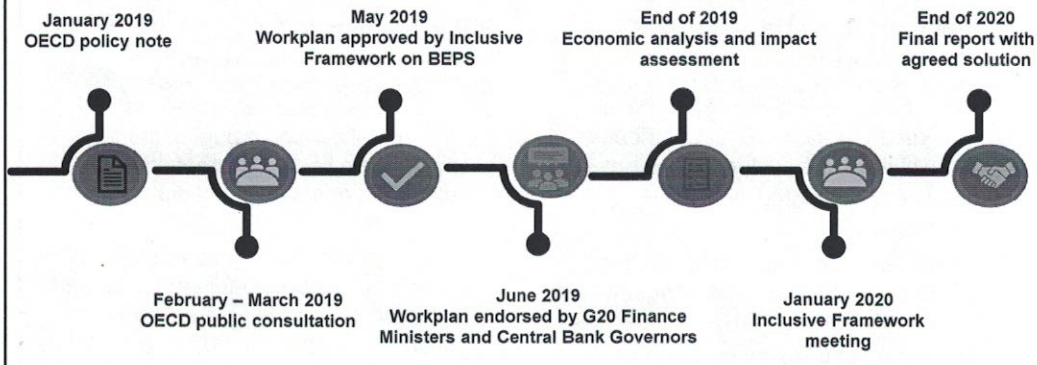
"There is a need for political endorsement and a spirit of compromise."

OECD Tax Talk Webcast, 11 June 2019 (bit.ly/2d1Qs3k)

1. Outlines of the architecture of a solution to be agreed by January 2020
2. Economic analysis and impact assessment to be provided to participating countries by the end of 2019
3. Final report with agreed consensus-based long-term solution to be delivered by the end of 2020
4. Work on technical and policy details to continue throughout the period, with consideration to be given to holding public consultations as necessary

- Technical work by working parties

The OECD Workplan
Timeline of events



Pillar 1 - Revised nexus and profit allocation rules Alternative proposals, commonalities and building blocks

3 proposals	Common aspects	3 building blocks
① *"User participation"* proposal	Allocating more taxing rights to the jurisdiction of the customer and/or user (the market jurisdiction)	① New profit allocation rules
② *"Marketing intangibles"* proposal	Finding nexus in the absence of physical presence	② New nexus rules
③ *"Significant economic presence"* proposal	The possibility of simplifying conventions	③ New market jurisdiction taxing right

User participation & significant economic presence

User participation proposal

Put forward by UK

(Source – Harter comments – January 2019 https://www.taxnotes.com/editors-pick/us-hopeful-global-digital-tax-deal-after-oecd-breakthrough

- Refers to "active user contribution" which creates value for business
- Applies to highly digitalised businesses
- Location of users alone would be enough to establish a company-country nexus.
- Minimum thresholds re size of business likely.
- Mimics UK's proposed DST

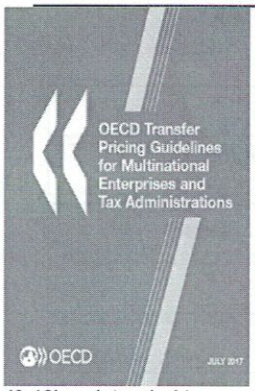
Significant economic presence proposal

Put forward by India

(Source – Harter comments – January 2019 https://www.taxnotes.com/editors-pick/us-hopeful-global-digital-tax-deal-after-oecd-breakthrough

- 3-factor allocation model of global income if a company meets the threshold of a significant digital presence
- Country-company nexus would exist based on "a purposeful and sustained interaction with the jurisdiction via digital technology and other automated means."
- Very significant change to nexus rules

Marketing intangibles v trade intangibles



(6.13) … intended to address transfer pricing matters exclusively. It is not intended to have relevance for other tax purposes.

Marketing intangibles

- *(6.5) "An intangible that relates to marketing activities, aids in the commercial exploration of a product or service, and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include (for example) trademarks, tradenames, customer lists, customer relationships and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers."*
- *(6.8) legal, contractual, or other forms of protection may affect the value of an item and the returns" but not a condition for intangible for TP*

Trade intangibles

- *An intangible other than a marketing intangible. (6.15) no attempt is made in these Guidelines to delineate with precision various classes or categories of intangibles or to prescribe outcomes that turn on such categories.*
- *(2.144) patents*

The OECD Workplan
Pillar 1 – Methods of allocating profits to explore

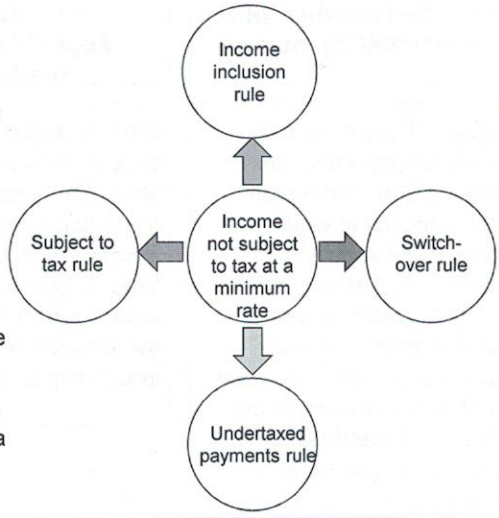
Modified residual profit split (MRPS) method	Fractional apportionment method	Distribution-based approaches
Step 1: Determine total profits (accounting / tax?) **Step 2:** Remove routine profit, including value of capitalised expenditure, and proxy methods **Step 3:** Split the non-routine profit to market jurisdictions (as if between independent enterprises) **Step 4:** Spread resulting profits, integrating to TP rules	**Step 1:** Determine profits **Step 2:** Select the allocation factors "including employees, assets, sales, and users" **Step 3:** Spread profit to market jurisdictions, while avoiding double taxation , integrating to TP rules	**Step 1:** Determine baseline profit for marketing, distribution, and user-related activities **Step 2:** Adjust based on group's profitability (or other factors) **Step 3:** Attribute return to market jurisdictions, integrating to TP rules

Pillar 1 – Key considerations include

Who	Separate entity versus group versus regional
What	Profits per transaction versus profits per group/division; Design scoping limitations
When	From fixed place to market nexus, prior year losses?
Spillover effects	Withholding taxes and dispute resolution
How	Simplification versus accuracy
Consensus	Impact assessment, businesses and profits in scope
Implementation	Necessary changes to tax treaties and domestic law

The OECD Workplan
Pillar 2 – GloBE (Global anti-base erosion proposal)

- Income inclusion rule
  - Parent country taxes income of controlled entity to top-up to a minimum rate of tax
- Switch-over rule
  - Residence country turns off the benefit of exemption for income of a branch that is not subject to a minimum rate of tax
- Undertaxed payments rule
  - Payer country denies deduction for payments made to related party that are not subject to a minimum rate of tax
- Subject to tax rule
  - Payer country denies treaty benefits for items of income that are not subject to a minimum rate of tax



Pillar 2 – Key considerations

Who	Prioritization of rules to determine which jurisdiction can act
What	Measurement of base to determine effective tax rate
How	Blending or not
When	Thresholds and carve-outs? Losses
How much	Top up or full rate
Consensus	What minimum rate of tax; how to calculate it
Administrability	Effectiveness, simplicity, transparency
Implementation	Necessary changes to domestic law and tax treaties

Next steps

PILLAR 1

- 1. Modified Residual Profit Split
- 2. Fractional apportionment
- 3. Distribution-based approaches
- 4. Business line and regional segmentation
- 5. Design scope limitations /
- 6. Treatment of losses
- 7. New nexus rules
- 8. Elimination of double taxation*
- 9. Dispute resolution*
- 10. Dispute prevention*
- 11. Administration*
- 12. Modifying Tax Treaties*

PILLAR 2

- 1. Inclusion Rule
- 2. Switch-over rule
- 3. Undertaxed payment rule
- 4. Subject to tax rule
- 5. Rule co-ordination, simplification and thresholds and compatibility with international obligations*
- 6. Other issues arising in connection with Pillar 2

ECONOMIC ANALYSIS

- 1. Economic analysis and impact assessment

* – includes FTA MAP Forum

Thank you

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