TAXATION AND THE DIGITALISED ECONOMY

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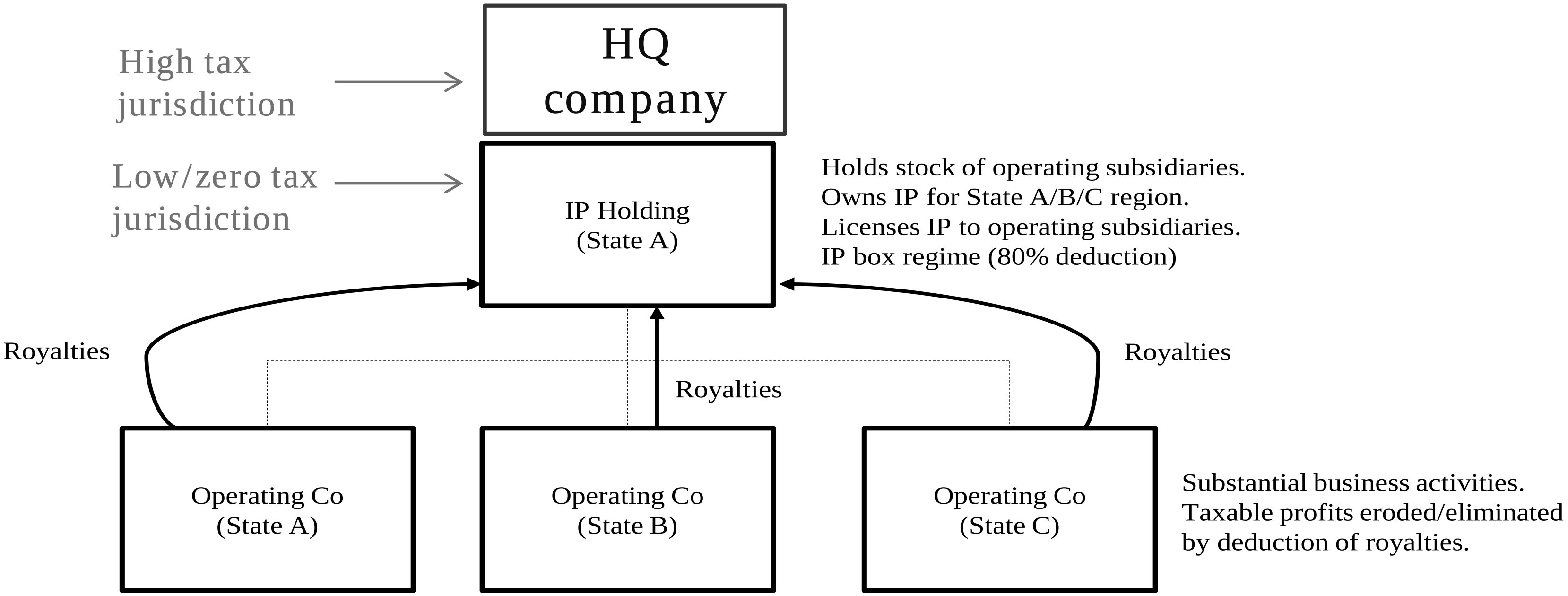
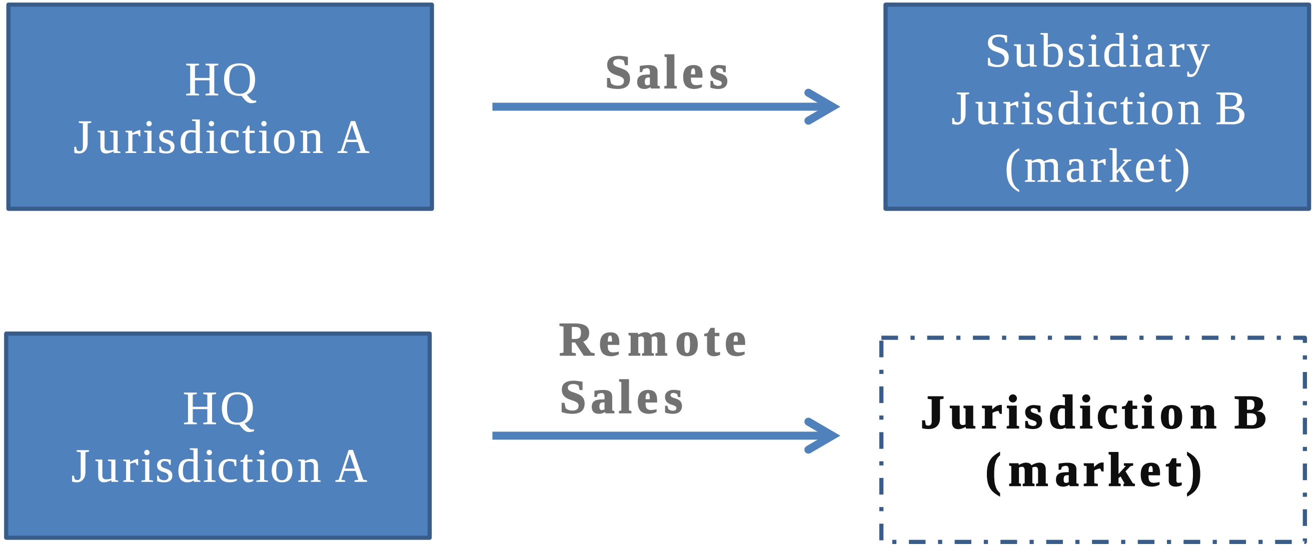
Background

- Different tax challenges posed by digitalisation:
    1. **BEPS activities**: activities based on intangibles; easily moveable to low tax jurisdictions
    2. **Countries' ability to tax (= revenues)** between countries based on physical presence in a jurisdiction
        - Digital companies can have deep economic interaction w/o physical and hence, taxable presence in jurisdiction where they sell
        - This may reduce taxing abilities for some countries

BEPS activities



Countries' ability to tax



INTRODUCTION

Timeline

January 2017: New TFDE mandate

March 2017: Request from the G20

September 2017: Request for input

November 2017: Public consultation

16 March 2018: Interim Report delivered

The 2018 Interim Report

- 8 Chapters, in particular:
  - In-depth analysis of business models and value creation
  - Stock-taking exercise on BEPS implementation and impact
  - Long-term solution
  - Interim measures
  - Special feature
  - Next steps

Key messages from the Interim Report

- Global engagement on the work in the Inclusive Framework (110+ countries)
- Technically complex questions on taxing rights (profit allocation and nexus)
- Diverse positions: 3 broad groups
- Interim measures
- Delivery by 2020; next meeting in July 2018

HIGHLY DIGITALISED BUSINESS MODELS AND VALUE CREATION

Business models and value creation

Complex reality. Three key factors prevalent in highly digitalised businesses (HDBs):

1. Cross-jurisdictional local scale without local mass
   - HDBs often highly involved in economic life of a jurisdiction without any significant, physical presence
2. Reliance on intangible assets, including IP
   - Intangible assets crucial support of business models of HDBs
3. Data, user participation and their synergies with IP

User participation: countries' views

- General agreement:
  - Data and user participation are common characteristics of highly digitalised businesses
- Current different opinions on
  - **Whether** and **the extent to which** they represent contribution to value creation by enterprise

User participation: countries' views

1. Role of user participation is a unique and important driver of value creation
   – Allows HDBs to collect a great deal of information and monetise it in various ways (e.g., pricing, advertisement)
2. The action by HDBs to source data from users is NOT an activity to which profit should be attributed
   – User's contributed data, content and other information similar to any other input sourced from an independent, third party

BEPS IMPLEMENTATION
& OTHER RELEVANT COUNTRY MEASURES

BEPS package: Implementation and Impact

Relevant measures of the BEPS package

- **Amended PE definition** (Action 7)
- **Revised TP guidelines** (Acton 8-10)
- **Strengthened CFC rules** (Action 3)
- **VAT collection** (Action 1)
- **Other BEPS measures** (Action 6, 5)

Impact assessment

- **Impact on BEPS issues:**
  - E.g., conversion from remote sales models to local reseller models
  - On-shoring of assets
- **Limited impact on the broader direct tax challenges** (nexus, data and characterisation)

Relevant Tax Policy Developments

Many uncoordinated country measures

Alternative PE thresholds

- Significant Economic Presence test (e.g. Israel, India)
- Virtual Service PE (e.g. Saudi Arabia)

Withholding Taxes

- Broader royalty definitions
- Technical service fees
- Online advertising

Turnover/ Excise Taxes

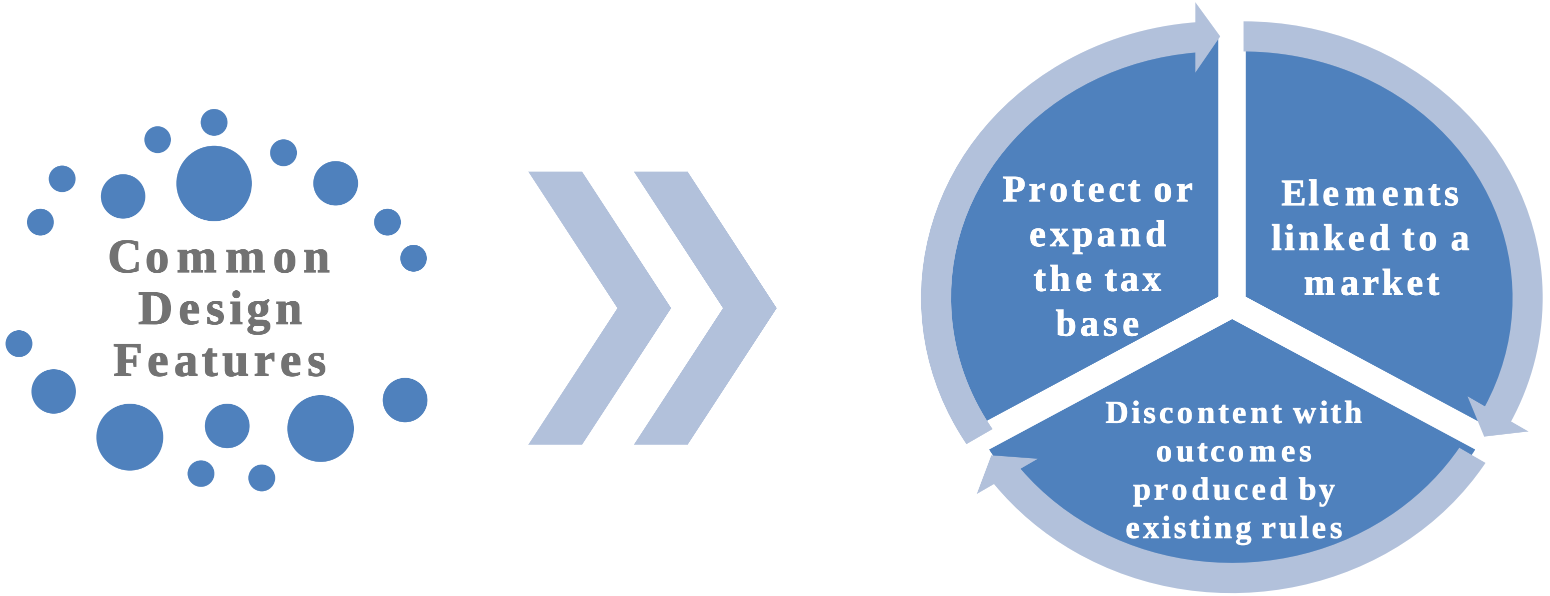
- Sectoral taxes, such as for advertisement (e.g. Hungary)
- Levy on Digital Transactions (Italy)
- Equalisation Levy (e.g. India)

Specific regimes for large MNEs

- Diverted Profits Tax (e.g. UK and Australia)
- BEAT (US)

Relevant Tax Policy Developments

Analysis in consultation with relevant countries



ADAPTING THE INTERNATIONAL TAX SYSTEM TO THE DIGITALISATION OF THE ECONOMY

Key concepts of international tax system

NEXUS

Rules that determine jurisdiction to tax a non-resident enterprise

PROFIT ALLOCATION

Rules that determine the relevant share of the profits subjected to taxation

Tax implications of digitalisation

Cross-jurisdictional scale without mass	Reliance on intangible assets	Data and user participation
Impacting the **distribution of taxing rights** by potentially reducing the number of Jurisdictions allowed to tax	Significant progress under BEPS project, but often difficult to determine how to allocate income from intangibles among different parts of an MNE group	If considered a source of value creation, could pose challenges, as such a concept of value creation is currently not captured by the existing tax framework

Divergent perspectives

The views of countries generally falling within 3 groups

First Group

User participation may lead to misalignments between where profits are taxed and where value is created. This does not undermine the principles of the existing international tax framework.

Only targeted changes needed: ring-fencing to digital HDBs

Second Group

Digitalisation present challenges to the broad international tax framework, not exclusively to HDBs.

Changes to affect entire tax system, not only HDBs

Third Group

BEPS package has largely addressed double non-taxation, but still too early to fully assess the impact.

Not currently see the need for any significant reform

Review of the key concepts

Members of the Inclusive Framework have agreed to:

Undertake a review of profit allocation & nexus rules

that would consider the impacts of digitalisation, relating to the principle of aligning profits with underlying economic activities and value creation

Work towards a consensus-based solution by 2020

with an update to be provided in 2019

INTERIM MEASURES

Interim Measures

- No consensus on the need for, or merit of, interim measures
- The Report **does not recommend** the introduction of such measures

Lack of conceptual basis & potential for adverse consequences	Acknowledge challenges but imperative to act pending global solution
• Impact of a gross tax on investment, innovation and welfare • Potential economic incidence of taxation on consumers and business • Possibility of over-taxation • Concern that interim measure may prove not be interim • Compliance and administration costs	• Untaxed value is being generated within their jurisdiction • Current position undermines the fairness, sustainability and public acceptability of the system • Any challenges need to be weighed against the consequences of not acting • At least some of the possible adverse consequences can be mitigated through the design of the measure.

Interim Measures

Countries favouring introduction of interim measures agreed on guidance for the design of such a measure:

- Compliance with a country's international obligations, including tax treaties, WTO, EU and EEA membership
- Temporary
- Targeted, discussion of both internet advertising and online intermediation services
- Minimising over-taxation with lower rate
- Minimising impact on start-ups, business creation and small business more generally
- Minimising cost and complexity

WHAT'S NEXT?

Next phase of work

- Next TFDE meeting in July 2018
- Delivery of final report by 2020, with 2019 update
- Test feasibility of technical options relating to profit attribution and nexus
- Monitor the impact of BEPS implementation and the introduction of any unilateral measures
- Explore opportunities and risks for tax policy and administration as a result of new technologies

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