



ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY

Action 1 of the BEPS Action Plan

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For Asian Countries - Tokyo, 23 April 2014

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Tax Challenges of Digital Economy

Action 1

- Identify the **main difficulties** that the digital economy poses for application of existing international tax rules
- Develop detailed **options** to address these difficulties



Outputs and Work Progress

- In-depth report **identifying issues** raised by the digital economy and **possible actions** to address them
 - September 2014
- Work carried out by **Task Force on the Digital Economy**
 - Two meetings so far (October and February)
 - Produced Public Discussion Draft March 24
 - Third meeting 23-25 April



Discussion Draft

- **Preliminary consideration of the issues** since publication of the Action Plan and identifies **issues for public comment**
 - Analysis of digital economy
 - Its key characteristics
 - BEPS issues raised by the digital economy
 - Broader tax challenges, and
 - Preliminary discussion of options to address those tax challenges



ICT and its Impact on the Economy

- Rapid technological progress has brought prices down, and
- These new technologies have spread throughout the economy

Advances in personal computing hardware, telecommunications, software, content, use of data (including personal data), cloud-based computing

- **Meaning that information and communication technology can be applied throughout economy at low cost**



Spread of ICT Across All Sectors

- Not possible to ring-fence the digital economy as a separate sector
 - Due to advances in technology and falling prices, ICT has permeated nearly every aspect of the modern economy, transforming industry from the high-tech to the traditional
- **But there are new business models that can be identified, and key features that warrant further attention**



Key Features Identified in Discussion Draft

- Mobility
 - Intangibles
 - Users
 - Business Functions
- Reliance on Data
- Network Effects
- Multi-Sided Business Models
- Tendency toward monopoly/oligopoly
- Volatility



Emergence and Growth of New Business Models

- Electronic Commerce (B2B, B2C, C2C)
- App Stores
- Online Advertising
- Cloud Computing
- Payment Services
- High-Frequency Trading
- Participative Networked Platforms

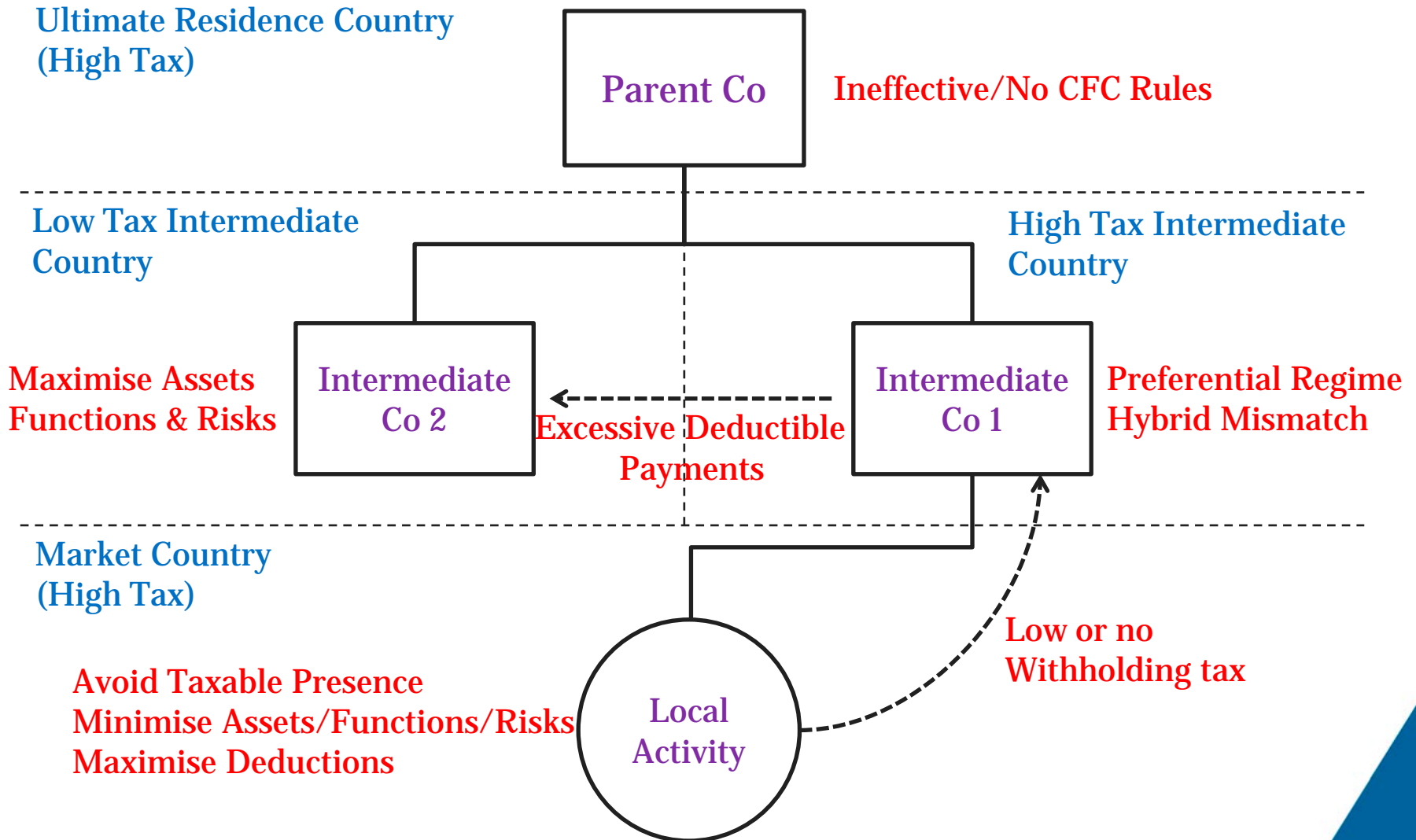


Opportunities for BEPS in the Digital Economy

- Coordinated BEPS strategies with respect to income tax
 - Minimisation of tax **in market country** by avoiding PE, or by shifting profits or maximising deductions
 - Low/no withholding tax **at source**
 - Low/no taxation at **level of recipient** (through low-tax jurisdictions, preferential regimes, or hybrid mismatch arrangements)
 - No current taxation at **level of ultimate parent**



Illustration of BEPS Planning with respect to Income Tax





Opportunities for BEPS with respect to VAT

Minimization of input VAT on

- Remote digital supplies to **exempt businesses**
- Remote digital supplies to a **'multi-location enterprise'**



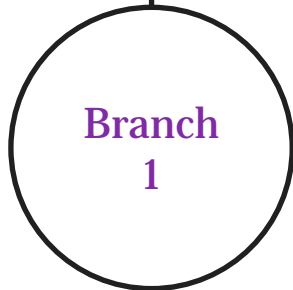
Illustration of BEPS Planning with respect to VAT

High VAT Country



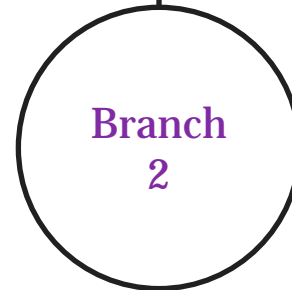
Acquires Services From Branch 1
(no VAT on internal cost allocations)

Low/No VAT Country



Acquires Services Used In Worldwide Operations

High VAT Country



Acquires Services From Branch 1
(no VAT on internal cost allocations)



Tackling BEPS in Digital Economy

- **No unique BEPS issues** identified in digital economy
- **But key features (mobility in particular) may exacerbate opportunity** to take advantage of BEPS structures
- **Work on other action items will restore taxing rights** in both market and ultimate parent jurisdiction



Tackling BEPS

- Restoring Taxation in **Market Jurisdiction**
 - Prevent Treaty Abuse (Action 6) and Artificial Avoidance of PE Status (Action 7)
- Restoring taxation in **both market and parent jurisdiction**
 - Hybrid mismatch arrangements (Action 2)
 - Limit base erosion (Actions 4 and 9)
 - Counter HTP (Action 5)
 - Transfer pricing (Actions 8-10)
- Restoring taxation in jurisdiction of **ultimate parent**: Strengthen CFC Rules (Action 3)
- BEPS in the area of **consumption taxes** addressed by the International VAT/GST Guidelines on B2B trade in services and intangibles



Broader Tax Challenges

- In addition to BEPS issues, action plan identified several broader challenges:
 - **Nexus:** Reduced need for extensive physical presence raises questions about whether current rules are effective
 - **Data:** Increased collection and use of data raises questions about appropriate attribution of value from generation of data, and how to characterise supply of data for tax purposes
 - **Characterisation:** Uncertainties about characterising income earned through new business models, including cloud computing
 - **VAT Collection:** Challenges for collection of VAT in cross-border services, particularly B2C



Options

- Report initially discusses a few options considered, including:
 - Modification of **exemptions from PE status**
 - New PE standard based on **Significant Digital Presence**
 - **Virtual PE** options identified in TAG work
 - **Withholding Tax** on Digital Transactions
 - **VAT Options**
 - Exemptions on Imports of Low Value Goods
 - Remote Digital Supplies to Consumers



Consultation and Next Steps

- Consultation:
 - Comments on Discussion Draft were due 14 April
 - Public Consultation April 23
 - G20 International Tax Symposium, Tokyo, May 9-10
- Next Steps on Report
 - Further development of Options
 - Framework for analysing options, building on Ottawa Framework conditions of Neutrality, Efficiency, Certainty & Simplicity, Effectiveness and Fairness, and Flexibility
 - Discussion of fundamental principles of taxation
 - More detailed examples of BEPS structures