Tax Challenges arising from Digitalisation - Presentation

Purpose: Information
Submitted by: OECD
Cannot ring-fence the digital economy

BEPS issues exacerbated but not unique

Key Findings

No consensus on the direct tax issues
(but important to continue working together)

Several broader tax challenges
(Direct and Indirect tax issues)
The 2018 Interim Report

includes:

- In-depth analysis of how digitalisation affects markets, business models and value creation
- Stock-taking exercise on BEPS implementation and impact on BEPS issues
- Monitoring of other tax measures adopted by countries potentially relevant to digitalisation
- Discussion of systematic challenges and possible adaptations of the tax framework (long-term solutions)
- Discussion of pros & cons of Interim measures, with a view to minimise the harm
- Description of how digitalisation can help improve tax services and compliance (special feature)
Key Messages from the Interim Report

- Technically complex questions on tax jurisdiction and profit allocation
- Seek a consensus-based solution
- Interim measures
- Diverse positions: 3 broad groups of countries

Global engagement on the work in the IF
DIGITALISATION, BUSINESS MODELS & VALUE CREATION
Business Models and Value Creation

3 key factors prevalent in certain highly digitalised businesses (HDBs)

- Cross-jurisdictional scale without mass
  - Ability to remotely develop & interact with a global customer base
  - Facilitates relocation of production processes & centralisation of functions
  - Highly involved in economic life of a jurisdiction with little/no physical presence

- Reliance on intangible assets
  - Growing importance of investment in intangibles
  - Intangible assets a crucial value driver

- Data, user participation and their synergies with IP
  - Data value cycle (e.g. collection, storage, analysis) becomes a key aspect
  - Users increasingly involved in value creation process
The issue of user participation and data

A determinant of value creation
- Amount of data collected, content contributed and network effects dependent on the level of user engagement, irrespective of the monetisation model (e.g., pricing, advertisement)
- User participation is a unique and important driver of value creation for some HDBs

A business input sourced from third parties
- Contributed data, content and other information are the result of transactions between HDBs and users (e.g. barter transactions)
- User participation is NOT an activity to which profit should be attributed
- User data can be a valuable intangible asset of HDBs

Income Tax Implications
Whether and the extent to which they represent contributions to value creation by enterprise
IMPACT OF BEPS & VAT MECHANISMS
How BEPS measures address the issue

1. **BEPS implementation is only in its early stages: need stock-taking exercise to...**
   - Take stock of progress achieved in implementation of the BEPS package
   - Assess impact of the BEPS package on issues exacerbated by digitalisation (incl. taxpayer behaviour), and identify any potential limitations /outstanding issues

2. **Monitoring focused on relevant measures of the BEPS package identified in Action 1 Report, namely**
   - Amended PE definition (Action 7); Revised TP guidelines (Action 8-10); Strengthened CFC rules (Action 3); VAT collection (Action 1); Other BEPS measures (Action 6, Action 5).

3. **Impact assessment extended to the broader direct tax challenge (nexus, data and characterisation)**
VAT/GST Mechanisms – Implementation

Collection of VAT on cross-border B2C supplies of services and intangibles (recommendations)

• Taxing rights accrue to jurisdiction of «usual residence of the customer»
• Simplified registration and compliance regime for remote suppliers (e.g. web-portal, e-payment) – NB: implementation package released in October 2017

Collection of VAT on imports of low value goods (best practices)

• Range of approaches to remove or lower the exemption threshold for imports and improve efficiency

Implementation through domestic legislation

• Collection mechanisms for online sales of services and intangibles are being implemented globally (over 50 jurisdictions), and many more are considering implementation
• Key reform initiatives on imports of low value goods from online sales (e.g. Australia, EU), generally based on requirements for seller and/or intermediary
DIFFERENT VIEWS & INTERIM MEASURES
## Different Country Perspectives

Broad spectrum of divergent countries’ views, that can generally be described as falling within three groups

<table>
<thead>
<tr>
<th>No fundamental change needed</th>
<th>Targeted changes needed</th>
<th>Broader changes needed</th>
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<tr>
<td>• BEPS measures have largely addressed double non-taxation, and more time is required to assess their full impact</td>
<td>• Failure to take into consideration user-generated value in certain HDBs create misalignments between where profits are taxed and where value is created</td>
<td>• Digitalisation and globalisation pose challenges to the effectiveness of some basic concepts underlying the existing international tax framework (e.g. transfer pricing, PE definition)</td>
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<tr>
<td>• Generally satisfied with the existing tax system and do not currently see the need for any further reform</td>
<td>• This does not undermine the principles of the existing international tax framework</td>
<td>• These challenges are not exclusive or specific to highly digitalised business models</td>
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Key concepts at stake

**Nexus**

| Rules that determine jurisdiction to tax a non-resident enterprise | PE threshold (e.g. fixed place of business, dependent agent) |

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**Historical & well-established concepts**

**Fundamental principles of the existing tax framework**

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**Profit Allocation**

| Rules that determine the relevant share of the profits that will be subjected to taxation | Arm’s length principle (e.g. TP rules, PE profit attribution) |
Interim measures

Multilateral work on nexus and profit allocation and delivery of a consensus-based solution will take time…

Some countries support more immediate action (e.g. excise tax)

- Untaxed value being generated → mismatches b/w taxable profits & value creation (e.g. HDBs reliant on user participation)
- Requires interim measure pending global consensus-based solution
- Potential risks & adverse consequences need to be weighed against consequences of not acting; can be mitigated through design of the measure

Other countries oppose such measures irrespective of design

- Disagree with conceptual basis
- Potential risks and adverse consequences, inter alia:
  - Negative impact on investment, innovation and overall welfare
  - Risk: Economic incidence passed on to consumers / businesses
  - Risk: Over-taxation
  - Risk: Will become permanent; inhibit move to global solutions
  - Disproportionate compliance and administration costs
Interim measures

Multilateral work on nexus and profit allocation and delivery of a consensus-based solution will take time...

Some countries support more immediate action (e.g. excise tax)

Other countries oppose such measures irrespective of design

No consensus on the need for, or merit of, interim measures...

... and no recommendation for the introduction of such measures
## Categories of potential measures

### Alternative PE thresholds
- Digital presence-type of PEs (e.g. Israel, India, Slovakia)
- Virtual Service PE (e.g. Saudi Arabia)

### Withholding Taxes
- Broader royalty definitions (e.g. Philippines, Malaysia, UK)
- Technical service fees (e.g. UN Model Tax Convention)
- Online advertising (e.g. Thailand)

### Turnover Taxes
- Sectoral taxes, such as for advertisement (e.g. Hungary) or audio-visual content (e.g. France)
- Levy on Digital Transactions (Italy)
- Equalisation Levy (e.g. India)

### Specific regimes for large MNEs
- Diverted Profits Tax (e.g. UK and Australia)
- Base-Erosion and Anti-abuse Tax (e.g. US)
Countries that favour the introduction of interim measures have agreed a framework for the design of any such measures:

- Compliance with international obligations (e.g. tax treaties, WTO, EU)
- Temporary
- Targeted
- Minimising over-taxation
- Minimising impact on start-ups & business creation
- Minimising cost and complexity
Design of Interim Measures

Countries that favour the introduction of interim measures have agreed a framework for the design of any such measures:

- **Avoid multitude of different unilateral measures**
- **Limit potential adverse side-effects of the measure**
CHALLENGES & OPPORTUNITIES FOR TAX ADMINISTRATION
Challenges and opportunities

Digital Frontier

- P2P Platforms
- AI
- Robotics
- Block-chain
- Big data
- 3-D printing

Implications for tax policy and administration
P2P / Multi-sided Platforms

Opportunities and Challenges

Data reporting
- Transactions channeled/recorded through online platforms
- May include payment and identification data
- Opportunities to improve compliance, reduce informality

Tax Collection
- Possibilities to use platforms as collection agents
- Extent of information available varies
- Limited power when platform is in another jurisdiction

Simplified tax regime
- Foster innovation and reduce compliance burden
- Unequal treatment with competitors (level playing field)
Further work areas

- Assess the impact of the shift from standard to non-standard labour contracts on both revenue and tax mix.
- Build on existing best practice with respect to taxpayer education.
- Peer-to-peer knowledge sharing between tax administrations to build a database.
- Analysis of the risks of tax evasion posed by crypto-currency and block-chain technology.
NEXT STEPS

• Undertake a coherent and concurrent review of the profit allocation and nexus rules

• TFDE meeting in July

• Update to the report in 2019
MORE INFORMATION

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