Current trends in the taxation of international digital activities

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19 April 2018
The status quo

- The **rapid transformation** of the global economy due to **digitalisation** has put new pressures on corporate tax systems internationally.

- In particular, **misalignments** between the **place where the profits are taxed** vs. **place where value is created** occur more-and-more often, leading to increased **tax avoidance** and loss of public revenues.

- The **OECD** and the **EU** have already planned various initiatives to address the above tax issues.
The BEPS Project

• In 2012, the G20 asked OECD to create an action plan to address base erosion and profit shifting (BEPS) by identifying domestic and international actions to address the problem under a specific timeline.

• Subsequently, in September 2013, OECD/G20 countries adopted a 15-point Action Plan to address BEPS.

• The Action Plan nr. 1 was named Addressing the Tax Challenges of the Digital Economy. A Final Report was published in October 2015.
The BEPS Project (2)

- The Final Report on the tax challenges of the digital economy also included the following conclusions:

  ✓ Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy for tax purposes.

  ✓ While the digital economy does not generate unique BEPS issues, some of its key features exacerbate BEPS risks [mobility of intangibles, distance selling, etc.].

  ✓ Cross-border trade in goods, services and intangibles creates challenges for VAT collection, particularly where such products are acquired by private consumers from suppliers abroad.
The EU solutions

• In late 2017, the EU Commission and Council officially identified various possible avenues to make the taxation of digital activities fairer:

1. A long-term solution: «embedding the taxation of the digital economy in the general international corporate tax framework»; and/or

2. Short-term measures, such as an equalisation tax on turnover of digitalised companies, a withholding tax on digital transactions or a levy on revenues generated from the provision of digital services or advertising activities.
The EU legislative proposals

• On 21 March 2018, the Commission advanced two Directive proposals:

1) The first proposal aims to reform corporate tax rules so that profits are registered and taxed where businesses have significant interaction with users through digital channels. This forms the Commission's preferred long-term solution;

2) The second proposal responds to calls from several EU states for an interim tax which covers the main digital activities that currently escape tax altogether in the EU.
The EU long-term proposal

• This proposal aims at setting out a comprehensive solution within the existing EU corporate tax systems to tax digital activities in the EU.

• Firstly, the proposal lays down rules to determine a taxable nexus for digital businesses operating across border in case of a non-physical commercial presence (a "significant digital presence").

• Secondly, the proposal sets out principles for attributing profits to a digital business. These principles should better capture the value creation of digital business models which highly rely on intangible assets.
The «significant digital presence»

• Under the current international tax framework, a business established in Country A can be taxed on its profits in Country B only when the business holds a physical presence of some sort in Country B.

• Yet, digital businesses can generate profits and create value in multiple countries without the need of any physical presence in the latter countries.

• The concept of “significant digital presence” is meant at creating a taxable nexus in a jurisdiction where the digital business does not have any physical presence.
The «significant digital presence» (2)

• A business holds a «significant digital presence» in an EU state during a specific tax period if and when:

1. Its activities consists, wholly or partly, of digital services supplied through a digital interface; and

2. At the group level, at least 1 of the following thresholds is met during a tax year:

✓ threshold of > €7 million in annual revenues in that EU state; or
✓ It has > 100,000 users in that EU state; or
✓ Over 3000 business contracts (B2B) for digital services are created in that tax year.
Meaning of digital services

• Digital services are those services:
  ✓ delivered over the internet or an electronic network
  +
  ✓ the nature of which renders their supply essentially automated +
  ✓ involving minimal human intervention +
  ✓ impossible to ensure without information technology.

• According to the Directive proposal, they also include:
  a) Supply of digitised products, including software and changes/upgrades of software;
  b) Services providing/supporting a business/personal presence on an electronic network (e.g., a website or a webpage);
Meaning of digital services (2)

c) Services automatically generated from a computer via the internet or an electronic network, in response to specific data input by the recipient;

d) Online Marketplace intermediation services;

e) Internet Service Packages (ISP) going beyond mere internet access and including other elements such as content pages giving access to news, weather or travel reports, playgrounds, website hosting, access to online debates or any other similar elements;

f) The services listed in Annex II to the Directive proposal.
Profits distribution

• The rules will be built on the current principles for profit attribution and be based on a **functional analysis** of the functions performed, assets used and risks assumed by a significant digital presence.

• **Transfer pricing** rules are expressly referred to.

• In determining the attributable profits, due account shall be taken of the **economically significant activities** performed by the significant digital presence relevant to the development, management and exploitation of intangible assets.
The EU short-term proposal

• In the short term, the EU Commission has proposed a Digital Service Tax (DST) for adoption by EU states.

• The measure is meant at preventing unilateral, non-coordinated actions by single EU states (e.g., Italy).

• The DST is a levy on gross revenues that would go alongside Corporate Income Tax.
Who is taxed

- The DST would apply to businesses that meet **two** cumulative conditions:

  1. Carrying out supplies of the **digital services expressly falling** within the scope of the tax; and, furthermore

  2. Being above **both** of the following thresholds at **the group level**:

    ✓ Annual worldwide total revenue above Eur 750 million; and
    ✓ EU annual revenues from digital revenues in the range of at least Eur 50 million.
Which services are taxed

- The DST would apply to revenues generated with services «where users play a very active role in the value creation for the business», namely:

  1. the placing on a digital interface of advertising targeted at users of that interface;
  2. the making available to users of a multi-sided digital interface («marketplace») which allows users to find other users/to interact with them, and which may also facilitate the provision of underlying supplies of goods/services directly between users;
  3. the transmission of data collected about users and generated from users' activities on digital interfaces.
Which services are NOT taxed

• The DST would **NOT** apply to services consisting in the making available of digital content/solutions. For example, activities such as electronically supplied media, **streamine, gaming, cloud computing services**, etc.

• The **reasons** for such exclusion also include:

  ➢ Exempting digital services with minimal user intervention;
  ➢ Simplicity;
  ➢ Avoid political pressure by reducing the number of taxpayers/consumers concerned.
Place of taxation

- There is a need to assign taxing rights. To that extent, the focus is placed on user value creation:

1. Sale of advertisement space: *where* the advertisement is **displayed**;

2. Sale of data: «*where the user whose data are sold used a device to access a digital interface, whether during that tax period or any previous one*»;

3. Availability of digital platform/marketplaces to users: *where the user uses a device...in that tax period to access the digital interface and concludes an underlying transaction on that interface in that tax period*
Other aspects

• The DST will be charged **annually**.

• The levy will also apply to **domestic transactions**. Otherwise, the EC believes, the new tax would be in breach of the freedom of providing inter-EU services.

• The DST will be levied on **gross revenues**.

• There will be a **single 3% DST rate**.

• Businesses will be able to **deduct** the Digital Tax paid from the Corporate Income Tax base (not from the CIT itself).
Other aspects (2)

- Payment of the DST will be made to the EU state where the supply takes place in accordance with the place of supply rules.

- Businesses will be able to report and pay the DST by means of an electronic interface similar to the VAT MOSS.

- The DST will be **repealed** only when intra-EU long-term, comprehensive measures have been adopted and Double Taxation treaties with third country have been renegotiated for a fair taxation of digital activities.