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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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
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
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

- 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

- **Ultimate Residence Country** (High Tax)
- **Low Tax Intermediate Country**
  - **Maximise Assets, Functions & Risks**
  - **Market Country** (High Tax)
    - **Avoid Taxable Presence**
    - **Minimise Assets/Functions/Risks**
    - **Maximise Deductions**

- **Local Activity**
  - **Ineffective/No CFC Rules**
  - **Excessive Deductible Payments**
  - **Low or no Withholding tax**

- **Intermediate Co 2**
- **Intermediate Co 1**
- **Parent Co**
  - **High Tax Intermediate Country**
  - **Preferential Regime Hybrid Mismatch**
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

Multinational Bank

Branch 1

Acquires Services Used In Worldwide Operations

Low/No VAT Country

Branch 1

High VAT Country

Branch 2

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

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
• 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
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