ACCOUNTANCY EUROPE.

TAXING THE DIGITAL ECONOMY

How to capture the value created by tech companies

Factsheet

FACTS.

TAX POLICY
JUNE 2019

HIGHLIGHTS

The international tax system is based on a company's physical presence in a specific location. Ecommerce has disrupted how taxes flow, as companies can make substantial profits where they are not physically present. Governments and the public fear that companies do not pay the correct taxes in the right place. Therefore, the EU and OECD have taken action to more effectively collect tax on the revenue from digital activities.

This paper primarily summarises the EU's Digital Services Tax and the OECD's Digital Tax proposal. It does not aim to be exhaustive on all such measures.

The question on how to properly tax digital companies is far from being solved and this will likely remain an important policy priority. We thus intend to update this factsheet whenever there is a major new development.

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INTRODUCTION

National governments have been concerned about the impact of digitalisation on tax systems since global ecommerce became possible. From early on, policymakers identified the tax issues surrounding the ability to provide goods and services into other markets without a substantial physical presence. The increasing importance of intangible assets, together with their mobility, is also an important issue for tax authorities.

Even at an early stage of development, policymakers quickly identified the potential for a digitalised economy to disrupt traditional tax models. Initial fears centred around the loss of a domestic VAT\GST tax base due to the difficulty in collecting VAT from overseas suppliers – particularly in relation to the supply of digital products and low value goods.

More recently, the proliferation of new business models facilitated by the digitalisation of the economy has called into question the current international tax framework, which is nearly 100 years old. In particular, the growing importance of user participation challenges the current value creation model – and with it (amongst other concerns), which jurisdiction has taxing rights.

This document will mainly concentrate on the policy initiatives in respect of value creation and taxing rights – the source of recent policy initiatives.

The increased scrutiny and criticism by the public and tax policymakers of the tax planning strategies of multi-national entities (MNEs) was one of the consequences of the global financial crisis of 2007-2008. At an early stage, key issues emerged - including the increasing importance of intangible assets and the disconnection between legal ownership and business activity – which affected 'digital' MNEs even more than their 'traditional' counterparts.

Additionally, there were other issues specific to the digitalised economy that caused concern and deserved consideration – for example, the highly mobile nature of digital goods and services and the ease with which digital businesses can enter new territories without a significant physical presence.

In 2013, the European Commission formed a High-Level Expert Group on Taxation of the Digital Economy[1] to investigate this issue. In the same year, the OECD started work on its Anti-base erosion and profit shifting project (BEPS), with the digitalised economy specifically addressed by Action 1.

HIGH-LEVEL EXPERT GROUP ON TAXATION OF THE DIGITAL ECONOMY

The European Commission's High-Level Expert Group on Taxation of the Digital Economy issued a final report[2] in April 2014.

GENERAL CONCLUSIONS

There should be no special tax regime for digital companies – general rules should be adapted to ensure that 'digital' companies are treated the same way as others.

A well-coordinated tax system that is simple to comply with and administer is essential to fully exploit digitisation in the Single Market. Tax barriers for small and medium sized enterprises (SMEs) operating in the Single Market should be removed.

Tax incentives and credits should be viewed with caution and be carefully assessed before and after introduction.

[1] https://ec.europa.eu/taxation_customs/business/company-tax/tax-good-governance/expert-group-taxation-digital-economy_en#section_6
[2] https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf

VAT CONCLUSIONS

The way forward for VAT, both at a European and, ultimately, global level is taxation at the place of consumption - i.e. the destination principle.

Consideration should be given to extending the EU's Mini-One Stop Shop (MOSS) to encompass all cross-border B2C transactions, thereby reducing costs for SMEs doing cross border business in the Single Market.

ANTI-BASE EROSION MEASURES

It suggested that the OECD's BEPS project should:

- counter harmful tax practices by countries – particularly in respect to hybrid mismatches, controlled foreign company (CFC) rules and circumvention of withholding taxes (WHTs)
- review transfer pricing rules – to combat artificial transfer of intellectual property and use of contractual obligations that lack economic substance
- restore the connections between the amount or degree of business activity that must be present in a jurisdiction before the jurisdiction has a right to tax a particular entity ('taxable nexus'). Whilst the collection of data in a particular country should not lead to a taxable presence, the rules relating to the distinction between core and auxiliary activities should be reviewed

LONGER TERM WORK

The EU should examine whether the new transfer pricing (TP) rules will generate such significant costs that additional simplification is required – such as the Common Consolidated Corporate Tax Base (CCCTB).

More fundamental changes to the corporation tax system should be looked at – such as a destination-based cash-flow tax – but more information and analysis is required before such a fundamental policy change can be considered.

BEPS ACTION 1

The OECD's BEPS Action 1 Final Report[3] - *Addressing the Tax Challenges of the Digital Economy* - was published in October 2015.

Apart from outlining the evolution of information and communication technology and new digitalised business models, it also identified:

The report highlighted key features of the digital economy, including:

- mobility of intangibles, users and business functions
- reliance on data – particularly 'big data'
- network effects – for user participation, integration and synergies
- use of multi-sided business models - where the parties may not be in the same jurisdiction
- tendency towards monopoly or oligarchy – driven by network effects
- volatility – due to low barriers to entry and rapidly evolving technology

TACKLING BEPS IN THE DIGITAL ECONOMY

BEPS risk areas for the digital economy are: the importance of intangible assets; the mobility of intangible assets; business functions and users; and the facilitation of market penetration remotely, with minimum use of personnel.

[3] https://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm

The report concluded that all elements of the BEPS Action Plan will have an impact on the digital economy but highlighted the importance of Action 3 – *Designing Effective CFC rules*. This was due to the importance of intangibles in generating income from digital services and goods, making this income particularly mobile.

Other remedial actions include:

- Action 7 - *Preventing the Artificial Avoidance of PE Status*: Digitalised business models increased the possibility of misusing exemptions for activities of a *'preparatory or auxiliary'* nature

  Remedial action includes modifying the definition of Permanent Establishment (PE) to combat fragmentation and artificial arrangements and restricting the activities that are of a *'preparatory or auxiliary'* nature. This is to deal with, for example, the situation where a large local warehouse is used to supply goods, but the sales originate from the internet and are booked in a different jurisdiction
- Actions 8-10 - *Aligning TP Outcomes with Value Creation*: again, the importance of intangibles in digitalised business models increased the possibility of BEPS through the misallocation of business risk to entities with little or no business activity

  Remedial action includes a clear definition of intangibles for TP purposes and the valuation techniques to be used to determine arm's length value, particularly of hard-to-value intangibles. It also tightens the guidance for contractually transferring risks where the recipient lacks the resources to take on the risk. Finally, guidance on transactional profit split methods is enhanced to clarify when to use such methods and how to value the respective value creation of all parties

The report also highlights BEPS issues in respect of VAT and other consumption taxes.

- the digitalisation of the economy has made it easier for businesses (and consumers) to obtain a wide range of services and intangibles from suppliers in other jurisdictions and to structure their operations in a global manner. These developments have allowed exempt business to avoid and minimise the amount of irrecoverable VAT suffered on their inputs
- remedial action would be to implement Guidelines 2 and 4 of the OECD's *International VAT\GST Guidelines*[4]

  Guideline 2 recommends that the taxing rights of a cross-border supply of services and intangibles should be the jurisdiction where the customer is located and that the customer be required to self-assess VAT on remotely supplied services

  Guideline 4 provides that where a business is established in more than one jurisdiction, taxing rights should accrue to the jurisdiction where the services are consumed

PRELIMINARY CONCLUSIONS

It would be difficult, if not impossible, to ringfence the digital economy from the 'traditional economy' for tax purposes. Most of the urgent BEPS issues affecting direct and indirect taxes can be dealt with by the prompt implementation of the BEPS Actions and the recommendations in the *International VAT\GST Guidelines.*

The digital economy also raises broader direct tax challenges for policymakers – particularly in respect to the often-interconnected challenges related to nexus, data and characterisation. Cross-border trade presents challenges for VAT collection, particularly for B2C supplies where the consumer cannot be expected to self-assess.

As part of the process, several options were assessed to address the broader tax challenges raised by the digitalised economy - namely, broader changes to the existing PE rules, a withholding tax (WHT) on certain types of digital transactions and the introduction of an 'equalisation levy'.

None of these other options were recommended at the time of publication, although it was suggested that countries could introduce any of these options, provided that international treaty objectives were respected.

[4] https://www.oecd.org/ctp/international-vat-gst-guidelines-9789264271401-en.htm

However, it was important to continue working on these issues and monitor developments in the digital economy over time.

DEALING WITH THE BROADER TAX CHALLENGES

In May 2015, the European Commission announced its Digital Single Market initiative . The aim was to make the EU's single market fit for the future by removing unnecesary regulatory barriers and producing a harmonised set of rules across the EU.

In the mid-term review, the impact of digitalisation on taxation systems was added as an important challenge to be addressed - to help ensure tax certainty for businesses and to prevent tax base erosion for Member States.

This reflected a growing concern amongst legislators worldwide that the current international rules on the taxable nexus were based on the traditional economy. As a result, they failed to address the new value creation models facilitated by the digitalised economy. This led to several countries, both worldwide and within the EU, developing or proposing new taxes to capture some of the value they believed was being created in their jurisdiction but where the taxing rights currently fell in another country.

At an EU level, in September 2017, four Member States issued a statement calling for an "'*equalisation tax' on the turnover generated in Europe by the digital companies. The amounts raised would aim to reflect some of what these companies should be paying in terms of corporate tax*". This was followed by a political statement including a further six Member States supporting a digital tax. With the threat of significant unilateral measures potentially fragmenting the single market, the Commission acted.

THE EUROPEAN COMMISSION'S RESPONSE

In September 2017, the Commission published a communication[5], *A Fair and Efficient Tax System in the European Union for the Digital Single Market.* In October 2017, the Commission issued a public consultation[6], to which Accountancy Europe responded[7]

In March 2018 the Commission published a 2-tier legislative proposal:

TEMPORARY DIGITAL SERVICES TAX (DST) [8]

The Commission proposed a DST that would remain in force until a comprehensive solution is agreed.

The DST would apply to activities based around a 'digital interface' - meaning *'any software, including a website or a part thereof and applications, including mobile applications, accessible by users'*.

A 3% DST would be charged on **gross revenue** (after deducting VAT or GST) derived from the digital interface arising from:

- advertising targeted at users of the interface
- income (such as commission and fees) generated from multi-sided platforms allowing users to find and interact with other users and facilitate the supply of goods and services between them
- the transmission of data collected about users and generated from users' activities on the digital interface

Excluded services were:

- direct supplies of digital content – such as music, software, games etc

[5] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017DC0547&from=EN
[6] https://ec.europa.eu/info/consultations/fair-taxation-digital-economy_en
[7] https://www.accountancyeurope.eu/consultation-response/ecs-consultation-fair-taxation-digital-economy/
[8] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0148&from=EN

- data obtained for internal purposes, from sensors or machinery, or where the sharing of data with other parties is for no consideration
- income derived from trading platforms related to points (1) to (9) of Directive 2014/65/EU, from the granting of loans on crowdfunding platforms and data transferred on multi-sided platforms in respect of investment services and investment research

Taxable Persons under the DST are defined as a legal person that exceeds both of the following thresholds:

- global revenue exceeds €750 million, and
- EU revenue exceeds €50 million

The place of taxation under the DST is the Member State where the user is located. In most cases, the user's location would be determined by the IP address when the user uses a device to access the interface. The total amount of revenue generated by the interface in the EU would be split between the Member States - broadly based on the number of times that a user accesses the interface, concludes transactions or has an advert appear on their device.

For the collection of tax, a group can nominate a single entity within the EU responsible for each taxable person liable to DST. A DST return must be submitted electronically within 30 days of the tax period end to the Member State of nomination and pay the total tax due to that Member State. The Member State of nomination would then be responsible for accounting to other relevant Member States for their share of the total DST received from that taxable person.

In respect of double tax relief, the proposal contained no specific proposals for dispute resolution or to relieve double taxation. However, the preamble to the draft Directive states that '*it is expected that Member States will allow businesses to deduct the DST paid as a cost from the corporate income tax base in their territory, irrespective of whether both taxes are paid in the same Member State or in different ones*'.

LONG-TERM SOLUTION BASED ON A SIGNIFICANT DIGITAL PRESENCE (SDP)

The Commission proposed that the Significant Digital Presence (SDP) proposal would supersede the DST proposal once it came into force.

The existing concept of PE assumes that businesses need a significant physical presence in another country to supply goods or services. Digitalisation has broken this link for many businesses. This proposal was intended to add to existing PE rules and create a 'virtual PE' for businesses that make supplies without the need to be physically present. As such, the proposals were a significant change to the PE rules, which have been a foundation of the international corporate income tax framework for almost a century.

The geographic scope of the Directive applies to all entities, irrespective of physical location, with a significant digital presence in the EU

A Significant Digital Presence is when a PE is taken to exist in a Member State where digital services are supplied through a digital interface and **one or more** of the following conditions are met during a tax period:

a) **total revenues** from the supply of those digital services to users located in that Member State exceeds €7 million
b) the **number of users** of one or more of those digital services who are located in that Member State in that tax period exceeds 100 000
c) the number of **business contracts** for the supply of any such digital service that are concluded by users located in that Member State exceeds 3 000

The revenues earned by entities and their associated enterprises is aggregated when applying these thresholds.

Once an SDP has been established in a Member State, the profits attributable to that Member State are taxable within its national corporate income tax system.

Concerning the calculation of attributable profits, the SDP would be treated as a hypothetical separate entity with profits appropriate for the functions it performs, the assets it uses and the risks it assumes in connection with DEMPE (see glossary) functions. The relevant economically significant activities include:

a) the collection, storage, processing, analysis, deployment and sale of user-level data
b) the collection, storage, processing and display of user-generated content
c) the sale of online advertising space
d) the making available of third-party created content on a digital marketplace
e) the supply of any digital service not listed in points (a) to (d)

To determine attributable profits, the *profit split method* shall be used unless the taxpayer can demonstrate an alternative approach – based on internationally accepted principles – more accurately reflects the results of the functional analysis.

REACTIONS

Gaining political agreement on the DST was prioritised over the SDP. This was due to both the perceived political urgency (to avoid national unilateral measures) and the acceptance that the SDP would be a fundamental change in taxing rights, requiring more time for agreement.

Whilst the DST had support from some of the larger EU economies, there were equally some Member States that saw the proposals as potentially damaging and harmful to their local digital companies. The US was also hostile, claiming that the DST proposal has been 'designed to discriminate against US companies and undermine the international tax treaty system'[9].

Opposition from certain Member States continued - accordingly, in December 2018, Germany and France proposed a measure with reduced scope, to cover only income arising from advertising sales. Even this was politically unacceptable to some Member States so after the March 2019 ECON meeting the Commission stopped further work on the DST proposal.

The DST and SDP are still formal proposals. The Commission has indicated that it will re-start work on the files should the OECD's work prove fruitless.

The Commission also considered that the proposal had been successful - by persuading Member States to base their own national DSTs on the Commission's proposal and for driving forward the OECD's timeline.

THE OECD'S RESPONSE

The OECD, working through the Task Force on the Digital Economy (TFDE) of the Inclusive Framework on BEPS, has continued to work on the broader tax challenges of the digital economy. It accelerated the publication of an interim report[10] in March 2018. In January 2019 it published a Policy Note, *Addressing the Tax Challenges of the Digitalisation of the Economy*[11].

This was followed in February 2019 by a Public Consultation[12] of the same name, setting forward 5 options in two separate pillars

- Pillar one – revised profit allocation rules, containing 3 proposals for discussion:
    - user participation proposal
    - marketing intangibles proposal

[9] https://www.finance.senate.gov/imo/media/doc/2018-10-18%20OGH%20RW%20to%20Juncker%20Tusk.pdf
[10] https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm
[11] https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf
[12] https://www.oecd.org/tax/beps/public-consultation-document-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy.pdf

  - Significant economic presence proposal
- Pillar two – global base erosion rules, containing 2 proposals for discussion
  - Income inclusion rule
  - Payment denial rule

Accountancy Europe responded to the Public Consultation.[13]

PILLAR ONE

Pillar one deals with the broader tax challenges to existing profit allocation and taxable nexus rules. In other words, they are proposals focused on reassigning the rights to tax the profits associated with the digital economy rather than increasing the amount of global profits subject to taxation. This requires consideration of how certain elements of the digital economy, particularly user participation and scale without mass, impact on the value creation process and how the value is to be assigned across different markets.

THE '*USER PARTICIPATION*' PROPOSAL

This looks at how developing an active and engaged user base impacts the value creation process, which is currently not always captured in the user's jurisdiction. It suggests that the current 'arm's length' principle is inadequate to deal with this form of value creation.

Due to the importance of user generated content and user data for these business models, this proposal would be restricted to three business models - social media platforms, search engines and online marketplaces.

For these business models, the profit allocation rules would be changed to allow an amount of profit to be allocated to jurisdictions where the business has an active and participatory user base - irrespective of whether the business has a physical presence.

To allocate profit to the user jurisdiction, the following approach is proposed:

- calculate the *residual* or non-routine profits of the business
- attribute a proportion of those profits to the value created by the activities of users, perhaps:
  - through quantitative/qualitative information, or
  - through a simple pre-agreed percentage
- allocate those profits between the jurisdictions in which the business has users - based on an agreed allocation metric, such as revenues
- give the jurisdictions a right to tax that profit, irrespective of whether a PE exists

MARKETING INTANGIBLES (MI) PROPOSAL

This approach also changes the taxable nexus and profit allocation rules, but it has a much broader scope than the *user participation* proposal.

Conceptually, it monetarises the positive attitude from customers and the use of their data by the **active intervention** of the company in the market. As marketing intangibles are very important to highly digitalised businesses, it is a way for market jurisdictions to assert taxing rights over such companies without ringfencing specific business models, as is the case with the user participation proposal.

To allocate MI profits to the user jurisdiction, two stages are required:

1. **calculate the residual profits attributable to MIs** - two approaches are:
   - using current transfer pricing principles – this is a 'bottom up' approach where MIs and their contribution to profit would need to be determined. The contribution to profit would be

[13] https://www.accountancyeurope.eu/consultation-response/oecds-public-consultation-on-addressing-the-tax-challenges-of-the-digitalisation-of-the-economy/

calculated based on the current rules and then again with the assumption that MIs (and their attendant risks) are allocated to the market jurisdiction

The difference between the two calculations would be the MI adjustment. This method retains the need to identify specific MIs and a calculation of their contribution to profits, based on the facts of each case

- using a revised residual profit split analysis based on mechanical approximations. First, determine 'routine' profit and deduct it from total profit, leaving residual profit. This could be done via a full transfer pricing analysis or via a mechanistic method, such as a mark-up on costs or on tangible assets

  Second, allocate the proportion of residual profit between MIs and other intangibles. Again, this could be done via a cost-based method or by more formulaic approaches, such as using fixed contribution percentages

2. **allocate MI income to each market jurisdiction**. This would be done using an agreed metric such as sales or revenue. The market jurisdiction is the place of consumption by the end consumer – for example, in the case of advertising, it would be the location of the customers targeted by the advertising rather than the location of the entity that paid for it.

SIGNIFICANT ECONOMIC PRESENCE PROPOSAL

Although this concept has been under discussion for some years, the *significant economic presence* proposal was a late introduction to the public consultation and lacks the detail of the other two.

Proponents of this concept contend that technological advances have rendered existing nexus and profit allocation rules obsolete. As such, it represents the proposal that would result in the most change to the existing international tax framework.

A taxable presence would arise when a '*purposeful and sustained economic interaction with the jurisdiction via digital technology and other automated means'* is indicated by certain factors, such as:

- sustained revenue generation
- existence of a user base and associated data input
- volume of digital data generated
- billing and collection in local currency or with a local form of payment
- maintenance of a website in a local language
- responsibility for the final delivery of the final product to the consumer or the provision of after sales service and support
- sustained marketing and promotional activity

Taxable profits would be the share of profits generated by the significant economic presence and would be taxed through the normal national corporate income tax system.

The apportionment of profits is discussed as a form of fractional apportionment. This would involve:

- the definition of the tax base to be divided
- determination of the allocation keys to divide that tax base
- weighting these allocation keys

For example, the tax base could be determined by applying the global profit rate of an MNE to the revenue it generates in a particular jurisdiction. This tax base would then be apportioned to particular jurisdictions by using sales, assets and employees as factors in the formula – this could be extended to include user involvement in value creation, where relevant.

The consultation also suggests that a withholding tax could also be imposed as part of this proposal.

ISSUES RAISED

All these proposals represent significant changes to the current international taxable nexus rules.

The OECD's public consultation acknowledges that there are challenges to overcome before any of these proposals can be implemented and that more technical consideration is necessary. Concerns were also raised at the Stakeholders' Meeting that took place in April 2019.

Obtaining political agreement was highlighted as a key issue – all these proposals assume the reallocation of taxing rights between different jurisdictions and there will, inevitably, be winners and losers. Obtaining political agreement from jurisdictions that will lose tax base will be difficult. Of the three proposals, the current indication is the MI proposal has the greatest chance for agreement – not least because it doesn't ringfence sections of the economy.

Dispute avoidance and resolution was another important issue raised. Reallocating taxing rights between jurisdictions increases the possibility of disputes between jurisdictions and the possibility of double taxation (or even unintentional non-taxation) on the same income. The OECD acknowledges the need for an enhanced dispute resolution process but there have been many calls for a **dispute prevention** process to minimise the chance that disputes will arise in the first place.

The user participation and MI proposals will probably add complexity to already very complex transfer pricing rules. It was felt that calculating residual profit is already very complex and that splitting it between different categories, and then between different jurisdictions, would make it even more difficult to implement.

Due to this complexity, there were many calls for simplified rules ('safe harbour' rules) that businesses could use to avoid the costs of full transfer pricing calculations. It was highlighted that in the United States, where such safe harbour rules exist, they are chosen by most businesses - even if this results in a sub-optimal tax position

It was considered by many that more work is required on how these proposals would apply to business to business transactions where the impact of user data and marketing intangibles may not be as easily traceable as for business to consumer transactions

PILLAR TWO – FIGHTING BASE EROSION

These proposals are designed to strengthen the existing BEPS actions on the belief that opportunities still exist to allow MNEs to set up base eroding structures. These provisions are not specific to digital businesses, albeit there is a view that digital businesses are better able to exploit such structures due to their reliance on intangible assets.

INCOME INCLUSION RULE

This would operate as a minimum tax provision, such as the United States' Global Intangibles Low-Taxes Income (GILTI)[14] legislation. It requires a shareholder with a significant interest in a corporation to bring into account a proportionate share of the income of that corporation that was not subject to tax at a minimum rate.

The tax would be calculated based on the local law of the shareholder with credit for any tax paid on the income in the 'low tax' jurisdiction. The rules would supplement rather than replace existing controlled foreign company (CFC) rules. For exempt foreign branches, this would operate by way of a switch-over rule

ISSUES

The consultation paper states that further technical work would be required on this proposal and highlights some key issues, including:

- types of entities covered and minimum level of ownership

[14] https://www.govinfo.gov/content/pkg/FR-2019-06-21/pdf/2019-12437.pdf

- the determination of the effective tax rate (i.e. a set minimum rate or a percentage of national tax rates)
- threshold and safe harbour provisions
- mechanisms for avoiding double taxation
- the compatibility of the provision with international and EU law

TAX ON BASE ERODING PAYMENTS

This proposal is designed to allow the jurisdiction that is the source of the income to protect its tax base by denying relief for payments where the corresponding income has been subject to a low effective tax rate – an example of this is the United States' Base Erosion and Anti-Abuse Tax (BEAT)[15] legislation.

The effective tax rate would account for any withholding tax imposed on the payment. The proposal suggests a 25% common ownership test – as suggested in the income inclusion rule and BEPS Action 2 on hybrids.

The proposal suggests that the rule should apply to a broad range of payments – including where an undertaxed payment is 'imported' into the payer's jurisdiction that is otherwise outside the scope of the rule. To complement this rule, a 'subject to tax' rule would also be included that applies to undertaxed payments that would otherwise be eligible for relief under a double tax treaty.

ISSUES

Again, the consultation paper states that further technical work would be required on this proposal – which highlight broadly the same issues relating to the design of the income inclusion rule.

WHAT NEXT?

The OECD has continued work on these proposals through the TFDE, under the aegis of the Inclusive Framework.

On 31 May 2019 it published a detailed work programme[16]. All the elements of Pillars One and Two are still included – the Pillar Two proposals have been rebranded as GloBE (Global anti-Base Erosion). The programme has three categories of technical issues that need to be resolved:

- different approaches to determine the amounts of profits subject to the new taxing right and the allocation of those profits among the jurisdictions
- the design of a new nexus rule to reflect business presence in a market jurisdiction without the necessity of a physical presence
- legislative instruments to ensure full implementation and efficient administration of the new taxing rights – including the elimination of double taxation and the resolution of disputes.

The work programme also includes economic analysis and impact assessment.

The work will be split between several working parties. A progress report and political agreement is anticipated by December 2019 and a consensus-based, long-term solution is hoped for by the end of 2020.

At the Stakeholders' Meeting in April, the OECD committed to further public consultation on any revised proposals.

[15] https://www.irs.gov/pub/irs-drop/reg-104259-18.pdf
[16] http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm

ANNEX 1: TAXING THE DIGITAL ECONOMY: NATIONAL INITIATIVES

AUSTRIA

Austria has been working since January 2019 on a planned national DST, targeting tech companies to 5% of their advertising revenue - up from the previous 3%. The rate increase is part of a package of measures targeting large digital businesses and all business with global revenues of at least €750m and domestic revenues of €10m. The package also includes lowering the VAT threshold for small consignment packages entering the country.

The third measure aims at the taxation of online sharing platforms - for example, those involved in tourism. Operators would be obliged to report certain relevant information to the tax authorities facilitating the imposition of taxes. In addition, operators could be held liable to enforce reporting obligations.

The government hopes to raise more than €200 million a year and expects the parliament to vote on the proposal before August. If the package of legislation passes, the measures would become effective from 1 January 2020.

On 4 April, the federal law enacting the Digital tax Act 2020[17] was published. The assessment period ended on 9 May. [18]

Following the ongoing political crisis in the country, the bill is not a priority of the government.

BELGIUM[19]

On 23 January 2019, two bills were submitted in the Chamber of Representatives.[20] Given the current political situation it is doubtful that these bills will be adopted during the current legislative term. At this time, no mention has been made of any retroactive application upon their eventual implementation.

Provisional taxation of the most important digital services:

The first bill aims to introduce a provisional national tax on the most important digital services of the online giants. The tax targets enterprises with a total global revenue exceeding €750 million and a total taxable revenue in the EU of at least €50 million, when the user is in Belgium at the moment the taxable service is provided (localisation based on the IP address).

The Belgian DST involves a provisional tax of 3% on revenues from three main services if their greatest value is created by users, including the online posting of advertising messages aimed at the users of a platform, the sale of data collected about users; and the offering of digital platforms facilitating interaction between users and the supplying of goods and services between users.

This proposal has elements in common with the European Commission's DST proposal.

Harmonisation of corporation tax for digital activities

The second bill provides for an extension of the concept of "Belgian institution" to include a "significant digital presence". This occurs when an enterprise in Belgium satisfies one or more of the following criteria:

- the revenue from the provision of digital services to users in a jurisdiction exceeds €7 million during a financial year
- the number of users in a Member State exceeds 100,000 during a financial year
- The number of business agreements for the provision of digital services that are concluded by users exceeds 3,000

[17] https://www.bmf.gv.at/steuern/Text_DiStG_Beg.pdf?6x1a07
[18] https://www.bmf.gv.at/steuern/Digitalsteuerpaket.html
[19] https://www.bdo.be/en-gb/news/2019/belgium-jumps-on-the-bandwagon-to-tax-online-giants
[20] http://www.dekamer.be/FLWB/PDF/54/3483/54K3483001.pdf

Just as for the provisional taxation, the location of a user is identified using the IP address of the user's device. This proposal has elements in common with the European Commission's SDP proposal.

CZECH REPUBLIC

The Czech Finance Ministry announced on 30 April a new legislative proposal setting out a 7% national digital tax[21].

The tax would apply to advertising and to the sale of user data on internet platforms that have global revenue of more than €750 million. The country has yet to set a minimum threshold for domestic revenue generated in the Czech Republic.

On 20 May, the government released its budget plans in which the DST should raise around 5 billion crowns. The bill should be effective at the start of 2020.

FRANCE

The French government unveiled its proposal on 6 March 2019[22]. Modelled along the provisions of the European Commission's DST, the proposal targets companies with a global turnover of €750 million and a French turnover of €25 million. These will be subject to a national 3% digital turnover tax.

It will cover targeted online advertising, the sale of data for advertising and the linking of internet users by platforms. The tax is deductible on corporate taxes paid. The French authorities predict the tax to collect €400 million this year, and gradually increase to yield €650 million in 2022.

The proposal was adopted by the French National Assembly at first reading with 55 votes in favour[23]. The French Senate voted on the bill on 22 May, with 180 votes in favour and 4 against. Minor changes have been brought to the text adopted by the National Assembly. More information from the government could be given in the coming months.

The provisions are intended to be retroactive with effect from 1 January 2019. Concerns[24] have been raised that these measures could breach the EU principles of freedom of establishment and free competition.

ITALY

Italy's tax bill would target companies with a global turnover of more than €750 million worldwide and at least €5.5 million in Italy derived from revenue from online advertising and the sale of user data.

The parliament passed a bill in December, but a decree from Italy's tax authority is still necessary to understand how the tax will apply. Italy missed an April 30 deadline to release the guidance. The tax would become effective 60 days after that decree is published.[25]

In line with the proposed European Union DST, the Italian DST is an indirect tax of 3%.

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[21] https://www.mfcr.cz/cs/aktualne/tiskove-zpravy/2019/ceska-republika-zavede-digitalni-dan-ve-35090
[22] http://src.bna.com/F9D
[23] http://www2.assemblee-nationale.fr/documents/notice/15/ta/ta0256/(index)/ta
[24] https://www.linformaticien.com/actualites/id/51641/taxe-gafa-la-liste-des-29-entreprises-qui-seraient-concernees.aspx
[25] https://news.bloombergtax.com/daily-tax-report-international/digital-tax-impasse-pushing-more-countries-to-go-it-alone

POLAND

Poland's government aims to introduce a DST of 3% effective in 2020. The measure would be modelled on the EU's DST proposal: establishing a virtual taxable presence for companies that meet thresholds for revenue, users, and contracts for digital services; and targeting revenue from services like online advertising and user data, the official said.

The government is expected to publish a formal proposal for the tax in June.

SPAIN

The re-elected socialist government of Spain, led by Prime Minister Pedro Sanchez, announced increases to corporate and income taxes, as well as the introduction of a digital tax on online services of 3%[26]. The net effect on revenue is expected to be €1.7 billion from cutting corporate tax exemptions, €1.2 billion from a levy on digital services and €850 million from a levy on the financial transactions. Overall, the government intends to increase taxes by more than €20 billion.

UK

The proposed measure targets companies that generate more than £500 million of global revenue and U.K. digital sales in excess of £25 million.

The measure would impose a 2% tax on revenue from social media platforms, search engines, and online marketplaces that are "linked to the participation of U.K. users."

The findings of a public consultation closed in February should be published this summer. The government has indicated that it will include its DST as part of its Finance Bill 2019, which will become effective in January 2020, with the first tax bill with effect from April 2020.

WHO'S NEXT?

THE NETHERLANDS AND GERMANY

The Netherlands has joined Germany in supporting the introduction of a global minimum tax. They announced their position in a joint statement, in which both countries commit to engaging on further work on a global minimum tax standard. They two countries also commit to take into account risks of double taxation and administrative burdens. It appears that the Netherlands prefers a global minimum tax to a destination-based solution to the digitalised economy, as sought by the US and China in particular.

[26] https://www.neweurope.eu/article/digital-taxes-to-bolster-spains-revenue/

ANNEX 2 – DIGITAL TAX: THE EARLY DAYS

Although ecommerce can be traced back to CompuServe, founded in 1969, modern web-based ecommerce only started in 1994 with the introduction of Netscape's Navigator web browser and the formation of Amazon – followed by eBay in 1995.

Even at an early stage, the importance of ecommerce and its potential for distorting tax revenues was not lost on legislators.

Initial concepts included the possibility of using the internet as a new source of taxation - partly to shift the tax base and to reduce the amount of 'junk' being transmitted. This so-called 'bit-tax'[27] concept did not gain acceptance but the wider implications of the impact of an increasingly digitalised economy were recognised and a report, *Electronic Commerce: Taxation Framework Conditions*[28], was presented by the OECD's Committee on Fiscal Affairs at the Ottawa Ministerial meeting of the G20 in October 1998.

THE OTTAWA TAXATION FRAMEWORK CONDITIONS

The report from that meeting concluded that not only did the emerging technology offer significant new opportunities to improve taxpayer service but also that the '*taxation principles which guide governments in relation to conventional commerce should also guide them in relation to electronic commerce*'. It was decided that the digital economy should not be faced with discriminatory treatment and certain broad taxation principles should apply to ecommerce, namely:

I. neutrality – taxes should be neutral between different types of business
II. efficiency – minimise compliance costs for taxpayers and authorities
III. certainty and simplicity – rules should be clear and simple to understand
IV. effectiveness and fairness – produce the right amount of tax at the right time; avoiding double taxation and unintentional non-taxation
V. flexibility – flexible and dynamic enough to keep pace with technological and commercial development and the developing needs of governments

This framework is still considered to be an important reference point when developing new policy proposals.

The report mentioned that one of the factors to be considered in any changes to existing international tax principles was '*to achieve a fair sharing of the tax base from electronic commerce between countries and to avoid double taxation and unintentional non-taxation*'. However, at this point, much of the focus was on consumption taxes - albeit a technical expert group was set up to examine how ecommerce interacted with tax treaty rules on business profits.

As ecommerce began to grow and new business models emerged, work continued[29] as to how the digitalised economy would impact the international framework on direct taxation - the post Ottawa agenda already highlighted issues with:

- determination of taxing rights – including issues regarding PE
- classifying income for taxation purposes
- issues with the existing transfer pricing framework
- avoiding harmful tax competition for e-commerce

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[27] Soete, Luc & Karin Kamp, "The BIT TAX": the case for further research, MERIT, University of Maastricht, the Netherlands.
[28] https://www.oecd.org/tax/consumption/1923256.pdf
[29] 'Taxation and Electronic Commerce Taxation and Electronic Commerce – Implementing the Ottawa Taxation Framework Conditions'
https://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf

However, this remained a low priority until digital companies came under the spotlight as part of concerns about multi-national corporations' tax strategies.

ANNEX 3 – ADDITIONAL RESOURCES

Summary of VAT\GST measures to tax the digital economy https://blog.taxamo.com/insights/international-digital-tax-trends

Summary of VAT\GST measures to tax the digital economy https://quaderno.io/blog/digital-taxes-around-world-know-new-tax-rules/

Review of certain global digital tax initiatives https://news.bloombergtax.com/daily-tax-report-international/digital-tax-impasse-pushing-more-countries-to-go-it-alone

Review of certain global digital tax initiatives https://taxfoundation.org/digital-taxation-wave/

GLOSSARY

DEMPE – an acronym introduced by BEPS Action 8, the appropriate compensation that a member of a multinational group should receive is related to its contribution of the ***Development, Enhancement, Maintenance, Protection and Exploitation*** of the enterprise's intangible assets. It may not necessarily correlate to the legal ownership of the intangible assets in question

Fractional\formulary apportionment - also known as *unitary taxation*, is a method of allocating corporate profit earned to a particular tax jurisdiction in which it has a taxable presence. Formulary apportionment treats the corporation as a single entity and allocates the overall group profit or loss to each jurisdiction - based on factors such as the proportion of sales, assets or payroll in that jurisdiction. It is an alternative to separate entity accounting, under which a branch or subsidiary within the jurisdiction is accounted for on a stand-alone basis, requiring prices for transactions with other parts of the corporation or group to be assigned according to the arm's length standard commonly used in transfer pricing. When applied to a corporate group, formulary apportionment requires combined reporting of the group's results. An example is the European Commission's proposal for a Common Consolidated Corporation Tax Base[30]

Residual profits - the profits that remain after routine activities have been allocated an arm's length return

Routine profits – the profits that could be earned by a comparable business that did not have unique or valuable intangible assets

Taxable nexus – the amount or degree of business activity that must be present in a jurisdiction before the jurisdiction has a right to tax a particular entity

[30] https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en

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