Digital Economy

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BEPS Action Item 1 Final Report: Tax challenges of the Digital Economy

BEPS Action 1: Outline

BEPS Action Item 1 identifies the three main tax policy concerns peculiar to the digital economy:

1. Nexus
2. Data
3. Characterization

BEPS Action 1: Nexus

In digital economy, an enterprise may be able to establish 'significant digital presence' in the Source State without attracting tax liability.

BEPS Action 1: Data

Issue: Determination of value creation through data generated with help of digital products and services.

BEPS Action 1: Characterization

New business models give rise to income characterization issues.

BEPS Action 1: Potential Solutions

The BEPS Action 1 Final Report considered the following three options:

1. New nexus test in the form of significant economic presence requirement;
2. Withholding tax on certain types of digital transactions; and
3. Equalization levy.

BEPS Action 1: New Nexus Test SEP

Significant economic presence might be established on the basis of:

1. Revenue-based factor
2. Digital factor
3. User-based factor
4. Combinations of the revenue-based factor with other factors

BEPS Action 1: Withholding tax on digital transactions

Payments by Source State residents/ local PEs towards online sale of goods and services by non-resident sellers.

BEPS Action 1: Equalisation Levy

Possible 'solution' for resolving difficulties arising from the significant economic presence alternative.

BEPS Action 1: Equalisation Levy

Key features of the equalization levy considered in BEPS Action Item 1 Report:

- Imposed on gross value of the goods/ services sold to in-country customers/ users;
- Paid by in-country customers/ users;
- Alternatively, collected by the foreign enterprise through a simplified registration regime or collected through a local intermediary.

BEPS Interim Report Action 1 (March 2018)

Interim Report On BEPS Action 1 – Digital Economy:

Outline

1. Analysis of value creation across different digitalized business models.
2. Limitations of the contemporary international tax systems.
3. The taxation issues related to the digital economy.

Interim Report On BEPS Action 1 – Digital Economy:

Purpose

Identify points of divergence

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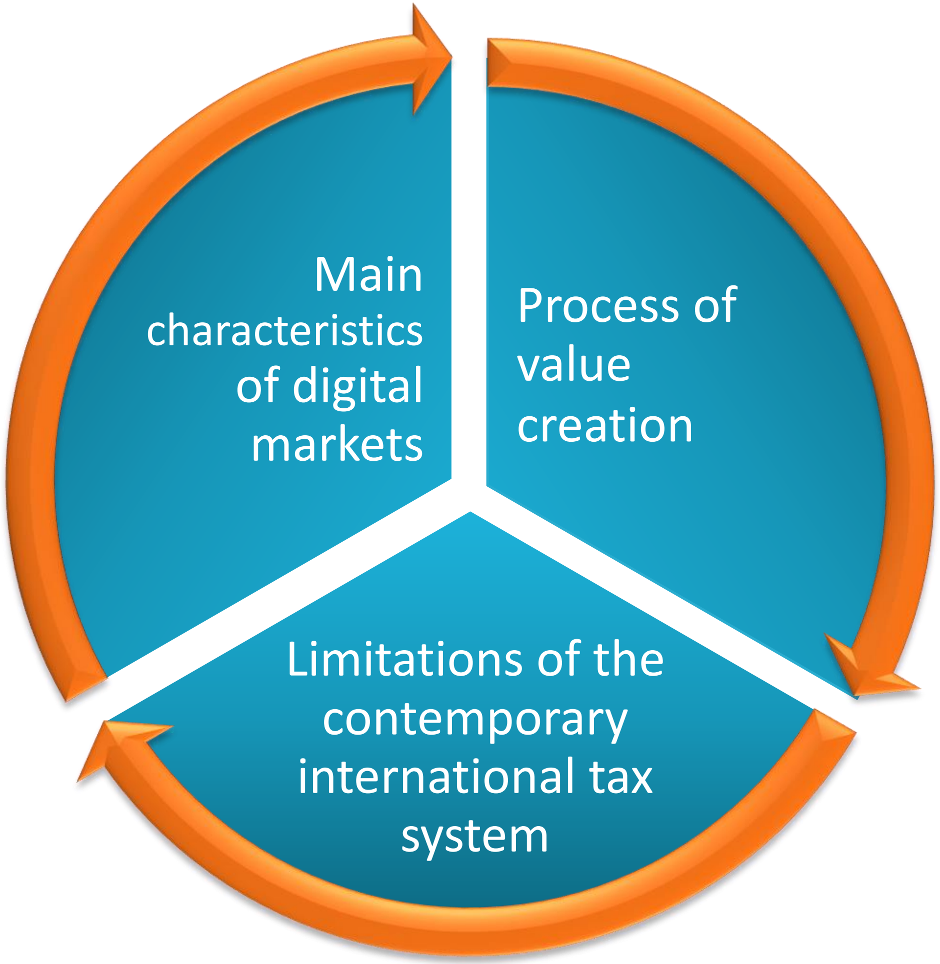
Lay down the groundwork for articulating a tax solution

Analysis of value creation across various digitalized business models

Digital Economy & Value Creation



Digital Economy & Highly Digitalized Companies

Key Features

1. Cross-jurisdictional scale without mass: Ability to participate in the economic lives in various jurisdictions without need for significant physical presence in those jurisdictions.

Digital Economy & Highly Digitalized Companies

Key Features

2. Role of intangibles including intellectual property: Highly digitalized enterprises leverage on intangibles, particularly intellectual property.

Digital Economy & Highly Digitalized Companies

Key Features

3. Data, user participation and their synergies with intellectual property

BEPS – Progress as of March 2018 with respect to digital economy

BEPS: Progress vis-à-vis digital economy

Apparent from the MLIs signed as of March 2018 that implementation of the tax treaty amendments recommended in the BEPS Action 7 Final Report is rather limited:

1. **17 percent** of the tax treaties: Amended for implementation of recommendation concerning dependent agency PE provisions.
2. **22 percent** the tax treaties: Amended for implementation of the anti-fragmentation measures.

Digital PE – the EU version

Digital PE: The EU Version

The EC has recommended through a resolution (dated 21 March 2018) that the Member States should renegotiate tax treaties and incorporate the following features:

1. Expansion of the "permanent establishment" definition;
2. Thresholds for existence of significant digital presence;
3. When is a user regarded as located in a jurisdiction?

Digital PE: The EU Version

4. Rules for income attribution;
5. Relevance of the DEMPE functions; and
6. Profit split method.

Developments in Select Jurisdictions

India:
Equalisation levy

Digital Economy: India’s Approach

- India’s approach for taxing digital economy transactions differs from that of other jurisdictions;
- Other jurisdictions (e.g. Russia, Belarus, New Zealand) have preferred imposition of indirect tax;
- India has preferred imposition of ‘equalization levy’.

Indian Equalisation Levy

Indian Equalisation Levy: Important Features

Applicable

Effective from 1 June 2016, through The Finance Act, 2016.

Indian Equalisation Levy: Important Features

Rate and Charging event

At the rate of six percent on the payment of consideration, for any *specified service*, receivable by a non-resident person from a resident of India carrying on business or profession in India, or from a non-resident having a PE in India.

Indian Equalisation Levy: Important Features

Specified Service

Specified service" means *online* advertisement, any provision for digital advertising space or any other facility or service for the purpose of online advertisement and includes any other service as may be notified by the Government of India in this behalf.

Indian Equalisation Levy: Important Features

Objective

To *neutralize* 'unfair advantage' (as per a Committee constituted by the Central Board of Direct Taxes (CBDT)) enjoyed by certain foreign enterprises on account of absence of tax liability in India.

India:
Significant economic presence (SEP)

India: SEP

The Indian Finance Bill, 2018 has introduced the following provision in Sec. 9(1)(i) of the Indian Income Tax Act 1961, w.e.f. 1 April 2019:

“**Explanation 2A.**––For the removal of doubts, it is hereby clarified that the significant economic presence of a non-resident in India shall constitute “business connection” in India and “significant economic presence” for this purpose, shall mean––

(a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or

India: SEP

transactions during the previous year exceeds such amount as may be prescribed; or
(b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:
Provided that the transactions or activities shall constitute significant economic presence in India, whether or not the non-resident has a residence or place of business in India or renders services in India:
Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.” [Emphasis supplied.]

But, that should not lead to any adverse implications for a foreign enterprise from a tax treaty jurisdiction.

Italy:
The Italian web tax

Italian Web Tax: Important Features

Applicable

Effective 1 January 2019.

Italian Web Tax: Important Features

Rate and Charging event

At the rate of three percent net of value added tax (VAT) on certain *transactions carried out through Internet* without much human involvement. It would apply equally in case of Italian (resident) as well as foreign (non-resident) enterprises.

Italian Web Tax: Important Features

Operation

This tax will operate in a manner *similar to a withholding tax*, and it would apply in case of specific transaction categories.

Italian Web Tax: Important Features

Exemption

A service provider with less than 3,000 global transactions per calendar year will be exempt from the web tax.

UK position paper on international taxation in digital economy

UK Position paper on international taxation in digital economy

- The UK's approach is aligned with the view that active participation of users in market jurisdictions creates value for the digital enterprises, even if those enterprises lack physical presence in the market jurisdictions.

- The UK government distinguishes between the customers of traditional enterprises (i.e. other than digital enterprise) and the users of certain digital platforms – on the basis that the users of digital platforms create value for the digital enterprises (through participation and content generation).

Taiwan:
Amendments to the VAT law

Taiwan: Amendments to the VAT law

The Taiwanese value added tax (VAT) law requires foreign enterprises, institutions, and groups - not having a fixed place of business in Taiwan – to register for VAT if:

1. They provide 'electronic services' to the Taiwanese individual customers; and
2. The annual sales of such services to the Taiwanese individual customers exceeds NT$480,000.

Taiwan: Amendments to the VAT law

Application

Such enterprises are obliged to collect VAT from the Taiwanese customers and deposit the same with the exchequer.

Taiwan: Amendments to the VAT law

Scope

"Electronic services" for the purposes of the Taiwanese VAT obligations includes digital content such as music, games, travel booking portals, etc.

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