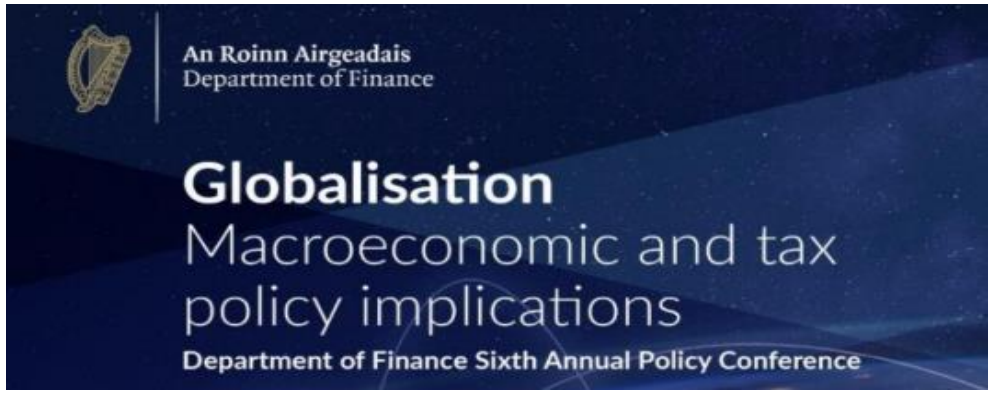
Digital tax landscape

Presentation by **Edwin Visser**
30 April 2019



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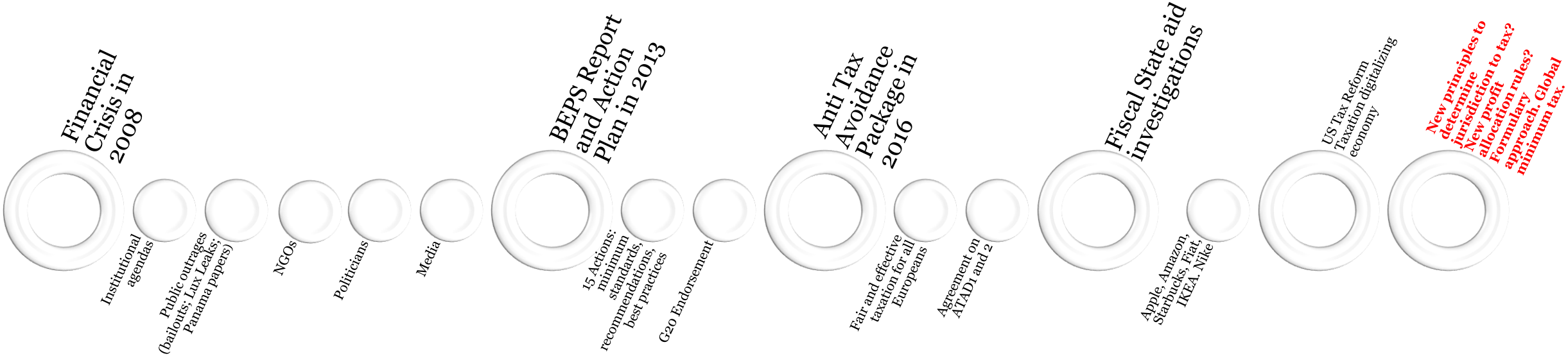
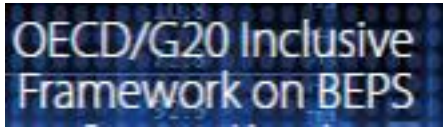
International developments, dynamics and players

International developments and dynamics





European Commission

European Council
Council of the European Union

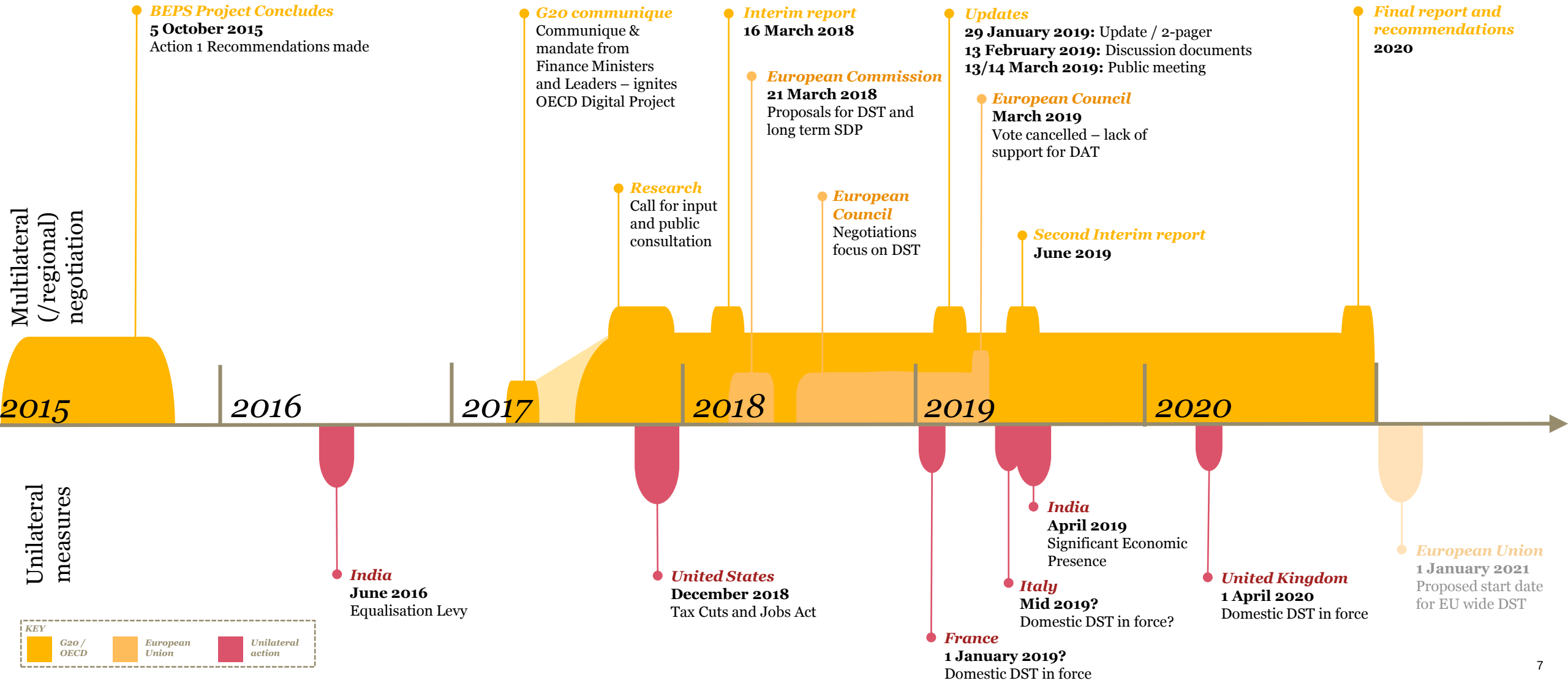
The BEPS Project – Key Themes

Coherence Improving interaction of corporate tax in different territories	**Substance** Aligning taxation with value-adding activity	**Transparency** Increased disclosure
Action 2: Neutralise the effect of hybrid mismatch arrangements	Action 6: Prevent treaty abuse	Action 11: Collect and analyse data on BEPS
Action 3: Strengthen CFC rules	Action 7: Prevent the artificial avoidance of PE status	Action 12: Disclosure of aggressive tax planning arrangements
Action 4: Limit base erosion via interest deductions and other financial payments	Actions 8-10: Assuring that transfer pricing outcomes are in line with value creation	Action 13: Transfer pricing documentation and country-by-country reporting
Action 5: Counter harmful tax practices more effectively		
Action 1: Address the challenges of the digital economy		
Action 14: Make dispute resolution mechanisms more effective		
Action 15: Develop a multilateral instrument		
Extend to wider stakeholder group – developing countries and international organisations		

Digital Tax Landscape

Background

Tax and the digitalization of the economy Timeline



Tax and the digitalization of the economy
Background – post-BEPS concerns raised

OECD Interim Report 2018

- Scale without mass
- Heavy reliance on intangible assets
- Data and user participation

Existing profit allocation rules

Existing nexus rules

- Ability to limit local functions and serve market remotely and limit/eliminate local functions
- Presence without taxing rights
- Significant presence without control of risk or material assets

Effectiveness of BEPS actions

- DEMPE / Risk
- Avoided PEs
- Treaty access
- Tax competition

Two pillars

Tax and the digitalization of the economy
OECD Update – 29 January 2019 – key points and perceptions in the media

"...the digitalisation of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalised businesses"

OECD Policy Note

The proposals may go beyond the arm's length principle and also consider innovative types of nexus that would not require a physical presence

OECD TaxTalks webcast

Christine Lagarde

An overhaul of the international tax system can wait no longer

...The public perception that large multinational companies pay little tax has led to political demands for urgent action. The call for a new approach is intense, and with good reason. The ease with which...

Widespread public support for tax on tech giants

European Parliament outraged by Council's deadlock on taxation of digital sector

Digital Tax Landscape

OECD: Two pillars, Four proposals

Tax and the digitalization of the economy
Pillar 1: Revised profit allocation and nexus rules: (A) User Participation

Rationale

- Activities and participation of “users” are a critical component of value creation, both absolutely and relatively
- This is only true for certain highly digitalised businesses

Business models in scope

- Social media
- Search engines
- Online marketplaces

Proposed methodology

- Calculate “residual” profits
- Attribute portion of residual to “user base”
- Allocate between jurisdictions where users are located
- Give rights to jurisdictions to tax these profits

Tax and the digitalization of the economy
Pillar 1: Revised profit allocation and nexus rules: (B) Marketing intangibles

Rationale

- Remote / limited access to markets can allow for development of large customer bases / user bases
- Customer data and relationships contribute to brand / marketing intangibles (more than favourable demand conditions alone)
- Distinction between “trade” and “marketing” intangibles

Option 1

- Update transfer pricing rules to recognise “marketing” intangibles (and risks) separate to “trade” intangibles
- Allocate to “market” jurisdiction based on agreed metrics (e.g. revenues or users)

Option 2

- Undertake a residual profit split (functional or formulaic) following allocation of routine functions
- Allocate to “market” jurisdiction based on agreed metrics (e.g. revenues or users)

Tax and the digitalization of the economy
Pillar 1: Revised profit allocation and nexus rules: (C) Significant Economic Presence

Rationale

- Similar to (B), would apply to all businesses considered to be generating value from interactions with customers/users
- However, intended to be simpler to apply for developing countries, and would thus be closer to global formulary apportionment in practice

Nexus: Revenue + (one or more of…)

- Users
- Volume of digital content derived
- Billing/collection currency
- Local payment systems
- Local language website
- Sustained marketing activities

Allocation: Fractional apportionment

- Define tax base to be divided (e.g. global profit margin * local sales)
- Use **weighted** allocation keys (e.g. users sales, assets, employees…)

Tax and the digitalization of the economy
Pillar 2: Global anti-base erosion proposal/global minimum tax

Rationale

- Existing BEPS rules do not provide comprehensive solution to risk of moving profits to low/no tax jurisdictions
- Particular concern in relation to intangibles (which are prevalent in highly digitalised businesses, among others)

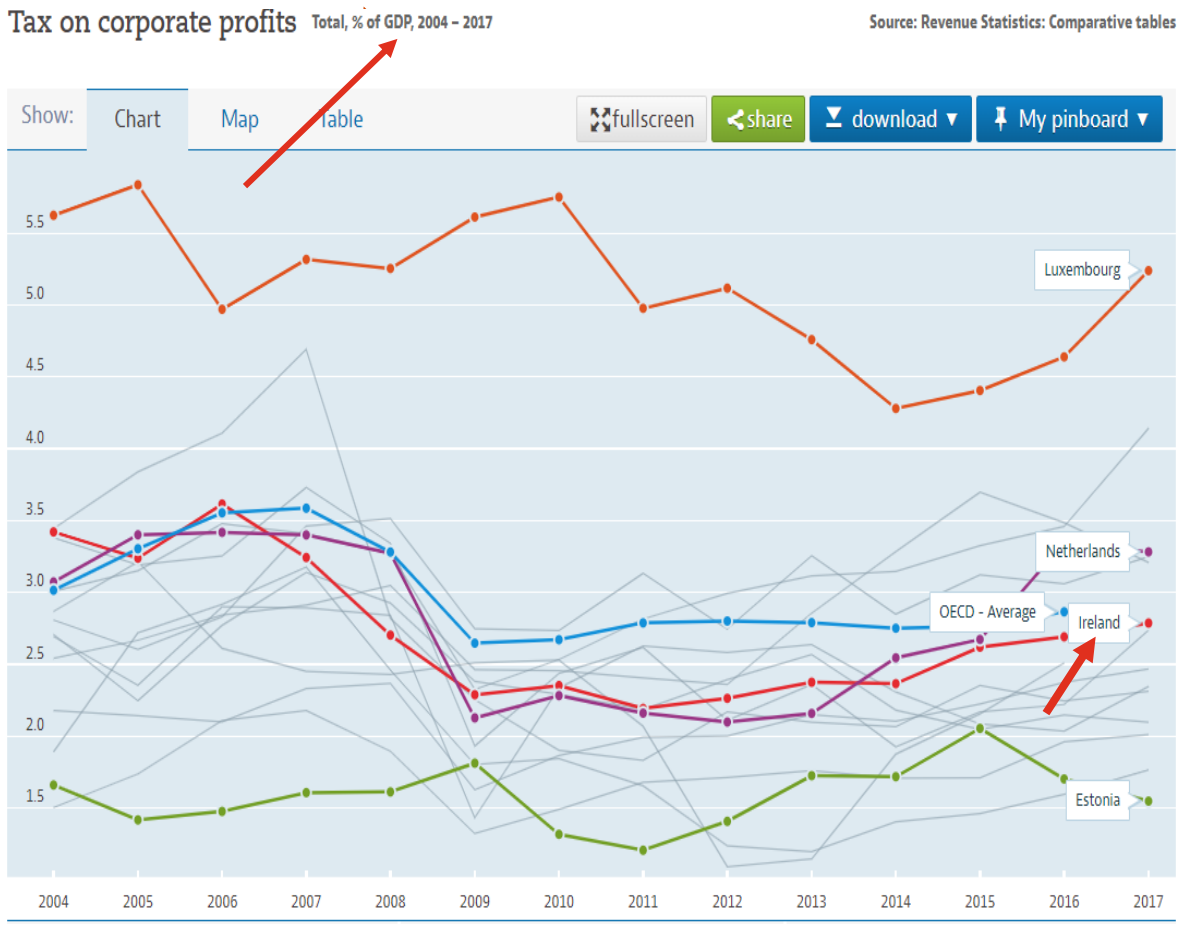
Income inclusion rule

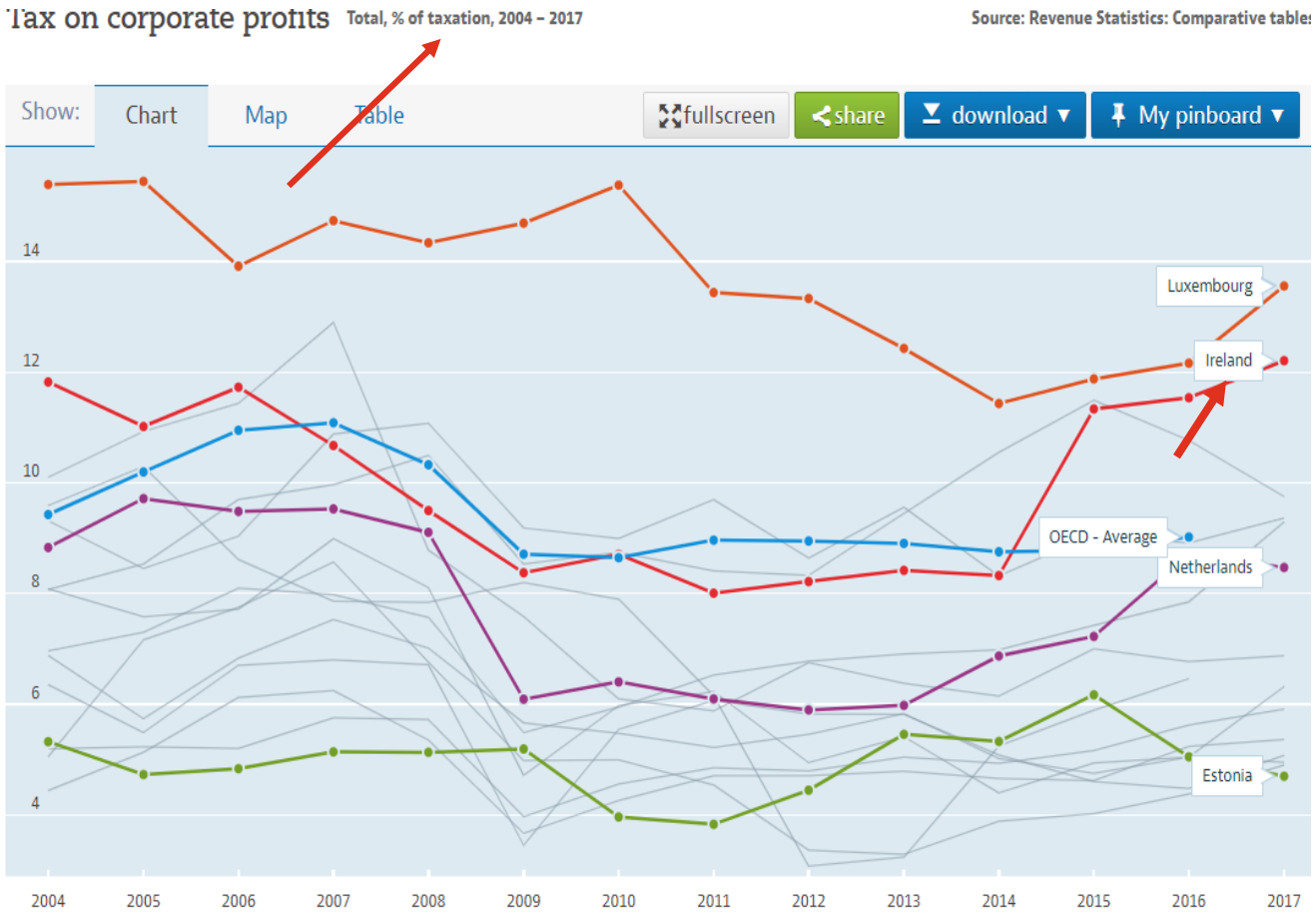
- Minimum taxation at shareholder level for significant direct / indirect ownership
- Foreign branch exemptions “switched” off if minimum tax not met
- Supplement (not replace) existing CFC rules
- EU could implement via Directive

Tax on base-eroding payments

- Denial of deduction for certain payments to related parties (common ownership) not subject to a minimum effective taxation by recipient
- Treaty benefit restriction where payments were “undertaxed” (limiting the application of Articles 7, 9, 10, 11-13 and 21) – some of which may also apply for third parties

Potential impact for Ireland





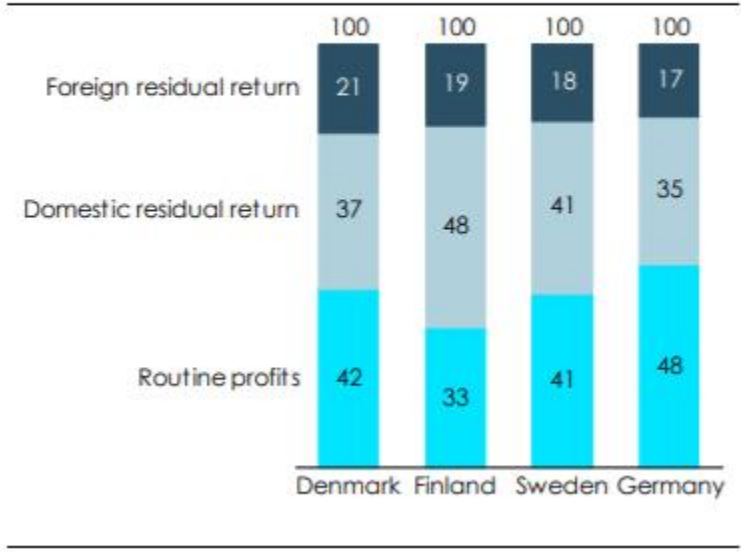
Potential impact for Ireland (2)

Figure 1 Marketing intangibles and other intangibles as a share of total enterprise value by sector, percent

Note: The definition of marketing intangibles is based on the IFRS 3 definition of marketing and consumer-related intangibles and equals the sum of the two. Furthermore, the results should be considered as indicative only according to the authors. See the appendix for a more detailed description.
Source: Brand Finance GIFT report 2017, pp. 33 & 47. Table 4: Copenhagen Economics based on OECD Structural Analysis (STAN) database

Source: Copenhagen Economics, 19 February 2019, Future taxation of company profits: what to do with intangibles?

Figure 2 Approximate distribution of tax revenue from routine and residual profits by country, 2017
percent



Observations:

- Exporting countries may face similar issues as the Nordics
- Pillar 1 and VAT
- Large exporting countries with higher tax rates could benefit from an agreement on a global minimum tax
- Interaction pillar 1 and pillar 2?
- Depending on design, a GMT could have serious impact on the position of small, open, exporting economies that have based their tax policy on capital import neutrality
- No impact analysis of the OECD yet
- Alternatives?

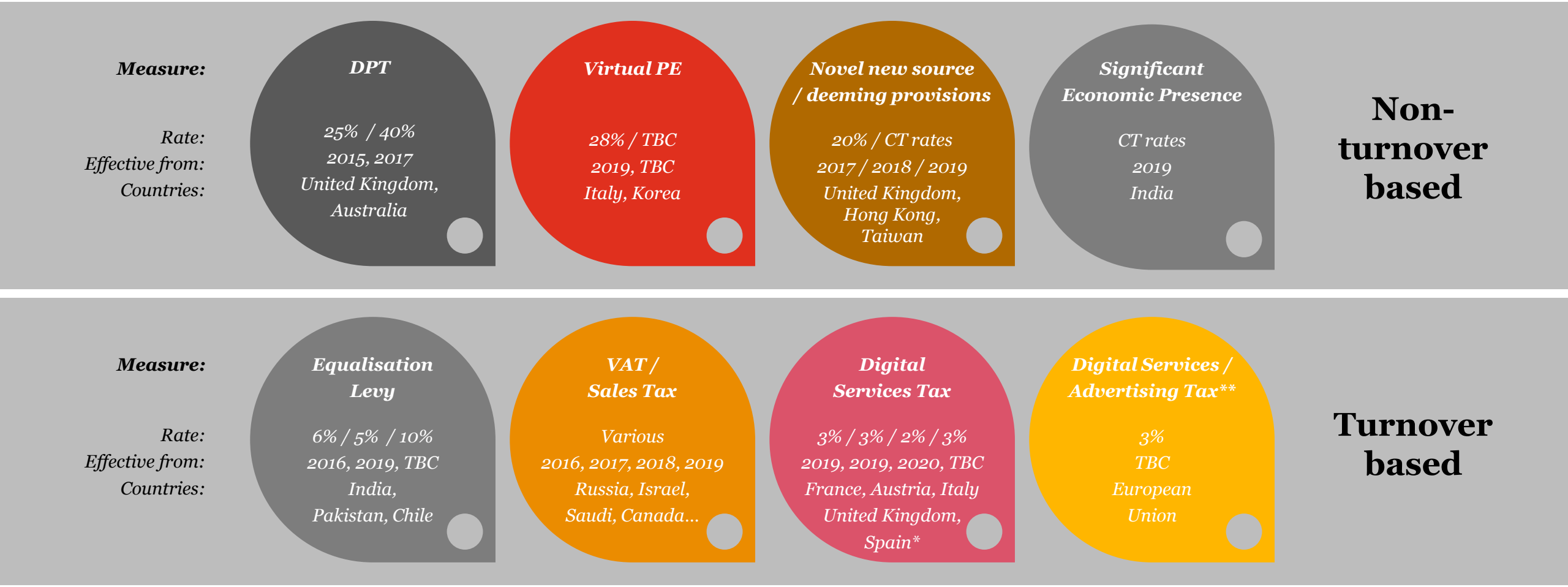
Conclusions Copenhagen Economics for the Nordic countries

- Loss of tax revenue
- Effective tax rates will increase
- Tax incentives to attract R&D intensive industries less effective
- Increased tax uncertainty
- High returns of successful firms shared globally, losses of unsuccessful firms absorbed locally

Digital Tax landscape

Unilateral measures

Tax and the digitalization of the economy
"Recent" unilateral measures



** Budget voted down – awaiting General Election*

*** Vote cancelled in March 2019 – may re-emerge from new Parliament and Commission in H2 2019*

Tax and the digitalization of the economy
EU proposals – latest developments

Long term solution

- Directive on Significant Digital Presence (i.e. digital PE)
- Threshold:
  - *3000 contracts; or*
  - *100,000 users; or*
  - *€7m revenues in a Member State*
- Scope:
  - *Broad – almost all digitally supplied services, except specific exemptions*
- Basis:
  - *Income allocated by profit split on destination favourable factors*
- Application:
  - *From January 1, 2020*

Not currently being discussed

"Interim" solution

- Directive for a common Digital Services Tax (DST)
- Threshold:
  - *€750m global turnover, with >€50m from EU*
- Scope:
  - *Advertising*
  - ~~*Intermediation platforms*~~
  - ~~*Transmission of user data*~~
- Basis:
  - *Where user (rather than payer or payee) is located*
- Rate:
  - *3%*
- Application:
  - ~~*From 1 January 2020*~~
  - *From 1 January 2021*
  - *Sunset clause – 2025, OECD or EU*

Vote cancelled due to lack of support – may re-emerge in H2 2019

Tax and the digitalization of the economy
EU unilateral measures

France, Italy, Austria, Spain*

- Local law intended to introduce European Commission's original proposals (following no agreement at EU level).
- Threshold:
  - *€750m global turnover*
    - *>€3m from Austria*
    - *>€25m from France*
    - *>€50m from Italy*
    - *>€TBC from Spain**
- Scope:
  - *Advertising (Austria, France, Italy, Spain*)*
  - *Intermediation platforms (France, Italy, Spain*)*
  - *Transmission of user data (Italy, Spain*)*
- Basis:
  - *Where user (rather than payer or payee) is located*
- Rate:
  - *3%*
- Application:
  - *From 1 January 2019 (France), mid-2019 (Italy), TBC (Austria & Spain*)*
- **Status: Enacting legislation / detail not yet available in any country; above based on original EC proposal and media reports**

United Kingdom

- Local law announced in advance of EU negotiations reaching initial conclusions. Tax based on user participation.
- Threshold:
  - *£500m global turnover, with >£25m from in scope, UK activities*
- Scope:
  - *Search engines*
  - *Social media*
  - *Online marketplaces*
- Basis:
  - *Direct or indirect revenues from activities in scope relating to UK users*
- Rate:
  - *2%*
  - *Safe harbour for low margin businesses (unclear how this margin / profitability will be calculated)*
- Application:
  - *From 1 April 2020*
- **Status: Domestic consultation running to February 19, 2019**

**Spanish Parliament rejected entire Budget in February 2019; although measure could be reintroduced at a later date*