Challenges for Taxation of the Digital Economy

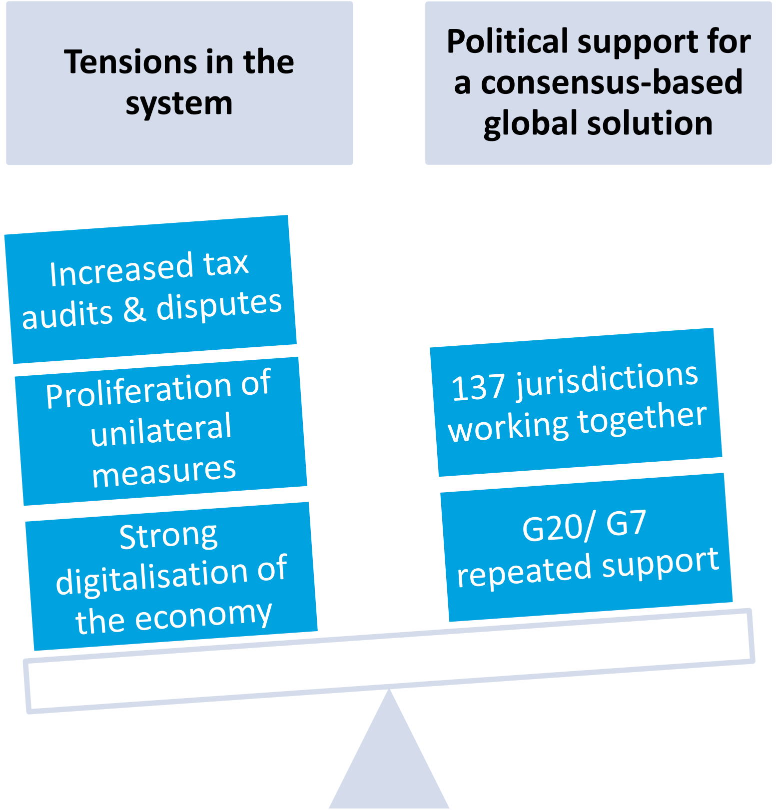
Leading Women in Tax

March 3, 2020

Panelists

- **Starling Marshall**, Partner, **Crowell & Moring** (moderator)
- **Linda Evans**, Director, Global Tax Policy, **IBM**
- **Ellen Kandel-Burg**, Executive Director – Corporate Tax, **JPMorgan Chase**
- **Grace Perez-Navarro**, Deputy Director - Centre for Tax Policy and Administration, **OECD**
- **Daniella Zagari**, Partner, **Machado Meyer Advogados**
- **Margriet Lukkien**, Tax Partner, **Loyens & Loeff** *(scheduled but unable to attend)*

State of Play



G20 mandate to arrive at a consensus-based solution by 2020

Two Pillars

Pillar One

Allocation of profits
and
new nexus rule

Pillar Two

GloBE

Economic analysis and impact assessment

Consensus-based long-term solution by the end of **2020**

Need for political endorsement & spirit of compromise

Pillar One

- Currently, businesses pay taxes based on their physical nexus with the taxing jurisdiction. However, as companies rely less and less on physical presence in order to drive revenue, this system of taxation may make less sense. Countries in which a company has no physical presence may be a large source of revenue for the company, but pay no tax to that jurisdiction.
- The OECD's proposal would reallocate taxing rights among countries, providing some thresholds and definitions for which companies might be impacted by the proposal, and has three separate categories of taxable profits that could be used to provide new taxing authority or create a baseline for taxing certain activities.

Pillar One Amounts

- Amount A: the deemed residual (non-routine) profit allocated to market jurisdictions
- Amount B: a fixed return for marketing and distribution activities in market jurisdictions
- Amount C: (i) additional amount beyond Amount B that should be taxed in a market jurisdiction, and (ii) binding and effective dispute prevention and resolution to minimize double taxation occurring under any of the elements.

Pillar One- Questions and Challenges

- Who is included?
  - Large businesses that meet threshold global revenue benchmarks and that are
    - "Consumer facing" businesses or
    - Automated digital services
- Taxing rights only for markets in which the company has a "sustained and significant involvement in the economy"
  - Definition of term
  - Is this a disincentive to businesses launching in new markets?
- Pillar One carve out proposal by United States

Pillar Two

- The consultation document describes the four rules under the Pillar Two or GloBE proposal as follows:
  - An income inclusion rule that would tax the income of a foreign branch or a controlled entity if that income was subject to tax at an effective rate that is below a minimum rate;
  - An undertaxed payments rule that would operate by way of a denial of a deduction or imposition of source-based taxation (including withholding tax) for a payment to a related party if that payment was not subject to tax at or above a minimum rate;
  - A switch-over rule to be introduced into tax treaties that would permit a residence jurisdiction to switch from an exemption to a credit method where the profits attributable to a permanent establishment (PE) or derived from immovable property (which is not part of a PE) are subject to an effective rate below the minimum rate; and
  - A subject to tax rule that would complement the undertaxed payment rule by subjecting a payment to withholding or other taxes at source and adjusting eligibility for treaty benefits on certain items of income where the payment is not subject to tax at a minimum rate.

Pillar Two Questions and Challenges

- Determination of tax base
- Blending of rates
- Carve outs and thresholds
- “White listing” GILTI

Unilateral DST measures

- Around the globe unilateral Digital Services Tax (DST) measures are being introduced or considered by a multitude of countries

Norway

Poland

Canada UK Belgium Austria Czech Republic Malaysia South Korea

Thailand

France Italy Slovenia Hungary

Greece Turkey Indonesia

India

Chile Spain Egypt Israel New Zealand

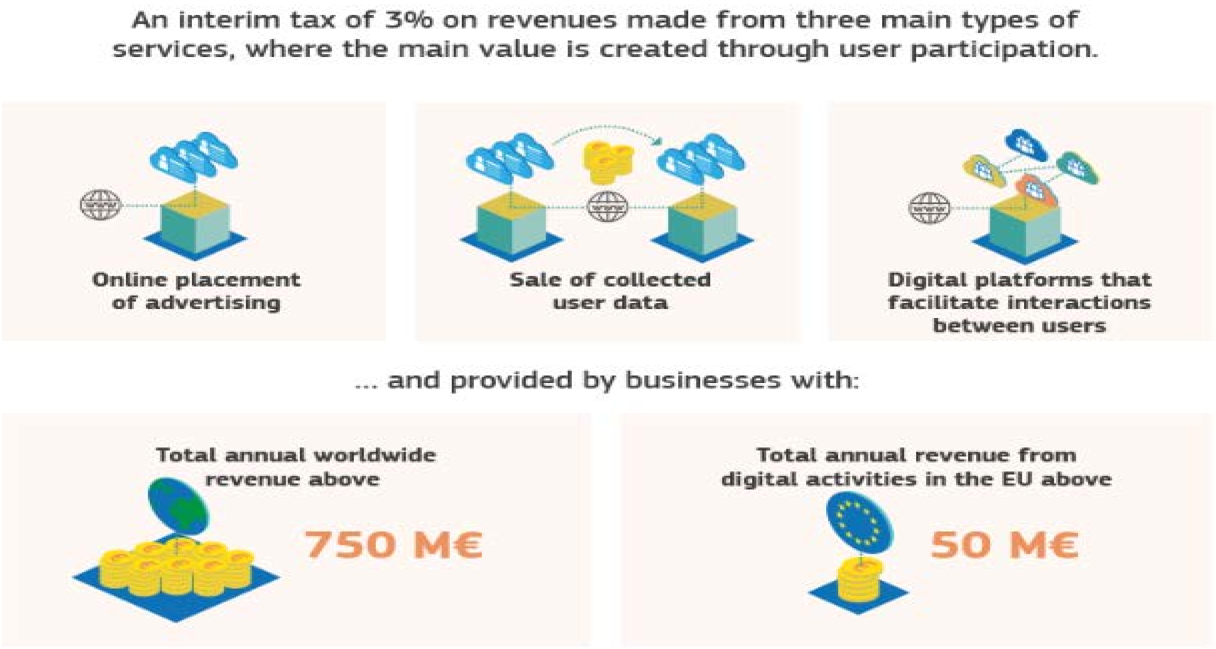
Ivory Coast Australia

EU Initiatives

EU proposals

- Initiatives are coming from individual EU member states, after the EU failed to reach agreement
  - In March 2018, the European Commission published its own two proposals for directives on the fair taxation of the digital economy, trying to ‘overtake’ the OECD:
    - A DST as an interim measure;
      - Basically 3% over revenue on 3 main types of digital services
    - A ‘digital permanent establishment’ (**PE**) as long term solution.
      - Basically a significant digital economic presence

EU DST Proposals



Various questions around the EU DST proposal (1/2)

Characteristics	DST	Questions/Comments
Time horizon	"Interim" measure	No comprehensive sunset clause?
Compatibility with existing international tax framework	Outside of current framework	DST would in principle not be covered by tax treaties. Allocation of taxing rights based on residence of user / customer.
Digital services	Limitative list of specific categories of services	Attempt to take into account the differences in business models (e.g., leave out businesses with razor-thin margins, such as general online retail?); intragroup services excluded
Thresholds of size to fall within scope	Cumulative: global turnover and EU revenues from digital services	Preliminary expected impact: about 150 companies affected. WTO issues?

Various questions around the EU DST proposal (2/2)

Characteristics	DST	Questions/Comments
Rate	3% over revenue	Can push loss-making companies into further difficulties
Tax base	Turnover	Shift away from traditional income taxation
Place of taxation	Where users of digital services in scope are located: various proxies depending on type of service	Appropriate proxies? Impact on privacy / difficulty to comply with GDPR?
Allocation between countries	Proportion of “DST-taxable” revenues in a Member State to worldwide “DST-taxable” revenues	Shift away from arm’s length principle / BEPS Actions 8-10
Double taxation risk	High	No mandatory deductibility of DST from CIT base; in principle no tax treaty benefits

EU Initiatives

EU proposals

- There was a significant push-back from EU Member States on the DST proposal:
- Instead a 'lighter' version of the DST was proposed in the form of a digital advertisement tax (**DAT**), which was explored further in Q1 2019
  - DAT would be levied over digital advertising revenue only (at a rate of 3%).

EU Initiatives

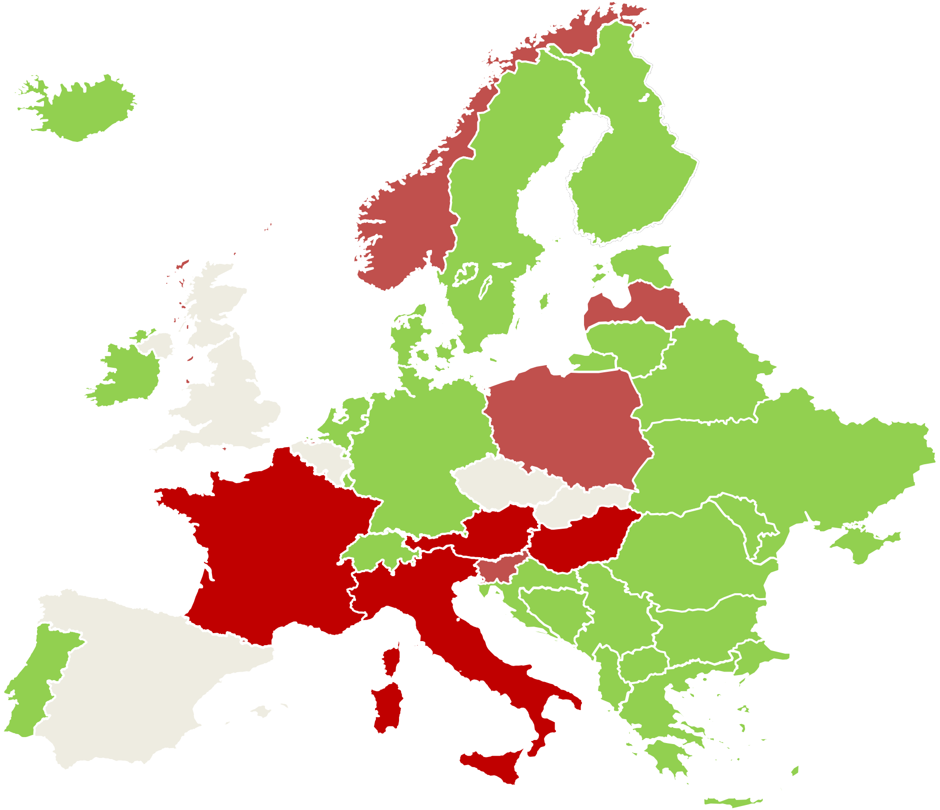
EU proposals

- Given the difficult discussions on reaching unanimous agreement of the EU Member States on the DST or DAT, the European Commission in addition proposed to change decision making on tax matters from unanimity to a qualified majority on 15 January 2019.
- That in itself requires unanimity.
- A number of jurisdictions, including the Netherlands, is opposed to this.
- The Ecofin discussions of 12 March 2019 revealed …

EU Initiatives

- Ecofin discussion of 12 March 2019:
  - Despite the broad support from a large number of EU Member States and the watered down and less far reaching DAT instead of the original DST, some EU Member States still have some concerns. Hence, so far no EU agreement was reached.
  - The EU presidencies have been working on the position of the EU in international discussions on this topic, particularly regarding the digital taxation proposals of the OECD.
- Despite all the efforts of the EU, the multilateral digital taxation ‘fight’ will continue via the OECD instead of the EU until at least the end of 2020!
- But in the meantime also some individual EU Member States take their own measures, inspired by the EU proposals

Map of National European developments



Implemented

Proposed

Announced

No action taken

National developments in the EU

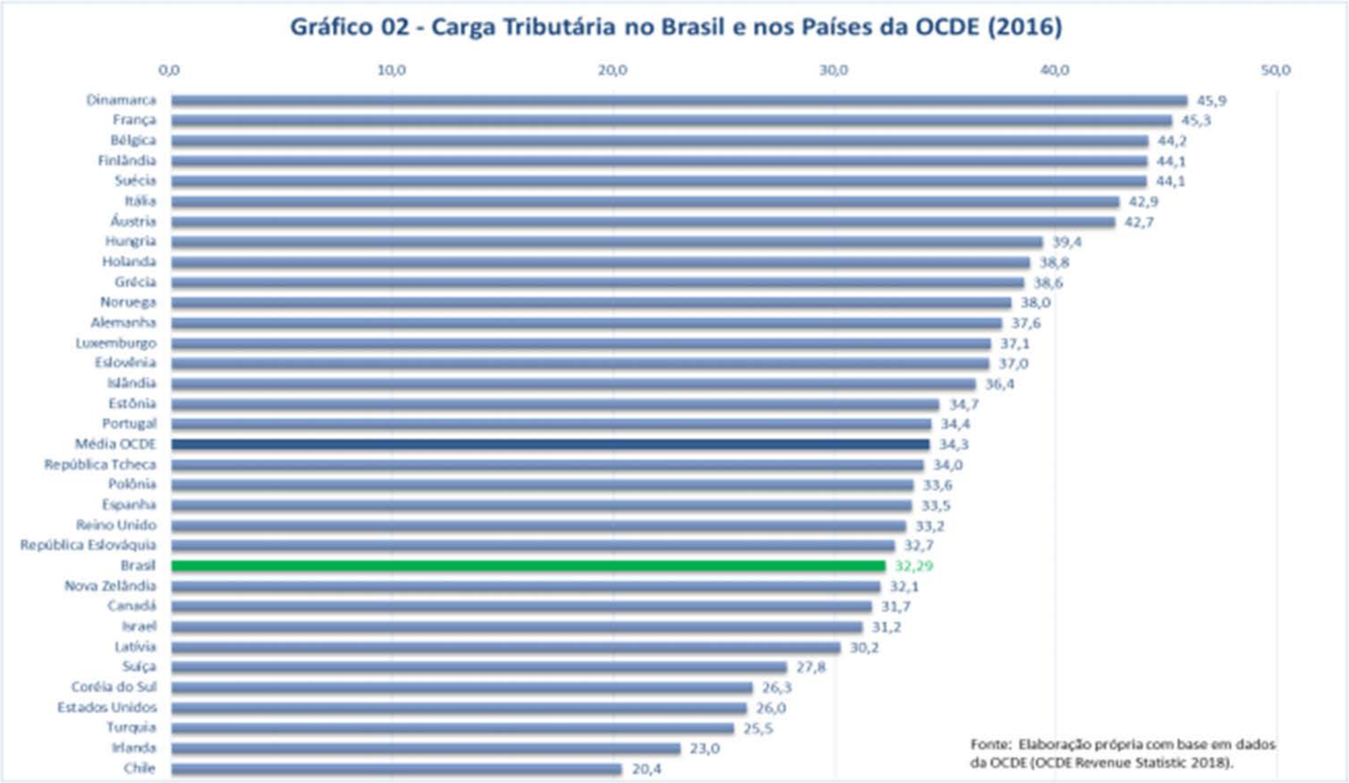
Country	Tax Rate	Revenue scope	Revenue threshold worldwide/EU
Austria	5%	Online advertising	€ 750 million / € 25 million
Belgium (proposal)	3%	Sale of user data, providing advertising services on digital platforms, use of multi-sided digital platforms	€ 750 million / € 50 million
Czech Republic (proposal)	7%	Targeted advertising, providing digital market places, sales of user data.	€ 750 million / CZK 100 million (€4 million)
France (Suspended till end 2020)	3%	Online platforms, advertising services based on users' data and sales thereof	€ 750 million / € 25 million
Hungary (effectively 0% till 31.12.2022)	7.5%	Online advertising	€ 300.000 / -/-
Italy	3%	Digital advertising, digital intermediation, sales of user data	€ 750 million / € 5.5 million
Spain (proposal)	3%	Online advertising, intermediary services and sales of user data	€ 750 million / € 3 million
United Kingdom (from 1 April 2020)	2%	Providing a social media platform, search engine or online marketplace	£500 million / £ 25 million (€ 554 million / € 28 million)

BRAZIL AND DIGITAL ECONOMY

- Digital tax solve Brazilian problem?
- Turnover taxes over digital companies in Brazil?
- In Brazil there are specific regulations that impose companies to have physical presence and so subject to normal taxation.
- The argument for the taxation of digital economy in Brazil based on the lack of taxation of such digital companies is not accurate.
- High rates over consumption and services.

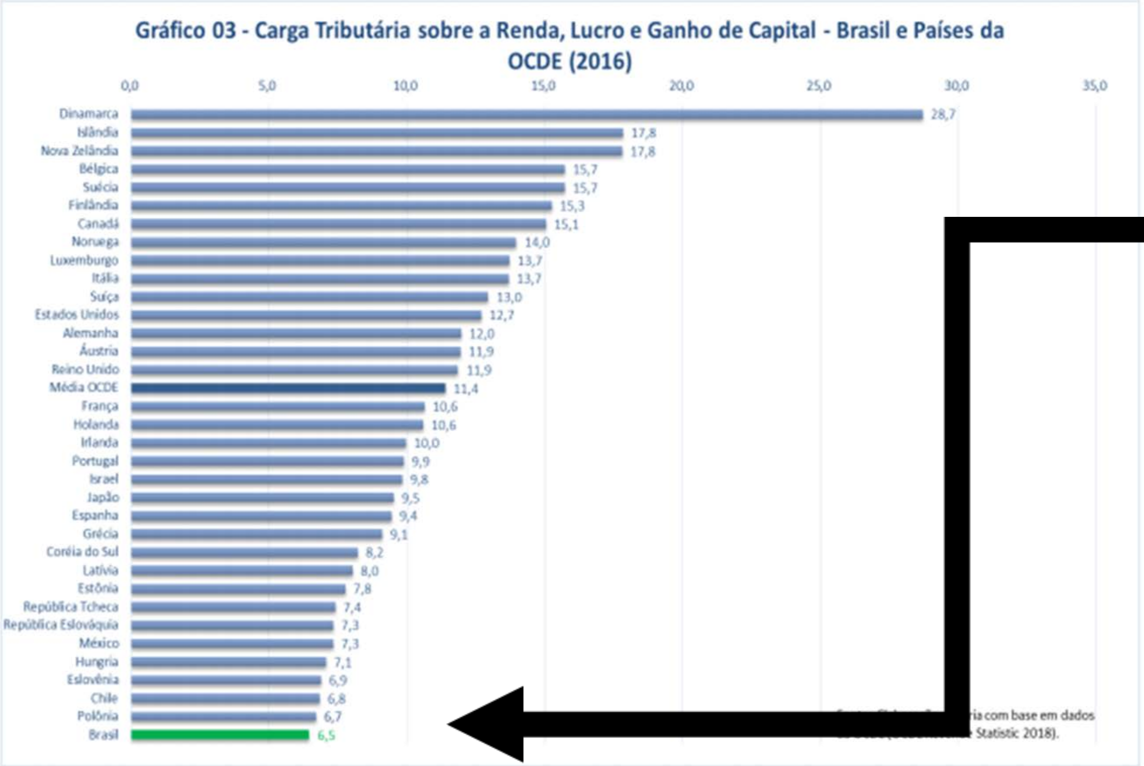
BRAZIL VS. OECD

Tax Burden in Brazil and in the OECD Countries (2018)



BRAZIL VS. OECD

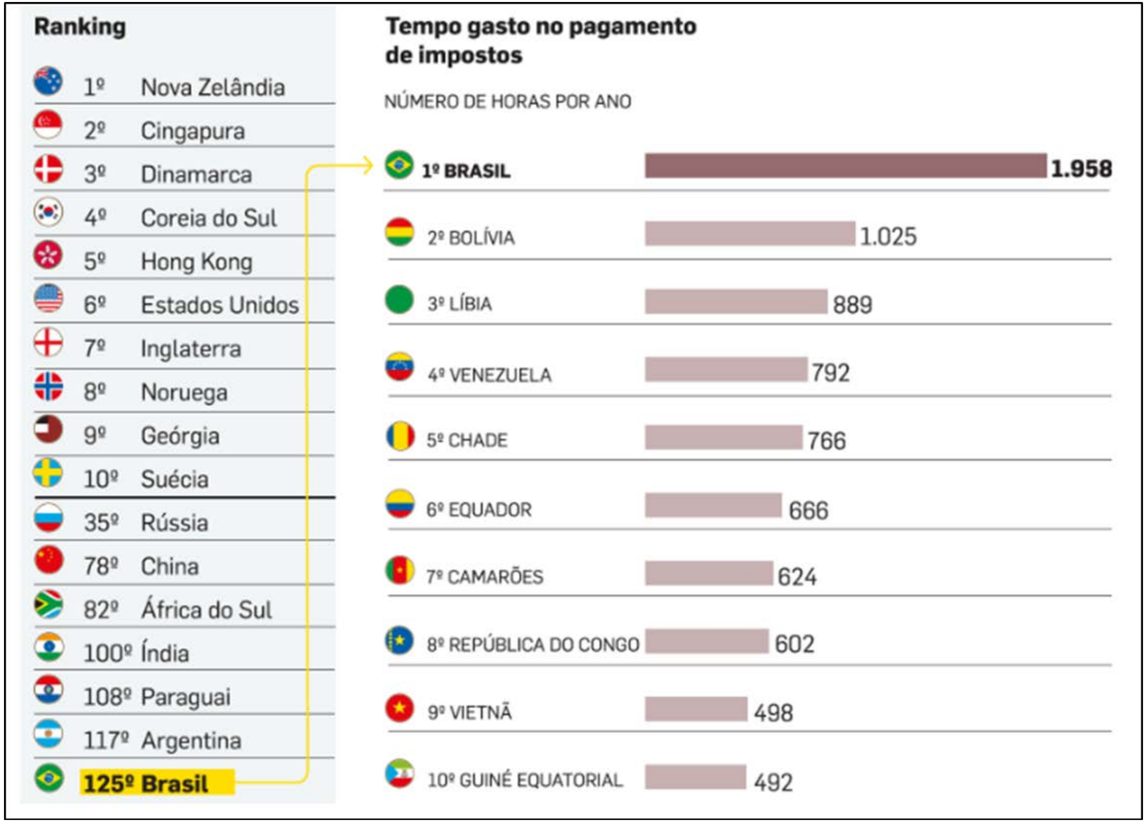
Tax Burden on Income, Profit and Capital Gains – Brazil and OECD Countries (2018)



As to the tax burden on income, profit and capital gains, Brazil is in the 34th place amongst the countries that integrate the OECD, also below the OECD average.

BRAZIL VS. OECD

Compliance Cost



- Pursuant to the Doing Business Report 2018, issued by the World Bank, Brazil is the most time-consuming country in relation to the payment of taxes.
- Around 1,958 hours are yearly spent by the taxpayers with compliance costs, almost twice the total of hours spent in the Bolívia, the second place ranked country.

BRAZILIAN TAX REFORM

- Main Aspects:
  - Incidence on the sale of goods, rendering of services, transmission/licensing of rights, rental of goods and imports
  - Non-cumulative
  - Extensive credits and timely refund of credits

Unification of the consumptions taxes into a non-cumulative model of the traditional VAT

- Discussions:
  - Rates;
  - Issue of federalism and autonomy of Member States;
  - Transition period.
- Status:
  - Is under analysis by a special commission with representatives of the Senate and House of Representatives.

BRAZIL AND DIGITAL ECONOMY

- Brazil suffers of a disassociation of the globe tax policy regarding digital economy;
- Brazilian taxation presents a problem of tax duality – goods (State value-added tax) and service (Municipal service tax).
- Two Amendments to the Brazilian Tax Reform discuss the digital tax (turnover tax).
  - Amendment 11/2019 – Congressman Celso Sabino
    - Federal Government would be responsible for the taxation of digital services;
    - Such Digital tax would not exclude the taxation of IBS;
    - Arguments for the taxation is based on the countries that imposed digital taxes.
- Amendment 05/2019 – Congressman Luis Miranda
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BRAZIL AND DIGITAL ECONOMY

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Unilateral Measures

- How will your company manage DSTs imposed unilaterally?
- Will there be credits for DST paid?

Navigating Uncertain Times

- How will these proposals affect your entity?
- Value of being involved in the comment process.
- How do you prepare for Pillars One and Two before they are finalized and adopted?

Ambitious schedule

2020 — End of 2020

29-30 January

Inclusive Framework Meeting, Paris, France

22-23 February

G20 Finance Ministers Meeting, Riyadh, Saudi Arabia Endorsement of progress made

1-2 July

Inclusive Framework Meeting, Berlin, Germany "agreement on the key policy features of a solution"

18-19 July

G20 Finance Ministers Meeting, Jeddah, Saudi Arabia

15-16 October

G20 Finance Ministers Meeting, Washington, DC

21- 22 November

G20 Leaders Summit , Riyadh, Saudi Arabia

What lies ahead…

- Next steps in gathering consensus and buy-in.
  - Challenges to consensus.
  - Conflict resolution.
- Opportunities to comment on proposals and raise issues.
- Implementation.
  - Old tax rules into new-challenges to implementation.
- Questions?