Taxing Digital Business Activities
Aarhus University 10 October 2017

Taxing Digital Business Activities

- Defining the digital economy
  - The result of a transformative process brought by information and communication technology (ICT),
  - Has made technologies cheaper, more powerful, and widely standardized, improving business processess and bolstering innovation across all sectors of the economy.
  - Digital economy is simply embedded in the economy.
    - Difficult to ring-fence from the rest of the economy

- Digital Economy Business Models
  - Key features
    - Mobility with respect to intangibles, users and business functions
    - Reliance on data
    - Network effects (decisions by other users may have a direct impact on the benefit received by others
    - The spread of multi-sided business models (intermediaries/platforms)
    - Tendency towards monopoly or oligopoly
    - Volatility
  - Examples
    - Online Retailer model (Amazon, Zalando, Alibaba)
    - Social media model (Facebook, Xing etc.)
    - Subscription model (Netflix, Spotify)
    - Collaborate platform model (AirBnb, Uber etc.)

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- Is the digital economy causing problems for the tax system and is there a need for fixing?
  - The rise of business on the internet tests many traditional tax principles.
  - Increase in remote activities creates problems for tax authorities, that may have difficulties imposing (or enforcing) their taxes on economic activities that takes place outside their geografic jurisdictions (Taxing Global Digital Commerce, 2013, p. 27).
  - Tax rules continue to focus primarily on the physical world and have yet to address many of the challenges posed by this new world ((Taxing Global Digital Commerce, 2013, p. 27)).
  - OECD and all EU MS agree that there is a problem with the taxation of the digital economy.

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OECD actions

- Some of the key features exacerbate BEPS risks (BEPS #1, p. 144)
  - Importance of IP.
  - Centralized infrastructure at a distance from a market jurisdiction and conduct substantial sales of goods and services into that market from a remote location, combined with increasing ability to conduct substantial activity with minimal use of personnel => fragmenting physical operations to avoid taxation.
  - Partially handled by other BEPS initiatives (PE, TP, CFC etc.)
- Other tax policy challenges
  - Nexus – current rules appropriate?
  - Data (valuation, nexus, profit attribution as well as characterization)
  - Characterisation of income from new business models
- BEPS highlighted comprehensive responses (not reccomended):
  - Significant economic presence.
  - Gross WHT on digital transactions.
  - Equilization levy (excise duty).
- Comprehensive OECD report expected by early 2018.

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EU actions

- Talinn Summit sept. 2017:Communication from the Commission – COM(2017)547 final.
- Currently no consensus among EU MS.
- *"The underlying principle for corporate tax is that profits should be taxed where value is created. However, in a digitalized world, it is not always very clear what the value is, how to measure it, or where it is created?", p. 7.*
- Two main policy challenges identified:
  - Where to tax? (nexus) – how to establish and protect taxing rights in a country where businesses can provide services digitally with little or no physical presence despite having commercial presence; and
  - What to tax? (value creation) – How to attribute profit in new digitalized business models driven by intangible assets, data and knowledge
- EU aims at coordinated approach.
  - Awaiting the 2018 OECD interim report.

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EU actions (continued)

- The way ahead:
  - Embed the taxation of the digital economy in the general international corporate tax framework
  - New international rules are needed to determine where the value of businesses is created and how it should be attributed for tax purposes:
    - Concept of PE; alternative indicators for significance presence
    - Transfer pricing: Requires alternative methods for attributing profit than better capture value creation in the new business models
    - Anti abuse rules
    - CCCTB – The Commission believes that the CCCTB provides for an EU framework for revised PE rules and for allocating profit of MNEs using the formula apportionment approach that should better reflect where value is created.
    - Short term alternative solutions:
      - Equilization tax on turnover of digitalized companies.
      - WHT on digital transactions.
      - Levy on revenues generated from the provision of digital services or advertising activity.

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Unilateral initiatives

- Absent conclusive guidance in the BEPS report – countries show themselves eager to raise additional revenues through innovative tax tooles (Teijeiro Oct. 4., 2017, Kluwer Tax Blog).
  - UK DPT
  - Indian Equilazazation levy
- Will national conflicting experiments lead to severe consequences to the industry in terms of multple layers of taxation?

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Tax policy considerations

- Is there an ”unfair” competition between old companies and tech companies?
  - Scientific basis for such conclusions?
  - ECIPE Occational Paper – No 4/2014, Lee-Makiyama and Verschelde:
    - Are bases eroding?- CIT has remained stable.
    - There is no causal relationship between the relatively recent rise of e-commerce as a sales platform and the corporate income tax base.
    - Result of Eurozone’s soverign debt crisis.
    - In sum, persistent myths surrounding the global taxation debate can easily be rebuked by looking at simple data.
    - The political economy of taxation os such that profitable internet companies are easy targets – the link between the internet and base erosion and profit shifting is simply conterfactual.

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Tax policy considerations

- Overall tax policy guidelines and questions
  - The Ottowa declaration: Principle of ”technology neutrality”.
  - The digital economy cannot be covered by a seperate regime.
    - Some of the proposals may actually achieve exactly that.
  - Conformity with EU law and WTO law?
  - Should country of consumption have income taxing rights? (what will happen if the US follows suit as a massive net importer?)
  - Is value created by consumption as opposed to production? Deviation from concept of value creation?
  - Is value creation really a general underlying principle for corporate income taxation?
    - A new principle rooted in BEPS and ATAD etc, but with no actual theoretical or legal basis.
  - Is market/data collection a factor?
  - Ability to engage in services without physical presence: does that provoke base erosion?
  - Digital presence:
    - Violation of function asset risk approach?
    - Does data in itself have value? Ability to monetize market data is not the same as having a presence

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- Research topics
  - Testing the basic assumptions.
  - Application of existing principles of taxing jurisdiction of digital usiness models – PE rule.
  - Classification of payment streams in international digital business models- royalty, business income, service etc.
  - The significance of IP and data in the digital economy.
  - Tax consequences of Internet of Things, 3D printing, Big data, Cloud computing.
  - International tax issues raised by proposed ”responses” – compatibility with tax treaties, EU law, WTO law.
    - Is it enough to change of the nomen iuris of a tax to go beyond the business income principle?

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