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Digital Services Taxes: At the Intersection of Trade, Tax, and Technology

SPEAKERS

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MODERATOR

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SIDLEY

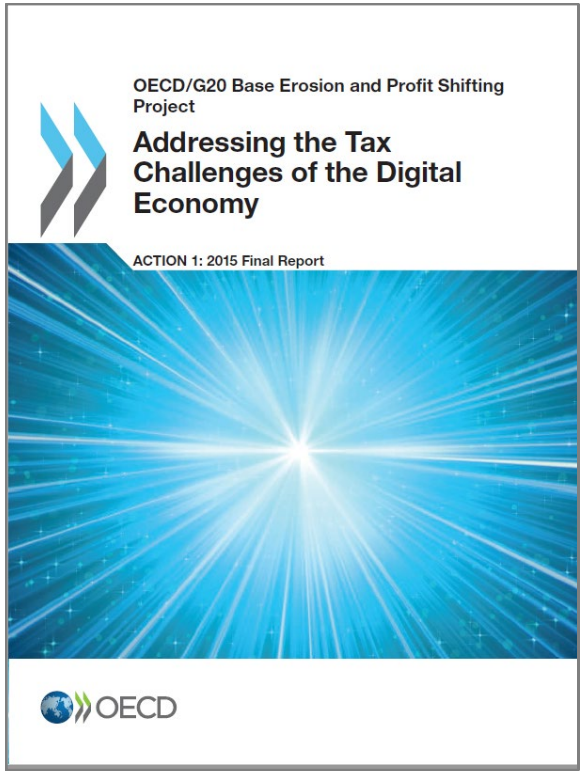
Introduction and overview

- Welcome and introduction
- Presentation on issues relevant to the international digital tax agenda
  - Origin
  - Unilateral initiatives and multilateral reform efforts
  - Drivers of the U.S. position
  - International trade rules and DSTs
- Panel discussion – exploring the intersection of the tax policy, trade, sectoral and political dimensions
- Q&A

G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS)

2013 → 2015 → 2018 → 2019 → 2020

Action 1 of the BEPS Action Plan



Two-Pillar Approach

Pillar One: allocation of taxing rights

- New **nexus rules**
- New **source rules**

Pillar Two: ensuring a minimum level of taxation

Aim to conclude by the end of 2020, but…

MULTILATERAL EFFORT: Origin of the Issues

- **February 2013 – Addressing Base Erosion and Profit Shifting, requested by G20 from the OECD**
  - **Observations re the Digital Economy**
    - "Nowadays it is possible to be heavily involved in the economic life of another country, *e.g.* by doing business with customers located in that country via the internet, without having a taxable presence therein (such as substantial physical presence or a dependent agent). In an era where non-resident taxpayers can derive substantial profits from transactions with customers located in another country, questions are being raised as to whether the current rules ensure a fair allocation of taxing rights on business profits, especially where the profits from such transactions go untaxed anywhere."
    - Primary focus on PE and profits attributable to the PE.
  - **Proposal re Action Plan**
    - "The different components of the action plan will include proposals to develop: … Updated solutions to the issues related to jurisdiction to tax, in particular in the areas of digital goods and services. These solutions may include a revision of treaty provisions."
  - **A Warning**
    - "Failure to collaborate in addressing BEPS issues could result in unilateral actions that would risk undermining the consensus-based framework for establishing jurisdiction to tax and addressing double taxation which exists today. The consequences could be damaging in terms of increased possibilities for mismatches, additional disputes, increased uncertainty for business, a battle to be the first to grab taxable income through purported anti-avoidance measures, or a race to the bottom with respect to corporate income taxes."

MULTILATERAL EFFORT: Origin of the Issues (cont'd)

- **July 2013 – BEPS Action Plan, developed by OECD and endorsed by G20 (September 2013)**
  - **Identified 15 Actions to examine, including Action 1 (Address the tax challenges of the digital economy)**
  - **Observations re the Digital Economy**
    - New business models involve (i) massive use of data, (ii) multi-sided business models, (ii) relocation of core business functions.
  - **Objective**
    - "Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation."
    - Specific issues to be examined included, but were not limited to:
      - the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules,
      - the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services,
      - the characterisation of income derived from new business models,
      - the application of related source rules, and
      - how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services.

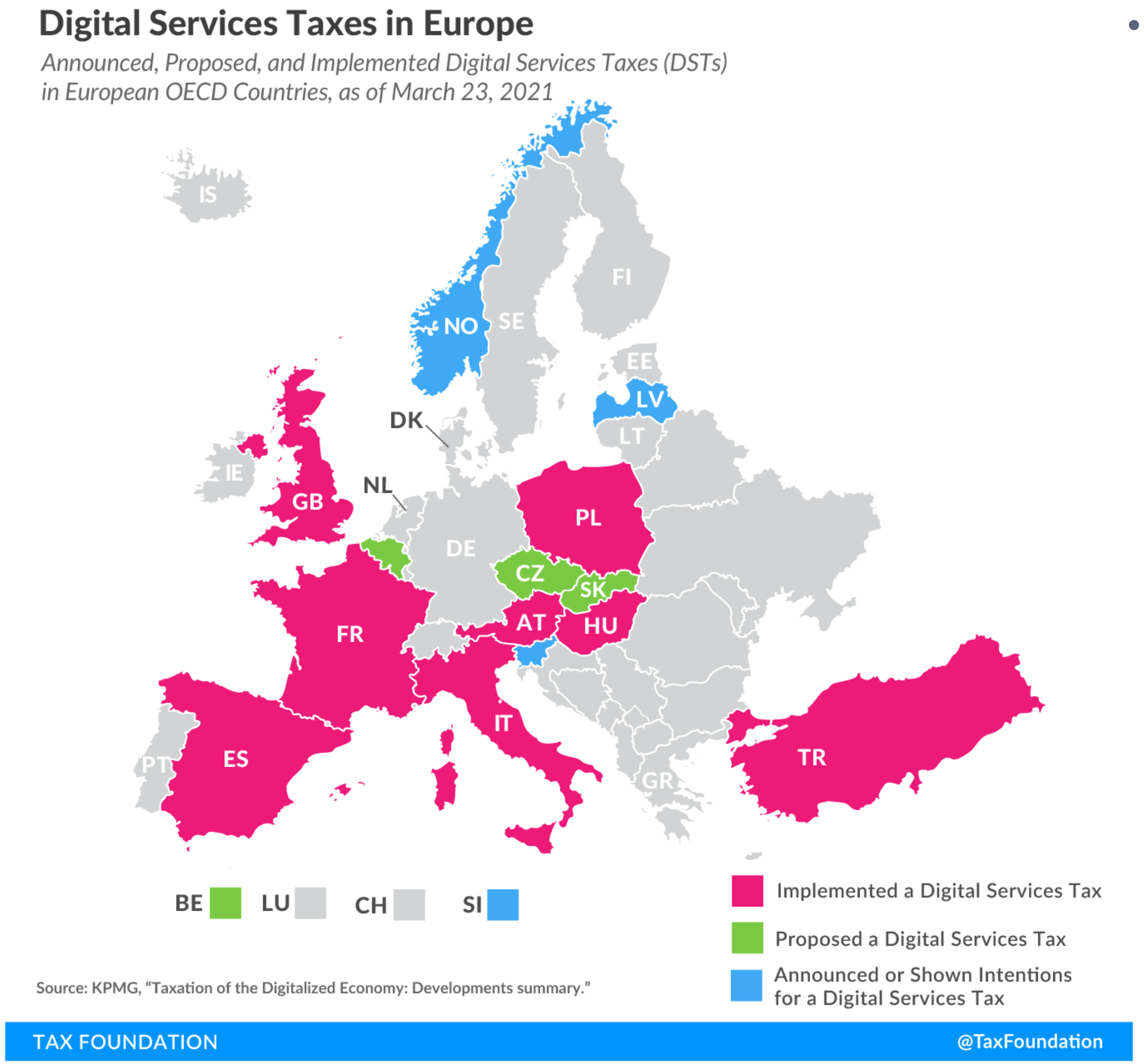
MULTILATERAL EFFORT: Origin of the Issues (cont'd)

- **2015 – Action 1 Final Report (Task Force on the Digital Economy)**
  - **Broader Tax Challenges**
    - Nexus – Ability to carry on business with little or no physical presence in the relevant jurisdiction
    - Data – Huge volume of data being exchanged, often in the context of multi-sided businesses
    - Characterization – Changing digital products creates uncertainty in relation to proper characterization of payments
  - **High Level Conclusions**
    - "Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes. The digital economy and its business models present however some key features which are potentially relevant from a tax perspective."
    - No current recommendations beyond the other BEPS Actions recommendations
      - Stated expectation that implementing other BEPS Actions recommendations would have a substantial impact on the BEPS issues identified with the digital economy
      - Tacit lack of consensus regarding broader tax challenges relating to data collection and supply, and location of value creation
    - "Countries could, however, introduce any of the options in their domestic laws as additional safeguards against BEPS, provided they respect existing treaty obligations, or in their bilateral tax treaties."
      - Among the options considered were a "withholding tax on digital transactions" and an "equalisation levy" (i.e., DST).

MULTILATERAL EFFORT: Origin of the Issues (cont'd)

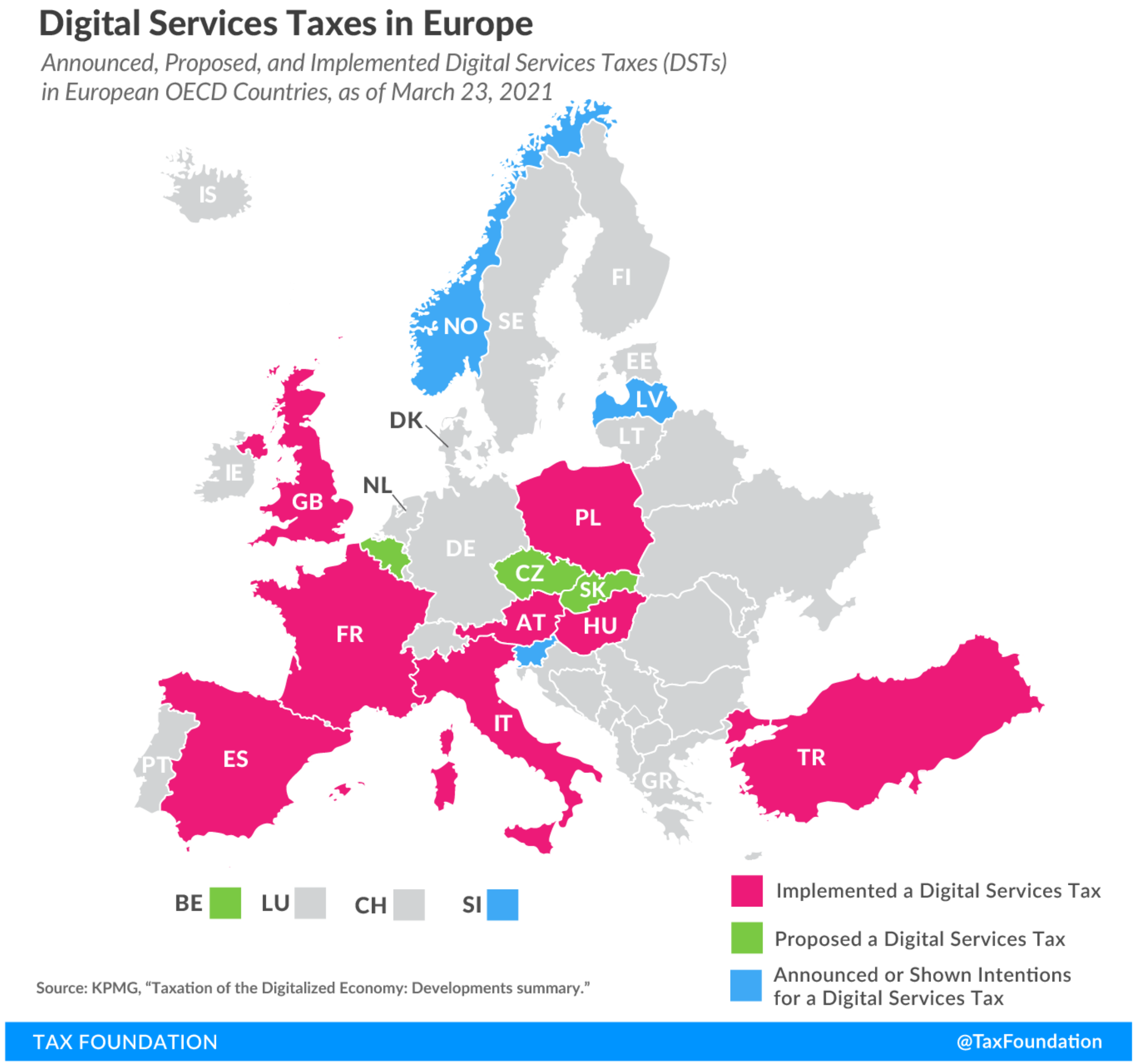
- **2016 – Inclusive Framework Established**
  - To work on implementation of the BEPS package
  - Currently 135+ countries participating
- **2018 – Interim Report on Tax Challenges Arising from Digitalisation (Inclusive Framework)**
  - **Updates**
    - Still no consensus on the relevance and importance of these characteristics to the location of value creation and identity of the value creator (e.g., Do data and user participation represent a contribution to value creation by the enterprise?)
    - Countries increasingly implementing unilateral measures (e.g., DST)
  - **Conclusion**
    - Proposal to further examine and work towards consensus-based solutions for nexus rules and profit allocation for the digital economy

UNILATERAL EFFORTS



- Digital Services Tax (DST)
  - DST, a de facto tariff, would tax the part of a digital firm's revenues attributed to the taxing jurisdiction (e.g., European and OECD member states);
    - In contrast, a digital profits tax would tax the slice of corporate profits derived in member state
- Despite attempts to reach an agreement, EU member states have been unable to reach a compromise on their own proposals and the European Commission has since conceded it will wait for progress at the (OECD) level and revisit its proposals again in 2021 if no progress is made. The COVID-19 pandemic has also severely impacted this timetable.
- In the absence of this full-fledged multilateral solution, several EU member states started to introduce their own initiatives for national taxes on digital companies which would include "sunset clauses" and expire if an agreement is reached at international or EU level.
- Such initiatives may potentially lead to double taxation and differing views of the transactions covered, and have also increased tensions at the global political level.

UNILATERAL EFFORTS (cont'd)



- Digital Services Tax (DST)
  - European country DST rates range from 1.5% in Poland to 7.5% in Hungary and Turkey (Note: Hungary's tax rate is temporarily reduced to 0%)
  - Most global thresholds among European countries are set at €750 million (though some are much lower, e.g., Hungary)
  - Domestic revenue thresholds ranging from €3 million (Spain) to €25 million (France and others)
- Other Unilateral Efforts: Expanded PE definitions
  - "Significant Economic Presence" tests (e.g., Israel, India)
    - Compare: US States' Economic Nexus
  - US Tax Reform Measures
    - GILTI
    - BEAT

UNILATERAL EFFORTS (cont'd)

Amazon to Pass Along Cost of Spanish Digital Tax to Advertisers

Posted on Jan. 25, 2021

Amazon has advised businesses using its platform to sell products in Spain that it will pass along the cost of the country's recently implemented 3 percent digital services tax.

The DST, which applies to revenues from online advertising, online intermediation, and sales of user data, is payable by technology companies with annual worldwide revenues of at least €750 million, of which €3 million is from sales to Spanish customers. The Ministry of Finance recently announced that while the tax's January 16 implementation date remains unchanged, the first quarterly payment date has been pushed back from April 30 to the end of July.

"Although the tax came into force on January 16, 2021, we will not apply the increased charge until April 1, 2021," an Amazon spokesperson said. "During this time, we will absorb the costs and will not charge the sellers."

The spokesperson said the government designed the DST in a way that will directly affect the businesses that use Amazon's services. "Like many others, we have encouraged the government to pursue a global agreement on the taxation of the digital economy at [the] OECD level, rather than unilateral taxes, so [the] rules would be consistent across countries and clearer and fairer for businesses," he said.

- DST is structured as a tax on gross receipts (without consideration for costs), not as a tax on corporate profits
  - Ignores costs associated with sales and customer acquisition costs
  - Ignores risks, including market penetration risk
- Similar to excise taxes, which are often passed along supply chains until they are paid by final consumers
  - Much like with taxes on alcohol, tobacco, drugs and gasoline, companies that are statutorily required to pay tax and any intermediate suppliers can raise their prices in the long run until the buck stops with the consumer
- Is DST a way to allow countries to indirectly impose a regressive excise tax on their own citizens and on everyday transactions of local consumers?
- Despite multiple statements by EU officials, DST has a substantially disproportionate impact on a few US companies.

MULTILATERAL EFFORT: Ongoing

- **2020 – Tax Challenges Arising from Digitalisation (Inclusive Framework)**
  - **Pillar I – New Nexus, Profit Allocation Rules**
    - Recommends a new (additional) taxing right for market jurisdictions with respect to a share of residual profits at the group level
    - Potential fixed return for marketing and distribution activities taking place in a market jurisdiction
    - Dispute prevention and resolution mechanisms
  - **Pillar II – Minimum Tax**
    - Income inclusion rule (IIR) – Shareholder level income inclusion when ETR of a controlled foreign entity is below a minimum rate
    - Undertaxed payments rule (UTPR) – Backstop rule if IIR doesn’t apply (e.g., due to Parent entity’s jurisdiction not adopting IIR)
    - Subject to tax rule (STTR) – Denies treaty benefits for certain deductible intragroup payments if payments are subject to low or no tax

G7 Finance Ministers and Central Bank Governors Communiqué (5 June 2021)

- Strongly support the efforts underway through the G20/OECD Inclusive Framework to address the tax challenges arising from globalisation and the digitalisation of the economy and to adopt a global minimum tax.
- Commit to reaching an equitable solution on the allocation of taxing rights, with market countries awarded taxing rights on at least 20% of profit exceeding a 10% margin for the largest and most profitable multinational enterprises.
- Provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies.
- Commit to a global minimum tax of at least 15% on a country by country basis.
- Agree on the importance of progressing agreement in parallel on both Pillars and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors.

DRIVERS OF THE US POSITION

“Chaotic Dome,” oil on canvas, by Elizabeth Roskam

- Washington is the slowest place until it is the fastest place
- No candlelight vigils for Big Tech
- Tax changes are not stopped by the Senate filibuster

INTERNATIONAL TRADE RULES AND DSTs

Unilateral DSTs affect trade in services and goods

- EU-style DSTs affect cross-border supply / commercial presence of certain services by foreign suppliers (*e.g.* advertising, data-related analyzing services, provision of services via online platforms)

A typical EU-style DST design elements:
- Definition of taxable services
- Threshold/exemptions: e.g. revenue threshold

Distinct treatment:
- Similar services supplied by different business models
- Same services, different suppliers

Vulnerable to challenges under the WTO

- Other DSTs (e.g. India) also tax the provision of goods via electronic means → affect trade in goods/services

Countermeasures (US Section 301 investigation) affect trade in goods

USTR Decisions:
- Discriminate against U.S. digital companies.
- Unreasonable because they are inconsistent with principles of international taxation
- Burden or restrict U.S. commerce

	Import duties	No. of tariff lines	Total value (USD)
France	25%	21	1.3 billion
Austria	25%	23	65 million
India	25%	26	119 million
Italy	25%	44	386 million
Spain	25%	27	324 million
Turkey	25%	32	310 million
UK	25%	67	887 million

Vulnerable to challenges under the WTO

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