Taxation & the Digital Economy

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Digital Economy – Key Terms

- **BEPS** : Base Erosion & Profit Shifting (BEPS) is the result of tax planning designed to take advantage of gaps in the interaction of different tax systems to **artificially** reduce taxable income or **shift profits** to low-tax jurisdictions in which little or no economic activity is performed.

- **Externalities** : Externalities occur in an economy when the production or consumption of a specific good impacts a **third party** that is **not** directly related to the production or consumption. i.e. Google maps, pollution. Externalities **are negative** when the social costs outweigh the private costs

Digital Economy – Key Terms

- **Business Model** A plan for the successful operation of a business, identifying **sources** of revenue, the intended **customer base**, **products**, and details of **financing**.

- **Dematerialisation** The dematerialization of a product literally means **less**, or **no material** is used to deliver the same level of functionality to the user. T**ransformation** of any material object into something of **virtual or digital** nature.

- **OECD** : Organizations for Economic Cooperation & Development was established on **Dec. 14, 1960**, by 18 European nations plus the United States and Canada to administer the predominantly U.S.-funded **Marshall Plan** for post-war reconstruction on the continent. It has expanded over time to include members from South America and the Asia-Pacific region. It includes most of the **highly developed countries**

Digital Economy - Introduction

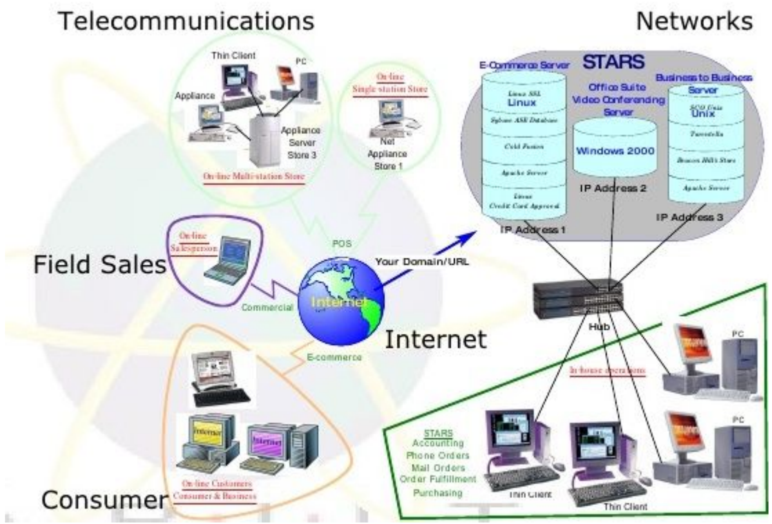
Characteristics of a Digital economy;

- **E-Business**: The use of electronic technologies to transact business.

- **Collaboration**: People and Organizations interact, communicate, collaborate and search for information

- **Information Exchange**: Storing, processing and transmission of information.

Digital Economy - Introduction



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Quote

- "The world's largest taxi firm, Uber, **owns no cars**. The world's most popular media company, Facebook, **creates no content.** The world's most valuable retailer, Alibaba, **carries no stock**. And the world's largest accommodation provider, Airbnb, **owns no property**. Something big is going on."

  - Tom Goodwin

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The **Digital** Economy v/s **Old** Economy

- EU retail sector revenue growth (2008 - 2016)

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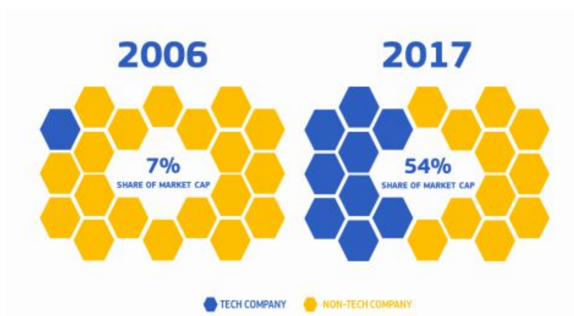
The Digital Economy v/s Old Economy

- Market share **top 20** companies in the EU . Statistics between 2008 and 2016



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CASE STUDY 1. **Old** Economy Taking Photos

- **Buy** a film in a store.
- **Load** your camera.
- Take pictures
- Take roll of film for **processing**
- **Pickup** the film when ready
- Select specific photos for **enlargement**
- **Mail** to family and friends

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Challenges of Digital Economy

Action 1 of the of the OECD project (Action Plan) on BEPS addresses the challenges of the digital economy

- International **tax rules**, which date back to the **1920's**, have not kept pace with the changing business environment and the growing importance of **intangibles** and the **digital economy.**

- Existing tax rules are rooted in clear-cut **jurisdictional boundaries** designed for bricks- and-mortar, physical locations.

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The Digital Economy is characterized by

- **Unparalleled** reliance on **intangible assets**
- **massive** use of **data** (notably personal data)
- **widespread** adoption of **multi**-sided **business models** capturing value from externalities generated by **free** products, and the
- **difficulty** of determining the **jurisdiction** in which **value creation** occurs.

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The **Risk** to the **Tax Base** by Digitization includes

- use of tax **planning structures** to "**artificially**" segregate income from the activities that generate it hence
  - increasing the risk of BEPS for **income taxes** in some circumstances.
  - Extending the same to indirect taxes (**VAT**).

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OECD identifies 4 areas of **BEPS for income taxes**:

- **Eliminating** or reducing tax in the market country through;
  - avoiding a **taxable presence**,
  - minimizing functions, assets and risks in market jurisdictions or
  - **maximizing deductions** in market jurisdictions;
- Avoiding **withholding tax.**
- Eliminating or reducing tax in the **intermediate country**.
- Eliminating or reducing tax in the **country of residence** of the ultimate parent.

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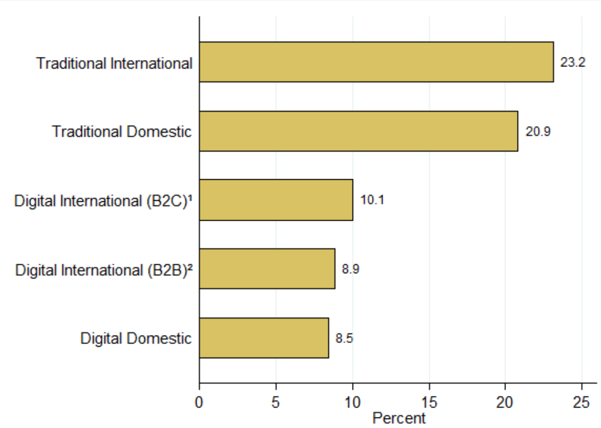
Figure 1. Effective average corporate tax rate by business model in EU



Data Source: Digital Tax Index 2017, PWC and ZEW

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VAT base-erosion:

- Where such goods and services are acquired by private consumers from suppliers abroad (B2C) ie consumption of **Facebook** and **Google** products.
- No **international framework** that would allow economic actors, and in particular **small and medium** enterprises, to register and manage VAT payments to a large number of tax authorities, as well as
- the need to manage **tax liabilities** generated by a high volume of **low value transactions**, which can create a significant **administrative burden** but marginal revenues.

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OECD received below **suggestions** to protect BEPS:

- Introduce **Turnover Tax** on revenue.
- Introduction of **withholding tax** (WHT) the same way you would apply WHT to dividends and interest earned by a foreign company.
- Applying an **equalisation levy** on digital transactions to bring their taxation to par with traditional businesses.

The verdict :

- The OECD concluded that the work on the other BEPS **action plans** (14 of them) would be sufficient to address BEPS issues in the digital economy.

- Countries are free to test out some of the new proposals in their domestic laws (and bilateral tax treaties) so far as they respected the provisions of other double tax treaties which were modeled after the OECD's recommendations.

CASE STUDY 2. **NEW** Economy Google

- A French court handed Google's parent company, Alphabet, a reprieve from a 1.11bn-euro ($1.27bn) tax bill on Wednesday in a major victory for the tech giant.

- The decision comes after six years of fighting with the French tax authority over back taxes it claims are due from the tech firm for the years 2005 to 2010.

- The French tax administration argued that Google had to pay taxes in France because the California firm and its subsidiary in Ireland have been **selling a service** for inserting online ads to clients in France for years through its Google search engine.

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CASE STUDY 2. **NEW** Economy Google

- But the Paris administrative court noted that the subsidiary, Google Ireland Limited, doesn't have a "**permanent establishment**" in France via the company Google France, also a subsidiary of the US group Google Inc.
- The court added that Google France doesn't have the **human resources** or the **technical means** to allow it to carry out the contentious advertising services on its own.

THE END