Base Erosion and Profit Shifting(BEPS)
Taxation of Digital Economy

James Karanja

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YouTube content creators watch out: Google will cut 24% tax from June 2021, here's why

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NEWSLETTER INDIA

ATAF Suggested Approach to Drafting Digital Services Tax Legislation

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"France demands digital tax payments from US tech groups"

US announces duties on $1.3B in French goods in digital tax dispute

The United States believes the way the French tax is structured unfairly targets large US internet companies like Facebook, Google and Amazon.

The failure to achieve a consensus-based solution would lead to a proliferation of unilateral measures, more uncertainty and trade disputes

- A digital service is a service which is delivered over the internet or an electronic network including through online platforms.
- Many Multinational Enterprises (MNEs) are able to make large profits in countries without necessarily booking these profits in these countries due to the fact that they may operate business without establishing any physical presence (no premises, no employees, etc.).
- **The digital economy is equivalent to 15.5% of global GDP** and is growing two and a half times faster than global GDP over the past 15 years, according to the World Bank.
- In 2013, the Organization for Economic Cooperation and Development (OECD)/G-20 began the Base Erosion and Profit Shifting (BEPS) Project, to create a single set of consensus-based international tax rules.

G20/OECD Base Erosion and Profit Shifting

- The OECD/ G20 BEPS Project analysed the tax challenges arising from digitalisation in its 2015 BEPS Action 1 of the BEPS Action Plan which dealt with the tax challenges of the Digital Economy.
- A lack of consensus prevented countries from taking collective action.
- It was expected that the measures developed in the BEPS Project will have a substantial impact on BEPS issues previously identified in the digital economy, that certain BEPS measures will mitigate some aspects of the broader tax challenges, and that consumption taxes will be levied effectively in the market country.
- In light of increasing public pressure, the G20 delivered a mandate in 2017 to the OECD/G20 to renew work on this issue.
- Since early 2019, the OECD Inclusive Framework (137 countries) embarked on a BEPS 2.0 to specifically formulate a collective approach and has been developing a Two-Pillar approach:

Pillar One

- would establish new rules on where tax should be paid ("nexus" rules) and a fundamentally new way of sharing taxing rights between countries.
    - The aim is ensure that digitally-intensive or consumer-facing MNEs pay taxes where they conduct sustained and significant business, even when they do not have a physical presence.
    - Adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits.
    - Expands the taxing rights of market jurisdictions under conditions of active and sustained participation in that market (Amount A); and
    - Seeks to identify a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the Arm's Length Principle (Amount B)
    - It also aims to significantly improve tax certainty by introducing effective dispute prevention and resolution mechanisms.

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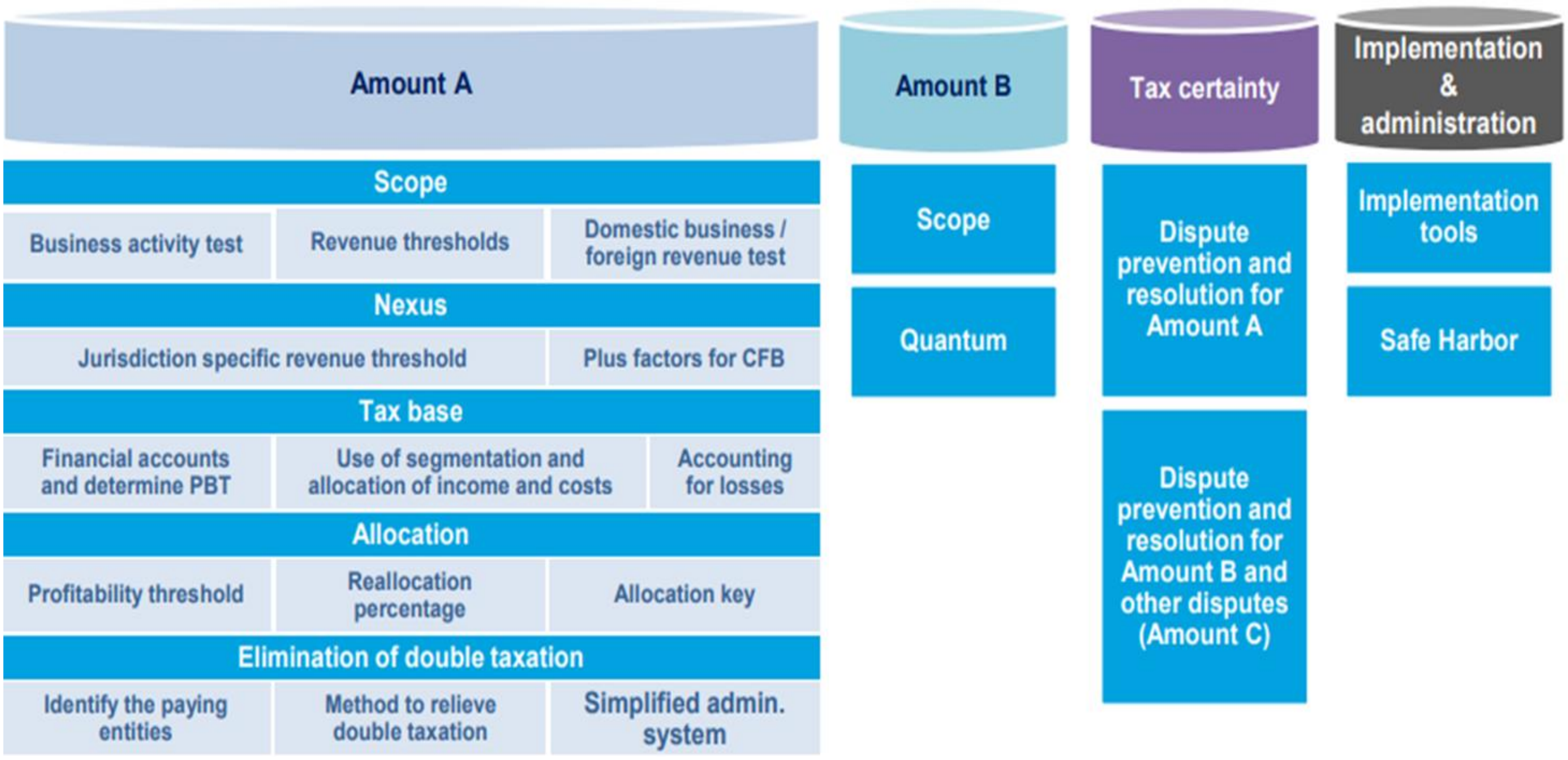
Pillar 1
Eleven building blocks constitute the bedrock of this Blueprint.



Amount A

- A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level
- The key design features of the new taxing right would include:
- A revenue threshold based on annual consolidated group revenue coupled with a de minimis foreign in-scope revenue carve-out.
- A profitability threshold to isolate the residual profit potentially subject to reallocation,
- A fixed reallocation percentage to identify an appropriate share of residual profit that can be allocated to market jurisdictions under Amount A (hereafter, the “allocable tax base)
- An allocation key to distribute the allocable tax base amongst the eligible market jurisdictions (i.e. where nexus is established for Amount A). It will be based on locally sourced in-scope revenue determined by applying the rules on scope, nexus and revenue sourcing

Automated Digital Services

The positive ADS list currently contains the following nine categories of services:

1. Online advertising services,
2. Sale or other alienation of user data,
3. Online search engines,
4. Social media platforms,
5. Online intermediation platforms,
6. Digital content services,
7. Online gaming,
8. Standardized online teaching services, and
9. Cloud computing services.

Consumer Facing Businesses

A multinational enterprise (MNE) would be regarded as being a “consumer-facing business” if the MNE is the owner of the consumer product/service and holder of the rights to the connected intangible property (including franchisors and licensors).

This is the MNE whose “face” is apparent to the consumer. In addition, the “retailer” would also be in scope, as they have a direct relationship to the consumer.

Examples include personal computing products (e.g. software, home appliances, mobile phones); clothes, toiletries, cosmetics, and luxury goods; branded foods and refreshments; franchise models, such as licensing arrangements involving the restaurant and hotel sector; and automobiles.

Formula for Amount A:

OECD has laid out a formula to calculate Amount A using a 3-step approach:

(1) A profitability (profit before taxes (PBT) to revenue ratio) threshold to isolate the residual profit,

(2) a reallocation percentage to identify an appropriate share of residual profit that can be allocated to market jurisdictions under Amount A (allocable tax base), and

(3) an allocation key to distribute the allocable tax base amongst the eligible market jurisdictions.

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Amount B

Aims to standardise the remuneration of related party distributors that perform “baseline marketing and distribution activities” in a manner that is aligned with the ALP. Its purpose is two-fold.

I. Amount B is intended to simplify the administration of transfer pricing rules for tax administrations and reduce compliance costs for taxpayers.
II. Amount B is intended to enhance tax certainty and reduce controversy between tax administrations and taxpayers. In these ways,

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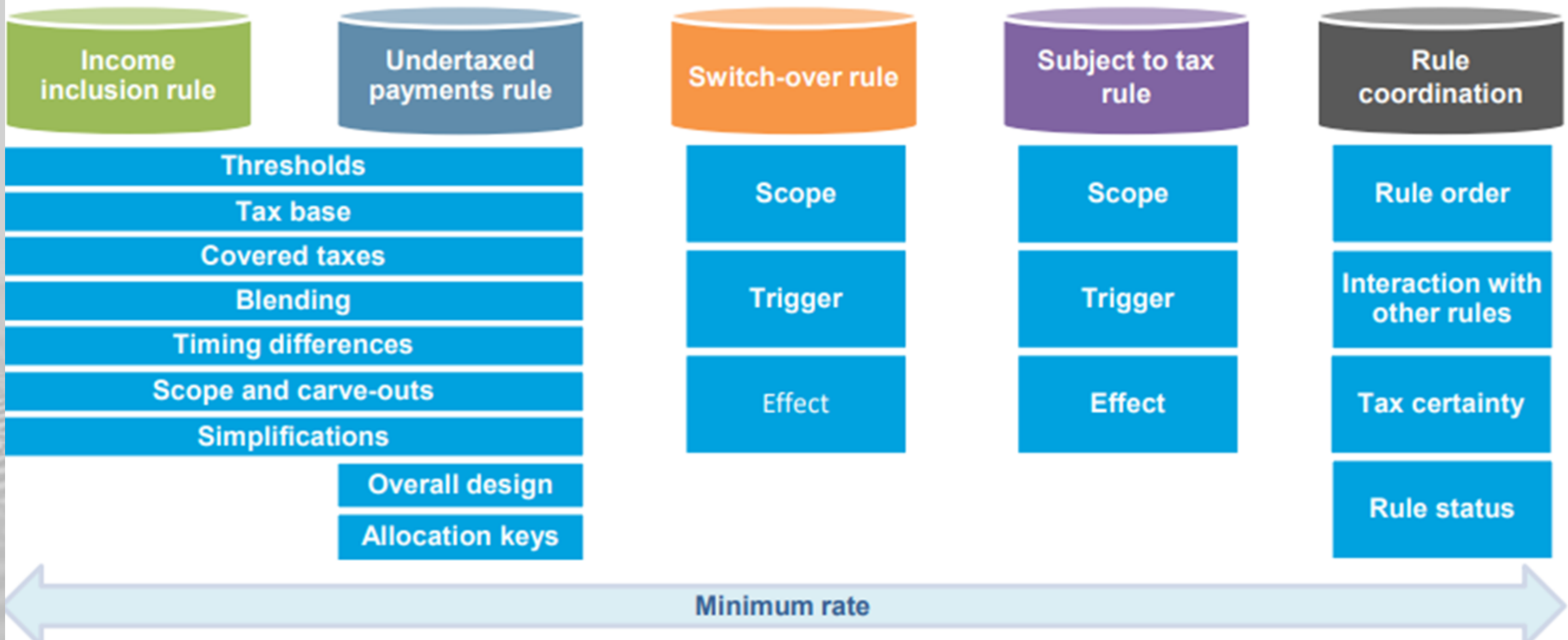
Amount B could be based on a return on sales, together with potentially differentiated fixed returns to account for the different geographic locations and industries of the in-scope distributors.

Pillar Two would introduce a global minimum tax that would help countries around the world address remaining issues linked to Base Erosion and Profit Shifting by MNEs

Pillar 2 – GloBE proposal



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(GloBE proposal)

The global anti-base erosion proposal – it seeks to ensure that all large and internationally operating businesses pay at least a minimum level of tax.

It includes the design of four rules set out in the Programme of Work:

A) the income inclusion rule (IRR);

B) b) the switch-over rule;

C) the undertaxed payment rule (UTPR); and

D) d) the subject to tax rule (STTR).

***This proposal is not limited to digital busine**sses

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Some issues arising

- Any new rules should be based on **net basis taxation – lack of access to information about group profits**
- **Thresholds not agreed-** developing countries may not benefit- not identified as market jurisdictions
- **Mandatory binding arbitration** for settlement of disputes
- **Removal of unilateral measures**- a commitment by members of the Inclusive Framework to withdraw relevant unilateral actions, and not adopt such unilateral actions in the future once consensus is reached.
- **Limited time left** to resolve technical issues and reach political agreement on key issues, develop model draft legislation, guidelines, and international rules and processes as necessary to enable jurisdictions to implement a consensus based solution by mid-2021

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Thank you

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