



Protecting the Tax Base in the Digital Economy

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Outline

- Introduction
- Digital Economy in Developing Countries
- Tax Challenges:
 - Base Erosion
 - Base Cyberisation
- Protecting the Tax Base

Digital Economy in Developing Countries

- ◉ Digital Economy
- ◉ Business Models
- ◉ Revenue models
- ◉ Status and trends in developing countries

“Digital Economy”: What is it?

- “The global network of economic and social **activities** that are **enabled by** platforms such as the **Internet**, mobile and sensor networks” (Australia)
- “The digital economy is the **result** of the transformational effects of new General Purpose **Technologies** (GPT) in the fields of information and communication.”

(EU Expert Group on Taxation of Digital Economy, May 28, 2014)

Business Models: E-commerce

- **Platforms:** Internet, social networks
- **Devices:** computers, smartphones, tablets ...
- **Parties:** B2B, B2C, C2C, B2G
 - > 90% is B2B
- **Transactions:**
 - **Digital technologies/services**, content, data, web-hosting, security,
 - Migrating **traditional business** to the digital world (auction, logistics, finance, trading ...)

Business Models: E-commerce

○ **Types of Businesses:**

- E-tailers
- Digital service providers
- content providers (information, music)
- Transaction brokers (travel, job placements)
- Market creators (e.g. eBay)
- Community providers (e.g. Facebook, Twitter, LinkedIn, Pinterest, Instagram ...)



Business Models: MNEs

- ◉ **Digital** companies (Google, Amazon)
- ◉ **Digitized** companies (hybrids)
- ◉ **Hybrids:**
 - ◉ Walmart, “trying to out-Amazon Amazon in areas such as logistics and making the most of social media.” (The Economist)
 - ◉ Amazon may be building stores
 - ◉ Google is designing cars
 - ◉ Dell: E-commerce supporting virtual company

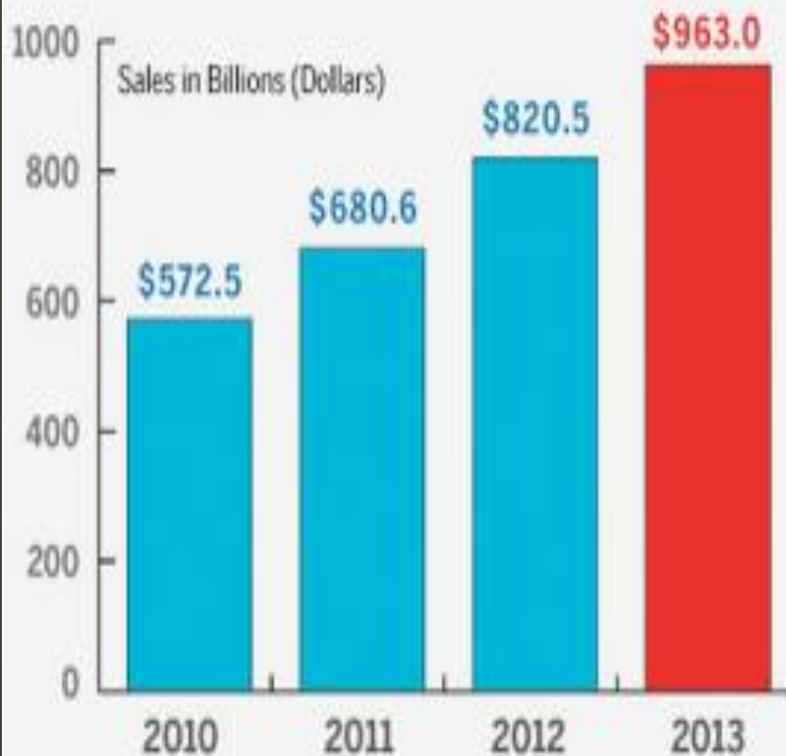


Digital Economy: Revenue Models

- ◉ Advertising
- ◉ Subscription
- ◉ Sales (goods and/or services)
- ◉ Selling of user data or customized research (data analytics firms, telemetrics)

Digital Economy

Drivers of sustainable growth

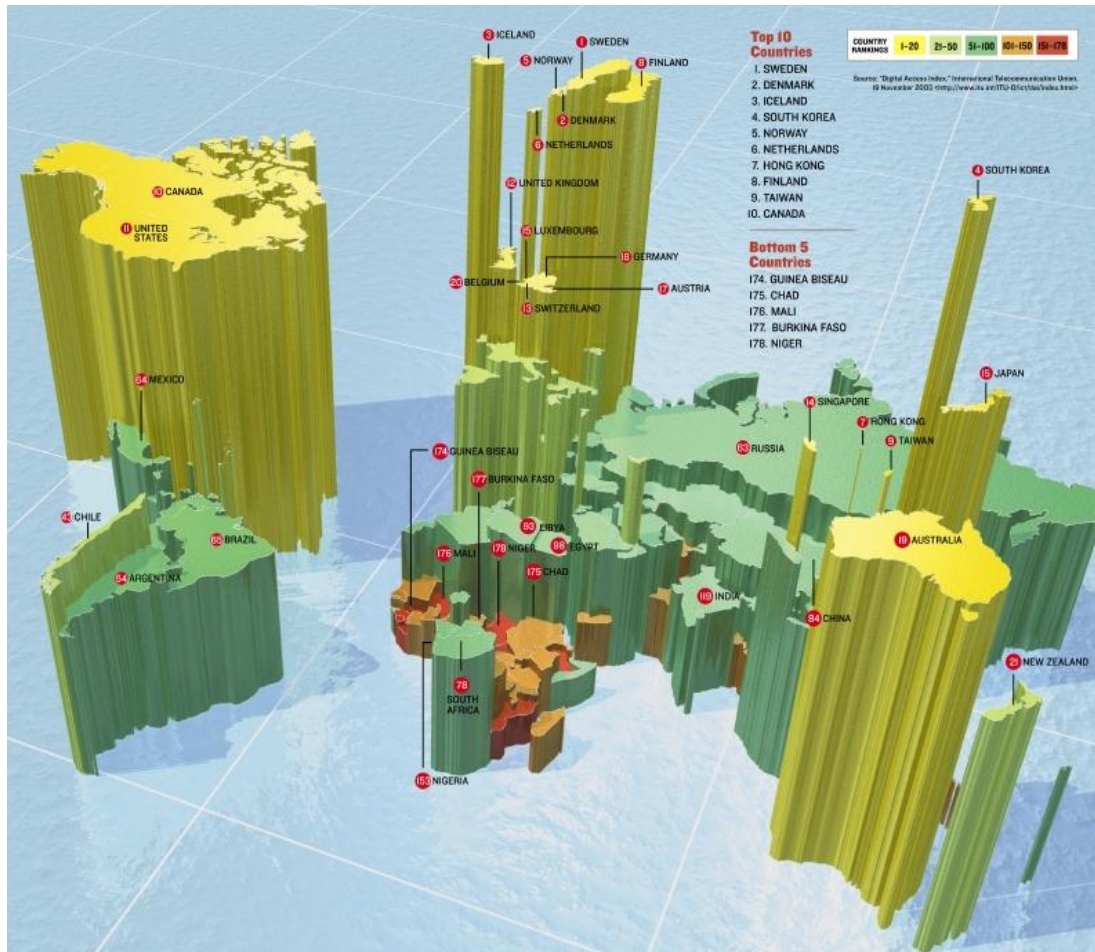


Global e-commerce sales are growing at more than 19% a year

Worldwide retail web sales will reach nearly \$1 trillion by 2013, predicts Goldman Sachs. E-commerce is growing at 19.4%, the investment bank says.

Source: Goldman Sachs. Sales in billions of dollars.

Digital Divide



- Connectivity to the Internet
- Rapid growth in developing countries
- Mobile telephony (next generation technologies)

WEF: *Global Information Technology Report* (2013)

E-commerce in Developing Countries: Trends

- ◉ **Leap-frogging**

- ◉ Social e-commerce: Facebook, Instagrams
- ◉ Mobile commerce

- ◉ **Market:** e.g., E-retail (global ranking)

- ◉ China #1
- ◉ Brazil #8
- ◉ Russia #13

- ◉ **Future growth rate:**

- ◉ Latin America: 27%
- ◉ Asia Pacific: 25%

E-commerce in Developing Countries: Various levels

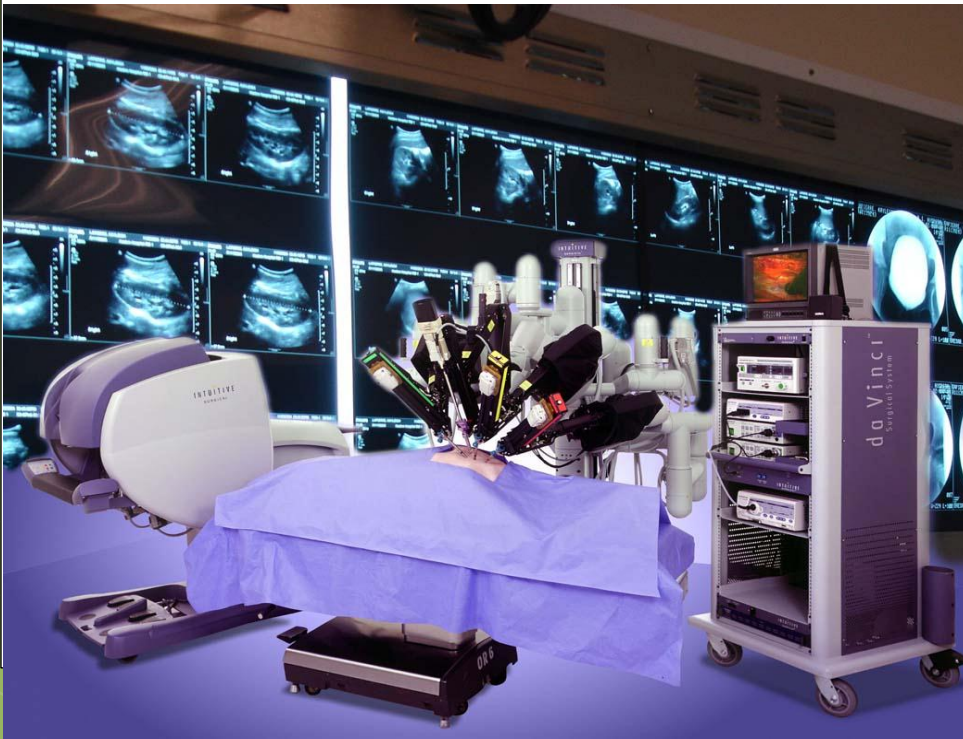
- BRIC
- Asia Pacific
- Latin America
- Africa

Key Features: Dematerialisation

Text
Sound
Image



Services
online



Key Features:

Dematerialisation

3D Printing:

- Prototypes
- customized parts
- Personalised jewellery
- Eye glasses
- Guns

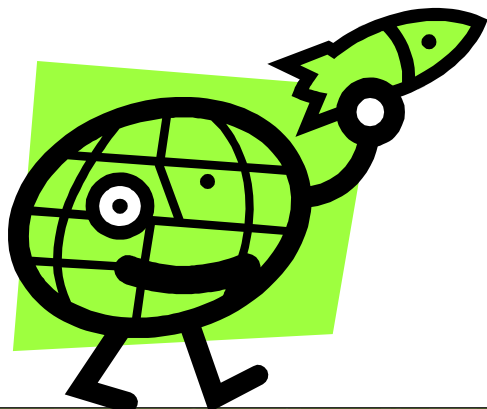


Transformation of goods into intangibles
Transformation of goods into services

Key Features:

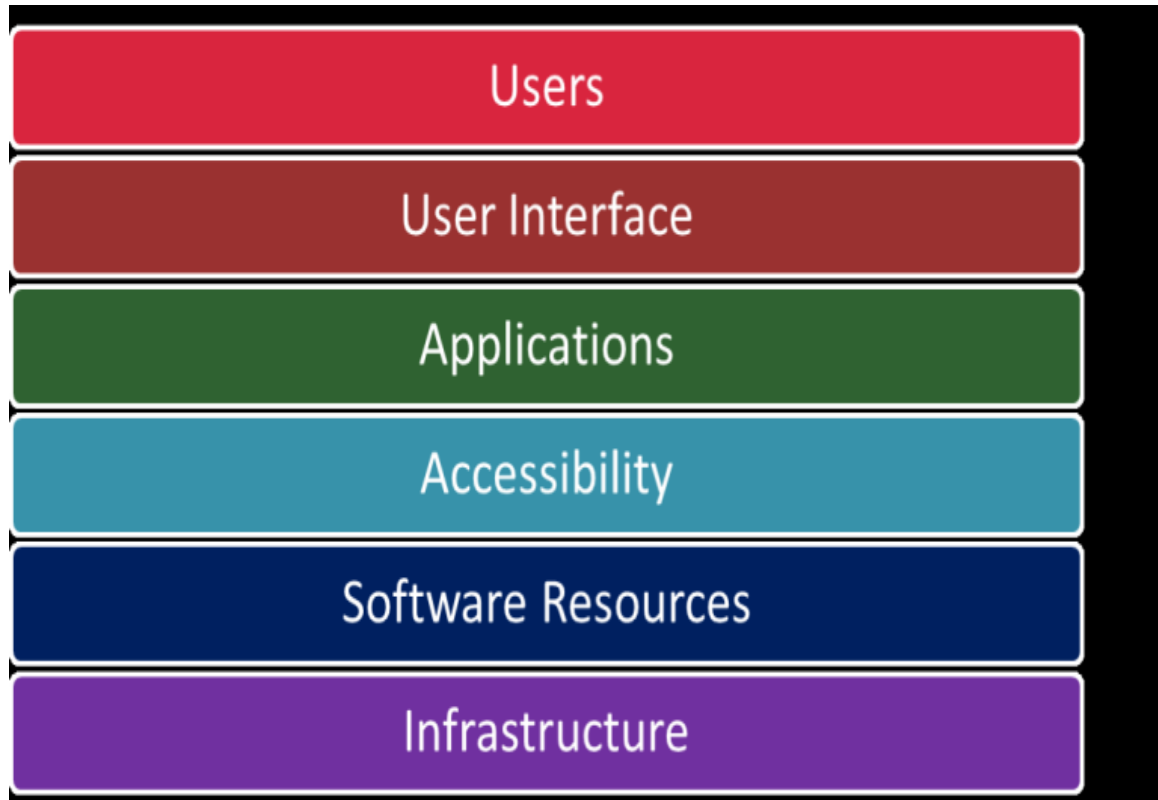
Connectivity (Mobility)

- Connected by technology:
people-machine-things-people
- 24/7 model
- Global (functions separate from customers)
- Virtual



Where?

Key Features: Connectivity

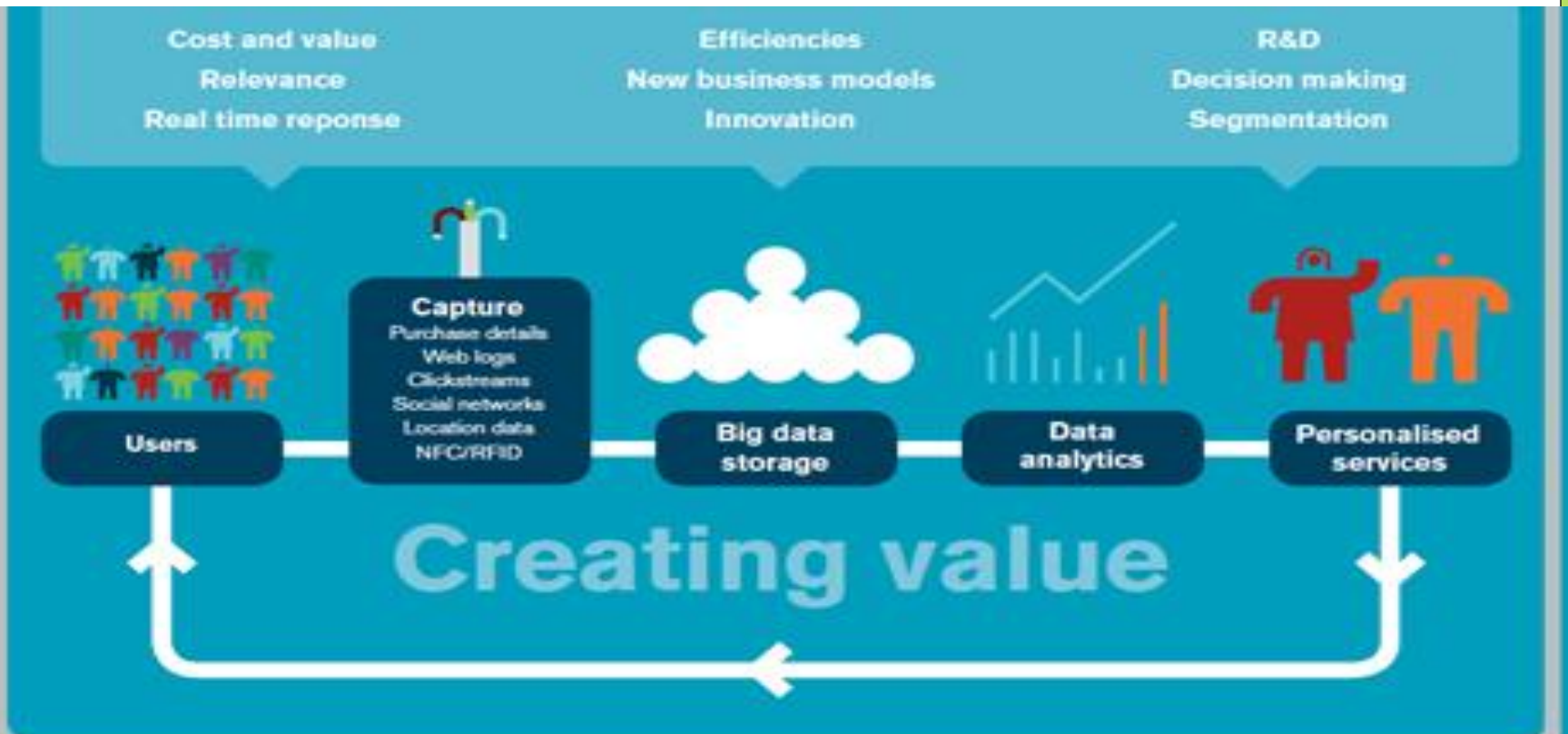


Features: Role of Customers

- Part of the ecosystem
 - “social e-commerce”: Facebook
 - 2-sided business models (eBay)
 - Advertising model (Google)
 - Customers = producers of content (Wikipedia)
- Source of data
 - About consumers
 - Everybody, every industry, business function

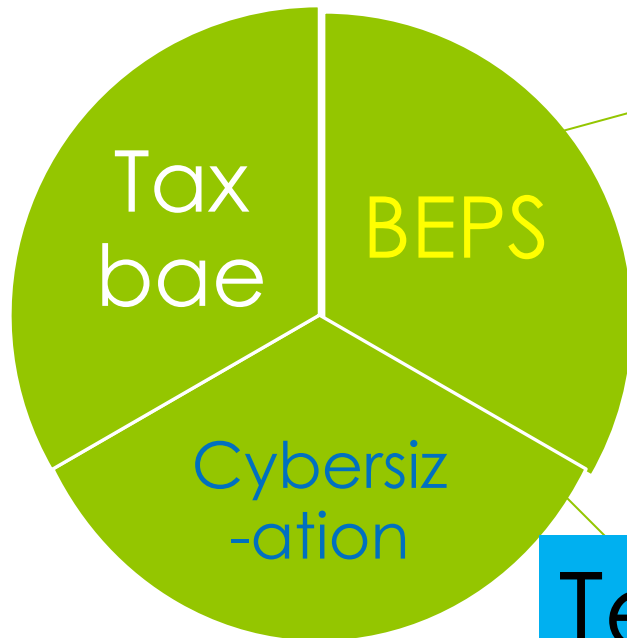


DATA = GOLD



Data is emerging from the back-office to become a major new business opportunity. Data-fever is sweeping the business world, from advertising and telecoms to financial services and energy utilities. And like the Californian gold rush, the data explosion will create its own winners and losers.

Challenges to Tax Base of Developing Countries



Artificial separation of
Income and activity/function

Technological Separation of
customers and producers

Base Erosion: BEPS

Exacerbating the risks of

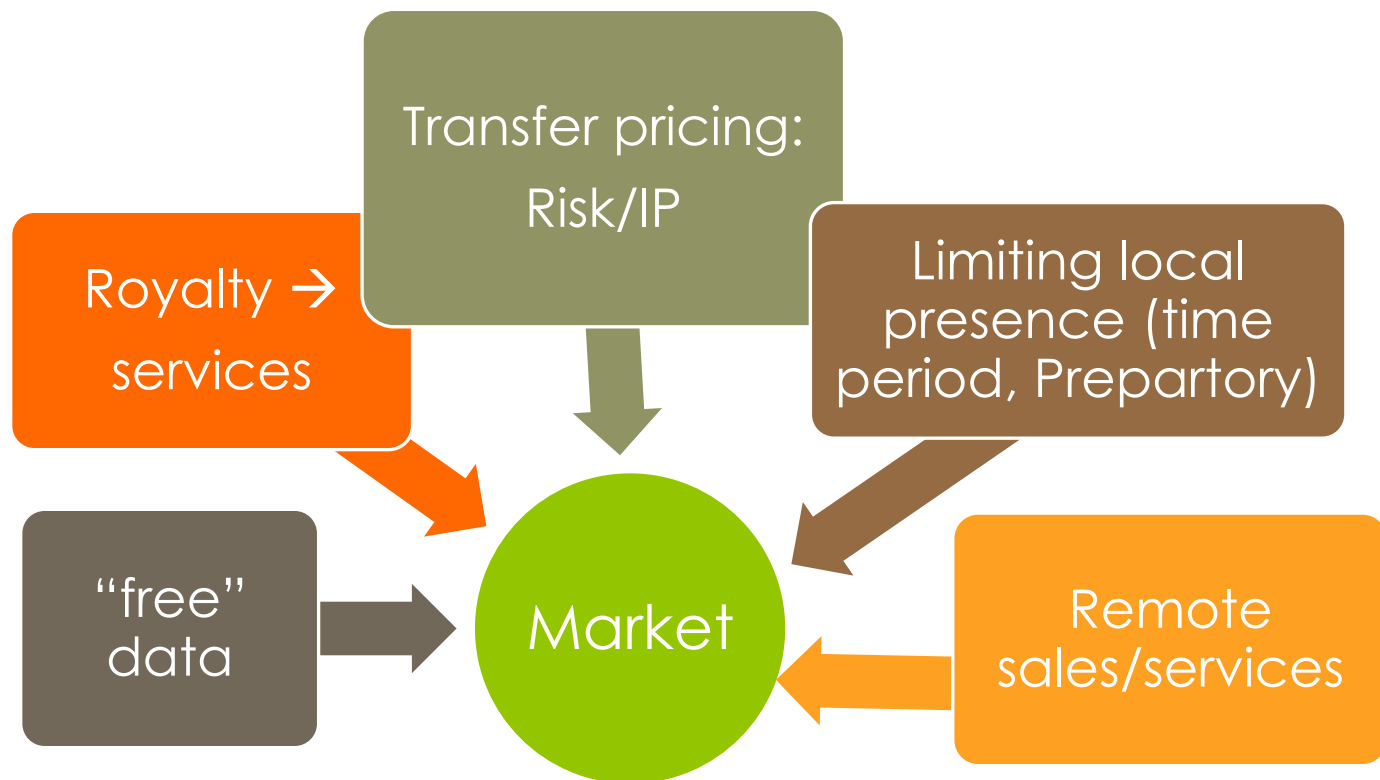
- PE Status
- Transfer Pricing

Base Cybersization

“Mismatch”: Law & Digitization
OECD Discussion Draft:

- Nexus
- Data
- Characterisation
- VAT

Base Cyberisation in Developing Countries



Tax challenges for Developing countries

- ◉ Administrative capacity
- ◉ Technology
- ◉ Access to information
- ◉ “United front”? (OECD, EU ...)
- ◉ Balancing Base Protection and Stimulating the Growth of Digital Economy

Protecting the Tax Base

- Why?
- Why now?
 - “global” Political commitment
 - OECD's work
 - Historic opportunity to “rethink” and “digitize” the tax system?
- Approach

Protecting the Tax Base: BEPS

- ◉ **BEPS Actions**
- ◉ **OECD's BEPS first** approach may not work for developing countries, because:
 - ◉ Solution to PE status manipulation may not serve developing country's needs
 - ◉ Remote sales problem require more "profound" solution
 - ◉ Royalty issue
 - ◉ Transfer pricing problems
- ◉ **Developing countries?** "Broader issues" should be addressed now

OECD: “Broader Issues”

- **Ottawa framework:**
 - Neutrality
 - Efficiency
 - Certainty and simplicity
 - Effectiveness and fairness

OECD: “Broader Issues”

- **Modifying Art.5(4)**
- **“Significant digital presence”**
 - “digital goods/services
 - “widely used or consumed”; existing branch offering secondary functions; does business in a country using personal data from users in that country
- **Virtual PE (website)**
- **New WHT on digital transactions**
- **VAT**

OECD: “Broader Issues”

- **Public comments**

- No “ring fencing” (Also EU Expert Group Report)
- Ottawa Framework
- BEPS before “broader issues”
- Requiring remote vendors to collect VAT (destination principle)

Developing Countries: Options

- ◉ **Additional principles and policy concerns**

1. Profit-value alignment
2. Market countries' taxing right (PE and TP)
3. “Royalty” and services

- ◉ **“Evolutionary” + “transformative”**

Developing Countries: Options

- ◉ **PE test revised and/or reinterpreted**
 - ◉ Art.5(4) exemptions removed or redraft
 - ◉ Interpretation of PE using purposive and substance-over-form approaches (“agency” relationship)
- ◉ **New test – “significant business presence”**
 - ◉ all businesses
 - ◉ Physical and digital presence in market country
 - ◉ “significant” to remove admin/compliance burdens and facilitate cross-border trade

Developing Countries: Options

- **Attribution of profit**
 - Role of customers as buyers and producers
 - “preparatory and auxiliary” functions
 - “functions, risk and assets”: Location or effects

Developing Countries: Options

- ◉ **Deeming B2B services fees as “royalty”**
 - ◉ Evolutionary
 - ◉ Less “draconian” than denying deduction to the payer
 - ◉ “transformative”: source rule and characterisation

Developing Countries: Options

o **Transfer pricing = “broader” issue**

1. **Theoretical** soundness of the ALP?
2. Digitised businesses defy “separate entity”, “comparable”, “transactional” “pricing” –based **methodologies**
3. **Profit-split:**
 - “2-entity” v. “Firm”
 - “risk” based on contractual allocation?
 - “Functions”?
 - “intangibles”? (LSA and location-relevant data)
 - “routine” v. “super” profit?

Developing Countries: Options

◉ VAT

- ◉ Destination-based principle
- ◉ Non-resident suppliers?
 - ◉ B2C
 - ◉ B2B
 - ◉ B2G
- ◉ Extending tax treaties to VAT?
- ◉ New taxes:
 - ◉ “bit” tax
 - ◉ “Amazon” tax
 - ◉ “Google” tax

Wrap Up

- BEPS v. base cybersization
- OECD v. developing countries
- Possible options:
 1. “global”, “digital” solutions
 2. Nexus - PE test: revised, reinterpreted and/or replaced
 3. Royalty include B2B service fees
 4. Transforming the transfer pricing rules
 5. VAT