Digital Services Taxation

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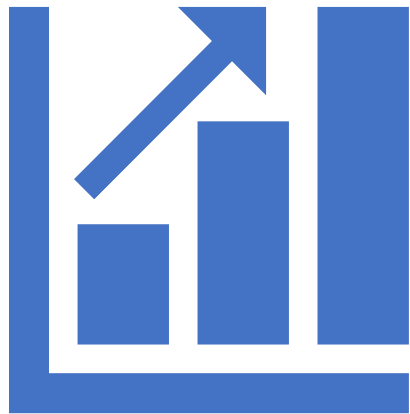
Overview

- The rise of the digital economy
- Why not tax it? The EU initiative
- The French DST and the trade fallout
- Other DSTs out there and in the pipeline
- The OECD and BEPS
- What about the WTO and legal consistency?
- Conclusions

The rise of the digital economy

- Digital economy getting up to one-fifth or GDP
- Growing 2.5 times faster than global GDP
- At the forefront of innovation
- A key source of competitiveness
- But geographical concentration, with 19 of the top 25 tech companies based in the US

Why not tax it? OECD and the EU initiative



- Idea that companies with huge revenues and no physical presence were underpaying their dues
- The OECD’s Base Erosion and Profit Shifting (BEPS) initiative - more later
- The EU’s digital services tax (Fair Taxation of the Digital Economy)
- A 3% levy on revenue earned by tech companies with >€750 million in global turnover and > €50 million in the EU

The EU’s DST (cont.)

- Tax take to be shared proportionately by sales in EU member states
- Approach changes two traditional features of international tax practice:
  - Arm’s-length pricing
  - Physical establishment
- Taxes income on a revenue base and not on profits
- The EU decided to hold off on the tax pending progress at the OECD

The French DST and the trade fallout

- In July 2019 France introduced a retroactive DST modelled closely on the EU scheme, with in-scope thresholds for enterprises of > €750 million in global turnover and > €25 million
- The US initiated a Section 301 (Trade Act 1974) case, securing an award of US$1.3 billion in retaliation with tariffs of 25%
- Among the US arguments: discrimination both in intent and effect (size thresholds plus industry selection)
- France and the US agreed to hold off action pending OECD outcome, but delay of tge latter to mid-2021 may mean France goes ahead with the tax

Other DSTs out there and in the pipeline

- Some 28 other jurisdictions have instituted DSTs or other similar taxes, or are contemplating them:
  - EU members: Austria, Belgium, Czech Republic, Hungary, Italy, Latvia, Poland, Slovakia, Slovenia, and Spain
  - Others: Brazil, Canada, India, Indonesia, Israel, Italy, Kenya, New Zealand, Nigeria, Norway, Pakistan, Peru, Saudi Arabia, Thailand, Tunisia, Turkey, the United Kingdom, and Uruguay
- The US has instituted 301 proceeding against 9 countries:
  - Austria, Brazil, the Czech Republic, India, Indonesia, Italy, Spain, Turkey, the United Kingdom
- These developments speak to the need for a multilateral deal -- US unlikely to be the only retaliating country
- Otherwise increased business costs, heightened uncertainty, and less trade with more friction

Digital tax aspects of the G20/OECD (BEPS) project

- Key tax elements of the project (parts and details of which yet to be agreed)
- Pillar 1: "Unified Approach"
  - Scope includes highly digitized business and consumer-facing businesses
  - New tax nexus between consumers and businesses without physical presence
  - New profit allocation rule beyond arm's-length principle regardless of ownership relationships
  - New tax mechanisms:
    - Amount A – Deemed "residual' profit to be shared among markets via a formula
    - Amount B:- Fixed taxable remuneration for baseline marketing and distribution functions within each jurisdiction
    - Amount C: Binding dispute prevention and settlement, plus possible additional tax for activities exceeding baseline under Amount B

Digital tax aspects of the G20/OECD (BEPS) project (cont.)

- Pillar 2
  - Establishes a minimum tax rate to discourage tax planning – known as the Global Anti-Base Erosion (GLoBE) proposal (not unlike the GILTI mechanism in the 2017 US tax legislation)
  - Includes a tax adjustment mechanisms in cases where sole reliance on the minimum tax rate creates skewed outcomes
- Numerous decisions points remain in BEPs exercise. Concerns include:
  - Possible discrimination through scope limitations (entities and products/activities)
  - Phase-in plans for different elements of proposals
  - Complexity and possibilities of inconsistent interpretations
  - Costs to firms and to tax administrations

What about the WTO and legal consistency?

- Mostly a GATS matter, in particular Modes 1, 2 and 3, the extent of specific commitment key, especially regarding national treatment
- Possibility *de jure* MFN and national treatment infringements a fairly straightforward matter
- The challenging issues relate do *se facto* discriminatory outcomes
  - “Likeness” refers to services and service suppliers – the DST action focuses on profits, so likeness is about suppliers (e.g. thresholds)
  - Likeness also important for “relevant market” considerations (substitutability)
  - Likeness and modes of supply
  - Likeness and technological neutrality (e.g. different technologies same output}
  - Likeness and ownership (e.g. platform versus content)
- Likeness and “less favourable treatment”
- Jurisdictional competence

Conclusions

- In today's digital word, a multilateral tax regime is needed in the same way that most of us believe we need a multilateral trade regime

- The absence of one is cost and conflict-laden in an uncertain world – lose-lose all around

- Consider emphasizing more indirect tax on a revenue base (i.e. sales tax or VAT) instead of a profits tax:
  - Legally more straightforward (fewer "likeness" questions):
  - Less prone to protectionist design
  - Scope issues more straightforward
  - Less to negotiate