The impact of the Digital Era on Tax

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Agenda

- The new Digital Era
- Impact on business models
- Tax consequences

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The new Digital Era

- Bitcoin
- Blockchain
- Cognitive Analytics
- Connected Home
- Drones
- The Cloud
- Internet of Things
- Robotic Process Automation
- Electric and Connected Cars
- Oculus Rift / VR
Blockchain – The biggest disruptive since the internet
Peer-to-peer network with shared ledgers

- Everyone keeps track of all the transactions and the blocks
- With regular intervals new blocks are generated (Bitcoin: every 10 minutes)
- Economic incentive to create & verify blocks
- Consensus: proof of work
- No single point of failure
- No barrier to entry

**Hash**: A calculated number that changes completely, even if there is only a minor change (e.g. space or dot) in the data

**Block hash**: A hash of the data contained in a block

This ensures that the entire ledger becomes a permanent, trusted record
Bitcoin – The new gold rush?

Cryptography currency with open source processes

Application of Blockchain technology

- Mining
- Financial services
- Buying, selling and storing
- Research and support
- Payments
- Retail

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IOT is about INTERCONNECTED TECHNOLOGY ARCHITECTURES that drive smarter actions.

IOT-Enabled processes can grow revenue, cut costs, and save time.
Cloud (Computing)

Cloud computing is characterized by making computing resources such as computing power, storage, databases, and applications available to customers generally through the internet, replacing the install-and-own approach with a pay-as-you-go approach, in which customers pay for the amount of computing resources actually used.

The Cloud: A network of servers with different functions that can provide online services.
The impact on Business Models

- Blockchain
- Internet of Things
- Cloud Computing
- Disruptive technologies
Blockchain – Impact on business models

Real life examples

- Mutual (P2P) insurance based on consensus (crowd insurance)
- Improve KYC process by introducing ID-token, certificate of KYC approval
- Automate & simplify life insurance using smart contracts
- Store and analyse personal health data on Blockchain
- Car insurance: register car and usage data to personalize premium and predict behaviour
- ‘Smart-claiming’: Optimize and automate claiming process (e.g. when missing a flight)
- Using prediction market (Augur) to collect actuarial data
- Real-time remote auditing of companies to ensure solvency
- Tracking valuables (diamonds, art) on Blockchain to secure ownership and guard against counterfeiting
There are many opportunities to create value with IOT
CONSUMER IOT is big and may present an opportunity to shift business models

**SPEED & CONVENIENCE**
- Optimized shopping experiences
- Convenience of payment
- Ease of identifying product and location

**PERSONALIZATION**
- Tailored shopping experiences
- Meaningful recommendations

**UNIQUE EXPERIENCE**
- Surprise and delight the customer
- Experience aligned with customer passions

**Product Development & Customer Experience**
**Consumer Products Company:** products bundled with voice recognition that enable two-way conversations, which the company uses to understand your preferences, offer personalized experience, and feed product development

**New Revenue**
**Global Express Shipping Company:** delivery fleet data is used to construct a real-time perspective of traffic, weather, and other transportation disruptions; this risk and disruption “picture” is sold to other companies

**Efficient Operations**
**Automotive Manufacturer:** automatic routing of auto-bodies through assembly lines based on the temperature and humidity in paint booths

**Product Differentiation**
**Europe-Based Port Authority:** aggregates information from port tenants, optimizes use of space in real-time, and makes the port a more attractive option to shippers
Cloud Computing – Impact on business models

**Providers of cloud computing**
- Creation of transformational technology
- Characterization of transactions
- Virtual permanent establishment status

**Users of cloud computing**
- In stead of buying hardware and software services are obtained on a pay-by-use basis
- Minimizing risks and costs
- Characterization of the transactions: Software, platform, infrastructure
Current organizational capabilities may not support the new model, and risk-averse stakeholders may be resistant to the change. The short-term impact on financial performance may have significant implications both internally and externally.

**The stakes are high and rising**
With traditional business models under threat, the pressure to offer flexibility in consumption is rising.

**The challenge is complex**
Scope of disruption requires a complete reconsideration, recalibration and redefinition of operations.

**There is little room for error**
Failure to act, execute, and transform in a timely manner may threaten the viability of the business.

A successful transformation to flexible consumption models requires strategic thinking, high levels of organizational coordination and alignment, driven by visionary leadership.
Tax consequences
BEPS and the Digital Economy
BEPS – Action 1 & 7

Action 1

Address the tax challenges of the digital economy

Action 7

Prevent the artificial avoidance of permanent establishment status

BEPS Key themes

Widening of the tax base  |  Compliance  |  Enforcement
BEPS – Action 1

The action plan looks at the ability of the company to have a significant digital presence in the economy of another country without being liable to taxation in the other country.

- Attribute digital sales to jurisdiction of customer?
- Attribution of value created to market location data?
- The characteristics of income derived from new business models
- Indirect tax (VAT) issues are also considered
The report examines the evolution over time of information and communication technology, including examples of new business models, and identifies the key features of the digital economy and confirms that treating ‘digital’ as separate from more traditional business for tax purposes would be difficult, if not impossible.

**New Business models**
- E-commerce
- App stores
- Online advertising
- Cloud computing
- High frequency trading
- Participative Networked Platforms
- Payment services

**Key features of the digital economy that are potentially relevant from a tax perspective**
- Mobility
- Reliance on data
- Multi-sided business models
- Networks effects
- Tendency to monopoly/oligopoly
- Volatility
BEPS – Action 1

Options proposed to the Task Force

- Creation of a permanent establishment for fully dematerialized activities based on a significant presence data systematically or having significant contractual, consumption or payment arrangements

- Virtual permanent establishment concept, such as based on maintenance of a website or technological conclusion of contracts or through on-site services at the customer’s location

- Requiring non-resident suppliers of remote digital business to consumer supplies to register and account for VAT in the jurisdiction of the consumer. Lowering the threshold for low value imports and requiring vendors to register and account for VAT in the jurisdiction of importation

- A withholding tax on payments made for digital services or goods

- Modifications to exemptions from PE status, e.g., warehousing
BEPS – Action 1

Consider whether this Action may affect your current tax strategy

- Does the group currently have an online internet site through which sales are made?
- Does the group provide cross-border services ‘remotely’?
- Does the group operate cross-border with centralised servers or data centres?
- Does the group gather data from online customers to which they attribute value?

Quantify potential exposure

- Identify sales income from online sales split by territory
- Calculate appropriate profit margins associated with income by territory
- Calculate additional tax cost consider:
  - VAT impact
  - CT impact
BEPS – Action 7

BEPS Action 7: Prevent the artificial avoidance of Permanent Establishment status

- Commissionaires
- Limited Risk Distributors that automatically bind the POC (e.g., inappropriate level of review at POC of price exceptions, sales contracts, material sales terms, etc.)
- Inventory owned in a warehouse in one jurisdiction by an entity in another jurisdiction
- Tolling arrangements where POC owns inventory
- Procurement or purchasing operations
- Fragmenting local operations in order to manage PE risk
- Splitting service contracts to manage the 183 day rule
- Insurance sales in one jurisdiction on behalf of foreign Insurance or Re-Insurance Co

The goal is to expand the tax base of the countries where the sales, warehousing, manufacturing, or service delivery take place (“source countries”)
BEPS – Action 7

Consider whether this Action may affect your current tax strategy

- Does the group have warehouses in territories which are not regarded as PEs? Are any goods held in these warehouses subject to any processing, modification or packaging?
- Does the group have material sales to customers in any territories, supporting by local marketing teams and/or warehousing, which are not booked as the sale revenue of that territory?
- Does the group have overseas VAT registration where there is no PE?
- Does the group operate any commissioner structures?
- Does the group 'artificially fragment' their operations among multiple group entities to qualify for the exceptions to PE status for preparatory and ancillary activities?
- Consider comment on how changes to PE regime may lead to tax in different jurisdictions but overall tax burden remains the same. Compliance burden will increase.

Quantify potential exposure

- Quantify income flows/profits associated with operations in territories where there is no current permanent establishment
- Calculate potential tax exposure if a Permanent Establishment were regarded as existing in those territories
- Consider whether alterations will be necessary to current structure and cost/time to implement
The Digital Economy – Change in tax fundamentals

Complex tax landscape – Technology and business models shifting faster than regulations can keep up

Indirect tax considerations – Shifting from products to services, nebulous indirect tax implications for cloud-based services

Transfer pricing considerations – Supply chain value drivers, shifting operations to low cost regions

What you call yourself publicly matters – Sub-SEC code definition, telecom nuances

Global tax reset considerations

Leading practices for companies:

- Get tax organization involved in the transition discussions early
- Analyze tax implications throughout the strategy, business model, capabilities and operating model discussion
- Integrate tax planning into the strategy so decisions can be made on after-tax basis
- Act fast and act strategically
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