

BEPS Action 1: Tax challenges of the digital economy

Introduction

The OECD released a discussion draft on 24 March 2014 as part of its work on Base Erosion and Profit Shifting (BEPS). The discussion draft includes proposals for Action 1 (Tax challenges of the digital economy) of the BEPS Action Plan. The Action Plan identifies changes in business as a result of the digital economy as one of the main threats to base erosion.

The draft proposals set out in the document do not represent the consensus views of either the Committee of Fiscal Affairs or its subsidiary bodies, but are intended to provide stakeholders with substantive proposals for comment.

Proposals

(A) Action 1 calls for the OECD to:

“Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services”.

The draft is divided into four main areas of discussion:

- Background on the digital economy,
- Perceived opportunities for BEPS within the digital economy,
- Ways of addressing BEPS with respect to the digital economy (which largely focuses on the manner in which the other action items will address such concerns), and
- A discussion of the potential options to address the broader tax challenges raised by the digital economy.

The proposed options discussed in the draft are:

1. Amendments to the permanent establishment definition,
2. Withholdings taxes on digital transactions, and
3. Consumption tax (VAT) options.

Amendments to the Permanent Establishment Definition

a) Modifications to the Preparatory and Auxiliary Exception

The preparatory and auxiliary exception would be modified or eliminated. The first option would eliminate the exception for preparatory and auxiliary activities for 'certain businesses' where the following activities constitute core functions of the business:

- The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise.

These 'certain businesses' are not defined, just as the 'digital economy' is undefined in the draft, but could catch some very well publicised business models.

Variations on the option are also discussed, including elimination of the preparatory and auxiliary activities exception entirely.

b) Defining Permanent Establishment to mean Significant Digital Presence

This option would provide that if an enterprise is engaged in certain 'fully dematerialised digital activities' then it could have a permanent establishment if it maintained a 'significant digital presence' in the economy of another country. If an enterprise was engaged in a fully dematerialised digital business, a permanent establishment would be deemed to exist if the business maintained a 'significant digital presence'.

c) Virtual Permanent Establishment

The draft also reproduces a few options for alternative permanent establishment standards that have been discussed previously including a 'virtual fixed place of business PE', a 'virtual agency PE' and an 'on-site business presence PE'.

d) Withholding Tax on Digital Transactions

This option would impose a withholding tax on certain payments made by residents of a country for digital goods or services provided by a foreign e-commerce provider.

Consumption Tax Options

With regard to the application of VAT to digital transactions, the discussion draft outlines two options. The first is to reduce or eliminate the generally available exemptions for imports of low valued goods. The second option would require a non-resident supplier to register and account for the VAT on supplies sold in the jurisdiction of the consumer. The compliance burden involved would be significant.

Timetable and Next Steps

Comments are requested by 7 April 2014 given the extremely tight timetable for the BEPS project. A public consultation event will be held in Paris on 14/15 April 2014 before the proposals are finalised in September 2014. Adoption of the final proposals will need to await the multilateral convention (Action 15 – due December 2015), as individual negotiation will be time-consuming.

Deloitte Comment

Tackling the fast-moving digital economy presents an enormous challenge to tax authorities around the world, making it probably the hardest issue faced by the OECD. The OECD is clear that 'structures aimed at artificially shifting profits to locations where they are taxed at more favourable rates, or not taxed at all, will be rendered ineffective by ongoing work in the context of the BEPS project'. There are no proposals for new digital taxes, however the draft seems to imply that unilateral approaches may be considered should the preferred multilateral solutions fail to reach consensus.

Contacts

Albert Baker

Tel: 416-643-8753

Email: abaker@deloitte.ca

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