INSTITUTO DE DIREITO ECONÓMICO FINANCEIRO E FISCAL FDL

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Digitalized Economy & Long-term solutions

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Discomfort with the Current International Tax System

- Action 1 admitted a problem with the current international tax system by discussing other options to tax the increasingly digitalized economy
- Other signs of discomfort with the current allocation of taxing rights rules in the BEPS project:
- The inadequacy of the current residence concept for corporations acknowledged
- Abolition of the place of effective management as a tie-breaker rule in case of dual resident entities, and the requirement of mutual agreement
- At least for groups, the value chain analysis of Action 8-10 renders the concept of residence useless: formal residence is not relevant anymore for the cases of letter or cash boxes

Discomfort with the Digitalized Economy

- February 2013 BEPS Report identifying reasons for discomfort:
- Minimization of taxation in the market country by avoiding a taxable presence
- Shifting gross profits
- Low or no WHT at source
- Low or no taxation at the level of the recipient
- Features of digital in the March 2018 OECD Interim Report: scale without mass, reliance on IP, user value creation



Long-term solutions & consensual aspects

- No specific taxes for the digital sector: exclude ring fence
- Opportunity to discuss the international tax system & allocation of taxing rights
- The role of market place as source with taxing rights on income and a proxy for a PE concept



Different long-term solutions

- Accepting the logic and methodology of BEPS: TP and value creation (functions performed and risks)
- Amending and improving the PE concept, where there is a minimum of active users or online contracts and including anti-fragmentation rules
- To move away from the dominant international tax system: more power to market places/source countries – Article 12 A UNMC vs. source net taxation
- To adopt a destination based-tax: not discussed here
- To integrate the digital economy in a formula-based TP regime or profit-splitting

Wait for BEPS implementation and see

- Actions 8-10 and value creation:
- They intend to level the playing field between source and residence (residence as a qualified source state, a genuine link)
- Do they have the potential to allocate rights to market places too?
- Chapter VI OECD Guidelines permits market states to allocate very relevant value to the 'market' if the concept of intangibles is fully developed, but many countries have not realized the potential of chapter VI (unlike the US or Canada, for instance (Adolfo Martin)
- But R and S obsolete? Value creation focus mainly on geographic location of people's function and assets – capital and risk (De Wilde)
- Actions 7 on PE, 6 on treaty abuse and 5 on harmful tax practices could improve taxation of digitalized economy?

Digital PE (EU Commission Proposal)

- Considered to exist in a Member State in a tax period

- If the business carried on through it consists wholly or partly of the supply of digital services through a digital interface

Digital PE (EU Commission Proposal): Significant Digital Presence as a relevant function

(1) the proportion of total revenues obtained in that tax period and resulting from the supply of those digital services to users located in that Member State in that tax period exceeds EUR 7,000,000;

(2) the number of users of one or more of those digital services who are located in that Member State in that tax period exceeds 100,000;

(3) number of business contracts for the supply of any such digital service that are concluded in that tax period by users located in that Member State exceeds 3,000.

Long-term solutions: Digital PE and significant digital presence

- Digital PE and the Israeli case:
- Amending the PE concept, on the basis of number of contracts, customers and taylored services (e.g., use of Hebrew language, style, use of Israeli currency, etc.);
- (are they equivalent to relevant functions? To sales with a minimum threshold?)
- Minimum threshold of sales equivalent to PE
- TP rules on the basis of value creation do not seem to fit
- Israeli rules add:
- high web traffic by Israeli users; and
- close correlation between the consideration paid to the foreign company and the level of internet usage of Israeli users
- Discretion on allocation of profits and bilateral conflicts



Long-term solutions: virtual PE

Conclusions

- Compatibility with tax treaties:
- The virtual PE will need new allocation of taxing rights rules (i.e. different from TP rules)
- Otherwise, ring fence and conflict with residency TP rules (potential double taxation)
- Profit splitting formula would be necessary/recommendable (Vikram Chand)

Withholding tax

Net v Gross withholding tax

Net: De Wilde

Gross: Article 12 A UNMC and Credit by the Residence State: Andres Baez

If only applicable to services: tax planning

Applicable to services and passive income

How to distinguish from independent activities under Article 14 UNMC

Incompatible with a digital PE?

Would there be agreement in OECD?

Regional standards: Article 12-A and CCCTB and profit splitting

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My position: Profit Splitting, CCCTB and Regional Coordination

- Profit splitting together with CbC reporting could in the future bring us to a formula apportionment regime
- If formula based on relatively immovable factors: sales, assets, payroll/employees, little room for avoidance
- No need to also amend and improve the PE concept in B2B situations
- CCCTB: only applicable to EU-based group
- Regional coordination
- If no international court: Still room for double taxation and conflicts among jurisdictions