Speakers

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— Matthew Herrington, Partner, International Tax, KPMG in the UK

— Kirsty Rockall, Partner, Global Transfer Pricing Services, KPMG in the UK
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Agenda

— Digital taxation – Overview
— Digital tax proposals
— A transfer pricing approach to the concept of digital presence
— Observations and looking ahead
— Q&A
Digital tax proposals

How did we get here?
Overview

2000 – 2010: e-commerce taxation and treaty commentary

October 2015: BEPS Action 1 report


2017: Emergence of unilateral measures

November 2017: OECD public consultation

March 2018: Delivery of OECD & EU report/draft
The terms of the debate

Why Ireland faces a fight on the corporate tax front

New charge chips away at the tax package which Ireland offers to foreign investors

© Mar, 15, 2018, 06:00

Cliff Taylor

IN THE SPOTLIGHT

IN THE SPOTLIGHT

Fair Taxation for the Digital Economy

Fair Taxation for the Digital Economy

The 2018 Interim Report

- 8 Chapters, in particular:
  - In-depth analysis of business models and value creation
  - Steck-leck exercises on BEPS implementation and impact
  - Long-term solution
  - Interim measures
  - Special feature
  - Next steps

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Where are we now?

OECD 2018 Interim Report
OECD 2018 Interim Report

DE tax concerns

- Nexus – exploitation without traditional nexus
- Data – how to attribute value
- Characterization – digital revenues

User value creation

- No consensus
- Concerns include user data, use of infrastructure, and base erosion

Organisation for Economic Co-operation and Development

Long-term solution

- No consensus
- Nexus – jurisdiction to tax nonresidents
- Profit allocation – how to allocate profits to jurisdictions

Interim measures

- No consensus
- No recommendations
- Framework agreed as to design of interim measures
## Unilateral DE measures

### Summary of unilateral country measures

<table>
<thead>
<tr>
<th>Alternative PE thresholds</th>
<th>Withholding taxes</th>
<th>Turnover taxes</th>
<th>Specific regimes for large MNEs</th>
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<tbody>
<tr>
<td>— Significant economic presence test (e.g., Israel, India)</td>
<td>— Broader royalty definitions</td>
<td>— Targeted sectors such as digital ads (e.g., Hungary)</td>
<td>— Diverted profits tax (e.g., U.K and Australia)</td>
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<td>— Virtual service PE (e.g., Saudi Arabia)</td>
<td>— Technical service fees</td>
<td>— Levy on digital transactions (Italy)</td>
<td>— BEAT (U.S.)</td>
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<td>— Online advertising</td>
<td>— Equalization levy (e.g., India)</td>
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The views of countries can be categorized into three groups

- **Group 1**
  - User participation is value creation
  - Targeted measures needed
  - Otherwise maintain existing international framework

- **Group 2**
  - Digitalization challenges existing international framework
  - Such challenges are not exclusive to DE

- **Group 3**
  - BEPS appears to be effective
  - Full impact yet unknown
  - Satisfied with existing framework
  - No significant reforms
Interim measures

Countries favoring interim measures agreed on design parameters

— Compliance with international obligations (treaty, WTO, EU, EEA, etc.)
— Temporary
— Targeted (e.g., digital ads, platform services)
— Minimizing over-taxation
— Minimizing impact on start-ups and SMEs
— Minimizing cost and complexity
Where are we now?

EU Proposal
March 21 EC Proposal

DE tax concerns
- Competition distortion between DE and traditional businesses
- DE intangibles are hard to value and distort concepts of jurisdiction to tax

User Value Creation
- Active engagement and user data
- Free use of legal and commercial infrastructure

Long-term solution
- Digital PE
- Wide scope of activities
- EU directive and amend treaties

Interim Measures
- Digital Services Tax (DTS)
- Source revenues based on user location
- De minimis thresholds
Proposals by the European Commission of March 21, 2018

Proposal of March 21, 2018 – unanimity required

**Comprehensive solution:** Stand-alone directive on digital PE + non-binding recommendation for double tax treaty situations

**Targeted (interim) solution:** Directive on DST

3% tax on gross revenues from user value creation

Annual worldwide (group) revenues > EUR 750 mil. and digital (group) revenues in the EU > EUR 50 mil
Taxation of the Digital Economy

Digital Services Tax: Scope

Transmission of Data
- Websites publishers
- Apps developers
- Advertisers
- Platform services that bring consumers and suppliers together (housing, taxi services etc.)

Intermediation Services

Outside of scope?
- Supply of digital content
- E-commerce (not including intermediary services)
- Multiplayer online games, payment services
- Traditional newspapers

Supply of Advertising
Taxation of the Digital Economy

Digital Services Tax in Brief

**Directive on a digital services tax on revenues**
- Address mismatches between taxation of profits and value creation (high involvement of users)
- Tax on gross revenues from user value creation (i.e., processing user participation):
  - Valorization of user data via ad space or sale
  - Making available digital platforms to users
- 3% single tax rate
- Businesses that have annual worldwide (group) revenues > EUR 750M and digital (group) revenues in the EU > EUR 50M
- Tax due where users are located
  - Allocation key depending on the digital services
  - One-stop-shop simplification system

— No difference between purely domestically operating companies of international operating companies. So not only the U.S. tech companies are affected.

— Does the taxpayer have to pay the tax also when it is making a loss or paying a “normal” effective tax rate?

— Is the DST deductible as an expense or creditable as a foreign tax credit?
Taxation of the Digital Economy

Digital Services Tax: Challenges

Direct or Indirect Tax?
- Has features of a **direct** tax
- Imposed on revenues
- From certain targeted activities.

Is It EU State Aid?
- Yes in principle ⇒ selective
- Justification? ⇒ end a distortion and unfair competition
- Approved state aid?

Double Tax Treaties?
- Is this an income or profit tax?

Mandatory Disclosure Rules?
- Does the DST fall under mandatory disclosure rules?
- Yes. It is imposed by a Member State (MS), and not mentioned under the exemptions.
EU Digital Permanent Establishment in Brief

**Scope**

*Standalone directive on the taxation of digital activities*

- Taxpayers incorporated or established in the EU and outside of the EU but with no relevant double tax treaty, AND with a **significant digital presence** in the EU
- *Outside of scope*: Situations where a double tax treaty with the relevant MS applies

**Significant Digital Presence**

*Taxable nexus in addition to the existing PE concept*

- Digital businesses relying on a large user base, user engagement and user’s contribution
  - Revenues from digital services in a MS > EUR 7 million, or
  - Number of users in a MS > 100,000, or
  - Number of online contracts with in a MS > 3,000
- Digital service ☰ service delivered over the internet or an electronic network, the nature of which renders its **supply essentially automated** and involving **minimal human intervention**

**Profit Allocation**

*Profit allocation relying on the current OECD framework applicable to PE*

- OECD arm’s-length principle based on significant people functions relevant to the attribution of risk and to the economic ownership of assets, AND
- Tailored framework for economically significant functions, e.g.:
  - Activities undertaken through a digital platform related to data and users
  - DEMPE functions, even if not linked to people functions in the same MS
  - Profit split method (e.g. R&D costs, marketing expenses, # users, data collected, etc.)
EU Digital Permanent Establishment: Challenges

**Double Tax Treaties**
- Yes, as this concerns a tax imposed on income, profits.

**Mandatory Disclosure Rules**
- Yes, it is a normal corporate income tax, imposed by a Member State, and not mentioned under the exemptions.

**Interaction with the OECD**
- Profit attribution based on OECD work
- Specific guidelines to be developed at the appropriate international fora

**Profit Allocation**
- How are profits allocated to the PE?
- In principle profit split but
- Taxpayer may use functional analysis if this proofs to be more appropriate
Where are we now?

UK Position Paper
UK Position Paper

DE tax concerns
- Active user participation creates value in user’s jurisdiction
- Current international framework does not recognize this value

User value creation
- Active engagement and user data
- Creation of content
- Network effects

Long-term solution
- Digital PE
- Split residual profits to user’s jurisdiction
- Amend treaties

Interim measures
- Gross revenue tax
- Source revenues based on user location
- De minimis thresholds

HM Treasury
A transfer pricing approach to the concept of digital presence
Underlying principle for transfer pricing is that profits should be taxed where value is created. However, in a digitalized world, it is not always clear:

— What the value is,
— How to measure it,
— or where it is created

How to capture activities which are increasingly based on intangible assets and data?

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<th>Development</th>
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<td>Protection</td>
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<td>Exploitation</td>
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What is digital presence?

“Occupy space online....”

What does this mean for transfer pricing?
Approach: where do you start?

01 Identification

02 Evaluation

03 Application
Observations and what lies ahead
Observations and design challenges

Both long-term and interim measures raise a number of design and implementation issues. Consensus on these considerations will be difficult and time consuming.

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<th>International obligations</th>
<th>Transfer pricing</th>
<th>Design considerations</th>
<th>Scope concerns</th>
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<tr>
<td>How do you design a digital tax consistent with treaty obligations?</td>
<td>Consistent with arm’s-length principle?</td>
<td>Party to tax</td>
<td>How to define what’s in and what’s not?</td>
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<tr>
<td>What are the implications?</td>
<td>Challenges with a “modified” authorized OECD approach (AOA)</td>
<td>Sourcing profits and revenue</td>
<td>Flexibility for future DE business models</td>
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<td>The “U.K. approach”</td>
<td>Assessment and collection</td>
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Big picture and looking forward

Will these proposals really become reality and what will it mean to international tax norms?

— What is this debate really about?
— Is consensus possible for a long-term solution that singles out the DE possible?
— Are there broader trade implications?
— Where will we be in the future (one year out? five years out?)

Q&A
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Thank you for joining us.

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