Speakers

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— **Lachlan Wolfers**, Head of Indirect Tax Digital Economy, KPMG China

— **Mimi Wang**, Partner, Transfer Pricing, KPMG China

— **Conrad Turley**, National Leader, Tax Technical Centre, KPMG China
Administrative

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Agenda

— Digital tax proposals
— A transfer pricing approach to the concept of digital presence
— Observations and looking ahead
— Indirect Taxes
— Future directions
— Q&A
Digital tax proposals

How did we get here?
2013: Collin & Colin Report in France

October 2015: BEPS Action 1 report

2016: Equalisation Levy in India

2016: 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 crops up as the tax package which Ireland offers to foreign investors

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Where are we now?

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
- Attempt to set out analysis of value creation processes, which will be further refined

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
Country views are categorized into three groups

Group 1
- Targeted rules for certain highly digitalised businesses where reliant on user participation/contributions
- Otherwise maintain existing international framework

Group 2
- Broader reconsideration of the international tax framework
- Different opinions on significance of user participation/contributions

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

OECD 2018 Interim Report - Three views on the way forward
### 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>
</tr>
</thead>
<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>
</tr>
<tr>
<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></td>
<td>- Online advertising</td>
<td>- Equalization levy (e.g., India)</td>
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Countries favoring interim measures observe design considerations

— 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 & UK Position Paper
Digital Services Tax - Interim solution

A. Scope
(i) Transmission of Data: website publishers, App developers, Advertisers
(ii) Intermediation Services: platforms that bring consumers and suppliers together
(iii) Supply of advertising
(iv) Out of scope?: supply of digital content, e-commerce ex intermediation, payment services?

B. Tax
(i) Tax on gross revenues
(ii) 3% single tax rate
(iii) Annual worldwide revenues > EUR 750M and digital revenues in the EU > EUR 50M
(iv) Tax due where users are located
   – Allocation key depending on the digital services
   – One-stop-shop simplification system

C. Observations
(i) No difference between purely domestically operating companies and international companies
(ii) Pay the tax also when it is making a loss or paying a “normal” effective tax rate?
(iii) Is the DST deductible as an expense or creditable as a foreign tax credit?
A. Standalone directive on the taxation of digital activities

(i) 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

(ii) Outside of scope: Situations where a double tax treaty with the relevant Member State applies

B. Taxable nexus in addition to the existing PE concept

(i) Rely on a large user base, user engagement and user’s contribution

(ii) Revenues from digital services in a MS > EUR 7 million, or no. of users in a MS > 100,000, or no. of online contracts with in a MS > 3,000

(iii) Digital service delivered over the internet or an electronic network, the nature of which renders its supply essentially automated and involving minimal human intervention

C. Profit allocation relying on the current OECD framework applicable to PE

(i) OECD arm’s-length principle based on significant people functions relevant to the attribution of risk and to the economic ownership of assets, AND

(ii) Tailored framework for economically significant functions
A transfer pricing approach to the concept of digital presence
The 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?

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

**International obligations**
- How do you design a digital tax consistent with treaty obligations?
- What are the implications?

**Transfer pricing**
- Consistent with arm's-length principle?
- Challenges with a “modified” authorized OECD approach (AOA)

**Design considerations**
- Party to tax
- Sourcing profits and revenue
- Assessment and collection

**Scope concerns**
- How to define what’s in and what’s not?
- Flexibility for future DE business models
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?)

Indirect Taxes
The digital economy - indirect tax policy issues

Problem 1 – low value imports of goods are not subject to VAT/GST, and online shopping has grown

The problem:

Recommendations:
— Thresholds below which VAT/GST does not apply should be lowered
— Tax authorities to significantly improve efficiency of processing imports
— Introduce simplified registration systems to enable non-residents to register for VAT/GST

Balance the costs
- Of Customs / Tax authorities collecting tax on importation and of enforcement
- Of compliance costs on business

With the potential inequity
- Overseas suppliers are favoured over local suppliers if no VAT applies
- Should overseas suppliers have to meet a turnover threshold? What about marketplace operators?
# Problem 1 - low value goods - collection method

<table>
<thead>
<tr>
<th>VAT regulatory change</th>
<th>Examples of jurisdictions</th>
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<tbody>
<tr>
<td><strong>Currently applicable</strong></td>
<td><strong>Legislative phase</strong></td>
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<tr>
<td><strong>Goods</strong></td>
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<tr>
<td>Vendor liable – withdrawal of import relief for low value consignments</td>
<td><img src="image" alt="Brazilian flag" /></td>
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<tr>
<td>Marketplace operator liable (in certain circumstances)</td>
<td><img src="image" alt="Brazilian flag" /></td>
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<tr>
<td>Marketplace operator jointly &amp; severally liable</td>
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<tr>
<td>Logistics provider liable under merged VAT/Customs e-commerce model</td>
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<tr>
<td>Collection from debit/credit card issuers facilitating transactions</td>
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<tr>
<td>Split payment method</td>
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<td>Deeming a PE through imposing VAT registration obligations</td>
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The digital economy - indirect tax policy issues

Problem 2 – how to collect the VAT/GST on importation of digitized services supplied Business-to-Consumer (B2C)

The problem:
— Overseas service provider may have no PE in country and is not registered for VAT
— No VAT or GST is currently being paid on importation
— Collecting the VAT from end consumer is impractical

OECD recommendations:
— Require non-resident suppliers to register for VAT/GST and account for output tax. Allow for simplified registration processes.
— No point in imposing VAT/GST collection obligations on end-consumers. Improve information exchanges, assistance with audits and recovery to enforce.
Problem 2 - digitized services B2C - models

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<tr>
<td>Marketplace operator liable</td>
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<tr>
<td>Customer withholds or assessed</td>
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<tr>
<td>Split payment method (including goods)</td>
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</table>
Problem 3 – how to collect the VAT/GST on imported intangibles and services supplied Business-to-Business (B2B)

The problem:
— No VAT or GST is paid on importation
— If recipient business is not eligible for a full credit, creates a bias in favour of procuring from offshore service providers rather than domestic service providers
— Largely affects banks and other FS service providers (not fully creditable)

OECD recommendations:
— B2B: introduce reverse charge rules
## Problem 3 - B2B models

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<td>VAT withholding by recipient</td>
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### Currently applicable

- Reverse charge on all supplies
- Reverse charge where leakage only
- Split payment method
- VAT withholding by recipient
- Nothing

### Legislative proposals

- (electronic services only)
- (transactions with public agencies only)

### Policy discussion / consultation
Other ASPAC DE examples

**Taiwan**
- 20% tax rate
- Applicable to cross border e-services (e.g. online games, ads and streaming) and services utilised in physical location in Taiwan
- May apply to both B2B and B2C services
- Net basis taxation applies, with deduction for either actual costs or by applying deemed profit ratio
- Collection on WHT basis through domestic and foreign platforms

**India**
- 6% equalisation levy applicable to online B2B advertising by foreign entities earned in India since June 2016
- Proposal now to apply “virtual PE” where “significant economic presence” in India. Applies where (1) foreign company provides goods, services into India, including through downloads and exceeds a threshold (TBD); and (2) foreign company engages in solicitation of business in India through digital means on a sustained basis. Intended to take effect from April 2019

**Thailand / Indonesia**
- At various stages, both have proposed variations of ‘deemed PE’ measures – though currently in abeyance
- Thailand has not progressed further at this stage, favouring VAT measures
- In 2016 Indonesia proposed requirement to establish a PE if providing digital services, and in 2017 issued Circular Letter proposing enhanced PE measures around servers/data centres
Multinational Anti-Avoidance Law (MAAL)

- Effective 1 Jan 2016- Deemed PE, plus penalties
- Applies to significant MNEs (AUD1B+ turnover) supplying goods or services to Australian customers, and recording revenue overseas
- Arrangements with “a principal purpose” of avoiding tax in Australia or reducing foreign tax liability
- Target 30 unnamed multinationals, but will have broader impact
- Restructuring to MAAL compliant structures

Diverted Profits Tax (DPT)

- Effective from income years commencing on or after 1 July 2017
- 40% tax rate
- Applies to significant global entities (AUD1B+ turnover)
- Arrangements entered into or carried out for a principal purpose of avoiding Australian tax
- Primarily relevant where payments made to a jurisdiction with a tax rate significantly lower than Australia.
Future directions
Direct taxes and indirect taxes are morphing

**Tax authorities are seeking to expand PE:**
Concept of a PE based on physical presence is under threat

**Will US Sales Taxes provide the answer:**
US Supreme Court to decide challenge to *Quill (1992)* in *South Dakota v Wayfair*
Direct tax and indirect taxes are morphing

Consider the following:

- Proposals by the OECD and the European Union (EU) to move away from traditional PE based concepts of taxation – e.g. EU’s Digital Services Tax, India’s “significant economic presence”, Trump’s original destination based border adjustment tax

- Corporate taxation based on place of consumption is perceived to achieve alignment with business self-interest and inherently more difficult to avoid

- Banking regulation (AML & KYC) as well as developments in payment processing are also making it more difficult to derive revenues in a country without a PE. MAAL rules such as AU and UK also triggering restructuring

- Conclusion - direct taxes which rely on indirect tax collection methods will proliferate
## Key takeaways - what it means for clients

| 1 | Clients are required to comply with new taxes based on where their customers may be located. They require our help since they may not have tax teams and resources in country. |
| 2 | Indirect tax collection methods and resources will need to be deployed for new direct taxes too – who should take ‘ownership’ of them? |
| 3 | A big challenge of the tax function amongst many digital economy clients right now is in managing the data. We need to help them get the information to meet their obligations. |
| 4 | These measures are currently focused on digital economy clients. How will this affect the next wave of clients – such as FinTech, traditional retailers with e-commerce business etc. |
| 5 | Direct taxes will increasingly be destination based – this has the potential to alter effective tax rates and the resourcing required to manage those taxes. |
| 6 | Assisting our clients requires greater member firm collaboration than normal in managing multijurisdictional obligations. |
| 7 | Watch developments in other taxes as a guide to the future direction of PE based concepts. |
| 8 | We need to ensure we communicate developments to clients and throughout the network on a very timely basis. Providing a global proposition is key. |
Q&A
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