

# Do we have the wrong tax system for the digital economy?

Alf Capito, Tax Policy Leader, EY Asia Pacific

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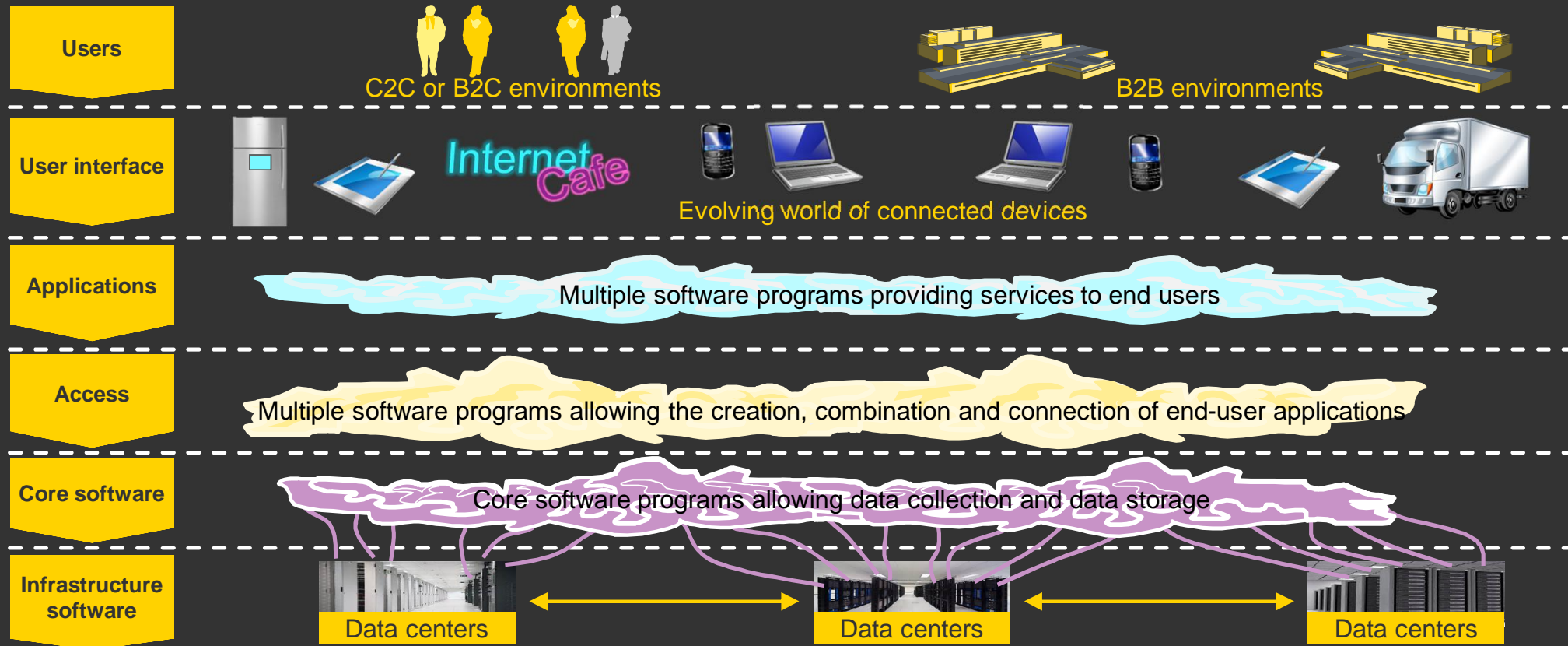


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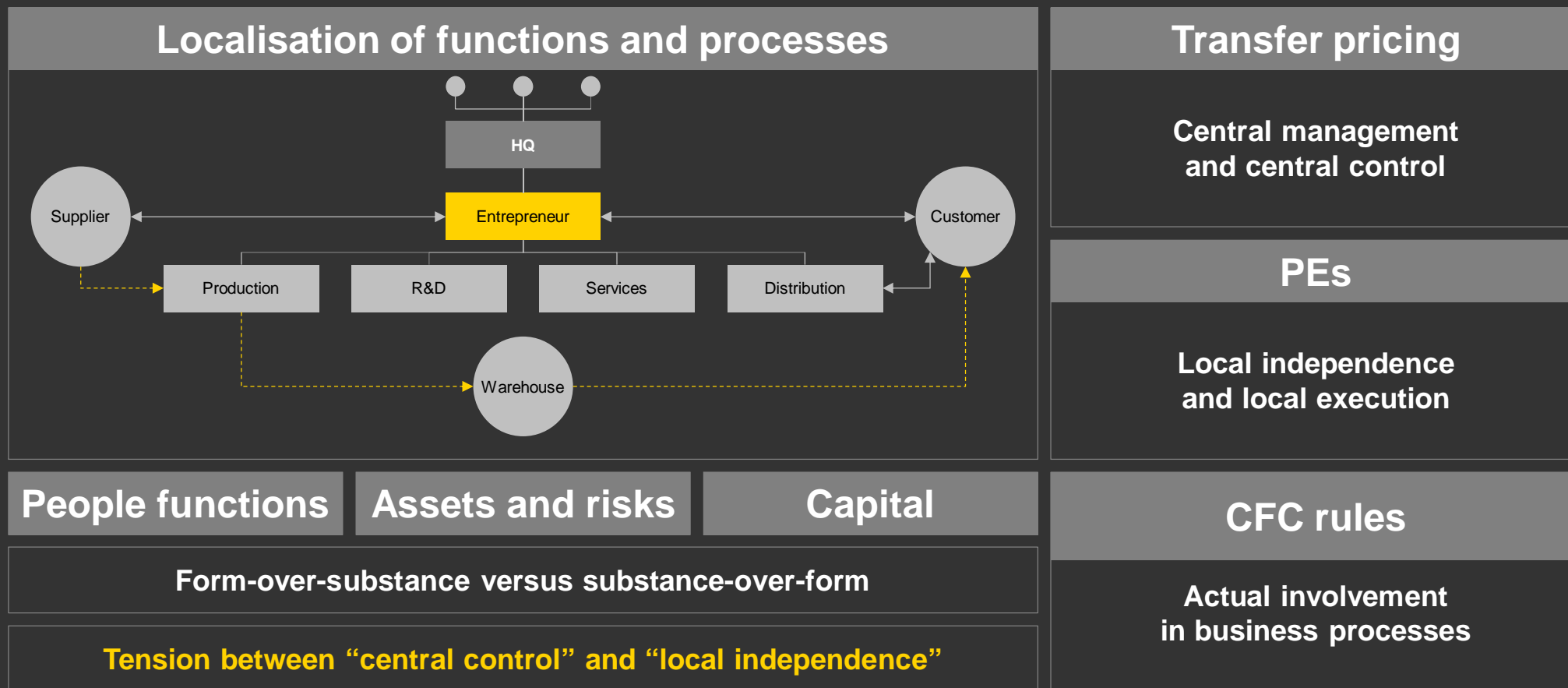
# Key features of the digital economy as seen by the OECD taskforce



# The key layers of the digital economy



# Bifurcation of business processes and inputs driving globalisation



# Case Study

## Allocation of functions in a global accounting firm

### Functions – transfer to other jurisdiction



### Topics

**Transfer of functions as qualitative business reason**

**Assessment of allocation of functions or assessment of transactions only**

**Form-over-substance versus substance-over-form**

# The current state of international taxation principles specifically concerning the digital economy

Changes introduced to model convention and its commentaries

Article 5 (PE) Commentary 42.2: **automated equipment may constitute a PE**

Article 5 Commentaries 42.2 and 42.3: **a website cannot constitute a PE, nor can the hosting of such a website on a server**

Article 12 (Royalties) Commentary 17.1: **principles expressed on software payments are also applicable as regards transactions concerning other types of digital products**

Article 12 Commentary 11.1: **know-how contract involves imparting to other party special knowledge and experience which remain unrevealed to the public**

# Addressing Tax Challenges of the Digital Economy incorporates all BEPS themes

1. Address the Tax Challenges of the Digital Economy
2. Neutralise the Effects of Hybrid Mismatch Arrangements
3. Strengthen Controlled Foreign Companies Rules
4. Limit Base Erosion via Interest Deductions and Other Financial Payments
5. Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
6. Prevent Treaty Abuse
7. Prevent the Artificial Avoidance of PE Status
8. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Intangibles
9. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Risks and Capital
10. Assure that Transfer Pricing Outcomes are in Line With Value Creation / Other High-Risk Transactions
11. Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It
12. Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements
13. Re-examine Transfer Pricing Documentation
14. Make Dispute Resolution Mechanisms More Effective
15. Develop a Multilateral Instrument

Coherence

Substance

Transparency

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# Benefits of the multilateral trading system

## Unilateral action (tax base land grab) creating new tariffs

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Fundamental WTO principle that open trade and an open economy unlock the benefits of the multilateral trading system

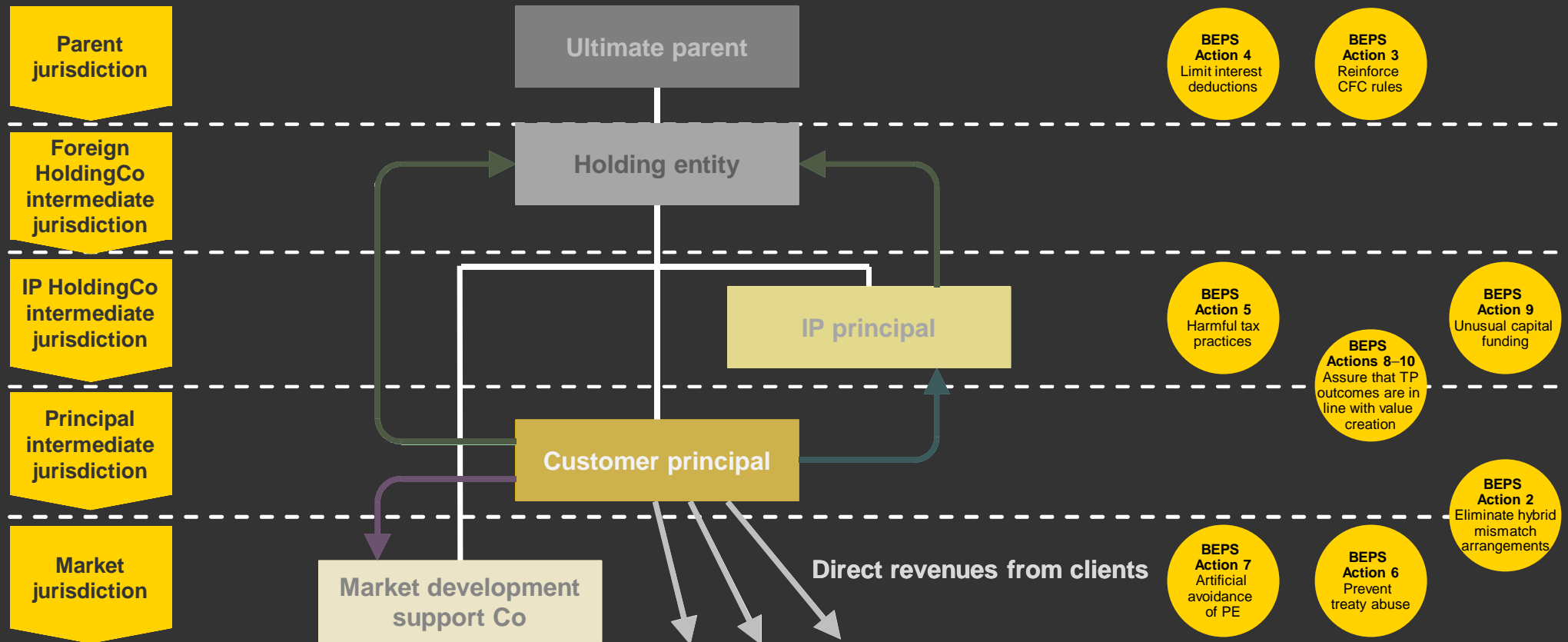
- ▶ Liberal trade policies (policies that allow the unrestricted flow of goods and services) sharpen competition, motivate innovation and breed success
- ▶ Temptation to ward off challenge of competitive imports always present (subsidies, complicated red tape, legitimate policy objectives)

London Model (1945), OECD (from 1968) and UN (from 1980) Models

- ▶ Merely selling into a market without physical presence or a dependent agent within the market is not sufficient to create a permanent establishment allowing that country to claim a share of the enterprise's profit



# According to the OECD, tax features of the digital economy exacerbate the possibility of BEPS activities



# The broader tax challenges raised by the digital economy and potential options discussed by the OECD taskforce

## Challenges

- ▶ Nexus and ability of significant economic impact without being liable to tax
- ▶ Value of marketable location data
- ▶ Characterization of income under new business models
- ▶ VAT and consumption taxes

Country-by-country reporting

Where appropriate if BEPS actions were insufficient

Country-by-country reporting

## Potential options

- ▶ Modifying exemptions under paragraph 4 of Article 5
- ▶ New nexus by reason of significant digital presence
- ▶ Virtual PE
- ▶ Withholding tax on digital transactions
- ▶ Consumption tax option

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# Will the Ottawa Conference principles really survive the forthcoming changes?

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# Certainty and simplicity

## Currently uncertainty prevails



**74%** of the largest companies say they feel that tax administrators are now challenging existing structures due to changes in the law or changes in their enforcement approach.



When asked to what extent they foresee more double taxation for their company in the next two years, **61%** of the largest companies expressing an opinion either agreed or strongly agreed.



**30%** of large companies think the situation will be characterized by relatively limited coordinated action and more unilateral actions by countries.

[www.ey.com/taxriskseries](http://www.ey.com/taxriskseries)

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# Australia's tax system already strong

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- ▶ CFC rules undermining ability to create global hubs without substance
- ▶ Transfer pricing rules very tight to the point of being dangerous by allowing hypothetical reconstruction
- ▶ Tight thin capitalisation rules
- ▶ No IP regime or patent box concession
- ▶ Interest withholding tax
- ▶ General integrity rule in new treaties and GAAR

**Thank you**

