

Taxing the Digital

Janette Toral

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E-COMMERCE ACTIVITIES



B2C

**Business to
Consumer**

When person
buys products or
services online.



B2B

Business to Business

When E-Commerce
Website orders
from suppliers or
sellers to deliver to
customer.



C2C

**Consumer to
Consumer**

When Consumers
directly trade with
one another.



**G2B
G2C**

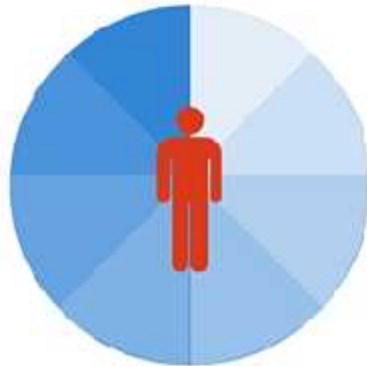
**Government to
Business or Consumer**

When government
transacts with
business or
consumer online.

E-Commerce



Basic Revenue Models



Guru

Person or entity
expert services.



Retail

Tangible and
electronic products.



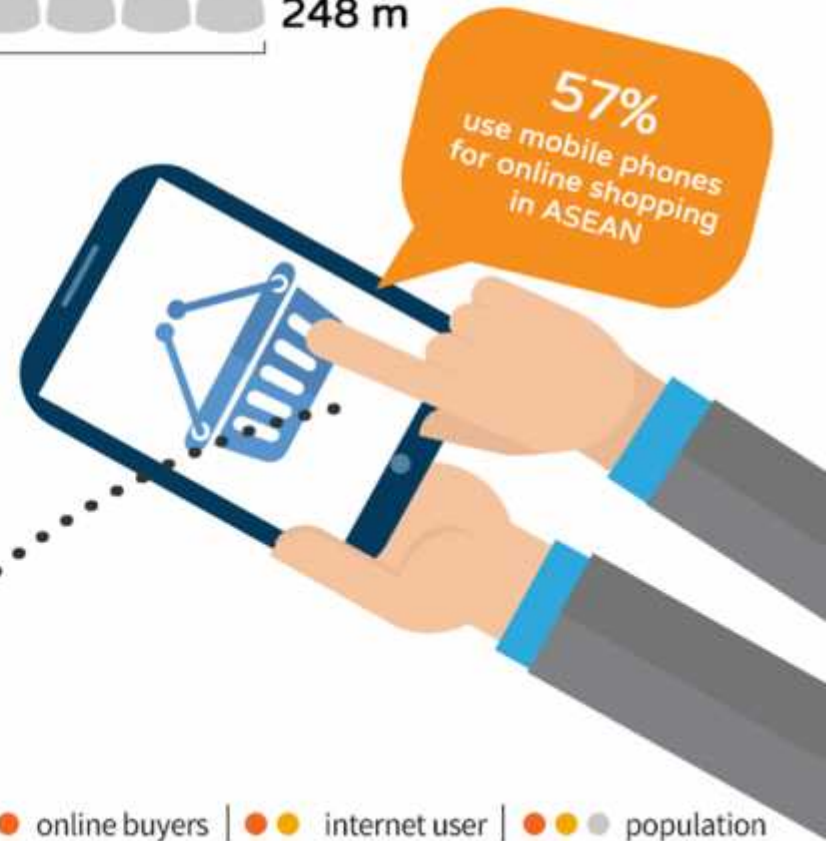
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eneloop

Intermediary – Retailer Relationship

- Receive payment from the intermediary net of commission but should include the 10% EWT on commission that should have been withheld from the intermediary; and
- Remit the 10% EWT on commission to the BIR.

Issuance of Sales Invoice & Official Receipts

- In paper form – mostly
- No approval of CAS at the moment
- Accreditation of web-based CAS
- Minor vs. Major Change

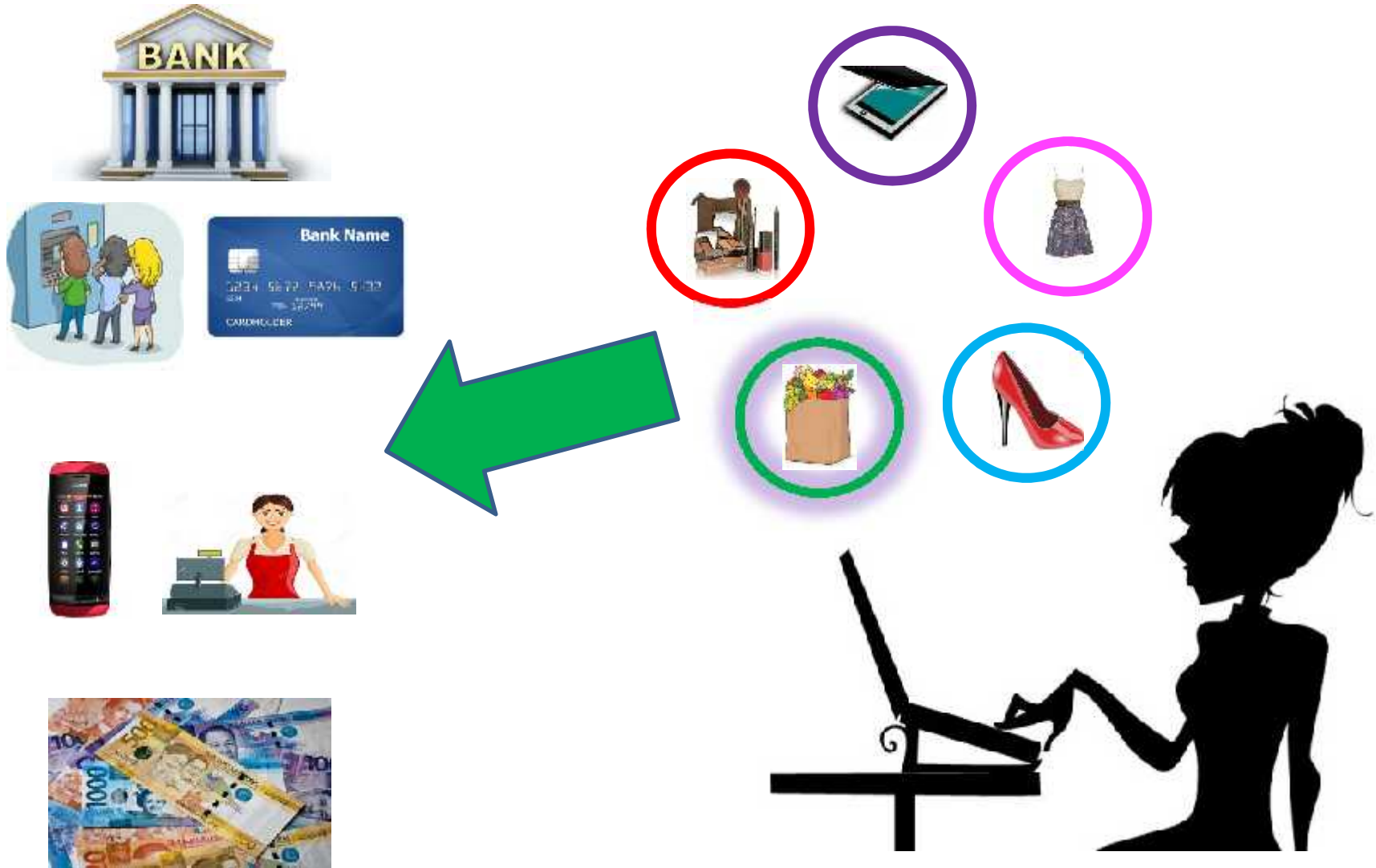
Retailers vs. Intermediaries

- A. RMC 55-3013 considers Online Intermediary Service Provider as merchant/retailer itself under the following circumstances:
 - *(a) when the intermediary markets multiple products for its own account (considered retailer as to the said products)*
 - *(b) when consumers buy goods or services from an intermediary service provider who controls such collection of buyers' payments and thereafter receives commission from the merchant/retailer.*
- Classifying the Intermediary as merchant/retailer as stated in **letter (b)** above is contrary to the true meaning of a merchant/retailer because the Intermediary's roles are limited.

Intermediaries

- Platform but do not have title to the goods nor in control of the physical goods nor its price.
- Acts as conduit to the payment gateways and/or links the merchant to its partner logistics company to effect the delivery of the sold items after payment is made.
- Not in control of the goods nor in control of the price but only gets service income by way of a percentage of the merchant dictated price or agreed fixed fee for the use of its platform.

Current E-Payment System





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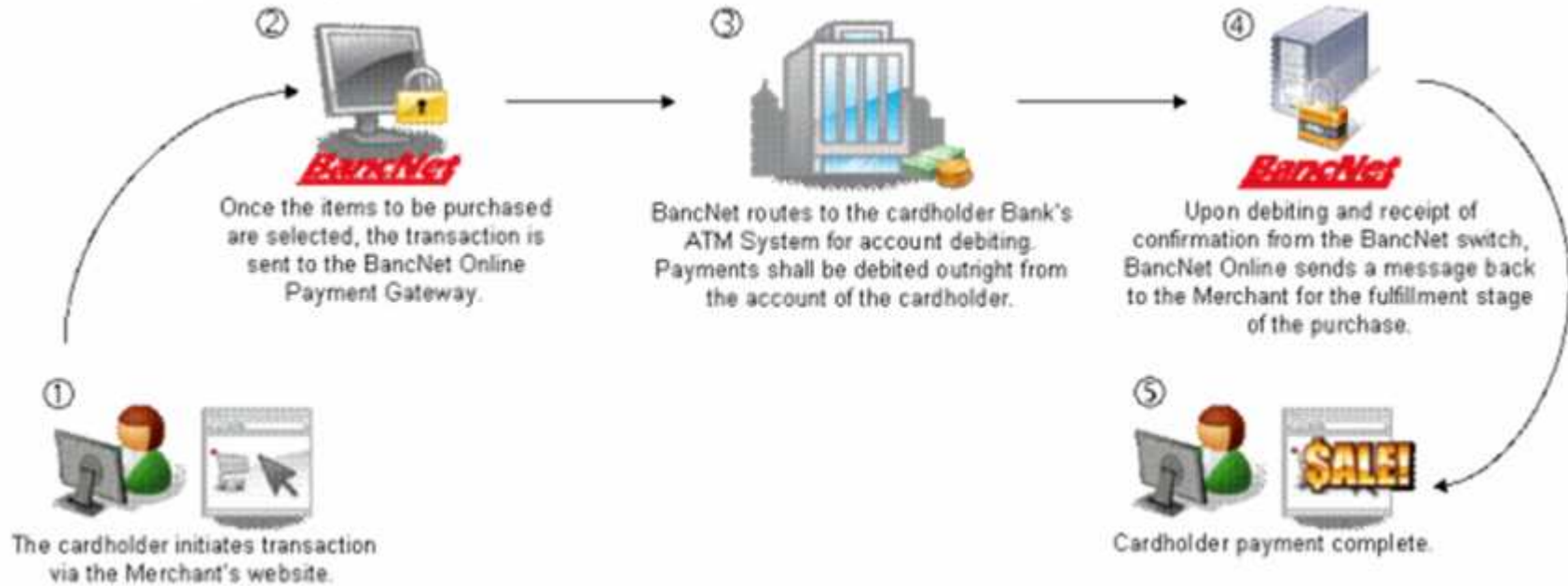
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9	1	0
5	8	7
CE	2	Clear

<https://www.bancnetonline.com/BancnetWeb/goToOnlineShoppingMerchantPage.do>

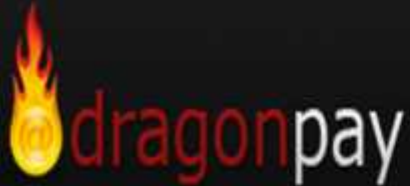
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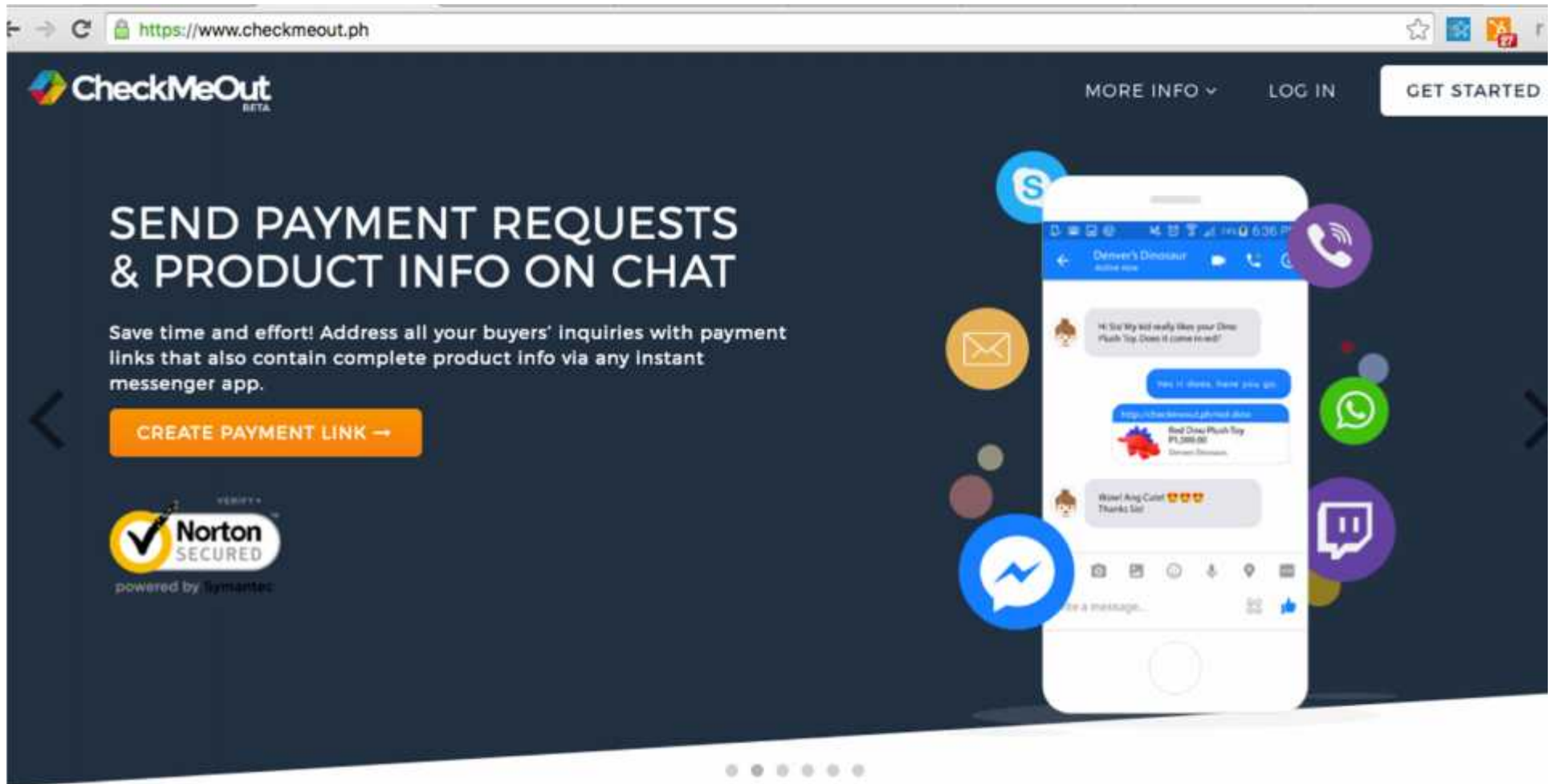
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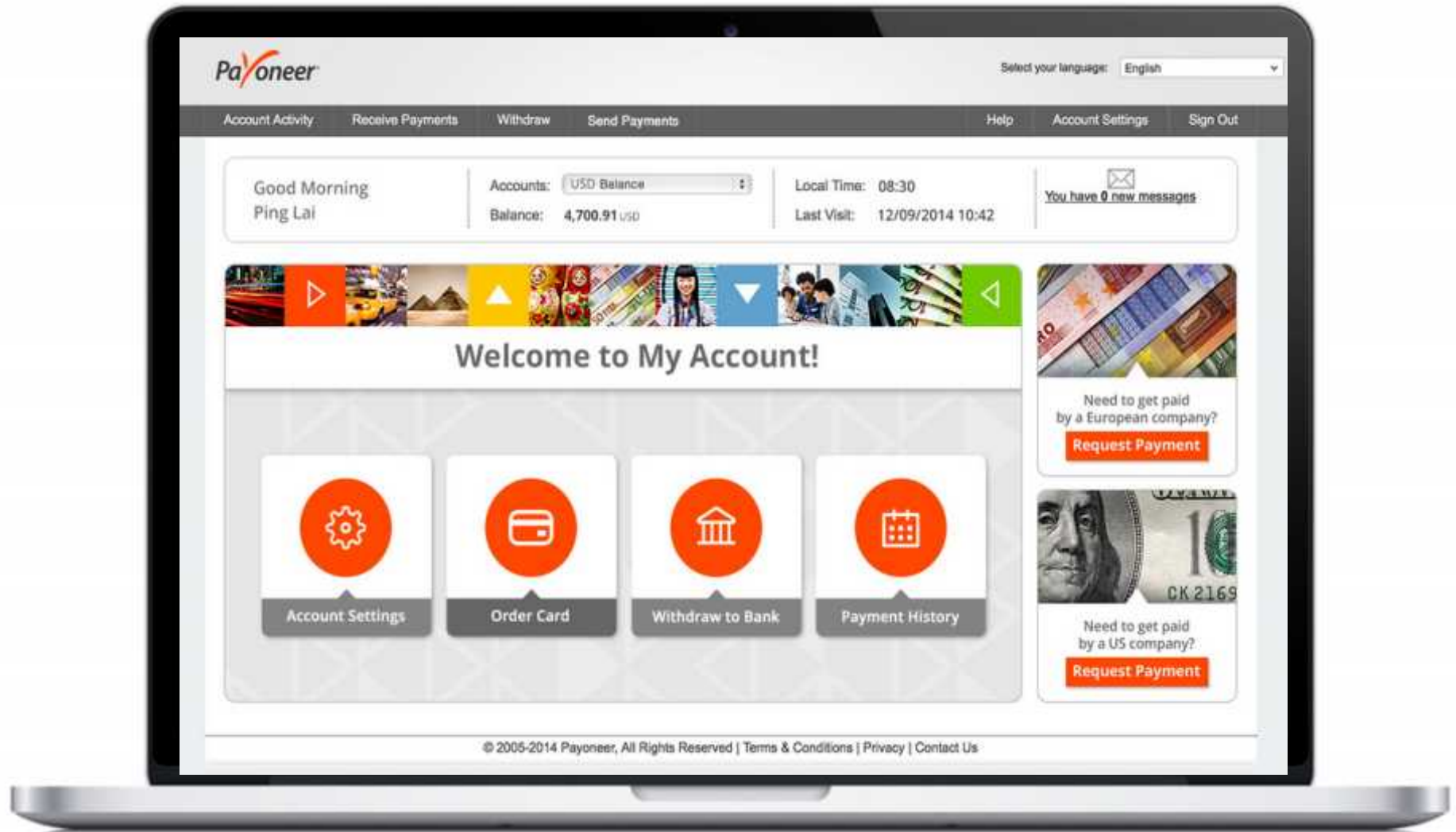
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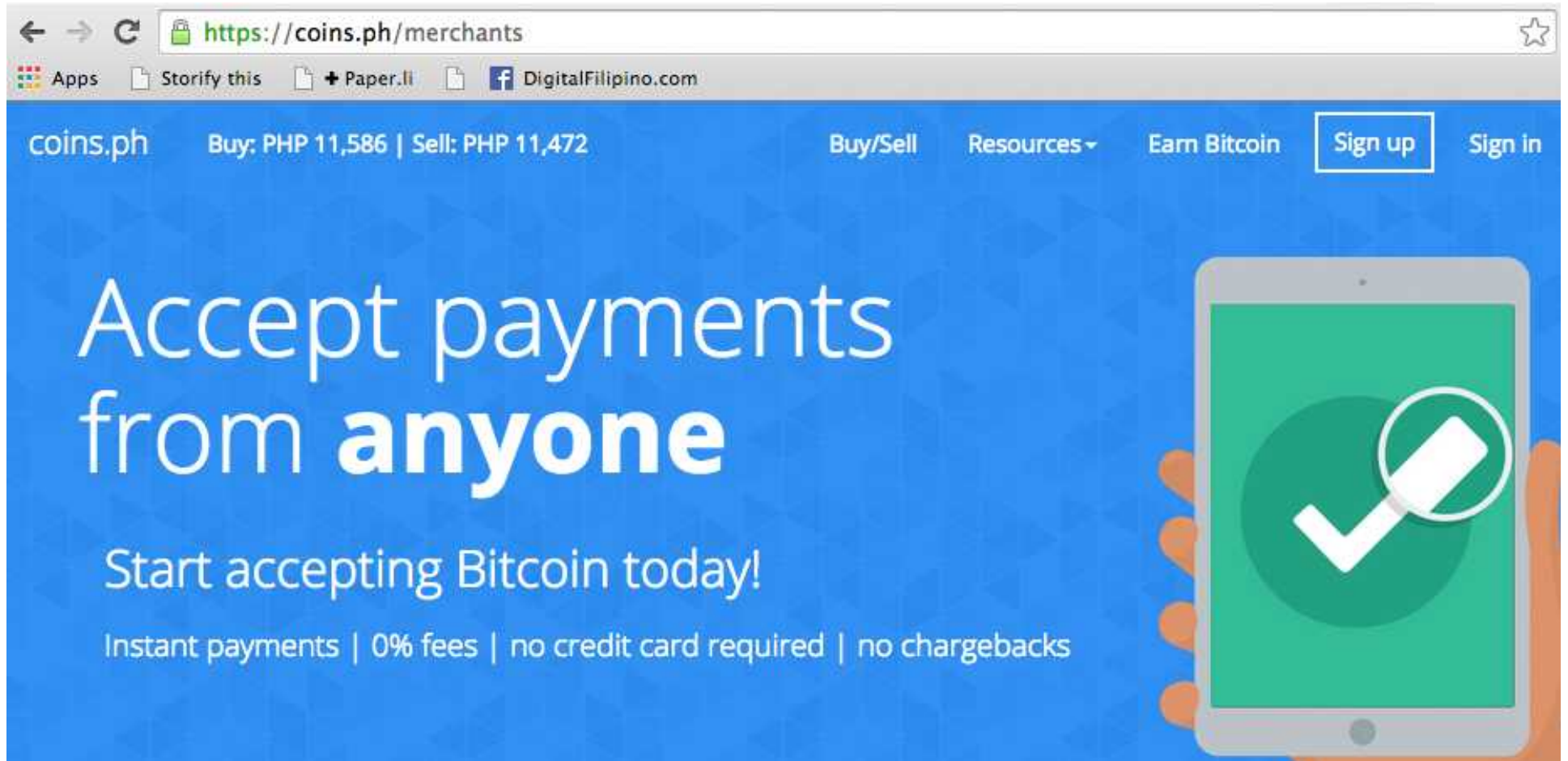
<http://www.paypal.com>

Payoneer for Cross Border Payments



<http://bit.ly/crossborderpayment>

Coins.ph



The image is a screenshot of a web browser displaying the Coins.ph website. The browser's address bar shows the URL <https://coins.ph/merchants>. The browser's toolbar includes navigation icons (back, forward, refresh) and several open tabs: 'Apps', 'Storify this', '+ Paper.li', and 'DigitalFilipino.com'. The website's header features the 'coins.ph' logo, the current Bitcoin price 'Buy: PHP 11,586 | Sell: PHP 11,472', and navigation links for 'Buy/Sell', 'Resources', 'Earn Bitcoin', 'Sign up' (highlighted with a white border), and 'Sign in'. The main content area has a blue background with a pattern of small Bitcoin icons. The primary headline reads 'Accept payments from **anyone**'. Below this, it says 'Start accepting Bitcoin today!' and lists benefits: 'Instant payments | 0% fees | no credit card required | no chargebacks'. On the right side, there is an illustration of a hand holding a smartphone. The phone's screen displays a green background with a large white checkmark inside a circular frame, symbolizing a successful transaction or payment.

coins.ph Buy: PHP 11,586 | Sell: PHP 11,472 Buy/Sell Resources Earn Bitcoin **Sign up** Sign in

Accept payments from **anyone**

Start accepting Bitcoin today!

Instant payments | 0% fees | no credit card required | no chargebacks

Taxing Payment Service Providers

- RMC 55-2013 requires the Online Merchant/Intermediary to pay the service fees or commission of the credit card company, net of the 10% EWT.
- The credit card company remits its collections from the cardholder to the merchant net of the .5% EWT and their service fees.

Question – Does this include cash based payment service providers?

Commission or Discount?

- Requiring an Online Merchant/Intermediary to act as withholding agent for payments which is not in his control will be contrary to the definition of a withholding agent.
- The treatment of the BIR for the service fee of the credit card company as “Commission” may be contrary to the true nature of the business of credit card.
- Requiring clarification: Are the transaction between the credit card company and merchants should be characterized as discounting or sale of receivables, which is not subject to final or expanded withholding tax. The imposition of the 10% EWT, the BIR has called this transaction as “commission” instead of “discount” which is a sale of receivable.

Proposition

Electronic Sales Invoice & Official
Receipt as a Norm rather than an
Exception.

Hobby Sellers vs. Registered Business

Bracket?

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Download presentation

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- <http://bit.ly/ecomactivation>



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- <http://business.inquirer.net/209130/regions-e-malls-failing-to-bring-in-the-crowds>
- <https://www.techinasia.com/transcosmos-metrodeal-acquisition>
- <http://www.bain.com/publications/articles/can-se-asia-live-up-to-its-ecommerce-potential.aspx>
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Taxing The Digital Economy

Tackling the BEPS challenges



Agenda

- » What is the digital economy?
- » Key features of the digital economy
- » How the digital problem arose for revenue authorities?
- » Challenges of the digital economy
- » BEPS – Avoiding a taxable presence
- » Tackling BEPS in a digital economy
- » Questions?

What is the digital economy?

- » Transformation of how we do business > ***‘the global network of economic and social activities that are enabled by information and communications technologies, such as the internet, mobile and sensor networks’*** - incl. communications, financial transactions, education, entertainment and business using computers, phones, and other devices.
- » Brought about by the growth of information and communication technology (ICT), which has made technologies cheaper, more powerful and widely standardised
Improving business processes and bolstering innovation
- » **Old economy** - was manufacturing based –where you did the work was where you generated the income and, consequently, where you were taxed.
- » **Digital economy** – divorces where the work is done from where the customers are.
 - » Makes it easier for a non-resident company to dramatically expand its sales into a jurisdiction without a physical presence – but taxation is still largely tied to physical presence
 - » this allows digital economy players to significantly lower exposure to corporate income tax, employment taxes, property and land taxes, etc.
 - » has the potential to significantly reduce an economy’s overall tax revenue.

Key features of the digital economy

- » It enables businesses to develop and maintain a customer base in a country without needing the level of local infrastructure and personnel that would have been needed in a “pre-digital” age and, more importantly, that would trigger a taxable presence.
- » Increased flexibility means functions can easily be relocated (as they are not tied to location of customers), centralised and automated (e.g. automated acceptance of sale contracts).
- » The digital economy is fast becoming THE economy itself, therefore unable to ring fence the digital economy for tax purposes.

Key features of the digital economy

» Key features include:

- » Mobility (with respect to users, intangibles and business functions)
- » Reliance of data (easier to use data cross-border, but harder to attribute value to IP)
- » Speed of processes
- » Volatility due to low barriers of entry and rapidly evolving technology.
- » Customer driven and demand.

» Types of business models:

- » app stores, e-commerce, Netflix, Amazon, Facebook, LinkedIn, Apple iTunes, Spotify, Pandora, online advertising, cloud computing, online payment services (PayPal)
- » new services like Uber and AirBnB.
- » In Australia, Uber is now moving to include restaurant food deliveries UberEATS

How the digital problem arose for revenue authorities?

- MNEs make use of gaps in the interaction of different tax systems to artificially reduce taxable income or shift profits to a more favourable tax jurisdiction (but where little, if any, economic activity or performed).
 - that the PEs are not triggered (e.g. having a significant warehouse operation in-country but making sales from outside) or doing almost everything necessary to conclude a contract except for the authorisation/ conclusion
 - separating the legal ownership to IP (and the return booked in that entity) vs. where the actual development and exploitation of the IP is taking place
- Broader issue – VAT/GST and how this applies to digital economy and cross-border transactions

Challenges of the digital economy

1. Taxation is still largely tied to physical presence (consider the definition of permanent establishments in the various tax treaties)
2. VAT/GST systems unable to ensure effective VAT/GST collection in jurisdiction of consumption (rather than sale) due to an absence of an effective international framework for charging, collecting and remitting VAT
3. Characterisation of income:
 1. royalties vs business profits (different taxation particularly under tax treaties and different requirements as to definition of PE)
 2. dependent on the type of digital product:
 1. infrastructure/software/payments-as-a-service (= business profits)
vs
 2. rentals of space on cloud service provider's servers (= royalties)
vs
 3. provision of technical services (=royalties)

Challenges of the digital economy

“The digital economy is continuing to evolve, and tax authorities need to find a way to keep up with this evolution.”

BEPS – avoiding a taxable presence

- » **Shifting gross profits via trading structures**
 - Some strategies employed include:
 - Interacting with customers remotely through a website or app with no physical presence in country
 - No physical presence = no taxable presence
 - Overlay strategies to eliminate taxation in country of residence and you get revenues not being taxable anywhere

BEPS – avoiding a taxable presence

» **Shifting gross profits via trading structures**

- Commonly used structures:
 - Establish a local subsidiary or PE to perform marketing/technical support, but it does not perform a sales functions
 - PE maintains mirrored server for faster customer access to digital products, but risk borne by parent entity, who also claims ownership of intangibles generated by these activities
 - PE maintains warehouse and assists in fulfilment of orders but sales technically concluded overseas (even if staff has effectively done everything possible to conclude the sales and have effective, but not formal, authority to conclude contracts) and booked overseas.

BEPS – avoiding a taxable presence

» Reducing net profit by maximising deductions at the payer's level

- Maximise royalty payments, service fees (carve outs), use borrowings in low-tax jurisdictions to fund working capital in high tax jurisdictions (and apply high tax jurisdiction interest rate to determine deductions). Lower withholding tax.

» Eliminating or reducing tax in the intermediate or parent country

- Preferential domestic tax regimes and hybrid mismatch arrangements
- Excessive deductible payments made to related entities in low/no tax jurisdictions
- Rights to intangibles (and related returns) transferred, at less than arm's length price to a related party in a friendly jurisdiction (say, which doesn't tax income on intangibles)

BEPS – avoiding a taxable presence

- » **Low or no withholding tax at source** - Treaty shopping
- » **Low or no tax at recipient level**
 - Low tax jurisdictions, preferential regimes, hybrid mismatch arrangements
 - Entitlement to substantial non-routine profits built up via intra-group arrangements
 - No current taxation (i.e. deferral achieved) of low-tax profits at parent level
- » **Indirect income tax** - avoiding VAT/GST on remote digital supplies

Tackling BEPS in the digital economy

1. Restoring taxation on stateless income

- Increasing transparency between taxpayers and tax administrations and also among tax administrations
- Mandatory disclosure of aggressive tax planning arrangements
- Uniform TP documentation requirements
- Country-by-country reporting
- Different actions will have an impact on BEPS in the digital economy

Tackling BEPS in the digital economy

» Various OECD Actions will have an impact on the digital economy

- Action 6 – preventing treaty abuse
- Action 7 – artificial avoidance of PE
- Action 2 – neutralise effects of hybrid mismatch arrangements
- Action 4 – limit base erosion via interest deductions and other financial payments
- Action 3 – strengthen CFC rules
- Actions 8-10 – Align TP outcomes with value creation

Tackling BEPS in the digital economy

» **VAT/GST**

- Taxing risks be allocated to the jurisdiction where the customer has located its business establishment which is using the services/products sold

Tackling BEPS in the digital economy

2. New nexus based on the concept of significant economic presence

- Revenue method
 - Consider factors evidencing a purposeful and sustained interaction with the economy of that country (whether by way of technology or other automated tools) – these could include digital factors (local domain name, local digital platform, local payment options) or user based factors (monthly active users, online contract conclusion, origin of data collected)
 - Compare value of total revenue derived from the remote transactions into the county and percentage of total global revenue – thresholds should apply to limit compliance burden on MNEs.

Tackling BEPS in the digital economy

3. Alternative taxing strategies

- **Modified deemed profit methods**

- apply a ratio of presumed in-country expenses to the enterprise revenue derived from transactions with in-country customers (challenge is determining an appropriate ratio)
- could be difficult for MNEs with complex structures and multiple lines of business.

Tackling BEPS in the digital economy

3. Alternative taxing strategies

- **Withholding tax on digital transactions**
 - could be imposed as a standalone gross-basis final withholding tax on certain payments made to non-resident providers of goods and services
 - Challenge here is who would collect the tax? Intermediaries processing the payment? Intermediaries would not know how the transaction is classified and, accordingly, how much to withhold. Would require dedicated architecture from vendors to intermediaries to process payment.

Tackling BEPS in the digital economy

3. **Alternative taxing strategies**

- **Equalisation levy** – to provide level playing field between domestic providers and non-resident providers (but could be double taxation, especially if the levy is not creditable in the country of resident taxation).

Questions



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Partner – Corporate & International Tax

Qualification

Education

- » Bachelor of Business (Deakin)
- » Master of Taxation (Melbourne)

Professional Background

- » Managing Partner at WTS since 2010
- » Tax Partner at Deloitte Touche Tohmatsu

Language

English

Specialisations

- » Tax compliance
- » International tax and cross border advisory
- » Tax risk management and tax controversy / audits
- » Cross-border restructuring and reorganization
- » Transfer pricing

Experience in Corporate & International Tax

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