

What are the **Tax Challenges** In Today's **Digital** **Economy?**



Digital Tax Effectiveness

Any digital revolution or change will unvaryingly have various tax implications.

The digital tax effective typically depends on:

The digital transformation: There are ever-evolving production and consumer models, new and innovative technologies which are empowered by the enhancement of the connected economy – all these are affecting all businesses in every sector and industry.

Congregating industries: Industries are obscuring and amalgamating the elements of the technology sector into facets of legacy business processes at a hastening pace. Current businesses now risk commotion from all the sides. New and forward-looking associations and collaborations are also transforming the landscape.

Prompt globalization: Digital helps in breaking down the barriers to entry and expansion, thus enabling businesses to promptly approach and monetize the global customers, redesigning markets and the supply chains, and eventually generating new business opportunities and also involved risks.

Major global modification in digital policy: These days, all the governments are insisting on more transparency and announcing new guidelines and regulations related to the digital economy. Many others are altering current tax and legal notions for the new world – thus initiating further uncertainty.



The Traditional Business Models In Technology Sector

The software development services in a captive model

- Contract Research and Development for software
- Reselling software products
 - Dealers reselling Microsoft Windows/Office Packages
 - Dealers reselling Adobe Products
- Commercial software development services
- IP ownership of software products

Some Examples of Highly-digitized and Unconventional Business Models

Resale of IT platform-driven services or products (with or without presence in India) or marketing support

Google Play Music

Spotify

Hulu

Vertically-integrated companies

Target stores

McDonalds

Starbucks

Multi-faceted platforms

Uber

E-bay

Airbnb

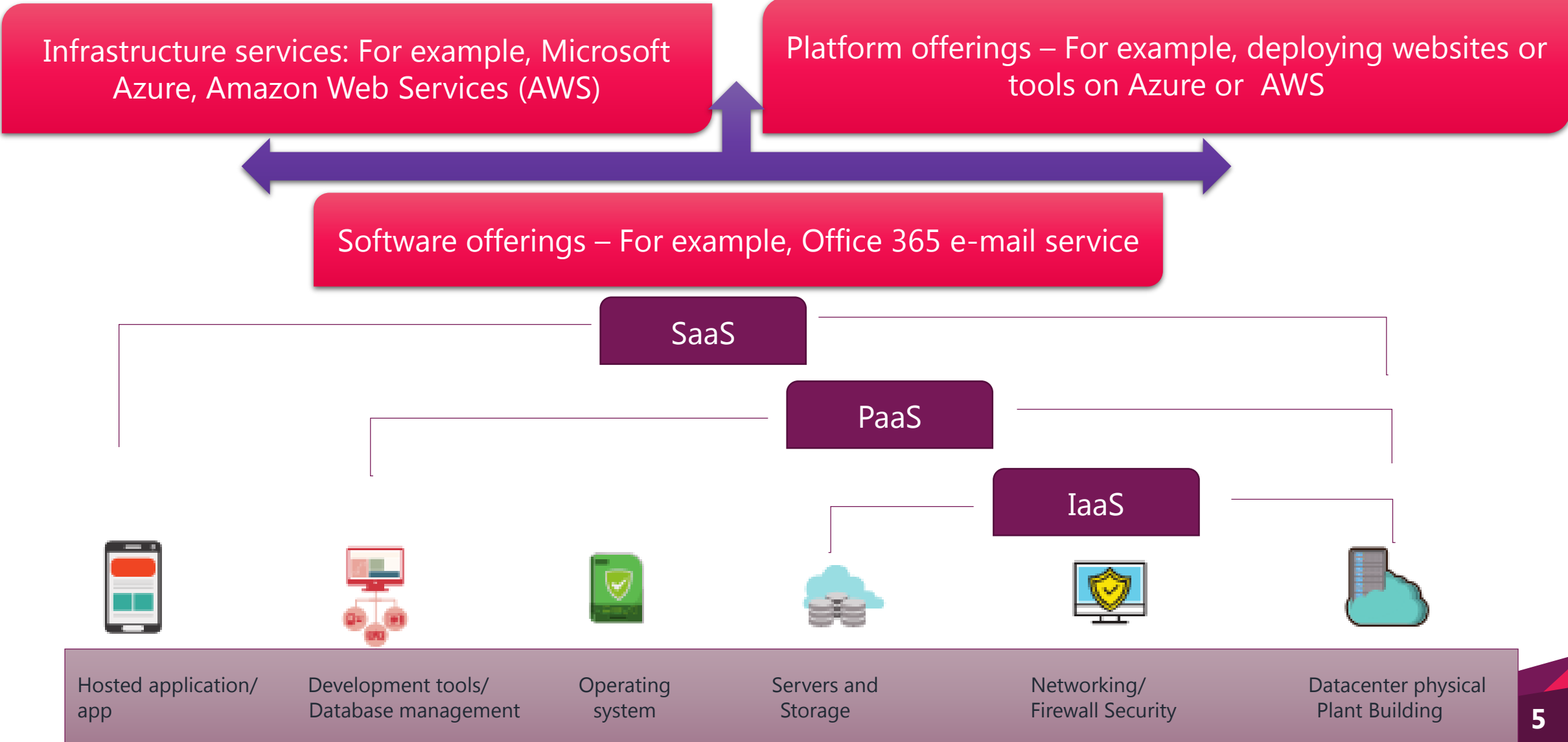
Apple

Microsoft

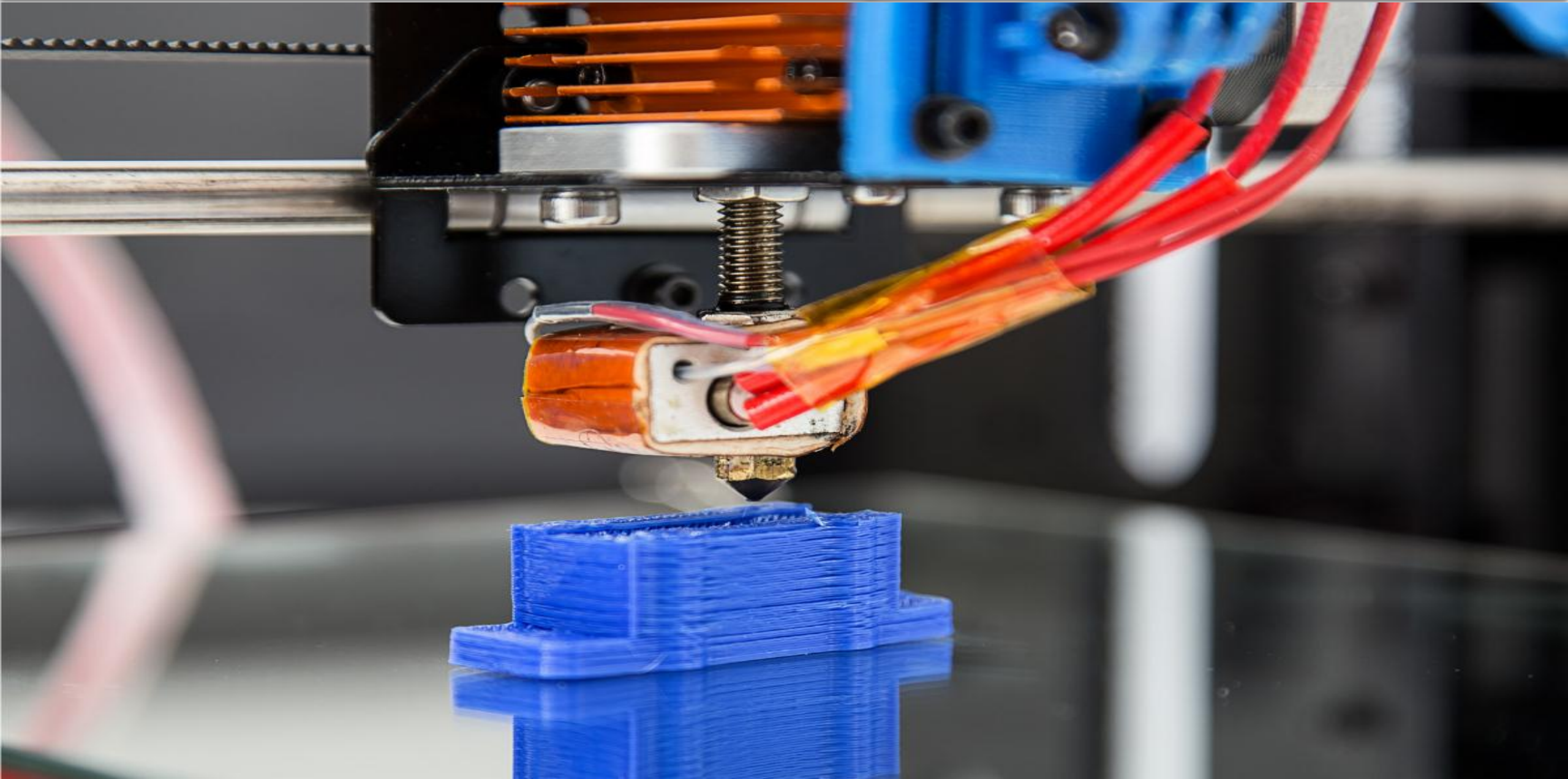
Google

WhatsApp

Services In Cloud Computing



Upcoming Evolution 3D Printing



Upcoming Advancements

3D Printing

Do you know that an **Airbus** A350 XWB airplane flies with over 1,000 3D printed parts and attains 25 percent fuel savings when compared to its competitors?

Have you heard that **UPS** had established its 3D printing facilities at Worldhub located in Louisville and over 60 other locations globally? The consumers can give their print orders for objects that they need urgently and UPS ships them at priority to any location in the world within 24 hours

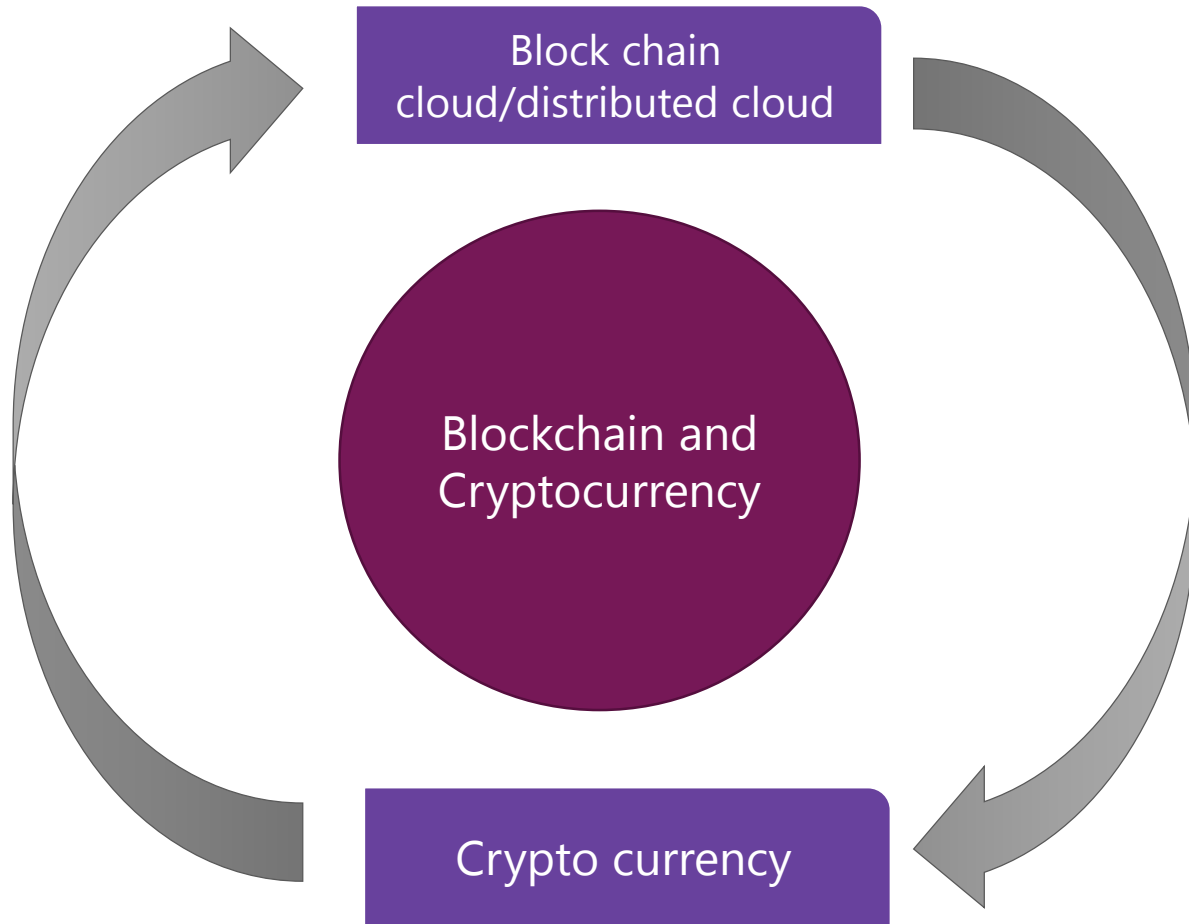
Hoet is known for designing and selling glasses that are aligned to the customer's facial shape and frames with new designs

Daimler Trucks 3D-prints various spare parts on demand of the customers and thus, saves huge logistics and manufacturing costs.

GE manufactures a jet engine fuel nozzle using a 3DP – integrating almost 20 parts into 1, and giving a 5 times longer product lifetime and approximately 15 percent fuel savings

Do you know how **Siemens** revamps and overhauls the burner tips of their gas turbines? It does so by cutting off the burner tip and then 3D printing the replacement part on top

Adidas has come out with high-end running shoes that have 3D printed midsoles under their Future craft 3D initiative. Customers can get their feet scanned in a store, while running. The resultant 3D model of the ideal midsole is then made with 3DP to be implanted in a pre-fabricated body of the pair of shoes that is green in color.



Industrial Collaborations

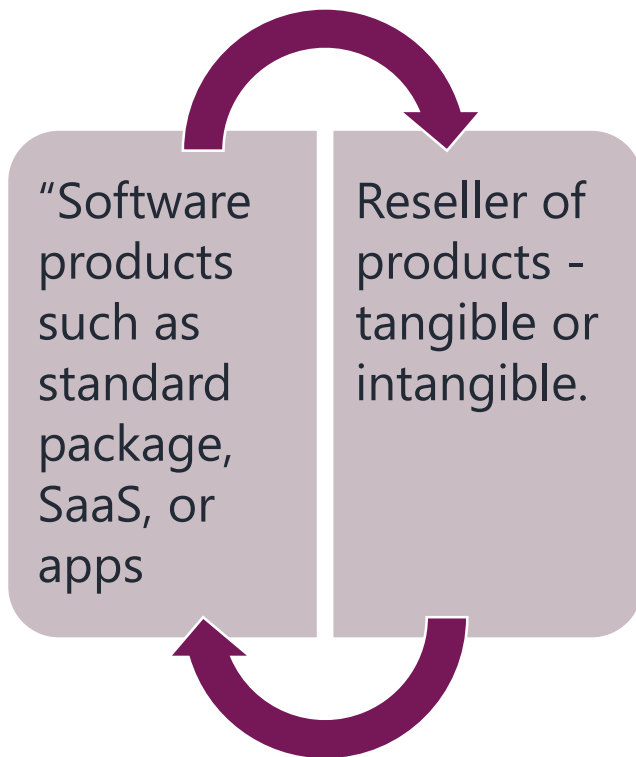
Apple Inc. and International Business Machines Corporation association to take IBM's big data analytics competencies to iPhone and iPad platforms for the demand by enterprise consumers

Johnson & Johnson is proposing to get a mobile app in the market that would act as a virtual coach for various patients in different situations. This app would be leveraging the clinical know-how of Johnson & Johnson and **Apple's** user experience design and attach the same to **IBM's** Watson for performing big data analytics intelligence and back-end cognitive computing

Internet Of Things (IOT)

Types of Value Creation

Value Chain Creation



Value Network Creation



Value Shop

Cloud platforms
(excluding
standardized
SaaS)

Software
development

Queries regarding taxation of highly-digitized business models

Multi-faceted platforms/Vertically-integrated companies

Who needs to tax the operator of the platform – the country where the platform is made or conceptualized or the location where users are situated?

What is the way to allocate the profits amongst various group entities?

Cloud Computing

What is the correct characterization of the income out of cloud computing, that is, IaaS, PaaS, SaaS?

Will the usage of server capacity in multiple countries activate PE for the consumer-contracting entity in the country or location where the server is physically situated?

Do the data localization laws have an impact on value chains and taxes?

3D Printing

Who would typically own a product's IP - the designer of the product, the programmer who transforms the design into a printable format or file, the company or consumer who is printing the product — or is it all of the above?

What would be the apt characterization of the income out of 3D printing?

How will 3D printing modify the global footprint of your company's functions, assets and overall risks?

What are the various taxable events in 3D supply chain? For instance, there is no cross-border interchange of goods in case they are printed close to the customer's location, thus avoiding customs control.

Block Chain

How would the provision of distributed cloud transform the characterization of businesses offering their un-utilized or additional computing capacity?

Will usage of server capacity in multiple countries activate PE for the nation where the server is physically situated?

Industrial Alliances

How does an industrial alliance affect the functioning, assets and risk profile of various alliance partners?

How will the profit be split amongst the group entities of all of the alliance partners, in case only a portion of the overall value chain is involved in the collaboration?

Trends in Digital Indirect Tax



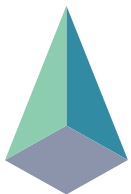
Lack of transparency and agreement between states or countries regarding how the tax would be applicable to the e-commerce sales and who would be accountable for charging and remitting it as that could lead to either double taxation or no taxation at all. In case the nonresident supplier is considered responsible for this, the compliance levels could be low.



“International VAT/GST Guidelines” issued with a huge focus on the location of supply of cross-border supplies of various services and intangibles and the applicability of the principles of destination and neutrality. There is a trend of all the digital supplies becoming taxable in the nation where they are consumed or utilized.



There are some challenges when different import values run through comparable distribution channels. Traditional product flows of various products bought through B2C (for example, in a brick and mortar store) could have varying prices as compared to products that are bought over the internet



The extensive use of 3D printing at the consumer’s premises would most likely enhance the trend towards moving the value chain to services.



Digital delivery and consumption of services would make it tough to enforce VAT or GST, particularly on barter transactions done on multi-sided platforms.



Using cloud computing could bring up challenges regarding how to determine the place of consumption of services; for example, the export of services could be inter-posed between the local consumption of these services.



Digital markets now enable trade between individuals and entrepreneurs – peer-to-peer (P2P) platforms – like online sale of previously-used goods platforms. Thus, there could be problems regarding collection of VAT or GST on such C2C transactions.

- 1. Who is supposed to collect tax and from whom?**
- 2. Is VAT to be collected from the non-resident supplier?**
- 3. Is VAT to be collected from the end customer?**
- 4. Is VAT to be collected from online marketplaces?**
- 5. Is VAT to be collected from the debit or credit card issuing agency/company/bank used in the transaction?**
- 6. Is the VAT to be collected through 'split payment method' (under which the purchaser pays the VAT into a different bank account, which is diverted for the tax authority's advantage)?**
- 7. Is the VAT to be collected by considering a permanent establishment to exist in the nation if the products or services are supplied to consumers in that nation either through a domestic domain name or address, or may be through local payment processing?**

Main Characteristics of Highly Digitized Business and its Effects on International Tax Rules



"Scale without mass"

Dependence on IP

Data value, user contribution

Explanation

Being able to have a major economic presence in a nation without being there physically

Predominantly heavy dependence on intangible assets like intellectual property.

Many new business models comprise elements of data, user-generated content and various network effects, and user participation

Government Challenges

Influencing the distribution of taxing rights over time by cutting down the total number of jurisdictions where a taxing right can be alleged over the profits of business of an MNE

Notwithstanding BEPS work: Mostly it is difficult to decide how to allocate the income coming from intangibles among various segments of an MNE group.

If deemed as a source of value creation, it could pose certain challenges; however, the concept of value creation is presently not captured by the current tax framework

Responses **Of THE Tax Administration**

1

Offers analysis of the key features often observed in some highly-digitalized business models and also value creation in the digitalized age.

2

Explains the complexities of the challenges involved, and the standpoint that different nations have regarding these features

3

Outlines framework of the design contemplations regarding interim measures

4

[BEPS IF] Members agreed to assume a clear and synchronized review of the "nexus" and "profit allocation" rules.

5

Members would work for a consensus-based solution, keeping in mind that divergent views do exist

6

The final report would be produced in 2020, which will be an update to the G20 in 2019.



Substitute PE thresholds
(Example - India, Israel, Italy)



Particular anti-abuse administrations
(Example - Australia, UK, US)



Equalization levies and turnover taxes
(Example- Hungary, Greece, India, Italy)



Withholding taxes



Application of VAT or GST
(Example - Argentina, Australia, New Zealand, Singapore, Turkey, etc. Over 50 countries now)

Recommended Profit Allocation and Nexus Rules

OECD Public Consultation Document

User Contribution and Involvement

Emphasizes on the value created by some highly-digitalized businesses (for example, search engines, social media platforms, and online marketplaces) by creating an active and engaged customer base, and imploring content and data inputs from them

Present global tax framework highlights the physical activities of an enterprise in defining where the profits and revenues should be allotted and the degree of the taxing rights of consumer jurisdictions.

The proposition will transform the existing profit allocation policies to require that, for some particular businesses, an amount of profit be assigned to jurisdictions in which those enterprises' participatory and active consumer bases are situated, regardless of whether those enterprises have a local or physical presence or not

This would be executed with the support of Residual Profit Split Method (RPSM) where the usual profits are first allocated to every entity in the value chain as per their functional profile. Then the remaining non-routine profits are assigned to different entities that have consumers, who use some decided allocation metric (like revenue).

Marketing Intangible

There is an inherent functional connection between marketing intangibles and the jurisdiction of the market. This connection is seen as revealed in the following two ways.

For example, some marketing intangibles like brand and business name, are reflected in customers' minds and therefore, can be viewed to have been formed in the market jurisdiction

Some other marketing intangibles, like customer data, consumer relationships and customer lists result from the activities planned for the customers in the market jurisdiction, reinforcing the treatment of these intangibles as being created in the market jurisdiction

If additional data regarding consumers can be collected, analyzed and used remotely by using digital technology, it will become easier to evade exercising any of the DEMPE and associated risk management functions particularly in the market jurisdiction that under present rules govern the distribution of income out of marketing intangibles

Thus, this proposition considers that the market jurisdiction would be eligible to tax some portions or all of the non-routine income that is properly linked to such intangibles and their associated risks, while all of the other income would be assigned among group members depending on the current transfer pricing principles.

Major Economic Presence

Digitalization of the economy and other technical advancements have facilitated businesses to be largely involved in the economy of a jurisdiction, when they don't even have a major physical presence

Under this proposition, a taxable presence in a jurisdiction will happen when a non-resident business has a major economic presence based on the factors (which are explained below) that mark a resolute and constant interaction with the jurisdiction by using digital technology and similar automated means

Revenue created on a continued basis from a particular jurisdiction, along with any of the below:

- The presence of a customer base and the related data input;
- The level of the digital content originating from the jurisdiction;
- Billing and collection done in the local currency or with any local form of payment;
- Website maintenance in a local language;
- Accountability for the final product delivery to customers or the provision of other support services by the business; for example, after-sales service and maintenance and repairs; or continuous activities for marketing and sales promotion (online or otherwise) for attracting customers

The proposition plans that the distribution of profit to a major economic presence could be dependent on a fractional apportionment method

Key Takeaways

Business models and technology have been continually evolving. The good news is that the tax regulators are trying to catch-up with it

Value creation should be observed from a broader perspective

There is no consensus amongst all the countries as yet

Though there are no clear proposals yet; however, the trends recommend

- Emphasis on re-stating the nexus rules to allow taxation process to happen for digital businesses
- More focus is on “demand” side factors
- Profit split method is opted over other methods
- Steadily, formulary or fractional apportionment appears to be more popular and preferred as compared to arm’s length principle
- Bigger compliance burden on different parties to meet the amended VAT and GST guidelines

Thank You

