



A balanced view

Helping you tackle digital
economy taxation

Introduction

The increasing importance of the digital economy and the substantial revenues generated by some digital businesses, together with the perception that digital business models provide greater opportunity for tax base erosion and profit shifting, has resulted in increased calls to update the international tax system to address the digital economy and the uneven balance between digital and non-digital businesses. The Organization for Economic Co-operation and Development (OECD), the United Nations, the European Commission, Congressional committees, individual countries, and US state tax authorities have all made recommendations for the path forward.



To find out more about the taxation of the digital economy visit:
eversheds-sutherland.com/digitaltax



Key considerations for taxation of the digital economy



What is the impact of digitalization?

- the digital economy facilitates cross border sales of goods without the need for physical presence
- services are increasingly able to be provided remotely, existing only in the cloud and capable of being accessed from anywhere in the world
- it expands the ability to monetize online user and customer communities, virtual marketplace environments and content sharing forums
- vast quantities of data is created that has value and has become a commodity in its own right



How does digitalization relate to tax reform globally?

- tax authorities are concerned that income attributable to activities in their jurisdiction is escaping taxation
- there is political and media pressure to ensure that multinational businesses pay their fair share of tax in the countries where it is perceived that value is being generated
- international tax systems, largely designed over 100 years ago before the impact of digitization could be foreseen, are perceived to no longer be fit for purpose



A balanced view

Helping you tackle digital economy taxation



Key projects and developments

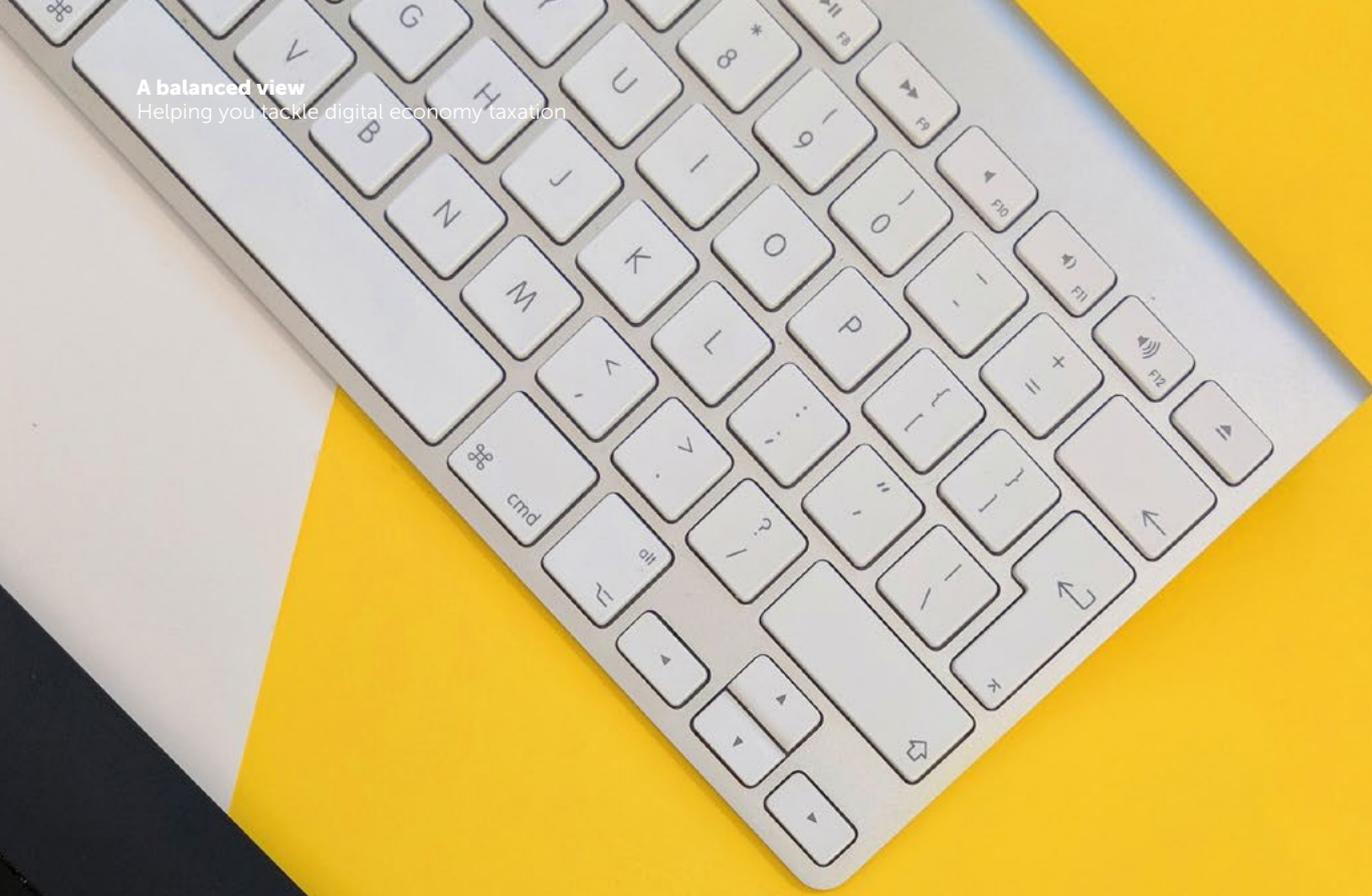
- action 1 of the OECD BEPS project is seeking international consensus on tackling the digitized economy
- the European Commission has written a proposal on the fair taxation of the digital economy, including proposals for an interim Digital Services Tax
- the UN has created a subcommittee on Tax Challenges Related to the Digitalization of the Economy also targeted at achieving international consensus and has recently proposed amendments to the UN Model Double Tax Convention to include a source-based taxation rule for automated digital services
- individual jurisdictions are increasingly adopting unilateral measures to address the digitalized economy
- significantly, the Biden administration in the US has made new proposals for the OECD to consider as part its Pillar 1 / Pillar 2 initiatives that align with new domestic tax reform in the US which may increase the chance of international consensus on digital economy tax measures



What are the challenges in this area?

- the absence of a consensus approach and the increasing number of unilateral measures results in significant uncertainty for businesses operating in the current environment
- very divergent views at an international level about how to reform tax systems, or indeed whether reform is required at all
- questions regarding whether it is appropriate or even possible to ring-fence the digitized economy for tax purposes
- delays in reaching consensus approaches at the OECD, EU and UN have resulted in unilateral domestic measures that are not consistent and could lead to double taxation
- turnover-based tax proposals could have a significant impact on businesses profitability
- double taxation may arise where some new digital tax proposals sit outside the scope of existing double tax treaties

A balanced view
Helping you tackle digital economy taxation



The direction of travel

Developments in this area are gathering pace and it is now possible to better understand the potential direction of travel for the taxation of the digitalized economy. Key developments include:

OECD BEPS Action 1

- this is the key initiative aiming to change the global taxation of the digitalized economy through consensus-based changes to domestic tax rules on an international basis. Obtaining wide agreement and adoption of reform measures has been central to this initiative but consensus has been difficult and discussions have been continuing for a long time
- however, significant progress has been made over the course of 2019/2020, culminating in the publication by the OECD of reports on blueprints the consensus proposals on taxing the digital economy (the two central proposals known as Pillar 1 and Pillar 2). The outline of these proposals is as follows:
 - Pillar 1 proposals – these are proposals with the objective of reforming cross-border profit allocation and nexus rules to allocate more taxing rights to countries where customers and users are located. The proposals are centered around concepts of significant digital presence (taxable presence without physical presence) and formula-based methods of profit apportionment
 - Pillar 2 proposals – these are proposals with the objective of protecting tax base against profit shifting to low/no tax jurisdictions. The proposals broadly consist of a global minimum tax that seeks to give jurisdictions taxing rights over profits earned by related entities or branches in other jurisdictions if such profits are not taxed locally at a certain rate, together with a new tax on certain related party payments that have the effect of reducing the local tax base
- the OECD are targeting agreement on the detail of these proposals in 2021. Reengagement of the US in the OECD discussion under the Biden Administration may increase the likelihood of reaching consensus agreement, although the final proposals may change as a result of this re-engagement

Unilateral digital taxes

- the length of time that the OECD process above has been ongoing, coupled with political and public pressure to act, is resulting in many countries taking unilateral measures to tax the digitalized economy
- a variety of different approaches are being taken, including taxation by reference to digital presence, equalization levies, withholding taxes on advertising payments, revenue-based digital services taxes (DSTs) and indirect consumption taxes
- unilateral measures of this nature are likely to lead to double taxation, increased administrative burden and uncertainty for multinational businesses, and are exactly what the OECD consensus approach was aiming to avoid. However, the longer the OECD process continues, it is inevitable that more of these unilateral measures will be introduced

US state tax developments

- comparisons are developing between the proposals to reform the international taxation of the digitized economy and state taxation in the US
- the 2018 decision in the case of *South Dakota v. Wayfair Inc* paved the way for an economic nexus basis of taxation (as opposed to taxation by reference to physical presence) for sales and use tax purposes. This is conceptually similar to the Pillar 1 proposals from the OECD and the different approaches and experiences at state level in the US offer some guidance and warning for the issues potentially still to arise at international level
- equally, at state level in the US, formulary apportionment has been used for many years in the calculation of state income taxes and provides a useful case study to the OECD when considering apportionment methodologies under Pillar 1 and for multinational businesses considering the potential implications of formulary apportionment at an international level

Why work with us



Technical excellence

Over the years, Eversheds Sutherland has been recognized as leaders in changing the dynamic of legal services. We have been consistently praised by clients and highly ranked in the most respected independent directories. Our goal is to deliver a high quality legal solution underpinned by a commitment to relationships that deliver. Formal client feedback programs have been established to support this approach.



Global coverage

We have a network of more than 200 relationship law firms around the world in addition to specific and formalized regional alliances. We manage client relationships and complex matters across national and international borders. With our newly expanded footprint, we provide cast experience of working on domestic and international projects with a consistent, high quality service wherever clients need us.



Quality and innovation

We work collaboratively and innovatively with our clients. We look to improve what we do continuously, fostering a culture which rewards innovative thinking. We regularly gain external recognition in this area, and we match that with our own internal innovation competitions to encourage our people to have the next great ideas to help our clients.



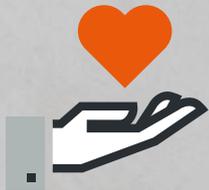
Sector strength

We provide the full range of legal services in key practice areas which include corporate and M&A, finance, dispute resolution and litigation, human capital and labor law, real estate and construction and tax. Our industry and business knowledge enables us to work with our clients to achieve their strategic objectives through innovative solutions. We have deep experience in a number of industry sectors, including energy and infrastructure, financial services, insurance, TMT and industrials.



Client service

Our diverse client base ranges from small and mid-sized businesses to the largest multinationals. We act for more than 50 of the FTSE 100 around 70 of the Fortune 100. We have over 160 + tax practitioners in 20 + countries.



Relationships

Our lawyers are accessible, engaged and responsive. We serve our clients as trusted advisers and cultivate deep and genuine relationships offering highly commercial insight across sectors and around the world.



Our Digital Tax Team

We advise on all aspects of corporate and commercial taxation, with a particular focus on advising multinational businesses on their international tax affairs and cross-border transactions.

We have particular experience advising businesses operating in the global digitized economy on the application of existing tax measures and the impact of digital tax reform measures. Our preeminent tax practice counsels clients of all sizes, and in all industries, offering tailored solutions to their specific cross-border tax needs. We work with our clients to ensure that they achieve their business objectives through the most effective, cost-efficient structures.



Gregory Komlosi
Counsel, Belgium
T: +32 2 737 93 67
gregorykomlosi@
eversheds-sutherland.be



Agnieszka Wierzbicka
Counsel, Poland
T: +48 22 50 50 759
agnieszka.wierzbicka@
eversheds-sutherland.pl



Torsti Lakari
Partner, Finland
T: +358 10 684 1480
torsti.lakari@
eversheds.fi



Andrey Grachev
Counsel, Russia
T: +74 9 56 62 64 34
andrey.grachev@
eversheds-sutherland.ru



Simon Weppner
Partner, Germany
T: +49 2 11 86 46 75 9
simonweppner@
eversheds-sutherland.com



Antonio Cuéllar Prats
Partner, Spain
T: +34 91 429 43 33
acuellar@
eversheds-sutherland.es



Tim Kiely
Partner, Ireland
T: +35 3 16 64 42 90
timkiely@
eversheds-sutherland.ie



Andrea Baetscher
Partner, Switzerland
T: +41 22 818 45 00
andrea.baetscher@
eversheds-sutherland.ch



Sebastiano Sciliberto
Partner, Italy
T: +44 20 7919 4686
sebastianosciliberto@
eversheds-sutherland.com



Ben Jones
Partner, UK
T: +44 20 7919 4686
benjones@
eversheds-sutherland.com



Anete Marhele
Specialist Counsel, Latvia
T: +371 6728 0102
anete.marhele@
eversheds-sutherland.lv



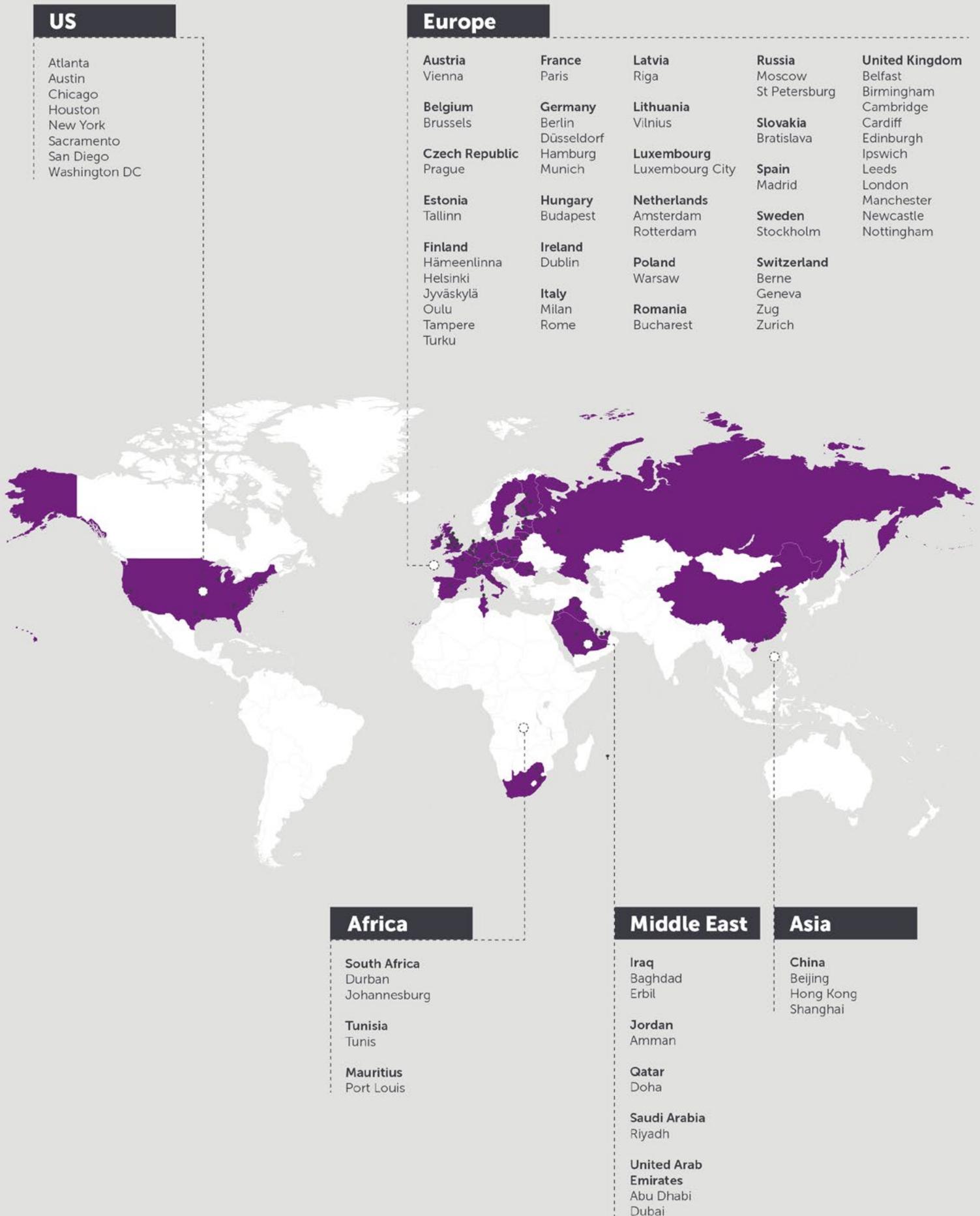
Robert S. Chase II
Partner, US
T: +1 202 383 0194
robbchase@
eversheds-sutherland.com



Renand Pretorius
Digital tax lead, Mauritius
T: +230 211 0550
renandpretorius@
eversheds-sutherland.mu

A balanced view

Helping you tackle digital economy taxation



[eversheds-sutherland.com/digitaltax](https://www.eversheds-sutherland.com/digitaltax)

© Eversheds Sutherland 2021.

All rights reserved. Eversheds Sutherland (International) LLP is part of a global legal practice, operating through various separate and distinct legal entities, under Eversheds Sutherland.

For a full description of the structure and a list of offices, please visit www.eversheds-sutherland.com.

DTUK002738_05/21